BC FINANCIAL SERVICES AUTHORITY

Official Change of Name

On November 1, 2019, BC Financial Services Authority (BCFSA) replaces the Financial Institutions Commission (FICOM) as BC's regulator of credit unions, trust companies, insurance companies, pension plans and mortgage brokers. All references in the attached document to **FICOM** and the **Financial Institutions Commission** should be read as **BCFSA** and **BC Financial Services Authority** until revised or replaced by the name of the Authority. The attached form or document will continue to be used until otherwise revised or cancelled.

If you have any questions, please contact us at 604-660-3555.
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INTERNAL CAPITAL TARGET GUIDELINE ANNEX

Summary of Consultation Comments and Financial Institutions Commission (FICOM) Responses

INDUSTRY COMMENT	FICOM RESPONSE
CATEGORY: GENERAL	
Capital requirements are already prescribed in regulation; additional guidance on capital targets is unnecessary.	Recent global financial stresses have demonstrated the importance of capital (both the quantity and quality) to a deposit-taking institutions' resiliency under adverse economic conditions and its ability to absorb losses without undue risk to depositors. The quantity and quality of a credit union's capital is therefore a primary area of focus for FICOM in its role as a prudential regulator. FICOM considers the prescriptive standards set out in *Financial Institutions Act* (FIA) and its regulations to be minimum operating requirements for a credit union; a breach of these statutory requirements provides for specific intervention by the regulator. The FIA provides the Commission with discretion to intervene where the Commission considers a credit union's liquidity or capital are or will be inadequate for it to carry on its business, or where a credit union is engaging in conduct such that it is placing the interests of depositors at risk. A buffer between the regulatory requirement and the supervisory capital target ratio (Supervisory Target) provides FICOM with sufficient time and flexibility to work with a credit union to implement contingency plans before statutory enforcement actions are necessary. A buffer between the Supervisory Target and a credit union's own internal capital target ratio (Internal Target) affords the board and senior management time to proactively initiate their own contingency plan before regulatory intervention. Standards set out in the Internal Capital Target Guideline (guideline) are designed to ensure both credit unions and FICOM effectively manage capital adequacy to avoid triggering automatic enforcement requirements or the compliance powers set out in the FIA.

CATEGORY: GENERAL, CON'T.	
The guideline does not identify any authority granted to FICOM to issue guidance or set supervisory standards. Requirements can only be set by legislature and policy should only be undertaken by the Ministry of Finance.	The FIA provides the Superintendent with powers to examine British Columbia financial institutions, including credit unions. The Supervisory Target and the Internal Target act as triggers for the Superintendent to undertake closer examination of a credit union that cannot meet or maintain these or any other supervisory standards. Like many regulatory bodies, FICOM provides guidance to communicate standards and expectations to the credit union system as part of its continued efforts to increase transparency and understanding of its supervisory practices. No explicit statutory authority is required to issue guidance. Supervisory guidance is informed by the legislative powers provided to the Commission and Superintendent to ensure compliance with prescriptive minimums as well as the non-prescriptive provisions of the FIA[1]. Guidelines provide transparency to decision-making and additional detail as to how legislation is administered by the regulator; they do not increase legislated powers. A credit union's inability to maintain supervisory standards may be indicative of governance, operational and/or solvency issues that warrant increased supervisory attention in the best interest of credit union depositors and the safety, stability and sustainability of the credit union system.
CATEGORY: REGULATORY REQUIREMENT	
The draft guideline asserts that the Regulatory Minimum for capital adequacy is 8%. The Credit Union Minimum Level of Capital Regulation prescribes that the minimum level of capital is 5%.	References to Regulatory Minimum have been corrected to Regulatory Requirement to provide clarity. The term Regulatory Requirement reflects that a credit union with capital below 8% will be subject to immediate statutory restrictions to its business operations.

[1] The FIA provides the Commission with authority to order increased liquidity and capital (section 67(2)), the general overriding power to take remedial action where the credit union is conducting its business in a way that might harm the interests of depositors (section 244), and the more intrusive powers of supervision (section 275) where, for example, a credit union's liquidity or capital have reached a level or are eroding in a manner that may detrimentally affect the interests of depositors.

CATEGORY: SUPERVISORY TARGET	
The guideline does not articulate the methodology or reasoning for why the Supervisory Target is set at 10%.	FICOM considered three factors in setting the Supervisory Target at 10%: **Regulatory harmonization and best practice** FICOM has joined other credit union prudential regulatory authorities across Canada in signaling its intention to model capital adequacy standards on the guidance issued by the Basel Committee and the federal Office of the Superintendent of Financial Institutions (OSFI)[2]. There has been considerable research and testing of these guidances since the global financial crisis and they are now considered minimum standards of prudence for deposit-taking institutions globally. **Empirical evidence** FICOM's research of historical fluctuations of capital adequacy levels in the BC credit union system indicates that 200 basis points is a prudent buffer under normal conditions. Maintaining this buffer above the regulatory requirement ensures credit unions remain resilient to adverse conditions. **Credit union resiliency** FICOM's approach to regulating is intended to rely first on a credit union's own contingency planning, second on regulatory oversight and third on statutory enforcement. Statutory enforcement is the least optimal intervention as it is higher risk and provides for less flexibility and time to resolve problems. A buffer of 200 basis points between regulatory intervention and statutory enforcement is an amount that provides FICOM with sufficient time and flexibility to work with a credit union to implement contingency plans before statutory enforcement actions are necessary.

