

Early Intervention and Crisis Preparation: Coordination Challenges and Lessons from the Canadian Experience

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Canada Federal Financial Sector Framework

Safety Net Agencies

OSFI

Prudential Authority and
Supervisor
(1987)

CDIC

Deposit Insurer and
Resolution Authority
(1967)

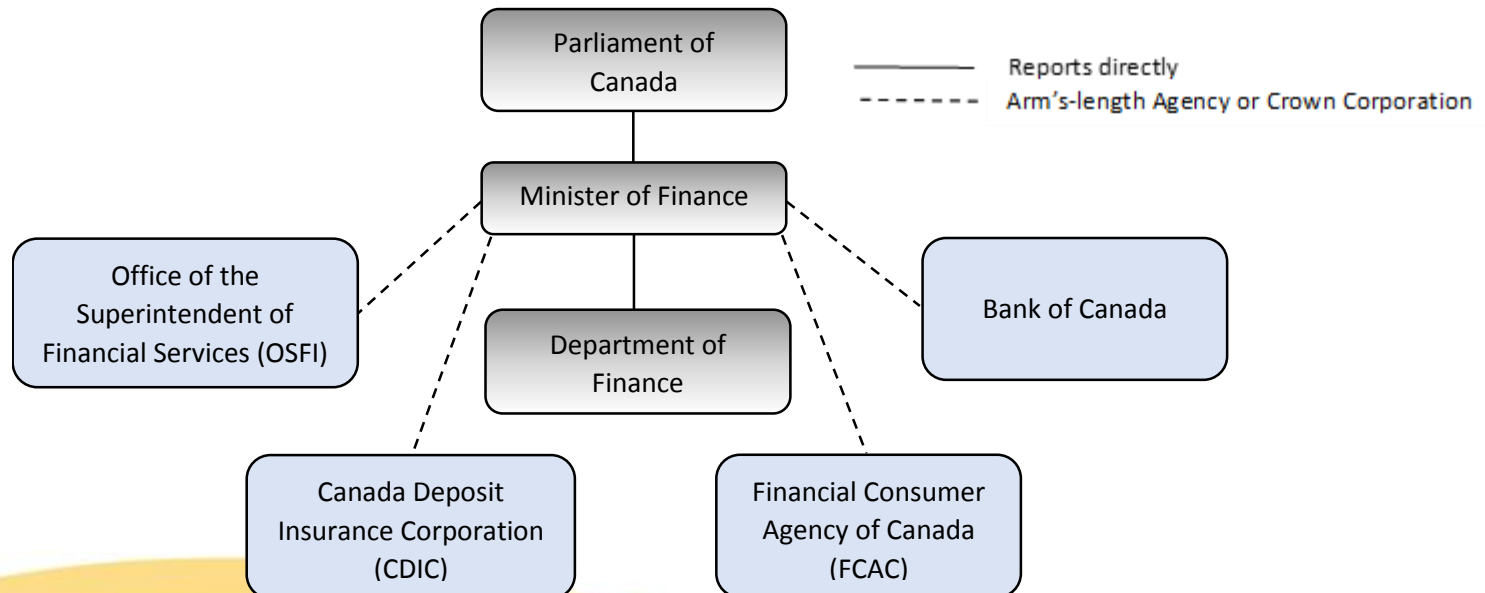
FCAC

Consumer Protection and
Education
(2001)

Bank of Canada

Monetary Policy, LLR, and
Payment Systems (1938)

Institutional Structure



Lessons from the Past

1. Single vs. Multiple Regulators

- Wave of bank failures in 1980s-1990s → impetus for regulatory reform
- **Estey Commission (1986) and Bill C-42 (1987)**
 - OSFI created as independent prudential regulator and supervisor
 - CDIC given stronger post-failure mandate and greater independence
- **Deposit Insurance Review (1994) and Government Policy Paper (1995)**
 - Concept of 'prompt action' introduced into intervention approach
 - Clear mandate for supervisor and deposit insurer
 - Powers for the supervisor to intervene and take control
 - Alignment with insolvency law
- **Bill C-15 (1996), McKay Taskforce (1998), and Federal Budget (2004)**
 - Clarification of CDIC and OSFI programs
 - Introduction and enhancement of new powers for CDIC
- **Trend: Increasingly clear division of responsibilities between regulatory agencies**

The mandates of OSFI and CDIC are different but they do intersect in certain areas...Parliament has adopted a regulatory system that provides checks and balances and a healthy tension between the two organizations (Auditor General, 2000)

