Canada Deposit Insurance Corporation
Société d'assurance-dépôts du Canada

Halifax Chamber of Commerce

Building resilience and confidence in Canada's financial system

March 11, 2021 (virtual event)

Remarks by Peter Routledge, President and CEO

CHECK AGAINST DELIVERY

Introduction

Thank you, Patrick, for that kind introduction. I'm honoured to have been invited to speak to you today. I'd like to begin by acknowledging that I am speaking from CDIC's offices in Ottawa which rest on the traditional, unceded territory of the Algonquin Anishnaabeg people. I thank all the generations who have taken care of this land.

Today is a solemn day in Canada, a National Day of Observance, a day we honor the more than 22,300 Canadians, and of that 65 Nova Scotians, we have lost to this terrible disease. I know the family and friends who mourn those whom we have lost are in our hearts today. We also express our profound gratitude to our fellow Canadians who have worked on the frontlines of the crisis in hospitals, grocery stores, foodbanks, restaurants, and schools to name but a few.

I want to salute the resilience of Nova Scotia's companies and broader business community. The health and economic impact of this virus has placed an enormous burden on your firms, the economy and financial system.

As the Bank of Canada noted in yesterday's policy-rate announcement, the economy is proving to be more resilient than anticipated to the second wave of the virus and the associated containment measures, noting that rising commodity prices and rising foreign demand have brightened Canada's economic prospects. So, let's hang in there. Better days are coming.

But, there remains a great deal of uncertainty about the evolution of the virus and the return to economic normalcy and growth. Canada's economic recovery will rest, in part, on the strong foundation of a resilient Canadian financial system. My agency, the Canada Deposit Insurance Corporation (CDIC), plays an important role in maintaining the system's health and resiliency.

Let me say a few words about Canada's resilient financial system. We generally don't give much thought to it because it works so well, but it underpins all of our financial transactions and, therefore, economic activity.

It encompasses everything from banks and credit unions to payment and settlement systems between financial institutions to insurance companies.

It facilitates the flow of capital from banks to businesses, sellers to buyers and employers to workers.

Its seamless web of connections is vital to the smooth functioning and growth of the economy.

Halifax has notable place in the history of the Canadian financial system. Think of the Bank of Nova Scotia, which was established in your city in 1832 in John Roman's Building at the corner of Duke and Granville streets. For the next 188 years without fail, through world wars and financial crises, it paid dividends to its shareholders and interest to its depositors, while growing a huge national and international footprint. It is one of the biggest players in Canada's banking system, which provides tens of thousands of jobs. At one of Scotiabank's competitors, one of your province's most illustrious citizens, the financier and philanthropist Izaak Walton Killam, got his start as a junior clerk at the Yarmouth branch of the Union Bank of Halifax in 1903. Royal Bank of Canada acquired the Union Bank of Halifax seven years later.

Now, CDIC is a much younger institution. We were born in 1967 – the federal government's response to financial instability at certain provincial deposit-taking institutions. Today, we are still responsible for protecting one critical part of the Canadian financial system, that is the federal deposit-taking sector.

Why is CDIC so important to Canada's financial system and to Canadians?

For those Canadians who have deposits in one of the 85 financial institutions that are members of CDIC, we protect them from losses on eligible deposits – losses that might arise due to the very rare outcome of one of our members failing. By protecting Canadians from losses, up to a specified limit, we lower the risks of holding deposits and, in so doing, lower the cost of those financing instruments in the Canadian banking system. For those deposits fund mortgages and business and consumer loans.

Let me be clear. We protect Canadian deposits from the risk of loss on their insured deposits. We do not protect lenders – that is the job of their Boards of Directors. Parliament charges CDIC with making sure that Canadians have access to their money in their accounts in each of our member banks, federally regulated credit unions or loan and trust companies should they fail. We insure the accounts of individual Canadians against losses from the failure of individual financial institutions. Lenders can then pass on the benefits of the savings from that reduced risk to borrowers in the form of lower borrowing rates than would otherwise be the case if CDIC did not exist.

As of today, CDIC protects close to $1 trillion in deposits in our member institutions across Canada. In fact, by virtue of the design of our deposit insurance product, virtually all Canadians (approximately 98%) whose deposits are held by CDIC member institutions have those deposits protected in full by CDIC.

Here in Nova Scotia, we estimate more than 90 per cent of Nova Scotians deposits are held by CDIC members and are, therefore, insured by CDIC. The remainder are deposits held by provincial credit unions, which are protected by Nova Scotia Deposit Guarantee Corporation.

Since our establishment in 1967, we have handled the failure of 43 of our members, directly affecting more than 2 million Canadians and protected over $26 billion in deposits from loss. No one has lost a single dollar of deposits under CDIC's insurance protection.

Let me tell you how we provide that protection – first by outlining the responsibilities assigned to CDIC by Parliament and second by explaining how CDIC fulfills those responsibilities.

CDIC's responsibilities

We have four key responsibilities assigned to us by Parliament via the CDIC Act:

- Number one: to protect depositors. We insure up to $100,000 in accounts in your name (chequing, savings and foreign currency accounts as well as term deposits). We also cover up to $100,000 for funds in each of your RRSP, RRIF, TSFA, trust and joint accounts (you and your partner for example). Next year we will include new categories for deposits held in registered education savings plans and registered disability savings plans.
- Number two: to promote financial stability.
- Number three: to do those first two things in such a manner that minimizes our exposure to loss; and
- Number four: to act as resolution authority. That means if we have to resolve or wind-up a failing bank, we have the power and the tools to do so in an orderly manner.

Many people who know about us think that if their bank is failing our job is simply to pay the insurance claim on their deposits. But paying out the claim on deposits can be expensive for us and can lead to financial instability. In certain circumstances, it may be smarter for us not to pay people out but to provide them continuing access to their deposits via another method – one which still protects depositors and also promotes financial stability … in manner that lowers CDIC's exposure to loss.

