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Crisis Management and Orderly Resolution of Banks in Canada and Internationally: A Perspective on Reforms and Challenges

Maziar PEIHANI

Post-Doctoral Fellow, Centre for Banking & Finance Law, Faculty of Law, National University of Singapore

lawmp@nus.edu.sg

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http://law.nus.edu.sg/cbfl/

Centre for Banking & Finance Law
Faculty of Law
National University of Singapore
Eu Tong Sen Building
469G Bukit Timah Road
Singapore 259776
Tel: (65) 66013878
Fax: (65) 6779 0979
Email: cbfl@nus.edu.sg

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ABSTRACT:

The principle objective of this article is to examine the current Canadian bank resolution regime in the context of recent international reforms. It takes stock of international standards that promote orderly resolution of global banks and discusses the mechanics, drivers, and actors that are involved in the resolution of banks in Canada. The Canadian experience with the recent crisis, as well as the subsequent legislative and regulatory amendments and policy proposals will be particularly stressed. There are two key arguments that I make. First, despite significant international attempts and the progress that has been made, the orderly resolution of a large cross-border bank still remains unfeasible. The resolution regimes cannot therefore be seen as ending the too-big-to-fail bank or the moral hazard associated with bank failures. Second, I argue that while Canada continues to benefit from a strong prudential regime, the absence of a holistic approach to systemic risk could nonetheless pose serious challenges to the orderly resolution of banks in Canada.

Crisis Management and Orderly Resolution of Banks in Canada and Internationally: A Perspective on Reforms and Challenges

Maziar Peihani[1]

I. INTRODUCTION

Until recently, creating a special resolution regime for banks rarely received attention from policy forums or academic literature. The Global Financial Crisis (GFC) and its accompanying bank failures placed this theme on top of the financial reform agenda. When the G20 leaders met in Washington in 2008 to formulate a coordinated response to the crisis, they called for the review of national laws and bankruptcy regimes in light of recent experience.[2] Transnational bodies and national jurisdictions have since then spent significant time and resources to enable the orderly resolution of large and complex banks. At its most basic, the term 'resolution' refers to measures that the public authorities take to prevent or contain the contagion associated with bank failures. Such contagion can arise due to the crucial role that banks play in the functioning of the economy. Banks take deposits, extend credit, process payments, and provide other necessary financial infrastructure. These functions interconnect banks with a wide range of economic and societal actors, thereby making them vulnerable to loss of confidence and perfect channels for triggering and transmitting systemic panic.

A special resolution regime is intended to reflect this special nature of the banks and equip authorities with powers and tools beyond what is normally offered by a corporate insolvency regime. Furthermore, it aims to end the moral hazard associated with bailouts and public support, a recurring issue in the recent crisis. Since the bankruptcy of a too-big-to-fail bank is costly and chaotic, authorities may see no alternative but to save the bank using money. Such intervention weakens market discipline and allow banks to unfairly privatize gains but socialize losses. Thus, resolution regimes aim to shift the exposure from taxpayers to the bank's shareholders and creditors so that the firm can fail in an orderly manner, without open-ended commitments from the government.

The principle objective of this article is to examine the current Canadian bank resolution regime in the context of recent international reforms. It takes stock of international standards that promote orderly resolution of global banks and discusses the mechanics, drivers, and actors that are involved in the resolution of banks in Canada. The Canadian experience with the recent crisis, as well as the subsequent legislative and regulatory amendments and policy proposals will be particularly stressed. It is hoped that my article makes a timely contribution to the literature by critically discussing an important topic has been largely absent from the Canadian legal scholarship.[3] There are two key arguments that I make. First, despite significant international

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[1] Maziar Peihani, Post-doctoral Research Fellow, Centre for Banking & Finance Law, National University of Singapore.

[2] G20, "Action Plan to Implement Principles for Reform" (15 November 2008) at 2, online: https://g20.org/wp-content/uploads/2014/12/Washington_Declaration_0.pdf.

[3] A few notable exceptions include: Janis Sarra, "Bank Groups and Financial Conglomerates, Retooling Resolution Regimes" (2014) 30:1 *Law in Cont*. 7-50 [hereinafter, Sarra, "Retooling Resolution"]; Janis Sarra & Gordon Dunning "Assuring the Future: Reform of the Insolvency Framework for Insurance Companies and other Financial

attempts and the progress that has been made, the orderly resolution of a large cross-border bank still remains unfeasible. The resolution regimes cannot therefore be seen as ending the too-big-to-fail bank or the moral hazard associated with bank failures. Second, I argue that while Canada continues to benefit from a strong prudential regime, the absence of a holistic approach to systemic risk could nonetheless pose serious challenges to the orderly resolution of banks in Canada.

