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The policies in this chapter are designed for credit unions that intend to use DICO's Workbook for Less Complex Institutions and cover most situations that may arise. The policies may not cover each and every situation and must be customized to meet each credit union's unique requirements.

The shaded text that appears in this chapter is customizable by your credit union. When customizing this chapter, use your software's Find/Replace function to insert your credit union's name wherever "the credit union" (or a variation of this phrase) appears.

Text in boxes, such as this one, is background information, and can be deleted when you customize this file.

Note: Material from By-Law No. 5 has been incorporated into this policy. Customizing it will provide your credit union with Central's policy recommendations. It is strongly suggested that credit union managers and boards consult the workbooks prepared by DICO for additional guidance that will help them comply with the By-Law.

The credit union believes that it is in keeping with the overall credit union philosophy to have appropriate and prudent policies, procedures and controls to manage the structural risk of the institution.

Depending on the structure of a credit union's assets and liabilities, interest rate fluctuations can have a significant effect on net earnings. Measuring and managing this risk is a regulatory requirement [Regulation 76/95 (Part IX)]. The board of directors will ensure that it and the credit union are familiar with this Structural Risk Management policy, and will also ensure that the credit union complies with these requirements.

Policy Objectives

To establish an overall framework of structural risk management which ensures that the credit union faces limited exposure to all material risks.

To implement a policy that addresses:

- criteria for pricing of deposits and loans
- limits on the exposure to changes in interest rates and other risk factors

Responsibility

a) The treasurer-manager is responsible for managing structural risk, which comprises:

   i) asset/liability spread risk

   ii) interest rate risk and

   iii) funding risk;

   in accordance with this policy and the annual business plan.

b) The Board of Directors may engage outside consulting help to establish and/or maintain the information and ongoing analysis required by this policy.

c) The board of directors is responsible for ensuring that any major variances to the budget are identified and that appropriate corrective measures are implemented.

Policy Guidelines

a) The credit union will ensure that its Structural Risk Management policy complies with:

- all applicable Regulations (section 78 of Regulation 76/95)
- Ministry of Finance's Guideline on Accounting for Derivatives
- DICO's Standards of Sound Business and Financial Practices
- other credit union policies.

b) The credit union will adhere to its Structural Risk Management policy and its annual business plan where possible, with respect to structural risk management.

c) The credit union will establish a basis for measuring and evaluating structural risk

d) The credit union will provide guidelines on the structuring of maturities and prices, and on the mix of deposits, loans, mortgages and investments.

g) The credit union will not engage in material off-balance sheet transactions.

h) Exposure arising from changes in interest rates, which might reasonably be expected to occur, must be in accordance with subsection 78(2) of Regulation 76/95, which restricts interest rate risk to no greater than the regulatory maximum of 15 basis points of total assets and to any lesser limit that may be established by the Board.

i) The credit union will appropriately measure and report on its risk position and exposure management. Summary measurements of structural risk management will be prepared for board review at least quarterly.

j) The board of directors will ensure that those responsible for the structural risk management of the credit union have the appropriate knowledge and training to implement this policy. The board may employ outside consultants or services to assist in the structural risk management of the credit union.

Sources/Uses of Funds

a) The Board of Directors shall establish, from time to time, guidelines for the pricing of loans and deposits that, provide an overall, a net contribution to earnings in line with member expectations. Promotional pricing or incentive pricing will be considered within the context of the credit union's structural risk management philosophy.

b) The Board shall also determine authority to deviate from pricing guidelines

c) An appropriate asset mix of loans and investments will be maintained in accordance with the board-approved annual business plan. Maximum terms to maturity for various products will be established by operational policy, and will not exceed five years without Board approval.

The following table contains sample maximum limits on balance sheet categories, based on a credit union that proposes to use the DICO Workbook for Less Complex Institutions. A credit union can alter the limits listed below to suit its size and range of services.

Sample Maximum Limits on Balance Sheet Categories

Category	Policy Limits as a Percentage of Total Assets
Personal Loans	40%
Residential Mortgages	40%
Financial Investments	25%
Capital Assets	3%
Gross Liquid Assets	15%
Term Deposits	50%
Demand Deposits	40%

Interest Rate Risk Management

a) Gap or duration analysis will be the starting point for interest rate risk assessment. Interest rate exposure will be measured over future time periods on the basis of asset cashflows in relation to liability cashflows.

b) Interest rate risk exposure measures will include stress-tests that measure:

- the estimated reduction in forecasted net income margin for the year end and the next 12, 24, and 36 months under a series of rate shock scenarios to be defined by management and approved by their Board.
- the reduction in net income margin in relation to forecasted earnings and surplus to year-end
- a method for measuring, monitoring and managing interest rate risk associated with all on and off balance sheet activity

c) Using a market valuation model, the exposure of equity at risk for a upward or downward shock to interest rates should be determined and measured against a limit established by the credit union's board. The exposure should be based on reasonably expected interest rate change fluctuations.

