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Financial Institutions Act and Credit Union Incorporation Act Review

Response to the Initial Public Consultation Paper

Central 1 Credit Union
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Executive Summary

Central 1 Credit Union ("Central 1") began as a credit union for credit unions on May 21, 1944 with assets of $44,000.[1] Today, the organization holds over $14 billion in assets and serves not only the 42 credit unions of British Columbia ("B.C.") and 82 of Ontario, but also many other members beyond provincial boundaries. A sophisticated, rated institution, with many specialized business lines, Central 1 has become a trusted partner of credit unions nation-wide.

This submission is Central 1's response to the Initial Consultation Paper issued by the Ministry of Finance (the "Ministry") as part of its review of the *Financial Institutions Act* ("FIA") and *Credit Union Incorporation Act* ("CUIA"). Our intent is to present recommendations that will assist the Ministry in forming strong public policy that will guide the development of more specific regulatory tools as the review progresses.

At the core of this public policy should be recognition that B.C. derives immense benefit from having a provincially-headquartered financial services sector. Central 1 is proud to serve as the hub for this sector that collectively produced approximately $1.19 billion in current dollar GDP in 2014.[2] Every day, nearly 9,000 employees make local decisions that help over 1.9 million British Columbians achieve their financial dreams. Central 1 exists to serve these British Columbians, and the credit unions they own.

In order to maximize the benefit credit unions derive from Central 1, we recommend:

- That the provincial legislation be amended to specifically address the powers currently incorporated by reference to the *Cooperative Credit Associations Act* (Canada);
- That Basel III capital and liquidity standards be applied to Central 1, with consideration for cooperative structures;
- That there be collaborative development of designation criteria and associated incremental regulatory requirements for domestic systemically important financial institutions ("D-SIFIs");
- That there be collaborative development of access protocols for the mandatory liquidity pool ("MLP"); and,
- That the MLP be reviewed holistically with the objective of maximizing its overall utility for the B.C. credit union system.

[1] Ian MacPherson. *Co-operation, conflict and consensus: B.C. Central and the credit union movement to 1994* (Vancouver: B.C. Central Credit Union, 1995), pg. 155.

[2] 2014 year-end. Source: Central 1 Economics.

Mandate and Role

Central 1's core purpose is successful credit unions, with the mission to "provide credit unions with the critical scale economies that we can access cost effectively working together"[3]. The largest B.C. credit unions are still only a small fraction of the size of the largest Canadian banks. As banking increasingly becomes a scale-driven business, it is essential that Central 1 continue to play a role in driving competitiveness of the credit union system.

Central 1 supports the competitiveness of the credit unions in British Columbia by offering services in three categories:

- Centralized liquidity and wholesale financial services;
- Digital, payment and other services; and,
- Government relations and trade services.

All three of these service categories are vitally important to providing credit unions with the scale necessary to fulfill their own mandates. Well beyond its key legislated role as the system's liquidity provider, Central 1 has been the hub for cooperative service provision for over seventy years. **Central 1 recommends that any changes to legislation must preserve and respect this essential role.**

Central 1's mandate and activities require the maintenance of, and adherence to, robust regulatory requirements. Active in the capital markets, in many ways Central 1 is the storefront of B.C.'s credit unions to the global financial marketplace. This necessitates the enhancement of a framework that supports prudent fiscal management, while maintaining strong financial performance.

Repeal of Part XVI of CCAA

The FIA and the CUIA should be amended to address lost powers required by Central 1 to carry on its current businesses and to address potential statutory ambiguities. The B.C. legislation is not generally as comprehensive as the *Cooperative Credit Associations Act* (Canada) (the "CCAA") and does not specifically address Central 1's participation as a group clearer in the Canadian Payments Association ("CPA"). For example, the CUIA incorporates by reference the powers of a Central under the CCAA as the powers of Central 1 under such legislation. This participation and these powers should be specifically addressed in amendments to this legislation.

