

Consultation Paper

# D-SIB Resolution Planning By-law Requirements

February 12, 2018



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## Foreword

In the 2017 federal budget, the Government announced its intention to introduce legislative amendments to further strengthen Canada's resolution regime. The *Budget Implementation Act, 2017, No. 1*, which received Royal Assent on June 22, 2017, provided the Canada Deposit Insurance Corporation (**CDIC, the Corporation**) with a by-law making authority respecting the development, submission and maintenance of resolution plans by domestic systemically important banks (**D-SIBs**)<sup>1</sup>, including specifying the contents of those plans.

The purpose of this consultation is to ensure that the proposed *D-SIB Resolution Planning By-law (By-law)* requirements are clear, and that the approach with respect to the assessment of resolution plans and mechanism to ensure adherence to the By-law are well-understood.

Input received from this consultation process will assist us in finalizing the By-law requirements. Comments on the draft By-law and any consequential amendments to related by-laws will be sought as part of the *Canada Gazette* process.

CDIC's intention is that the By-law will be brought into force by the end of 2018, with the first resolution plans submitted under the By-law in 2019. To meet this deadline, interested parties have until March 13, 2018 to provide their written comments. They are to be directed to:

### **Canada Deposit Insurance Corporation**

By hand or mail to: 17th Floor, 50 O'Connor Street, Ottawa, Ontario K1P 6L2

By email to: [consultation@cdic.ca](mailto:consultation@cdic.ca)

Information received throughout this submission process is subject to the *Access to Information Act* and the *Privacy Act*. Should you express an intention that your submission, or any portions thereof, be considered confidential, CDIC will make all reasonable efforts to protect this information.

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<sup>1</sup> This includes any D-SIB that has been designated by the Financial Stability Board as a global systemically important bank.

## Introduction

Consistent with the G20 financial sector reform agenda aimed at addressing the factors that contributed to the 2008 global financial crisis, Canada has taken a number of steps to strengthen the banking sector and reduce the risk associated with bank failures. *Economic Action Plan 2015* announced that the D-SIBs are responsible for preparing resolution plans that set out how each bank could be resolved in the unlikely event that their recovery actions fail. Most recently, the federal government made amendments to the *Canada Deposit Insurance Corporation Act (CDIC Act)*<sup>2</sup> which:

- Designate CDIC as resolution authority<sup>3</sup>; and
- Provide CDIC with a new by-law making authority respecting the development, submission and maintenance of resolution plans by the D-SIBs, including specifying the contents of those plans.<sup>4</sup>

As Canada's resolution authority for its member institutions, including the D-SIBs, we are working with the banks to ensure their resolution plans demonstrate that they can fail safely, so that Canadians can have confidence in the stability of the financial system in Canada. The proposed By-law requirements formalize our existing resolution planning guidance and practices as Canada's resolution authority for the banks.

To support the development of the banks' resolution plans, in 2016, we shared with the banks the [Resolution Plan Guidance \(Guidance\)](#) that outlined our expectations with respect to the information that should be included in their resolution plans.

In December 2016, the banks submitted their first resolution plans. We provided feedback focusing on areas to improve each plan, and measures to address any impediments to resolvability.

We have set out a multi-year timeline for the maturation of the resolution plans. Our expectation is that the banks will have addressed the material impediments to implement these plans that will enable us to consider these institutions resolvable by March 2020. The first resolution plans under the By-law requirements would be submitted by the banks in December 2019, and compliance with the By-law requirements assessed in the spring of 2020.

**Note that references to "bank" throughout this consultation paper are only in relation to the banks that will be subject to the By-law (i.e., the D-SIBs).**

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<sup>2</sup> <http://laws.justice.gc.ca/eng/acts/C-3/>

<sup>3</sup> *CDIC Act, paragraph 7(d)*

<sup>4</sup> *CDIC Act, paragraph 11(2)(e)*

## Discussion

The purpose of this consultation paper is to:

- Outline and seek feedback on the requirements that we propose to include in the By-law;
- Set out our approach with respect to the review and assessment of resolution plans submitted by the banks in accordance with the By-law; and
- Describe the mechanism to ensure adherence to the By-law;

Note that the final language to be included in the By-law may differ from that proposed in the consultation paper.<sup>5</sup>

### 1. Proposed By-law Requirements

#### 1.1 Scope

The By-law will apply to banks that have been designated as a D-SIB by the Superintendent of Financial Institutions.

#### 1.2 Definitions

Terms listed in [Appendix 1](#), and possibly other terms, will be defined in the By-law to provide more clarity with respect to certain requirements.

