



**PRUDENTIAL STANDARDS**

# **Pledging**

**SASKCENTRAL COMMUNICATION NUMBER  
Prudential Standard 2017-03**

**ISSUE DATE**  
JANUARY 2017

## **TABLE OF CONTENTS**

I.	Introduction.....	1
II.	Definition .....	1
III.	Background .....	1
IV.	Pledging Policies.....	2

## I. INTRODUCTION

Pursuant to Part XIII of *The Credit Union Central of Saskatchewan Act, 2016* (the Act), Credit Union Deposit Guarantee Corporation (the Corporation) may make Prudential Standards that apply to SaskCentral. The Prudential Standard (Standard) contained herein must be adhered to by SaskCentral.

This Standard is intended to assist SaskCentral in establishing, as required by the relevant provisions of the Act,<sup>1</sup> policies regarding the creation of security interests in its property and the acquisition of beneficial interests in property that is subject to security interests, hereafter referred to as “pledging.”

This Standard outlines factors that the Corporation expects SaskCentral's board of directors or committee of the board to consider when establishing pledging policies. These factors are aimed at ensuring that SaskCentral's policies reflect its business operations and associated risks and that the policies are implemented effectively.

The Corporation expects that SaskCentral will also develop pledging policies on an enterprise-wide basis, in a manner consistent with its overall liquidity and other risk management practices.

## II. DEFINITION

The *Cooperative Credit Associations Act* defines “security interest” as an interest in or charge on property by way of mortgage, lien, pledge or otherwise taken by a creditor or guarantor to secure the payment or performance of an obligation. Although certain activities, such as securities lending, may result in the creation of security interests, actually determining whether a specific activity or transaction results in pledging rests on the particulars of the transaction.

## III. BACKGROUND

The Corporation recognizes that pledging is an integral part of a number of activities or transactions that are important to SaskCentral's operations. The objective of pledging by SaskCentral is generally to secure its own financial obligations. However, pledging is also part of a number of activities that reduce risk to SaskCentral and to credit unions. For example, pledging may be used in support of SaskCentral's derivative contracts to hedge interest, currency or other market risks. As well, pledging requirements associated with participation in certain systems, such as clearing houses and payment systems, can help contribute to reducing systemic risk.

Pledging can affect SaskCentral's ability to meet its liquidity requirements. For example, in the event of a liquidity crisis, SaskCentral's ability to borrow money may hinge upon the availability of unencumbered assets.<sup>2</sup> Therefore, the Corporation expects SaskCentral to consider liquidity risk in establishing its pledging policies. Pledging policies can also affect unsecured creditors, because the higher the proportion of pledged property, the fewer the

---

<sup>1</sup> The provisions are found in sections 383 to 383.2 of the *Cooperative Credit Associations Act*, which applies pursuant to subsection 11-5(1) of the Act.

<sup>2</sup> For example, the Bank of Canada, as lender of last resort, lends only on a fully secured basis.

assets available for unsecured creditors (i.e., depositors and other creditors) in the event of SaskCentral's insolvency.

The Corporation expects SaskCentral's pledging policies to reflect an appropriate balance between the need to conduct its business and the responsibility to effectively manage the risks related to its operations, and the interests of its unsecured creditors. In this context, information relating to pledged assets is important from a liquidity management standpoint and, in the event of insolvency, becomes critical for credit unions and other stakeholders. Identifying business activity categories that require pledging and reporting pledged assets are key elements of SaskCentral's pledging policies.

#### IV. PLEDGING POLICIES

The Corporation expects SaskCentral to establish and implement pledging policies that are approved by the board of directors or a committee of the board. These policies establish the framework within which pledging can occur in relation to various business activities. Further, the Corporation expects that the board or board committee will review the policies at least annually and approve significant changes to them. When approving such policies, the Corporation expects that the board or board committee will take into account factors such as SaskCentral's size, the nature and complexity of operations, its overall risk philosophy, and its ability to monitor and control transactions that require pledging. Where it is appropriate to do so, the policies may specify the parameters for delegation of certain responsibilities and functions necessary to the implementation of some of the elements set out below.

SaskCentral's pledging policies should encompass the following elements:

1. An outline of SaskCentral's objectives when engaging in activities that require pledging, having regard to its policy towards risk and risk management, including tolerance of risk.
2. A description of the business reasons (e.g., hedging, liquidity management, access to markets, support for its core operations) for the activities or transactions that require pledging. Examples of such activities or transactions include:
  - participation in securities depositories and various clearing and settlement systems (including systems for payments and foreign exchange);
  - derivatives operations (e.g., pledging to counterparties in respect of over the counter derivatives operations);
  - borrowing on a secured basis (e.g., mortgaging of property); and
  - securities borrowing/lending.
3. Appropriate limits on pledging for particular business activities, having regard to whether the value of the assets pledged is reasonable in relation to the benefits that SaskCentral can expect to derive from the activity or transaction that requires pledging. Such limits are particularly important when the activity does not involve risk mitigation. The level of pledging for particular activities and the aggregate level of pledging for SaskCentral should be assessed with respect to their significance to SaskCentral's liquidity requirements and policies, the strength of capital and ability to absorb losses, and to the potential effect that the pledging may have on unsecured creditors, including credit unions and other stakeholders.
4. Quantitative limits on an individual officer's ability to execute agreements or approve transactions that require pledging, taking into account the standards that SaskCentral has in place (see item 3). SaskCentral should determine the circumstances where

individual (per officer) transaction limits as well as aggregate limits would be appropriate.

5. Measures aimed at monitoring the value of assets pledged in various activities or transactions, as well as the aggregate value of assets pledged, and the performance of appropriate stress tests to determine any additional collateral SaskCentral may have to pledge under various scenarios (e.g., market movements or triggers such as rating downgrades).
6. The basis on which reporting and monitoring of pledging should be performed, having regard to the type and nature of the operation and including other factors such as whether contracts are subject to novation or other legally valid forms of netting. Reporting should include information relating to pledged assets and unencumbered assets.
7. The frequency and format of internal reporting for monitoring adherence to the policies.
8. Appropriate practices and procedures to ensure that the policies are respected. Ultimate responsibility for the oversight of all such operations is expected to reside in a single, clearly defined department or individual that is independent of the departments where the operations originate.
9. A requirement that regular (at least annual) board (or board committee) reviews be carried out of established policies and of SaskCentral's adherence to the policies.

Where SaskCentral has other internal policies in relation to activities or transactions that require pledging, these policies should be included (or referred to) in its pledging policies.