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# CANADA

## FINANCIAL SECTOR ASSESSMENT PROGRAM

January 2020

## TECHNICAL NOTE—DEPOSIT-TAKING SECTOR: REGULATION AND SUPERVISION

This Technical Note on Financial Safety Net and Crisis Management for the Canada FSAP was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in May 2019.

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January 9, 2020

# TECHNICAL NOTE

## DEPOSIT-TAKING SECTOR: REGULATION AND SUPERVISION

Prepared By
**Monetary and Capital Markets Department**

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program that visited Canada in October 22–November 14, 2018. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at http://www.imf.org/external/np/fsap/fssa.aspx

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## Glossary

| | |
|---|---|
| AMF | Autorité des marchés financiers |
| AML | Anti-Money Laundering |
| BA | Bank Act |
| BC | British Columbia |
| BCBS | Basel Committee for Banking Supervision |
| BCSC | British Columbia Securities Commission |
| BCP | Basel Core Principles |
| BOC | Bank of Canada |
| C1 | Credit Union Central 1 |
| Can$ | Canadian Dollar |
| CDIC | Canada Deposit Insurance Corporation |
| CET1 | Common Equity Tier 1 |
| CFT | Combating Financing of Terrorism |
| CUDIC | Credit Union Deposit Insurance Corporation |
| CUPSA | Credit Union Prudential Supervisors Association |
| CMHC | Canada Mortgage and Housing Corporation |
| D-SIB | Domestic-Systemically Important Bank |
| D-SIFI | Domestic-Systemically Important Financial Institution |
| DSB | Domestic Stability Buffer |
| DTI | Deposit-taking Institution |
| ERC | Emerging Risk Committee |
| FBB | Foreign Bank Branch |
| FCAC | Financial Consumer Agency of Canada |
| FE | Financial Entity |
| FRE | Federally Regulated Entity |
| FICOM | Financial Institutions Commission |
| FinCoNet | International Financial Consumer Protection Organization |
| FINTRAC | Financial Transactions and Reports Analysis Centre of Canada |
| FISC | Financial Institutions Supervisory Committee |
| FMI | Financial Market Infrastructure |
| FRFI | Federally Regulated Financial Institutions |
| FSAP | Financial Sector Assessment Program |
| G-SIB | Global-Systemically Important Bank |
| HELOC | Home Equity Line of Credit |
| HoA | Heads of Agencies |
| ICAAP | Internal Capital Adequacy Assessment Process |
| IFRS | International Financial Reporting Standards |
| IRB | Internal Ratings Based |
| LCR | Liquidity Coverage Ratio |
| LTV | Loan-to-Value |
| MER | Mutual Evaluation Report |

| | |
|---|---|
| MoU | Memorandum of Understanding |
| NCCF | Net Cumulative Cash Flow |
| NPL | Nonperforming Loan |
| OSFI | Office of the Superintendent of Financial Institutions |
| PD | Probability of Default |
| RCAP | Regulatory Compliance Assessment Program |
| RSS | Risk Support Sector |
| RWA | Risk-Weighted Assets |
| SAC | Senior Advisory Committee |
| SMSBs | Small- and Mid-Sized Banks |
| TLCA | Trust and Loan Companies Act |
| TN | Technical Note |

# EXECUTIVE SUMMARY

**The Financial Sector Assessment Program (FSAP) conducted a focused review that primarily assessed the regulatory and supervisory frameworks through the lens of housing market-related risks.[1]** This thematic focus was chosen given sizeable mortgage exposures and persistent housing market imbalances. The review evaluated oversight of deposit-taking institutions (DTIs) in federal jurisdiction, as well as British Columbia and Québec—the two provinces that host large credit unions. The review also followed up on the main recommendations of the 2014 Basel Core Principles for Effective Banking Supervision (BCP) assessment (see Annex 1).

**The main DTIs are banks and credit unions.** All banks are regulated by the Office of the Superintendent of Financial Institutions (OSFI). Although the regulation allows for federally regulated credit unions, almost all credit unions are still provincially regulated. In British Columbia, the provincial supervisor, the Financial Institutions Commission (FICOM), oversees 42 credit unions with total assets of over Can$77 billion as of end-2017. In Québec, the Autorité des marchés financiers (AMF) oversees Desjardins Group (a network of caisses populaires) with assets of Can$275 billion, and a small stand-alone financial services cooperative. Seven institutions dominate the DTI sector and account for 84.7 percent of total DTI sector assets.

**The 2014 FSAP's findings that OSFI's supervision of banks is effective with a high level of compliance with (BCP) remain valid.** OSFI takes a conservative, risk-based approach to supervision that reflects the nature, size, complexity and risk profile of institutions. Its supervisory approach is well-structured and forward-looking, has solid foundation for consolidated and cross-border supervision, and appears adaptive to changing conditions. In addition to its close collaboration with relevant foreign supervisors, OSFI regularly conducts on-site inspections of significant overseas operations. Furthermore, OSFI practices "close touch" supervision and emphasizes the accountability of the board and management for the overall soundness of institutions. However, its informal approach that expects institutions to keep OSFI informed whenever issues arise may not work as well when the system comes under stress.

**There remain a number of areas which fall short of full compliance with the BCP, including some that have endured from 2014.** These include: OSFI's lack of de jure independence (BCP 2), an incomplete fit and proper process for new Board appointments (BCP 5), lack of powers over transfer of significant ownership (BCP 6), and limited monitoring of large exposures and related parties (BCPs 19 and 20). In addition, and related to the transfer of significant ownership, and related-parties exposures, the definition of significant interest should be broadened to capture indirect ownership and significant influence.

[1] This Technical Note was prepared by Dirk Jan Grolleman (IMF) and Toby Fiennes (IMF short-term expert) under guidance of Phakawa Jeasakul (FSAP deputy mission chief). The review was conducted as part of the 2019 Canada FSAP led by Ghiath Shabsigh (FSAP mission chief). The review reflects the regulatory and supervisory frameworks as per November 9, 2018.

**AMF is resourced for their role and maintains high regulatory and supervisory standards, but FICOM has struggled to perform its role effectively.** AMF has introduced the Basel III framework and has implemented a risk-based approach to supervision. AMF adheres to international standards and has developed a harmonized approach aligned as much as possible with the federal regime to ensure a level playing field across major Canadian DTIs. A key challenge arises from the dominance of Desjardins, which limits AMF's benchmarking ability. FICOM lacks operational independence and sufficient resources. While its supervisory practices are sound, FICOM has not been able to introduce formal Basel III requirements. The proposed legislative change would help address these weaknesses.

**While coordination and cooperation work well between federal as well as between provincial authorities, the federal-provincial nexus needs further enhancement.** There are many good, well-functioning mechanisms in place for cooperation. Areas that warrant improvement with regard to DTI regulation and supervision include policy development, especially between OSFI and AMF, coordination of data collection, and exchange of useful prudential information between different agencies. The authorities should explore how to remove barriers that prevent close and meaningful cooperation.

**Some unique features of the Canadian residential mortgage market need to be more accurately reflected in prudential settings.** One example is the five-year contractual period for mortgages. International Financial Reporting Standards 9 (IFRS9) expected credit losses may not be adequate from a prudential perspective as they are based on contractual maturity and do not take into account the amortization period and possible related renewal risk: a Pillar 2 add-on could be appropriate. For the same reason, the inflows in the Liquidity Coverage Ratio (LCR), which assume a 50 percent roll-over rate, may not be sufficiently prudent. In addition, OSFI's primary focus on consolidated supervision should be complemented by better monitoring of credit and liquidity risks of material licensed entities.

**Risk weights on mortgage lending appear too low for insured mortgages and may not be sufficiently through-the-cycle for banks using the Internal Ratings Based (IRB) approach.** The regulatory frameworks do not account for important exclusions from mortgage insurance coverage, such as lender-facilitated fraud and earthquake damages. Standardized risk weights are zero and most large banks' IRB models do not take sufficient account of the exclusions. While the IRB banks' residential mortgage models otherwise appear to be consistent with the IRB minimum requirement, they have some features that generate fairly strong procyclical effects. For example, some important inputs to the probability of default (PD) correlate positively with the economic cycle. The authorities should review and adapt their model approval frameworks to limit the variability of risk weights through the economic cycle.

**A common forbearance definition and monitoring framework for credit risk (in the context of loan restructuring by DTIs) should be adopted across all jurisdictions in Canada.** A similar definition, in line with the guidance of the Basel Committee for Banking Supervision (BCBS), and consistent data will help improve risk monitoring especially given the importance of debt restructuring for managing problem real estate exposures. Finally, OSFI's guideline on asset pledging should ensure sufficient unencumbered assets to support the claim of depositors.

**Table 1. Canada: Recommendations on Regulation and Supervision of Deposit-taking Institutions**

| Recommendation | Priority | Timeframe |
|---|---|---|
| Institutional arrangements, and coordination and cooperation | | |
| Remove remaining barriers and improve the coordination and cooperation between federal and provincial supervisors and other relevant agencies. (OSFI, AMF, other provincial regulators) ¶*82* | H | I |
| Embed OSFI's independence by codifying the "prudential veto" in the Bank Act (BA) so that the framework is robust to changes in personnel and culture. (OSFI, MoF) ¶*28, Annex 1* | H | NT |
| Modernize the institutional arrangements, granting FICOM autonomy and operational independence and the ability to move forward on the implementation of the Basel III framework and other relevant regulatory reforms. (BC MoF) ¶*72, 73* | H | I |
| Remove legislative prohibitions for FICOM to share information with the BOC. (BC MoF) ¶*82* | H | I |
| Capital, credit risk and provisioning | | |
| Disallow the PD substitution method by IRB banks for insured residential retail as the insurance contracts are not unconditional. (OSFI) ¶*40* | H | NT |
| Revise IRB model approval frameworks for residential mortgages to reduce the impact of point-in-time inputs, so that risk weights vary as little as possible with the economic cycle. (OSFI, AMF) ¶*41* | H | NT |
| Revise the zero credit risk weight used under the Standardized Approach for insured residential real estate exposures, given that these contracts are not unconditional (i.e. they contain exclusions). (OSFI, AMF, FICOM) ¶*39, 75, 78* | M | NT |
| Assess, as part of the from a prudential perspective, whether IFRS9 Expected Credit Losses (ECL) are adequate (e.g., using stress-testing exercises under Pillar 2) as IFRS ECL are based on contractual maturity and do not take into account the amortization maturity and possible related renewal risk. (OSFI, AMF, FICOM) ¶*38* | M | NT |
| Enhance the monitoring and supervision of forbearance by introducing a standardized definition, aligned with the Basel Committee on Banking Supervision's (BCBS's) guideline, and prudential reporting. (OSFI, AMF, FICOM) ¶*37* | M | NT |
| Liquidity risk | | |
| Assess whether the inflows in the LCR (assuming a 50 percent roll-over rate) and Net Cumulative Cash Flow (NCCF) framework are prudent considering the nature of banks' residential mortgage portfolio and the difference between contractual and amortization maturity. (OSFI, AMF, FICOM) ¶*46* | H | I |
| Establish LCR requirements for the main Canadian entities as well as Canadian-dollar liquidity monitoring tools. (OSFI) ¶*45* | M | NT |
| Review and enhance the regulatory framework for Central One. (FICOM) ¶*76* | M | NT |

**Table 1. Canada: Recommendations on Regulation and Supervision of Deposit-taking Institutions (concluded)**

| Recommendation | Priority | Timeframe |
|---|---|---|
| Regulatory framework and reporting | | |
| Review and update the large exposure guideline in line with the BCBS standards as well as introducing a large exposure prudential report. (OSFI) ¶26, Annex 1 / Introduce a large exposure guideline and prudential reporting. (AMF) ¶*67* | M | NT |
| Continue to monitor and engage with the industry on the implementation of the revised Corporate Governance Guideline. (AMF) ¶*68* | M | NT |
| Enhance the pledging guideline by including a prior notification or approval requirement for secured borrowing when a certain threshold is reached, assuring that DTIs retain sufficient uncollateralized assets to support the claims of the depositors. (OSFI) ¶*43* | M | NT |
| Introduce a formal process for vetting and approving new Board members. (OSFI) ¶*49, Annex 1* | M | NT |
| Improve the significant interest and related party definition in the BA and consider requiring more regular prudential reporting of related-party exposures. (OSFI) ¶*26, Annex 1* | L | NT |
| Supervisory framework | | |
| Review, in absence of the power to impose administrative penalties, whether the current supervisory approach gives sufficient weight to AML/CFT non-compliance observations. (OSFI) ¶*52* | M | NT |

Note: Institutions in the parenthesis are the agencies with responsibilities. In terms of priories, H, M, and L stand for high, medium and low. In terms of time frame, I, NT, and MT stand for immediate (within one year), near-term (within 2–3 years), and medium-term (within 3–5 years).

# INTRODUCTION

## A. Scope and Approach

1. **The 2014 assessment recognized Canada's very high level of compliance with the BCP.** On the regulatory side the continued high-level of compliance is confirmed in the Regulatory Compliance Assessment Program (RCAP) as conducted by the BCBS in their review of the risk-based capital standards (October 2014) and the LCR standard (October 2017).

2. **Canadian supervisory authorities are participating actively in international financial sector standard setting bodies.** For example, OSFI is an active participant in the BCBS and the International Association for Insurance Supervisors (IAIS) and played a leading role in the Financial Stability Board (FSB) working group on governance frameworks to mitigate misconduct risk. The Commissioner of the Financial Consumer Agency of Canada (FCAC) is currently the chair of the International Financial Consumer Protection Organisation (FinCoNet), and AMF is an active member of the IAIS as well as FinCoNet.

3. **Macrofinancial vulnerabilities, although have declined in recent years, remain substantial.** Canada has experienced elevated household debt and housing market imbalances. Analytical work of the Bank of Canada (BOC) as published in its Financial System Reviews highlights these two factors as key vulnerabilities for the financial system (see Figures 1 and 2 for household financial soundness and housing market developments).

4. **While providing an overview of the main developments since 2014, the FSAP took the approach to assess the Canadian DTI regulation and supervision framework through the lens of housing market risks.** As part of the 2014 FSAP, a full BCP assessment was conducted. The current review followed up on the 2014 recommendations, but instead of a full assessment focused on the regulation and supervision of exposures directly or indirectly relating to residential and commercial real estate. In taking this approach, it was decided not to focus only on federally regulated banks, but to take a more holistic view on the supervision and regulation of Canadian DTIs, covering federal and provincial supervisory authorities. In this context provincial supervisory authorities of British Columbia and Québec—the two provinces that host large credit unions—were selected.