Central 1 is committed to engaging with the appropriate stakeholders to ensure that the repeal of Part XVI of the CCAA does not diminish its overall powers, including those related to clearing. Indeed, an ongoing three-way dialogue between Central 1, B.C.'s provincial regulators and the CPA is required to ensure that Central 1 can seamlessly transition from being a dual-regulated financial institution to a provincially-regulated financial institution. Central 1 has begun this dialogue and commits to keeping the Ministry engaged in the progress of these developments.

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[3] Central 1 Credit Union. "2015-2017 Strategic Plan", pg. 5. https://www.central1.com/sites/default/files/Strategic%20Plan%202015-2017.pdf

Basel III Application to Central 1

Central 1 strongly supports the application of an OSFI-adopted framework for Basel III to our organization. As we transition to sole provincial regulatory oversight, we appreciate the opportunity to comment on how the Basel III rules could be best applied to Central 1, in recognition of its cooperative structure and links to the broader credit union system. It should be noted that any references made to the Basel III framework in the following sections are synonymous with OSFI requirements.

Increased Quality and Quantity of Capital

Basel III requires an increase in both the quality and quantity of capital. These enhanced requirements are an effort to better absorb losses and ensure sufficient capital in periods of stress. Stricter capital requirements reduce the amount of allowable capital and higher risk weighting requirements increase the need for more capital. This, coupled with an increase in the overall ratio minimum, results in a significant rise in the amount of total capital that is required.

The majority of the following discussion focuses on the increased regulatory emphasis on quality of capital and how rules based on joint-stock companies may apply to cooperative institutions. As a central credit union, our business model is more constrained by a leverage requirement than it is by a risk based capital ratio. Further discussion on how the Basel III leverage ratio may serve as a complement to the risk based capital ratio for a central credit union is included.

Harmonized Capital Definition

Currently, there are regulatory inconsistencies between the provinces and the federal government in the way capital is defined. Central 1 is aware that the Credit Union Prudential Supervisor's Association ("CUPSA")[4] is working to harmonize the definition of capital across provinces. It is anticipated that these efforts will eliminate confusion and allow for more reliable and even comparisons of financial institutions. Central 1 strongly supports CUPSA's efforts in harmonizing the capital definition to be consistent among financial institutions across Canada.

Accumulated other comprehensive income ("AOCI") is a substantial element of the capital definition where there is a lack of uniformity inter-provincially and federally. Specifically, under Basel III, banks are able to include AOCI gains in their capital base[5] whereas, under the FIA, credit unions are only permitted to include them to the extent that they offset any losses. Central 1 supports inclusion of AOCI in the capital definition.

Determining what components can be deducted from capital is another area where there is a lack of consistency. For example, for banks, OSFI capital deductions for unconsolidated subsidiaries are subject to a threshold deduction, which limits the amount of the total deduction. However, credit unions are required to deduct the entire investment in unconsolidated subsidiaries as a substantial investment. The deduction for subsidiaries is a significant factor in Central 1's regulatory capital calculation due to strategic investments such as CUMIS, The

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[4] CUPSA is an interprovincial association composed of credit union deposit insurers and prudential supervisors across Canada.

[5] OSFI. "Capital Adequacy Requirements (CAR): Chapter 2 – Definition of Capital." http://www.osfi-bsif.gc.ca/eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/CAR_chpt2.aspx#fnb4.

Cooperators and Credential that it holds on behalf of the system. Central 1 supports a threshold dedication for unconsolidated subsidiaries.

Membership Shares

There has been limited consistency internationally on the application of Basel III to cooperative institutions. The core issue is whether membership shares can be considered permanent since the cooperative structure allows membership shares to be redeemed at the option of the holder.

