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Rethinking Prudential Rules to Strengthen Canada's Economy Through Improved Business Lending

Second and Final Meetings of the C.D. Howe Institute Task Force on OSFI Prudential Requirements and Business Lending

INTRODUCTION

The C.D. Howe Institute Task Force on Office of the Superintendent of Financial Institutions (OSFI) Prudential Requirements and Business Lending has met three times since its formation in early 2026. The inaugural meeting established the framing and questions to guide the task force's work.¹ The two subsequent meetings focused on developing concrete, practical recommendations in six areas where members believe adjustments to the prudential framework could improve the flow of credit to Canadian businesses. This second and final communiqué presents the task force's findings and recommendations.

The Institute established this short-term task force in response to several OSFI statements issued in the fall of 2025. These statements centred on finding ways to increase credit to Canadian businesses to strengthen the economy amid global challenges, including the trade war with the United States. The task force's goal is to provide commentary and recommendations on OSFI's proposed changes, such as revisions to capital requirements for banks and insurance companies, and to explore new ideas that may warrant consideration.

The task force expanded its membership after the first meeting and now consists of nine experts in the field: Riaz Ahmed, Cindy Forbes, Jamey Hubbs, Blair Keefe, Timothy Lane, Peter Levitt, Kathleen Taylor, Mark Zelmer, and Jeremy Kronick, who is Chair.²

Members began with a shared observation that Canada's major banks and life insurers currently hold capital well above their public regulatory requirements. As a result, these capital requirements do not appear to be a binding constraint on business lending. The group thus focused on how those requirements are distributed, particularly the specific capital charges applied to different types of credit extension, which in certain cases appear disproportionate to the actual risk of the underlying credit

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- 1 C.D. Howe Institute Task Force on OSFI Prudential Requirements and Business Lending. 2026. "Prudential Requirements and Business Lending in Canada: Issues, Questions, and Near-Term Priorities." Toronto: C.D. Howe Institute. February 19. <https://cdhowe.org/publication/prudential-requirements-and-business-lending-in-canada-issues-questions-and-near-term-priorities/>.
 - 2 Peter MacKenzie sat in on the meetings and was instrumental in the drafting of the communiqué. The Committee also thanks Eli Monas for contributing comments, which helped to develop parts of the communiqué.

exposure. The task force adopted a straightforward test for its recommendations: changes to the prudential framework should increase productive capital deployment without imposing undue risk on depositors and policyholders, and should continue to promote confidence in the financial system as a whole.

The task force identified six areas for targeted recommendations:

- Calibration of capital requirements for small and medium-sized enterprise (SME) lending;
- Treatment of life insurer investments in private credit funds;
- Capital treatment of equity and growth capital investments;
- Portfolio allocation constraints on insurer investments in private credit;
- Potential for life insurers to use their own models to calculate capital charges for credit exposures; and
- Steps that could be taken to help credit unions and fintechs play a more active role in supplying credit to small and medium-sized entities.

While focusing on the prudential requirements most relevant to business lending and infrastructure projects, members recognized that prudential regulation is only one part of a broader set of constraints on credit extension and business growth in Canada. They highlighted other barriers, including a tax code that discourages businesses from scaling up, slow regulatory approvals across multiple agencies, and an institutional culture that has historically favoured caution over speed.

Members also noted that the Institute's Financial Regulatory Excellence Initiative³ has documented that Canada has 44 federal and provincial financial regulators, with rules and mandates that continue to expand. Most regulatory activity remains focused on stability rather than competition and growth.⁴ Members then argued that, for the recommendations in this communiqué to have the greatest effect on changes to the supply of credit, parallel efforts are needed across other parts of the regulatory and policy landscape. Changes to specific capital charges, while directionally sound, will not be sufficient on their own to resolve the broader challenge of credit availability for Canadian businesses.

Governments at all levels should look for opportunities to boost competition and innovation in the financial sector, including by accelerating credit union reforms, and to create conditions that allow for more productivity in the economy. Members also observed that reducing the gap between standardized and internal model capital requirements approaches is important for competitive balance: smaller institutions using the standardized approach currently face materially higher capital charges for equivalent exposures, putting them at a significant disadvantage. OSFI should continue efforts to narrow this gap. Improving resolution frameworks for federally regulated institutions could also give regulators more social license to reduce conservatism in supervisory practice, since robust resolution capacity supports a more proportionate approach to prudential oversight.⁵

3 C.D. Howe Institute. 2026. "The Financial Regulatory Excellence Initiative." <https://cdhowe.org/financial-regulatory-excellence-initiative/>.

4 Bourque, Paul C., and Gherardo Gennaro Caracciolo. 2024. *The Good, the Bad and the Unnecessary: A Scorecard for Financial Regulations in Canada*. Commentary 664. Toronto: C.D. Howe Institute. <https://cdhowe.org/publication/good-bad-and-unnecessary-scorecard-financial-regulations-canada/>.

