REGULATORY GUIDELINE AND PRUDENTIAL STANDARD

Financial Reporting and Disclosure

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I. INTRODUCTION

For credit unions, this is a Regulatory Guidance Document (Guideline) as contemplated by the Standards of Sound Business Practice (the Standards). It supplements and expands upon section 1, Corporate Governance and section 2.1, Financial Management of the Standards, and must be adhered to by Saskatchewan credit unions.

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

This guideline and prudential standard identifies requirements and expectations to help credit unions and SaskCentral, collectively referred to as Provincially Regulated Financial Institutions (PRFIs), fulfill their financial reporting and disclosure responsibilities to members and other key stakeholders. Key principles and considerations are presented to support PRFIs in developing accounting and disclosure policies and practices, related to operations and risks, as well as capital and liquidity adequacy. PRFIs are expected to apply those disclosures that are relevant to their business model.

II. FINANCIAL REPORTING

IFRS 9 GUIDANCE ON THE FAIR VALUE OPTION

International Financial Reporting Standards (IFRS) 9 allows entities to designate a financial asset or financial liability at fair value through profit or loss upon initial recognition. This option is referred to as the "Fair Value Option." The following provides guidance to PRFIs applying the Fair Value Option.

The Corporation expects all PRFIs using the Fair Value Option to meet the following expectations:

1. Apply the Fair Value Option to meet the criteria set forth in IFRS 9 in form and in substance.
2. Have appropriate risk management systems (including related risk management policies, procedures, and controls) in place prior to initial application of the Fair Value Option for a particular activity or purpose and on an ongoing basis.
3. Not apply the Fair Value Option to instruments for which they are unable to reliably estimate fair values.
4. Provide supplemental information to assist the Corporation in assessing the impact of a PRFI's use of the Fair Value Option.

The Corporation understands that PRFIs using the Fair Value Option may apply IFRS 9, as amended from time to time, including paragraphs 4.1.5 and 4.2.2 of the IFRS 9 Financial Instruments Standard.

For Paragraphs 4.1.5 and 4.2.2(a), PRFIs may apply the Fair Value Option under this criterion if:
(a) consistent with a documented risk management strategy, it eliminates or significantly reduces[1] the measurement or recognition inconsistency of measuring financial assets or liabilities together on a different basis[2]
(b) the fair values are reliable at inception and throughout the life of the instrument

For Paragraph 4.2.2(b), PRFIs may apply the Fair Value Option under this criterion if:
(a) the PRFI has a documented risk management strategy to manage the group of financial instruments together on a fair value basis and can demonstrate that significant financial risks are eliminated or significantly reduced
(b) the fair values are reliable at inception and throughout the life of the instrument

USING THE FAIR VALUE OPTION FOR LOANS

Notwithstanding the above, the Fair Value Option should not be used for loans and mortgages. However, PRFIs are advised that there is opportunity to request the Corporation's approval to use the Fair Value Option for loans and mortgages to companies with annual gross revenue in excess of $75 million. PRFIs demand for this option is not anticipated to be high but with demonstrated need, the option will be considered.

IMPAIRMENT GUIDANCE ON SOUND CREDIT RISK PRACTICES

The objective of impairment guidance on sound credit practices is to set out the Corporation's expectations associated with the implementation and on-going application of the IFRS 9 Expected Credit Loss (ECL) accounting framework. This presents the Corporation's view of the appropriate application of the IFRS 9 standard, including:

- the application of materiality and symmetry
- giving consideration to forward-looking information and the use of experienced credit judgement
- limiting the use of the more than 30 past day due rebuttal presumption

The scope of credit risk practices for this section of the document is limited to those practices affecting the assessment and measurement of allowances under the IFRS 9 ECL accounting framework.

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[1] "Significantly reduce" is to be determined by the PRFI and subject to internal and external audit review. The Corporation does not expect PRFIs to use effectiveness tests similar to those required for hedge accounting in their assessment of whether the "significantly reduce" criterion is met.
[2] A PRFI may satisfy this requirement by a documented and implemented strategy which may include, but is not limited to, the following strategies to eliminate or significantly reduce risk:

1. Asset liability matching in duration and amount.
2. Assets which are approximately matched in amount to the liabilities and have a higher (or lower) duration within a documented range.
3. Assets which are less than the liabilities but have a higher duration within a documented range.
4. Assets which exceed the liabilities but have a lower duration within a documented range.

