

JUNE 2024

Capital Modernization

Consultation Summary Report

BCFSA 

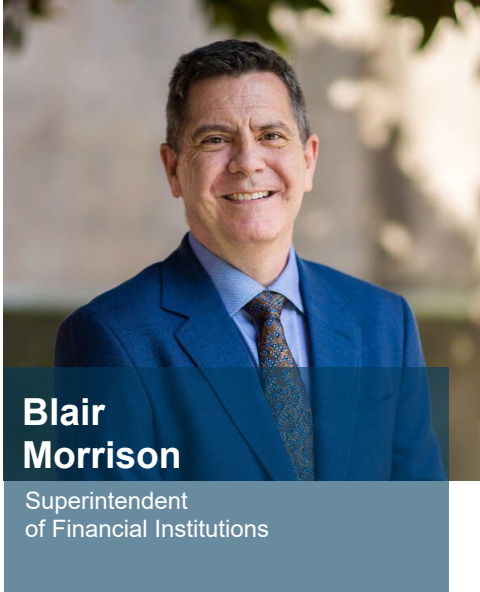
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Introduction from the Superintendent



I am pleased to introduce the Consultation Summary Report for BCFSA’s Capital Modernization Project. The Report highlights the adjustments we have made to our initial public Consultation Paper, Capital Modernization: Consultation Paper for B.C. Credit Unions, (“Consultation Paper”). The Report encapsulates BCFSA’s approach to modernize British Columbia’s capital framework for B.C. credit unions and will ultimately inform a new Capital Rule that will replace portions of the existing Capital Requirements Regulation.

Credit unions play a vital role in the B.C. economy by contributing to the financial health and prosperity of consumers, communities, and businesses. The current capital requirements were introduced over

30 years ago. Updating the capital framework is an important undertaking, as well as a priority for BCFSA.

BCFSA has a mandate to maintain confidence in the financial services sector by focusing on the safety and soundness of regulated entities and consumer protection – the goal being a well-functioning financial system that safeguards market participants from unnecessary risks.

The timing for introducing risk-based capital rules could not be better. The credit union segment in B.C. has grown significantly in size and, perhaps more importantly, in complexity. Evolving customer needs, accelerating technological innovation, and a growing range of competitors have resulted in greater complexity of business strategies and operations. B.C. credit unions, like all other financial institutions, are operating in a challenging and ever-changing global environment, with the need to withstand not only volatile economic conditions and financial markets but also the increasing risks of cyber-attacks and climate change. In response, the segment has experienced a trend in consolidation that is expected to continue as credit unions look for scale to support the investments required to remain competitive and economically productive. With the framework being put forward today, B.C. credit unions and their customers will have a capital framework that is adapted to these developments and to the dynamic environment in which we all live.

We are confident that by viewing the financial landscape through multiple lenses, BCFSA has developed a balanced framework that reflects a robust view of the risks faced by deposit-taking institutions and embodies best practices tailored for the practicalities of the B.C. credit union segment.

In developing its new capital framework, BCFSA considered the unique characteristics of the B.C. credit union segment. We worked closely with credit unions and other stakeholders to ensure transparency. We received feedback from a diverse representation of credit unions and the Canadian Credit Union Association (“CCUA”), and during our information sessions, working group, and public consultations, we heard feedback that helped us ensure the unique characteristics of the B.C. credit union segment were considered.

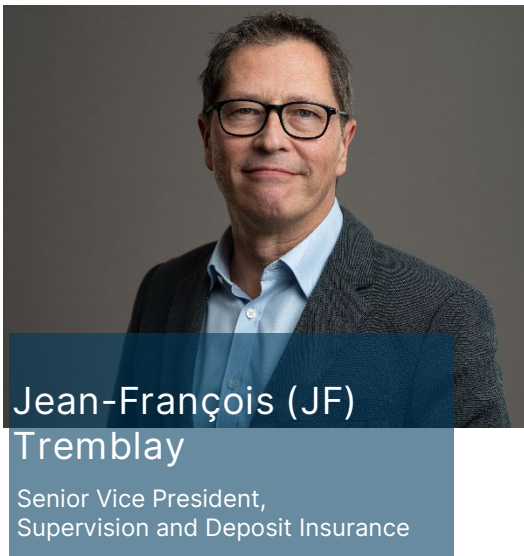
Now that consultation is complete, BCFSA has finalized its approach. BCFSA expects that this approach will be brought into force by government regulation set out in the *Financial Institutions Act* and regulation. BCFSA expects the Capital Rule to come into force on January 1, 2026. To facilitate the transition, BCFSA is planning transitional phases before and after the effective date which are outlined in the Report.

The publication of the Report marks an important milestone in the history of the B.C. credit union segment. I would like to thank everyone who contributed to it. Your time and feedback have been key to developing a new framework that we are confident will support a relevant, resilient, and sustainable credit union system and a strong financial services sector in British Columbia.

A handwritten signature in black ink, reading "Blair Morrison". The signature is written in a cursive style with a long, sweeping tail on the "n".

Blair Morrison
Superintendent of Financial Institutions

Message from the Senior Vice President Supervision and Deposit Insurance



It is with great enthusiasm that I envisage the final stages of the journey that began with the launch of BCFSA's Capital Modernization Project in June 2022.

In just 18 months from now, a more risk-sensitive and proportional capital framework is expected to govern and support B.C. credit unions' business and their broader economic contribution. The ultimate goal is to ensure that these unique member-based and community-oriented financial institutions can continue to thrive and deliver on their mission.

From inception, BCFSA's approach to modernize the capital framework has been multi-faceted. Considerations that guided BCFSA's assessment centred on the characteristics of the B.C. credit union segment, standards and best practices in other provincial jurisdictions, comparative features of the federal framework under Office of the

Superintendent of Financial Institutions ("OSFI"), Basel III standards, as well as the broader economic environment and market trends, and analysis of the financial pressures facing credit unions and their customers.

Throughout the consultation, BCFSA has received wide-ranging and extensive feedback, primarily through a working group of stakeholders as well as from information sessions for market participants and a broader public consultation. Internal teams at BCFSA took these inputs and considerations to the "BCFSA Lab" and carefully reviewed and analyzed the feedback to develop the appropriate responses. An external expert also worked alongside BCFSA to share insights and information on specific topics. By being attuned to the unique characteristics of B.C. credit unions, this updated framework reflects best practices and international standards balanced with the cooperative nature of the segment.

Key Engagement Activities

- Hosted four information sessions in August and September 2023 for all stakeholders to learn more about the changes proposed in the Consultation Paper. The sessions discussed key topics contained in the public Consultation Paper, including regulatory capital, credit risk, operational risk, capital buffers, leverage ratio, and an overview of market risk;
- Provided a consultation overview on BCFSA's website containing the Consultation Paper, advisories, recordings, and presentations from the information sessions;

- Developed a self-assessment tool for use in conjunction with the Consultation Paper to assist credit unions to better understand the proposals discussed in the paper and the potential impact to their respective institution. Credit unions used the tool at their discretion with the knowledge that the outcomes could change;
- Conducted an extended public consultation on proposed changes in its Capital Modernization Framework (November 2022 to November 2023). B.C. credit unions and the public were asked to provide feedback on questions within the Consultation Paper ([Appendix A](#)); and
- Proactively engaged with credit unions and stakeholders to have further discussions and clarifications on feedback.

As we have explained throughout the process, the changes BCFSA is introducing are deliberately significant in scope and depth, and we expect they will be positively transformative for B.C. credit unions and the B.C. financial system more generally. Larger amounts of, and better-quality, capital will bring greater financial agility and resilience. This will instill even more confidence in the robustness of the B.C. credit union segment, as the segment works to attract members and remain competitive.

Our initial consultation paper and the additional inputs and feedback received through the consultation process have led to the identification of 34 distinct measures that BCFSA staff have carefully considered. The main body of this Report (next section) systematically summarizes each initial proposal, stakeholders' feedback, and BCFSA's final decision.