The article proceeds as follows. First, I briefly discuss the international standards setting out the requirements and attributes of resolution regimes, as well as how their implementation are coordinated and monitored. I then move to discuss the Canadian resolution regime, looking at how Canada has sought to reform itself in line with international standards. The resolution regime is considered against the backdrop of the broader financial system and regulatory landscape, so that the reader can better understand how laws, regulators and banks interact during the resolution process. A detailed discussion follows on the core elements of the crisis management and resolution regime in Canada, focusing on the early intervention mechanism, emergency use of public funds, the proposed bail-in regime and the actual process of resolution. The final two sections provide further assessments and observations on challenges that national jurisdictions and Canada face in resolving large and complex bank groups. I also provide some recommendations on how Canada can further improve its capacity in dealing with bank failures.

II. INTERNATIONAL STANDARDS FOR ORDERLY RESOLUTION

Severe disruptions and instability caused by failures of too-big-to-fail institutions in the recent crisis brought home the inadequacy of the legal regimes for the resolution of financial institutions. A key milestone in the post-crisis reform agenda has been the establishment of a new set of international standards for the resolution of systemically important financial institutions. The Financial Stability Board's *Key Attributes of Effective Resolution Regimes for Financial Institutions* aim to eliminate the 'too-big-to-fail' by enabling the orderly resolution of financial institutions.[4] They set out the powers and tools essential for effective resolution and call for cooperative approaches for resolution of cross-border groups. Furthermore, the standards seek to end taxpayer-funded bailouts by imposing losses on shareholders and creditors, thereby improving the incentives for oversight and containing moral hazard.[5]

The Key Attributes were adopted by the Financial Stability Board (FSB) in 2011 and received the political endorsement of the G20 Heads of States and Government at the Cannes

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Institutions under the Canadian Winding-up and Restructuring Act" in Janis P. Sarra, ed. in chief, *Annual Review of Insolvency Law* (Carswell, 2010) [hereinafter, Sarra, "Reform of Insolvency"]. The first paper provides a comparative perspective on resolution reforms at the international level, as well as in UK, US, and Canada. The paper, however, primarily engages in a broad and normative assessment of the reforms and is not aimed to provide a detailed discussion of the resolution regime in Canada. It also needs to be noted that the paper was written at a time when some important legislative reforms were not yet in effect. The second paper provides a comprehensive analysis of the insolvency framework for financial institutions. While the paper discusses some elements of bank restructuring in Canada, its primary focus, as the title indicates, is on insurance companies and the legislative reforms that are necessary in this respect.

[4] FSB, *Key Attributes of Effective Resolution Regimes for Financial Institutions* (October 2014) online: http://www.financialstabilityboard.org/2014/10/r_141015 [hereinafter, *Key Attributes*].
[5] *Ibid* at 3.

Summit in 2011.[6] In October 2014, the FSB adopted additional guidance on specific attributes relating to information sharing for resolution purposes and how the Key Attributes should be applied for insurers, financial market infrastructures (FMIs) and the protection of client assets in resolution.[7] The newly adopted guidance provisions have been incorporated as annexes into the 2014 version of the Key Attributes. It is worth noting that the text of the twelve key attributes remain unchanged since their original release in 2011.[8]

The Key Attributes set out twelve essential features that must be part of the resolution regime in all jurisdictions. They relate to: 1) scope; 2) resolution authority; 3) resolution powers; 4) set-off, setting, collateralisation, segregation of client assets; 5) safeguards; 6) funding of firms in resolution; 7) legal framework conditions for cross-border cooperation; 8) Crisis Management Groups (CMG) ; 9) institution-specific cross-border cooperation agreements; 10) resolvability assessments; 11) recovery and resolution planning; and 12) access to information and information sharing.[9] Every financial institution that is systemically important should be subject to a resolution regime that has the features set out in the Key Attributes. This regime should require all Global Systemically Important Financial Institutions (G-SIFI) to have in place recovery and resolution plans and subject them to regular resolvability assessments as well as institution-specific cross-border cooperation agreements.[10]

All jurisdictions should have a designated authority responsible for exercising the resolution powers over firms which fall within the scope of the resolution regime. The resolution authority should pursue financial stability and ensure continuity of systemically important financial services. It should protect depositors, insurance policy holders and investors which are covered by relevant insurance schemes. The resolution authority should have operational independence and have the power to enter into agreements with other resolution authorities.[11] The resolution authority should initiate the resolution process when a firm is no longer viable and/or likely to be no longer viable. Thus, timely and early entry into resolution should occur if a firm's balance sheet is insolvent and before all equity has been wiped out by losses.[12] Clear and suitable standards or indicators of non-viability should help guide the decision on whether a firm meets the conditions for entry into resolution.[13]