Central 1 believes that the Basel Committee on Banking Supervision ("BCBS") intended to allow cooperative shares with a high degree of permanence and the ability to absorb losses to qualify as common equity tier 1 ("CET1") capital.[6] In one report, the BCBS stated "Basel III permits some flexibility in order to accommodate the nature of capital instruments of different mutually owned banks."[7]

Central 1 believes that our membership shares demonstrate sufficient permanence to meet the requirements for CET1. Credit unions are required in B.C. to be members of Central 1, by statute, and Ontario credit unions must provide 5 years' notice of their intention to cease membership. It would be impossible for a "customer" of Central 1 to maintain deposits and other activities requiring capital at Central 1 without also holding membership shares. Additionally, there is a long history of stability in Central 1's share structure. Unlike a bank, our owners are also our customers and thus are more likely to maintain their relationship under times of stress. This is evidenced by our consistent, decades-long relationship with our members in times of stress and uncertainty such as the 2008 financial crisis. This is further reinforced by the mandated membership of B.C. credit unions and the required 5 year notice period for our Ontario credit unions to cease membership.

Non-Viability Contingent Capital

Non-viability contingent capital ("NVCC") refers to the conversion of capital instruments, typically preferred shares or subordinated debt, into either common shares or to be devalued to nil upon a predetermined trigger event. A conversion would pose a challenge for Central 1 as the cooperative structure does not include common shares. Specifically, such a conversion into membership shares would create issues related to proportionate membership, resulting in inconsistency with the one-member-one-vote cooperative principle.

Currently OSFI does not allow for capital instruments to be devalued to nil. If, in this context, a credit union issued an instrument that converts to nil, it would likely result in a higher risk premium than a comparable instrument which would convert to common shares. Flexibility for credit unions is needed with respect to NVCC application as the risk premium may result in additional capital instruments being too costly for Central 1 to issue.

The majority of the capital base of credit unions in B.C. (87 percent)[8] is composed of retained earnings, while preferred shares and subordinated debt do not comprise a significant component of the capital base. This very

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6 World Council of Credit Unions (August 2012). "Credit Union Shares as Regulatory Capital under Basel III", pg. 25.

7 BCBS (December 2014). "Regulatory Consistency Assessment Programme (RCAP) Assessment of Basel III regulations – European Union" pg. 17, http://www.bis.org/bcbs/publ/d300.pdf.

8 DBRS (September 2015)."Rating Report – Central 1", pg. 10.

significant portion of extremely high quality capital would not be impacted by NVCC requirements. In order to encourage sustainable growth, however, credit unions must be supported in the ability to issue alternative capital instruments. **As such, Central 1 requests temporary exclusion from the NVCC requirement until the development of NVCC-compliant instruments that are suitable for the cooperative structure of Central 1 are developed.**

Borrowing Multiple

OSFI currently subjects central credit unions to a regulatory capital requirement known as the Borrowing Multiple ("BM"). The BM is a leverage ratio that is calculated by dividing the central's total borrowings by its total capital. Borrowings are comprised of total deposit liabilities and other loans payable. The BM has been in existence for over 20 years, but it has not been reviewed and updated by OSFI to reflect Basel III standards.

In 2017, when OSFI ceases its regulation of central credit unions, OSFI will no longer maintain the BM calculation. In light of regulation being transferred to the provinces, Central 1 believes this change **presents an opportunity to explore alternatives to the BM that may be more robust and appropriate for central credit unions** such as the Basel III leverage ratio.

Leverage Ratio

OSFI adopted the Basel III leverage ratio effective Q1 2015 that applies to banks and cooperative retail associations. This ratio is defined as Tier 1 capital divided by the sum of on-balance sheet exposures, derivative exposures, securities financing transaction exposures, and off-balance sheet exposures. The OSFI limit is set at 3 percent or a maximum of 33 times capital.[9] It is a more refined regulatory measure than the BM, as it includes more off-balance-sheet exposures and a narrower definition of capital (CET1 instead of total capital). **Central 1 would like to work with the Ministry of Finance and the Financial Institutions Commission ("FICOM") to further evaluate the use of the leverage ratio in replacing the BM.**

Liquidity

OSFI's interpretation of Basel III Liquidity metrics, the Liquidity Coverage Ratio ("LCR"), Net Cumulative Cash Flow ("NCCF") and Net Stable Funding Ratio ("NSFR") are of varying suitability to Central 1. The regulation of liquidity is premised on the need for financial institutions to have access to sufficient amounts of cash and other highly liquid assets. Maintaining adequate liquid funds enables a financial institution to fund operations and cope with increased withdrawals of demand deposits during times of economic stress. However, overly prescriptive liquidity requirements limit the availability of funds for investment and lending. It is important to balance prudential considerations with competitiveness.

