



A GOOD ENDING: STRENGTHENING RESOLUTION FOR FINANCIAL STABILITY

SPEAKING NOTES FOR MICHELE BOURQUE

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Mesdames et messieurs, bonsoir.

Good evening,

I realize that I am standing here between you and dinner and between you and a playoff hockey game. Not any game, one with my Canadiens de Montreal.

Nevertheless, I am very pleased to be with you.

This is my first time as a keynote speaker at this event. And I think it is particularly fitting to be here now, given the growing relevance of resolution in maintaining financial stability.

This is particularly true in CDIC's corner of the system: the resolution of systemic banks.

For many years, this was not a top-of-mind issue.

The financial crisis made it one, and today it forms a key part of the sweeping financial reform agenda now under way around the world.

Years of discussion have led us to action. Countries are taking the necessary steps to ensure the largest global banks can be resolved while protecting taxpayers and without disruption to the wider financial system.

Change is happening -- to rules about capital, liquidity, bank structure and more. And Canada's largest banks certainly understand what is required to succeed in this changing global financial system.

For large banks, having a credible resolution plan is just not an option. It is something that financial authorities in every country will require.

And in Canada, that authority is CDIC.

So I would like to focus my remarks this evening on the steps we must take with banks, our reasons for taking them as well as some obstacles we must overcome, so that together we can strengthen the resolvability of Canada's systemically important banks.

TOO BIG TO FAIL

The public policy reasons for doing this are clear.

Beyond the deep, immediate impact to the Canadian financial system of a disorderly failure, all Canadians would be affected by the aftershocks because of the size of our large banks, their interconnections and the difficulty of replacing the critical services they provide.

The resulting disruption of access to transaction services or financing to corporations, individuals and other financial institutions would cause a loss of economic output that could take many years to recover from.

Fortunately, Canada has made good progress:

- We have identified our systemic banks and are working with them on resolution planning – a step many countries have yet to take.
- We are making strides toward implementing the Financial Stability Board – or FSB -- guidelines, known as the Key Attributes of Effective Resolution Regimes for Financial Institutions.
- All Canadian banks' new subordinated debt and preferred share issuances have had to comply with

non-viability contingent capital rules to qualify as regulatory capital.

- And, two weeks ago, Budget 2015 announced the establishment of a bail-in regime.

And I was pleased to see the latest review of Bank Resolution Regimes from Moody's earlier this spring, which noted Canada is well on its way to catching up to the E.U., U.S. and Switzerland.

At the G-20 meeting of finance ministers and central bankers in Istanbul earlier this year, there was consensus that critical steps remain to be taken to end too big to fail.

These include finalizing a proposed international standard for loss absorbing capacity and enhancing cross-border cooperation.

So we are making progress.

But clearly we still have more work to do, around the world and also in Canada, to improve the resolvability of our largest banks.

KEY ATTRIBUTES

As defined by the Key Attributes, resolvability focuses on two broad concepts:

- Feasibility of the strategy – or could it be done?
- Credibility of the strategy – or would we do it?

I'd like to address these concepts from CDIC's perspective and discuss what actions can be taken to improve resolvability.

FEASIBILITY

First, feasibility. Does CDIC have the legal, financial and operational capacity to implement the resolution strategy?

Let's start with legal capacity. With the Financial Institution Restructuring Provisions in the CDIC Act – what we call FIRP -- and the bridge bank tool, we have sufficient legal authority to resolve large banks if necessary.

We are working with the government to develop additional tools that could provide more flexibility and reduce execution risk in a resolution scenario.

Turning to financial capacity, the 2015 budget has introduced a key element.

The proposed Taxpayer Protection and Bank Recapitalization Regime, or bail-in, clarifies that bank shareholders and creditors are responsible for bearing losses.

The bail-in framework is an important element – along with CET1 capital and the capital surcharge – in meeting proposed international standards for loss absorbency.

However, some questions remain about recapitalization of the failed bank.

Would bail-in alone provide enough to get it done? What if more capital is required? These are questions that many other countries are considering.

From an operational viewpoint, it's important to recognize that CDIC would not act alone in resolving large banks.

Our operational readiness work is designed to integrate the efforts of federal agencies and each systemically important bank, or D-SIB, to ensure there is an effective playbook in place.