Generally speaking, BCFSA's approach will strengthen B.C. credit unions' capital either by making capital requirements more risk sensitive or by improving the loss absorption capacity of the capital being "set aside" by credit unions. Additionally, BCFSA has also been mindful that credit unions have special characteristics, and

adjustments were made to reflect these traits as well as the need to recognize their varying degrees of preparedness to meet more stringent requirements.

MAIN CHANGES TO STRENGTHEN THE CAPITAL FRAMEWORK:

- Adopted consolidated approach to risk assessment;
- Adopted Basel standards focusing on high-quality banking capital;
- Updated minimum capital requirements and capital targets;
- Mandated capital conservation buffer;
- Introduced standardized approach to address credit risk;
- Introduced new leverage ratio; and
- Introduced comprehensive operational risk capital requirements.

KEY ADJUSTMENTS TAILORED FOR B.C. CREDIT UNIONS:

- Maintained membership shares treatment;
- Developed new B.C.-specific capital composition, including respective criteria;
- Introduced new commercial and residential lending categories, assessment factors, and risk weights;
- Included B.C.-specific regulatory retail portfolio and general commercial lending risk weights;
- Updated treatment of Home Equity Line of Credit ("HELOC") to align with term mortgages (Refer to Item [14](#) and [Appendix C](#));
- Adjusted implementation timeframe to three years, instead of two, effective January 1, 2026 through January 1, 2029 (Refer to Item [28](#));
- Included relief from full deduction of investments in the common equity of banks, financial entities and insurance

entities that are outside the scope of regulatory consolidation through the introduction of thresholds (Refer to Item [1](#)) including a transitional arrangement addressing non-significant investments (Refer to Item [34](#)); and

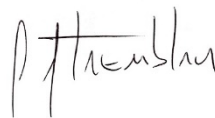
- Introduced an interim measure that will raise the threshold for commercial loans from 30 per cent of the credit union's assets to 35 per cent while still attracting a risk weight of 1.00 as long as risk management is commensurate (Refer to Item [33](#)).

Now that consultation is complete, the project will move towards steps required for implementation, including developing the legislation and operational requirements. The Capital Rule will be brought into force by government regulation set out in the *Financial Institutions Act* and regulation. Assuming the Capital Rule and the proposed January 1, 2026 effective date are approved, BCFSa will facilitate a gradual transition to the new framework.

Recognizing that reaping the benefits of the new framework will require significant changes in business practices and require careful planning, BCFSa is planning transitional arrangements for both before and after the effective date of

January 1, 2026. Before, there will be an opportunity to conduct parallel reporting and to start strengthening internal risk management and controls. As mentioned above, this inaugural transitional period will also include a gradual lifting of the commercial lending threshold. After January 1, 2026, there will then be a three-year transitional period to allow credit unions to gradually adjust to the higher capital requirements ([Appendix B](#)). We will provide additional information in the weeks to come to clarify procedures and reporting requirements around these transitional arrangements.

On behalf of BCFSa and its team, let me thank all stakeholders in advance for their continued engagement. We look forward to holding follow up information sessions and to working with you towards a smooth execution of our modernized capital framework for B.C. credit unions.



Jean-François (JF) Tremblay
Senior Vice President
Supervision and Deposit Insurance

Summary Response to Consultation Feedback

For clarity, the body of this Report is organized by themes that reflect the type of the feedback received during the consultation. These are capital, credit risk, operational risk, market risk, other, and transitional arrangements. BCFSA's decision is provided in response to the feedback received.

CAPITAL

Capital

1. Investments in the Common Equity of Financials or other Total Loss-Absorbing Capacity ("TLAC") instruments

BCFSA proposed to fully deduct from Tier 1 capital, investments in the common equity or other TLAC instruments of banks, financial entities, and insurance entities that are outside the scope of regulatory consolidation. Stakeholders commented that the full deduction is punitive when compared to international capital standards. For competitive reasons, it was requested that BCFSA introduce relief from deduction in a manner that is aligned with international capital standards.

BCFSA's Decision

BCFSA is adopting a simplified methodology utilizing a threshold set at 10 per cent of the credit union's Tier 1 capital.

- I. Non-significant investments (i.e., where the credit union holds less than 10 per cent of the financial entity) will be treated as follows:

The amount of all such holdings that is smaller than or equal to 10 per cent of the credit union's Tier 1 capital will not be subject to a deduction. Instead, these investments will attract a 250 per cent risk weight if considered equities or 150 per cent if considered subordinated debt or capital instruments other than equities. The amount of all holdings that exceed 10 per cent of the credit union's Tier 1 capital will be fully deducted from Tier 1 capital. BCFSA has granted a temporary exemption to this deduction. See Item [34](#) for more information.

- II. Significant investments (i.e., where the credit union holds 10 per cent or more of the financial entity) are treated as follows:

The amount of all holdings that is smaller than or equal to 10 per cent of the credit union's Tier 1 capital will not be subject to a deduction. Instead, these investments will attract a 250 per cent risk weight. The amount of all holdings above the threshold of 10% of Tier 1 capital will be fully deducted from Tier 1 capital.

2. Deferred tax assets

Stakeholders noted that BCFSAs proposed to fully deduct net deferred tax asset balances from Tier 1 capital. Respondents said that the full deduction of deferred tax assets was punitive when compared to international capital standards. For competitive reasons, it was requested that BCFSAs introduce relief from deduction in a manner that is aligned with international capital standards.

BCFSAs's Decision

Consistent with international capital standards, BCFSAs will make a distinction between deferred tax assets arising from temporary differences and unused tax loss carry forwards.

Temporary Differences

Deferred tax assets arising from temporary differences will be deducted from Tier 1, subject to a threshold. BCFSAs is adopting a simplified methodology utilizing a single threshold. Under this single threshold approach, deferred tax asset amounts exceeding 10 per cent of the credit union's Tier 1 capital will be fully deducted from Tier 1 capital. Amounts below this threshold would not be subject to a deduction but would attract a 250 per cent risk weight.

Unused Tax Loss Carry Forwards

Consistent with international capital standards, deferred tax assets arising from unused tax loss carry forwards will not be subject to a threshold and will be fully deducted from Tier 1 capital.

3. Consolidated requirements with subsidiary regulated by OSFI

BCFSA requires capital to be measured and reported on a consolidated basis. Consolidation includes bank subsidiaries, if applicable. Since the framework deviates from OSFI for the risk weighting of assets, respondents expressed concern that the consolidation approach poses resource, administrative and other challenges when a B.C. credit union with an OSFI-regulated bank subsidiary are consolidated for capital adequacy purposes. A capital rule that materially aligns to OSFI and Basel III will allow the management and reporting of risks and capital adequacy in a way that is transparent and comparable to federally regulated banks.

BCFSA's Decision

BCFSA believes that the proposed framework has been appropriately tailored for the B.C. credit union segment and acknowledges that differences exist between the proposed framework and federal bank rules. This position does not suggest that BCFSA questions the adequacy and appropriateness of OSFI capital rules as they apply to Canadian banks. As well, BCFSA acknowledges the potential challenges faced and will introduce a practical expedient in situations where a B.C. credit union holds an OSFI-regulated bank subsidiary with balance sheet assets amounting to less than 10 per cent of the credit union's total consolidated assets.

In such cases, credit unions will not be required to apply BCFSA's capital framework to the bank subsidiary's exposures and may rely on the subsidiary bank's own capital requirements as filed with OSFI and which may be aggregated with those of the parent credit union. This practical expedient applies only to the subsidiary bank's exposures; direct exposures of the parent credit union remain subject to the BCFSA's capital framework. In addition, the 10 per cent asset threshold is to be calculated at each reporting period.

In situations where a bank subsidiary's assets amount to greater than 10 per cent of the parent credit union's total consolidated assets, the credit union must apply BCFSA's framework on a consolidated basis, including the bank subsidiary. As such, BCFSA's approach has not changed from that which was set out in the Consultation Paper.

4. Contributed surplus

The Consultation Paper includes in Tier 1 capital: “*Share premium resulting from the issue of instruments included in Tier 1 capital, including contributed surplus resulting from the issue of membership shares in a merger/amalgamation.*” The stakeholders advised that contributed surplus arising from mergers and amalgamations is not related to the issuance of membership shares.