Lessons from the Past

2. Prompt Corrective Action

- **Evolution of clearer goals and sharper incentives governing safety net agencies have led to an operating framework based on Prompt Corrective Action (PCA)**
 - Early intervention in troubled financial institutions to prevent depositors and safety net agencies from incurring undue losses
- **The application of PCA in Canada relies on agencies' judgement, rather than statutory or regulatory rules**

The intervention process is not a rigid regime under which every situation is necessarily addressed with a predetermined set of actions (OSFI, 2014)

- Division of responsibilities ensures that agencies' judgements are bounded by a clear mandate
- Healthy tension between agency mandates ensures that crises are examined from multiple perspectives

Coordination Mechanisms – Normal Conditions

Financial Institutions Supervisory Committee (FISC)

- Focus on emerging issues that may have an impact on financial institutions, the financial system, or raise systemic risk concerns
- **Members:** Superintendent of Financial Institutions (Chair), Deputy Minister of Finance, CDIC President, Governor of the Bank of Canada, FCAC Commissioner

CDIC Board of Directors

- Oversee strategic direction and activities relating to role as resolution authority
- **Members:** CDIC President, Superintendent of Financial Institutions, Deputy Minister of Finance, Governor of the Bank of Canada, FCAC Commissioner, five private sector members

Senior Advisory Committee (SAC)

- Policy focus on legislative, regulatory and policy issues affecting the financial sector
- **Members:** Deputy Minister of Finance (Chair), Superintendent of Financial Institutions, CDIC Chairperson, Governor of the Bank of Canada, FCAC Commissioner

Coordination Mechanisms – Crisis Conditions

1. Recovery Phase

➤ Financial Institutions Supervisory Committee (FISC)

- Decision-making and discussion forum for federal safety net agencies during the recovery phase
- Greater focus on operational considerations during crisis than under normal conditions
- Meet with greater frequency. E.g. daily

➤ CDIC Board of Directors

- Functions as an information sharing forum during the recovery phase of a crisis
- Discussions of potential non-viability of troubled financial institution and implications for resolution

➤ Guide to Intervention for Federally Regulated Deposit-Taking Institutions

- Framework setting out individual and joint responsibilities of CDIC and OSFI for managing troubled institutions up to the point of non-viability

Coordination Mechanisms – Crisis Conditions



Coordination Mechanisms – Crisis Conditions

2. Resolution Phase

➤ **CDIC Board of Directors**

- Main decision-making forum once non-viability has been invoked by Superintendent
- Board examines and approves proposed resolution strategy
- Main forum to exchange information regarding the funding position and funding needs of a financial institution undergoing open bank resolution

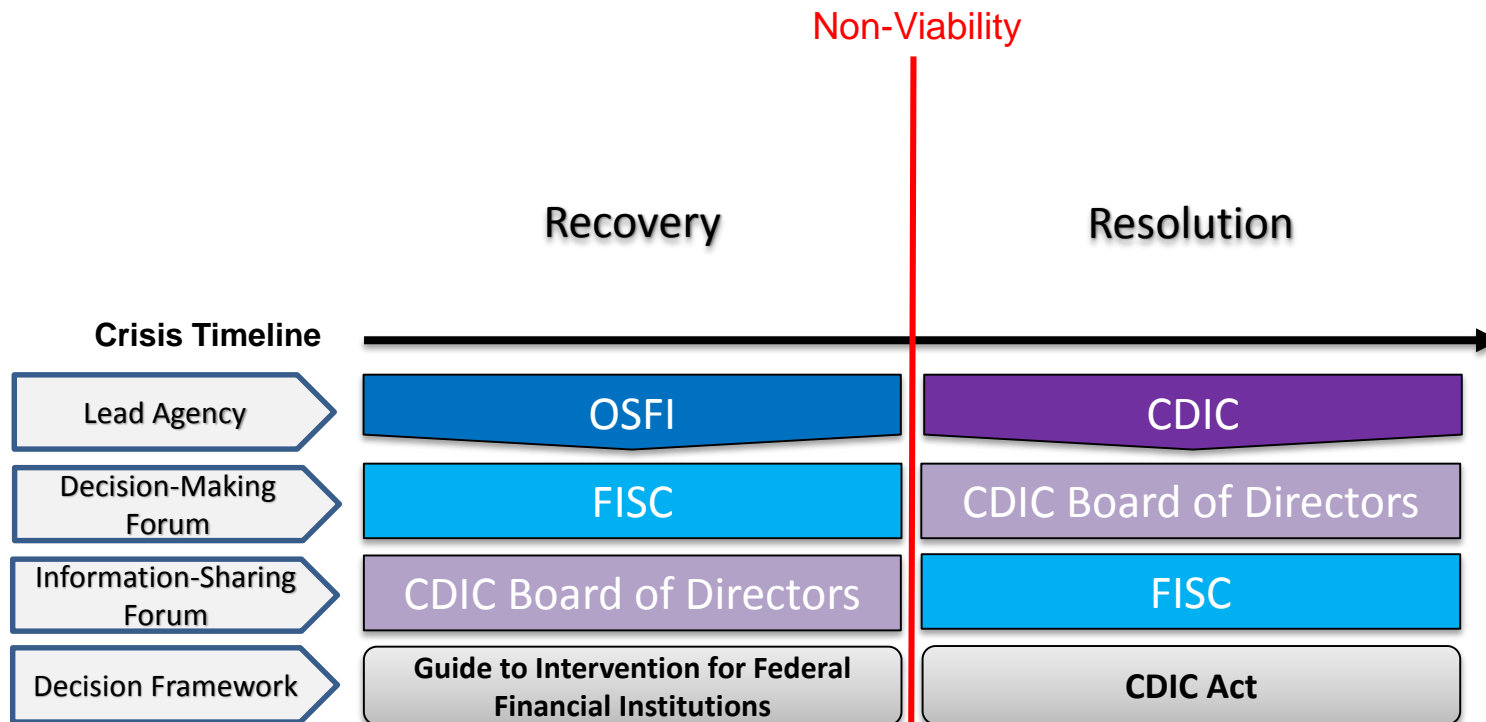
➤ **Financial Institutions Supervisory Committee (FISC)**

