AUTORITÉ DES MARCHÉS FINANCIERS

Notice related to designation of Desjardins Group as a domestic systemically important financial institution

Background

This Notice complements various guidelines published by the *Autorité des marchés financiers* (the "Authority"), including the guideline pertaining to an adequate capital base and the guidelines underpinning the Authority's prudential framework, namely:

- *Ligne directrice sur les normes relatives à la suffisance du capital de base* (adequacy of capital base guideline)[1] – applicable to financial services cooperatives (available in French only)
- *Governance Guideline*[2]
- *Integrated Risk Management Guideline*[3]
- *Compliance Guideline*[4]

Domestic systemically important financial institutions

In the wake of the financial crisis, G-20 countries agreed on the need to oversee large financial institutions that could threaten financial stability and economic growth. The Bank for International Settlements ("BIS"), through the Basel Committee on Banking Supervision ("Basel Committee"), examined the supervision of financial institutions that have a direct impact on global financial stability,[5] referred to as "global systemically important banks." The Basel Committee also released a document dealing with domestic systemically important banks,[6] or D-SIBs. One of the principles of this document underscores the need for national authorities to establish a methodology for assessing the degree to which banks are systemically important in a domestic context.

The Basel Committee therefore gives regulatory authorities the necessary flexibility to account for the features and characteristics of the financial system they are supervising, thereby allowing them to define an optimal framework for the institutions under their jurisdictions.

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1 *Autorité des marchés financiers*, *Ligne directrice sur les normes relatives à la suffisance du capital de base*, January 2013. http://www.lautorite.qc.ca/files//pdf/reglementation/lignes-directrices-insti-depot/ld_capital_coop_2012_final.pdf

2 *Autorité des marchés financiers*, Governance Guideline, April 2009.

3 *Autorité des marchés financiers*, Integrated Risk Management Guideline, April 2009.

4 *Autorité des marchés financiers*, Compliance Guideline, April 2009.

5 Basel Committee on Banking Supervision, Global systemically important banks: Assessment methodology and the additional loss absorbency requirement, Rules Text, November 2011.

6 Basel Committee on Banking Supervision, A framework for dealing with domestic systemically important banks, October 2012.

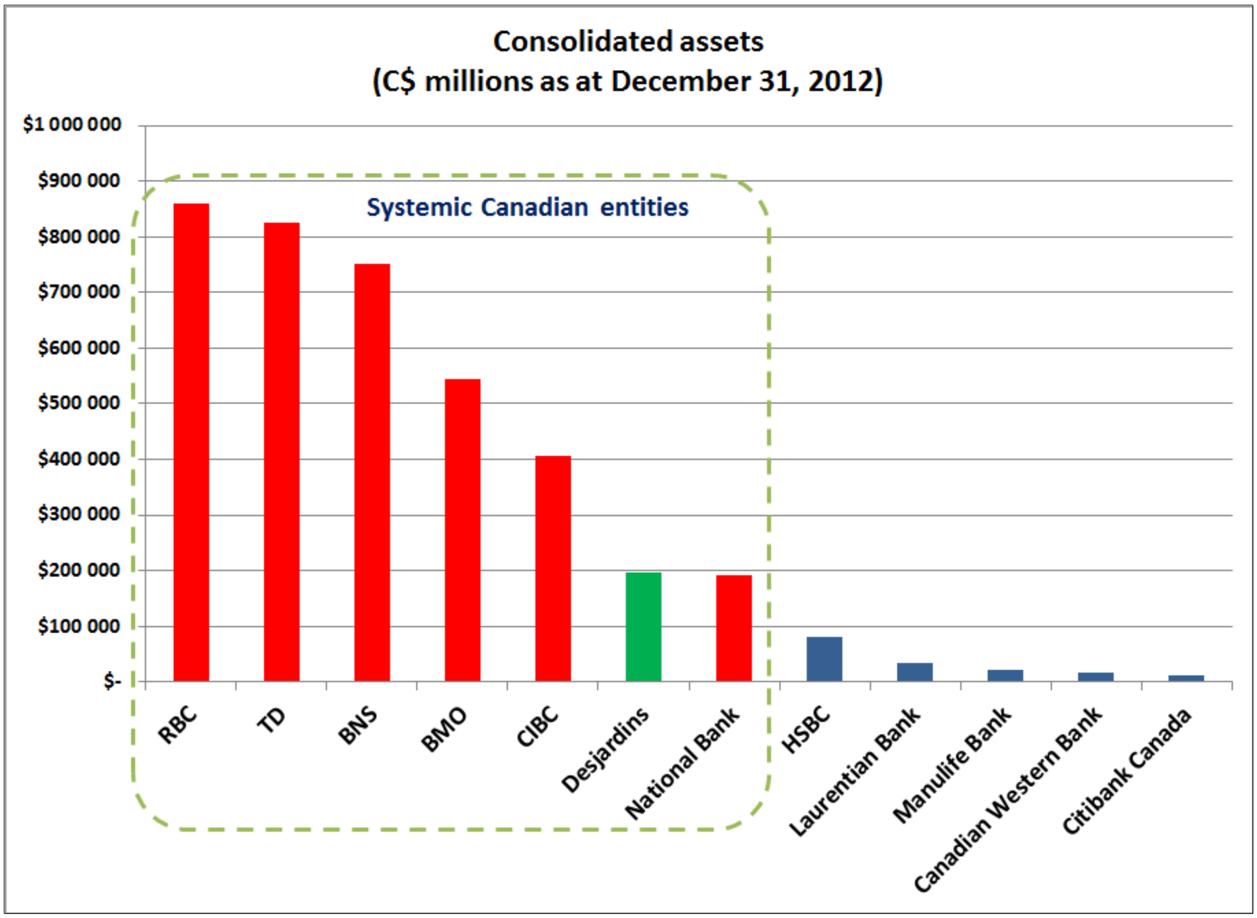
I. Assessment criteria for domestic systemically important banks (D-SIBs)

