ROSS MCDONALD
Personal blog. Wiser together.

Statutory Liquidity Deposits / HQLA

Treasury tactics for smaller credit unions - March 2021

Household pets have been covering their ears

Household pets have been covering their ears. During the first calendar quarter, once reticent finance executives, and finance-engaged CEOs, of B.C. and ON credit unions may have been raging expletives. It's been a frustrating, challenging and unfamiliar period. Financial instruments once wholly alien to small Canadian credit unions, perhaps large ones too, are now commonplace. A whole new lexicon of investment terminology has been explored, digested and applied. Stakeholder reporting may have underwhelmed expectations. New journal entries may have being imagined from first principles. Financial reports and risk oversight may require a refresh. BCFSA has a new guideline and a new regulatory report (and several consultations). And your prudential supervisor Relationship Manager has requested a touch-base video conference call, again.

Almost two years ago, FICOM issued a decree. The 'mandatory liquidity pool' structure was dead. It had been used for decades to execute credit union compliance with Liquidity Requirement Regulation of the B.C. Financial institution Act and equivalent ON legislation, and as a contingent funding source. Jumping to 2021, substantially all B.C. and ON credit unions likely now have portfolios of fixed income securities, held in legally ring-fenced trust accounts, on their balance sheets. Forget proportionality. Regulatory changes impacted the largest and smallest credit unions alike. Identical regulatory reporting requirements and frequency. Hopefully Canadian consumers can sleep a lot more easily each night, safe in the knowledge that their cooperative financial institution has lower systemic liquidity risk due to it directly holding a ring-fenced portfolio of high quality liquid assets. Or not. Retail banking, it seems, is a whole lot more complex than it used to be.

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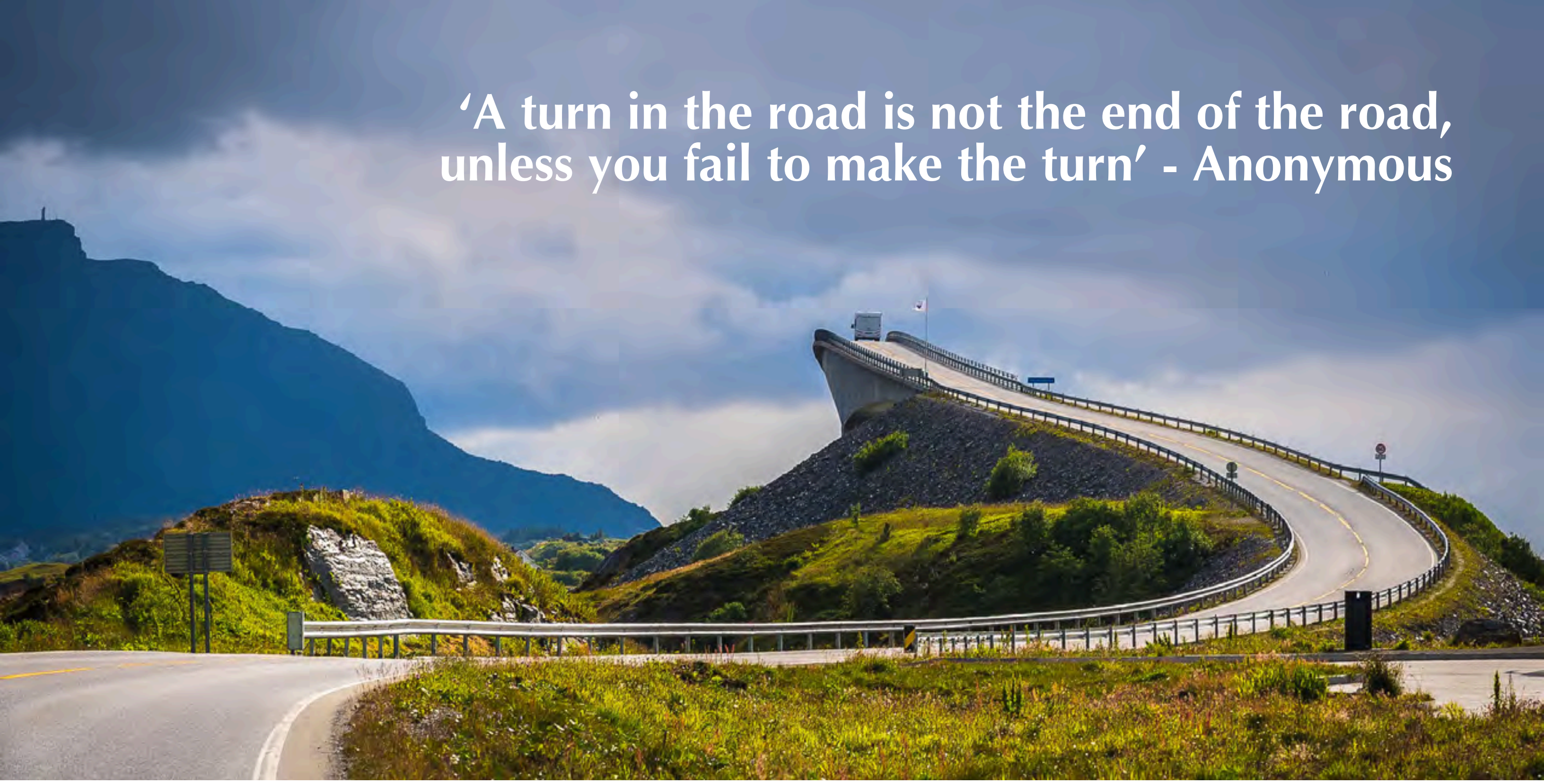