The Key Attributes calls for a comprehensive resolution toolkit. A resolution authority should have the power to:

- Remove and replace the senior management and directors and recover money from the responsible persons;
- Appoint an administrator to take control and manage the firm;
- Operate and resolve the firm, including the power to terminate, continue, or assign the contracts, purchase or sell assets, write down debt and taking any action necessary for restructuring or winding down the firms' operations;

[6] *Ibid* at 1.
[7] *Ibid*.
[8] *Ibid* at 2.
[9] *Ibid* at 1.
[10] *Ibid* at 5.
[11] *Ibid* at 6.
[12] *Ibid* at 5.
[13] *Ibid* at 6.

- Ensure the continuity of essential services by requiring other entities in the same group to provide those services;
- Override the right of shareholders including their right to approve particular transactions such as merger, acquisition, and recapitalization of the firm;
- Transfer or sell assets, liabilities, legal rights, and obligations including deposits and share ownership to a solvent third party;
- Establish a temporary bridge institution to take over and continue critical functions or viable operations of a failed institution;
- Carry out bail-in within resolution as a means to achieve continuity of essential functions, either by recapitalizing the institution that is no longer viable or capitalizing a new established entity or bridged institution to which those functions have been transferred.
- Temporarily stay the exercise of early termination rights that may otherwise be triggered upon entry of a firm into resolution;
- Impose a moratorium on payments to unsecured creditors and customers and imposing a stay on creditor actions to attach assets or otherwise collect money or property from the firm;[14]and
- Liquidate the whole or part a failing firm with timely payout or transfer of insured deposits and prompt access to transaction accounts and to segregated client funds).[15]

These resolution powers are subject to two important safeguards: the respect of creditor hierarchy; and the *no creditors worse off* principle.[16] With respect to the first safeguard, the Key Attributes recognize the general principle that creditors of the same class should be treated equally. As a result, equity should absorb losses first and no loss should be imposed on senior debt holders until subordinate debt, including regulatory capital instruments, have been written off entirely. At the same time, the Key Attributes also allow jurisdictions to depart from the *pari passu* principle if reasons for such departure are clearly explained.[17] The second safeguard, the no creditor worse off principle, means that creditor should have the right to compensation when they do not receive the minimum that they would have received under general corporate insolvency laws.[18]

The Key Attributes document calls on all jurisdictions to allow and encourage their authorities to look for coordinated solutions in resolution.[19] Official intervention or initiation of resolution in one jurisdiction should not trigger automatic action in another jurisdiction. National laws and regulations should not discriminate against creditors based on their nationality, the location of their claims, or the jurisdiction where it is payable.[20] The resolution authorities should have the legal capacity to share information, subject to proper confidentiality safeguards, with

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[14] Payments to central counterparties ("CCP") and those entered into the payment, clearing and settlements systems are excluded from this provision. *Ibid* at 8.
[15] *Ibid* at 7.
[16] *Ibid* at 11.
[17] *Ibid* at 11. The flexibility to deviate from the creditor hierarchy is important as some jurisdictions may seek to protect vulnerable stakeholders such as depositors and employees in resolution. See for further discussion, Sarra, "Retooling Resolution", supra *note* 3 at 21
[18] *Key Attributes*, *supra* note 4 at 11.
[19] *Ibid* at 12.
[20] *Ibid* at 13.

relevant foreign authorities to achieve a coordinated resolution.[21] Home and key host authorities of all G-SIFI should maintain Crisis Management Groups (CMG) to enhance preparation for, and facilitate management and resolution of, cross-border financial crises that affect these firms.[22] In addition to supervisors, central banks and resolution authorities, the CMG should include finance ministers, as well as authorities responsible for guarantee schemes of jurisdictions that are home or host to material entities of a G-SIFI. The objectives and processes for cooperation through CMG should be established by institution-specific cross-border cooperation agreements.[23] These agreements define the roles and responsibilities of the authorities prior and during a crisis and set out the processes for exchange of information, coordination of recovery and resolution plans (RRP) for the firm.[24]

Finally, as previously mentioned, the G-SIFI should be subject to regular resolvability assessments and recovery and resolution planning. Resolvability assessments, which are prepared by the home authority of the financial group, evaluate the feasibility of resolution strategies in light of the likely impact of a firm's failure on the financial system.[25] These assessments should assess the nature and extent of intra-group exposures and the extent to which critical services and functions can continue to be performed. They should also test the robustness of cross-border cooperation and information sharing arrangements.[26] If a resolvability assessment reveals areas of concern in the firm's resolution, the resolution authorities should have the power to improve the resolvability through adoption of appropriate measures. Such measures include changes to a firm's business practices and reducing complexity of its organization.[27]

