Guideline

Title	Prudent Person Approach
Category	Prudential Limits and Restrictions
Date	January 31, 1993
Sector	Banks Life Insurance and Fraternal Companies Property and Casualty Companies Trust and Loan Companies
No	B-1

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Guidance to be rescinded

As a result of OSFI's policy review, this guidance was identified as outdated, redundant, or no longer fit-for-purpose. It will be rescinded and removed from the website by April 1, 2025.

By lawThe legislative references are: section 465 of the *Bank Act*, section 450 of the *Trust and Loan Companies Act*, section 387 of the *Cooperative Credit Associations Act* and sections 492 and 551 and subsection 615(1) of the *Insurance Companies Act*., the board of directors of a financial institution is required to establish, and the financial institution is required to adhere to, "investment and lending policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments and loans to avoid undue risk of loss and obtain a reasonable return." In addition, each financial institution must comply with the statutory investment limits set out in the applicable legislation (see Appendix).

This guideline outlines factors that the Office of the Superintendent of Financial Institutions expects the financial institution to consider in establishing investment and lending policies and in ensuring that they are effectively implemented. It is meant to serve as a guide and the provisions of the guideline should be adapted by each institution to reflect the activities and risks of its business.

Policy

Every financial institution is required to have written investment and lending policies. These policies should describe the objectives for the investment and lending programs and the overall risk philosophy of the institution. They should take into account the strength of the institution's capital and its ability to absorb potential losses.

The policies should take note of the liability structure of the financial institution and the anticipated demands for funds and address how maturity profiles are to be established on the portfolios of investments and loans in light of these demands. They should establish limits on the institution's exposure to a person or a group of associated persons and to interest rate and currency risk. In setting these limits the institution should consider its exposure under a variety of potential scenarios.

> Please refer to OSFI’s *Corporate Governance Guideline* for OSFI’s expectations of financial institution Boards of Directors in regards to operational, business, risk and crisis management policies.

Procedures

Financial institutions are required to have written internal procedures outlining how the investment and lending policies will be implemented and monitored. Institutions should ensure that the policies are implemented by persons, either on staff or under contract, who have the appropriate level of expertise. These procedures should address exposures arising from both on-balance sheet and off-balance sheet items.

The procedures should:

- identify responsibilities and accountabilities;
- set out the process for recommending, approving, and implementing decisions; and
- prescribe the frequency and format of reporting.

In addition, they should describe the method for classifying loans and investments and the basis for valuing loans and investments that are not regularly traded. There should be written procedures describing custodial arrangements of these assets. In developing these procedure, reference should be made to the regulations on protection of assets.

Procedures should be in place to monitor and control the institution's exposure to fluctuations in interest rates, foreign exchange rates, and market prices.

Potential sources of conflict of interest should be identified and procedures should be in place to ensure that those involved with the implementation of the investment and lending policies understand where these situations could arise and how they should be addressed.

Limits

The investment policy should identify acceptable ranges for investments in different types of instruments, including cash, equities, bonds and debentures, and real property. The lending policy should establish limits on aggregate outstanding loans by type of loan broken down by major category (e.g., commercial, consumer). These broad categories should be further subdivided as necessary; for example, mortgages could be subdivided between insured and uninsured mortgages and limits set accordingly.

The policy should set limits according to the source of loans where third parties such as mortgage brokers or syndications are relied upon. In addition, there should be an aggregate limit established on externally sourced loans.

Financial institutions should set limits on investments and loans according to their quality. For example, financial institutions may use ratings from recognized rating agencies in establishing quality criteria for their investments. Internal criteria would have to be established for non-rated investments. Similarly, internal criteria should be established for assessing the credit quality of borrowers.

Where applicable, limits should be established on exposures to industries and geographic regions.

Financial institutions should establish limits to contain the risks arising from potential changes in currency or interest rates. They should have policies outlining the circumstances in which derivative instruments can be used. In addition, they should establish limits on the use of derivative instruments by type of instrument (e.g., swaps, options, futures) and by counterparty.

Providing Information to the Office

Institutions are not required to file policies and procedures with the Office on a regular basis; however, the written policies and procedures should be available for review immediately upon request.

The institution will be expected to maintain information on its portfolios presented in a manner that facilitates analysis, for example:

- a comparison of outstanding amounts against the limits established in its policies;
- an analysis of asset quality and concentration;
- an analysis of its interest rate and maturity mismatch, including the results of scenario testing as appropriate; and
- an analysis of the diversification of its funding sources.

