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Dear Ms. Thouin,

The Canadian Credit Union Association is the trade association for Ontario's credit unions and caisses populaires. We offer the following feedback to the proposed changes to the DIRF adequacy assessment framework.

It is our primary concern that FSRA have the resources to reimburse depositors without delay if an insured firm were to become insolvent. But what is required to reimburse depositors should be grounded in reality, reflective of risk, and communicated to the sector in a clear, regular, and transparent manner.

We believe that FSRA is taking the right approach to build a more robust tool to determine DIRF adequacy. When complete, the stress testing model will more effectively determine adequacy by more comprehensively capturing the risks that credit unions face, and the measures that firms have in place to protect against them.

But the work done to date on the new stress testing model appears insufficient to render a defensible judgment on DIRF adequacy to depositors, the sector, and the Minister of Finance.

Our opposition to using the new model at this time is based on a lack of confidence in the scenario development process and the use of imprecise proxies and expert judgments to populate the model. These concerns are accentuated by our lack of access to information regarding how the model actually works, and how the model quantitatively determines the fund size's 'adequacy'.

We recommend that FSRA use its existing assessments of the adequacy of the fund (formed over the past 3-5 years) to form the basis of its report to the Minister of Finance until such time as the stress testing model is fully developed.

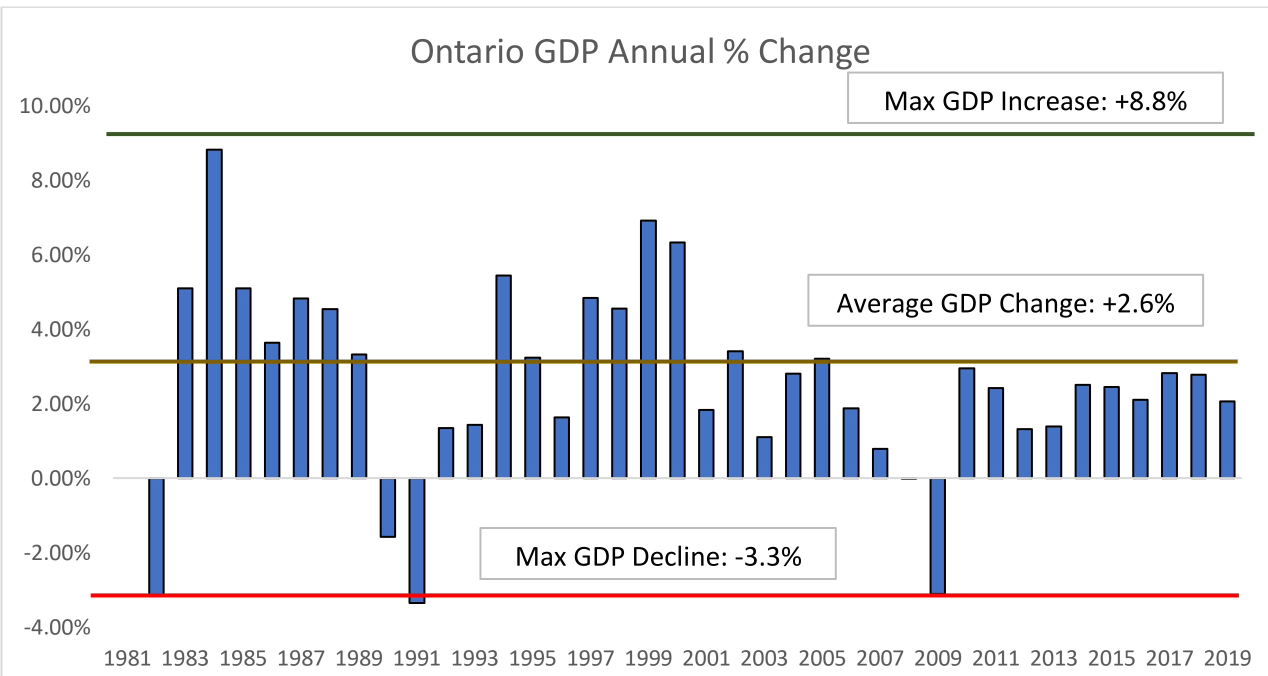
We offer the following feedback on the elements of the new model as described in the consultation.

Scenarios

The hypothesized scenarios included in the consultation are unrealistic and do not reflect historical fact. As an example, in the base case scenario, it is suggested the Ontario provincial economy will shrink by 10.1% on an annual basis. In reality, Ontario's real GDP only declined by 3.0% in 2020, and as of writing this letter, Ontario's GDP is above pre-pandemic levels. Stress testing scenarios should be highly unlikely yet plausible, and the scenario mentioned seems implausible given even the most recent stress event undergone with this pandemic.

During this time, lockdowns and economic closures were worse than predicted and thereby would have been classified as an 'adverse' scenario. The stated GDP decline in the base case scenario is more than 3x worse than Canada's actual GDP decline, which included adverse events brought on by the pandemic.

