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## ARTICLE

# OSFI Proposes Changes to its Leverage Requirements Guideline

Canadian banks, federal credit unions, bank holding companies, federally regulated trust companies, federally regulated loan companies and cooperative retail associations (collectively, the institutions) are required by their respective Acts<sup>1</sup> to maintain adequate capital. The leverage requirements set out in OSFI's Leverage Requirements guideline (the LR guideline), together with the capital standards specified in the Capital Adequacy Requirements guideline (the CAR guideline), provide the framework within which OSFI assesses whether an institution maintains adequate capital pursuant to the Acts. In particular, the LR guideline sets out the framework for the leverage ratio for institutions, which provides an overall measure of the adequacy of an institution's capital and serves as a supplementary measure to the risk-based capital requirements specified in the CAR guideline.

Previously, OSFI issued a draft version of the CAR guideline that included proposed changes related to derivatives exposures and certain securitization exposures, to reflect Canadian adoption of certain aspects of the Basel III framework of the Basel Committee on Banking Supervision (Basel Committee). In order to ensure that the LR guideline remains aligned with the CAR guideline, OSFI is proposing the following changes:

1. Replacing the Current Exposure Method (CEM) with the Standardized Approach to Counterparty Credit Risk (SA-CCR) as the method for computing counterparty credit risk exposure amounts for derivatives.

The Basel Committee formulated the SA-CCR to develop a risk sensitive methodology for computing counterparty credit risk exposure that, among other things, appropriately differentiated between margined and unmargined derivatives transactions and provided more meaningful recognition of netting benefits than the CEM. The CEM had been criticized for several limitations, in particular that it did not differentiate between margined and unmargined transactions, it did not sufficiently capture the level of volatilities as observed over stress periods and the recognition of netting benefits was too simplistic and not reflective of economically meaningful relationships between derivatives positions.

The proposed change to the LR guideline aligns with the planned implementation of SA-CCR under Chapter 4 (Settlement and Counterparty Risk) of the CAR guideline.

2. Amending the treatment of securitized assets that meet the operational requirements for recognition of significant risk transfer (SRT) to align with the proposed revisions to Chapter 7 (Securitization) of the CAR guideline.

The securitization framework is applied in determining the risk-weighted capital treatment applicable to all securitization exposures that meet the definitions and operational requirements in Chapter 7 (Securitization) of the CAR guideline. Institutions must apply the securitization framework for determining regulatory capital requirements on exposures arising from traditional and synthetic securitizations or similar structures that contain features common to both.

The treatment of securitized assets that meet the operational requirements for recognition of SRT is proposed to be revised in Chapter 7 (Securitization) of the CAR guideline. The proposed change in the LR guideline is intended to align with these changes.

3. Aligning credit conversion factors for off-balance sheet securitization exposures in the LR guideline with those under the proposed revisions to Chapter 7 (Securitization) of the CAR guideline.

## What's Next

Comments on the proposed changes are due by September 21, 2018. Once the public consultation is complete, OSFI will consider all comments when developing the final version of the LR guideline, which will be effective November 1, 2018 (for institutions with a fiscal year ending October 31) or January 1, 2019 (for institutions with a fiscal year ending December 31).

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<sup>1</sup> Subsections 485(1) and 949(1) of the *Bank Act*, subsection 473(1) of the *Trust and Loan Companies Act* and subsection 409(1) of the *Cooperative Credit Associations Act* (collectively, the "Acts").

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By: [Stephen J. Redican](#), [Michael Taylor](#)

Services: [Securities Disputes](#), [Financial Services Regulatory](#)

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