Where information required to perform this analysis is not available through the filing of statutory returns, the Office may request supplemental information that expands on the areas of greatest risk.

Appendix - Summary of Statutory Limits

Appendix - Statutory Investment and Lending Limits for Federally Regulated Financial Institutions and Holding Companies

Type of Institutions	Restrictions on Commercial and Consumer Lending	Restrictions on Investments in Real Property	Restrictions on Investments in Equities	Restrictions on Aggregate Investments in Real Property and Equities

Life Insurance (Domestic)	Sections 503 and 504 of the *Insurance Companies Act* (ICA) Commercial Lending • 5% of total assets if regulatory capital ≤ $25 million • companies and prescribed subsidiaries with regulatory capital > $25 million or that are controlled by a financial institution with regulatory capital > $25 million may exceed the 5% of total assets limit with Superintendent approval Consumer Lending • no restriction on consumer lending	Section 506 of the ICA and subsection 5(1) of the *Investment Limits (Insurance Companies) Regulations* (ILICR) Aggregate of: • 70% of the amount calculated pursuant to subsection 5(4) of the ILICR • 15% of non-par liabilities • 25% of par liabilities • 5% of liabilities in respect of prescribed annuities Limits do not apply to: • companies, other than mutual companies, that are widely held and have equity ≥ $5 billion or to companies with equity ≥$5 billion and controlled by a widely held eligible entity (refer to subparagraph 3(b)(ii) of the ILICR) • mutual companies having an aggregate surplus and	Section 507 of the ICA and subsection 5(2) of the ILICR Aggregate of: • 70% of the amount calculated pursuant to subsection 5(4) of the ILICR • 15% of non-par liabilities • 25% of par liabilities • 5% of liabilities in respect of prescribed annuities Limits do not apply to: • companies, other than mutual companies, that are widely held and have equity ≥ $5 billion or to companies with equity ≥ $5 billion and controlled by a widely held eligible entity (refer to subparagraph 3(b)(ii) of the ILICR) • mutual companies having an aggregate surplus and minority	Paragraphs 508(c) and (d) of the ICA and subsection 5(3) of the ILICR Aggregate of: • 100% of the amount calculated pursuant to subsection 5(4) of the ILICR • 20% of non-par liabilities • 40% of par liabilities • 5% of liabilities in respect of prescribed annuities Limits do not apply to: • companies, other than mutual companies, that are widely held and have equity ≥ $5 billion or to companies with equity ≥ $5 billion and controlled by a widely held eligible entity (refer to subparagraph 3(b)(ii) of the ILICR) • mutual companies having an aggregate surplus and

Life Insurance (Foreign) and Fraternal Benefit Society (Foreign) (Note: Foreign Fraternal deemed to be Foreign Life)	Subsection 616(1) of the ICA and section 11.1 of the *Commercial Loan (Insurance Companies, Societies, Insurance Holding Companies and Foreign Companies) Regulations* (Commercial Loan Regulations) Commercial Lending • 5% of assets in Canada in the case where the excess of assets over the aggregate of liabilities and the margin referred to in subsection 608(1) of the ICA is ≤ $25 million • 100% of assets in Canada where the excess is > $25 million Consumer Lending • no restriction on consumer lending	Subsections 618(1) and (2) of the ICA and paragraphs 3(a) and (b) of the *Investments Limits (Foreign Companies) Regulations* (ILFCR) • 15% of assets in Canada vested in trust for classes of life insurance, accident and sickness insurance, credit protection insurance and other approved products insurance (foreign life company) • 10% of assets in Canada vested in trust for classes of insurance other than the above (foreign composite companies)	Subsections 619(1) and (2) of the ICA and section 4 of the ILFCR • 25% of assets in Canada vested in trust	Paragraph 620(a) of the ICA • total accepted values referred to in subsections 618(1) and 619(1) of the ICA shall not exceed prescribed percentage of the value of assets in Canada • no regulations promulgated to prescribe an aggregate percentage limit

Fraternal Benefit Society (Domestic)	Section 562 of the ICA and section 8 of the Commercial Loans Regulations • aggregate of commercial and consumer lending is 5% of total assets where capital is ≤ $25 million • 100% of total assets where capital is > $25 million	Section 563 of the ICA and subsection 4(2) of the *Investment Limits (Canadian Societies) Regulations* (ILCSR) • 15% of total assets as defined in subsection 4(1) of the ILCSR	Section 565 of the ICA and subsection 4(2) of the ILCSR • 25% of total assets as defined in subsection 4(1) of the ILCSR	Section 566 of the ICA • no regulations promulgated to prescribe an aggregate percentage limit

