Draft Guideline

Subject: Small and Medium-Sized Deposit-Taking Institutions (SMSBs) Capital and Liquidity Requirements

Category: Capital Adequacy Requirements
Leverage Requirements
Liquidity Adequacy Requirements

Effective Date: November 2022 / January 2023

Subsections 485(1) and 949(1) of the Bank Act (BA), subsection 473(1) of the Trust and Loan Companies Act (TLCA) require banks (including federal credit unions), bank holding companies, federally regulated trust companies, and federally regulated loan companies to maintain adequate capital and adequate and appropriate forms of liquidity. This Small and Medium-Sized Deposit-Taking Institutions Capital and Liquidity Requirements Guideline (SMSB-CLR) is not made pursuant to subsections 485(2) or 949(2) of the BA, or to subsection 473(2) of the TLCA. However, the capital, leverage and liquidity standards referred to in this guideline, from the requirements set out in the Capital Adequacy Requirements (CAR), Leverage Requirements (LR) and Liquidity Adequacy Requirements (LAR) Guidelines, provide the framework within which the Superintendent assesses whether a bank, a bank holding company, a trust company, or a loan company maintains adequate capital and liquidity pursuant to the Acts. For this purpose, the Superintendent has established the following minimum standards:
- the leverage ratio described in the LR Guideline;
- the risk-based capital ratios described in the CAR Guideline²;
- the Liquidity Coverage Ratio (LCR) described in the LAR Guideline; and,
- the Net Stable Funding Ratio (NSFR) described in the LAR Guideline.

The first measure provides an overall measure of the adequacy of an institution's capital. The second measure focuses on risk faced by the institution. The third and fourth measures – in conjunction with additional liquidity metrics where OSFI reserves the right to apply supervisory requirements as needed, including the net cumulative cash flow (NCCF), the operating cash flow statement (OCFS), the liquidity monitoring tools and the intraday liquidity monitoring tools which, when assessed as a package – provide an overall perspective of the liquidity adequacy of an institution.

¹ For institutions with a fiscal year ending October 31 or December 31, respectively
² The capital and leverage requirements for domestic systemically-important banks are supplemented by the requirements described in OSFI’s Total Loss Absorbing Capacity (TLAC) Guideline.
Notwithstanding that a bank, bank holding company, trust company, or loan company may meet these standards, the Superintendent may direct a bank or bank holding company to increase its capital or to take actions to improve its liquidity under subsections 485(3) or 949(3) of the BA, or a trust company or a loan company to increase its capital or to take actions to improve its liquidity under subsection 473(3) of the TLCA.
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I. Purpose of the Guideline

1. This guideline details the criteria OSFI uses to segment small and medium-sized deposit-taking institutions (SMSBs) into three categories for the purposes of determining capital and liquidity requirements.

2. Capital and liquidity requirements for SMSBs are detailed in the Capital Adequacy Requirements (CAR) Guideline, the Leverage Requirements (LR) Guideline and the Liquidity Adequacy Requirements (LAR) Guideline, which are referenced throughout. This guideline is a reference tool for SMSBs to clarify which parts of the CAR, LR and LAR are applicable to SMSBs in their category.

II. Scope of Application

3. For the purposes of this guideline, SMSBs are banks (including federal credit unions), bank holding companies, federally regulated trust companies, and federally regulated loan companies that have not been designated by OSFI as domestic systemically important banks (D-SIBs). This includes subsidiaries of SMSBs or D-SIBs that are banks (including federal credit unions), federally regulated trust companies or federally regulated loan companies.

4. The segmentation, capital and liquidity requirements referenced in this guideline apply to SMSBs on a consolidated basis.

III. Segmentation of SMSBs

5. SMSBs are segmented into three categories for the purposes of their capital and liquidity requirements based on the general criteria, as follows:
   - SMSBs reporting more than $10 billion in total assets are in Category I; and,
   - SMSBs with less than $10 billion in total assets are either in
     - Category II, if they report more than $100 million in total loans; or,
     - Category III, if they report less than $100 million in total loans.

6. Subsidiaries of SMSBs are subject to the same capital and liquidity requirements as their parent institution. Provided the criteria outlined in the exemption of section 1.2 of the LAR Guideline are met, some subsidiaries of SMSBs may be exempted from adhering to minimum liquidity requirements.

7. Subsidiaries of D-SIBs are considered to be in Category I for the purposes of capital and liquidity requirements.

8. Notwithstanding the general criteria in paragraph 5, OSFI has the discretion to move an institution into a different category. Factors OSFI may consider include:
   - Changes in an institution’s activities that may not yet be reflected in its balance sheet; and,

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3 All dollar values in this guideline are in Canadian dollars, unless otherwise noted.
- An institution’s business model, where its category, based on the general criteria above, would result in capital or liquidity requirements that do not appropriately reflect its activities and risks.

OSFI will notify any institutions that are moved into a category different from the general criteria in paragraph 5, including the time period in which the institution must meet the requirements of its new category.

9. New SMSBs will be categorized based on the planned activities and balance sheet in the institution’s business plan. The categorization will be confirmed at the time the Superintendent issues an Order to Commence and Carry on Business.