5. **This Technical Note discusses the main observations and recommendations as a result of the review of DTI regulation and supervision in Canada.** The Technical Note first describes the institutional setup relating to DTI supervision and provides a brief overview of the DTI market structure. The Technical Note then discusses the main observations and recommendations regarding the federal and provincial supervisory frameworks with a focus on residential real estate exposures as well as the cooperation and coordination arrangements between OSFI and the provincial supervisory authorities. An overview of the status of the recommendations of the 2014 BCP assessment is provided separately in Annex 1.

**6. The assessors are grateful to the authorities and private sector participants for their excellent cooperation**. The authors benefitted greatly from the inputs and views expressed in meetings with regulators, supervisors, DTIs, and professional organizations. The team sincerely thanks OSFI, AMF and FICOM staff for their professionalism, spirit of cooperation, and for making enormous efforts to respond to the team's requests and overcome logistical challenges.

# INSTITUTIONAL SETTING

## A. Supervisory Responsibilities, Objectives, and Powers

**7. On a federal level Canada has six agencies with distinct and complementary mandates related to regulation and supervision of DTIs.**

- **The Minister of Finance:** responsibility for all matters relating to the financial affairs of Canada, including the overall stability of the financial system. The Minister of Finance has overarching authority over federal financial sector legislation, including the governing legislation that establishes the mandates and powers of federal financial sector regulatory agencies. The Department of Finance supports the Minister in fulfilling this mandate (see: http://www.fin.gc.ca/fin-eng.asp).

- **The Bank of Canada (BOC):** Canada's central bank has four main areas of responsibility: monetary policy, currency, financial system, and funds management. The BOC promotes the stability and efficiency of the Canadian financial system by providing liquidity; overseeing key domestic payments, clearing and settlement systems; participating in the development of financial system policies in Canada and globally; and assessing risks to the overall stability of the financial system.

- **The Office of the Superintendent of Financial Institutions (OSFI):** OSFI is an agency of the Government of Canada established in 1987 to contribute to public confidence in the Canadian financial system. OSFI supervises and regulates all banks and federally regulated life and property and casualty insurers, trust and loan companies, cooperative credit associations, fraternal benefit societies and private pension plans subject to federal oversight (http://www.osfi-bsif.gc.ca). OSFI is also responsible for reviewing and monitoring the safety and soundness of Canada Mortgage and Housing Corporation's (CMHC) commercial activities. CMHC is a Crown corporation that offers mortgage insurance and securitization products to Canadian lenders (http://www.cmhc-schl.gc.ca).

- **The Canada Deposit Insurance Corporation (CDIC):** Canada's federal deposit insurer and resolution authority for federally regulated deposit-taking institutions which includes banks, federally and provincially regulated trust and loan companies, federally regulated retail cooperative credit associations and federal credit unions. CDIC is an agent of Her Majesty in right of Canada and is a Crown corporation, established in 1967 by the *Canada Deposit Insurance Corporation Act*. (http://www.cdic.ca).

- **The Financial Consumer Agency of Canada (FCAC):** a federal regulatory body working to protect financial customers by overseeing federally regulated financial entities and by strengthening the financial literacy of Canadians (http://www.fcac-acfc.gc.ca).

- **The Financial Transactions and Reports Analysis Centre of Canada (FINTRAC):** Its mandate is to facilitate the detection, prevention and deterrence of money laundering and the financing of terrorist activities. It is Canada's financial intelligence unit and undertakes supervision of reporting entities to verify that they comply with their obligations.

8. **On a provincial level the institutional settings and regulatory frameworks vary.** In British Columbia, FICOM is responsible for prudential and conduct supervision of credit unions, insurance companies and trusts of provincially regulated financial entities (FEs), while the British Columbia Securities Commission (BCSC) is responsible for securities market surveillance and conduct. FICOM is also the administrator of the provincial Credit Union Deposit Insurance Corporation (CUDIC), a statutory corporation, funded by the industry. In Québec, AMF is a fully integrated regulatory authority (responsible for prudential as well as conduct supervision, with a focus on the following areas: client services and compensation, DTIs and insurance companies, distribution of financial products and services as well as securities) and is also responsible for the administration of the provincial deposit insurance scheme, which is guaranteed by the Government of Québec.

## B. Interagency Cooperation Mechanisms

9. **At the federal level, several mechanisms have been created to facilitate cooperation and information sharing across the various agencies.** These mechanisms aim to ensure ongoing dialogue and to enhance the stability of the financial system. Important inter-agency committees relevant for regulation and supervision of federally regulated DTIs are:

- **The Financial Institutions Supervisory Committee (FISC):** established in 1987, is mandated in the *Office of the Superintendent of Financial Institutions Act* to facilitate consultation and the exchange of information on matters relating to the supervision of financial institutions between OSFI, CDIC, the BOC, FCAC, and the Department of Finance. FISC provisions contained in the OSFI Act provide that every member of the committee is entitled to any information on matters relating directly to the supervision of financial institutions, bank holding companies or insurance holding companies that is in the possession or under the control of any other member. The Superintendent of Financial Institutions chairs the committee. It meets at least quarterly, and more often as needed. Among other roles, FISC is responsible for coordination and communication amongst federal agencies with respect to strategies and action plans for addressing problem financial institutions and other emerging issues that may have an impact on the financial system, as well as ensuring the effective coordination of responses to events and requests.

- **The Senior Advisory Committee (SAC):** A committee chaired by the Deputy Minister of Finance with participation from the same regulatory agencies as FISC. SAC acts as a discussion forum for financial sector policy issues, including financial stability and systemic vulnerabilities. The Committee allows for an exchange of views among financial sector agencies on specific financial sector policy issues and risks in order to inform the advice provided to the Minister of Finance on legislative, regulatory, and policy issues affecting the financial sector. When appropriate, other government agencies are invited to this discussion (e.g., the CMHC).

- **The CDIC Board of Directors:** The CDIC Act sets out the composition and responsibilities of the CDIC Board of Directors which is responsible for governing the organization and making decisions and/or recommendations on the use of resolution tools for federally-regulated member institutions. The Board comprises the Deputy Minister of Finance, the Governor of the BOC, the Superintendent of Financial Institutions, a Deputy Superintendent of Financial Institutions, the Commissioner of the Financial Consumer Agency, and six others drawn from the Canadian private sector, including the Chair. Use of some of CDIC's resolution tools requires the approval of the Minister of Finance and/or the Governor-in-Council (Cabinet).

- **The Heads of Agencies (HoA) Committee**: chaired by the Governor of the BOC and includes the Department of Finance, OSFI, and four provincial Securities Regulators (the Ontario Securities Commission, AMF, Alberta Securities Commission, and BCSC). This forum allows federal authorities and provincial securities market regulators to exchange information and views, and to coordinate actions on issues of mutual concern such as hedge funds and over-the-counter derivatives.

The bodies outlined above are supported by the efforts of separate working-level sub-committees, as a further layer of collaboration between agencies.

**10. The provincial prudential regulators and deposit insurance corporations cooperate through the Credit Union's Prudential Supervisors Association (CUPSA).** CUPSA exists to promote effective regulation and supervision of Canadian credit unions. The forum allows for the exchange of policy and supervisory framework developments as well as other prudential issues. A Memorandum of Understanding (MoU) is in the process of being finalized to formalize the information exchange on this platform.

## C. Deposit-taking Institutions

**11. The Canadian framework allows for different types of DTIs.** Generally, the framework distinguishes between banks, trust companies, loan/savings companies and credit unions, which are known in Québec as *caisses populaires*.

**12. The Bank Act (BA) distinguishes different types of banks.** Banks can only be licensed at the Federal level. The BA distinguishes between licensed Canadian banks (Schedule I), foreign bank subsidiaries (Schedule II), and foreign bank branches (Schedule III). Foreign bank branches (FBBs) have the same powers and are subject to the same restrictions as banks, except for the fact that a foreign bank branch does not have the ability to take a material amount of retail deposits (i.e., deposits of less than Can$150,000). A "full-service" foreign bank branch is permitted to accept deposits in Canada of Can$150,000 or greater (section 545) and a "lending" foreign bank branch is generally prohibited from accepting deposits. Banks may not carry out certain activities reserved for other federally regulated financial institutions (FRFIs) (e.g., trustee activities are exclusive to trust companies).

**13. The permitted activities of federal trust and loan companies are defined in the Trust and Loan Companies Act (TLCA).** Permitted activities of trust and loan companies are similar to those of banks, but there are some differences. Trust companies are the only DTIs able to act as a trustee in Canada. Unlike banks, they are subject to a limit on their commercial lending. Loan companies are also subject to a limit on their commercial lending (e.g., lending to small and medium enterprises and corporates) activities and are precluded from engaging in trust (fiduciary) activities. The commercial lending limit established in the TLCA is 5 percent of total assets. However, for companies with a regulatory capital of Can$25 million or more the Superintendent may approve a higher limit. Federal prudentially regulated trust and loan companies also need to be licensed by the regulatory authority responsible for the conduct supervision of the province, in which they operate and as such are subject to a dual regulatory and supervisory framework.

**14. The provincial regulatory frameworks for trust and loan companies varies.** For example, in Ontario all loan and trust corporations must be federally incorporated in order to register to conduct business and the Financial Services Commission is responsible for the registration of federally incorporated loan and trust corporations that wish to conduct business in Ontario. On the other hand, British Columbia allows for the incorporation of provincial trust companies (which are however not authorized to take deposits) for which the FICOM will act as the primary regulator. Federally or in other provinces licensed trust companies can also get permission to operate in British Columbia. In this situation FICOM acts as the secondary (responsible for conduct) regulator. Québec has a similar framework, but in addition allows the provincial incorporation of savings companies, which are more or less the provincial equivalent of federally regulated loan companies. However, provincially incorporated deposit-taking trust and loan/savings companies appear to be immaterial as a percentage of total DTI system assets.

**15. Credit unions can be licensed provincially as well as federally.** In 2014 the BA was amended to facilitate the entry of provincially regulated credit unions into the federal regime. Federally regulated credit unions are allowed to perform the same activities as banks. At the time of the review only one credit union had used the opportunity to become federally regulated.[2] All other credit unions are regulated at the provincial level. Although the provincial regulatory frameworks of the two provinces reviewed allow for the licensing of extraterritorial provincial credit unions, this only appears to occur to a limited extent.

[2] Shortly after the assessment, a second credit union received a federal license.

# MARKET STRUCTURE

**16. Consolidated DTI assets (including foreign subsidiaries) totaled about Can$6,012 billion (Table 2), representing 364 percent of GDP at end-2017.** Federally regulated banks (86), trusts and loan companies accounted for the majority (92 percent) of total DTI sector assets. Provincially regulated credit unions (254 credit unions and 271 caisses populaires) accounted for the remaining 8 percent. More than a third of Canada's population is a member of at least one credit union. Credit union membership is most common in Québec and in the western part of Canada. As of end-2017, the credit unions held Can$308 billion in deposits/savings, of which Can$120 billion was held by caisses populaires in Québec,[3] and Can$66 and Can$44 billion by the credit unions in British Columbia and Ontario respectively.[4]

**17. In total there are 43 federally licensed trust companies and 18 federally licensed loan companies.** A large proportion of these are subsidiaries of banks and insurance companies. Stand-alone (not part of a Canadian banking group) and foreign owned trust and loan companies represent less than 1 percent of total DTI sector assets. Consolidated financial indicators of provincially regulated loan and trust companies are not readily available, but it appears that the size of this market segment is not material.

**18. The DTI sector is highly concentrated.** The top 6 banks plus Desjardins account for 84.7 percent of total DTI sector assets. In March 2013, OSFI designated six of the federally regulated banks as D-SIBs. Besides these D-SIBs, the Québec-headquartered provincially regulated financial group, Desjardins Group, has also been designated in 2013 as a D-SIFI by AMF. Desjardins Group (including its insurance activities) is slightly larger than the sixth largest bank in Canada and accounts for approximately 4.6 percent of total DTI sector assets.

**Table 2. Canada: DTI Assets Overview**

| | In billion Canadian Dollars | | | | | As a percentage of total | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2013** | **2014** | **2015** | **2016** | **2017** | **2013** | **2014** | **2015** | **2016** | **2017** |
| Total DTI Assets 1/ | 4444 | 4873 | 5487 | 5723 | 6012 | 100% | 100% | 100% | 100% | 100% |
| o/w federally regulated DTI assets 2/ | 4,066 | 4,467 | 5,051 | 5,265 | 5,524 | 91.5% | 91.7% | 92.0% | 92.0% | 91.9% |
| o/w the top 6 banks | 3,727 | 4,111 | 4,657 | 4,853 | 5,097 | 83.9% | 84.4% | 84.9% | 84.8% | 84.8% |
| o/w provincially regulated DTI Assets | 377.8 | 405.5 | 436.6 | 457.2 | 487.5 | 8.5% | 8.3% | 8.0% | 8.0% | 8.1% |
| o/w Desjardins Group | 212 | 229.4 | 248.1 | 258.4 | 275.1 | 4.8% | 4.7% | 4.5% | 4.5% | 4.6% |

Sources: OSFI, Canadian Credit Union Association, and IMF staff estimates.
1/ consolidated (worldwide) assets of Canadian licensed entities
2/ including one federally regulated credit union as of end 2016

[3] This does not include any deposits or assets held by the Desjardins Federation.

[4] Source: Canada Credit Union Association (https://www.ccua.com).

**19. The Canadian D-SIBs are also large by international standards.** Five of the 6 D-SIBs are among the top 75 banks as determined by the Basel III leverage ratio exposure measure as and part of the sample used by the BCBS for the global systemically important bank (G-SIB) assessment. As a result of this exercise, the Financial Stability Board identified the Royal Bank of Canada as a G-SIB in November 2017.

**20. While Desjardins Group operates mainly in Québec, the top Canadian D-SIBs have large international operations concentrated primarily in the United States.** Several D-SIBs position themselves as North-American banks rather than as Canadian banks. The second largest bank behind Royal Bank of Canada is among the top ten banks in the United States and its U.S. retail revenue accounts for almost 30 percent of its total revenue. One of the D-SIBs has a somewhat different profile in that it has significant operations in Latin America and Asia Pacific.

**21. Canada's banking system is well capitalized and profitable with low Non-Performing Loans (NPLs).** Canada and its banks weathered the global financial crisis well, putting them in a strong competitive position after the crisis and allowing them to expand and fill the gaps left by other international banks that needed to reorganize their operations. In addition, their performance is supported by strong earnings, driven by the economic growth in their home markets, and historically low NPLs in the Canadian market.

**22. The business lines of the D-SIBs are mainly built around retail, commercial banking and wealth management and to a lesser extent around proprietary trading activities**. D-SIB residential and commercial real estate exposure totaled about Can$1.5 trillion and Can$235 billion, respectively, accounting for approximately 29.4 and 4.6 percent of D-SIB total assets as of end-2017. Residential retail portfolios (overwhelmingly Canadian and United States) are the largest exposure class of the D-SIBs.