Therefore, an amendment was requested to explicitly include contributed surplus arising from a merger or amalgamation transaction that is unrelated to the issue of membership shares.

BCFSA was asked to provide the criteria for approval for the following: “*Contributed surplus arising from mergers or acquisitions may be included in Tier 1. Credit unions wishing to include any contributed surplus arising from other sources in Tier 1 must obtain approval from BCFSA.*”

BCFSA’s Decision

Given the share capital structure applicable to B.C. credit unions, BCFSA will tailor the Basel text and remove the reference to share premium, while retaining the element of contributed surplus, as follows:

Contributed surplus resulting from a merger or amalgamation may be included in Tier 1 Capital. Contributed surplus arising from sources other than a merger or amalgamation may only be included in Tier 1 with the prior approval of BCFSA.

For purposes of approving the inclusion in Tier 1 capital, contributed surplus arising from sources other than a merger or amalgamation, BCFSA will apply the principles underlying the capital quality for Tier 1 capital:

- Absorption of losses on a going concern basis;
- Permanence;
- Subordination to depositors; and
- Freedom from mandatory fixed charges.

BCFSA expects contributed surplus arising from sources other than mergers or amalgamations to be rare and will be assessed on a case-by-case basis.

Capital

5. Accumulated other comprehensive income

BCFSA included the pension component within Accumulated Other Comprehensive Income (“AOCI”) as part of Tier 1 capital. Respondents commented that swings in the pension component are due to changes of actuarial assumptions giving rise to volatility. The inclusion deviates from the regulatory guidelines set forth by the Financial Services Regulatory Authority of Ontario (“FSRA”) and OSFI.

BCFSA’s Decision

Regulatory capital acts as a safeguard against unexpected losses. Changes in the pension component within AOCI are a point-in-time proxy of the worst-case scenario for potential future gains or losses. Although actuarial assumptions can change from one period to the next, the principles underlying the Basel III rules support the inclusion of the pension component through Tier 1 and is consistent with OSFI’s Capital Adequacy Requirements (“CAR”) guideline. Accordingly, BCFSA will continue to require the pension component within AOCI to be included in Tier 1 capital.

Capital

6. Subordinated debt

Under the current legislation, subordinated debt owed to the Credit Union Deposit Insurance Corporation of British Columbia (“CUDIC”), or Stabilization Central Credit Union of British Columbia (“Stabilization Central”) qualifies as Tier 1 capital. The amount eligible for inclusion in the capital base is subject to discounting if there is a fixed date for repayment or redemption (s.6(a), Capital Requirements Regulation).

A tool that is available to Stabilization Central when assisting a distressed credit union is to provide a loan to the credit union, which is subordinated in right to all other indebtedness. The stakeholders noted that in the interest of maximizing the stability of the credit union segment as a whole, subordinated debt owed to the stabilization authority should be explicitly recognized and treated in the same manner as subordinated debt owed to CUDIC.

BCFSA’s Decision

Given the role of Stabilization Central and CUDIC, BCFSA agrees to expressly state in the framework that subordinated debt issued to Stabilization Central or CUDIC receives Tier 2 capital treatment. Further, consistent with the treatment of qualifying subordinated debt included in Tier 2 capital under the framework, any subordinated debt issued to CUDIC or Stabilization Central will be subject to straight-line amortization in the final five years to maturity or fixed repayment date.

Capital

7. Significant investments in wealth management and insurance companies

Respondents noted that all significant investments in financials are subject to deduction under the proposed framework. Significant investments in wealth management entities and regulated personal and commercial insurance companies should be exempt from deduction.

BCFSA's Decision

The purpose of deducting investments in financial entities is to limit the double counting of capital in the financial system. When financial institutions invest in capital instruments of other financial institutions, problems at one institution can directly affect the financial health of other institutions investing in its capital instruments. Exempting significant investments in Wealth Management and Personal and Commercial insurance companies from deduction would be inconsistent with Basel III and inappropriate given the prudential rationale underlying this requirement. As such, BCFSA's approach has not changed from what was set out in the Consultation Paper.

Capital

8. Securitization gain

BCFSA was asked to clarify the statement in the Consultation Paper that an asset representing a securitization gain represents a highly concentrated credit risk position.

BCFSA's Decision

For further clarity, the deduction applies to a recognized gain on sale that is recorded as an increase in equity and is associated with future margin income arising from a sale of securitized assets when they are removed from the credit union's balance sheet in the context of a securitization transaction.

These gains may only be potential gains and the size of the gain that will be earned in the future may differ significantly. Consequently, it would not be appropriate for credit unions to treat these gains as a regular component of earnings for prudential purposes, as it would automatically increase the level of their regulatory capital without, in some cases, increasing their actual ability to absorb future losses. As such, BCFSA's approach has not changed from what was set out in the Consultation Paper.

9. General allowances

Respondents noted that the general allowance included in Tier 2 capital should not be limited to 1.25 per cent of credit risk-weighted assets, as the general allowance is determined by comprehensive models, is reviewed by the respective credit union's senior management and Audit Committee, and is audited by external auditors as part of the annual preparation of audited financial statements. Restricting the inclusion of the general allowance to a fixed percentage of credit risk-weighted assets is completely arbitrary and no reasons have been advanced to limit the inclusion of the full general allowance.

The following wording should be revised as the meaning is not clear "*the general allowance included in Tier 2 capital should exclude allowances held against underlying assets treated as a securitization for capital purposes.*"

BCFSA's Decision

A general allowance represents expected losses on total loans when credit losses cannot yet be estimated on an individual basis (stage 1 and stage 2 allowances under International Financial Reporting Standards ("IFRS") 9). Given the nature of a general allowance and that its availability in a gone concern scenario is expected to be limited/questionable, placing a limit on its inclusion is prudent and disincentivizes overreliance on this form of capital. The general allowance limit of 1.25 per cent of credit risk-weighted assets is consistent with international capital standards and OSFI's CAR.

BCFSA will clarify that the general allowance included in Tier 2 capital should exclude allowances held against underlying assets when they are removed from the credit union's balance sheet in the context of a securitization transaction.

Capital

10. Deferred tax liability

Respondents commented that a net-deferred tax liability should receive capital recognition under the framework since net-deferred tax assets are deducted.

BCFSA's Decision

BCFSA believes a net-deferred tax liability fails to meet the international standards of capital quality, in particular, its ability to absorb losses in a stress scenario. Accordingly, a net-deferred tax liability should not be included in regulatory capital.

Capital

11. Create a B.C. version of non-viability contingent capital instruments

Stakeholders suggested that BCFSA repurpose system capital in a similar manner as non-viability contingent capital ("NVCC") instruments that are issued by Federally Regulated Financial Institutions ("FRFI") to provide contingent capital cushions, should an event occur that triggers an FRFI as "non-viable."

BCFSA's Decision

BCFSA will explore further the possibility of credit unions issuing contingent capital instruments such as NVCC. The concept requires additional research and discussion with key stakeholders such as the Ministry of Finance and credit unions. This is currently beyond the scope of the Capital Modernization Project.

CREDIT RISK

Credit Risk

12. Repurchase agreements and reverse-repurchase agreements

Respondents noted that the Consultation Paper did not cover the capital treatment for repurchase agreements (“repos”) and reverse-repurchase agreements (“reverse-repos”) and requested guidance to be included in the framework, given that some credit unions regularly enter into such transactions.

BCFSA’s Decision

Under international capital rules, repos and reverse-repos are treated as collateralized transactions. For repos and reverse-repos, counterparty credit risk is the primary risk which is mitigated by financial collateral. To ensure consistent capital treatment across the B.C. credit union segment, BCFSA will introduce Basel standards designed to address the capital treatment for repos and reverse-repos. The Basel standards allow for the supervisory recognition of financial collateral in the measurement of capital requirements provided a series of specific operational requirements are met. BCFSA also expects that these operational requirements will be met.

