



February 27, 2014
File No.: 72000-01
Ref. No.: 0954

To: CEOs and Board Chairs, BC Credit Unions

Re: Identification of Central 1 as a Domestic Systemically Important Financial Institution (D-SIFI)

This letter is to inform you that Central 1 Credit Union (Central 1) has been identified as a domestic systemically important financial institution (D-SIFI). This resulted from a review by the Financial Institutions Commission (FICOM) on the regulatory and supervisory oversight of BC credit union system liquidity. This review was based on a prior review of liquidity risk management within the Canadian credit union system. These two reviews resulted in a number of recommendations to bolster liquidity risk management at the institutional and credit union system levels.

Enclosed is a copy of Notice CU-14-001. This notice outlines the criteria used to identify Central 1 as a D-SIFI, and the corresponding regulatory and supervisory implications. FICOM's current supervisory requirements for Central 1 (refer to Appendix 1) have also been provided. These requirements will be re-evaluated and updated, if necessary, on an annual basis.

If you have any questions regarding the content of the notice, please contact Frank Chong, Executive Director, Supervisory Support and Policy, at frank.chong@ficombc.ca.

Best regards,

Douglas B. McLean
Deputy Superintendent,
Financial Institutions

-
- Superintendent of Financial Institutions
 - Superintendent of Pensions
 - Superintendent of Real Estate
 - Registrar of Mortgage Brokers

Suite 2800, Box 12116
555 West Hastings
Vancouver, BC V6B 4N6
Telephone: 604 660-3555
Facsimile: 604 660-3365
www.fic.gov.bc.ca

Enclosure

cc: Julie Dickson
Superintendent of Financial Institutions (OSFI)

Credit Union Prudential Supervisors Association

Wilma Van Norden
Managing Director, OSFI

MB/kw

NOTICE: CU-14-001

TITLE: Identification of Central 1 as a Domestic Systemically Important Financial Institution

DATE: February 2014

PURPOSE

This notice is to advise that Central 1 Credit Union (Central 1) has been identified as a domestic systemically important financial institution (D-SIFI) in the context of the Canadian credit union system.

BACKGROUND INFORMATION

In October 2012, the Basel Committee on Banking Supervision (BCBS) set out a principles-based framework for the identification of D-SIFIs.¹ D-SIFIs are financial institutions whose disorderly failure could cause significant disruption to the wider financial system and economic activity. The main criteria to determine systemic importance are:

- interconnectedness;
- substitutability;
- complexity; and
- size.

Core functions of D-SIFIs have two components: 1) they are provided to third parties; and 2) the sudden failure to provide the function would likely have a material impact on the third parties, give rise to contagion, or undermine the general confidence of market participants.

Central 1 is considered systemically important in a Canadian context based on its provision of two core functions to credit unions:

- management of the liquidity of member credit unions²; and
- clearing and payment services for credit unions in all provinces³ and other third parties⁴.

¹ Canada is not home to any globally systemically important financial institutions, but the application by the Office of the Superintendent of Financial Institutions (OSFI) of the Basel methodology resulted in the designation of the six largest banks as domestic systemically important institutions.

² In British Columbia, Newfoundland and Ontario.

³ In the context of this notice, references to 'all provinces' exclude Quebec.

⁴ Such as governments and other Canadian financial institutions.

In British Columbia, credit unions are mandated by legislation to hold their statutory liquidity with Central 1.⁵ Central 1's position in the credit union system outside British Columbia is established through bylaws, which require member credit unions from other provinces to maintain minimum liquidity deposits with Central 1, and by contractual arrangements with other provincial central credit unions to provide payment system access and liquidity support.

The section below outlines the BCBS criteria for determining systemic importance and how it applies to Central 1.

D-SIFI Criteria

Interconnectedness

The BCBS includes lending to and holding deposits of financial institutions as indicators of interconnectedness. By these measures, Central 1 is highly interconnected with credit unions in BC and in other provinces (as the holder of a major portion of the liquid assets of its member credit unions), as well as centrals in other provinces through its clearing and payment system access and liquidity support.

Substitutability

The volume of a financial institution's payment system is a measure of substitutability in the BCBS framework. Central 1's unique role as group clearer for both credit unions and centrals in British Columbia and other provinces makes it an essential element of the national credit union system infrastructure. There is no ready alternative to the clearing and payment services provided by Central 1.

Complexity

The BCBS considers the business, structural and operational complexity of an institution as indicators of the time and costs needed for its resolution. The complexity of Central 1 arises from the intra-provincial arrangements for liquidity management and clearing and payments systems, which result in the potential involvement of authorities from multiple provinces in ongoing oversight and resolution.

FICOM, as regulator of Central 1⁶, has an interest in risks to Central 1 that might arise from its exposure to other provincial centrals and credit unions which it does not have the authority to regulate. Regulatory authorities in other provinces have an interest in Central 1 as its failure could present a material threat to the credit unions and the central which they do regulate. This provides an incentive for cooperation among the provinces, but also raises the potential for

⁵ BC credit unions are mandated by legislation to hold at least 8% of their total deposits and other debt liabilities with Central 1, or hold deposits in an amount that is at least equal to 1.5% of the total value of all credit union assets in British Columbia. Class A Member credit unions from other provinces are required to hold 6% of total assets with Central 1.

⁶ FICOM's role as regulator includes supervisory functions.

differences in failure resolution as agencies with provincial mandates could pursue options in the best interests of their own province, even if an alternative could provide for a better overall outcome.

