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

Michèle Bourque Speech

"CDIC at 50: Are we ready for the next crisis?"

C.D. Howe Institute – Keynote Address

Toronto, Ontario

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Good afternoon, and thank you for being here.

I am very pleased to be joining you today in the year that marks CDIC's 50th anniversary.

I've had the privilege of working at CDIC for half of that time, witnessing the evolution of our organization through good and difficult times.

We are now in a new era, however, and we are tackling issues we could not possibly have anticipated 50 years -- or even 10 years -- ago.

This sea change began with the 2008 financial crisis. We all know the profound impacts it created around the globe. Uncertainties in major markets continue to this day.
For example, as we speak, the government of Italy is supporting the resolution of the world's oldest operating bank, Monte dei Paschi di Siena, which was established in 1472, around the time Michelangelo was born.

The financial crisis has shown us that things we may think are impossible can quickly become reality.

But if the past does not necessarily predict the future, we have, nonetheless, much to learn from it.

Prior to 2008, while I recognized there was a statistical possibility that a systemic bank could fail, it was hard to envision how anyone could handle such a catastrophe effectively – smoothly.

It is remarkable to observe that, Canada had -- on a comparable, international scale -- relatively few failures and no full-blown banking crisis.

Beginning in 1967, CDIC had developed a solid track record in resolving the failures of 43 members. Not a single dollar under CDIC protection was lost.

It is worth stressing that our experience was in resolving, not saving, banks to ensure that we were imposing losses on shareholders and creditors, not taxpayers. This market discipline approach was not one generally followed in many countries, whether for small or big banks, a fact that was underscored during the crisis.

Our legal powers were robust, having been used and improved over time.

Canada's discipline of reviewing its financial legislation every five years resulted in many incremental improvements. By the time of the 2008 crisis, as we weighed the most feasible and credible approach for the possible failure of a systemic bank, it was clear that we had the fundamental architecture required. And as it turned out, an architecture that met global best practices.

We should not be modest in acknowledging that Canada's framework was well ahead of many countries.

But while we were in an enviable position, and thankfully avoided the worst effects of the crisis, the foundation we had was not enough.

And so, since that time, with a combined effort at the federal level, we have tackled the complex issues of resolving domestic systemic banks – or D-SIBs -- and built a strong approach to resolution.

This is true, even though the solutions have not been obvious. We had to consider questions in ways that had no precedent in Canada. In fact, there were few precedents globally from which we could draw upon.

CDIC, tasked with this undertaking, is making progress but there has been – and continues to be - some heavy lifting required as we clear the path ahead.

I will now provide an overview of our resolution work so far, including some difficult issues that will require more effort to address, and look ahead to where we are going in the future.

In 2011, while our work was underway, the Financial Stability Board issued 12 core elements necessary for the effective resolution of systemic banks. These are known as the Key Attributes, or KAs.

The KAs set out the powers that resolution authorities should possess. For example, they should ensure that essential services and functions of a failing systemic bank continue to operate while it is being resolved.

Depositors should be protected. Shareholders and creditors should bear the cost of the failure, not taxpayers. And importantly, creditors should be no worse off when these new resolution tools are used than they would be in a liquidation.

The KAs were endorsed by the G-20, including Canada, and we were gratified that we already met most of these principles.

We have continued to evolve our tools to ensure we are as consistent with the KAs as possible. In fact, last March, the FSB evaluated the regimes of 24 jurisdictions against the progress they have made on implementing the Key Attributes.

I am pleased to note that among jurisdictions that do not have a global systemically important bank, Canada is one of the few regimes to have substantively met the KAs.

CDIC's toolkit includes an array of powers that provide flexibility depending on the circumstances. Among them is the power to facilitate a private transaction to sell a troubled institution to a healthy acquirer.

We have the bridge bank tool. Introduced in 2009, this power permits us to "bridge" the time between when an institution fails and the point at which one or more buyers could be found. A key advantage of the bridge bank is to provide an alternative to the creation of a "megabank" by amalgamation with another DSIB.

However, this tool contemplates creating a new bank – the bridge bank – from, at a minimum, the critical parts of a systemic bank in a single weekend.

This would be tremendously difficult to do for a D-SIB with a large international footprint, where the top of the house is the operating entity and not a holdco. But it remains an important tool, particularly for entities with mainly Canadian operations.

We have powers that allow us, without shareholder consent, to take control of the assets or shares of a troubled institution for a relatively short period of time, known as the Financial Institution Restructuring Provisions or FIRP.

This allows us time to force a sale or merger while keeping the institution open for depositors, rather than closing it. However, the time factor may prove impossible for a D-SIB, as viable acquirers may not be waiting in the wings, especially in a time of financial turmoil.

