

Guidelines for Financial Institutions

Prudent Person Approach

Date: July 2004

Introduction

Under Section 15 of the Alberta Treasury Branches Act, ATB Financial “shall adhere to prudent loan and investment standards in making loan and investment decisions and in managing its total loans and investments. For the purposes of [the Alberta Treasury Branches Act], prudent loan and investment standards are those which, in the overall context of a loan and investment portfolio, a reasonable and prudent person would apply in making loan and investment decisions on behalf of another person with whom there exists a fiduciary relationship to make such decisions without undue risk of loss or impairment and with a reasonable expectation of fair return or appreciation. The fact that [ATB Financial] is in compliance with the other provisions of [the] Act and the regulations relating to loans and investments does not of itself mean that [ATB Financial] is in compliance with [this Section].” In addition, ATB Financial must comply with the statutory investment limits set out in the Alberta Treasury Branches Act and Regulation (see Appendix).

This guideline outlines factors that the management and the board of directors of ATB Financial are expected to consider in establishing investment and lending policies and in ensuring that they are effectively implemented. It is meant to serve as a guide and the provisions of the guideline should be adapted ATB Financial to reflect the activities and risks of its business. This guideline is consistent with the requirements of several of the Standards of Sound Business and Financial Practices issued by the Canada Deposit Insurance Corporation, including the standard on Securities Portfolio Management, and with Guideline B-1 issued by the Office of the Superintendent of Financial Institutions Canada.

Policy

ATB Financial is required to have written investment and lending policies. These policies should describe the objectives for the investment and lending programs and the overall risk philosophy of ATB Financial. They should take into account the strength of ATB Financial’s capital or retained earnings and its ability to absorb potential losses.

The policies should take note of the liability structure of ATB Financial and the anticipated demands for funds and address how maturity profiles are to be established on the portfolios of investments and loans in light of these demands. They should establish limits on ATB Financial’s exposure to a person or a group of associated persons and to interest rate and currency risk. In setting these limits ATB Financial should consider its exposure under a variety of potential scenarios.

Procedures

ATB Financial is required to have written internal procedures outlining how the investment and lending policies will be implemented and monitored. ATB Financial should ensure that the policies are implemented by persons, either on staff or under contract, who have the appropriate level of expertise. These procedures should address exposures arising from both on-balance sheet and off-balance sheet items.

The procedures should:

- identify responsibilities and accountabilities;
- set out the process for recommending, approving, and implementing decisions; and
- prescribe the frequency and format of reporting.

In addition, they should describe the method for classifying loans and investments and the basis for valuing loans and investments that are not regularly traded. There should be written procedures describing custodial arrangements of these assets.

Procedures should be in place to monitor and control ATB Financial's exposure to fluctuations in interest rates, foreign exchange rates, and market prices.

Potential sources of conflict of interest should be identified and procedures should be in place to ensure that those involved in the implementation of the investment and lending policies understand where these situations could arise and how they should be addressed.

Limits

The investment policy should identify acceptable ranges for investments in different types of instruments, including cash, equities, bonds and debentures, and real property. The lending policy should establish limits on aggregate outstanding loans by type of loan broken down by major category (e.g., commercial, consumer). These broad categories should be further subdivided as necessary; for example, mortgages could be subdivided between insured and uninsured mortgages and limits set accordingly.

The policy should set limits according to the source of loans where third parties such as mortgage brokers or syndications are relied upon. In addition, there should be an aggregate limit established on externally sourced loans.

ATB Financial should set limits on investments and loans according to their quality. For example ATB Financial may use ratings from recognized rating agencies in establishing quality criteria for their investments. Internal criteria would have to be established for non-rated investments. Similarly, internal criteria should be established for assessing the credit quality of borrowers.

Where applicable, limits should be established on exposures to industries and geographic regions.

ATB Financial should establish limits to contain the risks arising from potential changes in currency or interest rates. It should have policies outlining the circumstances in which derivative instruments can be used. In addition, it should establish limits on the use of derivative instruments by type of instrument (e.g., swaps, options, futures) and by counterparty.

