Letter

Title	2024 Capital Adequacy Requirements (CAR) – Letter (2023)
Category	Capital Adequacy Requirements
Date	October 20, 2023
Sector	Banks Trust and Loan Companies

To:

Banks

Bank Holding Companies

Federally Regulated Trust and Loan Companies

Today, the Office of the Superintendent of Financial Institutions (OSFI) is publishing the Capital Adequacy Requirements (CAR) 2024 guideline and revised Basel Capital Adequacy Reporting (BCAR) instructions, which take effect fiscal Q1 2024.[1] The updated BCAR 2024 returns were published on September 8, 2023.

The revised CAR guideline builds on the CAR 2023 and reflects two key revisions:

- Changes to capital requirements for mortgages with growing balances, where payments are insufficient to cover the interest component; and
- Adjustments and clarifications that had been previously communicated via the frequently asked questions – Basel III reforms (FAQs).

This summer, OSFI conducted a consultation in respect of proposed capital requirements changes for mortgages with growing balances. We appreciate the stakeholder engagement that occurred during this consultation, and we have updated the CAR guideline in consideration of the feedback we received. See Appendix 1 for a summary of key stakeholder comments and OSFI responses.

Stakeholders will note that the list of FAQs on our website has been updated to remove the items now reflected in the guideline. The few remaining FAQs on our website will be further reviewed and/or reflected in future updates to guidance, as appropriate. Also note that Chapter 9 of the CAR guideline is not being updated at this time.

Should you have any questions, please contact Tara-Lea Herkert (Tara-Lea.Herkert@osfi-bsif.gc.ca), Director, Capital and Liquidity Standards Division, Risk Advisory Hub.

Sincerely,

Amar Munipalle

Executive Director, Risk Advisory Hub

Appendix 1: Summary of Comments and OSFI Response

Comment	OSFI Response
The definition of negative amortization (i.e., where balances are growing) is too broad and captures more exposures than just variable-rate fixed-payment mortgages where balances are growing due to increases in interest rates. For example, as drafted, the text would capture borrowers who skip a single payment, and those who have been provided relief due to extreme circumstances (e.g., flood or forest fire relief). It would also capture borrowers that respond quickly, but not immediately, to adjust their payments for rising interest rates.	We agree and have revised the text to target variable-rate fixed-payment mortgages with loan-to-value (LTV) ratios above 65%, where payments are insufficient to cover the interest portion of the mortgage for three or more consecutive months, due to increases in interest rates.
Mortgages in negative amortization should not be labelled as "not compliant with the spirit of Guideline B-20." These mortgages are compliant at origination as per Guideline B-20, and changes in interest rates should not affect that status.	The final CAR 2024 guideline text has been amended to address this feedback.
There is a potential double counting of capital since the risk-weighted asset amounts already depend on LTV ratios and those would be changing as mortgage balances increase. Moreover, some banks, who use an internal ratings-based (IRB) approach may already account for this risk.	OSFI generally expects there is limited or no double counting of capital requirements. The LTV ratio of a mortgage is a risk driver that is considered in the CAR guideline. Mortgages that are negatively amortizing present an additional risk – i.e. the increased unlikeness of the borrower to pay – that had not previously been considered in the calibration of the capital framework. OSFI recognizes the possibility that a bank using an IRB approach may already be holding additional capital for mortgages with balances that are growing. In this situation, OSFI may exempt an institution from using the prescribed correlation factor set out in the CAR 2024 guideline for a variable-rate fixed-payment mortgage, if the institution can demonstrate, to OSFI's satisfaction, that its estimates of IRB parameters account for this risk in a manner that is at least as conservative as the prescribed approach.

Comment	OSFI Response
The implementation time is very tight.	As it is important to address this risk in a timely manner, the effective date for this capital change remains fiscal Q1 2024.

1 November 1, 2023, for institutions with an October 31 year-end and January 1, 2024, for institutions with a December 31 year-end.