Our readiness model ultimately relies on the operational resilience of the people, processes and technology of the D-SIBs themselves.

Therefore, we are building our own readiness in parallel with the banks and with a full understanding of each D-SIB's existing crisis management capabilities and planned enhancements.

CREDIBILITY

The second broad resolvability issue is credibility.

Would the resolution strategy be used in practice or would it have grave consequences on stability in the economy?

I would like to take a moment to discuss why credibility is so important.

Let me be clear. The expectations for resolvability now being imposed on Global Banks – or G-SIBs -- in jurisdictions such as the U.K. and U.S. will soon arrive on Canada's doorstep.

While Canada does not have G-SIBs, our largest banks are not typical domestic banks as they have large foreign footprints:

TD, BMO and National in the United States; Scotiabank in our southern hemisphere; and RBC in the UK and Europe.

Host regulatory authorities – especially the U.S. and U.K. -- will place a great deal of scrutiny on resolvability of our banks to protect their own financial systems and economies.

They will seek assurance from us that a large bank's resolution plan is credible.

In the absence of this assurance, local authorities could take unilateral action to mandate resolvability in their own jurisdictions.

That could mean actions such as ring-fencing, which makes it difficult, if not impossible, to repatriate capital and liquidity back to the parent bank in times of financial turmoil.

From this perspective, not having a plan that is both credible and transparent is a competitive disadvantage.

And I can tell you from my discussions with resolution authorities around the world that global banks -- in Europe, for example -- are making rapid progress on this. So we have to maintain our momentum.

How do authorities assess credibility?

First, the plans must be based on realistic assumptions.

In the U.S. last year, the FDIC informed its 11 largest institutions that their plans were not credible.

Their shortcomings included unrealistic assumptions that capital and funding would remain from existing sources long enough to facilitate an orderly resolution.

They frequently assumed that host and home authorities would not take defensive actions such as ring-fencing.

The FDIC warned these banks could face tougher rules on capital, leverage and growth if they should fail to address these shortcomings in their plans by July of this year. We will monitor developments in this process with interest, and I am sure our D-SIBs will do so as well.

Second, there must be effective business continuity with critical services continuing to function.

What impact will the complexity and interdependencies of the bank have on ensuring operational continuity of these services?

Can early termination of critical service-level agreements be averted in resolution? Would the bank maintain access to payment, settlement or clearing systems that are critical to the provision of essential services?

CDIC and the Bank of Canada are working with financial market infrastructures – FMIs -- to develop a process to ensure the system would remain functional in resolution.

These are critical issues that we must address to ensure credibility.

ACTIONS TO IMPROVE RESOLVABILITY

So what can we do to improve the overall resolvability of our largest Canadian banks?

There is no one-size-fits-all approach and each of our D-SIBs has unique characteristics.

However, I would like to share some broad issues that pose challenges to the resolvability of our own banks.

Derivatives

First, a key challenge is stays on derivatives terminations, without which counterparties could terminate *en masse*, frustrating efforts to stabilize a failing institution.

In 2014, the FSB encouraged the International Swaps and Derivatives Association – ISDA -- and G-SIBs to work with regulators to develop a contractual solution to enforce resolution actions against financial contract counterparties in other jurisdictions.

Work is progressing steadily on this front with the ISDA protocol being adopted by an increasing number of global banks.

Standard derivative agreements can now be amended on mutual agreement to clarify which country's resolution rules would apply in a failure. And the FSB has encouraged more countries and industries to follow.

We are working with our financial safety net partners to refine Canada's approach to this issue.

Cooperation with foreign jurisdictions

Second challenge. Legal uncertainty about the cross-border effectiveness of resolution measures is a key obstacle.

Without a clear and committed legal path, it will be difficult to contemplate the cooperation of foreign jurisdictions in a resolution event.

As a member of the FSB Cross-Border Crisis Management Group, CDIC is working with others to find ways to provide greater certainty for effective group-wide resolutions.

We also have regular outreach discussions with resolution authorities in other countries to improve their understanding of our framework and our plans.

Currently, there are very few bank-specific agreements – or Co-Ags -- between countries on resolution.

To date, through our outreach program, CDIC has an agreement in place with the U.S. and we expect to complete one very soon with the U.K.