[2] See Credit Union Prudential Supervisors Association Capital Principles announcement at http://www.fic.gov.bc.ca/pdf/creditUnionsTrusts/CUPSA_Announcement.pdf

CATEGORY: SUPERVISORY TARGET, CON'T.	
The guideline does not articulate the difference between FICOM's Supervisory Target (10%) and the Credit Union Deposit Insurance Corporation (CUDIC) standard of 13% capital adequacy for maximum capital points under the variable assessment model.	FICOM and CUDIC perform different roles in the oversight of credit unions and protection of depositors and therefore apply capital standards for differing purposes. FICOM is a prudential and market conduct regulator and sets capital standards to apply to its risk-based supervisory framework and to encourage the adoption of prudent policies and practices by credit union boards and senior management. CUDIC insures depositors of credit unions against losses in the event of a failure. CUDIC sets capital standards in order to assess premiums for deposit insurance differentially, based on the relative risk between insured institutions. FICOM and CUDIC, by necessity, have differing risk appetites and set capital standards to reflect those risk appetites. While a credit union is expected to manage its risk appetite to FICOM's supervisory standards and guidelines, it may choose to make business decisions to hold less capital than CUDIC's standard.
The guideline is not clear in what a credit union can expect from FICOM if it falls below the Supervisory Target. What is the relationship between the Supervisory Target and the composite risk rating (CRR)?	When a credit union's capital position falls below 10%, FICOM will stage the credit union. As detailed in the Guide to Intervention[3], staging does not trigger operational restrictions but does trigger increased attention and examination. The credit union will be expected to implement an immediate improvement plan and, depending on circumstances, FICOM may work with the credit union to implement specific actions under set timelines. A credit union whose capital falls below the Supervisory Target will also see the capital assessment portion of its CRR fall below the acceptable level.

[3] See FICOM Guide to Intervention at http://www.fic.gov.bc.ca/pdf/creditUnionsTrusts/GuideToIntervention.pdf

CATEGORY: INTERNAL TARGET	
The guideline is not clear in what a credit union can expect from FICOM if it falls below its own Internal Target. Some credit unions may determine an Internal Target that is below the Supervisory Target.	FICOM's guidance sets out the expectation that each credit union will establish its own Internal Target that reflects its risk appetite, strategic plan and operating environment. A credit union should also have in place a contingency plan that it will initiate in the event that capital levels fall below its Internal Target. When a credit union falls below, or expects to fall below, its own Internal Target it should advise its FICOM relationship manager as soon as possible. At that time, the credit union is also expected to advise FICOM on the actions it intends to take to improve its capital position and the expected timeline for restoring its capital to a level consistent with its own Internal Target. If a credit union sets its Internal Target below the Supervisory Target and its capital position sits at that level it will be subject to the heightened oversight activities as described for not meeting the Supervisory Target.
The guideline does not emphasis the role of the board when determining an Internal Target.	FICOM expects the board to set its Internal Target by applying its judgment in combination with the guidance provided. Capital targets reflect the board's risk appetite and must be appropriate to support the credit union's strategic plan; setting the credit union's Internal Target is one of the most important decisions the board can make in exercising its oversight role. FICOM expects the board to demonstrate rigour in setting its Internal Target and to be able to articulate the relationship between its capital target, risk appetite and strategic plan.
The guideline does not provide information on minimum levels of stress-testing or more explicit guidance on how to establish an Internal Target.	FICOM is undertaking further research and analysis in the areas of capital planning and stress-testing and will communicate with the credit union system on any future guidance.

CATEGORY: QUALITY OF CAPITAL	
The guideline suggests that some forms of capital prescribed under the Capital Requirements Regulation are considered lower quality by FICOM and should be excluded when establishing Internal Targets.	A key lesson from recent banking failures is that the quality of capital is equally important to the quantity of capital. Quality of capital describes the availability of the capital to absorb losses. The Capital Requirements Regulation under the FIA prescribes components of capital that can be included in a credit union's capital adequacy ratio for the purposes of calculating statutory minimum requirements however, not all forms of capital are equally loss absorbing. FICOM believes it is prudent for boards to consider the ultimate purpose of its capital and to view its capital both in terms of quality and quantity when setting an Internal Target to support its risk appetite. Ultimately a board must satisfy itself that it has both the amount and type of capital available to absorb the losses that might reasonably be anticipated in implementing its strategy. FICOM appreciates the unique circumstances of credit unions and the limitations credit unions have in measuring and raising capital. These issues were considered in developing the guideline and FICOM remains mindful of the cooperative nature of credit unions in setting standards moving forward. FICOM is working with other credit union regulators to determine effective ways to adapt standards to the credit union environment. FICOM will also continue to consult directly with BC credit unions to seek feedback and to ensure guidelines can be effectively implemented.