# DEPOSIT-TAKING INSTITUTION SUPERVISION

## A. Federal Deposit-taking Institution Supervision

### Supervisory Approach65

**23. The 2014 assessment's conclusion that OSFI's supervision is effective and of a high standard remains valid.** OSFI takes a risk-based and conservative approach to supervision that reflects the nature, size, complexity and risk profile of the institution. When an institution is found to have a material weakness, it is subject to increased and more intense supervision. OSFI engages on a regular basis with members of the board of directors, key management personnel, and bank staff. OSFI conducts in-depth onsite visits, using a mix of specialist staff and supervisors with more intimate knowledge of the institution. The supervisory approach is well structured, has a solid foundation in consolidated and cross-border supervision, is forward looking and appears to be adaptive to changing conditions.

**24. OSFI has experienced supervisors, who are in close communication with the supervised entities.** Communication between OSFI senior staff and the banks is frequent and open and occurs at all levels. OSFI expects to be informed by bank management whenever issues arise. However, this informal approach to information flows is vulnerable to staff turnover at the banks and OSFI and may not work as well when the system comes under stress.

**25. There remain several areas where reporting and notification obligations could be made more formal or more frequent**. For example, currently there is limited formal reporting with regard to related-party transactions and large exposures (see also Annex 1).[5] In addition, regulatory reporting is largely based on consolidated positions, leaving it to the supervisor to determine and obtain from the institution the necessary more detailed underlying information. While this process appears to work well for the supervision of individual banks, it seems to sometimes limit the ability to analyse aggregate figures across the industry as format and definition of financial information obtained may vary bank by bank.

**26. The statutory framework governing OSFI provides comprehensive powers and operational flexibility and has been interpreted to grant OSFI de-facto independence.** While OSFI lacks the authority present in some other jurisdictions to issue its own legally enforceable regulations, it has effectively worked around the absence of this authority through the use of guidelines (backed up by enforceable instruments), which banks view as equivalent.

**27. The framework would be stronger if OSFI's independence were more explicitly embedded in the legislation.** The BA provides the Minister of Finance with the authority to override the prudential judgment of OSFI in some key areas. Broadly, Ministerial approvals are required at significant institutional moments, meaning the creation, change of control, merger or failure of a bank. While this has not proved to be a problem in practice, the supervisory framework would be even stronger if the legislation was amended to ensure that when OSFI rejects a transaction on prudential grounds, such a decision cannot be overridden by the Minister except under extraordinary circumstances and with full public disclosure.

**28. The legislative framework and guidelines are regularly updated.** All financial sector legislation includes provisions requiring review and renewal five years from enactment. Unless an amendment is passed, the legislation authorizing banks to conduct business lapses due to a sunset clause, presenting a strong discipline upon government to keep to the timetable. There is consultation on prospective necessary or desirable changes during the review period. An overview of the main legislative changes and new or updated guidelines since the 2014 FSAP is incorporated for reference in Annex 2. The overview is indicative of the efforts of the Canadian authorities to keep the framework up to date and be at the forefront of the implementation of the global regulatory reform agenda.

[5] After the assessment, OSFI published in April 2019 a Large Exposure Guideline for D-SIBs (implementation date November 2019).

## Supervision of Mortgage Exposures

**29. OSFI closely monitors Canadian mortgage exposures.** OSFI's Emerging Risk Committee (ERC), chaired by an Assistant Superintendent, convenes quarterly to review major risks to their mandate and decide on any actions to take in response. Residential mortgage risk has featured high on the risk register for some years, and this is reflected in the attention paid to the risk in their engagement with all levels of supervised DTIs.

**30. OSFI has taken a number of useful and proactive initiatives to monitor and reduce the risk in DTIs' housing exposures.** OSFI's updated B20 guideline sets expectations for DTIs' residential mortgage underwriting. B20 was updated in October 2017 to include a prescribed stress test for borrowers,[6] resulting in a tightening of the underwriting standards. OSFI reviewed the implementation of B20 with a cross-sector review, starting with a self-assessment followed by a review of DTIs' residential underwriting and supporting policies. The next phase of the project will focus on effectiveness testing. DTIs clearly pay heed to the B20 guideline and the principles outlined in the document. OSFI also undertook a hypothetical portfolio exercise, based on data at December 2017, assessing the consistency of D-SIBs' risk weights across a hypothetical portfolio. OSFI should consider fine-tuning and repeating this exercise on a regular basis while housing market vulnerabilities remain high; and explore the variations in RWAs between D-SIBs further. While RWA differences may be explained by differences in underlying risk, and hence desirable, there may also be dispersion due to differences in practices. While not all practice-based differences are "undesirable", these practices should in principle not produce material differences for similar risks.

## Capital Adequacy Regulation

**31. Canada displayed a high level of compliance with Basel standards in the 2014 RCAP.** Since then OSFI has continued to proactively implement changes in international capital standards. The one area which scored largely compliant was the definition of capital: preference shares are eligible as additional tier 1 capital in Canada even though they do not have a going-concern principal loss absorption feature. This remains the case but did not result in a non-compliant rating. OSFI has continued to implement Basel III as it has developed. They have mandated disclosure requirements under Pillar 3. In addition to its consolidated capital requirements, OSFI expects D-SIBs to hold capital within the consolidated group in a manner that is consistent with the level and location of risk.

**32. OSFI has implemented a risk-weighted assets (RWA) floor for IRB banks at 72.5 percent of standardized RWAs.** For IRB banks, they have replaced the previous risk weight floor of 90 percent of Basel I RWAs with a floor of 72.5 percent of Basel III standardized RWAs. They plan to increase this to 75 percent in 2019. No bank is currently impacted by the floor.

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[6] OSFI's B20 Guideline sets out OSFI's expectations for prudent residential mortgage underwriting. Originally issued in 2012 and since updated, it articulates five fundamental principles for sound residential mortgage underwriting. The first principle relates to the lender's own internal governance, the next three relate to the credit decision and the underwriting decision, and the final one relates to risk management including mortgage insurance where applicable.

**33. OSFI has implemented the Basel capital buffers and run a full and systematic review of the Internal Capital Adequacy Assessment Process (ICAAP).** OSFI apply a conservation buffer of 2.5 percent to all banks and an additional 2.5 percent for all D-SIBs (consisting of a 1 percent D-SIB buffer and a 1.5 percent Pillar 2 Domestic Stability Buffer (DSB)), all on the consolidated basis. The countercyclical capital buffer has not been activated, however, the DSB acts as a kind of countercyclical capital buffer, but only applies to D-SIBs. There is no additional buffer for the single Canadian G-SIB. OSFI's ICAAP process is thorough and systematic. Their annual process requires the banks to propose a Pillar 2 add-on, the input to which includes a risk appetite statement, capital planning and stress testing. OSFI reviews this material, comparing the results across the industry.

**34. DTIs are monitored against a prescribed institution specific leverage ratio.** OSFI introduced its leverage ratio guideline in 2014 and is currently in process of updating it in line with the finalized Basel III standard (see Annex 2). While the guideline specifies a minimum requirement of 3 percent, OSFI prescribes institution specific leverage ratio requirements for individual DTIs (corresponding with the DTI's business model and capital target). These leverage ratios are communicated to individual institutions on a bilateral basis. The prescribed leverage ratio is considered supervisory information and is not permitted to be disclosed.

**Credit Risk Regulation and Supervision**

**35. OSFI undertake active, risk-based supervision of credit risk.** OSFI employ skilled credit risk professionals for their significant activity reviews. Specialized staff in the Risk Support Sector (RSS) department and a pool of credit consultants provide support on credit risk monitoring and supervision as well as on model validation for the D-SIBs. The responsible supervisory teams perform the credit risk monitoring and supervision for small and mid-sized banks (SMSBs).

**36. Collecting consistent information on loan forbearance would further enhance and support OSFI's credit risk monitoring and supervision.** Although in practice banks are required to have policies regarding forbearance, OSFI has not issued guidance on the definition of forborne exposures or regulatory reporting thereof. The BCBS issued guidance in 2017 on the prudential treatment and definition of nonperforming exposures and forbearance.[7] Collecting information on forbearance in banks' portfolios on a consistent basis helps to keep track of institution specific and system-wide developments. At the same time, applying the BCBS definition would make figures collected for Canadian banks comparable to other international banks. While refinancing and restructuring may not be an issue at this point of the economic cycle, market participants explained that restructuring would be an important tool for managing risks in banks' mortgage portfolio.

**37. The provisioning requirements are based on IFRS.** Canada implemented IFRS 9 on January 1, 2018. While amortization schedules of (commercial and residential) real estate contracts are based on longer term horizons (for residential mortgages 25–30 years), the mortgage contracts are based on the interest period. For prime residential mortgages the market standard would be

[7] BCBS, Prudential treatment of problem assets – definition of nonperforming exposures and forbearance (April 2017).

5 years, while for Alt-A it would usually be a shorter maturity. Under IFRS 9 the lifetime losses in stage 2 and 3 are calculated based on the contractual maturity as it assumes that renewal is at the discretion of the lender. In a downturn scenario this assumption may not hold. It would be advisable to consider the implications from a prudential perspective in for example stress-testing exercises under Pillar 2.

**38. Credit risk weights for insured residential real estate exposures do not fully capture the residual risks.** Banks should be required to hold capital to cover the risk of non-payment of mortgage insurance. None of the three regulators covered in the review (OSFI, FICOM and AMF) require risk weights under the Standardized Approach that do this adequately. All three regulators accord a zero risk weight to mortgages insured by or securitizations guaranteed by the Canada Mortgage Housing Corporation (CMHC—a Crown Corporation of the Canadian government) because it is seen as sovereign risk. There are, however, important exclusions from CMHC's cover (and similarly in those of private mortgage insurers), including lender-facilitated fraud and damage from certain natural hazards, including earthquakes. There are also limitations to CMHC coverage of recovery costs and the time value of money. These exclusions, and its resulting residual risk, are not captured in the risk weights under the Standardized Approach.

**39. The exclusions in the insurance contracts are also relevant for IRB banks when modeling the PD and loss given default (LGD) of insured mortgages.** OSFI currently appears to allow banks to apply the guarantor/PD substitution method for modelling the PD of insured mortgages, meaning that the PDs are modelled on the default risk of the CMHC (which is considered equivalent to Canadian sovereign risk). It appears that banks however make no adjustment for the exclusions. In addition, PD substitution would only be appropriate if the payment by the guarantor is unconditional,[8] which given the presence of exclusions is not the case. The effect of the insurance could still be considered in the LGD. However, also in this case OSFI should assure that the potential losses from the exclusions are properly reflected in the LGD.

**40. IRB banks' residential mortgage PD estimation models appear to exhibit point-in-time rather than through-the-cycle characteristics.** Except for the use of PD substitution for insured mortgages these models appear to be consistent with the Basel IRB minimum requirements. IRB banks' residential mortgage models have some features which can generate fairly strong procyclical effects in an economic downturn. For example, some important inputs to the PD, such as the Beacon score and current default rates, correlate positively with the economic cycle. Also, some models will every year add the most recent year's data which produces a trend of falling PDs during benign times, resulting in PD "erosion". OSFI and AMF should review how they could adapt their model approval frameworks (e.g. by requiring the use of stressed data to compensate for the lack of recent downturn data, or by setting floors on PDs that reflect regulator-set stress parameters) to reduce the

[8] The Basel framework does not allow to take conditional guarantees into account under the Standardized Approach and Foundation Internal Ratings Approach. Under the Advanced Internal Ratings Based Approach, the Basel Framework makes an exception in this regard (see BSCBS, International Convergence of Capital Measurement and Capital Standards, June 2006, paragraph 484), however, this exception is only applicable for LGD modelling.

impact of point-in-time inputs, so that risk weights are structurally less likely to vary with the economic cycle.

**41. IRB commercial real estate mortgages risk weights are in line with Basel Standardized Approach, as are risk weights on residential real estate U.S. business.** Commercial real estate mortgages carried an average risk weight of 54 percent which compares to a minimum 60 percent under Basel III. Some Canadian banks have U.S. subsidiaries active in the U.S. mortgage market. For these banks, the risk weights average around 30 percent and appear to vary appropriately across the portfolios.

**42. The regulatory framework contains limits for covered bonds, however similar limits or guidelines regarding collateralized (wholesale) borrowing are not in place.** OSFI's guideline set a limit of four per cent (4 percent) of the total assets for covered bonds. DTIs have to notify the Superintendent if this limit is breached and, unless due to reasons outside the DTI's control, provide a remediation plan. The limit provides assurance that sufficient assets are available to support the claims of retail depositors. While OSFI's pledging guideline (guideline B11) requires banks to have prudent internal policies and limits for pledging of assets, it does not set a similar (or a combined) limit for other secured borrowing as for covered bonds. At a minimum OSFI should review the guideline by adding a prior notification or approval requirement for secured (wholesale) borrowing to provide more assurance and a better view on the availability of assets to support the claims of retail depositors.

### Liquidity and Market Risk Regulation and Supervision

**43. The 2017 RCAP concluded that OSFI achieve a high level of compliance with Basel liquidity standards.** There was only one comment in the RCAP and that was for the BCBS to clarify a technical point. OSFI and AMF have consulted on implementation of the Net Stable Funding Ratio, which they have been monitoring informally on a quarterly basis since 2015.[9]

**44. Nevertheless, OSFI should increase its focus on Canadian dollar liquidity and on solo banking entities.** OSFI currently sets requirements on a consolidated basis; for the regulatory LCR, all currency positions are converted to Canadian dollar and reported on a consolidated basis. Canadian dollar-equivalent positions are also reported for select individual currencies (Can$, USD, EUR, GBP, and JPY). Currency-specific LCR figures are monitored, although there are no minimum requirements. OSFI's alternative liquidity measure, Net Cumulative Cash Flow (NCCF), excludes select USD subsidiaries from consolidated reporting due to ring-fencing concerns. They are monitored separately with stand-alone requirements. Like capital, in times of crisis liquidity can be trapped in foreign subsidiaries as result of ringfencing. Minimum liquidity requirements on a solo level provide protection against such measures. OSFI should develop minimum liquidity requirements for the main solo banking entities in the group as well as Canadian dollar liquidity monitoring for the main Canadian entities.

[9] After the assessment, OSFI published the final guideline (implementation date January 1, 2020) in April 2019.

