

Greater Vancouver Board of Trade

Economic Outlook Forum

January 21, 2021 (virtual event)

Remarks by Peter Routledge, President and CEO

CHECK AGAINST DELIVERY

1. Introduction

Thank you, Bridgitte, for the kind introduction. I would also like to thank the Greater Vancouver Board of Trade for hosting this forum, a task made more challenging by the incredible circumstances which face us today.

Let me begin by acknowledging that I am speaking to you today from the traditional, unceded territory of the Algonquin Anishnaabeg people.

I thank all the generations who have taken care of this land.

2. Outlook – cautiously optimistic

Let me start with a few of the highlights from yesterday's Bank of Canada's policy-rate announcement and economic outlook.

The Bank noted that the post-Christmas surge in COVID-19 cases is a serious setback.

However, the prospects for a strong, sustained recovery in 2021 have improved with the arrival and distribution of effective vaccines.

The costs of pandemic have fallen unequally on workers and businesses in high-contact industries – restaurants, hotels, travel services.

Employment of lower-wage workers are 20% below pre-pandemic levels, and other job categories have returned to pre-pandemic levels.

Given this outlook, I want to reassure you that Canada's financial system remains resilient, in part because of public confidence in our financial institutions.

Resilience to volatility, not its absence, is the mark of a sound financial system.

To reinforce your confidence in the system, I'd like to outline for you today:

1. our responsibilities;
2. the preparations we've made; and
3. the tools we have to address institutions in trouble.

3. Our responsibilities

We are in the resolution business more than the insurance business.

We resolve troubled or non-viable members for the benefit of insured depositors and promote financial stability.

Some resolutions may involve winding up an institution which requires a deposit insurance claims payout.

Other resolutions may not – I will speak to that in a moment.

Our Act gives us four key responsibilities:

- i. Protect depositors within limits
- ii. Promote financial stability
- iii. Do those first two things in such a manner that minimizes CDIC's exposure to loss
- iv. Act as resolution authority for our members

There is an intended tension in our responsibilities.

For instance, we risk moral hazard if we are too zealous in our efforts to promote financial stability; we risk financial instability if we over-index avoidance of moral hazard.

Moral hazard is a situation in which one party engages in risky behavior or fails to act in good faith because it knows the other party bears the economic consequences of their behavior.

Any time a party does not have to suffer the full economic consequences of a risk, moral hazard can occur.

Parliament asks that we balance our responsibilities and thereby balance the tension between moral hazard and financial instability.

CDIC's management makes recommendations to our Board of Directors, they approve / amend, then we seek ministerial approval from our Minister, the Finance Minister and in some cases the Governor in Council.

4. Our tools and preparations

We know from history that resolution authorities tend to both minimize costs and promote financial stability when they act early as opposed to late.

But, it is not quite that simple and there is a fine line to walk.

Acting too early can lead to moral hazard. We don't want banks to take reckless risks in the belief CDIC will bear the financial losses.

Alternately, acting too late could trigger contagion or a loss of public confidence in an institution, which could destabilize the financial system and result in much higher costs to CDIC.

Two key sections of the Canada Deposit Insurance Corporation Act instruct us on how to manage this tension and give us tools to do so.

One section allows us to act before the point of non-viability.

We have a wide array of investments / support available - including guarantees, recapitalization, loans and loss-sharing arrangements with acquirers.

We can deploy whichever we think appropriate provided any action we take is in accord with our objectives

Another section of the Act allows us to intervene after the point of non-viability and the powers in that section are quite substantial. We could:

- Liquidate an institution via the Winding Up and Restructuring Act and reimbursing insured deposits.
- Vest shares of non-viable institution to force a sale.
- Establish a bridge bank into which we would transfer the failed institution's good assets and certain liabilities.
- For systemically important banks - convert capital and certain debt instruments (not deposits) into common equity.

History teaches us that earlier actions tend to lower costs and the risk of financial instability.

In our history 24 of our 43 member failures have involved payouts.

In the U.S., the Federal Deposit Insurance Corporation (FDIC) - has often made use of loss-sharing agreements to facilitate acquisitions of failing members by healthy members.

Only 26 of FDIC's more than 500 resolutions have involved post-failure payouts.

Between 2008 and 2013, FDIC payout resolutions led to median costs to FDIC of 34.5 per cent of the failed institution's assets.

Resolutions in which FDIC facilitated the sale of troubled assets were much cheaper: a median cost of 21.3 per cent.

So our opportunity and challenge is to construct resolution strategies to act early while minimizing moral hazard risk. Preventative and preparatory habits are key to developing these sound strategies. There are three of them and I list them by distance from non-viability

1. **Resolution Planning** - we now have resolution plans at Canada's six largest banks. In the last 18 months, we've turned our focus to developing resolution plans with smaller institutions.
2. We routinely conduct "**war games**" to play out potential financial crises in a safe, simulated environment so we can test our resolution plans and coordination.
3. **Early collaboration with troubled members.** We have the power to conduct special examinations of member institutions of assets / deposit liabilities or both. Through these exams we can anticipate problems and respond sooner to a crisis before too much value and capital are lost. Conducting a special exam sends a powerful message to the boards of financial institutions in trouble.

I share these tools, strategies, and habits with you because many people think CDIC's job is only to liquidate a failing institution and send cheques to the insured depositors.

We can and may do that. But in certain cases, it may be better to keep the bank open through a sale or restructuring facilitated by CDIC.

If we opt for an assisted transaction, we can mitigate the risk of moral hazard by structuring the assistance in such a way that shareholders and others bear financial losses.

Non-payout resolutions, however, may not always be possible in Canada's consolidated financial system.

In cases where a private-sector solution cannot be found and financial stability is not a factor, then liquidation and a payout could be the best course of action.

It is important to note that there is no cost to taxpayers. CDIC is funded by premiums paid by its member institutions and does not receive public funds to operate.

Let me conclude.

Since CDIC was established in 1967, no one has lost a penny that was protected by CDIC.

In this time of pandemic and 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.