SPEAKING NOTES FOR CDIC PRESIDENT AND CEO MICHELE BOURQUE

CDIC'S NEW ROLE AS CANADA'S RESOLUTION AUTHORITY

CD HOWE INSTITUTE
JUNE 9, 2014

INTRODUCTION

Good afternoon. I am pleased to be here today and I thank the CD Howe Institute for this opportunity to speak with you.

When I joined CDIC in 1992, as a young economist, I didn't know much about deposit insurance or even what CDIC was. But I thought it would be an interesting place to work. A bit quiet, perhaps. It has turned out to be anything but that. Within two months of my joining, we had the largest bank failure ever in Canada.

To refresh you on some details, CDIC has been protecting Canadian dollar deposits since 1967.

The federal deposit insurance system was put in place to reassure depositors and instil confidence. In those days, the failures of financial institutions were quite common.

The demise of Atlantic Acceptance Corporation in 1965 was among the best known, but there were plenty of smaller ones.

In fact, earlier on the day the CDIC Act was passed, there was a bank run at the Montreal City and District Savings Bank.

CDIC deposit insurance confers a number of benefits:

- It clarifies our obligations to depositors;
- It defines what is protected and what is not;
- It plays a role in promoting public confidence;
- It helps to contain the costs of resolving failed banks by providing an orderly process; and
- It provides a mechanism for banks to fund the cost of failures to insured depositors.

People are often surprised to hear there have been 43 member failures since CDIC was established, which affected about 2 million depositors. Not one of them lost a single dollar of their insured deposits.

But it has not always been a smooth ride. In the early years, our insurance losses varied wildly. The average loss was nearly 50 per cent because member institutions had already burned through value before CDIC was permitted to intervene.

Following the failures of Northland Bank and Canadian Commercial Bank in the mid-80s, CDIC was given new objectives and new powers intended to better protect depositors and minimize our exposure to loss.

These include the power to conduct special examinations so we can take early action and not allow losses to eat up all the value and capital in the failing bank. After 1987, our losses were held on average to about 17 per cent.

Our powers also allow us to handle more complex failures. For example, in 1992, CDIC financially supported the merger of the failed Central Guaranty Trust – CGT – with Toronto-Dominion Bank.

At the time, this deal represented both the largest financial institution failure and the biggest such acquisition ever in Canada.

In 1992, CGT had about 12 billion dollars in financial assets. It was then the fourth-largest trust company in the country.

CGT closed at midnight on December 31, 1991, and was reopened a minute later as a part of Toronto-Dominion Bank. Depositors did not have to lose a minute of sleep, nor did they lose a single dollar of their money. The cost of the failure was recouped through premiums collected from our member institutions.

The CGT case demonstrates that a large bank can be resolved without liquidation, with help from the resolution authority, protection for depositors, and no loss of its critical functions.

These are a few of CDIC's key objectives for resolution planning, which I would like to describe in more detail today.

RESOLUTION AUTHORITY

As you know, Canada's largest banks are critically important to our economy. The six largest were designated in March 2013 as domestic systemically important banks — D-SIBs — by the Superintendent.

The combined financial assets of the biggest six banks, at almost 3.5 trillion dollars, are nearly double the amount of Canada's annual economic output.

Whether they realize it or not, all Canadians — through savings and investments, insurance or pension funds — have dealings with our large banks.

And they are not just important to Canada. Our largest banks are truly global in scale, and in some cases, they are critical to the national economies of countries where they operate.

Although it provided liquidity during the global financial crisis, Canada was not forced to recapitalize or nationalize banks.

In contrast, European governments have injected more than 2.2 trillion U.S. dollars of taxpayers' money into ailing banks since the outset of the crisis. This has driven up debt levels, forced them to cut public spending, and left a legacy of unemployment and lost economic opportunity.

The crisis highlighted the need to solve 'too big to fail,' given the devastating effect that a large bank failure could unleash on the economy.

Countries – including Canada – required new tools to enable our largest banks to fail while maintaining financial stability and minimizing the impact on the economy, taxpayers and depositors.

We need their critical functions to work without interruption to serve capital markets and customers, and to ensure access to funds, credit and payments systems.

These services affect all Canadians and keep our economy moving.

Fortunately, the crisis galvanized countries to work together to address the root causes of the crisis.

It gave new mandates to agencies like the Financial Stability Board, or FSB, to help build a more resilient global financial system.

NEW TOOLS

In 2011, CDIC became the resolution authority for Canada’s largest banks.

Responding to this challenge, we have created a new team focused on the resolution of large banks, including the development of resolution plans, also known as living wills.

We have completed and updated such plans in the past two years, and we recently completed resolvability assessments of each of the largest banks.

I would like to commend the banks for their cooperation and hard work with us in this difficult task.

None of us would like to plan our own demise but our members recognize the importance of this exercise. In some cases, I think it has given them valuable insight into their own corporate structures.

CDIC’s new role requires more flexible and far-reaching resolution tools that permit us to act faster. For example, we have the power to force the sale of a failing bank if a buyer can be found.

If an acceptable buyer can’t be found on short notice, we can establish a “bridge bank” to preserve the critical functions of a troubled bank until it can be sold.

In this case, CDIC would transfer, at a minimum, the insured deposits and other key liabilities as well as most assets into a CDIC-owned bank until it could be sold.