10. For the purposes of SMSB segmentation, institutions must calculate average total assets and total loans at the end of each fiscal year based on the amount reported in OSFI’s M4 monthly Balance Sheet return for each of the previous 12 months. If an institution crosses either the $10 billion total assets or $100 million total loans thresholds, they must notify OSFI within 60 days of their fiscal year end, and after confirmation by OSFI, would be subject to the requirements of their new category the following fiscal year.

11. Once an institution migrates to a new category, it must remain in the new category for a minimum of two fiscal years. If, after two fiscal years in a category, an institution crosses a segmentation threshold, the institution would be subject to the requirements of their new category the following fiscal year.

The following example illustrates how the threshold for segmentation would operate in practice. The example focuses on the migration between Categories III and II, however the process would be the same with the $10 billion total asset threshold to move between Categories II and I.

An institution initially has $90 million in total loans and is therefore in Category III.

In Q1 2024, the total loans threshold would be assessed using fiscal 2023 data. If the average total loans using the 12 month-end balances from fiscal 2023 is above $100 million, the institution has crossed the threshold and would need to meet the capital and liquidity requirements for Category II for fiscal years 2025 and 2026.

In Q1 2026, the 12-month average calculation would be performed again using the 12 month-end balances from fiscal 2025. If the average total loans using fiscal 2025 data is below the $100 million threshold, the institution has crossed the threshold and would need to meet the capital and liquidity requirements for Category III for fiscal years 2027 and 2028.
IV. Category I SMSBs – Capital and Liquidity Requirements

4.1 Risk-Based Capital Requirements

4.1.1 Overview of Risk-Based Capital Requirements and Definition of Capital

12. Chapter 1 of the CAR Guideline explains how to calculate risk-based capital ratios and the minimum and target ratios.
   - The minimum risk-based capital ratios for Category I SMSBs are in CAR Chapter 1, section 1.6.1.
   - Category I SMSBs are also subject to the capital conservation buffer in CAR Chapter 1, section 1.7.1.
   - The capital targets for Category I SMSBs are summarized in CAR Chapter 1, section 1.10.
   - The countercyclical buffer (CAR Chapter 1, section 1.7.2) may also be applicable to Category I institutions. OSFI will inform SMSBs whenever the countercyclical buffer has been deployed in Canada and must be applied to domestic exposures. Category I institutions must also apply the countercyclical buffer for any international exposures where the countercyclical buffer has been deployed by the local regulator.
   - The D-SIB Surcharge and the Domestic Stability Buffer described in Chapter 1 of the CAR Guideline are not applicable to Category I SMSBs.
   - Annex 1 of Chapter 1 of the CAR Guideline (Domestic Systemic Targets and Capital Targets) is not applicable to Category I SMSBs.

13. Category I SMSBs are eligible to apply to use the Internal Ratings Based (IRB) approach for credit risk, as detailed in section 1.4.1 in Chapter 1 of the CAR. CAR Chapter 1, section 1.5, which describes the Capital Floor, is only applicable to Category I SMSBs that have been approved by OSFI to use the IRB approach.

14. Chapter 2 of the CAR Guideline defines the tiers of capital used in the calculation of the risk-based capital ratios, as well as required adjustments to each tier of capital.

4.1.2 Operational Risk

15. Chapter 3 of the CAR Guideline details how to calculate operational risk capital requirements using either the Simplified Standardized or Standardized Approach.

16. Category I SMSBs with an annual Adjusted Gross Income greater than $1.5 billion must use the Standardized Approach (see CAR Chapter 3, section 3.2 and section 3.4).

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4 The countercyclical buffer is to be computed and applied at the consolidated FRFI parent level, i.e. OSFI regulated deposit-taking institutions who are subsidiaries of an OSFI regulated deposit-taking institution are not subject to the countercyclical buffer.
5 Adjusted Gross Income is defined in CAR Chapter 3, section 3.3
17. Category I SMSBs with an annual Adjusted Gross Income less than $1.5 billion are also eligible to apply to use the Standardized Approach, if they meet the criteria detailed in section 3.2 of the CAR Guideline.

18. Unless approved by OSFI to use the Standardized Approach, Category I SMSBs with an annual Adjusted Gross Income less than $1.5 billion must use the Simplified Standardized Approach (section 3.3 of CAR Chapter 3). For these institutions, CAR Chapter 3, section 3.4 (Standardized Approach) is not applicable.

**Chart 1- Application of Operational Risk Framework (CAR Chapter 3) for Category I Banks**

![Diagram](image)

4.1.3 Credit Risk

19. The following section provides information related to the credit risk requirements for Category I SMSBs, broken down by the following exposure types:
   - Banking Book;
   - Securitization; and,
   - Exposures with Counterparty Credit Risk.

**Banking Book Exposures**

20. Risk-weighted assets (RWA) for *banking book* exposures, with the exception of certain securitizations, exposures with counterparty credit risk and CVA exposures, are calculated using either the Standardized or IRB approach.
   - Chapter 5 of the CAR Guideline details the IRB approach to calculating credit risk capital. This chapter is only applicable to those Category I SMSBs that have received OSFI approval to use the IRB approach.
   - Chapter 4 of the CAR Guideline details how to calculate credit risk capital using the Standardized Approach. This chapter is applicable to all Category I SMSBs. Category I SMSBs are eligible to apply a simplified treatment to the asset class groupings listed in
Appendix I of Chapter 4 of the CAR Guideline, provided the total exposure to the asset class grouping does not exceed $500 million.

