REGULATORY GUIDELINE

Control Environment - Financial Management

SYSTEM COMMUNICATION NUMBER

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INTRODUCTION

This regulatory guideline is a Regulatory Guidance Document as contemplated by the Standards of Sound Business Practice (the Standards). It supplements and expands upon section 2.1, Financial Management of the Standards and section II, Capital Standards of the Standards of Sound Business Practice – Capital Adequacy Requirements (Capital Standards) and must be adhered to by Saskatchewan credit unions.

The Standards specify the principles and requirements for an effective financial management framework. This guideline identifies the minimum policy and procedure requirements for capital and profitability management and interest rate risk management.

CAPITAL AND PROFITABILITY MANAGEMENT

Capital and profitability management is the ongoing determination of the level of capital and profitability needed to support operations, risks and growth.

Credit unions must have a policy and procedure in place with respect to:

- effective coordination of capital management with strategic management and risk management processes
- strategies for maintaining adequate capital support to operations, enterprise risks and growth
- amounts and types of capital necessary to meet operational and regulatory requirements
- establishment of financial performance targets and goals
- patronage programs, dividend payments, and/or redemption of capital
- a balanced and planned growth strategy that will achieve a desired balance sheet mix consistent with organizational plans and objectives
- product pricing and cost control practices that will take into account required profitability, risks involved and marketplace conditions
- ongoing analysis to maintain desired levels of efficiency and competitiveness
- disclosure to members and other interested stakeholders of the credit union's capital framework, including types of capital, terms and conditions of capital instruments, and capital adequacy to support operations, risks and growth

Regulatory Minimums, Conservation Buffer and Targets for Capital

As specified in the Capital Standards, credit unions are required to hold a capital conservation buffer of 2.5% effective January 1, 2016. This buffer is comprised of Common Equity Tier 1 Capital and it is established above the regulatory limit.

Credit Union Deposit Guarantee Corporation (the Corporation) expects that all credit unions set and pursue internal capital targets that are supported with a prudent internal capital adequacy assessment process (ICAAP) and meet and exceed the 2016 regulatory capital ratios plus the conservation buffer. This means “all-in” target ratios (minimum plus conservation buffer) of 7% Common Equity Tier 1 Capital, 8.5% Total Tier 1 Capital, and 10.5% Total Eligible Capital (all as a percentage of risk weighted assets).

Credit unions that remain below the “all in” targets during the July 1, 2013 to January 1, 2016 transition period should strive to meet the capital conservation buffer as soon as reasonably possible. This includes managing earnings and capital prudently, and avoiding actions that weaken their capital position.

While the conservation buffer does not apply to the leverage ratio, the Corporation expects credit unions to establish a prudent target that meets the requirements for capital limits specified in section 3, Limits and Restrictions of the Capital Standards.

Intervention thresholds are based on minimum regulatory ratios excluding the conservation buffer. Depending on the significance of negative capital trending and the adequacy of capital management practices and processes, credit unions may experience increased levels of regulatory interaction. This increased interaction may also trigger a requirement for a capital restoration plan before a credit union actually breaches intervention thresholds.

INTEREST RATE RISK MANAGEMENT

Interest rate risk is the potential impact on earnings and net assets values due to changes in market interest rates.

Credit unions must have policy and procedure with respect to:

- interest rate risk management to measure and control interest rate risk exposure including:
  - identifying material sources of interest rate risks, such as re-pricing risk and yield curve risk
  - effective sensitivity techniques, including stress testing, for measuring risk positions and for evaluating the impact on those positions from changes in underlying factors
  - maximum short- and long-term exposure limits with respect to:
    - changes in earnings
    - changes in aggregate net market value of on- and off-balance sheet items as a percentage of assets and eligible capital
  - strategies to ensure a stable and adequate net interest margin in support of required profitability