

DEPOSIT INSURANCE CORPORATION OF ONTARIO
BY-LAW NO. 6
RESERVES AND MONTHLY PROVISION FOR DOUBTFUL LOANS

**A By-law made under section 90 of the Credit Union and Caisses Populaires Act,
1994 and section 24 of Ontario Regulation 237/09**

This by-law provides direction on the methodology for establishing reserves and determining the monthly provision for doubtful loans.

1. ESTABLISHING RESERVES AND DETERMINING THE MONTHLY PROVISION FOR DOUBTFUL LOANS

A credit union shall assess at the end of each month whether a loan or group of loans is impaired. If there is objective evidence that impairment has occurred, then the carrying amount of the loan must be reduced either directly or through the use of a reserve by establishing an allowance for impaired loans. The amount of the impairment must be recognized in the calculation of the credit union's profit or loss for that month as a monthly provision for doubtful loans. When determining the allowance for impaired loans and the amount of the impairment, credit unions are required to follow the standards and interpretations issued by the International Accounting Standards Board (IASB). The following provides additional guidance to these standards and interpretations:

A. Recognizing impairment

Individual Allowance

Each credit union is required to establish an individual allowance for individually significant loans and other specifically identified individual loans

Each credit union is required to establish in its lending policies the amount at which a loan is considered "significant" for the purpose of assessing impairment for individually significant loans. This may be based on a dollar amount or percentage of capital or other criteria but would generally result in ensuring that the largest value loans for each loan category are assessed for impairment on a regular basis.

While arrears of payments with respect to the contractual terms of a loan is not a necessary precondition for recognition of impairment, DICO considers the existence of any of the following conditions to be an indication of objective evidence of impairment as required by the standards and interpretations of the IASB:

- a) payment on any loan, excluding credit card loans, is contractually 90 days in arrears, except where the loan is fully secured, the debt collection is in process and the collection efforts are reasonably expected to result in full repayment or restoration of the debt to current status within 180 days of the date payment went into arrears;
- b) payment on any loan, excluding a credit card loan, is contractually 180 days in arrears. Any credit card loan that has a payment 180 days in arrears should be written off.
- c) the debt is assigned to a collection agency;
- d) the member has absconded, has made a voluntary assignment for his creditors' benefit, has been named in a creditor's application for a bankruptcy order under the Bankruptcy and Insolvency Act of Canada, or has made a proposal, consumer proposal, or a notice to make a proposal under the Bankruptcy and Insolvency Act of Canada
- e) any loan which has been postponed where the recovery of principal and interest is deferred by more than six months beyond the loan's original term

An exception to these conditions is made for not more than 365 days from the date a loan is contractually in arrears where the loan is guaranteed or insured by the Canadian government (federal or provincial) or a Canadian government agency, the validity of the claim is not in dispute, and as a consequence the loss event does not have an impact on the estimated future cash flows of the loan.

Collective Allowance

Each credit union is required to establish a collective allowance for the remaining loans excluding those loans where an individual allowance has already been taken. The methodology and assumptions used are to be reviewed at least annually to reduce any differences between loss estimates and actual loss experience. The allowance should reflect management's experience and judgement surrounding changes in economic and other conditions that have occurred which may indicate a group of loans is impaired.

B. Measuring Impairment

In accordance with IASB standards and interpretations, the allowance is determined as the excess of the loan's carrying amount (i.e. outstanding principal plus interest owing less any allowance) above the loan's present value of estimated future cash flows discounted at the original effective interest rate. Further guidance on discounting, materiality, and other issues related to measuring impairment can be found in the DICO Guidance Note: Impaired Loans.

When determining estimated future cash flows, credit unions should consider the fair value of any security less any estimated legal and other costs related to the holding and disposition of the secured asset. The valuation of the security must be based on current market values and include documentation of the valuation source. Board policy must establish monetary limits and criteria that define when an independent qualified appraisal is required and the published sources or qualifications of other persons providing other objective opinions of value.

No value may be assigned to a security interest in tangible property which the credit union does not possess, which is not duly registered, or on which the registration is not in good standing (or for which the credit union does not hold non-filing insurance). No value may be given to security interests in intangibles such as goodwill, quotas, wage assignments, personal or third-party guarantees (excluding government guarantees), or lodgment of title.

C. Loan Loss Allowance Reversal

A loan may no longer be considered impaired when the borrower's financial circumstances have changed such that future repayment is not in doubt and the loan does not satisfy any of the conditions of impairment outlined in section A above or the standards and interpretations of the IASB. In these cases the allowance for impairment may be reversed in accordance with the standards and interpretations of the IASB.

D. Income Recognition

Write-offs and recoveries related to impaired loans should be recorded through the loan allowance account rather than being recorded directly as a charge or credit for loan impairment in the income statement. Any credit card loan that has a payment 180 days in arrears should be written off. Subsequent payments (whether designated as interest or principal) on an impaired loan should be recorded as a reduction of the recorded investment in the loan. When the recorded investment in the loan is completely written off, payments should be credited to the allowance for loan impairment. Interest income on impaired loans should continue to be recognized and must be reflected in the allowance.

E. Disclosure

Credit unions shall provide separate disclosure of individual and collective allowances by providing a reconciliation of changes to each of these accounts during the period.

2. DEFINITIONS

For the purposes of this by-law:

“Fully Secured” is a loan which is fully secured by charges on real property (such as land and buildings) or security interests in personal property (such as automobiles, securities) where the fair value of security or estimated net realizable amount is sufficient to discharge the outstanding principal and accrued interest in full.

3. APPLICATION OF BY-LAW:

This by-law applies to all financial years of a credit union that start after December 31, 2010. By-law No. 6 made on June 28th, 1995 continues to apply to all financial years of a credit union that started or starts prior to January 1, 2011.

ENACTED as a By-law of the Corporation by the Board of Directors on the 16th day of September, 2010.

APPROVED by the Lieutenant Governor in Council by Order dated the first day of December, 2010.