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COMMUNIQUÉ

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## DOMESTIC STABILITY BUFFER COUNCIL

# Give it Time: Council Recommends Holding Buffer at 3 Percent to Allow June Cut to Fully Take Effect

***Seventh Meeting of the C.D. Howe Institute Domestic Stability Buffer Council***

At its most recent meeting, the C.D. Howe Institute's Domestic Stability Buffer Council (DSBC) members unanimously recommended that the Office of the Superintendent of Financial Institutions (OSFI) maintain its Domestic Stability Buffer (DSB) at 3 percent at its upcoming setting in December. Council members agreed that the June cut to the DSB will take time to make its way through the economy in the form of increased credit provision. They therefore recommended waiting to further assess its impact before making any additional changes.

The Council provides OSFI, industry participants, and key economic policy voices with an independent assessment of the appropriate size of the buffer in pursuit of OSFI's mandate of contributing to public confidence in the Canadian financial system. Council members make recommendations for OSFI's upcoming DSB announcement. The Council consists of Vivian Abdelmessih, Cathy Cranston, Jamey Hubbs, Peter Levitt, Duncan Munn, Mark Zelmer, and Jeremy Kronick, who is Chair. All members attended.

The discussion began with a review of OSFI's analysis that led to the reduction of the buffer from 3.5 percent to 3 percent of risk-weighted assets in June, and the narrowing of the range from 0-4 percent to 0-3 percent. At the time, OSFI highlighted that bank balance sheets were well-positioned to absorb a lowering of the capital buffer, while the economy faced headwinds that warranted increased credit availability. Bank CET1 ratios exceeded capital requirements by a little over 200 basis points on average, and provisions for expected credit losses had stabilized. The headwinds included trade policies and supply chain restructuring, continued geopolitical tensions, and plans for significant investment here at home in defence and infrastructure (among other areas). The combination of financial system resilience and the drag on economic activity led OSFI to cut the DSB to 3 percent and lower the top end of the range to provide greater certainty for financial institutions and encourage increased credit supply.

The Council then assessed how economic and financial conditions have evolved since June. Household debt relative to disposable income remains stable, and the house-price-to-income index continues to drop from historically elevated levels. The household debt service ratio remains flat. Non-performing loans continue to increase, but provisions for credit losses have levelled off. On the macroeconomic side, discussions centred on auto plant closures, weak business investment, and labour market data

showing rising unemployment and high job losses in the last few months. This weakness is occurring alongside elevated inflation that prompted the Bank of Canada to hike the overnight rate for the first time in more than three years. Both the geopolitical risk index and other policy uncertainty indices have dropped since June, but remain historically high.

Overall, members concluded that economic and financial conditions have remained largely unchanged since June.

Several additional factors shaped the Council's recommendation. One big change since June was the US midterm elections, which shifted the balance of power in Congress. Members argued that while the process and details of trade policy may change, tariffs would likely remain part of the US economic agenda regardless of which party holds power.

Another consideration was the need to allow the 50-basis-point drop in the DSB in June to work its way through the economy. A change of this magnitude takes time to have a significant effect – and certainly more than six months. Bank CET1 ratios have declined modestly since June, though this occurred alongside share buybacks. Banks have also announced large investments, but few have materialized.

The 2026 federal budget also introduced a significant change, giving OSFI a more explicit secondary objective within its mandate: promoting competition. OSFI has also announced policies on proportional regulation and risk-weight adjustments. Canada's drive for more competition in financial services should give bank customers more choice and better pricing. The objective should be to do so in a way that maintains the resilience of the financial system, and members encourage OSFI to implement its new mandate through this lens. This also supports leaving the buffer unchanged, giving OSFI and the institutions it oversees time to adapt to the new mandate and assess how competition evolves.

Interest rates have also risen since June. The Federal Reserve appears poised to raise its policy rate again at its next announcement, while the Bank of Canada raised its policy rate in October. Interest rates across the yield curve have generally risen since June in both countries, and indeed across major economies. Higher rates will tighten financial conditions and weigh on global economic activity, although the Canadian dollar's depreciation over this period could cushion some of the impact on Canada's economy.

These economic headwinds could justify reducing the DSB below the top end of the 0-3 percent range. However, Council members ultimately agreed that OSFI should first more fully assess how the June cut affects credit provision and the broader economy before contemplating any further action.

Another risk that has attracted greater attention, despite remaining largely unchanged since June, is the narrow concentration of gains in US equities, particularly in the technology sector, and the market's vulnerability to negative news, as several recent events have demonstrated. This risk reinforces the case for increased prudence.

After weighing these considerations, members unanimously recommended that OSFI maintain the DSB at 3 percent. Economic and financial conditions remain broadly similar to those in June, when OSFI reduced the DSB: risks remain elevated, the financial sector is stable, and the economy faces significant headwinds. But members agreed that OSFI should wait to evaluate the cut's impact on credit provision and economic activity before making further changes. They also felt that risks today were more likely to crystallize, reinforcing the case for OSFI to keep its DSB powder dry.

The Council will meet again in May 2027 ahead of OSFI's DSB setting in June 2027.

## Chair of the Council:

- **Jeremy Kronick**, President and CEO, C.D. Howe Institute.

## Members of the Council:

- **Vivian Abdelmessih**, President and CEO, Global Risk Institute.
- **Cathy Cranston**, former Treasurer at BMO Financial Group.
- **Jamey Hubbs**, Senior Fellow, C.D. Howe Institute, former Vice Superintendent, OSFI.
- **Peter Levitt**, Co-Chair, Financial Services Research Initiative, C.D. Howe Institute, former EVP, Treasury & Taxation, CIBC.
- **Duncan Munn**, Chair and CEO, Elevate Export Finance.
- **Mark Zelmer**, Fellow-in-Residence, C.D. Howe Institute, former Deputy Superintendent of Financial Institutions, OSFI.

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