**45. While LCR requirements are consistent with Basel III standards, the unusual contractual nature of home loans in Canada means a more conservative approach is warranted.** Most Canadian mortgages are contractually limited to five years or less, even though the amortization schedule is calculated over a longer time period—25 or 30 years. In practice, most loans are renewed at the end of the contractual period. At the banks and credit unions, this retention ratio is generally around 90 percent whereas at the Alt-A lenders, such as certain trust companies, it may be closer to 50 percent (at least in benign market circumstances). For LCR and other liquidity metric purposes, OSFI (and AMF) permit the mortgage maturity to be recorded as a cash inflow—in line with the contract. The regulators should review this: if the loan is not refinanced elsewhere (or paid off), there will be no cash inflow. In particular, in less benign times when mortgage availability for lower quality borrowers is very limited, lenders will not be able to count on the possibility of such borrowers refinancing. For the system as a whole, the LCR metrics may materially overstate the liquidity position. However, NCCF reporting and limits set by OSFI exclude all cash inflows from maturing mortgage principal. For brokered retail deposits, a funding source on which some institutions experienced market pressures, OSFI applies run-off rates in line with the Basel LCR standards.[10]

**46. OSFI monitor the D-SIBs' market and interest rate risk in the banking book (IRRBB), and market risk requirements are consistent with Basel 2.5.** The D-SIBs all operate under internal models, and OSFI's well-qualified staff have a program of close engagement. IRRBB is monitored (like market risk on a consolidated basis) as part of this process. The D-SIBs have repositioned their IRRBB exposure considering central banks' aim to normalize monetary policy. OSFI reviews the models that D-SIBs use to calculate, monitor and manage IRRBB and market risk. While capital market-related activities (including intermediary business for clients) account at some banks for up to 25 percent of revenues, the actual market risk exposures of the D-SIBs are limited; well below 10 percent RWA (varying between 3 and 7 percent). Trading book positions related to real estate are limited (well below 10 percent of the total trading book).

### Nonfinancial Risks

**47. OSFI is in the process of rethinking the organization of its RSS.** In keeping at the frontier of international developments and practices, OSFI is in the process of rethinking the set-up of the RSS. The reset will give a more explicit position to non-financial risk next to financial risk, and in addition strengthen the role of risk and data analytics (including with supervisory technology tools). The reset has not been finalized, but it is indicated that the non-financial risk group would contain operational risk, technology risk, model risk and governance and culture. While this is still work in progress, it is indicative of OSFI's ambition to be at the frontier of international best practice and to tailor these practices to its own approach and Canadian market conditions.

[10] The liquidity adequacy requirements guideline requires brokered retail deposits to be categorized as less stable retail funding, which has a run-off under the existing framework of 10 percent. However, given run-off experiences in the market, OSFI has finalized in 2019 changes to its Liquidity Adequacy Requirements guideline to reflect higher run-off rates, depending on the characteristics of these deposits.

**48. OSFI is reviewing its approach to governance and culture.** OSFI initially issued its Corporate Governance Guideline, building on the Basel Principles for Corporate Governance for Banks, in 2013, with a revised version in September 2018. While OSFI has fit and proper powers in its relevant statutes which it can apply when needed, vetting/approval of all new board members and new senior management executives (see also Annex 1) is an informal process. For OSFI's work related to culture assessments, the focus so far has been on understanding the risk culture of institutions and how it drives behavior that supports or undermines effective risk management. In pilot risk culture reviews conducted since 2014, OSFI has shared its observations with institutions. The way in which the culture of an organization should feed into the assessment of the risk profile of an institution will be considered including whether it informs the effectiveness ratings of other risk mitigants (e.g., Board Senior Management, and Risk Management).

**49. The governance and culture division would also be involved in assessing FRFIs' conduct risk management frameworks.** In 2017 OSFI and FCAC conducted a concurrent assessment of banks' retail sales practices. In line with its risk-based approach, OSFI reviewed in this assessment the risk management framework and Board oversight frameworks that banks have in place for conduct risk. Discussion with staff indicated that internal guidance and awareness on how conduct risk can be incorporated in risk assessments could be enhanced.

**50. Following-up on the Mutual Evaluation Report (MER) issued in September 2016,[11] FINTRAC and OSFI enhanced their coordination of anti-money laundering and combating the financing of terrorism (AML/CFT) supervision.** Starting in 2013 OSFI and FINTRAC put in place a concurrent approach to AML/CFT supervision in order to coordinate their AML/CFT supervisory activities and minimize the burden for the supervised entities. In this model both agencies issued separate letters with their observations and findings. Since 2015/16 OSFI and FINTRAC have been piloting joint examinations and providing a joint supervisory letter with the observations and recommendations of the on-site examination. The pilot period ends in 2018, and FINTRAC and OSFI are currently in the process of evaluating the joint examination approach.

**51. OSFI has no powers to impose administrative sanctions for non-compliance with AML/CFT requirements or other requirements.** The 2014 BCP assessment and the MER recommended changing the BA to provide OSFI the power to impose penalties for non-compliance with OSFI's guidelines relating to AML/CFT compliance and fitness and probity measures. In practice OSFI will flag observed non-compliance to FINTRAC, who holds the authority to impose administrative monetary penalties for violations of the Proceeds of Crime (Money Laundering) and Terrorist Financing Act and associated regulations. There may be an indirect penalty in that, when OSFI assesses non-compliance to be a material deficiency. This could result in OSFI staging the institution, resulting in higher annual fees for OSFI's supervision as well as higher CDIC deposit insurance fees. There is however a risk that non-compliance observations regarding AML/CFT are not directly captured in OSFI's risk-based supervisory framework. While recognizing that the approach Canada has taken has its merits and in the absence of administrative sanctioning powers,

[11] Issued by the Asia/Pacific Group, a regional Financial Action Task Force (FATF) style body.

OSFI should review how it incorporates and weighs AML/CFT non-compliance observations in its supervisory approach.

**52. The Canadian authorities have issued a national strategy for cyber security.** The Government of Canada announced as part of Budget 2018 the creation of the Canadian Centre for Cyber Security (the Cyber Centre) and will be responsible for the coordination of the execution of the cyber strategy. The Cyber Centre will amongst other matters consolidate the work of the Canadian Cyber Incident Response Centre and will be housed within the Communications Security Establishment. While the banking sector appears to have informal arrangements for sharing of incidents, a more formalized approach like that developed by the industry in the United States ("Sheltered Harbor") has not been put in place yet.

**53. The supervision of cyber risk and increasing the resilience of the banking system is high on OSFI's agenda.** OSFI introduced in 2017 requirements for major incidents reporting. As part of its supervisory approach the operational/technology risk team monitors in particular the D-SIBs and selected SMSBs. In 2017/18 OSFI conducted a cross-sectoral cyber security review at 12 institutions, using an innovative scenario approach. Cross-sectoral work on cyber risk, goes back to 2013 when OSFI requested the industry to conduct a cyber self-assessment, followed by an on-site cyber risk management review in 2014.

**54. OSFI issued its revised Operational Risk Management Guideline in June 2016.** The guideline formalizes and consolidates OSFI's operational risk management expectations and outlines principles for effective operational risk management. As it is principles based, the expectations can be scaled to reflect the nature and complexity of institutions. OSFI has a separate guideline, published in 2001 and revised in 2009, for outsourcing. The risk management principles included in this guideline are more broadly applied by OSFI to third party risk management. A cross sector review of third-party risk management and possible refreshing of the outsourcing guideline is foreseen in the next fiscal year.

**55. As for the other specialized risks, the operational risk division focusses its attention on the D-SIBs and large SMSBs.** Over the past 18 months OSFI conducted 18 operational risk-related on-site activities, mainly focused on D-SIBs and large SMSBs. The activities cover varying topics like outsourcing, IT governance, operational risk management framework, change management and fraud. The operational risk division is leading the work for the large D-SIBs and advices the lead supervisor on the recommendations and rating of operational risk in the overall risk assessment. OSFI's supervisory approach recognizes operational risk is a component of all significant activities and it is assessed within each of those activities. Where IT support functions are recognized as a significant activity at the institution this is reflected as a separate activity line. Operational risk management as a second line/challenge function is also scored within risk management.

### Financial Consumer Agency of Canada (FCAC)

**56. The FCAC supervises FRFIs' compliance with consumer protection measures.** In addition, it promotes financial education and raises consumers' awareness of their rights and responsibilities. In total the FCAC has about 125 staff of which 27 are working in supervision, covering 376 FRFIs. FCAC is in the process of implementing a new supervisory framework that adopts a more risk-based approach. The approach distinguishes between Tier 1 (higher inherent risk) and Tier 2 (lower inherent risk) institutions. Banks and payment card network operators are generally included in Tier 1.

**57. The current consumer protection law does not contain "sound lending" or "best interest" provisions and only allows administrative penalties in case specific breaches of federal consumer legislation.** Proposals for new legislation to expand the scope of FCAC's role were announced in November 2018. The overall intent of the proposals and a concomitant increase in FCAC's resources would further strengthen FCAC's to effectively fulfill its mandate.

**58. Recognizing potential conduct issues in relation to the high level of household indebtedness the FCAC conducted several thematic reviews and studies.** Most recently, the FCAC published in June 2017 a study on conduct issues and information gaps in home equity lines of credit (HELOCs), and in March 2018 its findings on the cross-sectoral examination of banks' retail sales practices. The review of banks' retail sales practices was conducted concurrently and in close cooperation and coordination with OSFI (FCAC focusing more on identifying and evaluating risks to consumers and OSFI on banks' governance and risk culture).

**59. The Province of Québec has been proactive in addressing conduct risk.** Québec has established an Office of Consumer Protection which sets and monitors enforceable requirements around responsible provision of financial services. In addition, AMF has introduced the Sound Commercial Practices Guideline (2013), which is applicable to DTIs and it also integrated conduct risk in its supervisory framework.

## B. Provincial Deposit-taking Institution Supervision

**60. As part of the scope of the review, the structure and nature of prudential supervision of provincially regulated DTIs in British Columbia and Québec were assessed**. In British Columbia, FICOM supervises the country's largest stand-alone credit union and Vancouver has seen rapidly rising house prices in recent years. In Québec, AMF prudentially supervises Desjardins Group, a credit union cooperative with a balance sheet of about Can$275 billion (as of end-2017), larger than one of the D-SIBs.

### Autorité des Marchés Financiers (AMF)

**61. AMF is Québec's integrated financial sector regulator.** Established in 2004 under the Loi sur l'Autorité des marchés financiers (AMF Act), AMF regulates, in an integrated manner, nonbank deposit-taking, insurance, securities and derivatives. It is also the deposit insurer for the DTIs for which it is lead supervisor. The Act was updated in June 2018.

**62. AMF is operationally independent and has budgetary autonomy in practice.** AMF is able to put in place guidance for deposit-takers within its own authority. It is a self-funded institution, its funding coming from market participants, in part based on the time spent on each institution. Under s47 of the AMF Act, AMF must submit its budget estimates to the Minister of Finance for government approval. While this could compromise the regulator's independence, in practice successive Québec governments appear to have respected AMF's autonomy.

**63. Resources at AMF have increased since the 2014 FSAP and appear adequate for deposit-taking supervision.** AMF has increased staff in the Solvency Department, responsible for prudential supervision from 95 to 102, and in the deposit-taking directorate from 20 to 24. Turnover is low, and staff appear to have appropriate skills and experience. They have a well-developed infrastructure for data collection and a strong data analytics function.

**64. The dominance of Desjardins Group in the prudential DTI supervisory function presents challenges for resourcing and for concentration risk.** The Desjardins Group dominates the deposit-taking supervisory activities of the deposit-taking directorate. Both AMF and Desjardins Group understand the importance for public and market confidence of a strong regulatory regime. While AMF is aware and has put in place internal controls, the risk of regulatory capture is in principle heightened because it is not possible to move professional staff to supervise a different large DTI (as is commonly done in larger supervisory authorities such as OSFI). Finally, Desjardins Group supervisors do not oversee any peer institutions and so are mainly reliant on information from public sources or from OSFI for comparisons.

**65. AMF maintains high regulatory and supervisory standards, aligning as much as possible with international standards and with the federal regime.** AMF has introduced the Basel III framework and has a risk-based supervisory approach. AMF follows BSBC guidance and aligns its regulatory framework with the federal regime to ensure a level playing field for DTIs in Canada. For instance, it has introduced the Residential Hypothecary Guideline that is equivalent to the B20 Guideline (OSFI) as well as the ICAAP. In other cases, such as the RWA Floor, the AMF requirements present some variations that are the result of a different context and approach. Like OSFI, AMF employ skilled credit risk professionals for their loan book reviews.

**66. AMF set no large exposure limits although this is in practice not an issue for Desjardins Group.** There are no large exposures limits, either in the AMF Act or in AMF guidance. They intend to address this in the near future and will seek to coordinate with OSFI's review of their Large Exposures framework.

**67. AMF updated its governance guideline in line with the Principles for Corporate Governance issued in July 2015 by the BCBS.** The guideline clearly articulates and explains best practices, such as the separation of the role of the Chair of the Board from the Chief Executive

Officer. The Québec financial sector is in the process of adjusting its corporate governance structures to bring it in line with the issued guideline.

**68. Despite minor weaknesses identified above, potential risks are mitigated by the strong financial position of the Desjardins group.** Desjardins Group has a common equity tier 1 ratio of around 17.5 percent, well in excess of the required 8.0 percent, which number includes the capital conservation buffer (2.5 percent) and a D-SIFI add-on (1 percent). The AMF Act respecting Financial Services and Cooperatives contains a provision (s547.31 and s547.32) that makes all member caisses liable for the debts of the others. Thus, there is no vulnerability of depositors to the failure of an individual caisse provided Desjardins Group remains well-capitalized.

### Financial Institutions Commission (FICOM)

**69. FICOM has a broad supervisory mandate and oversees the credit union sector in British Columbia.** FICOM is responsible for prudential and market conduct supervision of all provincially-regulated entities in British Columbia. This includes 42 credit unions with total assets of over Can$77 billion.[12] FICOM is the regulator of Central One Credit Union (C1), an entity that provides services to credit unions in British Columbia and Ontario as well as to other central credit unions across Canada. British Columbia credit unions must hold deposits with C1 equal to the lower of 8 percent of their liabilities or 1.5 percent of British Columbia system-wide assets. While British Columbia credit unions are allowed to conduct similar activities as banks, their commercial lending is limited by the Financial Institutions Act of British Columbia to 30 percent of their total assets (exposures above 30 percent are risk-weighted with an additional 150 percent. Exposures above 35 percent are risk-weighted at 200 percent).

**70. FICOM also oversees the trust companies that operate in British Columbia.** In total 52 trust companies operate in British Columbia of which 46 are extra-provincially registered and six hold a primary license in British Columbia, but these six are not allowed to take deposits. Most extra-provincial trust companies are subsidiaries of larger financial institutions. In addition, FICOM also oversees insurance companies operating in British Columbia.

