Notice relating to new measures for deposit and trust institutions to reduce the impact of issues stemming from COVID-19

On March 19, the Autorité des marchés financiers (the "AMF") announced that it was taking various steps to maintain its operations and continue to fulfill its market oversight and consumer protection missions. Those steps included the immediate suspension of surveys and other public consultations relating to regulations and guidelines where the subject matter could be delayed, so that registrants and reporting issuers could focus on addressing the challenges posed by COVID-19.

This notice is further to that announcement and presents measures relating to capital and liquidity standards, minimum requirements and internal targets, consultations, the application of IFRS 9 and supervision elements for the benefit of trust companies, savings companies and other deposit institutions, credit unions not members of a federation, member credit unions of a federation and federations of credit unions respectively governed by the *Trust Companies and Savings Companies Act*[1] (TCSCA), the *Act respecting financial services cooperatives*[2] (LFSC) and the *Deposit Institutions and Deposit Protection Act* (DIDPA) (the "financial institutions concerned"). The measures proposed by the AMF are intended, among other things, to maintain the principle of comparability across Canadian financial institutions.

1. Adjustments to capital requirements

1.1 Definition of default[3] (delinquent loans)

In light of the current situation, some of the financial institutions concerned are offering or may offer clients principal and interest payment deferrals on their loans. So that these loans may benefit from a deferral, the AMF is authorizing the financial institutions concerned to treat them as performing loans for regulatory purposes if the institution deems that such loans, which were not in default at the time the deferral took effect, would have been performing loans. The AMF also asks for non-performing loans ex deferral to be identified.

The deferral granted on student loans by the Government of Québec will be afforded the same treatment as described above.[4]

As a result of this measure, the financial institutions concerned do not have to make any changes to the risk weight or probabilities of default associated with such loans benefiting from a deferral. This temporary measure is effective upon publication of this notice and will remain in effect for an initial period of 6 months.

[1] CQLR, chapter S-29.02
[2] CQLR, chapter C-67.3
[3] Section 3.1.15 of the *Capital Adequacy Guideline – credit unions not member of a federation, trust companies and savings companies* and the *Ligne directrice sur les normes relatives à la suffisance du capital de base applicable aux cooperatives de services financiers* ("Base Capital Adequacy Guideline applicable to financial services cooperatives")
[4] http://www.finances.gouv.qc.ca/documents/Communiques/en/COMEN_20200327.pdf

1.2 Transitional arrangements for capital treatment of expected loss provisioning

The AMF is introducing transitional arrangements for expected credit loss provisioning that are available under the Basel Framework. This treatment will result in a portion of allowances that would otherwise be included in Tier 2 capital to instead be included in Tier 1A capital.

The adjustment to Tier 1A capital will be dynamically measured each quarter as the increase in Stage 1 and Stage 2 allowances relative to the baseline level. The baseline level is the amount of Stage 1 and Stage 2 allowances as at the quarter ending December 31, 2019. This increased amount is adjusted for tax effects and subject to a scaling factor that will decrease over time. The scaling factor will be set at 70% in fiscal 2020, 50% in fiscal 2021 and 25% in fiscal 2022. Allowances allocated to portfolios treated under the Internal Ratings Based Approach that are in an Expected Loss (EL) shortfall position during the transition period will not be eligible for this treatment.

1.3 Treatment of exposures stemming form the introduction of new financing programs

On March 27, 2020, the governments of Québec[5] and Canada announced new measures to help individuals and businesses weather the economic repercussions of COVID-19.

This section describes how these exposures must be treated by the financial institutions concerned under the Base Capital Adequacy Guideline applicable to financial services cooperatives (COOP GL) and the Capital Adequacy Guideline applicable to credit unions not member of a federation, trust companies and savings companies (TCSC GL).

Canada Emergency Business Account

As the exposures covered by these measures are funded by the Government of Canada, the financial institutions concerned that take them on may exclude them from their risk-based capital and leverage ratios, calculated in accordance with the COOP GL or the TCSC GL.

Concerted Temporary Action Program for Businesses (CTAPB) and Export and Development Canada (EDC) Guarantee Program

Program objectives

The CTAPB is intended to support the working capital of businesses and consists of a loan guarantee for a minimum amount of $50,000, which can also be in the form of an Investissement Québec (IQ) loan.

The EDC program guarantees new operating credit and cash flow term loans that financial institutions extend to SMEs.

Regulatory treatment

The loan guarantees offered by IQ and EDC to the financial institutions concerned may be recognized as a guarantee for the purposes of the COOP GL and the TCSC GL as they satisfy the operational requirements set out in paragraphs 189 and 190 of those guidelines. The

[5] http://www.finances.gouv.qc.ca/documents/Communiques/en/COMEN_20200327.pdf

guaranteed portion of the loan can be treated as an exposure to the Government of Québec or Canada. The remaining portion must be considered as an exposure to the borrower.