The results of resolvability assessments inform the recovery and resolution plans. Recovery plans are prepared by SIFI and identify options to restore financial viability when a firm faces significant stress scenario such as capital shortfalls and liquidity pressures.[28] Resolution plans are prepared by the authorities and intended to facilitate effective use of resolution powers to preserve systemically important services and minimize the risk of exposing taxpayers to loss.[29] A resolution plan should define systemically important functions and identify potential barriers to effective resolution. Furthermore, it needs to set out the measures to protect insured depositors and insurance policy holders.[30]

Resolution reforms have been identified as a priority area under the FSB's *Coordination Framework for Implementation Monitoring*.[31] As a result, implementation of the Key Attributes by FSB member jurisdictions undergo intensive evaluations and detailed reporting.[32] The FSB

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[21] *Ibid*.
[22] *Ibid* at 14.
[23] *Ibid*.
[24] *Ibid* at 14-15.
[25] *Ibid* at 15.
[26] *Ibid*.
[27] *Ibid* at 16.
[28] *Ibid.*
[29] *Ibid* at 17.
[30] *Ibid.*
[31] FSB, *A Coordination Framework for Monitoring the Implementation of Agreed G20/FSB Financial Reforms* (18 October 2011) at 9, online: http://www.financialstabilityboard.org/wp-content/uploads/r_111017.pdf.
[32] *Ibid* at 6.

carried out the first peer review on the implementation of Key Attributes in 2013.[33] The objective was to evaluate the FSB jurisdictions' existing resolution regimes and the reforms they had introduced using the Key Attributes as a benchmark.[34] The main finding was that the implementation of the Key Attributes were at an early stage.[35] This finding was not surprising given the significant legislative changes that were required to fully implement the international standards. The report also found the jurisdictions had somewhat different interpretations of what constitutes a resolution regime and its relationship to ordinary insolvency and supervisory regimes.[36] The resolution regime for banks was found to be generally more developed than other financial institutions. Few jurisdictions, however, found to have equipped administrative authorities with the full set of powers to resolve banks.[37] Such gaps were particularly noticeable with respect to bail-in, namely the power to write down and convert debt instruments to equity. Moreover, in some cases, resolution actions, such as transfer of assets or liabilities, needed court approval or the cooperation of the failing firm or its shareholders.[38] In April 2015, the FSB announced that it has launched the second peer review of resolution regimes in FSB member jurisdictions.[39] A questionnaire to collect information from national authorities has been distributed between member states and the responses are to be discussed and analyzed by the FSB later this year. The peer review report is expected to be published in early 2016.[40]

III. Bank Intervention And Resolution In Canada

It has often been observed that Canada weathered exceptionally well during the recent financial crisis.[41] No financial institution failed or required financial support in the form of capital injection or debt guarantee.[42] Nevertheless, given the interconnected nature of the Canadian economy and strong ties with United States, the economy was hit by the slumping external demand. Core funding markets were also affected by the global financial shocks.[43] The most severe impact was notable in the structured finance markets, particularly the asset-backed commercial paper (ABCP). Fears of contagion arising from potential exposures to the US subprime mortgages, combined with uncertainty about the underlying assets and the associated leverage, led to a rush by investor to exit the market.[44] As a result, the non-bank ABCP conduits

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33 FSB, *Thematic Review on Resolution Regimes Peer Review Report* (11 April 2013) online: http://www.financialstabilityboard.org/wp-content/uploads/r_130411a.pdf [hereinafter, FSB, *Thematic Review*].
34 *Ibid* at 16.
35 *Ibid* at 8.
36 *Ibid*.
37 *Ibid*.
38 *Ibid* at 9.
39 FSB, "FSB Launches Second Peer Review on Resolution Regimes and Invites Feedback from Stakeholders" (13 April 2015) online: http://www.financialstabilityboard.org/2015/04/fsb-launches-second-peer-review-on-resolution-regimes-and-invites-feedback-from-stakeholders/.
40 *Ibid*.
41 See, e.g., IMF, *Canada: Financial System Stability Assessment—Update* (February 2008) at 1, online: http://www.imf.org/external/np/fsap/fssa.aspx [hereinafter, IMF, *FSAP* 2008]
42 FSB, *Peer Review of Canada* (30 January 2012) at 5, online: http://www.financialstabilityboard.org/2012/01/fsb-completes-peer-review-of-canada/ [hereinafter, FSB, *Peer Review of Canada*].
43 IMF, *Canada: Financial Sector Assessment Program-Crisis Management and Bank Resolution Framework-Technical Note* (7 March 2014) at 8, online: https://www.imf.org/external/pubs/cat/longres.aspx?sk=41403.0 [hereinafter, IMF, *FSAP: Resolution*].
44 FSB, *Peer Review of Canada*, *supra* note 42 at 6.