This highlights an important and intended tension in our assigned responsibilities – the tension between protecting depositors and promoting financial stability on one hand and avoiding moral hazard on the other. Moral hazard is a situation in which one party engages in a risky deal or fails to act in good faith because it knows another party bears the economic consequences of their behaviour. Any time a party does not have to suffer the full economic consequences of a risk, moral hazard can occur. Therefore, we don't want our member institutions to take reckless risks in the belief that CDIC will eventually bear the financial losses produced by that recklessness.

Put differently, we risk moral hazard in our zeal to promote financial stability and we risk financial instability if we focus too much on avoiding moral hazard. Parliament asks that we balance the tension between the avoidance of moral hazard and the promotion of financial stability. And CDIC's power in pursuing this balance is checked, as it should be given the immense powers in our Act, by our Board of Directors, our minister, the Governor-in-Council, and ultimately Parliament. Put more succinctly, the principle of accountability is central to Canada's system of democratic governance and, so, CDIC is accountable for its decisions to Parliament through the Minister of Finance.

How CDIC intervenes

What's our strategy for protecting your deposits and promoting financial stability? Or how do we manage the aforementioned tension?

First, by resolution planning. If a bank has to be wound up, we want a well-defined process for that to happen. In coordination with CDIC, Canada's six largest banks developed and now have detailed resolution plans in place. And over the last 18 months, we've turned our focus toward developing resolution plans with smaller institutions.

Second, we simulate failures. Because resolution plans on paper aren't enough. We must apply those plans in a real-world setting to truly understand their effectiveness. So we routinely conduct "war games" to play out potential financial crises in a safe environment. We hold a number of these each year, of differing size and complexity.

Third, we have the authority to conduct in-depth examinations of financial institutions. We can assess the assets and deposit liabilities of institutions whose financial condition is giving us cause for concern. Through these exams, we can anticipate problems and respond sooner to a potential failure before too much value and capital are lost.

If we conclude that a deposit-taking institution is in financial distress, we walk a fine line between acting too early or too late.

Acting too early can lead to moral hazard.

Alternatively, responding too late could trigger contagion, a loss of public confidence that could destabilize the financial system and result in much higher costs to CDIC.

A good rule of thumb is that shareholders and other capital providers should lose everything before CDIC and other senior creditors lose a dollar.

If we decide we need to intervene, we have a number of tools we can use to resolve a financial institution in trouble. Before we do so, we must determine how troubled an institution is. For our purposes, there are basically two states of the world for a troubled member: (1) the member is unwell but still viable; or (2) the member is determined to non-viable by the Superintendent of Financial Institutions.

It the troubled member is unwell but viable, we have a wide array of tools available to us via the CDIC Ac – including but not limited to guarantees, loans, recapitalization, and loss-sharing arrangements with the buyers of failing institutions.

We can deploy whatever tool we consider appropriate provided any action we take is in accord with our responsibilities. Our four objects bind our use of these tools. And our Board on behalf of the Minister ensures our fidelity to these four responsibilities.

If the institution has failed, according to the determination of the Superintendent, we could:

- Force or assist in the sale of the failing institution by helping a buyer acquire the assets. For example, we might agree to cover losses over five years, up to a fixed maximum, on any of the loans that the purchasing bank took on. We would do this to minimize our risk of loss on insured deposits. We wouldn't be obliged to hand over any money up front. And there is the possibility that those loans could perform reasonably well, and we could end not having to cover any losses.
- Establish a temporary bridge bank. We would transfer to this new bank all the healthy assets and certain liabilities (e.g., deposits) and liquidate what is left behind in the old bank. CDIC would hold the shares in the bridge bank but it would be operated by a board of directors and management team with expertise in running a bank until it could be sold to the private sector.
- For very large or systemically important banks, we would recapitalize the failed bank by converting its capital and certain debt instruments – not deposits – into common equity;
- Finally, we could execute a liquidation and payout – or reimburse all insured deposits immediately and liquidate the institution's assets.

As I mentioned, history has taught us that although we run the risk of moral hazard by intervening too soon, early actions tend to limit losses and the risk of financial instability. In our history, 24 of our 43 member failures involved payouts and liquidations and those tended to be more expensive than other forms of resolution.

Public awareness

Of course, just protecting deposits is not enough. Deposit insurance only works if people know it exists, that CDIC will make good on the promise to protect their deposits.

Our research has shown that informing Canadians about CDIC deposit protection helps keep the financial system safe and stable. In fact, the probability that depositors will panic and cause a run on a bank or other financial institution increases by over

40 percentage points if they are not aware that there is deposit protection. That's why we spend $6 to $7 million annually on a public awareness program to promote confidence in the system.

You may have seen our TV ads while watching the morning news or spotted our logo on the field during a CFL game last season, when we still had live games. We reach out daily through our social media channels, and work with bloggers and finance influencers on a regular basis to ensure that our message is heard. Not only does public awareness provide Canadians with vital information about protecting their money but it also helps build trust in their financial institutions. If you bank with one of our members, you'll have seen our purple lock on your financial institution website, mobile banking app, or branch door.

Conclusion

No deposit-taking institution has failed in Canada in 25 years. That says a lot about the health and resilience of our financial system. But we can't afford to be complacent. With this pandemic, Canada's businesses and the financial sector are facing the most profound set of challenges since the global financial crisis of 2007-08. The economic recovery may well be volatile. But in this time of financial uncertainty, Canadians can rest assured that CDIC has the strategies and toolkit to protect depositors and promote the confidence necessary to ensure our financial sector remains a key economic driver.

Thank you. I would be happy to answer your questions.