Protecting Financial Stability in the Era of Too Big to Fail

SPEAKING NOTES

MICHÈLE BOURQUE, CDIC PRESIDENT AND CEO

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Introduction

Good morning,

I am pleased to be here with you today and I thank the Economic Club for this opportunity to address you.

Financial stability and 'too big to fail' are topics at the centre of discussions around the world. Not a day passes without a flurry of articles coming out about them.

They are the focus of regulators, central bankers and supervisors everywhere. And for deposit insurers, they have become particularly important, as I will soon explain.

Looking back on my first 15 years at CDIC, protecting depositors and contributing to financial stability seem straightforward, in retrospect. We are now in a new era, one that demands that we look at the financial system through a more global lens, which in turn requires new tools and new kinds of expertise.

This era began five years ago when the global financial crisis started. We are still dealing with the aftershocks.

The crisis launched a transformation in financial regulation around the world, including here in Canada, in how we deal with very large and complex banks.

Today I would like to share with you how CDIC has changed in that time, and how these changes continue to put the depositor first.

CDIC mandate

CDIC was established in 1967. In fact, earlier on the day our *Act* was passed, there was a bank run at the Montreal City and District Savings Bank.

Today there are generations of Canadians who have never heard of a bank run.

Many of you have probably seen the classic 1946 movie, *It's a Wonderful Life*, with Jimmy Stewart, and will remember this scene.

People hear their bank is in trouble. It may be real or just a rumour, but it doesn't matter.

Nobody wants to lose their savings, so they line up to withdraw all their money before it's too late. Despite pleas and reasonable arguments from the bank manager, people still want their money. And if that bank wasn't really in trouble before, it is now. With its deposit base gone, it can't lend money, which means it has failed as a financial institution.

That movie scene shows people will go to any extent required to protect their savings.

Bank runs don't just happen in movies. They have also occurred in recent years – like Northern Rock bank in the U.K.

With the advent of social media, it doesn't take much for a rumour to spread like wildfire.

Nowadays, people don't need to line up to withdraw their money.

They just click the mouse on their Internet bank account while they text or tweet to their friends, and get out quickly.

Today, therefore, it is even more important for depositors to know about the CDIC guarantee.

Our guarantee

And we have delivered on this guarantee. Since we were created, 43 of our member institutions have failed, directly affecting two million people.

Not one of them lost a single dollar of their insured deposits.

Of course, deposit insurance will not prevent bank runs if depositors do not know they're insured.

In recent years, some countries have learned the hard way that it's not enough to simply have a good deposit insurance system. People need to know about it and trust it.

This is why CDIC makes public awareness of its protection such a big priority.

It's why we require our members to post bright red stickers on the doors of their branches; it is why we advertise and promote what's covered and, more importantly, what's not covered. We communicate using a variety of channels such as Twitter, LinkedIn, YouTube and traditional media.

And we also seek opportunities to meet with groups such as yours.

We want Canadians to know about our deposit insurance system, to understand it, and to know they can rely on it.

This is why I am here today.

Crisis

The recent financial crisis brought on an unprecedented collapse of confidence that rippled through the entire global financial system.

The collapse and liquidation of Lehman Brothers erased more than a trillion dollars in equity, with huge repercussions for the global economy.

The consequences of this large failure and others that followed were greater than anyone could have predicted.

Many financial authorities had neither the legal powers nor plans to resolve banks of this scale in an orderly way.

As a consequence, government bailouts became the default option.

During the crisis, some of the world's largest financial institutions were nationalized or re-capitalized by governments because they were considered too big to fail.

Fannie Mae and Freddie Mac. AIG. Royal Bank of Scotland. And many others – although none in Canada.

It is difficult to comprehend the scale of the cost of the financial crisis, and some will disagree on the exact figure.

But the crisis has left a legacy of extended unemployment and reduced economic opportunity in the U.S. and Europe.

Taxpayers were given no choice but to shore up these financial institutions. The burden of these staggering losses fell on the public rather than on bank shareholders and creditors.

Since then, global leaders have acted.

At the G-20 conference in Toronto in 2010, the global leaders agreed that in building a safer financial system, it would need to be more transparent, less leveraged, better capitalized and more liquid.

And it would require new legal powers and better coordination among regulators to resolve those large financial institutions considered systemically important.

This is the backdrop for the reforms that have been taking place in Canada and at CDIC.

CDIC powers

Canada was well positioned to avoid the worst effects of the crisis.

But even though no bank failed here, Canada, like other countries, felt the impact and recognized the need for better tools to cope with such events.

This recognition has led to changes for us at CDIC.

Briefly, let me provide you with some background.