Application of materiality and symmetry

- Consideration should be given to the application of the principle of materiality. The application of materiality should not result in individual exposures or portfolios being considered immaterial if, cumulatively, these represent a material exposure to the PRFI. In addition, materiality should not be assessed only on the basis of the potential impact on the income statement at the reporting date. For instance, large portfolio(s) of high-quality credit exposures would be considered material.
- The Corporation is primarily interested in preserving the stability of the credit union system and protecting credit union depositors. Thus, it is required that all PRFIs recognize allowances in a timely manner, so that the recognition of credit deterioration is not delayed, given the range of judgment existing in IFRS 9. Nevertheless, the Corporation recognizes that the IFRS 9 ECL framework is symmetrical in the way that subsequent changes (both deteriorations and reversals of those deteriorations) in the credit risk profile of a debtor should be considered in the measurement of allowances.

Consideration of forward-Looking information and use of experienced credit judgement

- In accordance with IFRS 9, consideration of forward-looking information, including macroeconomic factors, is a distinctive feature of the ECL accounting framework and is critical to the timely recognition of ECL. The Corporation expects PRFIs to incorporate forward-looking information into their ECL assessment and measurement process.
- Information on historical loss experience or the impact of current conditions may not fully reflect the credit risk in lending exposures. In that context, a PRFI must use its experienced credit judgment to incorporate the expected impact of reasonable and supportable forward-looking information, including macroeconomic factors, on its estimate of ECL. A PRFIs use of its experienced credit judgment is integral to its credit risk methodology and should be documented and subject to appropriate oversight.
- PRFIs may incorporate forward-looking information in a variety of ways. For example, they may use individual and/or collective assessments. This could also be done through modelled approaches or through the use of temporary adjustments. The Corporation will not prescribe the method by which a PRFI incorporates forward-looking information into its assessment and measurement of ECL.
- The Corporation understands that it may be challenging to incorporate forward-looking information in the estimate of ECL. Further, the Corporation accepts that ECL is an estimate and thus may not perfectly predict actual outcomes. The need to incorporate such information is likely to increase the inherent degree of subjectivity in ECL estimates, compared with impairment measured using an incurred loss approach. In the Corporation’s view, consideration of forward-looking information is essential to a high-quality implementation of an ECL accounting framework.
- The Corporation expects that PRFIs will exercise care when determining the level of ECL to be recognized for accounting purposes to ensure that the resulting estimates are appropriate.
- Additionally, PRFIs are increasingly considering a wide range of information, including that of a forward-looking nature, for risk management and stress testing purposes. The Corporation expects PRFIs to consider reasonable and supportable information derived from the different stages in the credit risk management process when developing their ECL estimates, such as information and assumptions relevant to ECL used in stress testing, planning, etc.

More-than-30-days-past-due rebuttable presumption

- Delinquency is a lagging indicator of significant increases in credit risk. PRFIs should have credit risk assessment and measurement processes in place to ensure that credit risk increases are detected ahead of exposures becoming past due or delinquent, to ensure a timely transfer of exposures to lifetime ECL measurement. Accordingly, the Corporation expects PRFIs to limit their use of the more-than-30-days-past-due rebuttable presumption in IFRS 9 paragraph 5.5.11, as a primary indicator of transfer to lifetime ECL measurement.

- The Corporation expects that any assertion that the more-than-30-days-past-due presumption is rebutted on the basis that there has not been a significant increase in credit risk will be accompanied by a thorough analysis evidencing that 30 days past due is not correlated with a significant increase in credit risk. Such analysis should consider both current and reasonable and supportable forward-looking information that may cause future cash shortfalls to differ from historical experience.

- In the limited instances where past-due information is the best criterion available to a PRFI to determine when exposures should move to the lifetime ECL measurement category, PRFIs should pay particular attention to their measurement of 12-month ECL to ensure that ECL are appropriately captured in accordance with the measurement objective of IFRS 9. Moreover, PRFIs should recognize that significant reliance on backward looking information could introduce bias into the implementation of an ECL framework risking that the objectives of the IFRS 9 impairment requirements (e.g., to reflect ECL that meet the stated measurement objectives and to capture significant increases in credit risk) are not met.

III. GUIDING PRINCIPLES SURROUNDING ALL DISCLOSURES

The guiding principles aim to provide a firm foundation for achieving transparent, high-quality risk disclosures that will enable users: to better understand and compare a PRFI's business and its risks, at a level of detail appropriate and proportional to the PRFI's nature, scope, complexity of operations, strategy, and risk profile.

The Corporation expects all disclosures made by PRFIs to be guided by the following principles:

- **Disclosures should be clear**. Disclosures should be presented in a form that is understandable to key stakeholders (e.g., members, regulators, analysts, others) and communicated through an accessible medium. Important messages should be highlighted and easy to find. Complex issues should be explained in simple language with important terms defined. Related risk information should be presented together.

