CANADIAN BANKERS ASSOCIATION

Focus: Global Banking Regulations and Banks in Canada

Focus Sheet

FAST FACTS

- During the 2007/08 global financial crisis, unlike banks in many other countries, no Canadian banks were bailed out or in danger of failing.
- The 2007/08 crisis resulted in a series of significant regulatory changes for the international banking sector.
- The COVID-19 pandemic of 2020/21 presented a new set of challenges that required governments and regulators to adopt measures to preserve financial stability.
- Canadians understand this: When asked to rate the performance of banks in Canada on stability and security, 75 per cent of Canadians provided a favourable rating.

The Bottom Line

The World Economic Forum has consistently ranked Canada's banks as among the soundest in the world. Canada's prudent banks, combined with effective regulation and supervision, form a model of stability in the global financial system.

Significant regulatory change continues

During the 2007/08 global financial crisis there was significant turmoil in the global financial system and a number of banks in other countries became insolvent and either failed or received taxpayer-funded bailouts. However, no Canadian bank was in danger of failing or needed a government bailout.

Canada's banks were well-capitalized, well-managed, and well-regulated going into the global financial crisis, and remain so to this day as we emerge from the COVID-19 crisis During the pandemic, Canada's banks played a critical role in supporting the Canadian economy and the

What is Basel III?

Basel III was developed and agreed to by members of the Basel Committee on Banking Supervision (BCBS). This is a longstanding committee of the Bank for International Settlements (BIS) that is mandated to review and develop banking guidelines and supervisory standards at a global level.

Basel III is a framework that sets out global regulatory rules for bank capital and liquidity. These rules were originally published in December 2010 in response to the global financial crisis and are subject to ongoing review and updates. In December 2017, the BCBS issued some notable updates entitled '*Basel III: Finalising post-crisis reforms*'.

The phase-in of Basel III capital rules began in 2013. Canada implemented these changes in January 2013, well ahead of many other countries and well ahead of the Basel III timeline. The phase-in of Basel III's liquidity rules began in 2015. Canada is now on a path towards implementation of the Basel III reforms starting in November 2022.

For more information, go to www.bis.org.

financial well-being of Canadians and demonstrated their ongoing resiliency.

While banks in Canada are extremely unlikely to fail, Canadian banks have developed "recovery and resolution plans" that would help the bank recover from financial distress or bring about an orderly resolution in the event of their failure.

However, the global financial crisis led to a series of significant regulatory changes to international banking rules, which are designed to reduce the risk of another financial crisis occurring. While these rules are developed internationally, it is up to domestic regulators to put them in place and enforce them.

There are many important participants – including Canadian policymakers and regulators – involved in shaping and adapting these regulatory changes for Canada's financial system. [See Table of Main Participants below.]

The most significant changes to global banking rules have been in the areas of capital and liquidity. Both the quantity and quality of capital – which helps banks absorb losses – have been increased. In addition, new liquidity requirements have been put in place to help ensure that banks can meet their financial obligations, even in times of stress.

Financial markets are globally integrated. So in the end, the aim is that consistent implementation of these regulatory changes in countries around the world will result in a better functioning global financial system.

Banks in Canada – through and with the Canadian Bankers Association – are working closely with domestic and global regulatory organizations to implement all of the international regulatory changes.

Regulatory Changes

The most significant changes to global banking rules have occurred in the area of capital and liquidity. These changes are described in greater detail below.

1. Capital

"Capital" is the money that bank owners have invested in the bank, either through the purchase of shares or through retained earnings. A bank holds capital to help protect depositors and other stakeholders against losses in the event that borrowers default. Capital is a cushion against the negative impacts of bank-specific and market-related activities that could jeopardize a bank's ability to stay solvent and continue to serve Canadians.

Basel III capital rules

- There are several categories of rules related to capital under Basel III. Taken together, these rules now require banks to hold enough capital to equal at least 10.5% of their total risk-weighted assets.

Global and domestic systemically important banks

- In 2013, the Office of the Superintendent of Financial Institutions (OSFI) named the six largest banks in Canada as "domestic systemically important banks" (D-SIBs). As a result, these six banks are required to hold an additional one per cent of capital as of January 1, 2016 (D-SIB surcharge), and are also subject to a Domestic Stability Buffer (DSB) that ranges from 0 to 2.5 per cent of capital along with more intense supervision and enhanced disclosure requirements.

- The Royal Bank of Canada and Toronto-Dominion Bank were designated by the Financial Stability Board as "global systemically important banks" (G-SIBs) in 2017 and 2019 respectively, but are not subject to any additional capital requirement beyond the existing D-SIB surcharge and DSB.

- The G-SIBs and D-SIBs are treated the same by OSFI given the potential impacts that a failure of any one of them would have on global and domestic economies.

- For small and mid-sized banks, OSFI is developing proportional reflecting the more limited systemic risk associated with smaller financial institutions

Basel III capital rules as they relate to banks in Canada

- The *Capital Adequacy Requirements (CAR) Guideline* reflects how Canadian regulators are implementing the Basel III capital rules in Canada. In December 2012, OSFI issued a revised CAR Guideline to incorporate earlier Basel III reforms and made further updates in subsequent years. OSFI is now in the process of concluding its consultations on the Basel III reforms and expects to publish an updated CAR Guideline in November 2021. In most cases, the updated rules will be implemented starting in November 2022.

- Under the CAR Guideline, OSFI already expects banks to meet target capital levels that equal or exceed the 2019 Basel III minimum capital requirements.