**71. FICOM's current institutional settings likely fall short of compliance with Basel Core Principles.[13]** They lack operational independence, being situated within the British Columbia Ministry of Finance. They have struggled to attract and retain adequate resources which is probably due in part to public sector pay constraints. The governing legislation, the Financial Institutions Act of British Colombia lacks flexibility, with key requirements set in primary legislation. For example, FICOM has been unable to introduce formal Basel III capital and liquidity requirements, even though

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[12] Shortly after the assessment, one of the larger provincially-regulated credit union became a federally regulated credit union, bringing the total number of credit unions overseen to 41. As of December 2018, the total assets of the 41 amount to USD 63.5 billion.

[13] Important weaknesses are identified and documented in the 2014 report on the supervision of credit unions by the Auditor General of British Columbia.

in practice it has started the implementation of Pillar 2 and reporting and monitoring of the LCR and the NCCF.

**72. Proposed legislative changes would help address these weaknesses.** The British Columbia government has announced the intention to establish FICOM as an independent Crown agency in in 2019. As well, other changes to FICOM's powers are being contemplated, including changes to provide the regulator with rule-making authority. In preparation of these reforms FICOM has conducted a self-assessment, supported by an external advisor, on the compliance with the BCP and Insurance Core Principles. The overall direction of the proposed changes is positive.

**73. FICOM has sound supervisory frameworks and committed, professional staff.** FICOM's risk-based framework is modelled on OSFI's. FICOM also runs housing market stress tests every two years. A structural lack of resources (28 vacancies on about 111 positions as of March 2018) has meant that they have not always completed the work in a timely manner—the average time between completion of an onsite review and communication of the findings to the regulated entity has been six months. However, the supervisory approach and method of identifying issues are sound. Despite their resourcing challenges, FICOM retains a core of committed and professional staff.

**74. Capital requirements for credit unions in British Columbia have some weaknesses.** As well as the need to move to a more Basel-III-type regime, which would be facilitated by legislative change (see above), the British Columbia risk weight requirements are too low in some important respects. The Financial Institutions Act sets risk weights at 0 percent for CMHC insured mortgages. This is the same as OSFI sets for banks but, for British Columbia housing exposures, it may be even less appropriate, given that mortgage insurance does not cover earthquake damage, a hazard to which British Columbia is vulnerable.

**75. The regulatory framework around C1 creates vulnerabilities.** Credit union exposures to C1 are zero risk-weighted. This does not appear to be appropriate, given that C1 is a private organization with no government guarantee. Because of its role in provision of clearing and settlement services to, and holding deposits for, credit unions, it is a systemically important financial market infrastructure (FMI) for the sector. Operationally, the funds deposited under both the British Columbia and Ontario liquidity pools are jointly managed under one strategy, distinct from the funds deposited with the Wholesale Financial Services business. However, legally the funds in both business lines are comingled under the ownership of C1. The member credit unions require these deposits be held in high quality liquid assets. However, in a crisis, and in the event C1's balance sheet was impaired, there is no framework in place for the timely and full repayment of credit unions' deposits, nor for allocating available funds among credit unions. Finally, it appears that there is no clear procedure for allocating C1's liquidity across credit unions in the event that several credit unions made requests for liquidity support around the same time.

### Differences Across the Three Main Regulators: OSFI, AMF, and FICOM

**76. OSFI and AMF apply standardized risk weights in line with Basel III standards, although FICOM are currently constrained from their legislation from doing so.** OSFI and AMF have applied Basel III risk weights to standardized DTIs. FICOM's risk weights on residential mortgages are based on Basel I and are generally consistent with, or more conservative than, Basel III. One area of divergence is that FICOM applies a 35 percent risk weight to residential development loans against the Basel III standardized 100 percent.

**77. FICOM's risk weights on privately-insured mortgages do not properly reflect the risk of default.** For the private mortgage insurers (where the Government covers 90 percent of the risk to the lender of counterparty default), OSFI adjusts the risk weights accordingly, but FICOM accord zero risk weights even for the 10 percent that is not covered by the federal government guarantee.

## C. Cooperation and Coordination

**78. Federal agencies cooperate and coordinate with each other well in practice.** Close and effective cooperation is observed between federal agencies whose respective mandates require it. For example, FINTRAC and OSFI have been piloting coordinated onsite AML/CFT visits, focusing on their areas of expertise and interest, while alerting each other if they identify issues of concern. OSFI and FCAC undertook a concurrent (see paragraph 51) investigation into banks' retail sales practices (see paragraph 59).

**79. The federal coordination mechanisms appear to be working effectively.** Information on prudential supervision is shared through FISC and policy developments are discussed in the SAC. The same federal institutions participating in the FISC and the SAC are also a member of the Board of the CDIC, which plays an important role in handling failing DTIs. In addition at the top level, coordination and communication at the working level take place through different working groups and informal communication.

**80. Cooperation and coordination between provincial regulators also appear well-developed.** The provincial regulators have established forums and mechanisms for keeping each other informed and promoting a consistent approach to the regulation of deposit-takers. The CUPSA meets quarterly and there is regular information exchange.

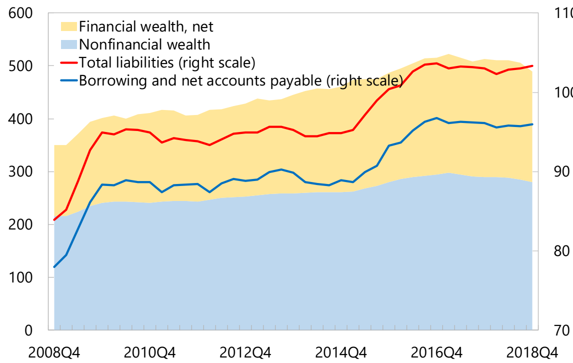
**81. Coordination between federal and provincial agencies needs further development**. It appears that staff at provincial and federal regulators can work well together informally but this is not consistent. On the policy front, there are material inconsistencies between federal and provincial regulations which can risk regulatory arbitrage. For example, four provinces provide unlimited deposit insurance for their credit unions while deposit insurance for federally-regulated DTIs has a limit. OSFI's B20 guidance that introduced stressing for residential mortgage borrowers was not fully communicated in advance to provincial authorities, nor has it subsequently been adopted by all regulators. Of particular concern is that OSFI does not share prudential data with AMF, given that Desjardins Group faces into similar markets and risks as the large Canadian banks. For their supervision of Desjardins Group, AMF would benefit from richer information on D-SIBs and the broader market. The current level of information flows inhibits detailed comparisons between Desjardins Group and the D-SIBs. Finally, FICOM is unable to share prudential data with authorities such as the BOC. As a result of the underdeveloped federal-provincial relationship there is no single authority that has a system-wide view on the DTI sector in Canada. The federal and provincial authorities should look for means of removing the barriers that prevent close and meaningful cooperation and adopt a more formalized framework for cooperation and information sharing.

**82. Some federal / provincial cooperation works well.** FINTRAC has MoUs with the relevant provincial regulators. Good coordination and communication between FINTRAC and FICOM are observed. AMF has established a MoU with FINTRAC, while MoUs and working relationships with the BOC and CDIC have also been established for crisis management purposes.

## Figure 1. Canada: Household Financial Soundness

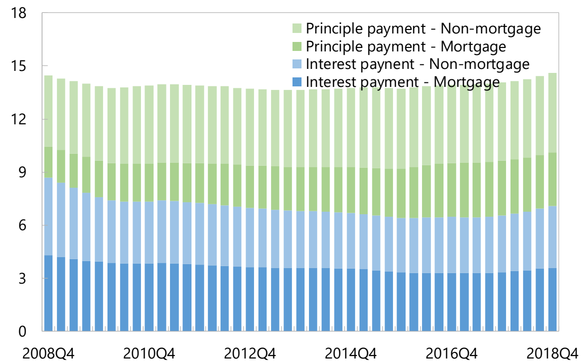
*The increase in household debt is significant, albeit concurrently with the increase in household wealth.*

**Household Indebtedness and Wealth, 2008-18**
(In percent of GDP)



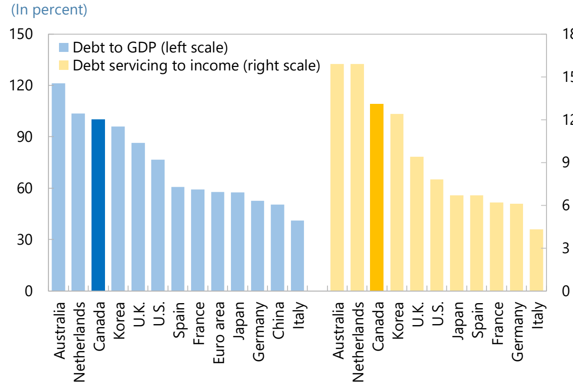

*Debt-servicing to income has been stable, though interest payment at a historically low level.*

**Household Debt-Servicing, 2008-18**
(In percent of disposable income)



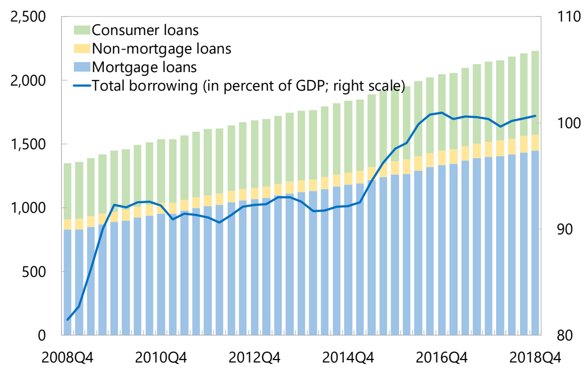

*Canadian households are among the most indebted, and their servicing obligations are also relatively high.*

**Household Indebtedness and Debt Servicing, 2018Q2**
(In percent)



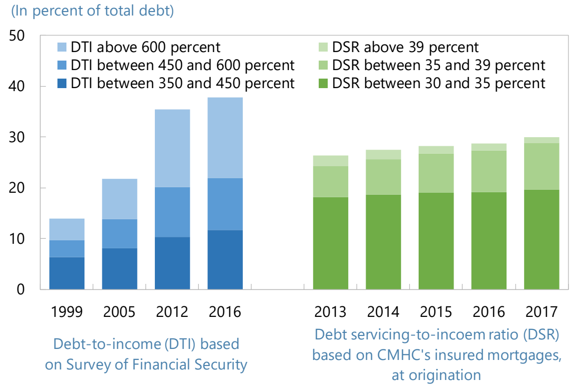

*Household borrowing has been largely driven by mortgage loans in recent years.*

**Household Borrowing, 2008-18**
(In billions of Canadian dollar)



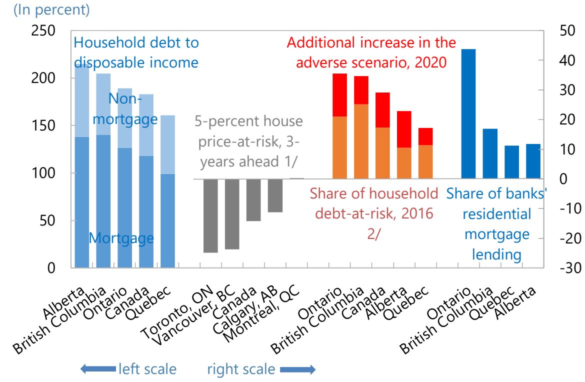

*Debt of financially weak households has gained a larger share over the past decade.*

**Debt of Financially Weak Households, 1999-2017**
(In percent of total debt)




*British Columbia and Ontario face more heightened financial stability risks given their larger household debt-at-risk and downside risk to house prices.*

**Housing Market Related Vulnerabilities By Regions**
(In percent)




Sources: CMHC; Haver Analytics; Statistics Canada, Survey of Financial Security; and IMF staff estimates.

1/ The 5-percent house price-at-risk measures a potential decline in real house prices (year-on-year) three years ahead with a 5 percent probability.

2/ Financially weak households are defined as households whose debt servicing-to-income is above 40 percent. Debt of these financially weak households is considered at risk.

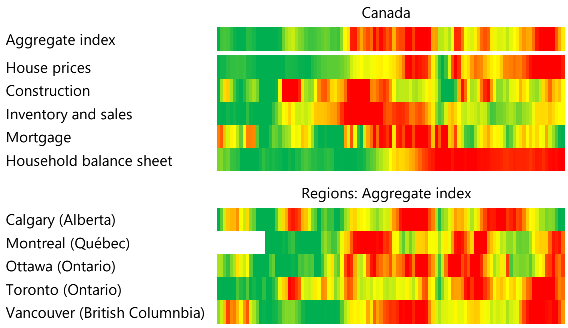
## Figure 2. Canada: Housing Market Developments

*Housing market imbalances have been driven by over-valued house prices and household financial weaknesses.*

*House prices became more stabilized in the past two years. Immigrations appear to be an important driver of rapidly rising housing prices in some regions.*

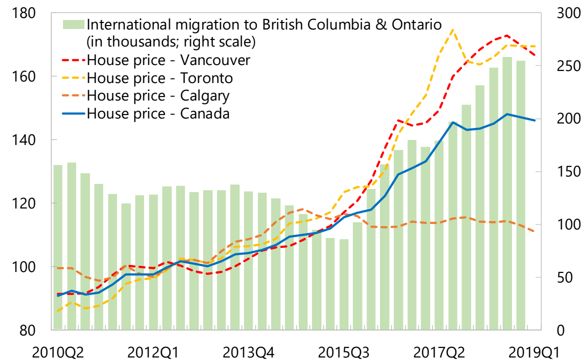
### Housing Market Imbalances, 1992-2018

Housing market imbalances index based on the z-score, comprising house prices, construction, inventory and sales, mortgage, and household balance sheet 1/




### Housing Market Development, 2010-19

(2012=100)

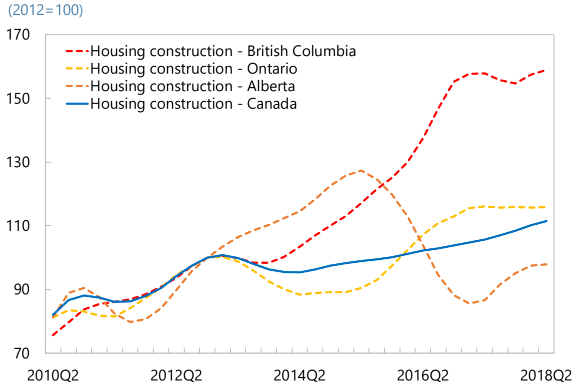



*A construction boom is evident in British Columbia, while Alberta saw a boom-bust cycle driven by oil prices.*

*The slowdown in residential mortgage lending is largely led by the decline in insured mortgages.*