Approval

At least annually, the board of directors of ATB Financial on the recommendation of a subcommittee appointed by the board should review and approve the investment and lending policies and is advised in writing of adherence to these policies. Deviations should be reported immediately. The board or subcommittee may delegate the responsibility for the day to day implementation and monitoring to management; however, ultimate responsibility rests with the board.

Maintaining Information

ATB Financial will be expected to maintain information on its portfolios presented in a manner that facilitates analysis, for example:

- a comparison of outstanding amounts against the limits established in its policies;
- an analysis of asset quality and concentration;
- an analysis of its interest rate and maturity mismatch, including the results of scenario testing as appropriate; and
- an analysis of the diversification of its funding sources.

APPENDIX

Category	Definition	Existing ATB Regulation Reference	Limit/Restriction
Real Estate Investments	<ul style="list-style-type: none"> - Includes any interests acquired by ATB and its subsidiaries in real property; or any improvements to real property which ATB or its subsidiaries has an interest in. - Property acquired through realization of a security interest is EXEMPT from this restriction for a period of 7 years from date of acquisition. 	Section (5)	<ul style="list-style-type: none"> - Cannot exceed 3.5% of the assets of ATB and its subsidiaries.
Equity Investments	<ul style="list-style-type: none"> - Includes: a) all participating shares of a corporation beneficially owned by ATB or its subsidiaries; orb) an ownership interest by ATB or its affiliates in an unincorporated entity; orc) ATB or its affiliates acquiring control of a corporation that beneficially owns shares or ownership interests referred to in clauses a) or b) above - In calculating beneficial ownership of participating shares of a corporation, no regard shall be taken of the ownership of shares in a corporation referred to in Section 19 (4) of the Act. 	Section (6)	<ul style="list-style-type: none"> - Aggregate value of all shares and ownership interests beneficially owned by ATB and its subsidiaries cannot exceed 3.5% of the assets of ATB and its associates. - This limit is also subject to the restrictions set out in the Combined Limitation Restriction.
Combined Limitation	<ul style="list-style-type: none"> - Includes situations where ATB and/or its subsidiaries have both Real Estate Investments and Equity Investments as defined in this Guideline. 	Section (7)	<ul style="list-style-type: none"> - Aggregate value of Real Estate Investments plus Equity Investments plus Trustee Powers as prescribed in Section (4) of ATB Regulations shall not exceed 5% of the assets of ATB and its subsidiaries.
Connected Persons	<ul style="list-style-type: none"> - A person is connected to another person if: a) the person is an affiliate of the other person; orb) in respect of a loan to or an investment in those persons: i) the loan or investment is for the same purpose, in whole or in part; ii) the expected source of repayment of the loan or investment is the same in whole or in part; iii) the security for the loan or investment is the same in whole or in part. - For the purposes of this guideline, a "loan" includes a guarantee. - Notwithstanding sections (a) and (b) above, persons who are financially independent of each other to a material extent are not considered connected persons for the purpose of this guideline. 	Section (8)	<ul style="list-style-type: none"> - The Aggregate of: <ul style="list-style-type: none"> a) the outstanding balance of principal and interest owing under loans other than guarantees; b) the face value of guarantees; and c) the book value of investments shall not exceed 1% of the assets of ATB.

Mortgage Investments	- ATB may purchase a mortgage or make a loan on the security of a mortgage on improved real estate in Alberta subject to the limitations noted herein.	Section (9)	Unless the mortgage investment is guaranteed or insured under the National Housing Act (NHA), or under similar terms or conditions by a Provincial or Federal Government agency, then the amount paid for or advanced on the investment mortgage must not exceed 75% of the market value of the real estate at the time the investment mortgage was purchased or granted.
Out of Province Syndicated Loans	- Includes participation by ATB in syndicated loan transactions involving corporations/borrowers who have operations or business dealings within the Province of Alberta, but whose head office is located outside of Alberta.	Section 9.2	Aggregate of syndication participations is not be exceed 10% of the non-consumer loan portfolio of ATB.

For more information, call **1-800-332-8383**, or visit any branch of ATB Financial. To locate the branch nearest to you, please use our [Branch Locator](#).