CDIC has a number of legal powers to deal with a failing bank.

The best known is the authority to liquidate a troubled bank and quickly pay out depositors.

But liquidation is not always the best way of handling – or 'resolving' –a failure.

Aside from the deterioration of the institution's asset value, and therefore often higher costs, it can cause major disruptions to important services the bank provides such as its ATM network, credit cards and handling payroll for business clients. This in turn can cause other spillovers across the entire financial system.

So CDIC has other powers, such as assisting the sale of a failing bank to a sound institution, or requiring the restructuring or sale of a failed bank's assets and liabilities.

In these instances, insured deposits are transferred to a new institution.

It may surprise many people to learn that almost half of the 43 failures resolved by CDIC involved CDIC assisting in a sale instead of a liquidation.

For example, back in the 1990s, CDIC financially supported the merger of the failed Central Guaranty Trust with the Toronto-Dominion Bank.

Central Guaranty was once Canada's fourth-largest trust company. The deal represented both the largest financial institution failure and the biggest such acquisition ever in Canada.

Central Guaranty closed on December 31 at midnight and re-opened one minute later as part of TD Bank, with no disruption to client services and no threat to financial stability.

Sea change

Our largest banks are essential to our economy. Indeed, the largest six have been designated by the Superintendent of Financial Institutions as domestic systemically important banks, or D-SIBs.

This designation does not mean these banks are too big to fail.

But it does mean they are too big to liquidate.

We need their critical parts to keep functioning for their customers – by this I mean access to daily accounts, credit, payments, things that affect millions of Canadians – so that the financial system and the broader economy can keep going.

New tools

In Canada, CDIC is the ‘resolution authority’ for our member institutions, including the D-SIBs, which means we would take the lead if one of them failed and had to be resolved.

Resolving banks of this size and complexity demands special tools.

In the past few years, CDIC’s powers have been broadened to allow it, in the absence of an acquirer, to restructure a large bank that’s failing, and preserve its critical services until it can be sold. Our borrowing capacity has been increased to $19 billion and our minimum fund target has been increased to 100 basis points of insured deposits to cover potential losses.

Further, banks have made significant investments in their deposit systems during the past few years to support a quick response by CDIC.

At the international level, the Financial Stability Board – or FSB – developed the Key Attributes of Effective Resolution Regimes for Financial Institutions. In November of 2011, the leaders of G20 countries committed to implementing the key attributes.

Consistent with these international standards, two years ago, CDIC began developing plans for the resolution of large banks – so called ‘living wills.’

We are not doing this alone. Our largest member banks are working closely with us and OSFI to develop these plans.

The objective is to articulate how CDIC could best protect depositors, preserve Canada’s financial stability, avoid unnecessary disruptions and destruction of value and minimize the overall costs of resolving the bank.

At the same time, shareholders, debt holders and management in the failed bank should be held accountable for the failure, for losses.

Much progress has been made since the process began two years ago, but this is very complex and we have much more work to do.

In the 2013 federal budget, the government proposed more tools to help accomplish this without the need for a bail-out by taxpayers.

One of the proposed tools would convert the failed bank debt into capital.

Shareholders and debt holders would bear the cost of the failure. This is the opposite of taxpayer-funded ‘bail-outs’ that were a hallmark of the crisis and one that no government wants to repeat.

Let me be very clear, however. Under no circumstances would insured deposits be subject to a bail-in or a haircut of any sort. Insured deposits in our member institutions will remain, as they have been since 1967, fully protected by CDIC regardless of how the bank is resolved.

Coordination

Key to effective resolution planning for our largest banks is working closely with other regulators, both domestically and internationally.

At the domestic level, we have excellent coordination mechanisms with our federal safety net partners, namely OSFI, the Department of Finance, the Bank of Canada and the Financial Consumer Agency of Canada.

Internationally, we are working with resolution authorities in other jurisdictions to strengthen cross-border cooperation.

In fact, we recently signed an agreement with the U.S. Federal Deposit Insurance Corporation (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 UK.

CDIC is also actively involved with other resolution authorities around the world, many of which are grappling with the same issues and challenges as we are.

This not only helps us keep pace with new developments, it allows us to influence outcomes on the global stage to ensure that new standards reflect Canadian reality.

Conclusion

In closing, I think you would all agree it has been an interesting five years.

Financial sector regulators around the world are tackling the complexities of large bank resolution and we are making progress, while much remains to be done.

As you know, bank failures are rare these days in Canada. Canada has earned a reputation as having the world's soundest banks. Nonetheless our job at CDIC is to ensure that in the unlikely event of a failure, large bank or small, we will be ready to handle it.

Thank you.