One of Central 1's unique and most valuable abilities is its capacity to move liquidity around the province. By accepting deposits from credit unions with excess liquidity and ensuring that credit unions have access to liquidity when needed, liquidity is efficiently moved throughout the province. In addition, having a common central liquidity facility serves to strengthen cooperative principles. The uniqueness of this feature means that leveraging its full

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[9] OSFI. "Leverage Requirements Guideline." http://www.osfi-bsif.gc.ca/eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/lr.aspx.

benefit will require recognition of higher cash inflows and outflows. In addition to assessing Central 1's standalone liquidity, it is important that it be considered at a system level in relation to other credit unions.

LCR

The LCR measures the short-term resilience of financial institutions by ensuring that they hold sufficient High Quality Liquid Assets ("HQLA") to survive a 30-day stress scenario. To avoid contagion among financial institutions, the LCR applies very high outflow rates to deposits from financial institutions, and assumes significant drawdowns of committed facilities to financial institutions. Given that Central 1's primary function is to manage liquidity in the system by providing committed liquidity facilities to, and accepting mandatory and excess deposits from, credit unions, applying the LCR as written would be unduly punitive to Central 1 and the system.

However, Central 1 considers the LCR a valuable metric for managing liquidity and currently calculates a modified LCR that makes allowances for the intricacies of the credit union system. An LCR metric applied to Central 1 should view Central 1 and the credit unions as a system and make special considerations for cash inflows and outflows between entities. **Collaborative work with FICOM would best determine its suitability to Central 1, including whether modifications enhance its usefulness as a liquidity tool.**

NCCF

The NCCF is a longer-term measure that helps identify potential cash flow shortfalls over a 12 month time horizon. Central 1 currently calculates the NCCF without modifications. As with the LCR, **collaborative work with FICOM would best determine its suitability to Central 1, including whether modifications enhance its usefulness as a liquidity tool.**

NSFR

The NSFR measures the stability of an institution's funding profile in relation to its assets and off-balance sheet activities. Central 1 is confident that when OSFI releases guidance on the NSFR[10], **collaborative work with FICOM would best determine its suitability to Central 1, including whether modifications enhance its usefulness as a liquidity tool.**

Central 1 as a D-SIFI

FICOM designated Central 1 as a D-SIFI in the context of the Canadian credit union system in February 2014. Central 1 recognizes its importance to the credit union system, including credit unions outside of B.C. Our risk appetite and activities reflect this fact. Central 1 has enhanced its preexisting risk management framework. This robust framework is designed to be business supportive, cost effective and risk disciplined. It focuses on managing risk both at the level of the enterprise and at that of the credit union system. Central 1 has purposefully limited its exposure, under normal and stressed conditions, to any one individual credit union reflecting its responsibility to all members.

[10] NSFR is currently included in OSFI's Liquidity Adequacy Guideline as a placeholder only, pending review of BCBS' final guidance. See: http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/LAR_chpt3.aspx

The D-SIFI designation has resulted in additional regulatory and supervisory implications over and above what is required for traditional financial institutions. Central 1 supports a robust regulatory approach to systemically important financial institutions, but does wish to highlight some areas that could be improved in order to more effectively meet the needs of its members.

Before making our recommendations in this respect, it is important to note that we acknowledge that FICOM and the Superintendent have been endeavoring to provide post-2008 standards of prudential regulation with a pre-2008 legislative basis. At the time of the most recent financial crisis, the FIA did not contemplate the designation of D-SIFIs, nor changes in international banking standards. Central 1 did need to make some significant changes in its approach to risk management in the post-2008 world. The recommendations below should not be viewed as criticism of FICOM's requirements on Central 1 over the past few years, but rather as suggestions to optimize the regulatory framework going forward.