were unable to rollover new papers to pay their maturing liabilities and ran out of liquidity in a very short period of time.[45] To stop the run by the investors and avoid potential spillovers to the banking system, the Canadian authorities intervened by restructuring the existing commercial paper into medium-term notes to match the term of the liabilities to that of the underlying assts.[46] Furthermore, to counteract the impact of the crisis, the federal and provincial authorities launched a major fiscal stimulus in January 2009.[47] The stimulus which targeted at the credit, housing, and labour markets, totalled about 4 percent of the GDP over two years, therefore representing one of the largest fiscal interventions in the advanced economies.[48] The Canadian economy emerged from the recession quite rapidly, with the output normalizing in early 2010.[49]

Since the crisis, Canada has launched a number of major regulatory initiatives, ranging from fine tuning the consumer protection framework and the introduction of a Cooperative Capital Markets Regulatory System to the implementation of Basel III prudential standards and development of central clearing counterparties.[50] More importantly, from the perspective of this paper, the Canadian authorities have sought to strengthen the bank resolution regime, in line with the international standards, namely the Key Attributes. Taking stock of recent reforms and the Canadian experiences in the recent crisis, the following attempts to provide a detailed and up-to-date discussion of the current resolution regime for federally-chartered banks. In order to contextualize the discussion, I start by providing a brief overview of the Canadian financial and regulatory landscape. I then move to focus on the key components of the Canadian bank crisis management and bank resolution regime.

1. The Canadian Financial and Regulatory Landscape

With assets totalling about 500 percent of GDP, the Canadian financial system is large and dominated by a handful of key players in most sectors.[51] The banking sector is highly concentrated with the six federally-chartered banks, namely, Royal Bank of Canada, Toronto Dominion, Bank of Nova Scotia, CIBC, Bank of Montreal, National Bank of Canada holding 93 percent of the total bank assets in Canada. As of December 2012, about half of the total CAD3 trillion (165 percent of GDP) credit to households and non-financial companies came from banks, followed by equity and bond financing (15 percent and 12 percent respectively) and financing from credit unions (7 percent).[52] Shadow banking, namely credit intermediation

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[45] IMF, *FSAP* 2008, *supra* note 41 at 20-21.
[46] FSB, *Peer Review of Canada*, *supra* note 42 at 6.
[47] *Ibid* at 12.
[48] *Ibid*.
[49] IMF, *FSAP: Resolution*, supra note 43 at 8.
[50] For further information on these reforms see: OSFI, "OSFI Releases Revised Capital Adequacy Requirements Guideline to Comply with Basel III" (10 December 2012) online: http://www.osfi-bsif.gc.ca/eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/CAR_nr.aspx; BoC, "Qualifying Central Counterparties" (28 July 2014) online: http://www.bankofcanada.ca/2014/07/qualifying-central-counterparties/; Department of Finance, *Canada's Financial Consumer Protection Framework: Consultation Paper* (3 December 2013) online: http://www.fin.gc.ca/activty/consult/fcpf-cpcpsf-eng.asp; "The Cooperative Capital Markets Regulatory System" (accessed on 9 August 2015) online: http://ccmr-ocrmc.ca/.
[51] IMF, *Canada: Financial Sector Stability Assessmen*t (February 2014) at 8, online: https://www.imf.org/external/pubs/cat/longres.aspx?sk=41299.0 [hereinafter, IMF, *FSAP*].
[52] *Ibid* at 10.

outside the traditional banking system,[53] is estimated by the IMF at 40 percent of GDP.[54] The main segments of the shadow banking system include: government-insured mortgage securitization (both asset-backed commercial paper and asset-backed securities), repos (predominantly in Government of Canada Securities), bankers acceptance, and commercial paper. Banks~~,~~ have a significant presence in all these segments.[55]

The Canadian insurance sector is mature and accounts for 16 percent of financial sector assets, with three quarters of life and health insurance assets held by three domestic firms: Sunlife Financial, Great West Lifeco, and Manulife Financial.[56] In contrast, the property and casualty insurance sector is highly competitive and includes a number of foreign-owned companies that collect more than half of the premiums earned in Canada.[57] The mortgage insurance are dominated by two corporations: Canada Mortgage and Housing Corporation (CMHC) and Genworth Financial Canada. As of December 2014, these corporations have insured almost 60 percent of the outstanding mortgages in Canada.[58]