- After non-viability invoked by superintendent, FISC reverts to secondary forum for information sharing about failed bank
- Focus on going concern issues related to surviving banks / financial system

➤ **CDIC Act**

- Resolution activities governed by CDIC Act and associated bylaws

Coordination Mechanisms – Crisis Conditions



Current Coordination Challenges

1. Normal Conditions

➤ Crisis Preparedness

- Interagency simulations must be sufficiently realistic to ensure that crisis framework can be applied effectively during real crises
- Assumptions should be critically examined to ensure that coordination-relevant challenges are not glossed over

➤ Monitoring Activities

- Agencies analyze information through the lens of their mandate, and may miss warning signs that are significant to other agencies
- Consistent sharing of information between agencies increases the likelihood of spotting issues before they become crises

Current Coordination Challenges

2. Crisis Conditions (Strategic)

➤ DSIB Recovery vs Resolution

- Asset encumbrance during recovery may reduce access to Emergency Lending Assistance (ELA) during resolution due to collateral requirements
- Requires coordination between prudential (OSFI) and resolution (CDIC) authorities to balance mandates

➤ Going-Concern vs Liquidation Valuation

- Falling asset values during recovery can reduce CDIC recoveries in liquidation
- Timing of non-viability call by Superintendent can significantly impact CDIC exposure to loss

➤ Enhanced Role for Other Liquidity Providers

- Liquidity assistance by non-safety net agencies (e.g. CMHC) faces barriers

Current Coordination Challenges

2. Crisis Conditions (Operational)

➤ Speed of Pathway to Non-Viability

- Safety net coordination mechanisms must be able to function on extremely tight timeframes and respond quickly to new developments

➤ Interagency Decision-Making During Crises

- Interagency decision-making forums should be focused, and attendance by non-essential personnel limited

➤ Collaboration at different levels between agencies

- Interagency collaboration at different levels requires that higher-level decisions are communicated efficiently through the agencies

➤ Operational roles and responsibilities

- Responding to fast-moving crises requires a clear understanding across agencies of key contacts on specific issues

➤ External communications

- Inconsistent public messaging from agencies can exacerbate crises

Lessons Learned and Keys to Success

1. **Getting the safety net structure right is critical**

- Clear mandates are critical
- Distribution of mandates across agencies creates checks and balances
- Formal coordination mechanisms should be established
- Informal coordination mechanisms should be encouraged and developed
- Importance of confidentiality

2. **Adequate structure is necessary for effective coordination, but not sufficient**

- Preparedness exercises must be detailed
- Scenarios incorporating worst-case assumptions should be tested
- The role of different coordination mechanisms in crisis versus non-crisis situations should be made explicit

3. **Choice of principles or rules governing safety net should be explicit**

- Intervention trigger(s) should be defined
- The mechanism for transitioning between recovery and resolution must be clear
- The relevant parties at each transition point must be clear

4. **Informal relationships between safety net participants**

- Frequent interaction at all levels creates an awareness of other's perspective and shared "culture"
- Informal information flow is crucial