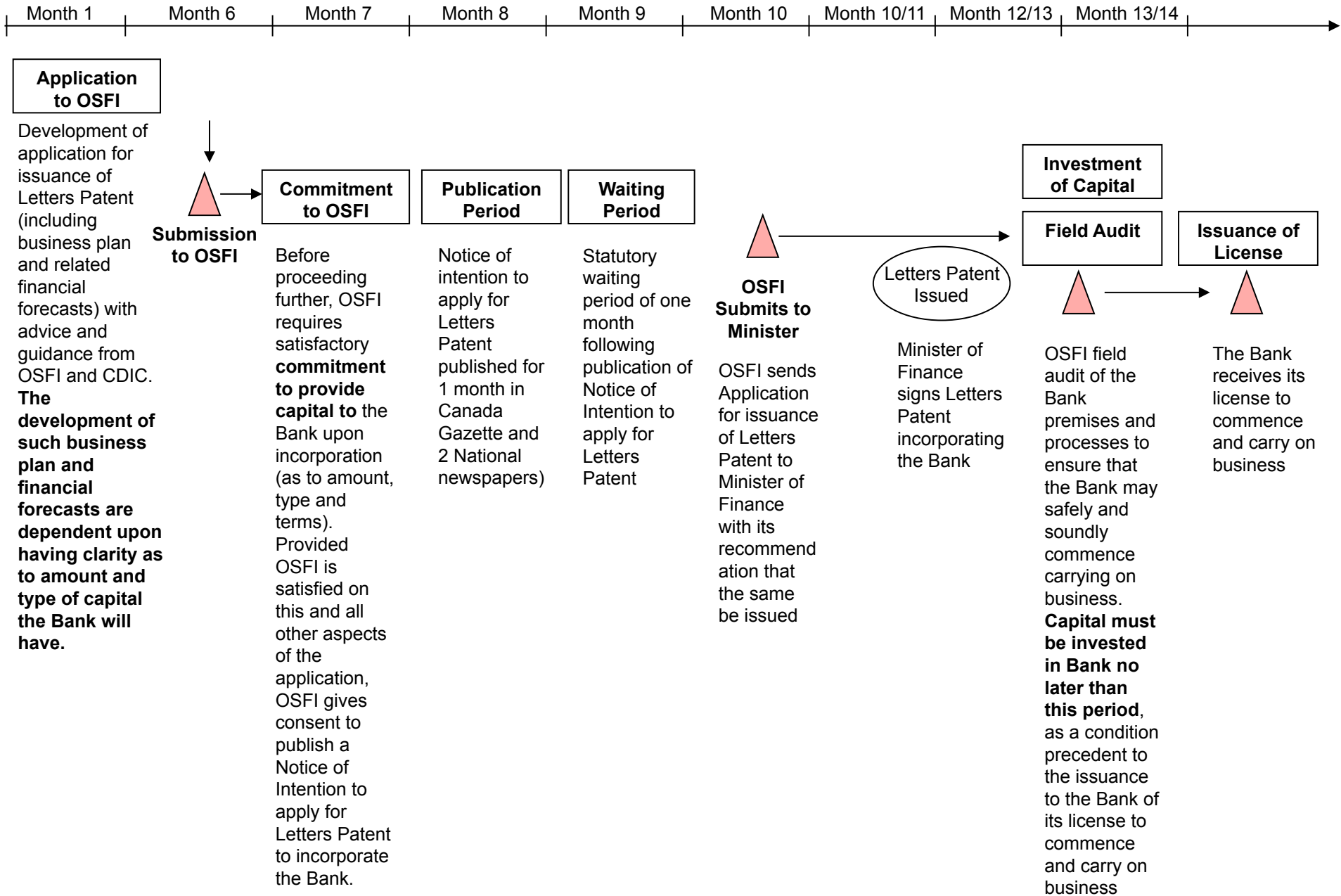


Financial Institution for the Voluntary Sector

Capitalization Alternatives

Timelines and Milestones for Federal Government Funding to the Bank



ALTERNATIVES FOR FEDERAL GOVERNMENT CAPITALIZATION OF THE BANK

Options	Description	Considerations	Assessment
<div style="border: 1px solid black; padding: 5px; width: fit-content;"> Grant or Contribution </div>	<ul style="list-style-type: none"> • Cash donation to the Bank 	<ul style="list-style-type: none"> • Constitutes Tier 1 capital as contributed surplus • Simple and inexpensive to put in place • Any terms and conditions attaching to a contribution would need to be carefully considered to ensure that they did not jeopardize Tier 1 capital status 	<ul style="list-style-type: none"> • Highly desirable • Responsive to all parameters: <ul style="list-style-type: none"> • Tier 1 capital • Voting control of the Bank is held by shareholders which are members of the voluntary sector • Strengthens the balance sheet of the Bank, leading to enhanced trust and confidence in its financial safety and soundness • Straightforward investment by the Federal Government in the success of the Bank • No Bank Act or OSFI Guidelines issues • Lowest possible cost of capital