As a result, this past year, the government adapted the FIRP power.

This enhancement – or open bank resolution option - gives CDIC the power to take control of the failed bank and keep it open. It introduces a mechanism for recapitalization and allows time to stabilize and restructure it for its return to private hands.

This past summer, I was pleased to see the passage of Bill C-15, which introduced this bail-in regime.

This will help recapitalize a failed D-SIB by converting part or all of their debts to common shares while they continue to operate. This approach is consistent with that of many resolution authorities around the world, who also believe the best way to privatize losses and protect the financial sector in a systemic bank failure is via a bail-in.

We are presently working with our colleagues at the Department of Finance on regulations that will specify the operational details of bail-in, including the quantity, quality and distribution of these instruments. There are still numerous key details to work out.

Bail-in is a significant addition to our tools. But the question remains: will this by itself be sufficient? Unfortunately not. Other things need to be done, including resolution planning.

Our largest banks, being systemically important to Canada, have a social responsibility within the Canadian economy, one that goes beyond that of our smaller members, since the consequences of their failure would be severe for the country.

As announced in the 2015 Federal Budget, our D-SIBs are now responsible for preparing their own resolution plans and for addressing how they could be resolved if their own recovery actions fail.

While CDIC worked on these plans in the past, early on we recognized that those who know the banks best should hold the pen on drafting a feasible resolution strategy. Leveraging what we developed, the banks began this work last year.

I have personally met with the leadership of each D-SIB, and I can say they are very engaged in this exercise.

As the resolution authority, CDIC is responsible for directing DSIBs in their planning and, to that end, we have provided them with guidance to assist their efforts.

We have not imposed a one-size-fits-all solution but rather set out key objectives that would drive our assessment of how well each bank's plans achieve an orderly resolution – one that protects Canadians and the financial system.

Early in my career, I was directly involved in handling failures, reimbursing depositors and effecting other types of solutions, such as the resolution of Central Guaranty Trust in the early 1990's – the largest one Canada had ever seen.

This was challenging but, today, after having read the resolution plans our D-SIBs just provided, I can tell you: t*his is not that.*

There are so many dimensions to our largest banks that make the resolution process extremely complex. Recapitalization through bail-in is just one aspect. Cross-border considerations are substantial and --depending on the D-SIB – can be critical. We know a resolution will not be effective without cooperation. That is why we have signed several memoranda of understanding on information sharing with key regulators, both international and domestic.

Let me highlight for you some of the other questions underscored by the plans:

Regarding legal structural suitability. Does the resolution strategy proposed by the D-SIB provide clarity about how CDIC's resolution tools will be applied? Does the proposed resolution strategy meet our broader financial stability objectives? Do the D-SIBs have legal and operational structures that will allow them to continue operating, and that are flexible enough to allow timely, rapid restructuring?

As to operational continuity, we ask ourselves: can the D-SIBs mitigate risks to service continuity in the event the parent bank is deemed non-viable?

We must also minimize disruption to the financial system. Does the plan explain how the banks can minimize contagion and limit the broader systemic effects that go along with the orderly winding down of derivative trading activity? Can they maintain access to payments, clearing and settlements? These are complex challenges.

Loss absorbency is another key area. Do the D-SIBs have the capacity to absorb severe but plausible losses in a way that minimizes the need for CDIC solvency support? Is this capital positioned to cover potential losses in Canada and in the foreign jurisdictions where they do business? OSFI is in the process of setting these loss absorbency standards (TLAC) for D-SIBs.

Finally, we must also consider access to liquidity. So we ask ourselves: In their strategies, do the D-SIBs have enough liquidity to withstand a severe run? Can they maintain their counterparty obligations? Have they taken into account potential steps that foreign regulators could take, such as ring-fencing?

CONCLUSION

For the banks, this is the first iteration of the plans. They address many questions and raise others. As we expected, there is more work to be done and we will work with the banks as we go forward.

The banks are taking this seriously and their management have dedicated the resources to it. This work is important, particularly with so many challenges for the financial sector on the horizon with Brexit, Italy, and uncertainties around the direction of regulation in the US.

Today, although we are at the leading edge of new resolution policies that will protect depositors and taxpayers, it is clear that we cannot afford to become complacent or think we have found all the answers for all time.

CDIC has grown up a lot since it started out 50 years ago, especially so in the recent years.

It has been a real privilege to be part of CDIC's journey.

I'm confident that progress will continue to be made here in Canada, so that even under the worst possible scenario, CDIC will continue to protect Canadians.

Thank you.