21. Category I SMSBs may reflect eligible guarantees or credit derivatives designed to mitigate credit risk for banking book exposures in the calculation of RWA using either:
   - the IRB approach, if an institution has approval to use the IRB approach for both the original exposure and the guarantor. The recognition of guarantees and credit derivatives under the IRB approach is detailed in section 5.4 of Chapter 5 of the CAR Guideline; or,
   - the Standardized Approach, as detailed in section 4.3 of Chapter 4 of the CAR Guideline, for all other guarantees and credit derivatives.

Chart 2 – Application of the CAR Guideline for Credit Risk in the Banking Book for Category I SMSBs (CAR Chapters 4-5)
Securitization Exposures

22. Chapter 6 of the CAR Guideline details how to calculate RWA for securitization exposures. This chapter is only applicable for Category I SMSBs if they have securitization exposures that involve tranching, with associated subordination of credit risk, as defined in paragraph 3 and section 6.1 of Chapter 6 of the CAR Guideline.\(^6\)

- Securitization exposures can include, but are not restricted to, the following: asset-backed securities, mortgage-backed securities, credit enhancements, liquidity facilities, loans to securitization vehicles to fund the acquisition of assets, interest rate or currency swaps, credit derivatives and tranched cover.\(^7\)

23. In order to apply the securitization treatment in Chapter 6 for exposures originated by the institution (e.g. assets sold into a securitization structure), the operational requirements for risk transference detailed in section 6.3 must be met.\(^8\) If these requirements are not met, institutions must risk weight the assets underlying the securitization as if they had not been securitized.

24. When calculating RWA for each securitization exposure, institutions must follow the hierarchy of approaches outlined in section 6.5.2 of Chapter 6 of the CAR Guideline. The terms used in the descriptions of the approaches are defined in section 6.2 of CAR Chapter 6.

- The Securitization Internal Ratings-Based Approach (SEC-IRBA, section 6.6.1 in Chapter 6 of the CAR Guideline) and the Internal Assessment Approach (SEC-IAA, section 6.6.3 in Chapter 6 of the CAR Guideline) are only applicable to Category I SMSBs that have received OSFI approval to use IRB approaches for the relevant assets in these securitization structures.

- Category I institutions that have not received OSFI approval to use IRB approaches for the relevant assets must use either the External Ratings-Based Approach (SEC-ERBA, section 6.6.2 in Chapter 6 of the CAR Guideline) or the standardized approach (SEC-SA, section 6.6.4 in Chapter 6 of the CAR Guideline).

\(^6\) For example, Chapter 6 of the CAR Guideline is not applicable for National Housing Act Mortgage-Backed Securities (NHA MBS) since these structures do not include tranches of securities with differentiated credit risk. NHA MBS should be risk-weighted as per CAR Chapter 4.

\(^7\) Tranched cover is described in CAR Chapter 4, paragraph 273.

\(^8\) Note that after recognizing the risk-mitigating effect of securitization, institutions must also report to OSFI any non-contractual support provided to such securitizations as described in section 6.8 of CAR Chapter 6. The provision of such support undermines the risk transference of securitization.
Chart 3 – Application of the CAR Guideline for Securitization Exposures for Category I SMSBs (CAR Chapter 6)

- **START**
  - **NO**
    - Does the institution have any exposure to "tranch"ed secuaritization structures or cover?
      - Chapter 6 is not applicable
  - **YES**
    - Has the institution sold assets into a "tranch"ed securitization structure?
      - **NO**
        - Are the operational requirements for risk transference (section 6.3) met?
          - Chapter 6 is not applicable, these exposures should be risk weighted based on CAR Chapters 4-5.
          - Follow the hierarchy of approaches outlined in section 6.5.2 for this exposure
      - **YES**
        - Does the institution have other "tranch"ed exposures (e.g., investments, loans, guarantees, commitments, credit protection)?
          - **NO**
            - Is the institution's exposure rated by a recognized external credit adjudication institution (ECAI)?
              - Apply the standardized approach (SEC-SA, section 6.6.4) for this exposure
              - **YES**
                - Apply the external ratings-based approach (SEC-ERBA, section 6.6.2) for this exposure

* "tranch"ed is where there is concentration or non-proportional mitigation of credit risk across a pool of assets (e.g., NHA MBS are not considered a tranch securitization structure)
Counterparty Credit Risk

25. Category I SMSBs with exposures to instruments with counterparty credit risk must also calculate a capital charge for counterparty credit risk for these exposures. Exposures with counterparty credit risk, as detailed in CAR Chapter 7, section 7.1.2, are:
   - Over the counter (OTC) Derivatives;
   - Exchange-traded derivatives (ETDs);
   - Long Settlement transactions; and,
   - Securities Financing Transactions (SFTs).

26. The following approaches should be used for counterparty credit risk exposure, unless the institution has approval from OSFI to use an Internal Model Method (IMM):
   - For derivative and long settlement transaction exposures:
     - the standardized approach for counterparty credit risk (SA-CCR), detailed in Chapter 7, section 7.1.7 of the CAR Guideline, should be used to calculate exposure or exposure at default (EAD); and
     - Chapter 4 or 5 of the CAR Guideline should be used to determine the applicable risk-weight, depending on whether or not the institution has been approved to use IRB models for the exposure.
   - For SFT exposures:
     - the simple or comprehensive approach (detailed in CAR Chapter 4, section 4.3.3), or the VaR model\(^9\) approach for collateralized transactions, should be used to calculate exposure or EAD; and,
     - Chapter 4 or 5 of the CAR Guideline should be used to determine the applicable risk-weight, depending on whether or not the institution has been approved to use IRB models for the exposure.