The Basel Committee publication indicates that domestic systemic importance should be assessed with reference to the impact that the distress or insolvency of a financial institution could have on the domestic economy. The Basel Committee therefore proposes assessment criteria that are closely tied to systemic spillovers.

The Authority took into consideration the assessment criteria recommended by the Basel Committee in order to define the domestic systemic importance of the deposit institutions under its jurisdiction. These financial system criteria are *size*, *interconnectedness*, *complexity* and *substitutability*. In addition, given the features specific to the institutions operating within its jurisdiction, the Authority added another criterion: *regional concentration of activities*.

Consolidated assets of Desjardins Group total C$197 billion. Based on the size criterion, Desjardins Group is one of Canada's largest deposit institutions (see Graph 1[7]).

Graph 1



In addition, as at December 31, 2012, Desjardins Group had more than 40,000 employees and held 40.7% of the mortgage lending market and 46.5% of the personal deposits market in Québec [8] (see Graph 2).

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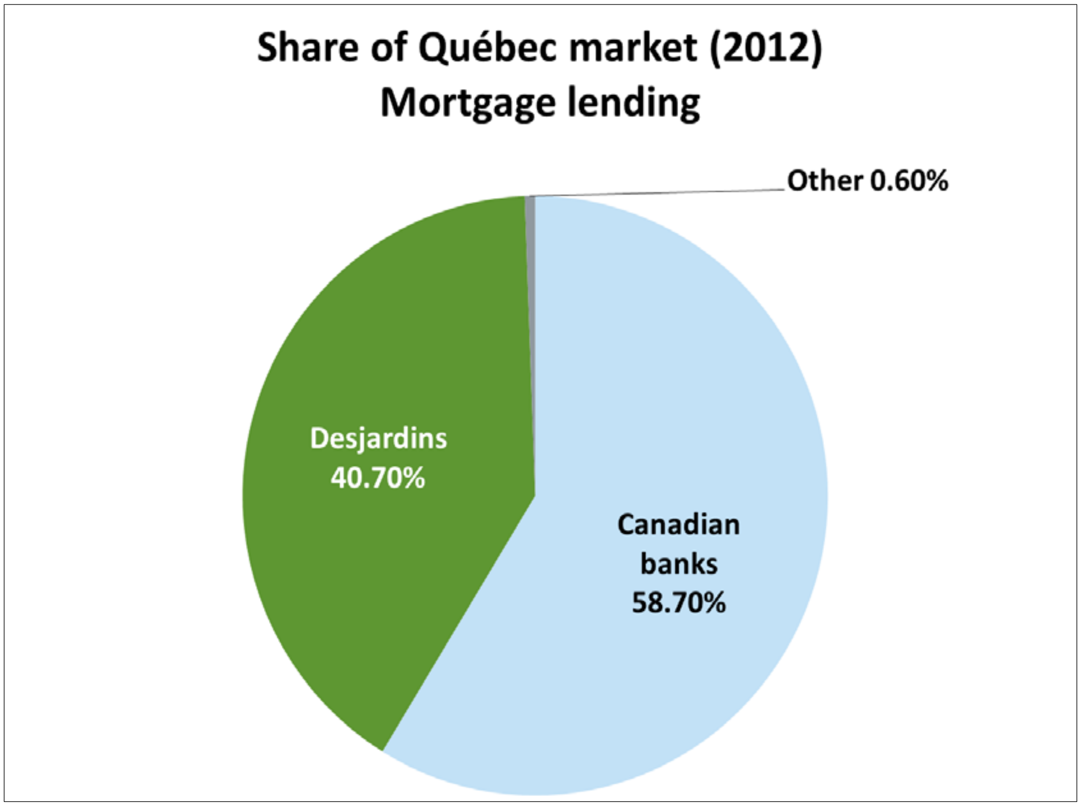
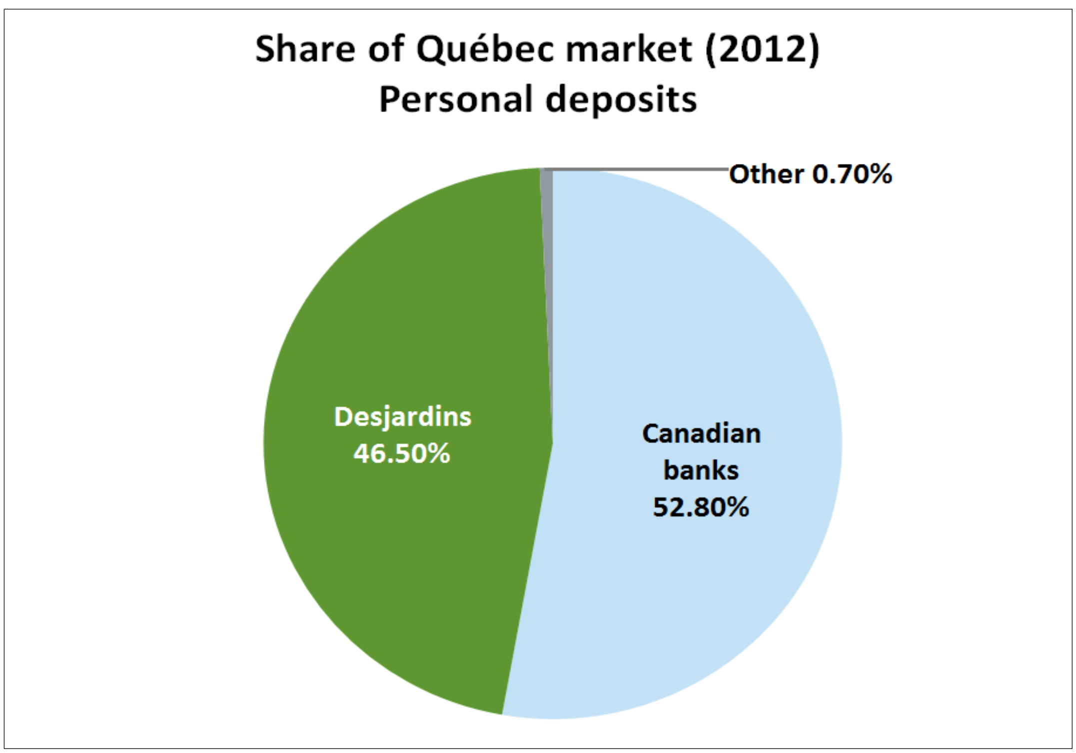
[7] Source: Office of the Superintendent of Financial Institutions Canada and Desjardins Group disclosures.

[8] Institut de la statistique du Québec, http://www.stat.gouv.qc.ca/donstat/econm_finnc/insti_finnc_coopr/statistique_an.htm

Graph 2


Share of Québec market (2012)
Mortgage lending
Other 0.60%
Desjardins
40.70%
Canadian
banks
58.70%


Share of Québec market (2012)
Personal deposits
Other 0.70%
Desjardins
46.50%
Canadian
banks
52.80%

The findings of the analysis conducted by the Authority confirm that Desjardins Group is a domestic systemically important financial institution (“D-SIFI”). In view of such designation by the Authority, Desjardins Group is required to comply with the guidance and requirements outlined below. This broad guidance is aligned with the federal regulator’s guidance for determining D-SIBs, while taking into account the cooperative function of Desjardins Group.

