

Sector Brief: OSFI Proposes Changes to Capital Adequacy Requirements (CAR)

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Introduction

On February 20th, 2025, the Office of the Superintendent of Financial Institutions (OSFI) launched a [consultation](#) on proposed changes to the Capital Adequacy Requirements (CAR) for Federally Regulated Financial Institutions (FRFI).

The stated intent of the proposed revisions is to clarify existing capital rules and support their more consistent application under the credit risk [Standardized Approach \(SA\)](#) and [Internal Ratings-based \(IRB\)](#) approaches in Chapters 4 and 5, respectively. This includes ensuring the treatment of Combined Loan Products is consistent with their risks and structure. OSFI intends to:

- update how it defines income-producing residential real estate exposures and clarify the treatment of certain U.S. government-sponsored entities;
- propose changes under the market risk Standardized Approach, so it aligns more closely with the Basel Framework, and clarify the credit valuation adjustment framework; and
- after the end of Canadian Dollar Offered Rate (CDOR) last June, OSFI will remove references to Bankers' Acceptances and CDOR.

CCUA has itemized substantial changes below and offers a redline version in the appendix for credit unions to reference.

CCUA welcomes sector feedback up to March 24, 2025. Please contact [Morgan Paulgaard](#).

Background: Indefinite Deferral of Capital Floor

The CAR Guideline also clarifies the next steps on the Basel III capital floor following its February 12th announcement that implementation of the capital floor has been indefinitely deferred. This means that the output floor will remain at 67.5% until further notice.

The announcement stems from uncertainty over slowed implementation of Basel III in other jurisdictions, such as the United States, due to political pressure. OSFI noted that requiring Canadian banks to conform to certain elements of Basel III while other jurisdictions decelerate adoption creates competitive challenges for Canadian banks operating internationally.

Moreover, OSFI states that it commits to notifying affected banks at least two years prior to resuming an increase in the output floor. The federal regulator also commits to monitoring the progress of the Basel III reforms in other jurisdictions and engaging with stakeholders to ensure its approach remains aligned with evolving global standards.



Summary of Changes

CCUA has listed substantive updates below for credit unions to reference. Due to the similarity of amendments in both [Chapter 4: Credit Risk – Standardized Approach](#) and [Chapter 5: Credit Risk – Internal Ratings-Based Approach](#), we have only listed updates to Chapter 4. However, credit unions are welcome to reference changes in Chapter 5, as applicable. To review the amendments in blackline, please see the appendix.

A summary of changes to Chapter 4 is as follows:

- Amend paragraph 82 and renumbered paragraphs 87 and 88 in subsection 4.1.9: Retail exposures, by renaming the third category for retail exposures from “Other” to “Non-Regulatory.”
- Amend renamed paragraph 104 in subsection 4.1.11: Exposures secured by residential real estate, by restructuring the paragraph and including a reminder to adhere to [Guideline B-20 – Residential Mortgage Underwriting Practices and Procedures](#).
- Add paragraph 105 in subsection 4.1.11: Exposures secured by residential real estate, which permits an institution to rely on its “internal indicators to determine which loans are identified as materially dependent on cash flows generated by the property” if it can demonstrate, at OSFI’s request, that its internal policies for investment and rental properties “do not permit loans where more than 50% of the borrower’s ability to service the loan comes from cashflows generated by the property.”
- Amend renamed paragraph 129 under section 4.1.18: Off-balance sheet items, by removing reference to Banker’s Acceptances.
- Amend paragraph 1.8 under section 4.1.21 Defaulted exposures, by adding the following: “Additional guidance on indications of unlikeliness to pay can be found in [OSFI Implementation Notes](#), [IFRS 9 Guidance](#) and applicable accounting standards.”
- Amend paragraph 142, also under section 4.1.21 Defaulted exposures, by substituting “credit obligation” for “facility”, and “borrower” for “obligor,” removing a reference to the Basel Framework (CRE 20.105), and adding the following: “All products secured by the same property issued as part of the same combined loan product (CLP) are to be considered a single facility. That is, if a retail borrower is deemed to have defaulted on any product within a CLP, it is deemed to have defaulted on all products in the CLP. [Basel Framework, CRE 20.104 and CRE 36.71]”

Footnotes

- Add footnote 14 to paragraph 19 under section 4.1.2 Exposures to non-central government public sector entities (PSEs). The footnote reads: “This includes US Government Sponsored Entities (GSEs) who are in conservatorship or receivership. As such, these will be assigned a 20% risk weight under the Standardized Approach. Further, US GSEs will be treated as PSEs under the IRB approach and subject to the parameter floors listed in paragraphs 85 and 98 of Chapter 5.”
 - For reference, the corresponding paragraph to footnote 14, paragraph 19, reads as follows: “PSEs in foreign jurisdictions should be given the same capital treatment as that

applied by the regulatory authorities in that jurisdiction^{Footnote14}. [Basel Framework, CRE 20.12]”

- Add footnote 26 to paragraph 70 in section 4.1.8 Subordinated debt, equity and other capital instruments. The footnote reads: “For investments in the capital and/or Other TLAC Instruments of banking, financial, or insurance entities, institutions should also refer to section 2.3 of Chapter 2 of this guideline and apply the applicable regulatory adjustment.”
 - For reference, the corresponding paragraph to footnote 26, paragraph 70, reads as follows: “The treatment described in paragraphs 71 to 78 applies to subordinated debt, equity and other regulatory capital instruments issued by either corporates or other institutions, provided that such instruments are not deducted from regulatory capital or risk-weighted at 250% according to section 2.3.1 of Chapter 2 of this guideline^{Footnote26}. It also excludes equity investments in funds treated under paragraphs 145 to 163. [Basel Framework, CRE 20.53]”

Note that the above updates exclude cosmetic changes (i.e., updates to graphs, grammatical changes, and re-numbering paragraphs and footnotes).

