



PRUDENTIAL STANDARDS

Prudent Person Approach

SASKCENTRAL COMMUNICATION NUMBER
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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.

By law¹, the board of directors of SaskCentral is required to establish, and adhere to, "investment and lending policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments and loans to avoid undue risk of loss and obtain a reasonable return." In addition, SaskCentral must comply with the statutory investment limits set out in the "limits" section.

This Standard outlines factors that the Corporation expects the management and board of directors of SaskCentral to consider in establishing investment and lending policies and in ensuring that they are effectively implemented. It is meant to serve as a guide and the provisions of the Standard should be adapted by SaskCentral to reflect the activities and risks of its business.

POLICY

SaskCentral is required to have written investment and lending policies. These policies should describe the objectives for the investment and lending programs and the overall risk philosophy of the institution. They should take into account the strength of SaskCentral's capital and its ability to absorb potential losses.

The policies should take note of SaskCentral's liability structure and the anticipated demands for funds and address how maturity profiles are to be established on the portfolios of investments and loans in light of these demands. They should establish exposure limits to a counterparty or a group of counterparties and to interest rate and currency risk. In setting these limits SaskCentral should consider its exposure under a variety of potential scenarios.

PROCEDURES

SaskCentral is required to have written internal procedures outlining how the investment and lending policies will be implemented and monitored. SaskCentral should ensure that the policies are implemented by persons, either on staff or under contract, who have the appropriate level of expertise. These procedures should address exposures arising from both on-balance sheet and off-balance sheet items.

The procedures should:

- identify responsibilities and accountabilities;
- set out the process for recommending, approving, and implementing decisions; and
- prescribe the frequency and format of reporting.

In addition, they should describe the method for classifying loans and investments, and the basis for valuing loans and investments that are not regularly traded. There should be

¹ The legislative reference is section 387 of the *Cooperative Credit Associations Act*, which applies pursuant to section 12-1 of the Act.

written procedures describing custodial arrangements of these assets. In developing these procedures, reference should be made to the regulations on protection of assets.

Procedures should be in place to monitor and control SaskCentral's exposure to fluctuations in interest rates, foreign exchange rates, and market prices.

Potential sources of conflict of interest should be identified and procedures should be in place to ensure that those involved with the implementation of the investment and lending policies understand where these situations could arise and how they should be addressed.

LIMITS

The investment policy should identify acceptable ranges for investments in different types of instruments, including cash, equities, bonds and debentures, and real property. The lending policy should establish limits on aggregate outstanding loans by type of loan broken down by major category. These broad categories should be further subdivided as necessary and limits set accordingly.

SaskCentral should set limits on investments and loans according to their quality. For example, SaskCentral may use ratings from recognized rating agencies in establishing quality criteria for its investments. Internal criteria would have to be established for non-rated investments. Similarly, internal criteria should be established for assessing the credit quality of borrowers.

Where applicable, limits should be established on exposures to industries and geographic regions.

SaskCentral should establish limits to contain the risks arising from potential changes in currency or interest rates. It should have policies outlining the circumstances in which derivative instruments can be used. In addition, it should establish limits on the use of derivative instruments by type of instrument (e.g., swaps, options, futures) and by counterparty.

COMMERCIAL AND CREDIT UNION LENDING LIMITS

Commercial lending is limited to five percent of assets if regulatory capital is less than or equal to \$25 million. Approval of the Corporation is required to exceed five percent if regulatory capital is greater than \$25 million.

SaskCentral is required to notify the Corporation immediately when a credit union's line of credit or borrowings exceed SaskCentral's policy limits.

APPROVAL

At least annually, the board of directors of SaskCentral or a subcommittee appointed by the board should review and approve the investment and lending policies and be advised in writing of adherence to these policies. Deviations should be reported immediately. The board or subcommittee may delegate the responsibility for the day to day implementation and monitoring to management; however, ultimate responsibility rests with the board.

PROVIDING INFORMATION TO THE CORPORATION

SaskCentral is required to consult with the Corporation in advance of making changes to its investment and lending policy limits. As well, written policies and procedures should be available for review immediately upon request.

SaskCentral will be expected to maintain information on its portfolios presented in a manner that facilitates analysis, for example:

- a comparison of outstanding amounts against the limits established in its policies;
- an analysis of asset quality and concentration;
- an analysis of its interest rate and maturity mismatch, including the results of scenario testing as appropriate; and
- an analysis of the diversification of its funding sources.

Where information required to perform this analysis is not available through the filing of regulatory reporting, the Corporation may request supplemental information that expands on the areas of greatest risk.