27. Only those Category I SMSBs that are required by OSFI to apply the market risk framework are eligible to apply to use an IMM for counterparty credit risk, as detailed in CAR Chapter 7, section 7.1.4. These institutions can apply to OSFI to use IMM for either derivative or SFT exposures (or both). CAR Chapter 7, section 7.1.5, details how to measure exposure and capital requirements using IMM.

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\(^9\) The VaR model approach, which is set out in CRE22.74 to CRE22.77, is only available to institutions approved by OSFI to use internal models for both credit and market risk.
28. Category I SMSBs are also subject to capital requirements for credit valuation adjustment risk (CVA, see Chapter 8 of the CAR Guideline) to cover the risk of mark-to-market losses on the expected counterparty risk for each of the following types of exposures:

- Over the counter (OTC) instruments with counterparty credit risk (e.g. OTC derivatives)\(^\text{10}\); and
- Securities financing transactions (SFT), if OSFI has notified the institution that it has determined that the institution’s CVA loss exposures arising from SFT transactions are material.

\(^{10}\) Institutions are not required to include in this capital charge transactions with a qualifying central counterparty (QCCP)
29. Chapter 8 of the CAR Guideline is not applicable for Category I SMSBs that do not have either of the two types of exposures in paragraph 28\textsuperscript{11}.

Chart 5 – Application of the CAR Guideline for CVA for Category I SMSBs

\textsuperscript{11} See Annex 2 for more detail on the applicability of CAR chapters for different types of exposures.
4.1.4 Market Risk and Trading Book Exposures

30. Category I SMSBs will be informed by OSFI if the market risk framework is applicable to their institution. These institutions should use one of the approaches detailed in Chapter 9 of the CAR Guideline to calculate RWA for market risk, in consultation with OSFI.

31. All other Category I SMSBs, for whom the market risk framework is not applicable, should include any trading book exposures in the calculation of RWA using the approaches detailed in other chapters of the CAR Guideline\(^\text{12}\). For these institutions, Chapter 9 of the CAR Guideline is not applicable.

Chart 6 – Application of the CAR Guideline for Market Risk for Category I SMSBs

4.2 Leverage Requirements

32. The LR Guideline outlines the leverage requirements for Category I SMSBs, including minimum and authorized leverage ratios. Category I SMSBs are not subject to the leverage ratio buffer described in section IV of the LR Guideline.

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\(^{12}\) See Annex 2 for more detail on the applicability of CAR chapters for different types of exposures.
4.3 Liquidity Requirements

33. Chapter 1 of the LAR Guideline provides an overview of the liquidity adequacy requirements. Category I SMSBs are subject to all of the liquidity metrics detailed in section 1.3 of the LAR Guideline, with the following exceptions:
   - Only those Category I SMSBs with a significant level of wholesale funding are subject to a minimum Net Stable Funding Ratio (NSFR) requirement (see paragraph 36 below).
   - Category I SMSBs are not subject to any requirements related to the Operating Cash Flow Statement (OCFS) (LAR Chapter 5).
   - Category I SMSBs are only subject to the intraday liquidity monitoring tools (LAR Chapter 7) if they are direct clearing.

34. OSFI generally considers the liquidity adequacy of subsidiaries of SMSBs in the context of the consolidated parent entity. Therefore, subsidiaries of Category I SMSBs may be exempted from the minimum liquidity requirements in the LAR, provided they meet the criteria in section 1.2 of the LAR Guideline. Subsidiaries of D-SIBs are subject to the same liquidity adequacy requirements as Category I SMSBs, with the exception of:
   - The NSFR (see paragraph 36); and,
   - The NCCF, provided they meet the criteria in the LAR (Chapter 1, paragraph 4).

35. All Category I SMSBs are subject to the requirements of the Liquidity Coverage Ratio (LCR), detailed in Chapter 2 of the LAR Guideline.

36. The Net Stable Funding Ratio (NSFR), detailed in Chapter 3 of the LAR Guideline, is only applicable to Category I SMSBs with significant reliance on wholesale funding, defined as funding 40% or more of their total on-balance sheet assets with wholesale funding sources, as detailed in Chapter 3, Annex 1 of the LAR. Note that the NSFR is only a requirement for the consolidated parent entity in Canada that is regulated by OSFI, therefore subsidiaries of D-SIBs and subsidiaries of SMSBs are not subject to separate NSFR requirements.

The following examples illustrate when the NSFR would, or would not, be applicable:

Example #1: A Category I SMSB is a subsidiary of another financial institution outside Canada. This SMSB would be subject to the NSFR requirement if its wholesale funding levels exceed the 40% threshold.

Example #2: A federally-regulated trust company in Canada is a subsidiary of a D-SIB. This SMSB would not be subject to the NSFR.

Example #3: A Category I SMSB is a subsidiary of a provincially-regulated credit union. This SMSB would be subject to the NSFR requirement if its wholesale funding levels exceed the 40% threshold.