If the operational requirements are met, there are two possible regulatory approaches for the recognition of financial collateral under the Basel standards: “simple approach” and “comprehensive approach.” BCFSA will adopt the simple approach which follows a substitution principle. This means that for those portions of an exposure collateralized by eligible collateral, the risk weight of the original counterparty is replaced by the risk weight of the collateral instrument, in general subject to a floor of 20 per cent. The remainder of the exposure must be assigned the risk weight appropriate to the counterparty’s risk profile. Under certain conditions, there are possible exceptions to the 20 per cent floor which will be specified in the rule.

13. Covered bonds, project finance, retail exposures for transactors

The Consultation Paper does not specifically address the capital treatment for exposure to covered bonds and corporate exposure for project finance. Further, all regulatory retail exposures are risk weighted at 75 per cent, regardless of whether the exposures are to transactors or non-transactors.

Covered Bonds

Since covered bonds may form part of the diversification of a credit union's high-quality liquid assets, BCFSA should consider adopting the Basel capital requirements applicable to covered bonds.

Project Finance

Project Finance is a loan where the lender looks primarily to the revenues generated by a single project, both as the source of repayment and as security. Since specialized lending for Project Finance may finance business in communities in which credit unions operate, the framework should consider adopting the specialized lending Basel capital requirements for Project Finance.

Retail Exposures for Transactors

Retail credit such as credit cards have additional risk sensitivity depending on whether the users are transactors, as compared to non-transactors. The transactors reference is missing in the framework. BCFSA should consider adopting the Basel capital requirements which recognizes the differences in the risk sensitivity of retail exposures to transactors versus non-transactors.

BCFSA's Decision

To ensure consistent application across the B.C. credit union segment, BCFSA will adopt the Basel-specified risk weight tables applicable to covered bonds, which are based on the rating of the covered bond. Guidance will include the definitions and other operational requirements specified in the Basel capital standards for exposures to covered bonds.

Similarly, for Project Finance, to ensure consistent application across the B.C. credit union segment, BCFSA will adopt the specialized lending provisions of the Basel framework relating to Project Finance. These provisions assign risk weights determined by the issue-specific external ratings (not the issuer rating). If no external ratings are available, the provisions specify risk weights that vary depending on the phase and quality of the project. These risk weights will be adopted in the framework.

To recognize the difference in risk sensitivity between retail exposures to transactors versus non-transactors, BCFSA will introduce the risk weights and definitions/limits applicable to these exposure categories based on OSFI's rules. Under these rules, retail class risk weights are as follows:

Transactors: 15 per cent

Non-transactors: 75 per cent

Other: 100 per cent

14. Treatment of HELOCs

Respondents asked why HELOCs have separate risk weightings than term mortgages and noted that the different treatment would result in additional data and reporting requirements. It was also noted that the underlying credit risk of the member is the same regardless of the mortgage type.

BCFSA's Decision

HELOCs are non-amortizing (revolving) credit facilities where borrowers are only required to meet interest payments and the outstanding balance may not reduce over time. The persistence of the outstanding balance increases risks to lenders and borrowers.

BCFSA has decided to update the Loan to Value ("LTV") threshold for HELOCs to 75 per cent to align with the threshold for term mortgages. BCFSA's approach will risk-weight a HELOC equivalent to a term mortgage with an amortization greater than 30 years. BCFSA believes this approach will reduce implementation effort while still recognizing the higher risk associated with HELOCs and keeping the risk-weighting between mortgages and HELOCs consistent. In general, risk weights for exposures under capital adequacy requirements are determined at a product level. Consistent with national and international capital requirements, credit unions will have to hold different amounts of capital for different types of loan exposures.

Further, BCFSA has removed the lowest category of risk factors from Table 2-2 of the consultation paper (i.e. LTV ≤ 50 per cent) to avoid a previous inconsistency where a HELOC would have a lower risk-weight than a term mortgage.

The updated risk weights are provided in [Appendix C](#).

15. General feedback

Stakeholders commented on the proposed new residential and commercial lending categories and risk weights that are tailored for the B.C. credit union segment and improve the risk-sensitivity of the framework. Specifically, stakeholders asked why BCFSA proposed to use risk factors beyond LTV in assigning risk weights.

BCFSA's Decision

The proposed capital framework is based on Basel III and tailored to the B.C. credit union segment to ensure capital adequacy for the risks faced by the B.C. credit union segment. The Consultation Paper describes these risks and the rationale for the additional risk factors. This made-for-B.C. approach also takes into consideration the approaches taken by other provincial regulators and OSFI that are considered relevant and appropriate to the B.C. credit unions.

BCFSA recognizes the importance of allowing credit unions to compete effectively and take reasonable risks and holds boards and senior management ultimately accountable for the viability of their institutions. BCFSA will continue to monitor the credit union segment and address competitiveness issues resulting from regulatory requirements and the credit union legislative framework.

BCFSA's capital framework reflects risk proportionality, risk-sensitivity and a forward-looking approach while capturing residential and commercial exposures consistently for all credit unions. The metrics proposed in the framework are based on established credit risk metrics and thresholds were established based on industry standards and evidence from credit unions' loan portfolios.

As such, BCFSA's approach has not changed from what was set out in the Consultation Paper.

Credit Risk

15.1 General feedback: alignment with other jurisdictions

Respondents noted that the proposals do not align with approaches adopted by other jurisdictions such as OSFI and FSRA and raised concerns over the complexity of using multiple risk factors in residential and commercial lending. Respondents also commented that the commercial lending categories are more granular than those used in other jurisdictions and noted that these deviations could result in competitive disadvantages for credit unions. Consequently, respondents indicated a preference to adopt the lending categories and risk weights used by OSFI.

BCFSA's Decision

BCFSA discussed the rationale for deviating from OSFI and Basel in the allocation of risk weights to residential and commercial real estate ("CRE") exposures in the Consultation Paper (Section 2). The rationale is based on credit unions' business activities which are highly concentrated in real-estate secured lending – 80 per cent of segment assets are secured by real estate. Given this concentration, one of BCFSA's focus areas is to adequately capture credit unions' lending exposures in the capital adequacy requirements regulation. This exposure concentration distinguishes credit unions from banks. Adding the relative importance of smaller credit unions in the B.C. credit union segment, BCFSA deems it necessary to deviate from national and international regulatory requirements.

BCFSA's objective is to adequately capture specific features of its regulated entities and segment and to appropriately capture the most material exposures.

With respect to commercial lending categories, commercial lending exposures for B.C. credit unions are concentrated in real estate-secured lending. BCFSA's proposed categories for commercial lending are tailored to the lending activities of the credit unions to better reflect the different risks that arise throughout the business cycle of lending to these commercial market segments.

As such, BCFSA's approach has not changed from what was set out in the Consultation Paper.

Credit Risk

15.2 General feedback: risk sensitivity

Stakeholders commented that risk sensitivity is captured in other aspects of the capital framework, such as the interaction between general loan loss allowance, Total and Tier 1 capital adequacy ratios. The respondents stated that a simpler approach using only LTV provides sufficient risk-sensitivity when viewed in conjunction with other components of the capital framework.

BCFSA's Decision

While risk sensitivity has increased under IFRS 9, it introduces additional management discretion in the determination of significant increases to credit risk and reduces comparability across credit unions. In addition, the loan loss allowance is designed to cover expected credit losses whereas capital is allocated to cover unexpected losses. BCFSA's proposal aims to ensure risk-sensitivity and sufficient regulatory capital being allocated to cover unexpected losses for credit risk.

As such, BCFSA's approach has not changed from what was set out in the Consultation Paper.

Credit Risk

15.3 General feedback: recalibration of thresholds

Some respondents asked if the proposed thresholds used in assigning risk weights would be recalibrated.

BCFSA's Decision

BCFSA will review the capital framework over time and update as needed as risks change. Under these reviews, risk thresholds may be recalibrated given sufficient evidence to support a recalibration.

Credit Risk

15.4 General feedback: property value updates

Stakeholders asked for clarification on the frequency and method of update for property value of commercial and residential mortgages.