Credit unions should reflect on unpleasant realities. Fixed income securities, once the domain of second-tier entities and wholesale banks, are new to substantially all credit unions and executives. Regulatory guidelines, prudential supervisory expectations, and regulatory reporting in regards liquidity management have escalated to a level unimaginable only a few years ago. This new world seems a permanent, irreversible change. It may contribute to collaboration, amalgamation or other strategic discussions. Any credit union that fails to duly adapt is likely to experience the relentless intervention wrath of its financial regulator.

In the spirit of cooperative values and wiser together, below are several treasury tactic ideas that smaller credit unions may consider in regards statutory liquidity deposits.

First, consider radical simplification. In January 2021, Central 1 Credit Union terminated legacy term deposits and migrated equivalent portfolio of fixed income securities. This provided member credit unions with duly equivalent exposure. Credit unions may continue in this way. But there is no such compulsion. Central 1 Credit Union, and its peers, are now service providers to be duly instructed. Credit unions have discretion in selection of asset manager and in the establishment of related investment strategy. Academic research highlights the 'cost of complexity'. Were it so inclined then a credit union could consciously instruct its asset manager to discard all fixed income securities and hold familiar bank deposits, provided that they satisfy HQLA criteria. Perhaps lesser yields may result. But the potentially material simplification of accounting journals, risk management and/or resourcing costs could make such an approach attractive. This approach aligns with strategic practice of choosing 'where-to-play'. Perhaps treasury, for some smaller credit unions, is somewhere not-to-play. K.I.S.S. is a timeliness axiom for a reason.

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Sometimes, simple is good

Second, constrain portfolio scope. Many types of securities qualify as High Quality Liquid Assets. A regulator may recommend, or require, that an Investment and Lending Policy provide detailed criteria of securities attributes (e.g. credit rating) for each security type. For example, if ILP states that corporate bonds are acceptable as a security type then it may need to state which issuers, industries, credit ratings or other attributes are acceptable or unacceptable. A credit union may determine that some potential HQLA security types are undesirable. Maybe the credit rating specification is unfamiliar. Or perhaps the accounting journals are troublesome. A credit union may direct its asset manager not to hold corporate bonds, mortgage backed securities or another type of HQLA. This approach may align with the concept of competitive advantage. Perhaps being good-enough at treasury management is just that - good enough.

Third, evolve oversight. Finance & Risk reporting should include Liquidity Adequacy Ratio. Prudential supervisors appear to have sharpened their liquidity compliance. The legacy broadly defined Statutory Liquidity Ratio has been effectively replaced by a more restrictive Liquidity Adequacy Ratio. Most liquidity held by a credit union outside of the in-trust account(s) does not count towards its compliance with legislative requirements. As part of 'Quality of Risk Management', assessment prudential supervisors may be re-reviewing executive expertise and board oversight of liquidity management. This approach may align with measuring what matters. Your friendly regulator may have said that LAR% now matters.

'As part of Quality of Risk Management assessment, prudential supervisors may be re-reviewing executive expertise and board oversight of liquidity management.' - Ross McDonald

Treasury competences are now cool in credit unions

Fourth, expectation management. Executive/board committees and boards may express commendable enthusiasm in regards HQLA. Fabulous. But internal stakeholders may be content to receive limited reporting on key finance & risk topics in regards HQLA, at least for an initial period. Reporting from an asset manager, custodian or other service provider may well be evolving in its rigour, scope or timeliness. Trailblazing credit union executives may have already designed comprehensive internal reporting. Smaller credit unions likely have not. Patience can be a virtue, and may save duplicated effort. Whether as part of mandated work scope; a response to industry feedback; or to mitigate threats from circling competitors then asset manager and/or other service providers have every incentive to provide appropriate reporting at their earliest convenience.

Fifth, professional development. Treasury competences are now cool in credit unions. Who'd have ever guessed that! Executive Asset & Liability Committees and board Investment & Lending Committees may find unfamiliar and elevated stakeholder attention. Some finance executives may need to brush up on technical knowledge of financial instruments. Or to initiate accelerated training. Scary times perhaps. Finance executives with a growth mindset may view HQLA as a wonderful opportunity to expand product knowledge; to extend functional maturity; and to better serve the business and membership. Executives with a curious mindset may ask 'dumb' questions about how liquidity, risk, return and cashflows impact their organization. This approach may align with functional maturity. Given changes in external environment, some credit unions may re-evaluate their current and target levels of functional maturity for Finance or treasury. Financial regulator(s) may have moved the goalposts. Time to recalibrate.