Property and Casualty Insurance and Marine Insurance (Domestic)	Section 505 of the ICA and section 5 of the Commercial Loans Regulations • 5% of total assets as defined in subsection 6(2) of the *Commercial Loan Regulations*	Section 506 of the ICA and paragraph 5(1)(b) of the ILICR • 10% of total assets as defined in section 1 of the ILICR Limits do not apply to: • companies that are widely held and have equity ≥ $5 billion or to companies with equity ≥$5 billion and controlled by a widely held eligible entity (refer to subparagraph 3(b)(ii) of the ILICR) • mutual companies having an aggregate surplus and minority interests ≥ $5 billion	Section 507 of the ICA and paragraph 5(2)(b) of the ILICR • 25% of total assets as defined in section 1 of the ILICR Limits do not apply to: • companies that are widely held and have equity ≥ $5 billion or to companies with equity ≥$5 billion and controlled by a widely held eligible entity (refer to subparagraph 3(b)(ii) of the ILICR) • mutual companies having an aggregate surplus and minority interests ≥ $5 billion	Section 508 of the ICA and paragraph 5(3)(b) of the ILICR • 35% of total assets as defined in section 1 of the ILICR Limits do not apply to: • companies that are widely held and have equity ≥ $5 billion or to companies with equity ≥$5 billion and controlled by a widely held eligible entity (refer to subparagraph 3(b)(ii) of the ILICR) • mutual companies having an aggregate surplus and minority interests ≥ $5 billion

Property and Casualty Insurance and Marine Insurance (Foreign)	Section 617 of the ICA and section 11.2 of the Commercial Loan Regulations • 5% of assets in Canada	Subsection 618(3) of the ICA and paragraph 3(c) of the ILFCR • 10% of assets in Canada	Subsection 619(3) of the ICA and section 4 of the ILFCR • 25% of assets in Canada	Paragraph 620(c) of the ICA • total accepted values referred to in subsections 618(3) and 619(3) of the ICA shall not exceed prescribed percentage of the value of assets in Canada • no regulations promulgated to prescribe an aggregate percentage limit

Insurance Holding Companies (IHC)	Section 963 of the ICA – per business powers, no consumer or commercial loans directly by IHC Commercial Lending • commercial loans held by subsidiaries cannot exceed 5% of total assets of IHC if IHC regulatory capital ≤ $25 million (section 979 of the ICA) • Superintendent approval required to exceed 5% if regulatory capital of IHC > $25 million (section 980 of the ICA) Consumer Lending • no limits in relation to IHC assets on consumer loans made by subsidiaries	Section 981 of the ICA and subsection 5(1) of the *Investment Limits (Insurance Holding Companies) Regulations* (ILIHCR) • 70% of the formula of A-B where A equals regulatory capital of the IHC and B equals the sum of equities, investments, loans, etc., of the companies controlled by the holding company (see subsection 5(1) of the ILIHCR for further detail on the formula) • limits do not apply to IHCs that are widely held and have equity ≥ $5 billion or to IHCs with equity ≥$5 billion and controlled by a widely held eligible entity (refer to paragraph 3(b) of the ILIHCR)	Section 982 of the ICA and subsection 5(1) of the ILIHCR • 70% of the formula of A-B where A equals regulatory capital of the IHC and B equals the sum of equities, investments, loans, etc., of the companies controlled by the holding company (see subsection 5(1) of the ILIHCR for further detail on the formula) • limits do not apply to IHCs that are widely held and have equity ≥ $5 billion or to IHCs with equity ≥$5 billion and controlled by a widely held eligible entity (refer to paragraph 3(b) of the ILIHCR)	Section 983 of the ICA and subsection 5(2) of the ILIHCR • 100% of the formula of A-B where A equals regulatory capital and B equals the sum of equities, investments, loans, etc., of the companies controlled by the holding company (see subsection 5(2) of the ILIHCR for further detail on the formula) • limits do not apply to IHCs that are widely held and have equity ≥ $5 billion or to IHCs with equity ≥$5 billion and controlled by a widely held eligible entity (refer to paragraph 3(b) of the ILIHCR)