A principle concern is that the FIA does not presently define a D-SIFI, nor does it give the Commission or Superintendent the authority to designate an institution as a D-SIFI. In the Basel Banking Committee's "Framework for Dealing with Domestic Systemically Important Banks", the first principle is "National authorities should establish a methodology for assessing the degree to which banks are systemically important in a domestic context."[11] This principle should also be applied to provincial authorities.

The authority to designate a D-SIFI should be provided to the Commission in the Act. **It would be of great benefit to the system if the D-SIFI qualifying criteria and obligations were developed and statutorily defined.** Given that OSFI aligns itself with international standards, Central 1 recommends using learnings from OSFI's approach for regulating domestic systemically important banks ("D-SIBs") when considering an appropriate supervisory framework for D-SIFIs in British Columbia. Modelling OSFI's D-SIB requirements would be preferable, though it would not be appropriate to have the requirements be identical, as even the largest credit union is still only a small fraction of the size of the largest D-SIB, and all are cooperatively structured. The requirements must also consider specifics relating to Central 1, such as the fact that it does not have retail operations.

Overarching Framework

FICOM's Supervisory Framework applies a principles-based approach to ensure that the risks provincially-regulated financial institutions face are adequately managed. FICOM considers the effectiveness of a financial institution's capital management processes for maintaining adequate capital relative to the risks across all of its significant activities. Financial institutions with higher overall net risk are expected to maintain a higher level and quality of capital and stronger capital management processes.[12] Central 1 supports the intent of this framework in establishing future standards for D-SIFIs.

Presently, the FIA provides the Commission with the authority to "establish guidelines relating to the operation of a credit union", including a central, only if that credit union "is subject to the supervision of the commission"[13].

[11] Basel Banking Committee (October 2012). "A framework for dealing with domestic systemically important banks." pg. 3 http://www.bis.org/publ/bcbs233.pdf

[12] FICOM (June 2012). "Supervisory Framework." http://www.fic.gov.bc.ca/pdf/aboutus/FICOMSupervisoryFramework.pdf

[13] s.277(c) – FIA.

Central 1 is not under supervision but is subject to *operational* restrictions imposed by the Superintendent.[14] These guidelines extend beyond the intent of the Supervisory Framework to establish standards at the entity level, and intervene in business-line management.

Central 1 believes that an effective framework for the regulation of D-SIFIs must not interfere with operational management. This section is intended to provide recommendations that respect the objectives of the Supervisory Framework, while also respecting the intent of the FIA.

Capital

Federally, there is an additional capital requirement placed on a financial institution recognized by OSFI as a D-SIB. The OSFI model for D-SIBs places a capital surcharge on the CET1 ratio of 1 per cent of risk-weighted assets ("RWA"). While traditional federal financial institutions are currently required by OSFI to have a minimum of 7 percent of their RWA as CET1 capital, D-SIBs must have 8 percent as CET1 capital which includes the 1 per cent additional surcharge.

At the provincial level, Quebec's regulator, the Autorité des Marchés Financiers ("AMF") has aligned itself closely to the rules created by OSFI under a Basel III framework. In 2013, the AMF recognized Desjardins Group as a D-SIFI, and mirrored OSFI's 1 percent capital surcharge for D-SIBs. The AMF has determined that the Desjardins will be subject to the surcharge commencing January 1, 2016.[15]

Although Central 1's current Tier 1 risk-weighted capital ratio is well above the national and provincial standards at 37.6 percent as of the end of Q2 2015, we feel strongly that a consistent regulatory standard be applied when considering institutions of systemic importance.[16] **As such, Central 1 supports the consideration of the OSFI and the AMF approach of an additional 1 percent capital surcharge for D-SIFIs in British Columbia.**

Liquidity

With respect to liquidity, the federal D-SIB requirement is to provide enhanced liquidity disclosures. There are no additional buffers or metrics applied. In the absence of legislated provincial D-SIFI requirements, Central 1 is now subject to liquidity requirements such as prescriptive business line level investment guidelines, and restrictions on derivative usage and duration. These restrictions are detailed in the section below.

