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Guidance Note

Subject: **Assets to Capital Multiple**

Date: **August 2000**

Representatives from a number of deposit-taking institutions (DTIs) have pointed out that an increase to the assets to capital multiple might be warranted for institutions that have a high proportion of low risk-weighted assets. This guidance note elaborates on the factors that OSFI will use to screen and assess applications for increases to the authorized assets to capital multiple pursuant to page 1-1 of the Capital Adequacy Requirements Guideline (CAR). CAR 1-1 sets out that:

> In setting the assets to capital multiple for individual banks, the Superintendent will consider such factors as operating and management experience, strength of parent, diversification of assets, type of assets and appetite for risk.

In particular, OSFI will consider applications for authorized multiples in excess of 20 times from DTIs that demonstrate that, in substance, they:

1. meet or exceed their risk-based capital targets (e.g., 7% and 10%);
2. have total capital[1] of a significant size (e.g., $100 million) and have well-managed operations that focus primarily on a very low risk market segment;
3. have a four-quarter average ratio of adjusted risk-weighted assets to adjusted net on- and off-balance sheet assets[2] that is less than 60%;
4. have adequate capital management processes and procedures[3];
5. have been at "stage 0"[4] for at least four consecutive quarters; and
6. have no undue risk concentrations.

Requests for increases for particular institutions should be addressed to the Registration and Approvals Division in Ottawa and should also include a business case that, at minimum, sets out:

- the DTI's own assessment of its risk profile and general financial condition, and an explanation of why these factors justify a higher assets to capital multiple;
- growth projections by business line;
- what percentage of total assets these business lines are expected to account for; and
- the expected impact of the projected growth on profitability and risk-based capital ratios.

Increased authorized multiples will not exceed 23 times capital.

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If a DTI exceeds its increased authorized multiple or allows its risk-based capital ratios to drop below its well-capitalized targets, OSFI will reduce the DTI's authorized multiple and will require the institution to file with OSFI an action plan for achieving the reduced multiple. The DTI would be required to operate at or below the original level for four consecutive quarters before being reconsidered for an increase to its multiple.

A DTI that receives an increase to the authorized multiple will be expected to provide an annual report, approved by the CFO, to its OSFI relationship manager for the following two years. The report must demonstrate that:

- it continues to meet the six pre-conditions required for the initial application, and
- its risk profile, including the balance sheet structure, remains essentially the same as that shown in the business case used to justify the increase.

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[1] Total capital as reported on CAR 2 – Capital Elements.

[2] The adjusted ratio of risk-weighted assets to net on- and off-balance sheet assets is used as a proxy for asset quality and is calculated by dividing:

Total risk-weighted assets

by

Net on- and off-balance sheet assets per CAR 1 + Credit equivalent amount of OTC derivatives contracts per Appendix II of CAR 4 (this includes contracts subject to and contracts not subject to permissible netting).

The ratio should be calculated using data from the four previous consecutive quarters.

[3] DTIs with adequate capital management processes and procedures can demonstrate that they have management reports that allow tracking of compliance with the assets to capital multiple and risk-based capital ratio targets between quarter ends.

[4] Refer to the *Guide to Intervention for Federal Financial Institutions* for further details. "Stage 0" means: "No problems/Normal activities -- Routine supervisory and regulatory activities pursuant to mandates of OSFI and CDIC. In addition, both agencies conduct research and analyze industry-wide issues and trends, appropriate to their respective functions."