Banks	None	Section 476 of the *Bank Act* (BA) and subsection 5(1) of the *Investment Limits (Banks) Regulations* (ILBR) • 70% of regulatory capital Does not apply to widely held banks with equity ≥$1 billion or to banks with equity ≥$1 billion and controlled by a widely held eligible entity (refer to paragraph 3(b) of the ILBR)	Section 477 of the BA and subsection 5(1) of the ILBR • 70% of regulatory capital Does not apply to widely held banks with equity ≥$1 billion or to banks with equity ≥$1 billion and controlled by a widely held eligible entity (refer to paragraph 3(b) of the ILBR)	Section 478 of the BA and subsection 5(2) of the ILBR • 100% of regulatory capital Does not apply to widely held banks with equity ≥$1 billion or to banks with equity ≥$1 billion and controlled by a widely held eligible entity (refer to paragraph 3(b) of the ILBR)
Bank Holding Companies (BHC)	Section 922 of the BA – per business powers, no commercial or consumer loans directly by BHC. No restrictions on commercial or consumer lending for the BHC subsidiaries	Section 938 of the BA and subsection 5(1) of the *Investment Limits (Bank Holding Companies) Regulations* (ILBHCR) • 70% of regulatory capital Does not apply to widely held BHCs with equity ≥$1 billion or to BHCs with equity ≥$1 billion and controlled by a widely held eligible entity (refer to paragraph 3(b) of the ILBHCR)	Section 939 of the BA and subsection 5(1) of the ILBHCR • 70% of regulatory capital Does not apply to widely held BHCs with equity ≥$1 billion or to BHCs with equity ≥$1 billion and controlled by a widely held eligible entity (refer to paragraph 3(b) of the ILBHCR)	Section 940 of the BA and subsection 5(2) of the ILBHCR • 100% of regulatory capital Does not apply to widely held BHCs with equity ≥$1 billion or to BHCs with equity ≥$1 billion and controlled by a widely held eligible entity (refer to paragraph 3(b) of the ILBHCR)

Trust and Loan Companies	Sections 461, 462 and 463 of the *Trust and Loan Companies Act* (TLCA) Commercial Lending • 5% of assets if regulatory capital ≤ $25 million • Superintendent approval to exceed 5% if regulatory capital > $25 million Consumer Lending • no restriction on consumer lending	Section 464 of the TLCA and subsection 5(1) of the *Investment Limits (Trust and Loan Companies) Regulations* (ILTLCR) • 70% of regulatory capital Limit does not apply to a widely held company with equity ≥ $5 billion or to a company with equity ≥ $5 billion and controlled by a widely held eligible entity (refer to paragraph 3(b) of the ILTLCR)	Section 465 of the TLCA and subsection 5(1) of the ILTLCR • 70% of regulatory capital Limit does not apply to a widely held company with equity ≥ $5 billion or to a company with equity ≥ $5 billion and controlled by a widely held eligible entity (refer to paragraph 3(b) of the ILTLCR)	Section 466 of the TLCA and subsection 5(2) of the ILTLCR • 100% of regulatory capital Limit does not apply to a widely held company with equity ≥ $5 billion or to a company with equity ≥ $5 billion and controlled by a widely held eligible entity (refer to paragraph 3(b) of the ILTLCR)

Cooperative Credit Associations	Sections 398, 399 and 400 of the *Cooperative Credit Associations Act* (CCAA) Commercial Lending • 5% of assets if regulatory capital ≤ $25 million • Superintendent approval to exceed 5% if regulatory capital > $25 million Consumer Lending • no restriction on consumer lending	Section 401 of the CCAAand subsection 5(2) of the *Investment Limits (Cooperative Credit Associations) Regulations* (ILCCAR) 1. 35% of regulatory capital if the association is primarily engaged in managing liquidity or providing treasury, clearing, settlement or payment services; 2. 70% of regulatory capital if the association is not an association referred to in a) above and its equity percentage does not exceed 30%; and 3. 100% minus its equity percentage if association is not an association referred to in a) above and its equity percentage exceeds 30%	Section 402 of the CCAA and subsection 5(3) of the ILCCAR 1. 35% of regulatory capital if the association is primarily engaged in managing liquidity or providing treasury, clearing, settlement or payment services; 2. 70% of regulatory capital if the association is not an association referred to in a) above and its equity percentage does not exceed 30%; and 3. 100% minus its equity percentage if association is not an association referred to in a) above and its equity percentage exceeds 30% (the equity percentage is defined in subsection 5(1) of the ILCCAR)	None