37. Chapter 4 of the LAR Guideline details the Net Cumulative Cash Flow (NCCF) metric and related requirements. Category I SMSBs are subject to the Comprehensive NCCF. The Streamlined NCCF is not applicable to Category I SMSBs.
38. The Operating Cash Flow Statement (OCFS) detailed in Chapter 5 of the LAR Guideline is not applicable to Category I SMSBs.

39. Chapter 6 of the LAR Guideline details several other liquidity monitoring tools applicable to Category I SMSBs that should be used to assess their liquidity adequacy.

40. Category I SMSBs are only subject to the intraday liquidity monitoring tools outlined in LAR Chapter 7 if they are direct clearers.
V. Category II SMSBs – Capital and Liquidity Requirements

5.1 Risk-Based Capital Requirements

5.1.1 Overview of Risk-Based Capital Requirements and Definition of Capital

41. Chapter 1 of the CAR Guideline explains how to calculate risk-based capital ratios and sets out the minimum and target ratios.
   - The minimum risk-based capital ratios for Category II SMSBs are in CAR Chapter 1, section 1.6.1.
   - Category II SMSBs are also subject to the capital conservation buffer in CAR Chapter 1, section 1.7.1.
   - The capital targets for Category II SMSBs are summarized in CAR Chapter 1, section 1.10.
   - The countercyclical buffer (CAR Chapter 1, section 1.7.2) may also be applicable to Category II institutions\(^\text{13}\). OSFI will inform SMSBs whenever the countercyclical buffer has been deployed in Canada, and must be applied to domestic exposures. Category II institutions must also apply the countercyclical buffer for any international exposures where the countercyclical buffer has been deployed by the local regulator.
   - The D-SIB Surcharge and the Domestic Stability Buffer described in Chapter 1 of the CAR Guideline are not applicable to Category II SMSBs.
   - Annex 1 of Chapter 1 of the CAR Guideline (Domestic Systemic Targets and Capital Targets) is not applicable to Category II SMSBs.

42. Category II SMSBs are not eligible to apply to use the Internal Ratings Based (IRB) approach for credit risk, therefore sections 1.4 and 1.5 of Chapter 1 of the CAR Guideline are not applicable to these institutions.

43. Chapter 2 of the CAR Guideline defines the tiers of capital used in the calculation of the risk-based capital ratios, as well as required adjustments to each tier of capital.

5.1.2 Operational Risk

44. Chapter 3 of the CAR Guideline details how to calculate operational risk capital. Category II SMSBs must use the Simplified Standardized Approach, therefore CAR Chapter 3, section 3.4 (Standardized Approach) is not applicable.

5.1.3 Credit Risk

45. The following section provides information related to the credit risk requirements for Category II SMSBs, broken down by the following exposure types:
   - Banking Book;

\(^{13}\) The countercyclical buffer is to be computed and applied at the consolidated FRFI parent level, i.e. OSFI regulated deposit-taking institutions who are subsidiaries of an OSFI regulated deposit-taking institution are not subject to the countercyclical buffer.
- Securitization; and,
- Exposures with Counterparty Credit Risk.

**Banking Book Exposures**

46. RWA for *banking book* exposures, with the exception of certain securitizations, exposures with counterparty credit risk and CVA exposures, are calculated using the Standardized Approach (detailed in Chapter 4 of the CAR Guideline). Category II SMSBs are eligible to apply a simplified treatment to the asset class groupings listed in Appendix I of Chapter 4 of the CAR Guideline, provided the total exposure to the asset class grouping does not exceed $500 million.

47. Category II SMSBs may reflect eligible guarantees or credit derivatives designed to mitigate credit risk for banking book exposures in the calculation of RWA using the Standardized Approach, as detailed in section 4.3 of Chapter 4 of the CAR Guideline.

48. Chapter 5 of the CAR Guideline is not applicable to Category II SMSBs.

**Chart 7 – Application of the CAR Guideline for Credit Risk in the Banking Book for Category II SMSBs (CAR Chapter 4)**
Securitization Exposures

49. Chapter 6 of the CAR Guideline details how to calculate RWA for securitization exposures. This chapter is only applicable for Category II SMSBs if they have securitization exposures that involve tranching, with associated subordination of credit risk, as defined in paragraph 3 and section 6.1 of Chapter 6 of the CAR Guideline.\textsuperscript{14}

- Securitization exposures can include, but are not restricted to the following: asset-backed securities, mortgage-backed securities, credit enhancements, liquidity facilities, loans to securitization vehicles to fund the acquisition of assets, interest rate or currency swaps, credit derivatives and tranched cover.\textsuperscript{15}

50. In order to apply the securitization treatment in Chapter 6 of the CAR Guideline for exposures originated by the institution (e.g. assets sold into a securitization structure), the operational requirements for risk transference detailed in section 6.3 must be met.\textsuperscript{16} If these requirements are not met, institutions must risk-weight the assets underlying the securitization as if they had not been securitized.

51. When calculating RWA for each securitization exposure, Category II SMSBs must use either the External Ratings-Based Approach (SEC-ERBA, section 6.6.2 of the CAR Guideline) or the Standardized Approach (SEC-SA, section 6.6.4 of the CAR Guideline) for securitization exposures. Since Category II SMSBs are not eligible to use either the Internal Ratings-Based Approach (SEC-IRBA, section 6.6.1 of the CAR Guideline) or the Internal Assessment Approach (SEC-IAA, section 6.6.3 of the CAR Guideline), these sections do not apply.