These agreements about information-sharing and coordination in resolution are a good step towards bank-specific Co-Ags.

Bank structure

Third challenge. We recognize that bank structures have developed over generations and are driven by business models, tax laws, regulations, client base and portfolio of products.

To date, the concept of resolvability has had virtually no impact on how banks structure their operations, at least in Canada.

Many other jurisdictions have taken steps to force structural changes – I can refer to the ring-fencing developments in the U.K. and the establishment of the Foreign Banking Organization rules in the U.S. as examples.

As part of our work, CDIC is examining the challenges to resolution posed by existing bank structures in Canada to seek practical solutions, on a bank-by-bank basis, rather than applying a broad standard.

Liquidity

Fourth challenge. We acknowledge that the government's introduction of a bail-in regime is an important step towards achieving resolvable banks.

However, recapitalization of a firm in resolution may not by itself ensure the continuity of a bank's critical function if it does not have access to liquidity to refinance its liabilities as they come due.

For example, we may need to raise massive amounts of liquidity in foreign currencies in a cross-border context.

As such, we will be working with the D-SIBs to identify appropriate internal liquidity sources that could be used to meet funding needs to the extent possible.

Markets should be the preferred source of funding in a resolution.

We cannot, however, assume funding from the markets during periods of financial turmoil.

We will work with our federal colleagues to establish credible public-sector backstop mechanisms to address temporary funding needs in order to maintain the continuity of critical functions.

Let me stress that public sector funds should always be the last option considered.

CDIC Activities

Given all this, CDIC has more work to do. In the near term, this includes:

- Identification. Producing a detailed mapping of each business line, and assessment of funding and liquidity needs to identify what is required to ensure operational continuity in a resolution.
- Closing gaps. We've developed a resolution assessment framework that starts with high-level principles of what needs to be in place to ensure credible and feasible resolution and drills down to a technical level with some hundreds of criteria. This year, we're putting each D-SIB through these to identify gaps or obstacles to resolution.
- We will discuss with each bank how obstacles to resolvability will be addressed over a reasonable period of time.

- Testing. As I mentioned, we are working with the banks to develop plans to ensure that systems, people and processes at each D-SIB are in place to support an orderly resolution. We intend to test the integrity of these plans, starting in 2017-18.

Further, consistent with the Key Attributes and emerging global practice among systemically important banks, CDIC will host its second set of crisis management groups this fall.

At these sessions, D-SIBs will discuss their work with an audience of domestic and international regulators and resolution authorities.

The focus will be on those areas of operation that could pose impediments to their successful resolution.

I am also pleased to note that we are establishing a working group – known as the D-SIB Forum – to discuss a number of the issues common to all D-SIBs. These issues, as mentioned earlier, include derivatives -- or EFCs, FMIs and the eventual operationalization of bail-in. The first meeting is to take place in a few weeks.

A topic we are certain to discuss is the Budget 2015 announcement that Canada's systemic banks will be responsible for drafting their own resolution plans.

In my view, this is a positive step. Banks understand the structure and complexities of their business. So they are best positioned to prepare plans that are tailored to their specific business model, reducing the risk of us imposing broad, one-size-fits-all changes.

However, CDIC, as the resolution authority, must challenge and test these plans – since ensuring resolvability is a shared responsibility and CDIC is ultimately responsible for implementation.

To build credibility, we need to involve the CEOs and the boards of our largest banks to ensure they are fully engaged and have confidence in their banks' operational resilience.

Analyzing the operations of a bank from a resolvability standpoint can yield important insights.

Some global banks have already recognized serious flaws and interdependencies that could prove harmful.

Addressing these flaws in good times can lend strength and flexibility in times of turmoil.

CONCLUSION

In conclusion, after some years of speaking in aspirational terms about resolution, we are now beginning to put policies into operation.

It will require regulators and bank leaders to work together to get results. But the global financial crisis showed us the consequences of inaction.

Recently, I had the very good fortune to hear Colonel Chris Hadfield, the astronaut, speak about the importance of planning for catastrophic events that may never happen. He said: *“if the stakes are at all high, it’s worth it.”*

The stakes in perpetuating too big to fail are certainly high.

I know that you agree.

Thank you.