Additionally, between 1981 and 2019, which included three major recessions, the largest GDP decline on record was 3.3% in 1991[1]. Based on these 38 observations, with a mean of 2.57% and standard deviation of 2.61%, the probability of a 10.1% year over year GDP decline is 0.00006%, or less than 1 in a 1,000,000.



1 https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3610022201&pickMembers%5B0%5D=1.7&pickMembers%5B1%5D=2.1&cubeTimeFrame.startYear=1981&cubeTimeFrame.endYear=2019&referencePeriods=19810101%2C20190101

Suggesting that the 'base case scenario' is a recession more than three times worse than anything on record undermines trust in the scenarios that ultimately form the basis of what is considered 'adequate'. If these scenarios are being borrowed from stress testing frameworks for other institution types, i.e. internationally active banks, they have little relevance as credit union risk exposures and activities are not the same.

For the credit union sector to endorse the new model, they must have confidence that the scenarios (including the probabilities associated with each scenario) and selection of model inputs are credible. As an asymmetrical relationship exists between FSRA and credit unions in terms of sector wide risk – the onus is on the regulator to share its assessment of the risk and how it was reached. Credit unions cannot provide credible feedback to the scenarios and inputs until FSRA is willing to share more information than what has been shared in the consultation paper so far.

We recognize that FSRA/Deloitte will expand the breadth of the modelling. This will solve some of the shortcomings of the scenarios that FSRA has presented in this consultation.

Data

The process described in the consultation paper included the use of proxies, external to Ontario credit unions, as well as 'expert judgements', also likely independent from the sector (i.e. banks)

The most relevant data for assessing the DIRF's adequacy is data that comes directly from Ontario credit unions. We do not support the use of imprecise proxies and estimates coming from 'experts' external to the sector. We have asked FSRA for the list of the additional data that is required to fully populate the new model – and understand that the complete list doesn't exist yet.

As FSRA cannot proceed with the stress testing model without additional data, the opportunity exists to review the data that is collected via the MIR (nearly 1500 data points), as well as the frequency of the reporting to improve efficiency.

Next steps – stress testing

Credit unions are willing to assist FSRA in its development of the stress testing model. This support is predicated on the assumption that increased reporting (and therefore added regulatory intensity) will decrease risk, and, by extension, burden in other areas including deposit insurance premiums.

What is 'adequate'?

At the present time, we understand that the determination of adequacy using the actuarial model is whether the fund doesn't become negative over a 20-year horizon. Since this model doesn't produce a specific target, the 100bps goal seems arbitrary.

It is our understanding from FSRA discussions with the T.A.C. that the actuarial model currently in use indicates that the DIRF will not become negative over the 20-year assessment horizon. By this standard, the DIRF appears either sufficiently funded or overfunded.

When FSRA has finished building its stress testing modelling – this framework model will produce an appropriate range at which the DIRF is ‘adequate’. This range should be the basis for the target size and be shared with the sector.

<u>Future of the DIRF</u>

It is our expectation that the DIRF contributions by percentage of insured assets decrease and the overall size of the fund stabilize over time as consolidation is leading to fewer, better governed firms with larger capital and liquidity buffers, better governance, more diversified streams of revenues, and consumer confidence.

Furthermore, since its launch in 2019, FSRA has tightened residential mortgage lending standards, introduced market conduct regulation, recovery planning, increased reporting (monthly) on liquidity, loan deferrals (commercial and residential to name a few), and segregated liquidity funds from Central1. FSRA is also gaining new enforcement powers as part of the new *Credit Union and Caisses Populaires Act* and a new and modern legislative and regulatory framework. These measures are intended in part to make the potential of a major drawdown of the fund increasingly unlikely.

A skilled and agile regulator provides far greater security to depositors than a large deposit insurance reserve fund.

Over the past decade, a driver for the continued push to 100bps has been a comparative assessment of other jurisdictions where the profile of firms differs. Ontario’s DIRF size as a percentage of insured deposits trails (despite significantly higher premiums) other provinces because of two failures that occurred 12 and 13 years ago, respectively, not because of any realistic risk going forward.

Consistent with FSRA’s mandate of being an outcomes focused regulator, we recommend that FSRA abandon the 100bps target and that deposit insurance premiums paid by credit unions be reduced to an amount that will sustain the current bps funded level, provided it is adequate as per the 20-year test. Only new deposits should be subject to premiums, as the current fund already supports existing deposits to an adequate level.

When the stress testing model is fully operational and if data and future trends support increased premiums, the justification for doing so should be shared with credit unions so that the sector knows to what level deposits are insured to. Firms will also be incentivized to reduce risk based on insights from the model. The degree of information shared to the sector on ‘adequacy’ should be comparable to the report to the Minister of Finance.

In addition to our recommendations, FSRA should gather feedback on its DIRF investment strategy at a subsequent TAC meeting or public consultation.

In conclusion, once the stress test model is further developed - we support the full shift to that approach at that time.

Sincerely,

Nick Best
Director, ON Government Relations
Canadian Credit Union Association