ALTERNATIVES FOR FEDERAL GOVERNMENT CAPITALIZATION OF THE BANK

Options

Shares

Description

- **Common Shares**
 - Constitutes Tier 1 Capital
- **Preferred Shares**
 - Constitutes Tier 1 or Tier 2 capital depending on their terms

Considerations

- Bank Act prohibits holding of any shares of any bank by any government but may technically permit holding of shares by certain entities controlled by a government. However, there are concerns about the policy & regulatory complexity entailed in enabling such a structure.

Assessment

- Share investment by Federal Government would raise a number of regulatory and policy issues
- Control of ownership by the charitable sector is considered an important element of creating a successful Bank, and important in building an appropriate ethos that will coalesce sector support

ALTERNATIVES FOR FEDERAL GOVERNMENT CAPITALIZATION OF THE BANK

Options

Debt

Description

- Perpetual (99 year) subordinated debentures (Tier 2A capital)
- Limited life (initial term greater than 5 years) subordinated debentures (Tier 2B capital)
- Innovative capital structures (Tier 1 capital)

Considerations

- Innovative capital structures are complex and expensive, and are unnecessary given the Bank's status as a registered charity
- Limited life Tier 2B capital can not exceed 50% of Tier 1 capital, and must be refinanced in short to medium term
- Perpetual and limited life subordinated debentures constitute Tier 2 capital, whereas Tier 1 capital is preferable, and it is mandatory that Tier 1 capital equal or exceed Tier 2 capital
- Perpetual and limited life subordinated debentures constitute debt, with potential interest cost and resultant increase in balance sheet leverage

Assessment

- Debt is undesirable from cost and balance sheet leverage perspectives
- Debt is also undesirable as constituting Tier 2 capital

ALTERNATIVES FOR FEDERAL GOVERNMENT CAPITALIZATION OF THE BANK

Options

Guarantee, Put or Other Support for Equity or Debt Issued to Third Parties

Description

- Guarantee of debt issued by Bank to third party or right of third party to put debt or equity issued by the Bank to the Federal Government
- Value of guarantee or put to Bank and to third party investor dependant upon terms of guarantee or put

Considerations

- Requires the Bank to find third party investors willing to invest on such terms, and risk of inability to do so
- Potentially very complicated, expensive means of raising capital (particularly put mechanisms)
- Debt issued by the Bank, even with benefit of Federal Government guarantee or put, still constitutes debt with adverse cost and balance sheet leverage concerns, and Tier 2 capital.

Assessment

- Undesirable due to complexity, expense and (re debt issued by the Bank) adverse cost and balance sheet leverage concerns, and Tier 2 capital status

Appendix

CAPITAL ADEQUACY UNDER THE BANK ACT

Capital Adequacy Ratios

- **Leverage Ratio:** the Bank's total assets divided by its total capital; generally can not exceed 20:1; OSFI will specify a much lower ratio at the outset, perhaps as low as 10:1
- **Risk-Weighted Asset Ratio:** the Bank's total capital divided by its aggregate risk-weighted assets; must exceed 10%; OSFI will specify a much higher ratio at the outset, perhaps as high as 20%
- **Capital:** the Bank's capital is key to both of these ratios, and is determinative of the Bank's lending capacity

Components of Capital

- **Tier 1:** common shareholder's equity, comprised of common share capital, contributed surplus and retained earnings, qualifying non-cumulative perpetual preferred shares (no retraction, obligation to redeem, redemption within the first 5 years, dividend step-up, right to cumulative dividends, or sinking or purchase funds); qualifying innovative capital instruments
- **Tier 2:**
 - Hybrid Instruments
 - Cumulative perpetual preferred shares (not retractable, redeemable after 5 years with the consent of the Superintendent)
 - Qualifying perpetual (99 year) debentures (unsecured, subordinated, not retractable, redeemable after 5 years with the consent of the Superintendent, non-compounding overdue interest, automatically converted to common or preferred share equity if retained earnings become negative)
 - Limited Life
 - Redeemable preferred shares (initial term of at least 5 years, not retractable within the first 5 years, redeemable within the first 5 years with the consent of the Superintendent)
 - Subordinated debentures or other debt instruments

Capital Restrictions

- Tier 1 capital must be equal to or greater than Tier 2 capital
- Innovative capital instruments and non-cumulative perpetual preferred shares may not exceed 25% of Tier 1 capital
- Innovative capital instruments may not exceed, at time of issuance, more than 15% of Tier 1 capital
- Limited life Tier 2 capital may not exceed more than 50% of Tier 1 capital