- Under a separate *Leverage Requirements Guideline*,[1] OSFI expects institutions to maintain a leverage ratio that meets or exceeds 3 per cent at all times. OSFI also prescribes authorized leverage ratio requirements for individual institutions.

2. Liquidity

"Liquidity" refers to the ease with which assets can be converted into cash (i.e., liquidated) and sold. For banks, good liquidity is important because it bolsters their resilience to internal and external shocks.

Basel III liquidity rules

- The Basel Committee on Banking Supervision (BCBS) has developed two minimum rules for liquidity – the Liquidity Coverage Ratio (LCR) that has a 30-day horizon, and the Net Stable Funding Ratio (NSFR) that has a time horizon of one year. Both metrics have now been fully implemented in Canada.

- The LCR rules are meant to ensure banks have sufficient, high-quality liquid assets to withstand a period of economic stress.

How OSFI is implementing liquidity rules for banks in Canada

- OSFI issued a revised *Liquidity Principles Guideline* B6 and made updates for the liquidity metrics (e.g. LCR/NSFR) in the *Changes to the Liquidity Adequacy Requirements Guideline*. These guidelines describe how the regulator assesses the strength of a bank's liquidity risk management framework and whether the bank would have adequate liquidity under stressed conditions.

- OSFI's approach is consistent with BCBS's September 2008 *Principles for Sound Liquidity Risk Management and Supervision*.

3. New forms of risk

As we exit the shadow of the financial crisis, banks and regulators around the world, including OSFI, are shifting focus towards new and evolving forms of non-financial risks such as risks related to COVID-19, technological innovation, and climate change.

- In relation to COVID-19, OSFI announced the unwinding of the special capital treatment of loans subject to payment deferrals at the end of August 2020. This was followed by the unwinding of other regulatory adjustments that were implemented during the pandemic related to market risk capital requirements and the covered bond limit. In June 2021, OSFI also announced that the DSB would be raised from one per cent to 2.5 per cent effective October 31, 2021.

- OSFI is evolving its regulatory and supervisory approach as part of its strategic goal to improve banks preparedness for, and resiliency to, non-financial risks. In doing so, OSFI recognizes the importance of banks providing innovative financial services to Canadians while also fostering trust and confidence in the financial sector.

- In 2020, as part of its work on non-financial risks OSFI also sought feedback through a discussion paper on a broad range of issues related to technology risk. These issues included cyber security, third-party risk and advanced analytics. OSFI has subsequently signaled next steps with a proposed schedule setting out upcoming guidance initiatives including developing a new technology and cyber risk guideline and a revised draft guideline on third-party risk.

- In January 2021, OSFI issued a Discussion Paper on climate-related risks in the financial sector which considered the impacts of such risks and how banks and other federally regulated financial institutions and pension plans could prepare for and build resilience to these risks. OSFI expects to publish a letter in the coming months that will summarize feedback received and describe their future plans in this area.

- As part of its work on non-financial risk, OSFI also plans to seek feedback from the industry on the incorporation of the BCBS' principles for operational resilience and the revised principles on operational risk management into domestic guidance.

Table of Main Participants

A number of organizations are involved in aspects of the regulatory changes underway. The table outlines the main participants and their role(s) in global regulations as it pertains to banks in Canada.

NAME OF PARTICIPANT	ROLE(S) IN REGULATION
Global	
Bank for International Settlements (BIS)	Swiss-based organization of which many central banks – including Canada's – are members. BIS and its committees lead much of the global regulatory work stemming from the global financial crisis. BIS was created in 1930. www.bis.org
Basel Committee on Banking Supervision (BCBS)	The BCBS is one of the committees of the BIS. It is the global standard setter for the prudential regulation of banks. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability. Basel

	Committee members include OSFI and the Bank of Canada. The Basel Committee was established in 1974. www.bis.org/bcbs
Financial Stability Board (FSB)	Global group created by the G20 countries in 2009 to monitor and make recommendations about the global financial system. The FSB coordinates the work of national authorities and international standard setters (such as the BCBS) and develops policies to enhance financial stability. Canadian FSB members include the Department of Finance, Bank of Canada, and OSFI. www.fsb.org
Domestic	
Office of the Superintendent of Financial Institutions (OSFI)	The prudential regulator of Canadian banks and other federally regulated financial institutions. Also responsible for implementing Basel Committee principles and guidance in Canada. www.osfi-bsif.gc.ca
Bank of Canada	Canada's central bank, responsible for setting monetary policy and promoting a stable and efficient financial system. www.bankofcanada.ca

Department of Finance	Responsible for the legislative framework governing banks and other federally regulated financial institutions in Canada. www.fin.gc.ca
Canada Deposit Insurance Corporation (CDIC)	CDIC is a federal Crown corporation created by Parliament in 1967 to protect deposits made with member financial institutions in case of their failure. CDIC insures deposits of up to $100,000. CDIC also oversees bank resolution planning and has the authority to intervene in a failing institution. www.cdic.ca

1 "Leverage Requirements Guideline", October 2014, http://www.osfi-bsif.gc.ca/eng/docs/lr.pdf
2 "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools", January 2013, www.bis.org
3 "Basel III: The Net Stable Funding Ratio", October 2014; and "Basel III International framework for liquidity risk measurement, standards and monitoring", December 2010, www.bis.org

The Canadian Bankers Association is the voice of more than 60 domestic and foreign banks that help drive Canada's economic growth and prosperity. The CBA advocates for public policies that contribute to a sound, thriving banking system to ensure Canadians can succeed in their financial goals.

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