BCFSA's Decision

In the context of retail residential and CRE lending activities, updates of LTV should be reaffirmed at time of renewal and refinance. This is done through the establishment of the lending value of the property relative to the proposed loan amount. The process by which the lending value is accepted is at the discretion of management supported by continuous appropriate oversight, monitoring, and control. BCFSA will provide additional guidance in the future.

16. Residential lending: property value updates

For Income Producing Residential Real Estate (“IPRRE”), respondents asked for clarification on what is considered materially dependent for loan repayments from the cash flows generated by the property securing the loan.

In addition, respondents noted that the cash flows generated by the residential property can change after the loan is funded and asked if the materiality requirement only needs to be met at origination.

Respondents commented that they have their own classification for owner-occupied vs rental mortgages.

Respondents noted a comprehensive review of whether all existing mortgages meet the materiality requirement for IPRRE would be a significant administrative effort and asked for grandfathering of current loan classification or a phased implementation.

BCFSA's Decision

As noted in the Consultation Paper, a loan's repayment is considered as materially dependent if more than 50 per cent of the income used in the credit union's assessment of the borrower's ability to service the loan is from cash flows generated by the residential property.

BCFSA expects the materiality requirement to be determined at origination or refinance. BCFSA will allow credit unions to use their internal definitions for income-producing mortgages, provided these definitions can be shown to be, at a minimum, as conservative as the materiality requirement. BCFSA may review the policies to ensure alignment with the materiality requirement.

Where a credit union's policy is less conservative than BCFSA's materiality definition, the credit union should revise its policy and update the classification in accordance with the classification under the capital rule.

The requirements are in effect as of January 1, 2026 and credit unions can update their processes as required during the three-year transitional period.

As such, BCFSA's approach has not changed from what was set out in the Consultation Paper.

Credit Risk

16.1 Residential lending: risk weights

Respondents asked for the risk weights for residential loans to be simplified into three categories with one threshold for each metric.

BCFSA's Decision

BCFSA introduced an additional category for lower LTV based on the project's Working Group feedback. In line with our risk-sensitive approach, a lower risk weight was given to reflect the lower risk of unexpected loss associated with these loans.

Credit Risk

16.2 Residential lending: RRE clarification

BCFSA was asked for clarification on whether residential real estate exposures ("RRE") need to be owner-occupied.

BCFSA's Decision

RRE do not need to be owner-occupied. A residential real estate loan can qualify as RRE if 50 per cent or less of the income used in the credit union's assessment of the borrower's ability to service the loan is from cash flows generated by the residential property. In addition, as outlined in Appendix C of the Consultation Paper, the principal residence is automatically considered as RRE.

Credit Risk

17. Commercial lending

BCFSA was asked to provide an updated definition of CRE Construction (speculative).

BCFSA's Decision

CRE Construction (speculative) refers to multiple draw interest-only commercial loans to finance the construction of commercial development for the purpose of selling or renting the completed units. At the time of underwriting, there is no identified buyer, tenant for the development project and/or take-out financing arrangements in place. This category captures serviced land, single family homes, duplexes, triplexes and fourplex homes. (Note: This category excludes construction projects for residential apartment buildings which is a separate category).

Credit Risk

17.1 Commercial lending: CRE construction definition

BCFSA was asked to provide an updated definition of CRE Construction (general).

BCFSA's Decision

CRE Construction (general) refers to multiple draw interest-only loans to finance the construction of commercial development projects. At the time of underwriting, there is a pre-identified user such as owner-occupied, pre-sale buyer and pre-lease rent-paying tenant for the development project upon completion.

(Note: This category excludes construction projects for residential apartment buildings which is a separate category).

Credit Risk

17.2 Commercial lending: DSCR threshold

BCFSA was asked to lower the Debt Service Coverage Ratios (“DSCR”) threshold of 120 per cent for commercial real estate lending.

BCFSA’s Decision

The DSCR threshold of 120 per cent for CRE exposures is established to ensure sufficient buffer such that the borrower’s business operating cash flow can service existing and any proposed additional debts through the business cycle. BCFSA considers this level to be in line with general industry and best practice. As such, BCFSA’s approach has not changed from what was set out in the Consultation Paper.

Credit Risk

17.3 CRE land-only (speculative) risk weights

BCFSA reviewed the risk weightings for the various lending categories and adjusted to calibrate with the overall feedback received.

BCFSA’s Decision

BCFSA revised Proposal 2(d)(ii) CRE Lending Land-Only (Speculative) risk weighting from 150 per cent to 140 per cent. The updated risk weight reflects the risk associated with this lending type and the gap between current and defaulted exposure.

Credit Risk

18. General commercial lending risk weights

BCFSA reviewed the consistency of its proposed approach to business lending under regulatory retail with general commercial lending and considered feedback from credit unions on determining risk weights based on DSCR for non-real estate secured loan exposures.

BCFSA's Decision

BCFSA revised its proposed approach to the treatment of exposures to businesses that qualify for a risk weight of 75 per cent under regulatory retail (compare to section 20.3). Given the relatively low materiality of exposures to non-real estate secured commercial lending compared to real-estate secured commercial lending, all general lending exposures to businesses that do not qualify under regulatory retail will be risk weighted according to Claims on Corporate under [Appendix D](#). The table 2(d)(iii) General Commercial Lending in the original proposal will be removed.

Credit Risk

19. Treatment of defaulted retail and commercial exposures

Respondents noted that the Consultation Paper does not specifically address the treatment of defaulted retail and commercial exposures.

BCFSA's Decision

For the treatment of defaulted retail and commercial exposures, BCFSA will align with OSFI's treatment:

- A defaulted exposure is defined as one that is past due for more than 90 days or is an exposure to a defaulted borrower.
- Defaulted general RRE exposures shall be risk-weighted at 100 per cent.

As for the existing framework, all other defaulted exposures (i.e. HELOC, CRE exposures, commercial loans, IPRRE exposures, etc.) shall be split into their secured and unsecured portion. The secured portion shall be risk-weighted as a performing loan. The unsecured or unguaranteed portion of the defaulted exposure shall be risk-weighted net of specific provisions and partial write-offs as follows:

- 150 per cent risk weight when specific provisions are less than 20 per cent of the outstanding amount of the loan; and 100 per cent risk weight when specific provisions are equal to or greater than 20 per cent of the outstanding amount of the loan.

Credit Risk

20. Other assets categories

Stakeholders recommended that the Basel IV risk weighting of 75 per cent to all claims with a BBB credit rating be adopted. Respondents also noted that both OSFI and FSRA have an additional category of BB+ to B- for claims on deposit-taking institutions and banks and also for claims on direct sovereigns which has a lower risk weighting than the proposed framework.

BCFSA's Decision

The capital framework proposed is based on Basel III standards and tailored for B.C. credit unions. BCFSA has agreed to adopt Basel III credit assessment categories and related risk weights. Refer to [Appendix D](#) for more information.

Credit Risk

20.1 Other assets categories: unsecured portion of personal loans

Stakeholders recommended that BCFSA apply one risk weighting to the unsecured portion of personal loans, past due more than 90 days, regardless of the amount of the specific provision.

BCFSA's Decision

Different provisions of the unsecured portion of person loans imply a different risk profile and therefore different risk weights. The same principle is applied in the current Capital Requirements Regulation and is also aligned with international standards. As such, BCFSA's approach has not changed from what was set out in the Consultation Paper.

Credit Risk

20.2 Other assets categories: fixed assets and foreclosed property

Stakeholders recommended excluding fixed assets and foreclosed property from the calculation of capital because there is no credit risk for these items.

BCFSA's Decision

Fixed assets and foreclosed property are not typically risk-weighted because of credit risk. Instead, they are risk-weighted for other reasons:

- Market value fluctuations: the risk weightings reflect the potential losses that could occur if the market value of these assets decline;
- Liquidity risk: risk weightings address the aspect of disposing of such assets in a stress scenario; and
- Operational and holding risks: risk weights address operational risk associated with managing and holding such assets including maintenance costs, legal issues, and the potential for further depreciation.