- **Disclosures should be comprehensive**. Disclosures should describe a PRFI's main activities and all significant risks, supported by relevant underlying data and information. Significant changes in risk exposures between reporting periods should be described, together with the corresponding responses by management. The level of detail of such disclosure should be proportional to the PRFI's complexity. Approaches to disclosure should be sufficiently flexible to reflect how senior management and the board internally assess and manage risks and strategy, helping users to better understand a PRFI's risk tolerance/appetite.

- **Disclosures should be meaningful to users**. Disclosures should highlight a PRFI's most significant risks and how those risks are managed, including information that is likely to receive members attention.

- **Disclosures should be consistent over time**. Disclosures should be consistent over time to enable key stakeholders to identify trends in a PRFI's risk profile across all significant aspects of its business. Significant changes should be highlighted and explained.

- **Disclosures should be comparable across similar financial institutions**. The level of detail and the format of presentation of disclosures should enable key stakeholders to perform meaningful comparisons of business activities, prudential metrics, risks, and risk management between financial institutions with similar characteristics.

Disclosure is a key tool for decision-making and market discipline[3]. It helps the Corporation meet our mandate of protecting depositors by ensuring appropriate information is available for members to understand the financial condition of PRFIs and the risks to which they are exposed. Disclosures also help to ensure that stakeholders have access to key risk information that would enable them to gain a fundamental understanding and knowledge of the PRFIs activities.

BOARD POLICY

PRFIs are expected to have a formal board-approved disclosure policy. The intent of the policy should be to ensure that the appropriate disclosures are in place to encourage member confidence in the PRFI. It should address the PRFI's method for determining what will be disclosed and the controls over the disclosure process. The policy should include a process for independently evaluating the suitability of disclosures, including both their content and frequency. The appropriate level of disclosure depends on the nature, scope, complexity of operations, strategy, and risk profile of the PRFI, and the materiality of the information.

IV. DISCLOSURES

MANAGEMENT'S DISCUSSION AND ANALYSIS

PRFIs are required to include a management's discussion and analysis (MD&A) section with their annual financial statements. MD&A disclosures are an important source of information for members and other key stakeholders. These disclosures are generally the starting point for stakeholders in assessing the organization's profitability and health. Together, the financial statements and MD&A form the groundwork for PRFI reporting.

MD&A is to be written in a straightforward and clear manner. It should provide stakeholders with relevant, comparable information over reporting periods in order to convey understanding of the PRFI's past, current, and future prospects.

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[3] Market discipline a market-based promotion of the transparency and disclosure of the risks associated with a business or entity. It works in concert with regulatory systems to increase the safety and soundness of the market.

PRFIs are expected to disclose information related to:

- management's analysis of results of operations, financial condition, reasons for changes from the prior reporting period, and a discussion of key trends
- risks and uncertainties important to senior management and PRFI stakeholders
- information that makes it possible to identify future risks and evaluate management's plans for the future
- information that is not revealed in financial statements
- risk information discussed in financial statement notes
- topics covered in this guideline and prudential standard

CORPORATE GOVERNANCE DISCLOSURES

Corporate governance disclosures are intended to provide members and other key stakeholders with assurance that the PRFI is well managed and operated in a sound and prudent manner. Disclosures should be at a level of detail appropriate and proportional to the nature, scope and complexity of operations, strategy, and risk profile of the PRFI, and the materiality of the information.

PRFIs are expected to disclose information related to their:

- purpose and ethics, including
  - vision, mission, and values
  - co-operative principles
  - code of conduct
  - market code
  - community involvement and corporate social responsibility initiatives
  - privacy policy
- executive management, including
  - structure
  - profiles
- board of directors, including
  - mandate and responsibilities
  - structure
  - profiles
  - nomination process
  - remuneration and meeting attendance
  - approaches towards
    - continuing education
    - assessing the board's performance
  - committees, including
    - mandates and responsibilities
    - members

RISK MANAGEMENT DISCLOSURES

Risk management disclosures provide assurance that management is balancing risk taking and risk mitigation. In order to provide this assurance, PRFIs are expected to disclose information that allows members and other key stakeholders to assess key information on the scope of operations, risk exposures and risk management processes. Disclosures are expected to be at a level of detail appropriate and proportional to the nature, scope, complexity of operations, strategy, and risk profile of the PRFI, and the materiality of the information.