Where there are currency mismatches (between the currency of the IQ or EDC guarantee and that of the loan) or maturity mismatches (between the term of the IQ or EDC guarantee and that of the loan), the amount of the guarantee recognized for capital purposes must be adjusted in accordance with section 4.1.5 (iv) of the COOP GL and TCSC GL.

As for the treatment of such exposures under the Standardized Approach to credit risk, the guaranteed portion of the loan would receive the risk weight applicable to the Government of Québec or Canada (i.e., 0%) and the remainder of the loan would be treated as an exposure to the borrower. Under the Internal Ratings-Based Approach to credit risk, the guaranteed portion would be treated as an exposure to the Government of Québec or Canada. The financial institutions concerned should therefore adopt the Probability of Default substitution approach or the Loss Given Default adjustment approach as outlined in section 5.8.7 (ix) of the COOP GL. The balance of the loan would be treated as an exposure to the borrower.

In calculating the leverage ratio, the entire amount of the loan would be included in the exposure measure.

Business Development Bank of Canada (BDC) Co-lending Program

To provide additional liquidity support for Canadian businesses, the Government of Canada announced a new co-lending program for SMEs. This co-lending program will bring the BDC together with financial institutions to co-lend term loans to SMEs for their operational cash flow requirements.

Under this co-lending program with BDC, the financial institutions concerned would hold a portion of the loan that is made to the borrower. The AMF expects, under the Standardized Approach to credit risk, the portion of the loan made by the financial institution concerned to receive the risk weight applicable to the borrower. Under the Internal Ratings Based Approach to credit risk, the portion of the loan made by the financial institution concerned would be treated as an exposure to the borrower.

In calculating the leverage ratio, the AMF expects the portion of the loan made by the financial institution concerned to the borrower to be included in the exposure measure of the leverage ratio. The BDC portion of the loan would be excluded from the leverage ratio.

2. Adjustments to liquidity requirements

2.1 Liquidity coverage ratio (LCR)

The AMF is providing the financial institutions concerned with the following guidance related to the minimum short-term liquidity requirement.

- No LCR outflow for secured funding transactions with the Bank of Canada. The AMF confirms that, in line with the current provisions in paragraphs 113 to 114 of Chapter 2 of the Liquidity Adequacy Guideline (LAG), no LCR outflow must be taken into account for secured funding transactions with the Bank of Canada, regardless of the type of collateral utilized in the transaction.

- No LCR outflow for bankers' acceptances (BAs), or BA-type debt securities, sold to the Bank of Canada under a purchase facility. The AMF confirms that, pursuant to paragraph 110 of Chapter 2 of the LAG, the financial institutions concerned do not need to recognize an outflow (i.e., a 0% outflow rate) for BAs sold to the Bank of Canada.

- For the purposes of paragraph 83 of the LAG, the AMF clarifies that the definition of hardship may be extended to include the current situation stemming from COVID-19, since it is a "pre-defined and documented" situation. In other words, the AMF regards the current crisis as exceptional circumstances and permits the financial institutions concerned to allow depositors to withdraw their term deposits without it changing the treatment of the entire pool of deposits.

2.2 Net Stable Funding Ratio (NSFR)

The AMF is providing flexibility within the NSFR treatment for assets encumbered as part of Bank of Canada liquidity operations during stress periods. Specifically, under paragraph 31 of Chapter 6 of the LAG, assets pledged for exceptional Bank of Canada liquidity operations will receive the same Required Stable Funding (RSF) factor that is applied to an equivalent asset that is unencumbered, regardless of the remaining time of encumbrance. On a temporary basis, the financial institutions concerned are therefore authorized to utilize this treatment up to a maximum RSF factor of 50% for any eligible asset pledged to the Bank of Canada to secure funding.

3. Minimum requirements and internal targets

The AMF could, on a case-by-case basis, allow the financial institutions concerned to operate at different thresholds than their usual internal targets and the minimum requirements set by the AMF under the LAG.

To obtain authorization to do this, the financial institutions concerned must each submit a request to the AMF, providing support for it.

Financial institutions requiring additional time to file their disclosures with the AMF may submit a request, providing support for it. The AMF will examine such requests on a case-by-case basis.

4. Consultations

As mentioned in its March 19 news release, the AMF is suspending all consultations currently underway, relating to both draft guidelines and quantitative impact studies, involving the financial institutions concerned.

On March 27, 2020, the Basel Committee on Banking Supervision (BCBS) announced[6] that it was deferring the implementation timeline of Basel III reforms. This measure was introduced to provide additional operational capacity for financial institutions and supervisors to respond to the immediate financial stability priorities resulting from the impact of COVID-19 on the global banking system. In line with this extension, the AMF is deferring the following implementation dates for all Basel III reforms.