The risk weights aim to align regulatory capital requirements with the overall risk profile of a credit union's asset portfolio. As such, BCFSA's approach has not changed from what was set out in the Consultation Paper.

20.3 Other assets categories: regulatory retail portfolio granularity criterion

Respondents requested further clarification on the granularity criterion for the regulatory retail portfolio. For clarity, explain what is included in the regulatory retail portfolio and the meaning of sufficiently diversified under the granularity criterion.

BCFSA's Decision

BCFSA will provide the following clarification in the rule regarding the meaning of the regulatory retail portfolio and criteria.

- To be included in the regulatory retail portfolio, claims must meet the following four criteria:

Orientation criterion – the exposure is to an individual person or persons or to a business.

Product criterion – the exposure takes the form of any of the following: revolving credits and lines of credit (including credit cards and overdrafts), personal term loans and leases (e.g., instalment loans, auto loans and leases, student and education loans, personal finance), and business facilities and commitments. Securities (such as bonds and equities), whether listed or not, are specifically excluded from this category. Mortgage loans are excluded.

Granularity criterion – Credit unions are expected to maintain sufficient diversification of their regulatory retail portfolio.

An exposure to an individual or a business will be risk-weighted at 75 per cent if the aggregate exposure is either:

- a) less than or equal to \$100K or
- b) greater than \$100K and less than or equal to \$1.5M and that the aggregated exposure to one counterparty does not exceed 0.2 per cent of the overall regulatory retail portfolio.

Low value individual exposures criterion – the maximum aggregated retail exposures to one counterparty cannot exceed an absolute threshold of \$1.5M. Business loans extended through or guaranteed by an individual are subject to the same exposure threshold.

- If meeting the above criteria, the retail portfolio will include revolving credits, line of credits, personal terms loans and leases, business facilities and commitments excluding securities and mortgage loans;
- An exposure to an individual that does not meet the above granularity criterion will be risk-weighted at 100 per cent;
- Exposures to corporates with external credit rating or that do not meet the granularity criterion will be risk-weighted according to the table risk weights for corporates (please refer to [Appendix D](#));

To apply the 0.2 per cent threshold of the granularity criterion, credit unions must: first, identify the full set of exposures in the retail exposure class; second, identify the subset of exposures that meet product criterion and do not exceed the threshold for the value of aggregated exposures to one counterparty.

Credit Risk

20.4 Other assets categories: federal or provincial exposures risk weight

BCFSA was asked to clarify that a zero-risk weight would be applied for all federal or provincial exposures, not just liquidity deposits.

BCFSA's Decision

BCFSA agreed with the comment and will update the wording to "Federal or Provincial government guaranteed security instrument" with a zero-risk weight.

Credit Risk

20.5 Other assets categories: municipalities non-rated debt risk weight

Stakeholders noted that consideration of the risk rating for non-rated debt by municipalities or provincial backing may be missing in the proposal.

BCFSA's Decision

For clarity, BCFSA will add that the Public Sector Entities ("PSE") risk weight is based on the sovereign credit rating (e.g., 20 per cent for Canadian provinces and municipalities). BCFSA will remove the condition that qualified the rating based on the municipalities' use of the funds as it was not considered practical to determine. Please refer to [Appendix D](#) for the updated PSE risk-weighting table.

Credit Risk

20.6 Other assets categories: fully secured loans risk weight

BCFSA was requested to risk-weight loans that are fully secured by deposits at 0 per cent.

BCFSA's Decision

BCFSA will update the risk weight for loans fully secured by deposits to zero.

OPERATIONAL RISK

Operational Risk

21. General feedback and clarifications

Stakeholders commented that gross income is not a determinant of operational risk.

BCFSA's Decision

The Basic Indicator Approach ("BIA") for determining the operational risk charge is a standardized approach that is simple and straightforward among the possible approaches under Basel. The BIA uses a credit union's gross income as a proxy for operational risk because income is considered an indicator of the volume and complexity of its business activities, which can increase the potential for operational risk events. BCFSA believes the BIA offers simplicity and is a reasonable starting point for quantifying operational risk capital requirements for B.C. credit unions. BCFSA will continue to monitor operational risk developments/practices with a view to introducing a more risk sensitive approach in the future. As such, BCFSA's approach has not changed from what was set out in Consultation Paper.

Operational Risk

21.1 General feedback and clarification: non-interest income

Respondents advised that there was inconsistent use of "non-interest income" and "net non-interest income" for gross income calculation purposes.

BCFSA's Decision

For the purposes of calculating gross income, BCFSA will clarify that the correct figure is "net non-interest income".

Operational Risk

21.2 General feedback and clarification: 15 per cent in the BIA

BCFSA was asked why 15 per cent is used in the BIA.

BCFSA's Decision

An alpha of 15 per cent is prescribed in the standardized calculation of the operational risk charge under the BIA and is used by regulatory authorities that have adopted this approach. For simplicity and consistency, BCFSA has adopted an alpha of 15 per cent.

Operational Risk

21.3 General feedback and clarification: subsidiary income

Stakeholders commented that including subsidiary income in gross income overstates operational risk and will create unintended consequences if the impact to a credit union's capital is punitive. Consider a reduced operational risk capital charge for insurance and wealth subsidiaries as they structurally have proportionately high expenses relative to income. Wealth and insurance subsidiaries allow credit unions to provide a unique holistic member relationship.

BCFSA's Decision

Given that wealth and insurance businesses are no less subject to operational risk than banking business, it would be inconsistent to either exclude them altogether or apply a lower capital charge for them. In addition, it would be inconsistent with Basel and OSFI and the consolidation approach adopted in the Capital Modernization Framework. As such, BCFSA's approach has not changed from what was set out in the Consultation Paper.

MARKET RISK

Market Risk

22. General feedback and clarifications

Respondents noted that additional clarification was needed regarding the treatment of market risk under capital adequacy requirements regulation to fully understand the impact.

BCFSA's Decision

During the public consultation, BCFSA gathered information about the market risk exposures across the B.C. credit union segment, through general consultation questions, as well as targeted discussion with credit unions. BCFSA plans to address market risk in a future Capital Rule.

Notably, the proposed Capital Rule to be implemented January 2026 will not include a specific capital charge for market risk. The Capital Rule will instead address market risk using a Pillar II approach. This will involve utilizing an updated Internal Capital Adequacy Assessment Process ("ICAAP") and Supervisory Review Process to capture interest rate risk for banking book positions and general market risk for trading book positions.

BCFSA plans to incorporate market risk into future amendments of the Capital Rule, particularly market risk in trading books, following a comprehensive impact assessment and consultation with credit unions.

BCFSA is committed to transparency and engagement, with plans for an information session in Summer 2024 to outline the planned approach to market risk, including timelines, the consultation process, and a Quantitative Impact Study. Continuous communication with credit unions will be maintained throughout the consultation process.

OTHER TOPICS

Other Topics

23. Consolidation

Stakeholders noted the challenges in producing monthly consolidated financials.

BCFSA's Decision

BCFSA acknowledges the challenges of producing monthly financials on a consolidated basis. BCFSA has extended the transitional timeline by one year which will assist with making necessary adjustments. This concern will be addressed during Phase IV Implementation and Transition of this project.

24. Capital buffer: distributions constraints

Respondents said that details were not provided on how BCFSA would constrain distributions if a credit union's capital falls below the capital conservation buffer amount. Both OSFI and FSRA provide the details which is helpful in order to evaluate and comment on the buffer.

BCFSA's Decision

BCFSA will introduce a detailed mechanic, consistent with other jurisdictions, of how distributions will be constrained if a credit union's capital falls below the capital conservation buffer amount, with the necessary adjustments for B.C.'s Tier 1/Total Capital framework:

Table 1-1 of BCFSA's Capital Modernization Consultation Paper provides the minimum capital ratios plus the 2.5 per cent capital conservation buffer:

	Tier 1	Total Capital
Minimum	6.0%	8.0%
Capital conservation buffer	2.5%	2.5%
Minimum plus buffer	8.5%	10.5 %

If a credit union's capital ratio falls below the levels set out in Table 24-1 (below), capital conservation ratios will be imposed that automatically limit distributions. Table 24-1 sets out the minimum capital conservation ratios a credit union must meet at various levels of Tier 1 capital. These limits increase as a credit union's capital levels approach the minimum requirements. For example, a credit union with a Tier 1 capital ratio in the range of 7.875 per cent to 8.125 per cent would be required to maintain the equivalent of 80 per cent of its earnings in the subsequent payment period (i.e. pay out no more than 20 per cent in capital distributions).