IFRS sets out specific qualitative and quantitative disclosures related to financial instruments. They specifically address, but are not limited to, credit, liquidity, and market risk. Required qualitative disclosures include:

- explanation of the risk
- exposures to the risk and how it arises
- objectives, policies, and processes used to measure, and manage the risk.

Additionally, PRFIs are expected to disclose information about their enterprise risk management framework, including:

- overview of the risk management framework
- definitions of and approaches to monitoring each key risk, including those that are not set out in IFRS (e.g., operational risk)
- responsibility within the PRFI for managing risk
- summary of the policies and procedures intended to minimize exposure to excessive concentrations of risk

In most cases, a summary of the information is all that is required. The disclosure is expected to provide enough detail to describe the risks associated with the PRFI and assure members and other key stakeholders that risk is appropriately managed and balanced.

CAPITAL AND LIQUIDITY MANAGEMENT DISCLOSURES

Disclosures of capital and liquidity management programs provide members and other key stakeholders with assurance that the PRFI is taking appropriate steps to protect members. They are intended to encourage confidence in the strength and sustainability of the organization.

IFRS sets out specific qualitative and quantitative disclosures related to capital and liquidity management. PRFIs are required to disclose information that allows stakeholders to evaluate the PRFI's objectives, policies, and processes for managing capital and liquidity. PRFIs are expected to provide sufficient qualitative discussion around capital and liquidity to facilitate understanding of the results and data provided.

Required qualitative disclosures related to capital and liquidity include:

- what the PRFI manages as capital
- the PRFI's regulatory capital requirements
- whether the PRFI meets the regulatory capital requirements
- how the PRFI meets its capital management objectives
- the PRFI's regulatory liquidity requirements
- whether the PRFI meets the regulatory liquidity requirements
- consequences of not complying with regulatory standards

Required qualitative disclosure credit unions are expected to make include:

- the approach to assessing capital adequacy for current and future operations
- the target for risk-weighted capital and the leverage ratio
- changes in risk-weighted capital and the leverage ratio over time
- the target for the Liquidity Coverage Ratio (LCR)
- changes in the LCR over time
- concentration of funding sources

Required quantitative disclosures credit unions are expected to make related to capital and liquidity include:

- tier 1 capital and its components
- tier 2 capital and its components
- deductions from capital
- risk-weighted assets and its components
- the stock of High-Quality Liquid Assets and its components
- Net Cash Outflows and its components
- Leverage ratio and its components

Required qualitative and quantitative disclosures SaskCentral is expected to make include:

- the approach to assessing capital adequacy for current and future operations
- the borrowing multiple and its components, including deductions from capital
- the target for the borrowing multiple
- changes in the borrowing multiple over time
- concentration of funding sources

Capital and liquidity disclosure is to include a level of detail that provides members and other key stakeholders with assurance that the PRFI is adequately capitalized and is maintaining an adequate stock of High-Quality Liquid Assets.

CREDIT RISK DISCLOSURES

Credit risk disclosures provide members and other key stakeholders with knowledge of the main characteristics and elements of a PRFI's credit risk management (business model and credit risk profile, organization and functions involved in credit risk management, risk management reporting). PRFIs must describe their risk management objectives and policies for credit risk, focusing on:

- how the business model translates into the components of the PRFI's credit risk profile
- criteria and approach used for defining credit risk management policy and for setting credit risk limits
- structure and organization of the credit risk management and control function
- relationships between the credit risk management, risk control, compliance, and internal audit functions
- scope and main content of the reporting on credit risk exposure and on the credit risk management function to senior management and to the board

CREDIT QUALITY OF ASSETS DISCLOSURES

The Corporation expects all PRFIs to make disclosures that will provide a comprehensive picture of the credit quality of a PRFI's on-and off-balance sheet assets. PRFIs are required to disclose their definition of default. PRFIs are also expected to disclose the following information broken down into three categories (loans, debt securities, and off-balance sheet exposures):

- gross carrying values of defaulted exposures and non defaulted exposures
- allowances/ impairments
- portion of which ECL accounting provisions for credit losses is allocated to specific and general category

DERIVATIVE DISCLOSURES

PRFIs must disclose the following as it pertains to their derivative instruments[4]:

- notional amount: These disclosures should be made either in the body of the financial statements or in the accompanying notes.
  - The notional amounts and other information about the extent and nature of all derivative instruments as well as the remaining term to maturity of all derivative instruments, as a minimum, for the following three-time bands: 1 year or less, over 1 year through 5 years, and over 5 years.

  - Notional amounts and other information about the extent and nature of derivative financial instruments should be disclosed by class (e.g., interest rate contract or foreign exchange contract) and by type (e.g., forwards, futures, credit default swaps, total return swaps, and options). Interest rate cross currency swaps should be included under foreign exchange contracts.

