Letter

Title	Final Guideline B-2: Large Exposure Limits for D-SIBs
Category	Prudential Limits and Restrictions
Date	April 10, 2019
Sector	Banks Foreign Bank Branches Trust and Loan Companies
Reference	Guideline for Domestic Systemically Important Banks (D-SIBs)

The Office of the Superintendent of Financial Institutions (OSFI) is releasing the final version of the *Large Exposure Limits* guideline for implementation in Q1 2020 by Canadian D-SIBs. The guideline, which was originally issued in 1994, establishes limits for a bank's exposure to a single counterparty (including connected counterparties), measured as a percentage of capital.

In 2014, the Basel Committee on Banking Supervision (BCBS) published its standard on large exposure risk management: *Supervisory Framework for Measuring and Controlling Large Exposures*. OSFI's final guideline incorporates the BCBS guidance to reflect current risk management sound practices and provides additional guidance on methods OSFI expects D-SIBs to use for identifying, measuring, managing and monitoring large exposures.

The final guideline revises the large exposure limits calculation, including: reducing the eligible capital base from Total capital to Tier 1 capital; introducing tighter limits for exposure to Global Systemically Important Banks (G-SIBs) and Canadian D-SIBs; and recognizing eligible credit risk mitigation techniques for measuring exposure, i.e., exposure is measured on a net basis rather than a gross basis. The guideline also provides additional guidance for determining groups of connected counterparties.

Annex 1 summarizes comments received and explains how the comments have been addressed in the final guideline. We thank those who participated in the consultation process.

Questions concerning the final guideline may be addressed to Lindsay Cheung, Senior Analyst, Capital Division by email at lindsay.cheung@osfi-bsif.gc.ca.

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Annex 1: Summary of Comments Received and OSFI Response

Comment	OSFI Response
The proposed tighter 15% limit for a Canadian D-SIB exposure to a G-SIB or to another Canadian D-SIB should be increased. This tighter limit is too stringent relative to the strength of the Canadian banking system. There could also be possible unintended consequences if banks are required to undertake actions to rebalance business activities in order to comply with the limit.	The large exposures framework contributes to the stability of the financial system by mitigating the risk of contagion between systemically important banks. Given the small number of Canadian D-SIBs and their significant market share, OSFI considers it appropriate to have a limit more stringent than the general 25% limit for a D-SIB exposure to another D-SIB or to a G-SIB. The BCBS also encourages jurisdictions to consider stricter limits for exposure between D-SIBs. OSFI decided to retain the limit for inter-G-SIB exposure at 15% of Tier 1 Capital and to increase the limit for exposure of a Canadian G-SIB to a Canadian D-SIB to 20% of Tier 1 Capital. OSFI also set the limit for a Canadian D-SIB's exposure to a G-SIB or to another Canadian D-SIB at 20% of Tier 1 capital. This recognizes the potential implications and unintended consequences of significantly tightening the limits relative to the original Guideline B-2, combined with changes in calculation method (e.g., Tier 1 capital versus Total capital, net exposure versus gross exposure, etc.).
The measure for indirect exposure via credit risk mitigation techniques, such as collateral received under Securities Financing Transactions (SFTs), should be subject to a reduced exposure value on the basis that such transactions have inherent credit risk mitigating conditions.	OSFI does not believe that the exposure measure for collateral arising from SFTs should be modified. The measurement of exposure in the guideline relies on existing standardized measurement methods or assumptions used for other regulatory metrics (e.g., leverage ratio, standardized approach for credit risk, standardized approach for counterparty credit risk, etc.). As a result, OSFI did not pursue developing an alternative measurement method solely for large exposure purposes.
Exposure to certain U.S. Government Sponsored Entities (GSEs) should be exempted from the large exposure limits due to the limited risk associated with exposure to these entities. Absence of such an exemption would place Canadian D-SIBs at a disadvantage compared to their U.S. peers, given exposure to certain entities are exempt under the U.S. Federal Reserve's Single Counterparty Credit Limits (U.S. SCCL) rule.	OSFI recognizes the financial support provided by the U.S. government to certain GSEs for which a conditional exemption exists under the U.S. SCCL rule. OSFI also recognizes the potential competitive disadvantage that could result from the exclusion of such an exemption under OSFI's guideline. Therefore, OSFI will include a conditional exemption for GSEs that broadly aligns with the U.S. SCCL rule.

Monitoring requirements of the revised guideline should be limited to the consolidated level for D-SIBs and should not apply to their domestic OSFI-regulated subsidiaries (banks, trust companies or loan companies). Additional subsidiary level monitoring would be operationally complex with limited incremental benefit over consolidated monitoring.	OSFI will apply the guideline at the consolidated entity (D-SIB) level. OSFI recognizes there may be operational complexities of applying the guideline at the subsidiary level due to the size and nature of their activities. However, OSFI expects all OSFI-regulated subsidiaries (banks, trust companies or loan companies) of the D-SIBs to have policies and processes to identify, manage, and monitor single-name concentration risk at the legal entity level.
The scope of exposures to be considered under the revised guideline should be clarified and aligned with the scope of application under OSFI's Capital Adequacy Requirements Guideline.	OSFI agrees with the comment. The guideline now makes clear that banks should consider all exposures defined under the risk-based capital framework for large exposure purposes.