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\textsuperscript{14} For example, Chapter 6 of the CAR Guideline is not applicable for National Housing Act Mortgage-Backed Securities (NHA MBS) since these structures do not include tranches of securities with differentiated credit risk. NHA MBS should be risk-weighted as per CAR Chapter 4.

\textsuperscript{15} Tranched cover is described in CAR Chapter 4, paragraph 273.

\textsuperscript{16} Note that after recognizing the risk-mitigating effect of securitization, institutions must also report to OSFI any non-contractual support provided to such securitizations as described in section 6.8 of CAR Chapter 6. The provision of such support undermines the risk-transference of securitization.
Chart 8 – Application of the CAR Guideline for Securitization Exposures for Category II SMSBs (CAR Chapter 6)

-start-

Does the institution have any exposure to "tranche" securitization structures or cover?

YES

NO

Chapter 6 is not applicable (exposures risk-weighted based on other CAR chapters)

Has the institution sold assets into a "tranche" securitization structure?

YES

Are the operational requirements for risk transference (section 6.3 of Chapter 6) met?

NO

Chapter 6 is not applicable, these exposures should be risk-weighted based on CAR Chapter 4.

YES

Does the institution have other "tranche" exposures (e.g. investments, loans, guarantees, commitments, credit protection)?

if Yes, follow these steps for each exposure

NO

Is the institution's exposure rated by a recognized external credit adjudication institution (ECAI)?

NO

Apply the standardized approach (SEC-SA, section 6.6.4) for this exposure

YES

Apply the external ratings-based approach (SEC-IRBA, section 6.6.2) for this exposure

* "tranche" is where there is concentration or non-proportional mitigation of credit risk across a pool of assets (e.g. NHA MBS are not considered a tranched securitization structure)
Counterparty Credit Risk

52. Category II SMSBs with exposures to instruments with counterparty credit risk must also calculate a capital charge for counterparty credit risk for these exposures. Exposures with counterparty credit risk, as detailed in CAR Chapter 7, section 7.1.2, are:
   - Over the counter (OTC) Derivatives;
   - Exchange-traded derivatives (ETDs);
   - Long Settlement transactions; and,
   - Securities Financing Transactions (SFTs).

53. The following approaches should be used for counterparty credit risk exposure, unless the institution has approval from OSFI to use an Internal Model Method (IMM):
   - For derivative and long settlement transaction exposures:
     - the standardized approach for counterparty credit risk (SA-CCR), detailed in Chapter 7, section 7.1.7 of the CAR Guideline, should be used to calculate exposure or exposure at default (EAD); and
     - Chapter 4 of the CAR Guideline should be used to determine the applicable risk-weight.
   - For SFT exposures:
     - the simple or comprehensive approach (detailed in CAR Chapter 4, section 4.3.3) should be used to calculate exposure or EAD; and,
     - Chapter 4 of the CAR Guideline should be used to determine the applicable risk-weight.

54. Only those Category II SMSBs that are required by OSFI to apply the market risk framework are eligible to apply to use an IMM for counterparty credit risk, as detailed in CAR Chapter 7, section 7.1.4. These institutions can apply to OSFI to use IMM for either derivative or SFT exposures (or both). CAR Chapter 7, section 7.1.5, details how to measure exposure and capital requirements using IMM.
Chart 9 – Application of Different Approaches for Counterparty Credit Risk for Category II SMSBs

55. Category II SMSBs are also subject to capital requirements for credit value adjustment risk (CVA, see Chapter 8 of the CAR Guideline) to cover the risk of mark-to-market losses on the expected counterparty risk for each of the following types of exposures:
   - Over the counter (OTC) instruments with counterparty credit risk (e.g. OTC derivatives)\(^{17}\); and

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\(^{17}\) Institutions are not required to include in this capital charge transactions with a qualifying central counterparty (QCCP).
- Securities financing transactions (SFT), if OSFI has notified the institution that it has determined that the institution’s CVA loss exposures arising from SFT transactions are material.

56. Chapter 8 of the CAR Guideline is not applicable for Category II SMSBs that do not have either of the two types of exposures in paragraph 55\(^{18}\).

**Chart 10 – Application of the CAR Guideline for CVA for Category II SMSBs**

\(^{18}\) See Annex 2 for more detail on the applicability of CAR chapters for different types of exposures.
5.1.4 Market Risk and Trading Book Exposures

57. Category II SMSBs will be informed by OSFI if the market risk framework is applicable to their institution. These institutions should use one of the approaches detailed in Chapter 9 of the CAR Guideline to calculate RWA for market risk, in consultation with OSFI.

58. All other Category II SMSBs, for whom the market risk framework is not applicable, should include any trading book exposures in the calculation of RWA using the approaches detailed in other chapters of the CAR Guideline\(^{19}\). For these institutions, Chapter 9 of the CAR Guideline is not applicable.

**Chart 11 – Application of the CAR Guideline for Market Risk for Category II SMSBs**

5.2 Leverage Requirements

59. The LR Guideline outlines the leverage requirements for Category II SMSBs, including minimum and authorized leverage ratios. Category II SMSBs are not subject to the leverage ratio buffer described in section IV of the LR Guideline.

