AUTORITÉ
DES MARCHÉS
FINANCIERS

TOTAL LOSS ABSOBING CAPACITY GUIDELINE

Financial Services Cooperatives

March 2019

Scope

The Total Loss Absorbing Capacity Guideline is established under the *Act respecting financial services cooperatives*, CQLR, c. 67.3 and applies on a consolidated basis by combining the credit unions that are members of a federation and the security fund established at the request of the federation and consolidating the federation and any other legal person or partnership controlled by one of the credit unions or by the federation.

This guideline applies to the entity as defined in the scope of the *Capital Adequacy Guideline* – Financial Services Cooperatives (*Ligne directrice sur les normes relatives à la suffisance du capital de base)*, available in French only (the "CAR Guideline").

Notwithstanding the foregoing, this guideline applies only to a financial institution that has been designated by the *Autorité des marchés financiers* ("AMF") as a domestic systemically important financial institution (D-SIFI).

Effective date and updates

The *Total Loss Absorbing Capacity Guideline* is effective March 31, 2019.

The AMF expects the financial institutions concerned to meet the requirements of this guideline by developing strategies, policies and procedures commensurate with their nature, size, complexity and risk profile.

This guideline will be updated based on developments in the area of total loss absorbing capacity and on observations made in the course of the AMF's supervisory activities in relation to the financial institutions concerned.

Overview

The Total Loss Absorbing Capacity Guideline sets out the AMF's expectations with respect to maintaining a minimum capacity to absorb losses.

These expectations are intended to ensure that a non-viable entity has sufficient loss absorbing capacity for a bail-in. This would, in turn, facilitate an orderly resolution while minimizing any potentially adverse impacts on the stability of Québec's financial sector, ensuring the continuity of critical functions, and minimizing taxpayers' exposure to loss.

Several parts of this guideline are drawn from the Financial Stability Board's Total Loss-Absorbing Capacity Term Sheet (the FSB TLAC Term Sheet)[1], the Basel III framework of the Basel Committee on Banking Supervision (BCBS) entitled *Basel III: A global regulatory framework for more resilient banks and banking systems* – December 2010 (revised June 2011), and the document entitled *Basel III leverage ratio framework and disclosure requirements*.

Where appropriate, this guideline cross-references other AMF expectations set out in the CAR Guideline, including the financial leverage ratio in its Annex 1-IV.

The AMF's expectations regarding TLAC are based on the following two minimum standards:

1. the "risk-based TLAC ratio", which uses the risk-weighted assets described in the CAR Guideline;

2. the "TLAC leverage ratio", which builds on the Basel III leverage ratio described in Annex 1-IV of the CAR Guideline.

The risk-based TLAC ratio is the primary basis used by the AMF to ensure that its expectations regarding TLAC are met. The ratio focuses on the risks faced by that institution. The TLAC leverage ratio provides an overall measure of the entity's TLAC.

[1] Total Loss-Absorbing Capacity (TLAC) Principles and Term Sheet. http://www.fsb.org/2015/11/total-loss-absorbing-capacity-tlac-principles-and-term-sheet/

Calculation of Total Loss Absorbing Capacity (TLAC)

TLAC is critical to the recapitalization of a D-SIFI.

Consequently, the AMF expects compliance with the minimum ratios: the risk-based TLAC ratio and the TLAC leverage ratio. These ratios are calculated as follows.

I. Risk-based TLAC ratio

The risk-based TLAC ratio is defined as the TLAC Measure (the numerator) divided by Risk-Weighted Assets (the denominator), with this ratio expressed as a percentage:

$$TLAC\ ratio = \frac{TLAC\ Measure}{Risk\text{-}Weighted\ Assets}$$

II. TLAC leverage ratio

The TLAC leverage ratio is defined as the TLAC Measure (the numerator) divided by the Exposure Measure[2] (the denominator), with this ratio also expressed as a percentage:

$$TLAC\ leverage\ ratio = \frac{TLAC\ Measure}{Exposure\ Measure}$$

III. Minimum TLAC requirements

The AMF expects the entity to maintain at all times, as of April 1, 2022, a minimum risk-based TLAC ratio of 21.5% of risk-weighted assets and a minimum TLAC leverage ratio of 6.75%.

However, the AMF may, if necessary and with prior notice, vary the minimum TLAC requirements for the entity.

A. TLAC Measure

The TLAC Measure used in both ratios is the sum of the instruments comprising the entity's TLAC, subject to certain adjustments.

Therefore, the following may be considered for the purposes of calculating TLAC:

- Tier 1A, Tier 1B and Tier 2 capital as defined in the CAR Guideline;
- instruments that meet the eligibility criteria set out in Section C of this guideline.

[2] Within the meaning of annex 1-IV of the CAR Guideline.

B. Eligibility of regulatory capital instruments as TLAC

The criteria for the capital elements comprising Tier 1A, Tier 1B and Tier 2 capital, as well as the various limits, restrictions and regulatory adjustments to which they are subject, are described in Chapter 2, Definition of capital, of the CAR Guideline.