Table 24-1: Minimum capital conservation ratios for corresponding levels of Tier 1

Tier 1 Ratio	Minimum Capital Conservation Ratios (expressed as percentage of earnings)
≤ 7.875%	100%
> 7.875% to 8.125%	80%
> 8.125% to 8.25%	60%
> 8.25% to 8.5%	40%
> 8.5%	0%

Similar capital conservation ratios apply where a credit union breaches its total capital requirements. In the event that a credit union simultaneously breaches more than one capital requirement (e.g. 8.5 per cent Tier 1, 10.5 per cent total capital) it must apply the most constraining capital conservation ratio.

BCFSA will include additional specifications in the final rule to account for the transition arrangements applicable to capital ratios and the capital conservation buffer appearing in [Appendix B](#).

Items considered to be distributions include dividends and share buybacks, discretionary payments on Tier 1 capital instruments and discretionary bonus payments to staff but does not include distributions that do not result in a reduction of Tier 1 capital, such as non-cash dividends paid on membership shares.

Other Topics

25. Internal capital adequacy assessment process

Stakeholders commented that they were unsure of the impact to the ICAAP and whether the framework replaces it and for Operational risk, if BCFSA intends to set minimum expectations in the ICAAP.

BCFSA's Decision

As a part of the capital project, BCFSA will be looking to update its ICAAP processes and a number of other guidelines. As mentioned in BCFSA's 2024/25 Regulatory Roadmap, a consultation on ICAAP will begin in Q4 2024/25.

Other Topics

26. CUDIC assessment

Respondents asked how the proposed capital framework will affect the CUDIC assessment.

BCFSA's Decision

CUDIC will be reviewing their Differential Premium System premium calculation and the methodology for the leverage ratio once the framework is in place.

Other Topics

27. Affordable housing

Respondents asked for a "Made for B.C." solution for credit unions to assist in providing affordable housing to British Columbians.

BCFSA's Decision

BCFSA recognizes that credit unions have an important role in local communities. BCFSA has engaged with CCUA and other stakeholders to understand the further role credit unions may play in supporting initiatives important to the B.C. economy, B.C. communities, and their members. Under the capital regime, BCFSA will work to consider flexibility on risk weighting for credit union lending as it relates to such initiatives as affordable housing, where there are demonstrated risk mitigants relative to market lending.

TRANSITIONAL ARRANGEMENTS

Transitional Arrangements

28. Extension of transition date

Respondents noted that the framework will come into effect on January 1, 2026. To allow credit unions sufficient time to meet the minimum requirements, BCFSA proposed that the risk-based capital ratio requirements be phased in over the subsequent two-year period (i.e. to January 1, 2028) at which time requirements must be met.

As noted in the overarching feedback themes, respondents expressed concern that a two-year transitional period is insufficient and provided rationale, including:

- The need to improve data availability, build processes and controls and enhance governance in respect of factors/metrics not previously required in the determination of capital requirements;
- Involvement and education of relevant stakeholders;
- Limited options for credit unions to raise capital in the short term;
- To absorb the impact of disqualifying system capital from regulatory capital; and
- To absorb the impact of newly introduced operational risk capital requirements.

BCFSA's Decision

To allow B.C. credit unions more time to meet the Capital Modernization requirements, BCFSA agrees to extend the transition date by one year and phase in capital ratio requirements over a three-year transitional period, at which time the requirements must be met. The framework still comes into effect on January 1, 2026 and credit unions will have a three-year period (i.e. to January 1, 2029) to meet the requirements. The revised transition periods and capital requirements are provided in [Appendix B](#).

As outlined in Item [32](#), BCFSA will provide an enhanced self-assessment tool well in advance of the implementation date, with a targeted release set for Fall 2024. This tool will serve as a vital resource, enabling credit unions to assess their readiness and compliance with the new framework's requirements. Credit unions that do not expect to meet the minimum capital requirements as stipulated in [Appendix B](#) should contact their Relationship Manager at the earliest opportunity.

Transitional Arrangements

29. Data and reporting

Respondents commented that significant time and resources are needed to collect and maintain the required data to calculate the proposed risk weights for residential and commercial lending. In particular, capturing historical data electronically that is currently on paper files would be a significant undertaking. Respondents commented that the need to change internal systems will divert resources from other strategic initiatives.

BCFSA's Decision

BCFSA recognizes that some credit unions may need to dedicate significant time and resources to populate data and/or upgrade systems. BCFSA will extend the transitional period to three years (i.e. January 1, 2026 – January 1, 2029). This will give additional time to allow credit unions to gather missing data and update systems/processes as needed. BCFSA will continue to work with credit unions to improve data quality over time. As part of Loan Data Reporting, BCFSA will expect these key credit risk metrics to be captured for new loan originations and refinances.

Transitional Arrangements

29.1 Data and reporting: increased requirements

Respondents were concerned that the increased data collection requirements, beyond what is required by banks, would negatively impact their members' experience and place credit unions at a disadvantage.

BCFSA's Decision

The metrics chosen are foundational to assessing credit risk and reflect key supervisory expectations for ongoing risk monitoring. Metrics including LTV/Loan to Cost, Total Debt Service ("TDS")/DSCR, and amortization are expected to be calculated and stored at loan origination and refinance and need to be monitored and reported on throughout the life of the loan. These metrics should be reviewed and updated (not exclusively at renewal) when there are material changes to a borrower's financial conditions and/or collateral risk. BCFSA anticipates that member interaction will typically be limited to member income updates.

BCFSA does not view the data collection requirements as putting credit unions at a disadvantage. These expectations are part of prudent risk management and in line with regulators' expectations in other jurisdictions. BCFSA will provide further details on requirements for updating the metrics in separate guidance. As such, BCFSA's approach has not changed from what was set out in the Consultation Paper.

Transitional Arrangements

29.2 Data and reporting: missing data

Respondents commented that defaulting missing data to the highest risk rating is punitive and could result in a capital ratio that does not reflect the real portfolio risk. They asked BCFSA to consider an alternative approach or transitional arrangement to treat loans with missing data.

BCFSA's Decision

BCFSA wishes to clarify that a loan will not automatically be assigned the highest risk weight if only one risk metric is missing. The other available metrics will also be used to determine the overall risk weight. Only the missing metric will be assumed to be above the highest threshold. Missing data reduces credit union's ability to effectively monitor, assess, and manage credit risk in their loan portfolio. BCFSA believes this conservative treatment for missing data is appropriate.

Transitional Arrangements

30. Phase-in of operational risk

Respondents noted that BCFSA introduced new capital requirements in respect of operational risk and provided no separate transitional period specifically for meeting operational risk requirements. The addition of operational risk to the capital adequacy requirements will immediately negatively impact credit unions' capital ratios. BCFSA should consider phasing in the operational risk requirement to allow credit unions to make adjustments that are not overly detrimental to long-term results.

BCFSA's Decision

Given the importance of operational risk in the current environment and foreseeable future, BCFSA believes it is critical that credit unions begin to fully reflect operational risk in their regulatory capital requirements and ICAAP at this time. Accordingly, BCFSA will not grant a separate transitional period for operational risk. However, an additional period of one year has been granted for the implementation of the framework as a whole, which includes operational risk, and this will provide additional time for credit unions to adjust as needed.

Transitional Arrangements

31. Phase-out of system capital

Respondents proposed that the removal of system capital be phased in over five years to give credit unions more time to adapt to the change, rather than experience a sudden drop in capital ratios. The transition would allow time for credit unions to rebuild their capital and adjust as needed.