As of end 2012, there were 1,498 active firms registered to carry out investment activities, of which 1,365 were headquartered in Canada.[59] 202 registrants were members of the Investment Industry Regulatory Organization of Canada (IIROC) and another 119 were members with the Mutual Funds Dealers Association (MFDA). The remaining registrants were directly overseen by the provincial securities regulators.[60] Similar to banking and insurance, the securities industry is also concentrated, with banks playing a dominant role through their subsidiaries. For instance, bank-owned asset management subsidiaries control about 60 percent of the assets under management (AUM) of the asset management subsidiaries and 20 percent of the sector's overall AUM.[61]

Canada has a complex regulatory system with the responsibility for financial supervision being divided between federal and provincial authorities. While banks are regulated federally, securities markets are regulated at the provincial level.[62] Firms in other sectors, such as insurance companies, trust and loan companies, credit unions non-deposit credit intermediaries, and pension plans can be incorporated and regulated at both the provincial and the federal level.[63]

Thirteen provincial and territorial authorities regulate the securities markets across Canada. While each regulator is operationally independent and administers a separate set of laws

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[53] For the definition of shadow banking, see FSB, "Shadow Banking: Strengthening Oversight and Regulation: Recommendations of the Financial Stability Board" (October 2011) at 3, online: http://www.financialstabilityboard.org/wp-content/uploads/r_111027a.pdf.
[54] IMF, *FSAP*, *supra* note 51 at 10.
[55] *Ibid*.
[56] *Ibid* at 58.
[57] FSB, *Peer Review of Canada*, *supra* note 42 at 9.
[58] CMHC, *2014 Annual Report*, at 4, online: https://www.cmhc-schl.gc.ca/en/corp/about/anrecopl/anre/upload/68315_w_ACC.pdf; Genworth MI Canada Inc, *2014 Annual Report*, at 9, online: http://investor.genworthmicanada.ca/files/AR2014/pdf/Genworth3204_AR2014_full_v001_a2z4zo.pdf.
[59] IMF, *Canada- Financial Sector Assessment Program: ISOCO Objectives and Principles of Securities Regulation—Detailed Assessment of Implementation* (March 2014) at 15 [hereinafter, IMF, *FSAP Securities*].
[60] *Ibid.*
[61] IMF, *FSAP*, *supra* note 51 at 10.
[62] OSFI, "Supervisory Framework" (April 2014) online: http://www.osfi-bsif.gc.ca/Eng/fi-if/rai-eri/sp-ps/Pages/sff.aspx.
[63] OSFI, "Who We Regulate" (accessed on July 21, 2015) online: http://www.osfi-bsif.gc.ca/Eng/wt-ow/Pages/wwr-er.aspx?sc=1&gc=4#WWRLink14; IMF, *FSAP*, *supra* note 51 at 21.

and regulations, a high level of harmonization in regulatory frameworks and convergence in supervisory practices have been achieved.[64] Alberta, British Columbia, Ontario and Quebec supervise about 95 percent of the capital markets.[65] The provincial nature of securities regulation was confirmed in the recent Supreme Court's decision of in *Re Reference*.[66] In this same case, however, the SCC also recognized the federal government's jurisdiction on matters of genuine national importance and scope going to trade as a whole in a way that is distinct from provincial concerns, including management of systemic risk and national data collection.[67]

At the federal level, the responsibility for financial oversight is shared among a number of federal agencies, including:

1. The Minister of Finance (MoF) is responsible for the sound stewardship of the financial system. Under s. 15 of the *Financial Administration Act (FAA)*, the MoF is charged with supervision, control and direction of all matters relating to the financial affairs of Canada not by law assigned to the Treasury Board or to any other minister.[68] The Department of Finance (DoP) is the operational arm through which the MoF fulfills its financial stability mandate.[69] In addition to its overarching authority over financial sector legislation and policy, the MoF has broad powers to provide financial support during the times of crisis
2. The Bank of Canada (BoC) is the ultimate source of liquidity for the financial system. It oversees the payment, clearing and settlement systems and conducts ongoing research into the stability and efficiency of the financial system.[70] The BoC's focus is on the financial system as a whole and parallels the Bank's approach to monetary policy, which focuses on the entire economy.[71]
3. The Office of the Superintendent of Financial Institutions (OSFI) is an independent and self-financing government agency which exercises prudential regulation and supervision of banks and federally incorporated or registered trust and loan companies, insurance companies, cooperative credit associations, fraternal benefit societies and private pension plans.[72] Since 2012, OSFI also conducts periodic examinations of the commercial operations of the CMHC.[73]
4. The Canada Deposit Insurance Corporation (CDIC) is the federal deposit insurer and the resolution authority for the federally regulated deposit takers.[74]

