Guideline impact analysis statement

Title	Liquidity Adequacy Requirements (LAR) Guideline – Guideline impact analysis statement (2019)
Category	Capital Adequacy Requirements
Date	April 30, 2019
Sector	Banks Trust and Loan Companies

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I. Background

OSFI's LAR Guideline provides a framework for assessing the liquidity adequacy of banks, bank holding companies and federally regulated trust and loan companies (collectively referred to as "institutions"). In January 2013, the Basel Committee on Banking Supervision (BCBS) released Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools. In May 2014, OSFI issued LAR Chapter 2 (Liquidity Coverage Ratio (LCR)), which came into force as of January 1, 2015, along with several other liquidity monitoring tools. This included LAR Chapter 4 (Net Cumulative Cash Flow (NCCF) supervisory tool). Finally, in October 2014, the BCBS released a complementary regulatory standard that promotes longer-term resilience, the Basel III: the net stable funding ratio (NSFR).

II. Problem Identification

The environment in which Canadian institutions operate has evolved considerably since the LCR and the NCCF metrics were introduced. Some institutions increasingly rely on deposit funding that may experience higher risk of withdrawals in periods of stress. Such funding models can amplify risks for both individual institutions and for the financial system at large.

Under the LCR and NCCF, deposits are allocated to different categories according to the degree to which those sources of funding would be at risk under stressed conditions. Currently, these two metrics do not sufficiently distinguish amongst these categories of deposits. Moreover, supervisory reviews indicate that there is a wide range of practice across institutions' internal frameworks for identifying and measuring less stable deposits.

In addition to building resilience to short-term liquidity stress, institutions should maintain a stable funding profile over a longer-term horizon to reduce the risk of future funding stress. Currently, OSFI does not have a structural metric, like the NSFR, that provides an incentive for institutions to maintain a stable and longer-term funding profiles in relation to the composition of their on- and off-balance sheet exposures.

Finally, OSFI does not have a monitoring tool that provides high-frequency data to identify and track less stable sources of funding that some institutions rely upon heavily.

III. Objectives

OSFI's objective is to ensure that the expectations in LAR Guideline for measuring and monitoring liquidity risk remain comprehensive and current. OSFI also aims to promote consistency of industry practice for the identification of risk exposures.

Specifically, Chapters 2 and 4 introduce targeted revisions to the treatment of less stable retail deposits. The revisions further distinguish between certain types of deposits that exhibit higher risk of withdrawal, and assign higher run-off rates to riskier deposits relative to the current calibration. The enhanced guidance on key definitions characterizing these deposits will aid with the institutions' risk identification practices as well as with OSFI's supervisory monitoring and review.

Chapter 3 introduces the NSFR, a long-term structural liquidity metric, designed to promote funding stability by limiting reliance on short-term wholesale funding. The NSFR aims to reduce the likelihood that disruptions to institutions' funding will erode liquidity positions in a way that could increase the risk of failures and that could lead to systemic liquidity stress.

Chapter 5 introduces an additional liquidity monitoring tool, the Liquidity Activity Monitor (LAM), that collects frequent and timely key account balances from select institutions. The LAM is designed to improve OSFI's ability to monitor changes in an institution's funding components.

IV. Consultations

OSFI issued the draft Guideline revisions on the NSFR for public consultation in December 2018. The targeted revisions to LCR, NCCF, and liquidity monitoring tools were issued for public consultation in February 2019. The cover letter to the final guideline contains a summary of material comments received from stakeholders and an explanation of how they have been addressed.

V. Recommendations

OSFI recommends that the LAR Guideline be updated to incorporate the targeted revisions to institutions' risk measurement of the LCR (Chapter 2), the NSFR (Chapter 3), the NCCF supervisory tool (Chapter 4), and other liquidity monitoring tools (Chapter 5), as well as corresponding amendments to Chapter 1 - *Overview* . These modifications will ensure OSFI's liquidity requirements remain sound and prudent in a manner that will maintain the overall resilience of deposit-taking institutions and the Canadian banking sector as a whole.

VI. Implementation & Evaluation

The guideline will be effective January 1, 2020. OSFI will monitor adherence to the guideline through ongoing supervision of institutions.