II. Higher loss absorbency targets

As a D-SIFI, Desjardins Group will be imposed, as of January 1, 2016, an additional Tier 1a capital requirement corresponding to 1% of its risk-weighted assets. This 1% surcharge reflects extreme loss probability scenarios assessed by the Authority and will help reduce the potential cost of a Desjardins Group insolvency to Québec’s financial system.

The Basel Committee provides regulatory authorities with the necessary flexibility to determine additional loss absorbency requirements based on the specifics of the financial system under their jurisdictions. Therefore, the Authority may periodically review this requirement in response to evolving oversight issues and observations further to its prudential supervision of Desjardins Group.

As of January 1, 2016, Desjardins Group must comply with a Tier 1a capital target of 8%.

III. Guideline implications

The following table updates the adjustments to capital conservation ratios in Appendix 1-II of the Authority’s January 2013 issue of the adequacy of capital base guideline (in French only) to account for the 1% additional Tier 1a risk-weighted assets requirement for D-SIFIs. The capital target ratio for Desjardins Group effective January 1, 2016 is expressed solely as Tier 1a capital, exclusive of the capital conservation buffer.

Minimum capital conservation ratios at Tier 1a capital level

2016	2017	2018	2019	Capital conservation ratio
5.5% to 5.656%	5.5% to 5.813%	5.5% to 5.969%	5.5% to 6.125%	100%
More than 5.656% to 5.813%	More than 5.813% to 6.125%	More than 5.969% to 6.438%	More than 6.125% to 6.75%	80%
More than 5.813% to 5.969%	More than 6.125% to 6.438%	More than 6.438% to 6.906%	More than 6.75% to 7.375%	60%
More than 5.969% to 6.125%	More than 6.438% to 6.75%	More than 6.906% to 7.375%	More than 7.375% to 8.0%	40%
More than 6.125%	More than 6.75%	More than 7.375%	More than 8.0%	0%

IV. Supervisory implications

Under the principles of its Financial Institution's Supervisory Framework,[9] the Authority can tailor its supervisory interventions to the nature, size, risk profile and complexity of an institution's activities.

The requirements of the Basel Committee recommend enhanced supervision of D-SIBs (and therefore of D-SIFIs) in view of the potential impact of the failure of such institutions on the financial system.

Since Desjardins Group is designated as a D-SIFI, the Authority will enhance its supervision by:

- increasing the frequency and intensity of its on-site and remote supervision; as a result, Desjardins Group must provide more granular reports;
- requiring implementation of recovery and resolution plans (living wills), in accordance with Basel Committee expectations;
- strengthening its exchanges with the board of directors and senior management of Desjardins Group;
- recommending the adoption of advanced approaches for the calculation of regulatory capital requirements for credit, market and operational risk;
- requiring the implementation of the various guidelines prepared by the Authority effective on their publication dates, with no prescriptive delay;
- increasing its interaction with national and international regulators in order to co-ordinate its supervision of Desjardins Group;
- developing a joint stress testing program with national regulators.

V. Impact on disclosure

Like the other Canadian financial institutions qualified as D-SIBs by the federal regulator, Desjardins Group must also comply with the recommendations of the Financial Stability Board's Enhanced Disclosure Task Force.[10]

The document published by this forum is essentially based on seven fundamental principles for enhancing the risk disclosures of financial institutions. Under these principles, disclosures should:

- be clear, balanced and understandable by all users (analysts. investors, market participants, etc.);
- be comprehensive and include all of the institution's key activities and risk;

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[9] *Autorité des marchés financiers*, Financial Institutions Supervisory Framework, October 2011. http://www.lautorite.qc.ca/files/pdf/reglementation/assurances-inst-depot/cadre-surveillance-2011-eng.pdf

[10] Enhanced Disclosure Task Force, Enhancing the Risk Disclosures of Banks, 29 October 2012. https://www.financialstabilityboard.org/publications/r_121029.pdf

- present relevant information;
- reflect how the institution manages its risks;
- be consistent over time;
- be comparable among financial institutions;
- be provided on a timely basis.

The Authority's disclosure expectations set out in section 11 of its Guideline[11] complement these seven principles of the Financial Stability Board.

June 19, 2013

[11] *Autorité des marchés financiers*, Ligne directrice sur les normes relatives à la suffisance du capital de base, January 2013. http://www.lautorite.qc.ca/files//pdf/reglementation/lignes-directrices-insti-depot/ld_capital_coop_2012_final.pdf