Using an income simulation model, the allowable exposure to income at risk for a upward or downward shock to interest rates should result in a negative change in net interest income of no greater than 15 basis points of assets for each of the next three years. The exposure should be based on reasonably expected interest rate change fluctuations.

d) When interest rate risk exceeds the policy limits of 15 basis points of assets, the credit union will take timely corrective action to deal with the problem and restore compliance in accordance with the Regulations (subsection 79(1) of Regulation 76/95). Solutions can include seeking either loans or deposits for specific maturity dates to reduce gaps. These actions may include incentive or disincentive pricing to affect member preferences.

e) The credit union will utilize derivative instruments only in conjunction with a league sponsored program such as Index-linked Term Deposits.

Each derivative transaction must be reported to the board at the first board meeting following the transaction. The board can then ensure the transaction was entered into for approved purposes only and pass a declaration stating so. If the board believes the transaction was entered into for another purpose management will immediately take action to unwind the transaction. If the unwinding would cause significant harm or could only be done on significantly detrimental terms, then the transaction should hedged until it can be unwound.

h) A list of approved counterparties for treasury actions will be maintained.

i) The credit union will not hold material foreign currency positions.

j) The board will monitor, on a monthly basis, the impact on earnings of any changes in interest rates. If a sustained shock based on reasonably expected interest rate change fluctuations produces a decline in 12- month net interest income of greater than 20 per cent, the credit union will immediately take the necessary steps to reduce this risk.

If the credit union has callable deposits that will reprice at higher interest rates if rates go higher, the credit union needs to measure the income effect of those items for a higher rate scenario.

Annual Business Plan

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b) The annual business plan will include budget expectations for:

- balance sheet mix
- asset and liability volumes by category and by term
- asset yields, liability costs and financial margin
- the trend in mismatch position.

c) The projection in the annual business plan will be on a monthly basis accompanied by descriptive narratives.

Reporting

The Treasurer-Manager will report on matters dealt with in this policy to the board of directors no less frequently than quarterly. Such reports will contain:

- compliance with this policy and regulatory requirements, including the quarterly report on interest rate risk as prescribed in the Regulations (section 80 of Regulation 76/95 (and, where applicable, the corrective action report required under subsection 78(4) of Regulation 76/95 should interest rate risk exceed policy limits))
- measurement of overall balance sheet mix and growth in major asset/liability categories
- measurement of the general sources and uses of future cashflows
- measurement of financial margin and net income relative to historical and budgeted margin with explanations for material variances.

In the event that the credit union has not complied with the board's policy on structural risk management, remedies must be immediately implemented by the board and management to obtain compliance. The Treasurer/Manager will report to the board on the circumstances that led to policy violations, and the corrective measures being put in place, as required in the Regulations (section 78(4) of Regulation 76/95). This report will be presented to the board within 21 days of the implementation of the actions taken to reduce interest rate risk.

If the level of interest rate risk exceeds the limits established in this policy for two consecutive quarters, the credit union will promptly submit a plan to the Director and to DICO, approved by its board, that describes the steps the credit union intends to take to bring itself within those limits, in accordance with the Regulations (section 79(2) of Regulation 76/95).

Management will prepare a report at the end of each quarter of its fiscal year on its management of interest rate risk, in accordance with the Regulations (section 80 of Regulation 76/95). The report will also comment on the credit union's ongoing compliance with policies as established.

Compliance

a) Annually/at year end, the Audit Committee will ensure compliance with this policy and will ensure that the policy complies with the requirements of the Act and Regulations.

b) The external auditor shall conduct whatever tests are necessary regarding this policy in order to meet generally accepted auditing standards, and shall report any shortfalls to the Audit Committee.

c) The board of directors, in conjunction with the Audit Committee, as stipulated in paragraph 26.17 of Regulation 76/95, will review written correspondence from the Ministry of Finance and DICO regarding structural risk management concerns and requirements, and will investigate and respond as appropriate.

Policy Approval and Review

This policy, and any subsequent recommended changes to this policy, must be approved by the board of directors. This policy will be reviewed annually for ongoing appropriateness by the board (or by a delegated subcommittee of the board).