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[64] Harmonisation has been facilitated by the Canadian Securities Administrators ("CSA"), the umbrella organization for provincial and territorial securities regulators which seeks to improve, coordinate and harmonise regulation of capital markets in Canada. See, CSA, "Who We Are" (accessed on 23 July 2015) online: https://www.securities-administrators.ca/aboutcsa.aspx?id=77.
[65] IMF, *FSAP Securities*, *supra* note 59 at 8.
[66] *Re Reference Securities Act*, 2011 SCC 66.
[67] *Ibid* at 3.
[68] *Financial Administration Act*, R.S.C., 1985, c. F-11 [*FAA*].
[69] *Ibid*., s. 14.
[70] BoC, "Regulation of the Canadian Financial System" (April 2012) online: http://www.bankofcanada.ca/wp-content/uploads/2010/11/regulation_canadian_financial.pdf.

[71] *Ibid*.
[72] OSFI, "About Us" (April 2015) online: http://www.osfi-bsif.gc.ca/Eng/osfi-bsif/Pages/default.aspx.
[73] IMF, *FSAP*, *supra* note 51 at 14.
[74] CDIC, "What CDIC Does" (Accessed on 21 July 2015) online: http://www.cdic.ca/CDIC/WhatCDICDoes/Pages/default.aspx; Michele Bourque, "CDIC's New Role As Canada's Resolution Authority" (Speech delivered at CD Howe Institute, June 9, 2014) at 4, online: http://www.cdic.ca/CDIC/Media/Documents/Speech_MBourque_CDHowe_jun2014.pdf.

5. The Financial Consumer Agency of Canada (FCAC) is responsible for protecting and informing consumers of financial products and services. It oversees payment card networks operators, expands financial literacy and enforces consumer related legislation.[75]

The role of OSFI deserves particular attention here given that it bears the primary responsibility for the supervision of the banking system. OSFI's approach to supervision is aligned with international standards, particularly the Basel Core Principles of Supervision, which serves as a basic reference for the banking supervisors around the world. [76] OSFI takes a risk-based approach to supervision that involves close monitoring of material risks faced by banks. The intensity of the supervisory work depends on the size, complexity, and the overall risk profile of an institution.[77] OSFI is also a principles-based regulator, meaning that it places significant reliance on sound judgment allocating its supervisory resources and identifying and addressing risks.[78] Accountability of the board and senior management is a tenet of OSFI's supervision. OSFI officials regularly meet with the board of directors of bank and expect them to be fully engaged in establishing a sound risk management culture and be proactive in disclosing areas of concern to OSFI.[79] OSFI's risk assessments pay significant attention to the Overall Net Risk of a bank, namely the adverse impact of the bank's activities on its earnings and capital position.[80] The Overall Net Risk can be rated as *low*, *medium* and *high*, and the direction in which it moves as *decreasing*, *stable*, or *increasing*. If a bank is found to be vulnerable to adverse economic or business conditions, it will be subject to more intense supervision followed by appropriate corrective actions, commensurate with the risks posed to financial stability.[81] In March 2013, OSFI designated Canada's six largest banks, Royal Bank of Canada, Toronto Dominion, Bank of Nova Scotia, CIBC, Bank of Montreal, National Bank of Canada holding, as Domestic Systemically Important Banks (D-SIB).[82] These banks are subject to continued intense supervision and have to comply with stricter capital and disclosure requirements.[83] As discussed further below, the CDIC has been named as the resolution authority for the D-SIB and recovery and resolution planning has been underway for them.

While the federal organizations named above each have a distinct legal mandate, they seek to achieve cooperation and coordination through a number of forums, including the Financial Institutions Supervisory Committee (FISC), Senior Advisory Committee (SAC), and the Heads of Agencies Committee (HOA).[84] The FISC is the primary forum through which the Department of Finance Canada, OSFI, CDIC, and the Bank of Canada exchange and discuss information on banks and coordinate intervention with respect to troubled banks. The FISC's meetings are chaired by OSFI and held quarterly.[85] The SAC is a forum for deliberation on