Appendix: Redline of Amendments to Chapter 4: Credit Risk – Standardized Approach

4.1.9. Retail exposures

82. Exposures within the retail asset class will be treated according to paragraphs 83 to 87 below. For the purpose of determining risk-weighted assets, the retail exposure asset class consists of the following three sets of exposures:

1. Regulatory retail exposures to transactors.
2. Regulatory retail exposures that do not arise from exposures to transactors.
3. ~~Other~~Non-regulatory retail exposures.

[Basel Framework, CRE 20.64]

Note: name change from “other” to “non-regulatory” is also proposed for renamed paragraphs 87 and 88.

4.1.11. Exposures secured by residential real estate

104. The primary source of these cash flows would generally be lease or rental payments, or the sale of the residential property. The distinguishing characteristic of these exposures compared to other residential real estate exposures is that both the servicing of the loan and the prospects for recovery in the event of default depend materially on the cash flows generated by the property securing the exposure. ~~The or on cash flows generated by other mortgaged residential properties. In addition, the~~ loan should be considered materially dependent on cash flows generated by the property and subject to the risk weights in Table 11, if the loan is identified as relying on rental income, consistent with the institution’s internal indicators. In addition, any loan where more than 50% of the ~~borrower’s~~borrower’s income used in the ~~institution’s~~institution’s assessment of the ~~borrower’s~~borrower’s ability to service the loan is from cash flows generated ~~by~~from the residential property. ~~Income generated from other residential real estate properties~~ should ~~not~~ be considered ~~when determining whether the loan is as~~ materially dependent

~~on the borrower's income-cash flows generated by the property and subject to the risk weights in Table 11. In cases where the borrower has multiple mortgages, the income used for this assessment should be adjusted by removing income used to validate the borrower's ability to service mortgages on other properties. Institutions may alternatively categorize all investment or rental properties, as identified usingshould be able to demonstrate, at OSFI's request, that their internal property purpose indicators, as income producing and subject to the risk weights in Table 11, provided that their internal policies for investment and rental properties can be shown, at OSFI's request, to require that less than 50% of the gross income from the property be used in the institution's assessment of the borrower's ability to service the loan, meet the expectations set out in OSFI's Guideline B-20 – Residential Mortgage Underwriting Practices and Procedures. [Basel Framework, 20.79]~~

105. If an institution can demonstrate, at OSFI's request, that its internal policies for investment and rental properties do not permit loans where more than 50% of the income used to assess a borrower's ability to service the loan comes from cash flows generated by the property, then the institution may solely rely on its internal indicators to determine which loans are identified as materially dependent on cash flows generated by the property.

4.1.18. Off-balance sheet items

~~126-127.~~ Off-balance sheet items will be converted into credit exposure equivalent amounts through the use of credit conversion factors (CCF). In the case of commitments, the committed but undrawn amount of the exposure would be multiplied by the CCF. [Basel Framework, CRE 20.94]

~~127-128.~~ A 100% CCF will be applied to the following items:

1. Direct credit substitutes, e.g. general guarantees of indebtedness or equivalent instruments backing financial claims (including standby letters of credit serving as financial guarantees for loans and securities) ~~and acceptances (including endorsements with the character of acceptances).~~ With a direct credit substitute, the risk of loss to the institution is directly dependent on the creditworthiness of the counterparty.

4.1.21. Defaulted exposures

~~140-142.~~ For risk-weighting purposes under the standardized approach, a defaulted exposure is defined as one that is past due for more than 90 days, or is an exposure to a defaulted borrower. A defaulted borrower is a borrower in respect of whom any of the following events have occurred:

[...]

8. Any other situation where the institution considers that the borrower is unlikely to pay its credit obligations in full without recourse by the institution to actions such as realizing security. Additional guidance on indications of unlikelihood to pay can be found in OSFI Implementation Notes, IFRS 9 Guidance and applicable accounting standards.

[Basel Framework, CRE 20.104]

~~141-143.~~ For retail exposures, the definition of default can be applied at the level of a particular credit obligation facility, rather than at the level of the borrower obligor. As such, default by a borrower on one obligation does not require an institution to treat all other

obligations to the banking group as defaulted. [Basel Framework, CRE 20.105 All products secured by the same property issued as part of the same combined loan product (CLP) are to be considered a single facility. That is, if a retail borrower is deemed to have defaulted on any product within a CLP, it is deemed to have defaulted on all products in the CLP. [Basel Framework, CRE 20.104 and CRE 36.71]

Footnote 14

This includes US Government Sponsored Entities (GSEs) who are in conservatorship or receivership. As such, these will be assigned a 20% risk weight under the Standardized Approach. Further, US GSEs will be treated as PSEs under the IRB approach and subject to the parameter floors listed in paragraphs 85 and 98 of Chapter 5.

Footnote 26

For investments in the capital and/or Other TLAC Instruments of banking, financial, or insurance entities, institutions should also refer to section 2.3 of Chapter 2 of this guideline and apply the applicable regulatory adjustment.