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OSFI UNWINDS CAPITAL DISTRIBUTION COVID RESPONSE MEASURE

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On November 4, 2021, the Office of the Superintendent of Financial Institutions ("**OSFI**") announced an immediate end to its COVID-19 pandemic response measure announced on March 13, 2020 relating to capital distributions. As such, federally regulated financial institutions ("**FRFIs**") may once again increase regular dividends and executive compensation and, subject to the existing requirement for Superintendent approval, repurchase common shares. Note that FRFIs are expected to maintain and update their capital plans reflecting their planned capital distributions and notify OSFI at least 15 days in advance of the payment of any dividend (pursuant to the *Bank Act and Insurance Companies Act*).

In his announcement, Superintendent Peter Routledge set out three reasons for the decision. First, the intent of the capital distribution restrictions was to "counter-balance" the regulatory support provided to FRFIs during the pandemic, most of which has since been reversed.[]]_Second, under the *OSFI Act*, FRFIs and their boards of directors are generally assigned the responsibility of taking competitive risks, including with respect to capital distributions. Though the capital distribution restrictions were justified in response to extraordinary market circumstances, those conditions have since subsided. Finally, OSFI has confidence that boards of directors and senior management will act responsibly in making decisions with respect to capital distributions, including taking into account environmental, social, and governance expectations.

The Superintendent's announcement follows several other COVID response measure rollbacks made throughout 2021. A discussion of some of OSFI's other impactful COVID-19 response measures for federally regulated deposit-taking institutions ("**DTIs**") is below.

Decrease to Stressed Value at Risk ("SVaR") Multiplier

DTIs are required to calculate their market risk capital requirement by including a VaR estimate of their portfolio under both current conditions (VaR) and under a stress period (SVaR). The intent of SVaR is to ensure that a minimum amount of capital is held against stress periods. However, as a result of COVID-19, VaR had increased significantly to reach SVaR levels, leading to excessive capital requirements. On March 27, 2020, OSFI reduced the SVaR multiplier from a multiplier of at least three to a multiplier of at least

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one. In a letter dated March 16, 2021, OSFI indicated that financial market conditions had stabilized and that the heightened volatility present in historical minimum observation periods used for calculating regulatory VaR should have subsided by the end of April, 2021. As such, this change was unwound as of May 1, 2021.

Covered Bond Limit

• On March 27, 2020, OSFI increased the covered bond limit from 5.5% to 10.0% of total assets, which provided DTIs with greater access to Bank of Canada facilities. Covered bonds are debt securities, issued by banks, designed to address issuer failure risk through collateralizing an asset pool. The increase was unwound on April 6, 2021 due to stabilized bank liquidity and access to term funding, in addition to the Bank of Canada's announcement on October 15, 2020 that own-name covered bonds, own-name term asset-backed securities and own-name asset-backed commercial paper would no longer be eligible for regular term repo operations.

Domestic Stability Buffer

 On March 13, 2020, the Domestic Stability Buffer ("DSB") for Canada's Domestic Systematically Important Banks ("D-SIBs") was reduced from 2.25% of total risk-weighted assets to 1.00%. This reduction enabled D-SIBs to absorb potential losses instead of preserving their capital to meet OSFI's requirements (for instance, by limiting their lending operations). Given OSFI's view that COVID-19 market disruptions have now ceased, the DSB was set at 2.50% of total risk-weighted assets effective October 31, 2021. OSFI views 2.50% as a prudent buffer given current vulnerabilities such as elevated household and corporate debt levels.

Exclusion of Sovereign-Issued Securities from the Leverage Ratio

On April 9, 2020, OSFI announced that DTIs can exclude central bank reserves and sovereign-issued securities that qualify as High Quality Liquid Assets (HQLA) under OSFI's Liquidity Adequacy Requirements Guideline from their leverage ratio exposure measures. The leverage ratio provides an overall measure of the adequacy of a DTIs capital, which is assessed together with the risk-based capital ratio set out in OSFI's Capital Adequacy Requirements Guideline. On August 12, 2021, OSFI confirmed that sovereign-issued securities will no longer be excluded from the leverage ratio exposure measure as of December 31, 2021. However, central bank reserves will continue to be excluded from the leverage ratio exposure measure for DTIs until otherwise notified.

With this announcement, OSFI unwinds one of the last significant COVID-19 response measure for DTIs, signaling its confidence in Canada's FRFIs and its optimism for Canada's post-COVID economy.



[] <u>Remarks by Superintendent Peter Routledge, Virtual event hosted by OSFI via webast on November 4, 2021</u>

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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