In place of the current restrictions, Central 1 supports enhanced liquidity disclosures as an appropriate D-SIFI requirement. Central 1 also supports working with the Ministry to develop appropriate liquidity requirements on which to provide enhanced disclosures.

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[14] Refer to Appendix 1: Supervisory Restrictions. "Identification of Central 1 as a Domestic Systemically Important Financial Institution." FICOM, February 2014. http://www.fic.gov.bc.ca/pdf/info_bulletins/CU-14-001.pdf

[15] DBRS. "Financial Institutions – The Evolving Canadian Credit Union Regulatory Environment".

[16] DBRS (September 2015). "Rating Report – Central 1", pg. 6.

Mandatory Liquidity Pool

In connection with the designation of Central 1 as a D-SIFI, FICOM has provided Central 1 with additional requirements related to the MLP. Central 1 recognizes the critical importance of the MLP and supports a regulatory framework that strengthens and safeguards system liquidity, but believes some of these additional requirements disrupt the intended benefits of liquidity pooling.

Access Protocols

The MLP is of greatest benefit to the system if credit unions have certainty that they can access it, clarity on the conditions and amount they can access. The lack of clarity regarding access to the MLP results in credit unions prudently assuming they will not have timely access to their mandatory deposits in a stress scenario. As such, they are incented to hold superfluous stores of High Quality Liquid Assets ("HQLA") in excess of their statutory requirement. Credit unions are also driven to hold excessive lines of credit with Central 1 and other financial institutions as contingent liquidity sources. This is inefficient both for Central 1, which must hold low-yielding HQLA to support the contingent commitments, and for the credit unions, that must pay costly standby fees.

The major obstacle in determining how a credit union might access the MLP is the requirement in section 67(1) in the FIA to hold liquid assets at all times: "A financial institution must *at all times* ensure that it has adequate liquid assets and an adequate capital base in relation to the business carried on by it, in accordance with the regulations."

The FIA's *Liquidity Requirement Regulation* further defines the adequate amount of liquid assets as deposits credit unions must maintain with Central 1 which forms the MLP.

While it is reasonable that credit unions must hold adequate liquid assets under normal conditions, under stressed conditions, a credit union with a credible recovery plan must be allowed to withdraw their statutory liquidity to meet unexpected cash outflows. This allows for institutions to utilize their liquidity when it is needed most. The following excerpt from OSFI's Liquidity Adequacy Requirements (LAR) Guideline, details how OSFI provides for institutions under stress to temporarily fall below the Liquidity Coverage Ratio ("LCR"). **Central 1 recommends a similar approach for the statutory liquidity requirement.**

> *The standard requires that, absent a situation of financial stress, the value of the ratio be no lower than 100% (i.e. the stock of HQLA should at least equal total net cash outflows) on an ongoing basis because the stock of unencumbered HQLA is intended to serve as a defense against the potential onset of liquidity stress. During a period of financial stress, however, institutions may use their stock of HQLA, thereby falling below 100%, as maintaining the LCR at 100% under such circumstances could produce undue negative effects on the institution and other market participants.* [17]

The other issue requiring clarification is the amount of the MLP credit unions have access to. **Central 1 recommends that in a non-systemic event, credit unions with a credible recovery plan be allowed to access liquidity greater than their contribution to the MLP,** subject to expedient regulatory approval.

[17] OSFI (November 2014). "Liquidity Adequacy Requirements (LAR): Chapter 2 – Liquidity Coverage Ratio." http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/LAR_chpt2.aspx.