BCFSA's Decision

As discussed in the Consultation Paper, system capital does not have loss-absorbance qualities in stressed situations. BCFSA will remove system capital from the calculation of a credit union's regulatory capital as of January 1, 2026. Applying a longer transitional period for system capital would add undue complexity to the framework. As mentioned, an additional period of one year has been granted for the implementation of the framework as a whole and this will provide additional time for credit unions to adjust.

Transitional Arrangements

32. Parallel reporting

Respondents asked to adopt parallel reporting in advance of implementation and transitional arrangements. Additionally, credit unions will need to develop new regulatory reporting processes. Credit unions would be running and submitting two sets of reporting; one that reflects the current capital framework, and one that reflects the proposed framework.

BCFSA's Decision

BCFSA recognizes the importance of facilitating credit unions as they navigate the transition to the updated capital framework and the new regulatory reporting requirements therein. BCFSA commits to providing support to credit unions in this transitional phase. To aid credit unions in preparing for the forthcoming changes, BCFSA will provide an enhanced self-assessment tool well in advance of the implementation date, with a targeted release set for Fall 2024. This tool will serve as a vital resource, enabling credit unions to assess their readiness and compliance with the new framework's requirements. This initiative builds on the self-assessment tool BCFSA provided in conjunction with the Consultation Paper to enhance the credit unions' understanding of the proposals contained in the paper.

Furthermore, BCFSA will organize an information session subsequent to the publication of the self-assessment tool. This session will afford credit unions an opportunity to gain a comprehensive overview of the updated framework and pose any pertinent questions they may have. By facilitating this interaction, BCFSA endeavors to equip credit unions with the knowledge necessary to navigate the intricacies of the new regulatory landscape. By affording credit unions a full 12-month window preceding implementation, credit unions will have the opportunity to evaluate the impact of the new framework on their capital requirements. Additionally, this extended timeframe will enable credit unions to ascertain the adjustments necessary to align with the updated regulatory reporting requirements.

Transitional Arrangements

33. Commercial lending - concentration risk adjustments

Stakeholders noted that the thresholds for the concentration risk adjustments have been static and credit unions have periodically asked BCFSA to reconsider these thresholds prior to the implementation of the Capital Modernization initiative.

BCFSA's Decision

BCFSA intends to introduce an interim measure to adjust the concentration risk threshold for commercial lending from 30 per cent to 35 per cent of total assets to take effect before the Capital Rule change. This measure will allow credit unions to start adapting to the more risk-based commercial lending risk weights under the proposed framework. In addition, credit unions are encouraged to begin strengthening their credit assessment and loan underwriting practices before the Capital Rule takes effect. BCFSA will provide additional information in an Advisory.

Transitional Arrangements

34. Transitional period for treatment of non-significant investments

BCFSA has not proposed a separate transitional period specifically for the requirement to fully deduct from Tier 1 capital any non-significant investments in the common equity and other TLAC Instruments of banks, financial and insurance entities. Respondents expressed concern that material holdings of securities falling into this category would adversely impact capital and leverage ratios over the medium term. Accordingly, relief was sought through a temporary exemption from deduction.

BCFSA's Decision

BCFSA will grant a temporary exemption from the requirement to fully deduct non-significant investment amounts exceeding the 10 per cent threshold described in Item [1](#) (i.e. amounts exceeding 10 per cent of the Credit Union's Tier 1 capital). The exemption will expire on January 1, 2029. Amounts in excess of the 10 per cent threshold, and which would otherwise be deducted during this transitional period, will be subject to a 250 per cent risk weight.

Appendix A: Consultation Questions Capital Modernization 2023 Consultation Paper

1. Do you have any general feedback concerning the proposals described in this paper?
2. Do you believe that the Capital Rule proposed in this paper would result in a framework that is suitable for credit unions? Are there any positions proposed in this paper that you disagree with? What additional items should be considered to reflect the unique capital structure of credit unions?
3. Do you have any suggestions on areas of the capital regime that could be made more risk-sensitive and/or areas that could be simplified or made less costly to administer?
4. Do you anticipate any barriers or challenges to implementing the changes to the capital framework? If so, are these challenges expected to be short-term or ongoing?
5. What are the challenges for your credit union in adopting the consolidated approach?
6. Does your credit union have capital instruments that do not qualify for recognition under the proposed Tier 1 and Tier 2 capital given the criteria in Appendix B of the 2023 consultation paper?
If yes, please explain what, why they do not qualify, and provide supporting information including terms and conditions of the instruments.
7. New risk-weighting categories:
 - a) How will the proposed credit risk impact your capital adequacy ratio?
 - b) Are there components of credit risks missing from the proposal? Please provide details.
 - c) Are the credit conversion factors in Appendix A of the 2023 consultation paper for the off-balance sheet commitments appropriate for both commercial and retail (including HELOC) commitments?
8. For operational risk, what is your view on the risk sensitivity of BIA? Please provide details to support your position.
9. How is your credit union addressing market risk? Please include, as relevant, type of market risk exposures, techniques for measuring exposure types, how the measures are incorporated in a credit union's overall capital adequacy requirements, governance, and risk mitigation measures employed.
10. Will the transition arrangements (section 5 of the 2023 consultation paper) provide enough time for you to adopt the consolidated regulatory reporting methodology? If no, why not?

Appendix B: Three-Year Transition Schedule January 1, 2026 to January 1, 2029

Year 0 refers to the effective date of the Capital Rule (i.e., January 1, 2026). Year 1 refers to the first fiscal year end after the Capital Rule takes effect. This will be January 1/October 1, 2027 for credit unions with a fiscal year ending December 31 or September 30, respectively. Credit unions will be expected to meet or exceed minimum capital requirements by Year 3 or January 1/October 1, 2029, respectively.

Risk-Based Capital Target Ratio				
Components of capital (Capital Rule effective Jan 1, 2026)	Year 0 (Jan 1, 2026)	Year 1 (Jan 1/Oct 1, 2027)	Year 2 (Jan 1/Oct 1, 2028)	Year 3 (Jan 1/Oct 1, 2029)
Tier 1 capital	4.5%	5.0%	5.5%	6.0%
Capital conservation buffer	1.0%	1.5%	2.0%	2.5%
Tier 1 capital with buffer	5.5%	6.5%	7.5%	8.5%
Total capital (Tier 1 capital plus Tier 2 capital)	8.0%	8.5%	9.5%	10.5%
Software intangibles	No deduction	No deduction	No deduction	Full deduction
Non-significant investments in financials	No deduction Risk Weight Applies	No deduction Risk Weight Applies	No deduction Risk Weight Applies	Full deduction, subject to 10% threshold
Leverage ratio	3%	3%	3%	3%

Appendix C: Risk Weights for HELOCs (Uninsured)

Risk Factors	Residential Real Estate	Income Producing Residential Real Estate
TDS > 42% AND LTV >75%	70%	105%
(TDS > 42% AND LTV ≤ 75%) OR (TDS ≤ 42% AND LTV > 75%)	50%	75%
TDS ≤ 42% AND LTV ≤ 75%	30%	45%

Appendix D: Basel III Credit Assessment and Risk Weights

Risk Weights for Claims on Sovereigns

Credit Assessment of Sovereigns	Risk Weight
AAA to AA-	0%
A+ to A-	20%
BBB+ to BBB-	50%
BB+ to B-	100%
Below B-	150%
Unrated	100%

Risk Weights for Claims on PSE

Credit Assessment of Sovereign	PSE Risk Weight
AAA to AA-	20%
A+ to A-	50%
BBB+ to BBB-	100%
BB+ to B-	100%
Below B-	150%
Unrated	100%

Risk Weights for Claims on Deposit Taking Institutions and Banks

Credit Rating of Sovereign	Deposit Taking Institutions and Banks Risk Weight
AAA to AA-	20%
A+ to A-	50%
BBB+ to BBB-	100%
BB+ to BB-	100%
Below B-	150%
Unrated	100%

Risk Weights for Claims on Corporates

Credit Assessment of Corporates	Risk Weight
AAA to AA-	20%
A+ to A-	50%
BBB+ to BB-	100%
Below BB-	150%
Unrated	100%



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