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\(^{19}\) See Annex 2 for more detail on the applicability of CAR chapters for different types of exposures.
5.3 Liquidity Requirements

60. Chapter 1 of the LAR Guideline provides an overview of the liquidity adequacy requirements. Category II SMSBs are subject to all of the liquidity metrics detailed in section 1.3 of the LAR Guideline, with the following exceptions:
   - Category II SMSBs are not subject to any requirements related to the Net Stable Funding Ratio (NSFR).
   - Category II SMSBs are not subject to any requirements related to the Operating Cash Flow Statement (OCFS).
   - Category II SMSBs are only subject to the intraday liquidity monitoring tools (LAR Chapter 7) if they are direct clearers.

61. OSFI generally considers the liquidity adequacy of subsidiaries of SMSBs in the context of the consolidated parent entity. Therefore, subsidiaries of Category II SMSBs may be exempted from the minimum liquidity requirements in the LAR Guideline, provided they meet the criteria in section 1.2 of Chapter 1 of the LAR Guideline.

62. All Category II SMSBs are subject to the requirements of the Liquidity Coverage Ratio (LCR), detailed in Chapter 2 of the LAR Guideline.

63. Category II SMSBs are not subject to the Net Stable Funding Ratio (NSFR) requirements. Therefore Chapter 3 of the LAR Guideline is not applicable to these institutions.

64. Chapter 4 of the LAR Guideline details the Net Cumulative Cash Flow (NCCF) metric and related requirements. Category II SMSBs should complete the Streamlined NCCF unless directed otherwise by OSFI.

65. The Operating Cash Flow Statement (OCFS) detailed in Chapter 5 of the LAR Guideline is not applicable to Category II SMSBs.

66. Chapter 6 of the LAR Guideline details several other liquidity monitoring tools applicable to Category II institutions to assess their liquidity adequacy.

67. Category II SMSBs are only subject to the intraday liquidity monitoring tools outlined in LAR Chapter 7 if they are direct clearing banks.
VI. Category III SMSBs – Capital and Liquidity Requirements

6.1 Risk-Based Capital Requirements

68. Category III SMSBs are subject to a Simplified Risk-Based Capital Ratio (SRBCR), as described in section 1.6.2 in Chapter 1 of the CAR Guideline.
   - The minimum SRBCRs for Category III SMSBs are in CAR Chapter 1, section 1.6.2.
   - Category III SMSBs are also subject to the capital conservation buffer detailed in section 1.7.1 of the CAR Guideline.
   - The capital targets for Category II SMSBs are summarized in CAR Chapter 1, section 1.10.
   - The countercyclical buffer (CAR Chapter 1, section 1.7.2) may also be applicable to Category III institutions. OSFI will inform SMSBs whenever the countercyclical buffer has been deployed in Canada, and must be applied to domestic exposures. Category III institutions must also apply the countercyclical buffer for any international exposures where the countercyclical buffer has been deployed by the local regulator.
   - The D-SIB Surcharge and the Domestic Stability Buffer described in Chapter 1 of the CAR Guideline are not applicable to Category III SMSBs.
   - Annex 1 of Chapter 1 of the CAR Guideline (Domestic Systemic Targets and Capital Targets) is not applicable to Category III SMSBs.

69. Sections 1.4 and 1.5 of Chapter 1 of the CAR Guideline (IRB approach) are also not applicable to Category III SMSBs.

70. Chapter 2 of the CAR Guideline defines the tiers of capital used in the calculation of the risk-based capital ratios, including the SRBCR, as well as required adjustments to each tier of capital.

71. Chapter 3 of the CAR Guideline details how to calculate operational risk capital. Category III SMSBs must use the Simplified Standardized Approach, therefore CAR Chapter 3, section 3.4 (Standardized Approach) is not applicable.

72. Chapters 4 to 9 of the CAR Guideline are generally not applicable to Category III SMSBs, as there are no Credit or Market RWA requirements for the SRBCR. However, chapters 1 to 3 of the CAR refer to certain sections of these other chapters, which Category III SMSBs may therefore need to review for certain exposures.

6.2 Leverage Requirements

73. Category III SMSBs are not subject to a minimum Pillar 1 leverage requirement. Therefore, the LR Guideline is not applicable to these institutions.

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20 The countercyclical buffer is to be computed and applied at the consolidated FRFI parent level, i.e. OSFI regulated deposit-taking institutions who are subsidiaries of an OSFI regulated deposit-taking institution are not subject to the countercyclical buffer.
6.3 Liquidity Requirements

74. Category III SMSBs are only subject to the requirements related to the Operating Cash Flow Statement (OCFS), as detailed in Chapter 5 of the LAR Guideline.