It is critical that the FIA "at all times" restriction be removed and, clarity on protocols to access the MLP are established. In order to survive a quickly escalating liquidity event, credit unions must have immediate access to their statutory liquidity and timely, transparent, and efficient protocols must be in place to allow FICOM to extend additional funding from the pool when appropriate.

Structure

It is important that the structure and management of the MLP maximize its utility to the B.C. credit union system, while simultaneously minimizing its exposure to risk. In order to be effective, these competitive and prudential objectives must be balanced.

Central 1 is of the opinion that over time the competitive utility of the MLP has been eroded. Presently, the MLP is subject to:

- A borrowing multiple of 16:1;
- A requirement that all securities be unencumbered;
- A requirement that all securities meet eligibility requirements for pledging to the Bank of Canada's standing liquidity facility ("SLF");
- A scheduled requirement to maintain a portfolio duration of no greater than one year[18]; and,
- A prohibition on the use of derivatives.

Central 1 believes that in its management of the MLP, it must at all times have as its principal objective safeguarding system liquidity. Central 1 commits to comprehensive system-wide liquidity oversight, the development of a crisis management plan, including recovery planning, in its management protocols.

However, proper risk management also requires the use of a full range of risk management tools, such as derivatives, which require the pledging of collateral. Central 1 is of the opinion that the present requirements unnecessarily impair the competitiveness of credit unions, and do not materially improve Central 1's liquidity profile. For example, the scheduled duration restriction would expose credit unions to market risk as they would be unable to vary the duration of their deposits in relation to prevailing market conditions and it would impede their ability to perform effective asset liability management.

Furthermore, the borrowing multiple for the MLP creates capital inefficiencies, hindering credit union competitiveness. The purpose of capital is to absorb potential losses resulting from business activities, yet the MLP is not engaged in any business activities, it is simply an investment pool of highly liquid securities[19]. Under OSFI's risk-based capital ratios, government securities would be risk-weighted at zero[20], and would therefore not require any capital. Given that credit unions' capital requirements are based on risk-weighted assets, government securities would not attract any capital if held on their own balance sheets. This capital inefficiency may be

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[18] To be fair, FICOM has postponed the implementation of this requirement, and has been open to an ongoing discussion about its utility.

[19] Over 80% of the MLP is invested in government securities, with the remainder invested in high quality corporate securities that can be pledged to the Bank of Canada's SLF.

[20] OSFI (November 2014). "Capital Adequacy Requirements (CAR): Chapter 3 – Credit Risk – Standardized Approach" http://www.osfi-bsif.gc.ca/eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/CAR_chpt3.aspx

exacerbated in conjunction with the potential application of Basel III (e.g. treatment of membership and investment shares, and system capital).

This legislative review presents an opportunity to examine liquidity pooling requirements holistically. This includes what is prescribed in the Liquidity Requirement Regulation, as well as how the pool is managed. **Central 1 recommends a collaborative review of the structure and management of the MLP.**

Conclusion

Section 90 of the CUIA stipulates "A central credit union may provide services … to or for its members if, in the opinion of the directors of the central credit union, the services are incidental or conducive to the sound operation of its members or to the attaining of the purposes of its members."[21] This section is clear that the role of Central 1 is to serve its members, and as such, it must be flexible in meeting the changing needs of credit unions.

In 1970, Enterprise Magazine reported on the March 31 merger of British Columbia Credit Union League with B.C. Central Credit Union. Two years of analysis and discussion concluded in a determination that housing the services of a central financial facility in the same organization as a trade association would most effectively meet the needs of modern credit unions. This commitment to ensure Central 1 provides services beyond clearing and liquidity has been reaffirmed many times since. While the services of Central 1 may have changed from operating a "computer facility" to operating an online banking platform, and from providing "printing supplies" to the wide range of trade services offered at Central 1, the organization's core purpose remains the same – successful credit unions.

The proposals above seek to ensure that the organization's governing legislation and its associated regulations allow Central 1 to meet this objective in service of its credit unions and the 1.9 million British Columbians that own them.

[21] s.90(1) - CUIA.