5 Zelmer, Mark. 2024. *Better Safe than Sorry: Options for Managing Bank Runs in the Future*. Commentary 660. Toronto: C.D. Howe Institute. <https://cdhowe.org/publication/better-safe-sorry-options-managing-bank-runs-future/>.

Members were mindful of the current environment surrounding private credit and the need for any changes to reflect emerging concerns of fragility in that market. Recent reports of governance failures, valuation concerns, and operational shortcomings in parts of the private credit market highlight the importance of maintaining rigorous prudential oversight even as specific capital charges are recalibrated. Facilitating greater institutional participation in private credit should not come at the cost of weakened standards, and regulators should remain attentive to emerging risks in this rapidly growing asset class.

The goal is not to push institutions into exposures that do not make sense for them, but to alleviate regulatory distortions that prevent institutions from pursuing sound lending and investment activities. Members also stressed that changes in how OSFI applies requirements in practice – on the supervisory side – may offer as much scope to facilitate credit extension as changes to the public requirements themselves. A more collaborative and responsive supervisory approach should be pursued regardless of any formal rule changes.

CAPITAL REQUIREMENTS FOR SME BUSINESS LENDING

Task force members focused on what they described as the “missing middle”: enterprises too large for retail bank lending but too small to access capital markets directly. This is where prudential policy can have the greatest impact, recognizing that very early-stage firms face financing challenges that go well beyond the capital requirements attached to such lending.

While large banks’ capital charges on SME lending are determined by their internal models, members noted that OSFI plays an active role in reviewing and approving those models and expressing its views on their outputs: it is a misperception to think that banks operating under the internal models set their own capital requirements entirely. Members observed that OSFI’s feedback on internal models has tended to push institutions toward more conservative calibrations, which may result in capital requirements for SME exposures that exceed underlying risk.

They argued that this bias toward conservatism, combined with lengthy approval timelines for model updates, is a central issue. Even if OSFI adjusts SME risk weights, the practical impact will be limited if the process for revising and approving internal models used by large banks remains slow.

LIFE INSURER INVESTMENTS IN PRIVATE CREDIT FUNDS

Next, members examined OSFI’s treatment of insurance company investments in private credit funds. When an insurer invests in a fund that holds corporate loans, OSFI requires it to hold capital against the limited partnership interest as though it were an equity exposure, even though the investment provides access to a portfolio of corporate credit. Capital charges can range from 30 to 50 percent of the investment, depending on various factors. If the insurer held those same loans directly, the charge would be significantly lower. The difference reflects the legal structure of the vehicle, not the underlying risk.

That said, members pointed to a meaningful distinction between direct and indirect credit exposures: when an institution lends directly, it generally conducts its own underwriting and credit approval, whereas fund investments mainly rely on a third party’s (typically the fund sponsor’s) credit management practices. Any move toward a more risk-based, look-through approach should account for this difference. On balance, members encouraged OSFI to look through the legal structure where possible and base capital requirements on the risk of the underlying assets, as it already does for certain equity investments in funds made by deposit-taking institutions.

Members then discussed the portfolio allocation constraint on insurer investments in private credit. The federal budget signalled its intent to remove the 5 percent ceiling on commercial lending allocations under the *Insurance Companies Act*, including the overly broad definition of commercial loans (amendments have passed but are not yet in force). Task force members support this change and encourage OSFI to seize the opportunity provided by the removal of the statutory limit to adopt a supervisory approach that calibrates expectations with the actual risk of the exposures and to the size, expertise, and risk management capacity of individual institutions, rather than replacing the legislative cap with equally restrictive guidance. This is especially relevant because smaller life insurers and all property and casualty insurers currently face this constraint. If there is no principled prudential basis for this difference, it should be corrected.

CAPITAL TREATMENT OF EQUITY AND GROWTH CAPITAL INVESTMENTS

For banks, a minority equity stake in a speculative unlisted Canadian company currently attracts a 400 percent risk weight – the highest in the standardized credit risk framework. This makes such investments prohibitively expensive for those banks to hold minority equity positions in Canadian growth companies. Banks are holding only very small equity positions, well below the 10 percent ceiling the rules permit. Because these holdings are small and well diversified, the 400 percent risk weight may overstate the actual portfolio-level risk. Members acknowledged that the fact that banks are not approaching the regulatory ceiling suggests that return-on-equity expectations – in addition to prohibitive capital charges – also play a significant role in constraining activity in this space.

The group also discussed which institutions are best suited for this activity – whether it should be large banks, given the risk in these types of investments, or smaller banks and non-banks that would be easier to resolve should they ever encounter distress. While this broader question is important, members agreed it is worth examining whether the 400 percent risk weight reflects actual risk or embeds undue conservatism in how certain exposures are classified, and whether addressing it could allow banks to compete in areas where they are currently present but constrained.