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Lastly, seek help. Sometimes we all need a little help from our friends. As appropriate, reach out to peer credit unions for advice. Or seek a paid contractor relationship with a credit union that has relevant expertise. B.C. credit unions may request the assistance of Stabilization Central Credit Union. Or explore support from service provider(s).

Make no mistake, prudential supervisors may well dispense some unpleasant letters. Remediation from a regulatory intervention is a thoroughly unpleasant place. Credit unions may mitigate regulatory risk through proactive adaptation of liquidity management practices, rather than naively hoping for the best.

During the pandemic, many executives and staff have been working from home. The presence of domestic pets may provide welcomed comfort and companionship. A wagging dog tail; a purring cat; a chirping bird; or otherwise may bring joy and smiles. Such selfish pleasures may be repaid through fewer expletives from their owners.

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Personal Blog Publications

"Canadian Credit Union Industry 2030" - *Beyond the planning cycle* (in progress)
Imagine the structure, purpose and value propositions of the Canadian credit union industry in 10 years time. Futuristic report will frame a series of 'strawman' scenarios that are designed to be bold, distinct and imaginative.

"Statutory Liquidity Deposits (HQLA)" - *Treasury tactics for smaller credit unions*
Household pets have been covering their ears. During the first calendar quarter, once quiet finance executives, and finance-engaged CEOs, of B.C. / ON credit unions may have been raging expletives. It's been a frustrating, challenging and unfamiliar period.

"Proportionality in Financial Services" - *Asset size, business complexity & risk profile should matter*
Financial regulation is not national security. Edward Snowden alleged that 'collect it all' was a mantra at the U.S. National Security Agency. But this seems rather heavy-handed for regulatory oversight of small provincial credit unions. As a self-declared 'data-driven regulator', BC Financial Services Authority (BCFSA) appears intent on maximum data collection regardless of it supervisory framework and industry consequences.

"Empowering CUDIC, Beyond FICOM's Shadow" - *Alternative regulatory structure (FIA/CUIA)*
CUDIC has outgrown legacy legislation and FICOM's shadow. CUDIC is responsible for deposit insurance of a C$77 billion industry that is used by almost half of British Columbians. Larger than most Canadian credit unions then it warrants full-time, permanent executive leadership. Larger than most B.C. Crown Corporations then it deserves independent, empowered and accountable governance oversight.

"Credit Union Deposit Insurance Policy" - *Board Discussion Paper*
A policy of unlimited deposit insurance may have significantly supported system growth and membership confidence. But it is unknown outside of Western Canada, may cause moral hazard, and may be increasingly expensive to credit unions in terms of earnings, capital and compliance.

"Leadership Vacancies" - *Empty Seats, Visionaries Wanted, Glass Slippers*
There is currently a void of permanent leaders at system-level organizations that impact B.C. credit unions. All leaders of credit union centrals and relevant provincial government entities are currently appointed on an interim, acting or retiring basis. Unquestionably improbable but such are circumstances. Individually each leader has system influence but collectively they wield transformative impact.

"Federal credit union value propositions" - *Beyond ice cream & sprinkles*
Ice cream with sprinkles. Provincial credit unions may be framed thus by strategy academics. Some aficionados may celebrate mouthwatering flavours and ingredient providence. But many a face-smeared kid may insist that ice cream is just ice cream, and that the real magic is in choosing sprinkles. Perhaps ice cream and sprinkles represent the commonalities and variations respectively in terms of value propositions across Canadian credit unions.

"Coast Capital Savings - Federal Strategy" - *Good Morning Canada!*
In the movie 'Good Morning Vietnam!', Robin Williams encouraged troops and energized betterment. Coast Capital Savings Credit Union CEO, Don Coulter, may have executed a similar feat. Though the recent member approval of its federal credit union strategy then Coast Capital Savings has arguably broadcasted 'Good Morning Canada!' to the national financial services industry.

"Credit union intervention" - *an ERM failure?*
John Lennon penned 'we get by with a little help from our friends'. Credit unions can need help too, say when placed under regulatory intervention. Does such an act signal ineffective ERM practices of the credit union?

"Coast Capital Savings - Member Vote" - *Federal credit union implications for the B.C. system*
One member one vote. A core principle of cooperative organizations. Coast Capital Savings Credit Union is currently conducting an important member vote. Its management and Board seek member approval to submit, and to progress, an application to the federal government for Coast Capital Savings to become a federal credit union. This is a big deal for members of Coast Capital Savings. But it also has significant and diverse implications for the B.C. credit union industry.

"Governance Guideline Compliance" - *Yellow card*
Symbolic 'Olympic yellow card' issued to the B.C. credit union industry in regards compliance with disclosure requirements of the Governance Guideline of its regulator, FICOM. Several B.C. credit unions demonstrate excellence. But the average rating is depressed by selective or negligible disclosures by many credit unions.