75. The rest of the metrics and returns described in Chapter 1 of the LAR Guideline are therefore not applicable to Category III SMSBs. As a result, the following chapters of the LAR Guideline are also not applicable to Category III SMSBs:
   - Chapter 2 (Liquidity Coverage Ratio - LCR)
   - Chapter 3 (Net Stable Funding Ratio - NSFR)
   - Chapter 4 (Net Cumulative Cash Flow - NCCF)
   - Chapter 6 (Liquidity Monitoring Tools)
   - Chapter 7 (Intraday Liquidity Monitoring Tools)
Annex 1 – Summary of SMSB Capital and Liquidity Requirements by Category

<table>
<thead>
<tr>
<th>OSFI Guideline Reference</th>
<th>Category I</th>
<th>Category II</th>
<th>Category III</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Risk-based capital</td>
<td>Risk-based Ratio(s) and Definition of Capital</td>
<td>CET1/Tier1/Total Capital Ratios</td>
<td>CET1/Tier1/Total Capital Ratios</td>
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<tr>
<td>requirements</td>
<td>CAR Chapters 1-2</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Operational Risk Capital Methodology</td>
<td>Standardized Approach* or Simplified Standardized Approach</td>
<td>Simplified Standardized Approach</td>
</tr>
<tr>
<td></td>
<td>CAR Chapter 3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit Risk Capital</td>
<td>Internal Ratings-Based (IRB)* or Standardized Approach with simplified treatment available for certain asset classes</td>
<td>Standardized Approach with simplified treatment available for certain asset classes</td>
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</tr>
<tr>
<td>Methodology</td>
<td>CAR Chapters 4-8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market Risk Capital</td>
<td>Internal Models* or Standardized Approach</td>
<td>Internal Models* or Standardized Approach</td>
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</tr>
<tr>
<td>Methodology</td>
<td>CAR Chapter 9</td>
<td></td>
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<tr>
<td>Leverage Ratio (LR)</td>
<td>Leverage Requirement</td>
<td>Leverage Ratio</td>
<td>Leverage Ratio</td>
</tr>
<tr>
<td>Liquidity Coverage Ratio</td>
<td>LAR Chapter 2</td>
<td>LCR</td>
<td>LCR</td>
</tr>
<tr>
<td>(LCR)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Flow-Based</td>
<td>LAR Chapter 4 or 5</td>
<td>Comprehensive NCCF (unless directed otherwise by OSFI)</td>
<td>Operating Cash Flow Statement (OCFS)</td>
</tr>
<tr>
<td>Requirement</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Stable Funding Ratio</td>
<td>LAR Chapter 3</td>
<td>Only for institutions with significant wholesale funding reliance&lt;sup&gt;23&lt;/sup&gt;</td>
<td>No NSFR</td>
</tr>
<tr>
<td>(NSFR)</td>
<td></td>
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<td></td>
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</tbody>
</table>

*with OSFI approval (note: OSFI approval to use the Standardized Approach for Operational Risk is not required if Adjusted Gross Income is greater than $1.5 billion)

<sup>21</sup> See Annex 2 for a summary of which CAR chapters are applicable to different types of exposures
<sup>22</sup> OSFI will inform any SMSBs if the market risk requirements, as detailed in Chapter 9, apply to their institution
<sup>23</sup> “Significant wholesale funding reliance” is defined as funding 40% or more of total on-balance sheet assets with wholesale funding sources as detailed in Chapter 3, Annex 1 of the LAR Guideline
## Annex 2 – Application of Credit and Market Risk CAR Chapters by Type of Exposure

<table>
<thead>
<tr>
<th>Type of Exposure</th>
<th>Credit Risk</th>
<th>Counterparty Credit Risk (CCR)</th>
<th>Credit Value Adjustment (CVA)</th>
<th>Market Risk</th>
</tr>
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<tbody>
<tr>
<td>“Tranched” Securitization Exposures that meet Risk Transference Criteria</td>
<td>Chapter 6</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
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<tr>
<td>Bilateral OTC Derivatives (including long settlement transactions)</td>
<td>Chapter 4 or 5, to determine the RW applicable to CCR EAD</td>
<td>Chapter 4 to determine the RW applicable to CCR EAD</td>
<td>Chapter 7 to determine CCR EAD</td>
<td>Chapter 8</td>
</tr>
<tr>
<td>Centrally Cleared Derivatives</td>
<td>Chapter 4 or 5, to determine the RW applicable to CCR EAD</td>
<td>Chapter 4 to determine the RW applicable to CCR EAD</td>
<td>Chapter 7 to determine CCR EAD</td>
<td>n/a</td>
</tr>
<tr>
<td>Securities Financing Transactions (SFT)</td>
<td>Chapter 4 or 5, to determine the RW applicable to CCR EAD</td>
<td>Chapter 4 to determine the RW applicable to CCR EAD</td>
<td>Chapter 4 or Chapter 7 to determine CCR EAD</td>
<td>Chapter 8&lt;sup&gt;24&lt;/sup&gt;</td>
</tr>
<tr>
<td>All other Banking Book Exposures</td>
<td>Chapter 4 or 5, depending on exposure</td>
<td>Chapter 4</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>All other Trading Book Exposures</td>
<td>Chapter 4 or 5, depending on exposure (only for non-Market Risk Banks**)</td>
<td>Chapter 4 (only for non-Market Risk Banks**)</td>
<td>n/a</td>
<td>n/a</td>
</tr>
</tbody>
</table>

<sup>24</sup> CVA requirements are only applicable for SFTs if OSFI has notified the institution that it has determined that its CVA loss exposures arising from SFT transactions are material.

<sup>* “Market Risk Banks” refers to institutions that have been informed by OSFI that they must apply the market risk framework</sup>

<sup>** “Non-Market Risk Banks” refers to institutions that have not been informed by OSFI that they must apply the market risk framework</sup>