# Letter

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| **Title** | Changes to the Liquidity Adequacy Requirements Guideline |
| **Date** | April 11, 2019 |
| **Sector** | Banks<br>Trust and Loan Companies |

OSFI is releasing the final version of its Liquidity Adequacy Requirements (LAR) guideline for implementation on January 1, 2020. Four chapters (Overview, Liquidity Coverage Ratio (LCR), Net Cumulative Cash Flow (NCCF), and Liquidity Monitoring Tools) received targeted revisions, while Chapter 3 introduces the Net Stable Funding Ratio (NSFR) standard. The revised expectations will ensure OSFI's standards for measuring and monitoring liquidity risk are comprehensive and reflect current sound practice.

OSFI has revised Chapters 2 (LCR) and 4 (NCCF) to further distinguish between certain types of retail deposits that may be subject to sudden withdrawal in a stressed environment. To mitigate this risk, the revised guideline assigns higher run-off rates to riskier deposits relative to the current calibration. OSFI also enhanced key definitions characterizing these deposits, which should assist institutions in their risk identification practices.

Chapter 3 introduces the NSFR, a long-term structural liquidity metric designed to promote funding stability and reduce the likelihood that a disruption to an institution's regular sources of funding will erode its liquidity position in a way that could increase the risk of its failure.

Chapter 5 now includes the Liquidity Activity Monitor (LAM), which will improve OSFI's ability to monitor changes in an institution's funding components.

The appendix provides a summary of comments received from the public consultation and outlines OSFI's responses. We thank those who participated in the consultation process.

Questions concerning the Guideline can be sent to Robert Bélanger, Senior Analyst, Capital Division, by email at robert.belanger@osfi-bsif.gc.ca.

Sincerely,

Carolyn Rogers

Assistant Superintendent

Regulation Sector

## Appendix: Summary of Public Consultation Comments Received and OSFI Responses

| Comment/Question | OSFI Response |
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| **Chapter 2 – Liquidity Coverage Ratio (LCR)** | |
| Why is OSFI introducing new categories and run-off rates for less stable deposits at this time? | The current version of the LCR includes a category of *less stable deposits* for retail and small business customers. This category encompasses several heterogeneous components that all receive a flat 10% run-off rate. This aggregation and single run-off rate does not appropriately consider certain customer and deposit product attributes that may lead to increased risk of deposit withdrawal in a stressed environment. OSFI believes that some customer and product attributes warrant a higher run-off rate. OSFI notes that the Basel LCR rules expect supervisors to develop additional categories of less stable deposits that reflect circumstances in their jurisdiction. The revised version of the guideline incorporates new categories in the LCR to increase its risk-sensitivity and to assign more appropriate run-off assumptions to some components of less stable deposits. |
| How did OSFI define the new categories and corresponding run-off rates for less stable retail deposits? | OSFI considers that the main contributors to the stability of retail deposits are the presence of an established client-institution relationship, the level of sophistication of the depositor managing the funds, and the rate sensitivity of the deposit product. The revised guideline segments the less stable retail deposit category along these attributes. Rates are commensurate with the expected risk of withdrawal of the deposit. |
| What is the rationale for OSFI decreasing the run-off rate for uninsured retail deposits to 10% from the 15% rate proposed in the public consultation? | While revising the run-off rates for less stable retail deposits, OSFI tried to ensure deposits that exhibit different characteristics are consistently and appropriately assigned run-off rates according to their risk of withdrawal in a stressed environment. The public consultation provided compelling evidence to support not increasing the run-off rate for uninsured retail deposits to 15% (as was proposed in the public consultation) and instead maintaining the run-off rate at 10% as is currently applied. |