Additional adjustments to Tier 1A, Tier 1B and Tier 2 capital are made in calculating the TLAC ratios, as set out below:

- Tier 1B or Tier 2 regulatory capital instruments issued out of subsidiaries to third parties will only be recognized as TLAC until March 31, 2022.

  After that date, such interests will only be eligible towards the entity's capital ratios in accordance with the CAR guideline.

- Regulatory capital instruments issued indirectly by a wholly- and directly-owned funding entity or via a special purpose vehicle (SPV) will only be recognized as TLAC where they were issued on or before March 31, 2022.

  After that date, such instruments will only be eligible towards the entity's capital ratios in accordance with the CAR guideline.

- Tier 2 capital instruments that are subject to amortization under the CAR guideline may be included as TLAC where their residual maturity exceeds 365 days.

Tier 1 and Tier 2 capital eligible for TLAC must be measured on an all-in basis.[3]

C. Eligibility criteria of other capital instruments to qualify as TLAC

The criteria for other TLAC instruments, as well as the various limits, restrictions and regulatory adjustments to which they are subject, are described below:

(a) The instrument must be a "prescribed debt" referred to in the second paragraph of section 1 of the Regulation respecting the classes of negotiable and transferable unsecured debts and the issuance of such debts and of shares.[4]

(b) The issuer of the instrument must have satisfied all the requirements of the Regulation respecting the classes of negotiable and transferable unsecured debts and the issuance of such debts and shares.

(c) The instrument, when issued, must be paid for in cash or, with the prior approval of the AMF, in property.

[3] All-in basis means based on the assumption that the Basel III deductions are fully applied by the entity (i.e., that the transitional arrangements have expired).

[4] This regulation is made under the second paragraph of section 40.50 and paragraph *s.2* of section 43 of the *Deposit Insurance Act*, CQLR, c. A-26, and under section 601.1 of the *Act respecting financial services cooperatives*, CQLR, c. C-67.3.

(d) Neither a component of the entity nor a related party over which the entity exercises control or significant influence[5] can have purchased the instrument. Such a purchase is permitted, however, if it is made for the purposes of re-sale, in which case it must be re-sold.

(e) The entity may under no circumstances knowingly fund, directly or indirectly, the purchase of the instrument.

(f) The instrument is neither fully secured at the time of issuance nor covered by a guarantee of the issuer (or by a component of the entity) or of a related party or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis the entity's depositors and/or other general creditors.

(g) The instrument is not subject to set-off or netting rights.

(h) Except as provided below, the instrument must not provide the holder with rights to accelerate repayment of principal or interest payments outside of bankruptcy, dissolution, insolvency, wind-up or liquidation. Events of default relating to the non-payment of scheduled principal and/or interest payments will be permitted where they are subject to a cure period of no less than 30 business days and it is clearly disclosed to investors, particularly in the instrument, that:

- Acceleration is only permitted where the resolution board has not ordered the implementation of resolution operations in respect of the cooperative group to which the issuer belongs under section 40.12 of the *Deposit Insurance Act*, CQLR, c. A-26.

- Notwithstanding any acceleration, the instrument continues to be subject to the powers of the AMF under the second paragraph of section 40.50 of the *Deposit Insurance Act*, c. A-26.

(i) The instrument is perpetual or has a residual maturity in excess of 365 days.[6]

(j) The instrument can be called or purchased for cancellation at the initiative of the issuer only and, where the redemption or purchase would lead to a breach of the D-SIFI's minimum TLAC requirements, with the prior written approval of the AMF.

(k) The instrument does not have credit-sensitive remuneration payment (or coupon) features that are reset periodically based in whole or in part on the issuer's or any other entity component's credit standing.

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[5] The term "significant influence" as used in this guideline means ownership of more than 10% of Tier 1A capital instruments or ownership of shares to which are attached more than 10% of the voting rights of a business corporation.

[6] If the instrument has a step-up or other incentive to redeem, it is deemed to mature on the date on which the incentive to redeem becomes effective. For such instruments, the residual maturity would be measured with reference to the effective date of the incentive to redeem rather than the contractual maturity date.

(l) Where an amendment or variance of the instrument's terms and conditions would affect its recognition as TLAC, such amendment or variance will only be permitted with the prior written approval of the AMF.

If the instrument is not governed entirely by the laws applicable in Québec, the issuer must provide the AMF with an external legal opinion confirming that the powers conferred on the AMF under the second paragraph of section 40.50 of the *Deposit Insurance Act*, CQLR, c. A-26, may be exercised in the event that the resolution board orders, under section 40.12 of the same Act, the implementation of resolution operations in respect of the cooperative group to which the issuer belongs. Such legal opinion shall be to the satisfaction of the AMF.

D. Risk-Weighted Assets Measure

The denominator for the risk-based TLAC ratio uses risk-weighted assets as calculated by the entity under the CAR guideline.

E. Exposure Measure

The denominator for the TLAC leverage ratio uses leverage ratio exposures as calculated under Annex 1-IV of the CAR guideline.