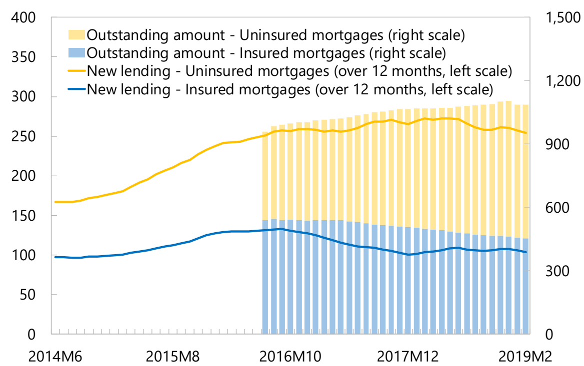
### Construction Activity, 2010-18

(2012=100)




### Banks' Residential Mortgage Lending, 2014-18

(In billions of Canadian dollar)

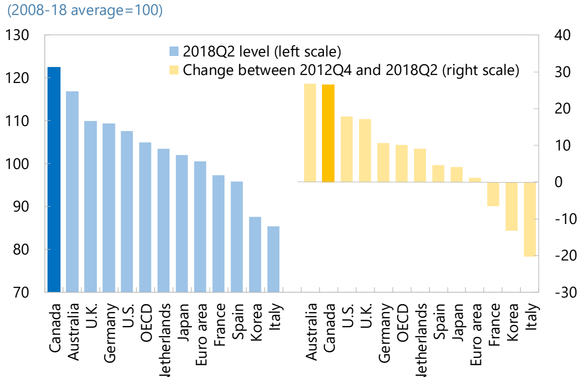



*House price to income is relatively high in Canada and has increased significantly since 2012.*

*Cities where house price-to-income most misaligned (i.e., overvalued) face larger downside risk to house prices.*

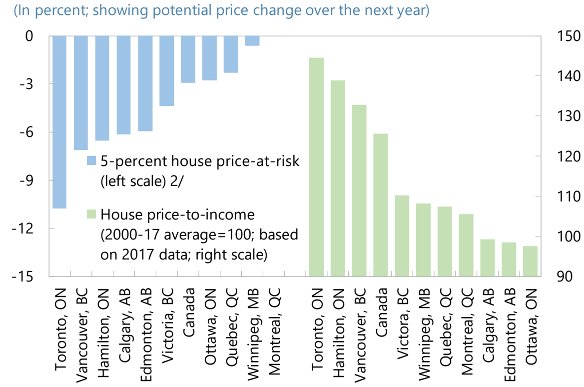
### House Price-to-Income in Advanced Economies, 2012-18

(2008-18 average=100)




### House Price-at-Risk across Cities, 2018

(In percent; showing potential price change over the next year)




Sources: Canadian Real Estate Association; Haver Analytics; OECD; and IMF staff estimates.

1/ The housing market imbalances index comprises house prices, construction, inventory and sales, mortgage, and household balance sheet.

2/ The 5-percent house price-at-risk measures a potential decline in real house prices (year-on-year) one year ahead with a 5 percent probability.

# Appendix I. Recommendations of the 2014 Assessment

## A. Introduction

**Notwithstanding the high-level of compliance, the 2014 assessment identified several areas where the regulatory framework and OSFI's supervision could be further improved.** The current FSAP followed up on the status of the implementation of these recommendations. An overview of the status of the different recommendations is provided in Annex Table 1. Several additional observations regarding these recommendations are discussed in more detail below.

## B. Significant Interest and Ultimate Beneficial Ownership (BCP 6 and 20)

**Indirect ownership through a corporate body is not included in the definition of significant ownership.** The BA defines beneficial ownership as "ownership through one or more trustees, legal representatives, agents or other intermediaries." This definition does not include indirect ownership through a (non-regulated) corporate body like a holding company. A significant interest (a direct or beneficial shareholding of 10 percent or more) needs, however, the approval of the Minister of Finance. This is not the case for changes in significant ownership in a holding company controlling the institution, even though this situation is not fundamentally different. Only instances in which the shareholders in a controlling holding company have control over the holding company need the approval of the Minister of Finance.

**OSFI's powers to obtain additional information are limited to persons who control a bank and entities controlled by that person.** The current framework does not include powers to obtain information from entities in which significant shareholders of the bank have a controlling or significant interest. In practice this issue may be addressed by requiring an undertaking from the significant shareholder to provide, for example consolidated financial statements, and other information on the entities controlled by that person.

**Significant influence is not included in the definition of significant interest.** Significant influence encompasses instances in which for example a shareholder with an interest of less than 10 percent has significant influence, meaning the power to participate (but not control) in the financial and operation policy decisions of the investee. The definition in the BA of control is, however, adequate as it encompasses control in fact (instances in which a shareholder has less than 50 percent shareholding, but effectively has control).

**The definition of significant ownership also impacts the scope of the related-party definition as imbedded in the BA.** While the definition includes "a person who has a significant interest in a class of shares or in membership shares of the bank," it does not include a person (and his/her spouse and children or any other entity controlled by them) who has an indirect significant interest through a corporate body. In the context of a future legislative review, OSFI has proposed that indirect significant interest captured in the definition of related party. Significant influence is also not considered in the related-party definition. However, OSFI has the power to designate as a related party any person who could reasonably affect the exercise of the best judgment of the bank. While the related-party framework in itself is very restrictive, the scope of the related-party framework seems too narrow.

**From a systemic perspective this observation is less material, as the described weakness does not—given their ownership structure—affect the D-SIBs.** However, non-regulated holding structures are not uncommon in smaller FEs. To ensure the integrity of the financial system priority should be given to closing this gap.

## C. Concentration Risk (BCP 19)

**OSFI is currently in the process of updating its guideline on large exposures and expects to issue to revised guideline early 2019.** OSFI's guideline on large exposures dates from 1994. The guidance on concentration risk management and the definition of connected counterparties need to be updated and brought in line with the Basel standards for measuring and controlling large exposures, issued in April 2014 and taking effect January 2019. In addition, OSFI should consider applying similar requirements (or monitoring under Pillar 2) to all Canadian licensed banks that are part of banking or financial groups on a on a solo basis.

**Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014**

| Banking Core Principle (BCP) | Recommendation | Implementation Update |
|---|---|---|
| BCP1 Responsibilities, objectives and powers | a) It is recommended that ways be explored to strengthen the enforceability of guidelines through statutory changes to the powers of OSFI under the *Bank Act*.<br><br>b) It is further recommended that consideration be given to whether there are any key prudential standards that would benefit from a migration to the format of a regulation. | a) OSFI's guidelines are enforceable in practice because FRFIs recognize that OSFI has various intervention powers that are legally enforceable. Through capital orders, directions of compliance and other mechanisms, Financial Institutions (FIs) can be forced to comply with prudential expectations found in OSFI guidance. Furthermore, OSFI's use of guidelines provides OSFI with the flexibility and ability to act independently and quickly in the face of emerging risks.<br><br>***Assessors' comments:*** *we agree that in practice OSFI's use of guidelines provides flexibility and ability to act quickly. The question is whether, during less benign times, the fact that guidelines are not enforceable may create the potential for entities to delay or contest the more formal mechanisms.*<br><br>*b)* Guidelines provide OSFI with greater flexibility than regulations, as expectations can be tailored to the size, nature and complexity of the FRFI. It is expected that very few guideline requirements would lend themselves to regulations.<br><br>***Assessors' comments:*** *we agree that this is a benefit of guidelines.* |

**Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (continued)**

| | | |
|---|---|---|
| BCP 2 Independence, accountability, resourcing and legal protections for supervisors | a) It is recommended that the authorities codify the "prudential veto" clearly in the *Bank Act* in respect of all approvals in which prudential considerations are relevant (for example, transfer of ownership and investment).<br><br>b) It is recommended that the authorities consider exempting the supervisors from the government's fiscal controls and administrative guidance, as in the case of some other financial agencies, in order to enhance OSFI's financial autonomy. | a) While the prudential veto is not formalized in the legislation, there is a failsafe for new incorporations in that the Order to Commence and Carry on Business is a Superintendent decision. Furthermore, in practice no Ministerial approval is considered without a recommendation from OSFI based on prudential considerations. OSFI considers this as evidence of a level of operational independence.<br><br>***Assessors' comments:*** *we understand and acknowledge that the process has worked smoothly in practice. We would still consider it best practice to codify the "prudential veto" in the Bank Act so that the framework is robust to changes in personnel and culture.*<br><br>*We also recommend that part (b) is taken forward—exempting the supervisors from the government's fiscal controls and administrative guidance.* |
| BCP3 Cooperation and collaboration | It is recommended that more frequent and structured arrangements, modeled perhaps on current formats, are put in place to ensure that relevant information is shared actively and proactively as necessary between provincial and federal authorities, rather than only on request, in order to enhance firm- and group specific supervision and wider systemic understanding. | Building on their existing relationships, OSFI and the Autorité des marchés financiers (AMF) instituted a cooperation framework in 2015, whereby meetings are scheduled on a regular basis to discuss issues of mutual interest. Discussions with the AMF have been initiated regarding possible enhancements to the cooperation framework.<br><br>***Assessors' comments:*** *please refer to our full commentary and recommendations on cooperation and collaboration in the main body of this report.* |

| Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (continued) | | |
|---|---|---|
| BCP4<br>Permissible activities | The scope of the federal system does not, and cannot under current law, encompass all deposit-taking entities of significance. The relevant Canadian authorities should assess and as necessary revise laws and arrangements to ensure the soundness and stability of the entire financial system within Canada, and not only the federal aspect of that system. | This issue is beyond OSFI's purview.<br><br>***Assessors' comments:*** *AMF's regulation and supervision of the other D-SIFI, Desjardins, are of good quality, substantially mitigating the risk that this recommendation would address. Improvements in cooperation and collaboration will mitigate it still further.* |
| BCP5<br>Licensing criteria | OSFI should institute a policy of assessing the fitness and properness of all new board members and new senior management executives. | The revised *Corporate Governance Guideline*, to be issued in September 2018, addresses this recommendation. While OSFI does not have a formal vetting/approval process, it is informed prior to the appointment of new board and senior management members. OSFI can (and does) raise any concerns it may have.<br><br>Furthermore, Guidelines E-4A and E-4B: *Role of the Chief Agent and Role of the Principal Officer* respectively, are up for review and will be revised to provide similar requirements applicable to foreign insurance company branches and foreign bank branches.<br><br>***Assessors' comments:*** *the revised Corporate Governance Guidelines set clear expectations for FRFIs to inform OSFI of new appointments. We note that OSFI does engage actively with the FRFI and raises concerns. One issue here is the same as BCP1, that there is a limited ability for OSFI to take prompt and decisive action without the cooperation of the regulated entity or a formal directive. The informal vetting process appears to be well embedded in OSFI's supervisory approach, and the assessors recommend that it be formalized as per the 2014 recommendation.* |

| Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (continued) | | |
|---|---|---|
| BCP6 Transfer of significant ownership | (a) OSFI should consider a standardized form for the annual reporting of shareholdings and should institute an annual check on ultimate beneficial ownership on all institutions in order to obtain comfort that OSFI will have timely notification should indirect holdings or changes in ownership and control—whether increasing or decreasing—take place.<br><br>(b) There should be a specific requirement for banks to notify OSFI of material adverse changes affecting the suitability of a major shareholder or controller. It is recommended that at a minimum OSFI introduce an explicit reporting requirement. If necessary, a requirement to file such a report to the Superintendent could be included in the next revision of the *Bank Act*. | (a) OSFI obtains sufficient information about important changes in significant interest through other channels. Acquisitions of significant interest/control are subject to legislative approval. Where a person is relinquishing control, it is also likely that another person would be acquiring a significant interest and/or control. OSFI does not intend to pursue a legislative amendment as appropriate notification requirements can be imposed by OSFI using its current authority.<br><br>(b) A legislative amendment is not being considered at this time, in part because it would be difficult to ensure consistent application to both owners that are entities and owners that are individuals. In addition, there are no legislative tools to force divestment (other than where the initial acquisition was in contravention of the legislation, i.e., no approval was sought) or otherwise sanction the owner. A notification may not be useful where there is no ability to sanction the owner.<br><br>***Assessors' comments:*** *this issue is covered in detail in Subsection B of Annex 1.* |

| Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (continued) | | |
|---|---|---|
| BCP7<br>Major acquisitions | It is recommended that the *Bank Act* be amended to introduce an approval, or at minimum, notification requirement to OSFI when an acquisition is made through a foreign or provincially-regulated subsidiary. | The Substantial Investment Advisory was updated in 2015 and now requires Federally Regulated Entities (FREs) to notify their OSFI Lead Supervisor of any material investment where the making of that investment does not trigger an approval requirement. Prompt notification is required where both of these elements are present:<br>• The FRE seeks to acquire control of, or acquire or increase a substantial investment in, an entity for which no approval is required under the applicable statute; and<br>• The acquisition or increase will be material to, or will present a significant change in the business strategy of the FRE.<br><br>***Assessors' comments:*** *noted and agreed.* |

**Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (continued)**

| | | |
|---|---|---|
| BCP8 Supervisory approach | (a) It is recommended that OSFI intensify its analysis of groups from a legal entity-based perspective to complement the understanding yielded by the examination of significant activities.<br><br>(b) OSFI should also review the effectiveness of its communication and coordination with nonbank regulators for entities within the consolidated groups. | (a) Work being undertaken on initiatives such as Recovery Planning and review of the level and location of capital held within consolidated groups may be leveraged to address the recommendation.<br><br>***Assessors' comments:*** *OSFI has initiated some steps to increase its analysis of solo entities, including the analysis of the level of capital. We encourage OSFI to continue this progress, including the recommendations in this report around liquidity.*<br><br>(b) The current state of informal interaction is deemed to be appropriate. However, as opportunities present themselves, OSFI may leverage the work of existing working groups to assess the need for greater communication and coordination with nonbank regulators outside Canada.<br><br>***Assessors' comments:*** *please see our full comments around coordination in the main body of this report.* |

| Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (continued) | | |
|---|---|---|
| BCP9 Supervisory techniques and tools | (a) It is recommended that OSFI consider whether its internal monitoring systems could be enhanced to further support the overarching, and risk-focused view of the institution to ensure timely actions and progress.<br><br>(b) A requirement should be introduced, through amendment to the *Bank Act* or otherwise, for a bank to notify OSFI in advance of any material adverse development in the institution. | (a) OSFI periodically reviews its monitoring processes, and believes the current monitoring processes, including tools that provide information on institution specific changes in risk profile, are appropriate. As well, we have processes that provide emerging risks at the industry level that are used for early identification of institutions with potentially higher risk, thereby allowing time for early intervention if needed.<br><br>In addition, we are building an information management system that will further support existing processes regarding risk profile and issues management.<br><br>***Assessors' comments:*** *we believe that the institution-specific processes and tools that OSFI has in place work effectively and note that they are regularly updated.*<br><br>(b) The *Corporate Governance Guideline* contains this expectation. OSFI also looks for appropriate opportunities (e.g., speeches, public speaking engagements, meetings with FRFI boards or senior management) to reinforce this requirement.<br><br>***Assessors' comments:*** *we agree that this addresses the point.* |
| BCP10 Supervisory reporting | It is recommended that OSFI review its prudential data needs to support ongoing supervision, taking into account particularly recent work on recovery and resolution planning which places greater focus on the individual legal entities. | No additional actions are recommended.<br><br>***Assessors' comments:*** *we note there have been a number of improvements since the last FSAP and further work is underway. Some elements could, however, be further enhanced (see paragraph 26)* |

| Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (continued) | | |
|---|---|---|
| BCP12 Consolidated supervision | (a) OFSI should require solo data for all regulated banks within the consolidated banking groups where this is not already the practice. It is recommended that OSFI require periodic data on intra-group transactions.<br><br>(b) OSFI should formalize its policy to always make access to parental data and notification of material parental business and governance changes a condition of licensing for those instances where the parent entity is not a regulated entity. | (a) OSFI is obtaining incremental solo information in addition to what has been collected to date through the Recovery Plan work stream. In addition, banking groups are expected to hold capital in a manner that is consistent with the level and location of risk. OSFI will look for opportunities to seek additional solo information as deemed pertinent to OSFI's risk-based approach (e.g., more detailed balance sheet information, liquid asset information, etc.).<br><br>Work completed includes the following:<br>• Domestic systemically important banks have to identify all banking entities engaged in deposit-taking activities, provide their analysis and develop crisis management strategies for relevant jurisdictions; and<br>• The US and UK regulators share their views about regulated banking entities in their jurisdictions on a regular basis through ongoing information sharing processes.<br><br>***Assessors' comments:*** *we agree that OSFI has worked to address this recommendation. We would comment that the analysis of the level of capital at the solo entity is rudimentary and recommend a more comprehensive approach for the main solo entities in banking groups.*<br><br>(b) In practice, OSFI obtains undertakings from a parent entity that is not a regulated entity, where the parent is engaged in financial activities. The undertakings are intended to provide OSFI with access to parental data and information, as needed.<br><br>***Assessors' comments:*** *we observed inconsistent approaches to obtaining undertakings. There is no standard template for these undertakings and they have not always been taken. We recommend a full review of relevant files and that a standard, comprehensive undertaking is put in place in all cases.* |

**Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (continued)**

| | | |
|---|---|---|
| BCP13<br>Home-host relationships | It is recommended that in its recovery planning, OSFI consider and anticipate the potential needs in a crisis of supervisors in jurisdictions where the Canadian entity is material. | OSFI continues its efforts to strengthen home/host cooperation in crisis management. OSFI is not restricted in its ability to consider the potential needs (in a crisis) of supervisors in jurisdictions where the Canadian company is material, and OSFI agrees that any approach to cross-border cooperation and coordination should consider such needs. OSFI will continue to follow FSB expectations as to how to work with relevant non-CMG host jurisdictions.<br><br>In response to the FSB guidance regarding home-host relationships, OSFI established outreach panels. The first panel took place at the start of 2016 and focused on recovery and resolution plan updates, GSIB designation, and information sharing protocols. The second Outreach Panel took place in 2017. Non-CMG members and CDIC have actively participated in the panel.<br><br>***Assessors' comments:*** *OSFI is alert to its responsibilities here and has implemented regular colleges with host jurisdictions.* |
| BCP14<br>Corporate governance | No recommendation provided | |

| Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (continued) | | |
|---|---|---|
| BCP15<br>Risk management process | OSFI should review its current set of prudential Guidelines relating to risk management against international standards and other OSFI prudential expectations and issue expanded or new guidance to close any identified gaps, particularly in areas such as credit risk. | OSFI remains of the view that its current suite of guidance, and the review process for updating and developing new guidance, achieves the purpose of covering important areas of risk management.<br><br>Post FSAP, OSFI has updated several guidance documents including publishing a self-assessment letter on Cyber risks and issuing a final version of guideline E-21: *Operational Risk Management*. See response in BCP17 for a list of the updated guidelines, in addition to those guidelines currently under review.<br><br>***Assessors' comments:*** *We have noted the updates and new guidance that OSFI has issued, and these seem to largely address important and emerging issues. As a general comment, we observed that policy development inevitably has to be prioritized and some dated policies, such as Large Exposures, are overdue a revision.* |
| BCP16<br>Capital adequacy | (a) Over time, OSFI may wish to consider whether the D-SIB capital surcharge should differ across banks according to their risk or systemic importance. | (a) All D-SIBs are subject to the same D-SIB capital surcharge. OSFI adopted a similar approach when announcing the Pillar 2 Domestic Stability Buffer in June 2018 (set at 1.5 percent of RWA for all D-SIBs). D-SIBs may be subject to idiosyncratic Pillar 2 charges based on their individual risks profiles.<br><br>***Assessors' comments:*** *we believe the principle of reviewing over time whether DSIB capital surcharges should vary remains valid but agree that from a microprudential perspective currently there is no obvious need for differentiating.* |

| Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (continued) | | |
|---|---|---|
| BCP16<br>Capital adequacy | (b) It is recommended that OSFI seek a formal BCBS Basel III FAQ to be published regarding the 'purchase for cancellation' provision for Additional Tier 1 and Tier 2 capital instruments. | *(b)* OSFI continues to believe it is appropriate that Additional Tier 1 and Tier 2 capital instruments could be purchased for cancellation at any time including the first five years—with the prior approval of the Superintendent. Common shares which are a higher form of capital may be repurchased (with the Superintendent's approval) at any time usually in a normal course issuer bid (NCIB) which is a common practice. An NCIB is a term for a company repurchasing its own stock from the public in order to cancel it. In a NCIB, a company is allowed to repurchase between 5 percent and 10 percent of its shares depending on how the transaction is conducted. The issuer repurchases the shares gradually over a period of time, such as one year. This repurchasing strategy allows the company to buy only when its stock is favorably priced.<br><br>Given the normal practice for common shares, we believe it would not be appropriate to apply a higher standard to a lower quality instrument. This issue was also initially raised by Regulatory Consistency Assessment Program (RCAP) assessors in the BCBS Basel III Canadian RCAP conducted in 2014. The assessors accepted OSFI's rationale and did not flag it as a deviation in its report nor did it include it on the list of items where further guidance from the Basel Committee is recommended. Accordingly, we believe seeking a formal FAQ is not required.<br><br>***Assessors' comments:*** *we note and agree the comments and that the 2014 RCAP did not raise this as a deviation, or for further follow-up.* |

| Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (continued) | | |
|---|---|---|
| BCP17<br>Credit risk | As discussed under BCP 15, OSFI should develop comprehensive guidance on credit risk management in line with international standards to ensure its expectations and minimum standards are well understood. | As it becomes due for review, OSFI will consider amending Guideline B-1: *Prudent Person Approach*, to strengthen the requirements on credit risk management in line with international standards. Note that OSFI's Guideline Review Committee contributes to the prioritization and planning of Guideline review.<br><br>Guideline B-20 *(Residential Mortgage Underwriting Practices and Procedures)* and Guideline B-21 *(Residential Mortgage Insurance Underwriting Practices and Procedures)* provide detailed guidance on credit risk management in relation to these activities and are aligned with the relevant international standards. Guideline B-20 was revised in October 2017 to reinforce expectations given high household indebtedness and vulnerabilities in some housing markets. In addition, OSFI's June 2016 Guideline on IFRS 9 Financial Instruments and Disclosures provides guidance on expectations of credit risk management processes with a focus on monitoring of changes in portfolio risks.<br><br>Since the last FSAP, the following guidelines, which incorporate guidance on credit risk, were amended:<br>• E-22—Margin Requirements for Non-Centrally Cleared Derivatives 2017<br>• E-23—Enterprise-wide Model Risk Management for Deposit-Taking Institutions<br>• B-7—Derivatives Sound Practices<br>• B-20—Residential Mortgage Underwriting Practices and Procedures (Effective January 1, 2018)<br>• B-21—Residential Mortgage Insurance Underwriting Practices and Procedures 2014 |

| Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (continued) | | |
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| BCP17<br>Credit risk | | In addition, the following guidelines are currently under review:<br><br>• B2 Guideline on Large Exposure DTI and Insurance<br>• B3 Guideline on Prudent Reinsurance Practices<br>• IFRS 17 Implementation<br>• IFRS 9<br><br>***Assessors' comments:*** *OSFI has been proactive and risk-based in this area. Some aspects could however be further enhanced (see for example paragraphs 37 and 43 in the main body of the report).* |
| BCP18<br>Problem assets, provisions and reserves | OSFI should consider setting out its expectations with respect to problem asset management in comprehensive guidance on credit risk management, as discussed in BCP 15 and BCP 17. | No action required. |
| BCP19<br>Concentration risk and large exposure limits | It is recommended that OSFI strengthen its large exposure reporting and monitoring regime to include, for example, regular regulatory reporting of compliance and notification of exposures greater than a specified level of capital. OSFI's Large Exposure Guideline dates from 1994 and OSFI should consider updating its guidance in light of the BCBS project currently underway and to cover concentration risks more generally. OSFI should also reconsider whether the higher exposure limit for subsidiary banks continues to be appropriate. | OSFI is currently reviewing Guideline B-2: *Large Exposure Limits*. The revised guideline aims to:<br>• Ensure that banks continue to have prudent management of large exposures, which contributes to their safety and soundness;<br>• Provide additional and clarified guidance on how banks should identify, measure, monitor, and control large exposures; and<br>• Have regard to minimum international standards, where appropriate.<br><br>***Assessors' comments:*** *noted and we recommend OSFI to also apply the Basel large exposure limit to all Canadian licensed banks that are part of banking or financial groups on a on a solo basis.* |

| Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (continued) | | |
|---|---|---|
| BCP20<br>Transactions with related parties | (a) OSFI should establish a more formalized regime, including regular regulatory reporting, for monitoring related-party transactions.<br><br>(b) OSFI should consider whether the *Bank Act* limit on aggregate related-party exposures of 50 percent of capital to directors and officers should be lowered to a level more consistent with the limits on large exposures. | (a) OSFI is not pursuing the recommendation. OSFI has a very restrictive regime for transactions with related parties. A formal regulatory return would create burden with no added value in terms of minimizing prudential risk.<br><br>***Assessors' comments:*** *we would encourage OSFI to review this periodically (see also Annex I subsection B).*<br><br>(b) In the context of a future legislative review, OSFI has proposed that the statutory limit on transactions with directors, officers and their interests be aligned with OSFI's limits on large exposures.<br><br>***Assessors' comments:*** *noted. We support this proposal.* |
| BCP21<br>Country and transfer risks | OSFI should consider issuing guidance documenting its expectations for the management of country and transfer risks. | OSFI will look at country and transfer risks and will update requirements if needed. Any work in this space will take into account BCBS guidance on sovereign risk, which is still under discussion internationally.<br><br>***Assessors' comments:*** *we note the intention to look at this again once the BCBS guidance is finalized.* |
| BCP22<br>Market risk | OSFI should consider clarifying its market risk management expectations for foreign bank branches and banks with small or no trading books, which are not subject to the Capital Adequacy Requirement Guideline on Market Risk. | Chapter 9 of CAR is applied only to internationally active institutions—in our case that is primarily our DSIBs. In CAR there is also a paragraph that says if we believe the trading activity is significant then we can require compliance with Chapter 9—there is no threshold provided because we use significance of the portfolio for the institution not a $ amount.<br><br>***Assessors' comments:*** *noted. The approach is adequate.* |

| Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (continued) | | |
|---|---|---|
| BCP23<br>Interest rate risk in the banking book | No recommendation provided | |
| BCP24<br>Liquidity risk | OSFI should ensure that, even with significant off-site analysis, reporting and review occurring, supervisors maintain regular on-site coverage of liquidity risk management to verify the effective application of policies and controls in practice. | In addition to planned liquidity work (e.g., regularly scheduled significant activity reviews and ongoing monitoring), OSFI will ensure planned work includes ongoing onsite coverage of liquidity risk management. In particular, OSFI will schedule onsite meetings with Corporate Treasury and "liquidity intensive" businesses to confirm FREs are applying liquidity risk management controls.<br><br>***Assessors' comments:*** *we are of the view that this risk is covered adequately in the on-site program and have taken note of OSFI's (RSS) intention to intensify its liquidity risk monitoring and supervision.* |
| BCP25<br>Operational risk | OSFI should consider issuing more comprehensive guidance on setting out its expectations for operational risk management and covering areas such as business continuity expectations. | In June 2016, OSFI released the final version of Guideline E-21: *Operational Risk Management*. The guideline reinforces OSFI's expectations regarding the management of operational risk through a consolidated piece of guidance.<br><br>***Assessors' comments:*** *OSFI has been investing more actively in operational risk guidance and oversight and is in the process of establishing a new Technology Risk Division distinct from the Operational Risk Division. See comments in the main body of the report around supervision of nonfinancial risks.* |
| BCP26<br>Internal control and audit | No recommendation provided | |

**Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (continued)**

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|---|---|---|
| BCP27<br>Financial reporting and external audit | No recommendation provided | |
| BCP28<br>Disclosure and transparency | (a) As OSFI and the banks view Pillar 3 requirements as minimum required disclosure practice, OSFI should consider issuing Pillar 3 requirements in Guideline format.<br><br>(b) OSFI may wish to review best practices in other countries and consider publication of time series data sourced from its regulatory returns that would enhance the public understanding of banks' operations and risk profile. | (a) In April 2017, OSFI released the *Pillar 3 Disclosure Requirements* guideline. The guideline sets out OSFI's expectations for domestic systemically important banks on phase I of the revised Pillar 3 financial regulatory disclosure requirements. Remaining Pillar 3 requirements that are in Advisory form will be converted to guidelines during the implementation of Pillar 3 phases II and III by the end of 2019.<br><br>***Assessors' comments:*** *this addresses the recommendation.*<br><br>(b) OSFI has an annual regulatory return change management process which includes the governance of reviewing and approving all newly collected FRFI data for public consumption. Please see sections 1.14 to 1.17 of the Annual Regulatory Data Planning Business Processes document (below) for data disclosure governance. As per the OSFI Act, OSFI discloses current and historical data where external stakeholders can select as many distinct filing dates as they want (one at a time) and build a time series of their own. The authorized set of publicly disclosed data are published at this OSFI website http://www.osfi-bsif.gc.ca/Eng/wt-ow/Pages/fd-df.aspx.<br><br>***Assessors' comments:***<br>*We are aware that OSFI has this matter under periodic review and would encourage steps towards a public data base which is easily accessed with consistent data across the industry.* |

| Appendix I. Table 1. OSFI: Progress on Implementing the BCP Assessment Recommendations 2014 (concluded) | | |
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| BCP29<br>Abuse of financial services | (a) It is recommended that OSFI explicitly state its expectation that banks' compliance officer (CAMLO) is appointed at the management level.<br><br>(b) It is also recommended that Guideline (B-10) on Outsourcing of Business Activities, Functions and Processes be amended to more clearly establish the requirement that the screening processes that are in place when the bank is entering into outsourcing relationships will ensure high ethical and professional standards. | (a) As it becomes due for review, OSFI will consider amending Guideline B-8: *Deterring and Detecting Money Laundering and Terrorist Financing*, to explicitly require that banks' compliance officers be appointed at the management level.<br><br>***Assessors' comments:*** *OSFI advises that they will look to make this change when the guideline is next due for review which they expect to be within the next two years.*<br><br>(b) As it becomes due for review, OSFI will consider amending Guideline B-10: *Outsourcing of Business Activities, Functions and Processes*, to explicitly require that the screening processes that are in place when the bank is entering into outsourcing relationships will ensure high ethical and professional standards.<br><br>***Assessors' comments:*** *noted and agreed.* |

# Appendix II. Main Regulatory Developments

**Several amendments have been made to the Bank Act (BA) and the Trust and Loan Companies Act (TLCA) since 2014**.

- In 2014, the BA was amended to add regulation-making powers respecting a bank's activities in relation to derivatives and benchmarks. As discussed earlier, additional amendments were made to federal financial institution statutes to discontinue supervision of provincial central cooperative credit societies[1] by OSFI and to facilitate the entry of provincial cooperative credit societies into the federal credit union system by simplifying the process for continuation and amalgamation that applies to them.