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| Why is OSFI expanding the definitions of *established relationship* and *transactional account* and introducing a definition for *rate-sensitive deposits*? Why is OSFI not allowing institutions to use their own internal definitions for these concepts? | The definitions of *established relationship* , *transactional account* and *rate-sensitive deposits* are critical to the appropriate categorization of deposits under the LAR Guideline. They directly influence the run-off rates applied to retail deposits in the LCR and NCCF. The accurate classification of deposits using these concepts is even more important now given the move away from a flat 10% run-off rate for all less stable retail deposits. Through its supervisory work since the introduction of the LCR, OSFI has observed a wide range of institution practice in applying these concepts. The guideline more clearly articulates these key definitions, which will lead to more comparable and predictable outcomes when institutions classify these deposits under the liquidity metrics.<br><br>OSFI opted for a presumptive approach to assess whether a client and institution have an *established relationship*. Evidence suggested that the proposed definition was too restrictive and was not representative of certain elements of current industry practice. OSFI expanded the list of criteria to include additional factors that can demonstrate the strength of a client's connection to its institution such that meeting one of the criteria allows the institution to clearly demonstrate that an established relationship exists. In order to address unforeseen situations or future market practices, OSFI retained the flexibility to consider other valid characteristics that demonstrate the presence of an established relationship.<br><br>Regarding the definition of a *transactional account*, OSFI considered comments that suggested focusing on a utilization test of the account rather than relying on generic characteristics of the account (e.g. ability to write cheques). Such generic characteristics may not be indicative of or aligned with the intent of classifying an account as transactional. In addition, OSFI expanded the criteria related to a customer's salary being automatically deposited in an account. The criteria now include non-salary income (e.g. pension income, government social assistance), which aligns with the original intent of this criteria, i.e., characteristics are present that enhance the stability of a deposit.<br><br>Revisions to the language for *rate sensitive deposits* shift the focus away from the marketing aspect of a deposit towards an identification of *outliers* (i.e. deposit rates paid that are significantly higher than comparable products). OSFI did not incorporate the suggestion to set a quantitative benchmark around this classification because the deposit rates offered by institutions should be the result of business decisions and competing forces, not the result of regulations. Lastly, several institutions raised concerns that the use of the high interest saving account (HISA) label in the public consultation draft could be misleading as this term is often used for flagship products offered in the retail |

| Chapter 3 – Net Stable Funding Ratio (NSFR) | |
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| We understand that the NSFR will initially apply only to the D-SIBs. What are OSFI's plans for non-D-SIBs? | As of January 1, 2020, only the D-SIBs will be subject to the NSFR requirement. OSFI is undertaking an assessment of the approach for small and medium-sized institutions. Further guidance will be provided in due course. |
| We believe that the NSFR creates cliff effects at the one year and six month marks. Has OSFI considered further granularity in residual maturity time periods (e.g. introducing a 3-month bucket)? | OSFI believes the current structure of maturity buckets is appropriate. The NSFR standard encourages a sound funding structure by limiting short term reliance on wholesale funding. OSFI believes a diversified funding mix and laddered maturity structure mitigates cliff effects. |
| The required stable funding (RSF) factor for non-HQLA is punitive and is not representative of the liquidity characteristics of some segments of the market (i.e. financials). | OSFI's liquidity standards are designed, in part, to reduce interconnectedness and limit contagion risk in the deposit-taking sector. For this reason, the LCR does not recognize securities representing obligations of financial institutions as HQLA. The NSFR RSF factor for non-HQLA securities reflects these considerations. |
| OSFI has designated only a limited set of transactions as interdependent. OSFI should extend this interdependent treatment to similar funding structures (e.g. ABS, covered bonds) and client-facilitation transactions. | In order to be considered as interdependent, the assets and liabilities of a particular set of transactions must meet several criteria to ensure that no residual liquidity risk remains. OSFI does not consider that the additional transactions suggested for interdependent treatment meet all the required criteria outlined in Chapter 3, paragraph 53. |
| **Chapter 4 – Net Cumulative Cash Flow (NCCF)** | |
| The NCCF and LCR run-off assumptions for the first month are similar; however, the increased rates and cumulative impacts for months 2 to 12 in the NCCF are extremely punitive. Where the NCCF is applied to a particular institution, these changes may mean the NCCF becomes a binding constraint if an institution's supervisory-communicated NCCF level is not consequently recalibrated. | OSFI adjusted some of the relevant NCCF rates in the final rules compared to the public consultation to reduce the longer-term run-off rates for the new categories of demand deposits introduced in the NCCF. This will ensure that the cumulative run-off rates are not overly punitive and are better aligned with historical experience. OSFI will review individual institutions' NCCF targets to determine whether any change to the target is necessary. |
| **Chapter 5 – Liquidity Monitoring Tools** | |

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| Although OSFI clarified that the LAM must be provided on a best-effort basis, we are still concerned that the intraday expectation may require significant and costly upgrades to our reporting capabilities. | OSFI believes that the language in the guideline provides sufficient flexibility to address situations requiring more comprehensive or frequent reporting while not requiring institutions to commit significant additional resources. As such, the language in the final rules remains unchanged. Institutions should contact OSFI directly if they have any remaining concerns. |