OSFI UNVEILS NEW SUPERVISORY FRAMEWORK (EFFECTIVE APRIL 2024)

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Following our previous update in October 2023, on February 8, 2024 the Office of the Superintendent of Financial Institutions ("**OSFI**") announced the release of its new Supervisory Framework ("**SF**") for federally regulated financial institutions ("**FRFIs**") and private pension plans.[1] The SF comes into force on April 1, 2024 and is touted to be the most significant change to OSFI's supervisory approach in 25 years.

Overview of the new SF

The revamped SF includes an expansion of OSFI's risk rating scale, introduces greater transparency for regulated institutions, and establishes new risk categories.[2]

The SF process is composed of four main elements: identifying risks, assessing risks, responding to risks, and reporting the results.[3] It categorizes FRFIs and pension plans into five different tiers according to their size, complexity, and system impact, and assigns each one an Overall Risk Rating ("**ORR**"). The ORR has a 1-8 scale and expands upon the existing Intervention Stage rating system by adding in four new early stages to enhance granularity and provide signals for early corrective action.[4] In addition to the ORR, larger institutions (in Tiers 1-4) will also receive ratings for each individual category considered in the risk assessment stage, and the largest institutions (Tiers 1-3) will receive additional risk analysis. These apply to both FRFIs and pension plans but are adapted to reflect the characteristics of their respective stakeholders.

The SF Process

For both FRFIs and pension plans, the risk identification stage involves analyzing risk trends and scanning for emerging risks in the broader environment. Data analytics are used to generate insights and to provide a starting point for supervisory judgement. For pension plans, risk identification also includes a review of actuarial reports and an estimate of the pension plan's solvency ratio.

In the risk assessment stage, OSFI will assign each FRFI and pension plan an ORR based on their business risk, financial resilience, operational resilience, and risk governance, with larger regulated entities receiving additional details. OSFI notes that perfection is not necessary to obtain the lowest risk rating (an ORR of 1), but it does require OSFI to have confidence in the FRFI or pension plan to manage the small issues identified. This can be achieved by being more transparent with OSFI with respect to the FRFI's or pension plan's internal oversight and governance processes.

OSFI will take an outcome focused approach, meaning that OSFI will relay to FRFIs and pension plans OSFI's desired outcomes of any identified risks, and give them significant autonomy in choosing how to address them. However, if a FRFI or pension plan fails to adequately address the identified concerns, OSFI will escalate the level of intervention, which could possibly lead to OSFI taking temporary or even permanent control of the regulated entity.[5]

The supervisory ratings are not disclosed to the public, and the regulated entities will be notified whenever their ratings change. OSFI may also communicate and share information with other regulators if the need arises.

Takeaways

The new SF aligns OSFI's methodologies with international principles, including those from the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors, and the International Organisation of Pension Supervisors.[6] OSFI acknowledges the inherent risk-based nature of the sector and its need to balance risk taking that is necessary for growth, and mitigating the fallout on society from an institutional failure. As such, the emphasis in the new SF is on prevention, early detection, and early resolution. OSFI has stated that it will review the new framework immediately after its implementation, and at least once every five years.[7]

If you have any questions about the new SF or OSFI's mandate, please do not hesitate to contact us.

[1] OSFI - OSFI releases new Supervisory Framework to modernize financial supervision
[2] OSFI - New Supervisory Framework
[3] OSFI - How we supervise financial institutions
[4] OSFI - How we supervise pension plans
[5] OSFI - A general guide to OSFI's intervention process
[6] OSFI - Supervisory Framework Overview
[7] OSFI - Deputy Superintendent, Ben Gully speech to C. D Howe Institute: What makes an effective prudential supervisor

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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.