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“Not Normal Times”: Council Recommends Holding Buffer at 3.5 Percent Amid Rising Economic Uncertainty

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

At its meeting on May 20, 2025, the C.D. Howe Institute’s Domestic Stability Buffer Council (DSBC) recommended that the Office of the Superintendent of Financial Institutions (OSFI) maintain the Domestic Stability Buffer (DSB) for the domestic systemically important banks (D-SIBs)¹ at 3.5 percent at its next setting in June.

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

The meeting began with a review of the data and how they compared with the data underpinning OSFI’s decision to leave the buffer unchanged at 3.5 percent in December. The Council noted that debt-to-disposable income and the debt service ratio have fallen off their peaks as the Bank of Canada reduced its policy rate over the last six months. This helped ease pressure on household debt-service costs and, hence, on bank balance sheets. That said, non-performing loans at financial institutions have continued to increase, as have bank provisions for credit losses. Whether interest rates will continue to fall is uncertain as yields increase south of the border and the Bank of Canada faces stagflationary concerns; namely, increasing unemployment and rising prices (despite headline inflation in April coming in at 1.7 percent, core inflation measures are now above 3 percent).

With the DSB currently set at 3.5 percent, big banks’ capital Common Equity Tier 1 (CET1) requirements sit at 11.5 percent. Actual CET1 ratios for these financial institutions range from 12.9 to 13.6 percent, putting them comfortably above the minimum. Members acknowledged that at these levels, in regular times, this would constitute a banking system that is well-prepared for a financial downturn. However, members argued that these were not normal times, and the extreme uncertainty and potential magnitude of a tail-risk downturn scenario materializing made it difficult to assess preparedness. A severe enough scenario could lower these capital ratios close to the 11.5 percent floor.

1 D-SIBs refer to the six major banks in Canada: RBC, TD, Bank of Montreal, Scotiabank, CIBC, and National Bank.

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Members then discussed the definition of the DSB and how one should think of its role as a countercyclical tool. Countercyclicality is the first principle listed under the DSB framework on OSFI's site:

OSFI requires Canada's largest banks or Domestic Systemically Important Banks (D-SIBs) to build up capital buffers during periods of growth and stability. During challenging times characterized by elevated uncertainty, OSFI will release or lower those buffers. Thus, capital buffers expand and contract to offset volatility in the financial system and broader economy.²

Members argued that the current environment is not stable, and there are clear signs that the economy is weakening, meaning, at minimum, an increase in the DSB was off the table. The discussion then centred around whether to hold the buffer at 3.5 percent or reduce it, given the current unprecedented economic and geopolitical uncertainty. Members highlighted one popular measure of uncertainty, the global economic policy uncertainty index, which is in uncharted territory, sitting far above levels seen during previous times of economic stress.

Members began the debate on the two options – hold or lower the DSB – by differentiating between two types of scenarios that call for lowering the buffer. The first is an emergency release, in the spirit of what we saw with the off-cycle announcement in March 2020 when COVID-19 first hit. In such a scenario, a significant immediate reduction in the buffer could be required if economic conditions and financial markets deteriorate quickly, capital and liquidity ratios come under threat, and the supply of credit to the economy is at risk of contracting materially. Members noted concern that this scenario was starting to materialize after the United States' "Liberation Day" tariffs and the bond market reaction, which included a sell-off of many assets, most notably normally safe-haven US treasuries. The reversal of US tariffs – a 90-day pause in most cases – prevented the need for an emergency DSB release.

The second scenario is a more gradual on-cycle reduction that recognizes that the economy is weak and the buffer is acting as a constraint on bank capital that would otherwise be deployed to supply credit to the economy. Members felt that the question at hand was whether we are (i) in this scenario and (ii) whether a small release of the buffer (25 or 50 basis points) would be helpful to the supply of credit.

2 See: Office of the Superintendent of Financial Institutions. 2023. Domestic Stability Buffer Design Framework. Ottawa: Government of Canada. December 8. <https://www.osfi-bsif.gc.ca/en/supervision/financial-institutions/banks/domestic-stability-buffer/domestic-stability-buffer-design-framework>.

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Members agreed that the combination of economic uncertainty and increasing signs of an economic slowdown made a strong case for OSFI to begin releasing the buffer. However, members noted the large gap between the minimum level of necessary capital, 11.5 percent, and the current range of CET1 bank ratios, 12.9-13.6 percent. They judged that a reduction of 25 or 50 basis points was unlikely to change the supply of credit to the economy in such circumstances. In other words, the buffer is not currently acting as a constraint on credit, especially in light of slowing demand for credit and larger-than-normal prepayments in the corporate segment of the economy.

Moreover, as noted earlier, members were concerned that the severity of a tail risk that materializes is much greater in today's economic environment than in previous cycles – for example, the potential loss of the automotive industry and other important parts of the economy in response to potential US trade actions. This would be compounded by a drop in the supply of credit from other sources of financing in the economy. As a result, members felt OSFI should keep its powder dry, but it should be ready to react quickly to lower the buffer if conditions warrant.

Members felt that even though the level of the DSB may not be constraining the supply of credit, there is a broader need to deploy capital into the Canadian economy, given the threat emanating from the current global tariff and trade environment and the ensuing potential structural changes to the economy. While the DSB was a blunt tool that was not designed to address this issue, the economic threats in the current environment were seen as an opportunity for a broader review of the current regulatory and prudential regime to assess what changes could be made to improve the allocative flow of credit and remove any impediments. Members did not endorse any particular changes but reinforced the importance of such a review as Canadians face these potential structural transformations – especially as the era of global coordination on regulation and supervision appears to be fraying.

In summary, the consensus among members in attendance was to leave the DSB unchanged. Ultimately, members agreed that two main factors – the current level of the buffer not acting as a significant constraint to the supply of credit and the desire for OSFI to keep its powder dry – outweighed the uncertainty and weakening economic conditions. Members judged a release would be premature, and OSFI might need the extra room to deal with an outsized economic downturn given the wide range of outcomes stemming from the US administration's trade policy. Members also agreed that should an emergency arise, OSFI should be nimble and ready to act quickly to release the buffer off-cycle.

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Chair of the Council:

- **Jeremy Kronick**, Vice-President, Economic Analysis and Strategy, C.D. Howe Institute.

Members of the Council:

- **Vivian Abdelmessih**, Chair of the Board at Export Development Canada.
- **Cathy Cranston**, Former Treasurer at BMO Financial Group.
- **Jamey Hubbs**, Senior Fellow, C.D. Howe Institute, Former Vice Superintendent, OSFI.
- **Peter Levitt**, Corporate and Philanthropic Director, Former EVP, Treasury and Taxation, CIBC.
- **Duncan Munn**, Chair & 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.