- The AMF's implementation date for the last series of Basel III reforms published by the BCBS in December 2017 is being deferred to the first quarter of 2023. This includes

[6] https://www.bis.org/press/p200327.htm

revisions to the Standardized Approach and Internal Ratings Based Approach to credit risk, the operational risk framework, and the leverage ratio framework, as well as the introduction of a more risk sensitive capital floor.

- The date for updating forthcoming templates and tables (paragraph 27) under the AMF's Pillar 3 Disclosure Requirements Guideline is deferred to the first quarter of 2023.

- In view of the complexity of, and adjustments to be made to, the infrastructure required to implement the final set of revisions to the BCBS market risk framework (i.e., the fundamental review of the trading book), which was published in January 2019, the AMF is deferring its implementation date to January 2024. Consequently, the implementation date of the revised credit valuation adjustment framework is also being deferred to January 2024.

5. Application of IFRS 9 in exceptional circumstances

IFRS 9 *Financial Instruments and Disclosures* is principles-based and requires the use of experienced credit judgement. The AMF is providing guidance on three specific aspects of the accounting for Expected Credit Losses (ECLs) due to the exceptional circumstances arising from COVID-19. This guidance is in keeping with *IFRS 9 and covid-19*[7] published by the International Accounting Standards Board (IASB) on March 27, 2020, and will allow financial institutions to remain compliant with IFRS 9 as issued by the Accounting Standards Board (AcSB). The financial institutions concerned should also consider any additional guidance provided by the AcSB on the application of IFRS 9 in relation to COVID-19.

5.1 Significant increase in credit risk

Under IFRS 9, financial institutions are required to classify and recognize Expected Credit Losses (ECL). Financial institutions must assess the allowance for losses for a financial instrument at an amount corresponding to the ECL for the life of the instrument if the credit risk of the financial instrument has increased significantly since initial recognition. The financial institutions concerned must make their assessment using the change in the risk of default occurring over the expected life of the financial instrument. The AMF supports the IASB's position and points out that the financial institutions concerned should not continue to apply calculation methods existing prior to the COVID-19 crisis; instead, they should review their assumptions to ensure that they are valid. The utilization of a payment deferral program should not therefore result in an automatic trigger for significant increase in credit risk.

5.2 Forward-looking information

At each reporting date, the financial institutions concerned must assess whether the credit risk on a financial asset has increased significantly since initial recognition. To make that assessment, they must compare the risk of default occurring on the financial asset as at the reporting date with the risk as at the date of initial recognition and consider reasonable and supportable information that is available without undue cost or effort and that indicates that the credit risk on the financial asset has increased significantly since initial recognition.

In determining the economic impacts of COVID-19, the financial institutions concerned are encouraged to consider the exceptional circumstances, significant government support, the high

[7] https://cdn.ifrs.org/-/media/feature/supporting-implementation/ifrs-9/ifrs-9-ecl-and-coronavirus.pdf?la=en

degree of uncertainty and established long-term economic trends evidenced by past experience in determining reasonable and supportable forward-looking information. As the situation is changing rapidly, the AMF expects the financial institutions concerned to remain up-to-date with developments and circumstances in order to revise their models as new information becomes available.

5.3 Disclosure

Due to the exceptional and sudden change in economic conditions, the AMF expects the financial institutions concerned to provide sufficient and timely disclosures to allow users to understand assumptions and judgments made by management during the period to address the COVID-19 outbreak. Disclosures should include transparency on the nature and uptake of payment deferral programs and significant changes made to forward-looking information and economic forecasts compared to the prior reporting period.

6. Supervision

6.1 Supervision activities will be adjusted for the period of the COVID-19 crisis to take into account the situation of the financial institutions concerned.The covered bond issue limit requirements are being increased to 10% from the current 5.5%. This temporary relief will be provided for at least one year and could be extended beyond this, if needed. The financial institutions concerned that exceed the 5.5% limit should return below this threshold as soon as market funding conditions permit, and provide the AMF with an implementation plan outlining their return to the 5.5% threshold.

6.3 The AMF is temporarily lowering the stress VaR (sVaR) multiplier from 3 to 1. The financial institutions concerned will be notified.

6.4 For financial institutions that file recovery plans, the AMF is deferring the next update to June 2021

7. Effective date and end date

The relief measures announced in this notice will come into effect as of their publication and, unless otherwise specifically indicated, will cease to be in effect upon further notice from the AMF. The AMF reserves the right to reassess all of these measures as the COVID-19 crisis evolves.

For any questions or to report specific issues, please contact

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