Some assets and shareholders and subordinated debtholders would be left behind in liquidation.

The key principle is that shareholders and investors, who enjoy the upside when times are good, are exposed to loss, while taxpayers and insured depositors are not.

Our work in this area is consistent with international standards adopted by the FSB and endorsed by the G20.

Our resolution tools are not perfect for all situations. In some cases, changes to the banks themselves may be necessary to make them more resolvable. This is a current topic of debate in policy circles.

COOPERATION

I have been speaking principally about CDIC.

But to do our work effectively, we work closely with regulators and resolution authorities, both domestically and internationally.

We have an excellent coordinating mechanism with our federal safety net partners, namely OSFI — which is responsible for bank recovery plans — as well as the Department of Finance, the Bank of Canada and the Financial Consumer Agency of Canada.

We have also had to expand our network of relationships.

This means reaching out to financial market infrastructures, capital market regulators and ratings agencies to ensure they understand CDIC's role and the kind of actions we would take to resolve a troubled large bank.

Internationally, we are working with resolution authorities in other jurisdictions to strengthen cross-border cooperation, which is critical to resolving large banks that operate around the world.

These negotiations are difficult. Many of these countries have their own regulatory challenges to overcome. As my old boss used to say, 'It takes two to tango,' and Canada is a very small dancer.

But we are making progress.

Last summer, we signed an agreement with the U.S. FDIC that formalizes and strengthens our information-sharing activities in the event of the failure of a large bank operating in both countries.

We are working on a similar agreement with the U.K. and we have, at this stage, general cooperation agreements with resolution authorities in Mexico and Japan.

All countries are grappling with the same issues and challenges that we face.

Currently, CDIC sits on a number of working groups of the FSB related to resolution and cross-border crisis management. We also participate in the development of assessment methodologies and peer group reviews.

Working in partnership not only helps us keep pace with new developments, it allows us to have some influence on the global stage to ensure that new standards reflect Canadian reality.

FUNDING

Some of you will undoubtedly have questions about funding. Do we have enough resources to deal with large bank failures?

CDIC is funded by its members, some 80 financial institutions that pay premiums based on their insured deposits and on the level and kind of risks they take.

These premiums are used to fund CDIC's operations and to build a deposit insurance fund that we can use when we must intervene in a failed member institution.

Canada was among the first countries to create a deposit insurance fund in anticipation of possible failures. This approach is now considered a 'best practice' among deposit insurers around the world.

The alternative is an ex post regime where the industry only puts up money after a bank fails.

That approach is unfair. It would penalize better-managed institutions, which would end up covering the costs of those that failed to survive but did not contribute in the first place.

CDIC's fund now totals about 2.7 billion dollars, and it is growing. We have set a target level of advance funding of 100 basis points of insured deposits. Our current fund level represents some 40 basis points, so we have some ground to make up.

In addition to our fund, we have a legislated borrowing capacity that currently sits at 19 billion dollars. This borrowing capacity is indexed to the growth of our insured deposit base. Funding beyond this amount would require a Parliamentary appropriation and CDIC would seek to recover those funds from the industry.

The key message here is that taxpayers do not bear the costs of a failure.

Under a CDIC resolution, the costs of the failure is borne by industry.

FSAP – BUDGET 2014

So how are we doing, and what's next?

Well, earlier this year, the IMF released its most recent report on Canada's financial system and oversight, including CDIC.

Among other things, it found our legal and institutional powers for resolving D-SIBs – and I quote -- 'robust and well-articulated.'

The IMF team found we had established leading practices, good operational capacity and an excellent collaboration with our financial safety net partners.

Looking to the future, more change is coming.

In this year's federal budget, the government announced several new measures relevant to CDIC.

These include a comprehensive review of Canada's deposit insurance framework. This is timely, given the last one was conducted some 20 years ago.

In addition, the government has announced rules to ease the transition of provincial credit unions into the federal regulatory framework by offering extended deposit insurance.

The government has also announced plans for a consultation on a bail-in resolution tool that would convert bank debt into capital in a failure.

CDIC will work closely with its safety net partners and industry on these measures.

CONCLUSION

Looking back, bank failure resolution used to be pretty straightforward.

When a bank failed, CDIC returned depositors' money and dealt with a liquidator to settle the bank's estate. Or we worked with the failing bank to facilitate a sale to a stronger viable institution. In the '80s and '90s, we got pretty good at it. We had a lot of practice.

Today's banks are bigger, far more complex and more globally connected than ever before.

I am sometimes asked, if something happened tomorrow, could CDIC resolve one of Canada’s large banks?

And my answer is this: We have the necessary legal powers to do it and depositors would absolutely be protected. But it would be costly and not everything would work perfectly. All countries face this. It’s a massive task.

We are all committed to advancing resolution work with banks, our financial safety net partners here in Canada and other resolution authorities around the world.

We are also looking forward to the deposit insurance review, which will help to ensure adequate protection for the savings of Canadians, taking into account the lessons learned from the financial crisis and the changes in the global banking landscape.

In closing, let me say this work is exciting and complex.

Much has been accomplished but much more work is required to develop the necessary tools, operational capacity and international cooperation to solve too big to fail.

What remains the same from 1967 is the CDIC bedrock guarantee to protect deposits.

Thank you.