- Further amendments were made to the BA and the TLCA in 2015 to enhance the protection of prescribed supervisory information that relates to FRFIs.

- The Bank Act was further amended in 2016 to: (i) facilitate the continuance of local cooperative credit societies as federal credit unions by granting the Minister of Finance the authority to provide transitional procedural exemptions, as well as a loan guarantee; and (ii) allow the designation of domestic systemically important banks by the Superintendent of Financial Institutions and require such banks to maintain a minimum capacity to absorb losses.

- Additional amendments were made to the BA and the TLCA on June 21, 2018 to extend the scope of activities related to financial services in which federal financial institutions may engage, including activities related to financial technology, as well as modernize certain provisions applicable to information processing and information technology activities. These amendments are not yet in force.

- The Department of Finance has been consulting with stakeholders during 2017–18 on legislative proposals to modernize provisions of the Bank Act, Trust and Loan Companies Act and Insurance Companies Act concerning the corporate governance of federally-regulated financial institutions. Legislation is anticipated to be introduced in 2019.

**In addition, OSFI has been steadily updating its guidelines in line with regulatory reform agenda of the international standard setting bodies.** Since the previous assessment OSFI issued or updated the following guidelines:

- *Capital Adequacy Requirements*—has been updated to:

  - 2019 (to be finalized)—incorporated domestic implementation of the standardized approach to counterparty credit risk (SA-CCR) and the revisions to the capital requirements

[1] Previously subject to dual regulation and supervision by the relevant provincial authority and OSFI.

for bank exposures to central counterparties (CCPs) as well as revisions to the securitization framework.

- o 2018—incorporated necessary amendments to implement the Total Loss Absorbing Capacity regime and for capital treatment of allowances as a result of the adoption of IFRS 9; incorporated changes to the output floor.

- o 2017—clarified application to federal credit unions regarding qualifying capital instruments, deductions from capital and transitioning of non-qualifying instruments; revised the treatment of insured residential mortgages to emphasize that credit risk insurance is a risk mitigant (guarantee) that relies on the due diligence of a mortgage originator with respect to the requirements of a mortgage insurance contract; clarified how national discretion will be exercised in the implementation of the countercyclical buffer, including the reciprocity of countercyclical buffers put in place in other jurisdictions; implemented the equity investment in funds rules issued by the Basel Committee on Banking Supervision (BCBS).

- o 2016—introduced a downturn loss given default floor for uninsured residential mortgages (2017 for insured mortgages),

- o 2014—introduced the credit valuation adjustment capital charge.

- *Liquidity Adequacy Requirements*—introduced in 2014 to incorporate the liquidity requirements coming out of various BCBS documents. OSFI implemented the Liquidity Coverage Ratio (LCR, standard in January 2015 with a minimum requirement of 100 percent (i.e., no phase-in). OSFI also incorporated the standardized Basel III liquidity monitoring tools (e.g., concentration of funding, available unencumbered assets, etc.) in 2015. Further, in 2015, OSFI formalized the use of the domestic Net Cumulative Cash Flow (NCCF) metric as a supervisory tool. Although the NCCF is not a standard with a uniform minimum requirement, OSFI has communicated a private target tailored to each supervised institution. OSFI has also communicated its intention to implement the Net Stable Funding Ratio (NSFR) in January 2020.

- *Leverage Requirements* (Draft)—introduced in 2014 and in process of being updated in 2018. The guideline transposes leverage requirements issued by the BCBS into OSFI guidance appropriate for Canadian banks. The revised version will 1) incorporate the Standardized Approach to Counterparty Credit Risk (SA-CCR) for calculating derivatives exposures; 2) will include changes to the treatment of securitized assets that meet the operational requirements for recognition of significant risk transfer (SRT) in order to align with proposed revisions to the Capital Adequacy Requirements guideline and 3) will align treatment of the credit conversion factors for off-balance sheet securitization exposures with those under the proposed revisions to the CAR guideline.

- *Total Loss Absorbing Capacity*—introduced in 2018 to implement the TLAC regime. The guideline sets out the framework within which the Superintendent will assess whether a Domestic

Systemically Important Bank maintains its minimum capacity to absorb losses pursuant to subsection 485(1.1) of the BA.

- *Total Loss Absorbing Capacity Disclosure Requirements*—introduced in 2018 to implement disclosure requirements for the TLAC regime for Domestic Systemically Important Banks. The guideline, which incorporates the TLAC disclosure templates published in the BCBS *Pillar 3 Disclosure Requirements—consolidated and enhanced framework standards* (issued in March 2017), will be in force as of September 2018.

- D-11 *Public Disclosure Requirements for Domestic Systemically Important Banks on Liquidity Coverage Ratio*—introduced in 2014 to set out the public disclosure requirements regarding the LCR for Domestic Systemically Important Banks.

- D-12 *Leverage Ratio Disclosure Requirements* (Draft)—introduced in 2014, with a revised version to be issued in late 2018—the guideline provides clarification on the implementation of the BCBS LR disclosure requirements. The revised 2018 version will include minor consequential amendments to reflect amendments to OSFI's Leverage Requirements and Capital Adequacy Requirements guidelines.

- *IFRS 9 Financial Instruments and Disclosures*—introduced in 2016 to provide guidance on the application of IFRS 9. The guideline addresses the expected loss framework, fair value option and various disclosure requirements related to financial instruments. It consolidates a number of existing guidelines that will be removed beginning in November 2018.

- *Pillar 3 Disclosure Requirements*—introduced in 2017 to clarify OSFI's expectations regarding domestic implementation of the *Revised Pillar 3 Disclosure Requirements* issued by the BCBS in January 2015.

- *Corporate Governance* *(Draft)*—the updated final version to be issued in September 2018 will be more principles based and outcomes based, i.e., what the Board should achieve, will more clearly delineate board and senior management responsibilities and will consolidate board requirements contained in other risk management or capital guidance.

- B-7 *Derivatives Sound Practices*—updated in 2015 to reflect the over-the-counter (OTC) derivatives market reforms initiated by G-20 leaders and communicate OSFI's expectations for central clearing of standardized OTC derivatives and reporting derivatives data to a trade repository. The guideline also reflects current practices with respect to the risk management of derivatives activities.

- E-13 *Regulatory Compliance Management*—issued in 2014 as an updated version of former guideline Legislative Compliance Management. The guideline sets out OSFI's expectations for the management of regulatory compliance risk inherent in business activities enterprise-wide.

- E-20 *CDOR Benchmark-Setting Submissions*—introduced in 2014 to assist Canadian Dollar Offered Rate submitting banks in establishing strong governance and controls in order to maintain confidence in CDOR as a robust interest benchmark in Canada.

- E-21 *Operational Risk Management*—introduced in 2016 to reinforce OSFI's principles-based expectations regarding the management of operational risk.

- E-22 *Margin Requirements for Non-Centrally Cleared Derivatives*—introduced in 2017 to require the exchange of margin to secure performance on non-centrally cleared derivatives transactions between covered entities. The requirements are consistent with those issued by the BCBS and the Board of the International Organization of Securities Commissions and support the financial stability objectives of the international framework.

- E-23 *Enterprise-wide Model Risk Management for Deposit-Taking Institutions*—introduced in 2017 to establish OSFI's expectations for institutions in managing and controlling the use of models, whether for regulatory capital determination, internal risk management, valuation/pricing, business decision-making or stress testing purposes.

**In addition, and in response to risks in the Canadian market, OSFI updated its residential mortgage underwriting guidelines.**

- B-20 *Residential Mortgage Insurance Practices and Procedures*—introduced in 2012 and updated in 2017, the guideline builds on the Financial Stability Board's international *Principles for Sound Residential Mortgage Underwriting Practices* and OSFI's own domestic supervisory work. The guideline sets out OSFI's expectations for prudent residential mortgage underwriting, which are articulated through five fundamental principles. The 2017 update reinforced OSFI's expectations through key changes, including a revised stress test, the need for lenders to establish and adhere to appropriate loan to value ratio limits and restricting lending arrangements designed to (or appear so) circumvent loan to value limits.

- B-21 *Residential Mortgage Insurance Underwriting Practices and Procedures*—introduced in 2014 to set out the OSFI's expectations for prudent residential mortgage insurance underwriting and related activities. (Note: this guideline does not apply directly to banks, but is based on principles set out in guideline B-20)

**In Québec, the most significant legislative change is the enactment of Bill 141 on June 13, 2018.** The most important legislative change since 2014 is the amendments enacted by Bill 141 to the AMF Act respecting financial cooperatives services in order to:

- add a scheme to supervise and control deposit institution business and authorized deposit institutions, including commercial practices standards, prudential and governance rules, the auditor's role, the conditions for authorizing a deposit institution, the review of such an authorization in various circumstances and the revocation or suspension of, or the attachment of conditions or restrictions to, such an authorization;

- determine the AMF's responsibilities and powers with regard to supervision and control;
- add the possibility for the AMF, as the insurer of deposits made with authorized deposit institutions, to take different measures to reduce the risk to the AMF or to avert or reduce a threatened loss to the AMF and to plan operations to resolve problems that could arise from the failure of financial institutions belonging to a cooperative group;
- prescribe miscellaneous prohibitions and monetary administrative penalties; and
- set the conditions under which the Minister of Finance may enter into agreements allowing a cooperative outside Québec having a mission similar to that of a financial services cooperative to obtain an authorization to carry on deposit institution activities in Québec.

The following guidelines were introduced or updated by AMF:

**Capital Guideline**
This new guideline came into effect on May 1, 2015. It is primarily intended to clarify the expectations of the AMF regarding the implementation by financial institutions of an internal assessment process of their risks in connection with their capital (ICAAP).

**Integrated Risk Management Guideline (Update)**
This guideline was updated on May 1, 2015, mainly to take into account new expectations relating to ICAAP. In addition, the AMF took this opportunity to clarify and reinforce its expectations, particularly with respect to risk appetite and the links between the risk management framework, the solvency position, the strategic objectives and their communication within the board of directors and senior management.

**Risk Data Aggregation and Risk Disclosure Guideline (New)**
The Guideline Governing Risk Data Aggregation and Risk Disclosure came into effect on February 1, 2016. It is exclusively applicable to federations of credit unions governed by An Act respecting financial services cooperatives, CQLR, c. C-67.3.

In this guideline, the AMF expects financial institutions to implement a framework enabling them to properly aggregate all material risk data and to disclose them to market participants in an accurate, timely manner appropriate to the circumstances. Moreover, the financial institutions are expected to ensure the accuracy, adaptability and timeliness of material risk data, based on the implementation of a control framework governing the data aggregation process. Furthermore, the AMF expects the risk data aggregation capability to be effective at all times, even during a crisis. The guideline also focuses on the fact that the reports produced shall enable stakeholders to clearly track the institution's ongoing exposure to risk, along with the effectiveness and efficiency of measures for handling risk.

**Governance Guideline (Update)**
The AMF Governance Guideline has been completely revised with an effective date on September 15, 2016. The new version aims to complete and clarify the roles and responsibilities expected from the Board of Directors and to reinforce the importance for its members to be independent and to promote a transparent, ethical and responsible corporate culture. In addition, the roles of the Chairman of the Board and the Audit Committee are discussed in more details.

**Operational Risk Management Guideline (New)**
The Operational Risk Management Guideline came into effect on December 1, 2016.
With respect to governance, this guideline aims to promote the strengthening of the risk culture since the identification, assessment, control, mitigation and oversight of operational risk require the commitment of all internal stakeholders and primarily the board of directors, senior management and the different lines of defense.

**Compliance Guideline (Update)**
With an effective date of April 15, 2017, the AMF has updated its Compliance Guideline to ensure consistency with recent changes to other AMF Guidelines, including Governance and Integrated Risk Management.
The changes made to the Guideline were also intended to reinforce the importance of effective and efficient compliance management that requires the commitment of all parties in the institution, including the Board of Directors, senior management and the three lines of defense. With this in mind, a new expectation specifying the roles and responsibilities of the various lines of defense (related to the Governance Guideline), including in particular those of the Chief Compliance Officer, has been added.

**Residential Hypothecary Lending Guideline (Update)**
In order to avoid regulatory arbitrage in the Canadian housing market and ensure a level playing field relative to federal institutions (who are subject to OSFI's updated B-20 Guideline) the AMF published in March 2018 an updated version of its Residential Hypothecary Lending Guideline. This updated version includes new provisions on mortgage underwriting standards and stress testing (equivalent to those introduced by OSFI in its updated version of B-20). Although the AMF's Guideline came into force in March 2018, an agreement was reached with the Desjardins Group, in the fall of 2017, that Desjardins, as a D-SIFI, would comply with the new provisions as of January 1st, 2018 (simultaneous to the application of these provisions by the Canadian banks).

**Fair Consumer Credit Practices Guideline (New)**
This Guideline came into effect in July 2018. The AMF closely monitored household debt given that it was materially related to the credit risk of financial institutions. For example, an increase in interest rates, an economic slowdown, a drop-in income, a life event or unexpected financial needs could pose a major challenge to many consumers, especially those who are, or are becoming, overindebted.