#### 1.3 Development, Submission and Maintenance of the Resolution Plan

The following requirements must be met by the banks with respect to the development, submission and maintenance of resolution plans.

##### Proposed Requirements

(i) Development and submission of the resolution plan

- (a) Upon receipt of a written request by the Corporation, the bank must develop and submit a resolution plan in whole or in part to the Corporation within a reasonable timeframe as specified in the request.
- (b) The resolution plan submitted to the Corporation must be approved by the board of directors of the bank, unless otherwise specified by the Corporation.

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<sup>5</sup> Interested parties will have the opportunity to comment on the final language to be included in the By-law as part of the Canada Gazette process.

**Proposed Requirements (cont.)**

- (c) The bank must provide the Corporation with a certified copy of the board of directors' resolution with respect to its approval of the resolution plan, as applicable.
- (ii) Maintenance of the resolution plan
  - (a) The bank must ensure that the resolution plan remains current with respect to matters that can affect the resolution strategy through ongoing maintenance and testing.
- (iii) Notice of a material change
  - (a) The bank must, in respect of any notice provided pursuant to subsection 17(2) of the *Canada Deposit Insurance Corporation Deposit Insurance Policy By-law*, provide an assessment of the impact of the event on the resolution plan, no later than 30 days after providing this notice, or any longer period that may be specified by the Corporation.

The banks will be required to submit resolution plans, or portions thereof, upon request by CDIC. The request will specify a reasonable timeframe for submitting the plan, generally a minimum of 90 days will be provided. A portion of the plan may be requested by CDIC if, for example, the plan is mature and no material changes have occurred since the submission of the previous resolution plan.

The banks will be required to update their plans to reflect any matters that may affect their resolution strategy (e.g., changes in the financial group's organizational structure or business), including if there is a material change.<sup>6</sup> If there is a material change, the bank must notify CDIC of this change. CDIC may request the submission of the updated resolution plan, or portions thereof, depending on the nature of the material change.

*CDIC is seeking your feedback on whether the By-law requirements with respect to the development, submission and maintenance of resolution plans are clear.*

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<sup>6</sup> Events contemplated in subsection 17(2) of the *Canada Deposit Insurance Corporation Deposit Insurance Policy By-law*.

## 1.4 Contents of the Resolution Plan

The By-law requirements with respect to the contents of resolution plans will be aligned with CDIC's existing guidance. We may issue additional guidance from time to time.

The content requirements are set out in the following four sub-sections:

- resolution profile;
- resolution strategy;
- implementation of the resolution strategy; and
- work plan.

Note that text in italics indicates a defined term included in [Appendix 1](#).

### Resolution Profile

#### Proposed Requirements

The bank must, for its *financial group*, identify and describe the following in its resolution plan:

- (a) each *critical function*;
- (b) each *critical shared service*;
- (c) each *material legal entity*;
- (d) any other *function* that, if it ceased to operate, could impede an effective implementation of the resolution strategy; and
- (e) details on the legal, financial and operational dependencies that support the elements referred to in (a) to (d).

The resolution plan should outline a comprehensive profile of the financial group that clearly identifies and describes its most material and critical aspects.

### Resolution Strategy

#### Proposed Requirements

The bank must, for its *financial group*, describe a resolution strategy or range of strategies that demonstrate how:

- (a) The Corporation could *resolve* a member institution in a manner that ensures continuity of the *critical functions*;

### Proposed Requirements (cont.)

- (b) Each *material legal entity*, other than a member institution:
- would continue to operate to ensure continuity of *critical functions* and/or *critical shared services*; or
  - could be placed into an orderly insolvency proceeding or an administrative *resolution* process under another jurisdiction, without impeding continuity of the *critical functions* and *critical shared services*; and
- (c) The size and operations of the *financial group* could be reduced through divestitures or wind down, with minimal or no adverse effect on the stability of the financial system in Canada.

The resolution strategy should aim to ensure that there will be no disruption to the continuity of critical functions that could arise from failure and separation of the financial group under multiple competing insolvency proceedings over which CDIC has no jurisdiction. The resolution plan needs to take into account the bank's responsibilities and requirements in the jurisdictions where the financial group operates, and only rely on cooperation with other authorities or major stakeholders (e.g., counterparties, suppliers or boards of directors of affiliates) with respect to the implementation of the resolution strategy to the extent that it is in their best interests and within the constraints of the applicable statutory and regulatory framework(s). The resolution plan should provide optionality, beyond the temporary stabilization benefits offered through the application of CDIC resolution tools, by providing meaningful de-risking and divestiture options to restore the long-term viability of the bank and the financial group.