QUALITATIVE DISCLOSURES RELATING TO SECURITIZATION EXPOSURES

The Corporation expects PRFIs with securitization exposures to provide members and other key stakeholders with qualitative information on their strategy and risk management practices for securitization activities. PRFIs must describe their risk management objectives and policies for securitization activities, and the main features of these activities according to the guidance below. If a PRFI holds securitization positions, the PRFI must describe each of the following points by distinguishing activities:

- The PRFI's objectives in relation to securitization and re-securitization activity, including the extent to which these activities transfer credit risk of the underlying securitized exposures away from the PRFI to other entities, the type of risks assumed, and the types of risks retained.
- A summary of the PRFI's accounting policies for securitization activities. Where relevant, PRFI's are expected to distinguish securitization exposures from re-securitization exposures.

COMPLIANCE ORDERS DISCLOSURES

PRFIs that have received an Order of Compliance or have been placed under supervision, administration, or are subject to a take control order (Stage 3 or 4 under the Corporation's Supervisory Framework) must disclose as much in their next annual report.

For credit unions, the Corporation may issue an Order of Compliance pursuant to section 464 of *The Credit Union Act, 1998* (the Act), or place a credit union under supervision or administration pursuant to section 466 of the Act.

For SaskCentral, the Corporation may issue an Order of Compliance pursuant to section 16-7 of *The Credit Union Central of Saskatchewan Act, 2016* (the SaskCentral Act) or take control of SaskCentral pursuant to section 16-11 of the SaskCentral Act.

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[4] The Standards of Sound Business Practice prohibit credit unions from investing in derivatives except for hedging purposes.

FREQUENCY AND LOCATION OF DISCLOSURES

The frequency of disclosure will depend on the type of information. For the majority of the information covered by this guideline, PRFIs are expected to make their disclosures at least annually.

PRFIs should determine the appropriate methods of disclosure based on the information to be disclosed, resources available, and ease of accessibility by stakeholders. Financial disclosures are to be attached to, or included in, the notes of financial statements. To complement traditional paper-based methods of disclosure, PRFIs are strongly encouraged to disclose information in an easily accessible and user-friendly way on their website.

The Corporation expects PRFIs to make available their full set of financial statements including the report of the auditor and any additional information the board feels necessary to disclose[5]. The Corporation does not consider summary financial statements suitable to satisfy the disclosure requirements contained in the Act.

DISCLOSURE RESTRICTIONS AND LIMITATIONS

There is certain information that PRFIs cannot disclose. This includes:

- confidential information such as results of supervisory assessments, risk ratings (including composite risk), and staged ratings assigned by the Corporation (unless otherwise noted above)
- information about employees or members covered by privacy legislation.

PRFIs are not expected to disclose proprietary information that would harm its competitive position if disclosed.

OTHER DISCLOSURE REQUIREMENTS

Board and management are to consider whether the disclosure requirements contained in other regulatory guidelines and directives issued by the Corporation are applicable their PRFI.

V. SUPERVISORY CONSIDERATIONS

As part of regular monitoring of financial performance, the Corporation will examine financial and non-financial reporting to determine whether the disclosure requirements contained in this guideline have been appropriately implemented and incorporated into PRFI's financial reporting. The review of disclosures will be appropriate and proportional to the organization's nature, scope, complexity of operations, strategy, risk profile of the PRFI, and the materiality of the information.

To facilitate the Corporation's monitoring of adherence to the requirements contained in the guideline, all PRFIs are required to provide their annual report to the Corporation, in addition to their audited financial statements. The deadline for submission of the annual report and audited financial statements can be found in the Regulatory Reporting Submissions Filing Instruction for credit unions and SaskCentral.

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[5] In order to satisfy section 259 of the Credit Union Act, 1998, and section 9-1(1) of the Credit Union Central of Saskatchewan Act, 2016, credit unions and SaskCentral are expected to make this information available at every annual general meeting.

VI. AUDIT EXPECTATIONS

PRFIs are required to submit financial and statistical information to the Corporation that is accurate in all material respects. As such, PRFI's are expected to engage an internal auditor, or other third party, to provide an unbiased and independent opinion over the accuracy of the regulatory submissions. This includes providing assurance over the processes and controls surrounding regulatory submissions for liquidity, capital, and the leverage ratio.

The scope of this opinion should be risk-based and reflect the PRFI's nature, complexity of operations, strategy and risk profile. PFRI's are expected to obtain this opinion once every three years.