Size

In the BCBS criteria, size is a proxy for the importance of the institution in the provision of financial services. While Central 1 is a large institution in the context of the credit union system, Central 1 deals with a relatively small number of counterparties; as such, the rationale for identifying Central 1 as systemically important is not based on size.

REGULATORY IMPLICATIONS

More Adequate Stock of Unencumbered High-Quality Liquid Assets

FICOM will apply investment requirements in order to bolster the resilience of Central 1's liquidity risk profile and support to its credit union members. These requirements will ensure that Central 1 maintains an adequate stock of unencumbered high-quality liquid assets that can be converted into cash easily and immediately to meet its liquidity needs in a liquidity stress scenario. This will improve Central 1's ability to absorb shocks arising from financial and economic stress, whatever the source, thus reducing the risk of liquidity spillover across the credit union system.

Higher Capital Requirements (Limits on Leverage)

The domestic and international approach to reducing the risk of D-SIFI failure includes the introduction of additional capital buffers so that D-SIFIs are able to sustain larger losses without bringing their viability into question.

Central 1 will apply specific measures to limit overall leverage, as defined and calculated by FICOM, to both the mandatory and excess liquidity pools. Central 1 will not exceed the defined leverage limits without the prior consent of FICOM.

Increased Regulatory Reporting

FICOM will require enhanced reporting from Central 1 to FICOM of key financial and non-financial information. Regulatory reporting from Central 1 will include, but will not be limited to, details of investment portfolios, collateral management, capital allocations and risk exposures. FICOM will continuously assess reporting requirements from Central 1 and may adjust the frequency and/or nature of the regulatory filing.

SUPERVISORY IMPLICATIONS

Central 1's D-SIFI identification is reflected in FICOM's supervisory approach. This aligns with FICOM's existing supervisory framework which determines the level, extent and intensity of the supervision of institutions based on the size, nature, complexity and risk profile of the institution.

FICOM's enhanced supervision of Central 1 will include the following:

- greater frequency and intensity of on-site and off-site monitoring of activities, including more granular forms of risk management reporting to FICOM and more structured interactions with boards and senior management;
- increased use of specialist expertise relating to treasury operations, liquidity management and payments and clearing activities;
- stronger governance and risk management expectations for core business activities;
- enhanced use of credit union system reviews, both provincially and extra-provincially, in order to confirm the use of good risk management, corporate governance and disclosure practices;
- selective use of external reviews to benchmark leading risk-control practices, especially for instances where best practices may reside outside Canada;
- regular system-wide stress tests to inform capital and liquidity assessments;
- development of a recovery and resolution plan; and
- use of supervisory colleges to share and coordinate supervision, including the execution of supervisory plans, with other provincial credit union regulators.

INFORMATION DISCLOSURE IMPLICATIONS

Central 1 is expected to have member information disclosure practices covering their credit union system responsibilities, financial condition and risk management activities. Disclosure enhances market confidence in the credit union system; as a result, Central 1 is expected to adopt disclosure best practices.

The identification of Central 1 as a D-SIFI as well as regulatory and supervisory requirements will be periodically reviewed and updated as needed.

Appendix 1: Supervisory Requirements – Central 1 Credit Union

- 1. Target ratios and calculation methods for the capital held against the mandatory¹ and excess liquidity pools. Central 1 will:**
 - a. Apply a borrowing multiple, as defined and calculated by the federal Office of the Superintendent of Financial Institutions (OSFI), to the mandatory and excess liquidity pools;
 - b. Maintain a borrowing multiple not exceeding 16:1 for the mandatory liquidity pool (14:1 for the excess liquidity pool);
 - c. Submit a copy of the borrowing multiple calculations to FICOM no later than 30 days after each calendar quarter; and
 - d. Ensure that the borrowing multiples are not exceeded without the prior consent of FICOM.

- 2. Investment and lending policies for the mandatory liquidity pool. Central 1 will:**
 - a. Maintain high quality liquid assets within the mandatory pool that meet the current Bank of Canada Standing Liquidity Facility eligibility requirements, where:
 - i. assets are unencumbered.² This includes no commitments or pledging under normal (non-stressed) business conditions;
 - ii. assets are not yield enhancing or speculative. This includes the prohibited use of derivatives, repurchase agreements and short selling.
 - b. Maintain a portfolio duration of no greater than 1 for the mandatory pool;
 - c. Reposition the portfolio to comply with expectations 2a and 2b (stated above)
 - i. by June, 2015; and
 - ii. without incurring material losses.

- 3. Capital management including ability to move excess capital from mandatory liquidity to other business lines and the criteria for capital calls on Class A members. Central 1 will:**
 - a. Restrict transfer of capital from the mandatory liquidity pool to other business lines during normal (non-stressed) business conditions;
 - b. Establish and report an Internal Capital Adequacy Assessment Process (ICAAP) as defined by OSFI's E-19 Guideline
 - i. file an approved ICAAP report to FICOM at least annually; and
 - c. Establish and implement board approved policies for capital calls.

- 4. Central 1 will provide detailed monthly reporting on the following:**
 - a. Balance sheet (by line of business);
 - b. Investment portfolios;
 - c. Mandatory and non-mandatory deposit information;
 - d. Borrowings (including debt securities issued, subordinated debt, repurchase agreements);
 - e. Loans and funding commitments; and
 - f. Pledged and encumbered assets.

¹ Mandatory also refers to the statutory liquidity pool.

² Unencumbered assets are assets that are not pledged to secure or collateralize any transaction.