### Implementation of the Resolution Strategy

#### Proposed Requirements

To demonstrate that the resolution strategy can be effectively implemented, the bank must include in the resolution plan:

- (a) Its assessment of how the legal structure and the financial and operational arrangements of the *financial group* would enable entry into *resolution* within the applicable legislative framework(s), without having an adverse effect on the stability of the financial system in Canada;

### Proposed Requirements (cont.)

- (b) Its scenario analysis based upon assumptions that are appropriately severe and demonstrate that:
  - public sector financial assistance will not be necessary, or if required it would be temporary, limited in scope and would minimize exposure of public sector authorities to a loss;
  - *material legal entities* would have access to a sufficient amount of loss absorbing capacity and liquidity or funding during resolution;
- (c) Its assessment demonstrating that the applicable regulatory and contractual requirements would not impede the implementation of the resolution strategy; and
- (d) Its assessment demonstrating that its governance framework and capabilities would support the implementation of the resolution strategy, and that their effectiveness has been tested, if appropriate, or otherwise validated.

The resolution plan should include an assessment of the bank's ability to implement each aspect of the plan and demonstrate that the bank took steps to address impediments to an effective implementation of the resolution strategy by the Corporation. The resolution plan should demonstrate that the financial group has access to sufficient financial resources and the necessary capabilities to execute the resolution strategy within the existing statutory framework, without having an adverse effect on the stability of the financial system in Canada. In the resolution plan, a bank is permitted to assume availability of public sector financial assistance, though, such assistance should be limited to short-term temporary liquidity support and minimize the exposure to loss for CDIC and protect taxpayers.

### Work Plan

#### Proposed Requirements

In the resolution plan, the bank must include a work plan that:

- (a) Outlines planned activities for maintaining and testing the resolution plan;
- (b) Proposes remedial actions and timeframes to address any impediments to an effective implementation of the resolution strategy identified by the bank; and
- (c) Proposes remedial actions and timeframes to address any *deficiency* that may have been identified by the Corporation.

The banks should conduct testing exercises, where appropriate, to demonstrate that their resolution strategies are implementable. The work plan should outline these planned activities. To the extent that the bank or CDIC has identified deficiencies in relation to the By-law requirements

or impediments to an effective implementation of the resolution strategy, the work plan should propose remedial actions and associated timeframes that meet CDIC's expectations.

*CDIC is seeking your feedback on whether the resolution plan content requirements are clear, and whether there are any requirements in relation to which CDIC should provide further guidance?*

### 1.5 Assessment of the Resolution Plan

The proposed By-law will also set out CDIC's review process, including for the notification of deficiencies and submission of the work plan by the bank. The process will provide the banks with an opportunity to address any deficiencies against the By-law requirements on a timely basis.<sup>7</sup>

#### Proposed Requirements

(i) Review of the resolution plan

- (a) The bank will be notified whether their resolution plan meets the requirements of the By-law, within a reasonable timeframe after the resolution plan has been submitted.

(ii) Notification of *deficiencies* and submission of work plan

- (a) If the bank is notified of a *deficiency* by the Corporation, the Corporation may request that a bank submit an updated work plan, within a reasonable timeframe, that describes the remedial actions that the bank will take to address the *deficiency* and the associated timeframe.

CDIC will assess the resolution plan as either:

1. **Substantially compliant** with the requirements of the By-law;
2. **Partially non-compliant** with the requirements of the By-law (i.e., one or more deficiencies have been identified that significantly impact the ability to implement the resolution strategy, and the deficiencies are being addressed in an acceptable work plan that demonstrates the bank's ability and clear intent to address the deficiencies within an acceptable period of time); or

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<sup>7</sup> Refer to [Appendix 2](#) for an overview of the proposed administrative process for submission, maintenance and review of resolution plans.

3. **Largely non-compliant** with the requirements of the By-law (i.e., one or more deficiencies have been identified that significantly impact the ability to implement the resolution strategy, and no acceptable work plan has been provided by the bank, or the work plan is not being implemented).

CDIC will assess the extent to which the resolution plan includes all the elements outlined in the content requirements (i.e., resolution profile, resolution strategy and whether the plan demonstrates an ability to implement the resolution strategy). A non-compliant assessment conclusion will be made when the Corporation identifies one or more deficiencies in the resolution plan that significantly impact the ability to implement the resolution strategy. We will also assess whether or not the work plan meets CDIC's expectations and the actions specified in the work plan are being implemented in accordance with associated timeframes. The assessment will focus on the following key elements:

**Assessment of the resolution profile.** Whether the resolution profile is comprehensive, in particular, if it contains sufficient details on the aspects of the financial group that are most material or critical, and therefore, require attention in the resolution strategy.