ALLOWING LIFE INSURERS TO USE INTERNAL MODELS

Unlike the major banks, life insurers cannot use internal models to compute their credit risk capital charges in the capital requirements set by OSFI. Task force members noted that the larger life insurers also have a long history of sophisticated credit risk management practices and should be allowed to seek OSFI approval to use their own risk models, subject to the same requirements that OSFI has imposed on the largest banks. This would enable insurers to compete more aggressively in business lending, especially in the supply of longer-term financing, as well as in the supply of infrastructure financing; the latter is currently constrained by the very conservative capital charge imposed on life insurers that seek to invest in projects that don't have published credit ratings.

HELPING CREDIT UNIONS AND FINTECHS EXPAND SME LENDING

Finally, members discussed the role that credit unions play in supplying credit to small and medium-sized businesses. Facilitating their migration to federal jurisdiction could potentially spark more competition, innovation, and the overall supply of credit. Members also noted that fintechs could play a complementary role.

Members therefore applauded OSFI's plans to fast-track the federal continuance of credit unions and the incorporation of deposit-taking fintechs. With respect to the former, members encourage provincial authorities to help larger credit unions transition federally, which would increase competition by allowing those credit unions to carry on business across Canada, allowing them to diversify lending geographically.

Task force members noted that credit unions need to expand if they are to play a larger role in supplying credit to SMEs. Achieving that expansion requires that they be able to access capital from institutional investors in ways that don't undermine their member-focused governance structures. For that to happen, members recommend that OSFI tailor capital rules to be more appropriate for federal credit unions. For example, non-viability contingent capital (NVCC) conversion features are unlikely to work for cooperative structures that lack common equity, and may be unnecessary unless a credit union becomes systemically important.

Members also encourage OSFI to consider following Australia's lead and permit Tier 2 forms of capital, like subordinated debt, to replace the requirements for Additional Tier 1 capital for smaller institutions with corresponding adjustments to leverage ratio requirements (and credit unions in particular). This could significantly reduce the cost of capital for those institutions.

CONCLUSION

Based on its deliberations, the task force puts forward the following recommendations, organized by implementation horizon.

Near-term Adjustments

- OSFI should apply a look-through treatment to life insurer investments in private credit funds, calculating capital requirements on the basis of the risk of the underlying assets rather than treating the investment as an equity exposure, while recognizing that credit risk is managed by the fund rather than the insurer in such cases.
- OSFI should dedicate resources to expediting the review and approval of bank internal model changes for SME lending. Without faster approvals, reductions in SME risk weights will not reach borrowers in practice.
- As the overly inclusive definition of commercial loan and the 5 percent ceiling on commercial lending allocations under the *Insurance Companies Act* are removed, OSFI should seize the opportunity to calibrate expectations to the size, expertise, and risk management capacity of individual institutions, ensuring that the removal of the statutory limit translates into a genuinely more risk-based supervisory approach. It should also ensure that smaller insurers have access to relief mechanisms equivalent to those available to larger life insurers.

- OSFI should continue fast-tracking the continuance of credit unions federally and the incorporation of deposit-taking institutions by fintechs. Provincial authorities should facilitate the migration of larger credit unions to the federal framework to support competition and permit greater geographic risk diversification.
- OSFI should tailor capital rules for federal credit unions, including by reconsidering NVCC conversion features that do not work for cooperative structures, and by considering whether Tier 2 subordinated debt could replace Additional Tier 1 capital requirements for smaller institutions, as in Australia.
- More broadly, OSFI should strengthen its partnership-oriented supervisory model by improving turnaround times and transparency. Changes to how OSFI applies requirements in practice may offer as much or possibly even more scope to facilitate credit extension as changes to the public requirements themselves.

Longer-term Adjustments

- OSFI should evaluate whether standardized SME risk weights, largely drawn verbatim from the Basel framework, are properly calibrated for Canadian conditions. (The Basel framework is designed for internationally active banks; its risk weights reflect international experience that may not be representative of loss experience in the Canadian market). OSFI should consider whether a different calibration is warranted for domestic institutions that operate exclusively in Canada. Continuing to simplify regulatory requirements for smaller deposit-taking institutions would also make them more competitive in serving SME borrowers.
- Unless there is a clear prudential rationale, OSFI should reexamine the capital treatment of credit exposures for life insurers under the Life Insurance Capital Adequacy Test (LICAT), particularly where the current framework produces materially different capital charges for equivalent underlying risks. A principles-based review of specific asset classes, starting with private credit and unrated infrastructure, could identify areas of undue conservatism.
- Over time, OSFI should consider allowing insurance companies to use their own risk models to compute their capital requirements, subject to OSFI review and approval, aligning the insurance framework more closely with that used for banks.
- OSFI should examine whether the 400 percent risk weight for speculative unlisted equity exposures reflects actual risk or whether there is undue conservatism in how certain exposures are classified. Addressing this could expand banks' ability to support Canadian growth companies.

MEMBERS OF THE C.D. HOWE INSTITUTE TASK FORCE ON OSFI PRUDENTIAL REQUIREMENTS AND BUSINESS LENDING

Members of the Council participate in their personal capacities, and the views expressed do not represent those of any institution or client.

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