**Assessment of the resolution strategy.** Whether the resolution strategy outlined in the resolution plan provides adequate options to ensure the continuity of the critical functions and whether it supports fulfilling CDIC's objects.<sup>8</sup>

**Ability to implement the resolution strategy.** Whether the potential legal, financial and operational impediments to implementing the strategy are limited and/or effectively addressed, as well as whether the bank's capabilities to execute key areas of the plan are adequate to implement the resolution strategy.

**Work plan.** Whether the work plan incorporates ongoing maintenance and testing activities for the resolution plan. If applicable, whether the remedial actions will address the deficiencies identified by the Corporation and/or the impediments identified by the bank within an acceptable period of time. We will also assess whether the remedial actions described in the work plan are being implemented in accordance with associated timeframes.

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<sup>8</sup> Refer to CDIC Act, s.7(a)-(d)

We are proposing to amend the *CDIC Differential Premiums By-law (DP By-law)* to include the final assessment conclusion as part of the premium determination process for the following premium year.

*CDIC is seeking your feedback on whether the By-law requirements with respect to the review of resolution plans, notification of deficiencies and submission of work plans are clear.*

*Additionally, we are seeking your feedback on whether there are any other factors that should be considered in determining the final assessment conclusion for a bank's resolution plan, and whether the consultation paper provides sufficient clarity on what constitutes non-compliance?*

## 2. Compliance Mechanism

The *DP By-law* classifies member institutions into different premium categories for annual premium purposes, by determining an institution's score for each of the assessment factors (e.g., capital adequacy and leverage ratios) and an overall score.<sup>9</sup> Premium rates differ per premium category and are set out in Schedule 1 to the *DP By-law* as a percentage of the maximum annual premium payable under the *CDIC Act*.<sup>10</sup> The effective premium rate must be multiplied by the total volume of insured deposits in order to compute the premium amount payable for the following financial year (i.e., baseline premium amount).

To encourage compliance with the By-law, CDIC proposes to amend the *DP By-law* to incorporate the conclusions from the resolution plan assessment, as set out in *Section 1.5* above. By doing so, compliance with the By-law requirements would become a factor in the determination of the annual premium amount for the banks.

As an example, if a bank's resolution plan is substantially compliant with the By-law, it is expected that there would be no impact on its annual premium amount. However, if a bank's resolution plan is found to be non-compliant with the By-law, it is expected that there would be an additional premium payable. The specific measure to determine the additional annual premium amount for

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<sup>9</sup> Refer to the *Differential Premiums By-law Manual*

<sup>10</sup> Section 21(4) of the *CDIC Act* sets out the maximum annual premium payable, being the greater of (a) \$5 000, and (b) one third of one percent of insured deposits (as of April 30 in the immediately preceding premium year).

each level of non-compliance would be predetermined and set out in the *DP By-law*, which requires Minister of Finance approval. Once the bank addresses the deficiencies in its resolution plan, there would be no additional premium payable over and above the baseline premium amount.

CDIC shares information related to the banks' resolution plans and the assessment conclusions with the federal financial safety-net members, including the Office of the Superintendent of Financial Institutions, the Bank of Canada, the Financial Consumer Agency of Canada and the Department of Finance; and may inform the Minister of Finance of a non-compliance status.

*CDIC is seeking your feedback on whether there are any drawbacks to the proposed compliance mechanism, and whether there are alternatives that would be more effective in encouraging the banks to comply with the By-law requirements?*

## Appendix 1: Definitions

**Financial group** means the bank, its affiliates (as defined in section 2 of the *Bank Act*), any entity in which the bank has a substantial investment (as defined in section 2 of the *Bank Act*) and any business enterprise that the bank operates with other persons for profit, including a joint venture or a special purpose vehicle.

**Material legal entity** means any entity within the financial group, or any foreign branch of an entity within the financial group, that performs a critical function and/or a critical shared service or that could impede the effective implementation of the bank's resolution strategy, if it abruptly ceased to operate.

**Function** means an activity that any entity within the financial group performs for third parties.

**Critical function** means a function that would have an adverse effect on the stability of the financial system in Canada if it abruptly ceased to operate and any function that has been identified as systemically important or critical by another regulatory authority.

**Critical shared service** means an activity performed within the financial group or outsourced to third parties that is necessary to ensure continuity of one or more critical functions.

**Resolution or to resolve** means the exercise by the Corporation of its powers under the *CDIC Act* for the purpose of resolving financial or other difficulties of a member institution, or similar powers that may be exercised by authorities in other jurisdictions.

**Deficiency** means that one or more By-law requirements are not being met by the bank in its resolution plan.

## Appendix 2: Illustrative Administrative Process