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[75] FCAC, "Our Mandate" (May 2014) online: http://www.fcac-acfc.gc.ca/Eng/about/Pages/OurManda-Notreman.aspx.
[76] OSFI, "Supervisory Framework", *supra* note 62 at 1; BCBS, "Core Principles for Effective Banking Supervision" (2012) online: BIS http://www.bis.org/publ/bcbs230.htm.
[77] OSFI, "Supervisory Framework", *supra* note 62 at 3-4.
[78] *Ibid* at 2.
[79] *Ibid*.
[80] *Ibid* at 5.
[81] *Ibid* at 5-6.
[82] OSFI, "The OSFI Pillar" (Spring 2013) at 1, online: http://www.osfi-bsif.gc.ca/Eng/Docs/op_2013_sp.pdf.
[83] OSFI, *Annual Report 2013-2014*, at 10, online: http://www.osfi-bsif.gc.ca/eng/docs/ar-ra/1314/eng/ar1314.pdf.
[84] *Report of the Auditor General of Canada to the House of Commons* (2010) at para 5.12
[85] *Ibid* at para 5.16.

financial policy issues such as proposals for legislative changes, the financial stability framework and the regulatory framework. The SAC's membership is the same as FISC but it is chaired by the Deputy Minister of Finance. The meetings are held three to four times a year.[86] HOA is serves as an informal forum for policy coordination among the securities regulators and the federal agencies. It includes chairs of the four largest securities commissions in Canada, namely Alberta, British Columbia, Ontario and Quebec, the BoC Governor, the Superintendent of Financial Institutions, and senior officials from the DOF.[87] Currently, the HOA's work has been focused on implementing G20 commitments, particularly with respect to systemic risk. OTC derivatives, shadow banking, hedge funds and most recently financial benchmarks are among themes being considered.[88]

Finally, before ending this short overview, it is worth noting a unique feature of the Canadian regulatory regime: it lapses every five years. This statutory sunset provision results in the periodic review of the financial sector legislation by the federal government to ensure that it is current and up to date with the fast-pace changes in the financial markets. For example, the most recent review was completed in 2012 under the *Financial System Review Act*, which made important amendments to OSFIs' authority for exchange information and the CDIC's exercise of resolution powers.[89]

2. Early Intervention Regime

Canada enjoys an excellent track record for its early intervention mechanism.[90] Under s. 4(2)(b) of the *Office of the Superintendent of Financial Institutions Act*,[91] OSFI has a legal mandate to promptly advise the management and board of directors of a financial institution if it is not in sound financial condition or is not complying with the governing laws or supervisory requirements.[92] In such a case, OSFI should require the management or board to take necessary corrective measures to deal with the situation in an urgent manner.[93] In addition to OSFI, the bank intervention regime involves another key actor, CDIC, which performs the dual role of deposit insurance as well as the resolution authority for member institutions. In order to enable early identification of potential problems and effective intervention, OSFI and CDIC have developed the Guide to Intervention for Federally Regulated Deposit-Taking Institutions. The Guide summarizes the circumstances under which intervention measures may be expected and the coordination mechanisms that take place between OSFI and the CDIC with respect to an institution.[94] Coordination between OSFI and CDIC is also underpinned by the Strategic

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[86] *Ibid* at para 5.17.
[87] IMF, *FSAP Securities*, *supra* note 59 at 41.
[88] *Ibid* at 42.
[89] *Financial System Review Act* S.C. 2012, c. 5; See also Mark Mahabir & Adriane Yong "Legislative Summary of Bill S-5: An Act to Amend The Law Governing Financial Institutions And To Provide For Related And Consequential Matters" (12 December 2011) online: Parliament of Canada http://www.parl.gc.ca/About/Parliament/LegislativeSummaries/bills_ls.asp?ls=s5&Parl=41&Ses=1.
[90] For a more detailed discussion of early intervention in Canada, see Sarra, "Retooling Resolution", supra *note* 3 at 23-27.
[91] *Office of the Superintendent of Financial Institutions Act, R*.S.C., 1985, c. 18 (3rd Supp.) [*OSFIA*].

[92] *Ibid*, s. 4 (2)(b).
[93] *Ibid*.
[94] OSFI, "Guide to Intervention for Federally Regulated Deposit-Taking Institutions" (2014) online: http://www.osfi-bsif.gc.ca/eng/fi-if/rai-eri/sp-ps/Pages/gid.aspx [OSFI, "Guide to Intervention"].

Alliance Agreement that applies to CDIC's federal member institutions.[95] The Agreement promotes consultation and information sharing between the two agencies so that they can both perform their mandates efficiently.[96] It addresses an array of issues ranging from cancellation of insurance and license, and development of policies and guidelines, to intervention and winding up processes.[97]

The Intervention regime operates on a ladder basis, entailing four key stages: early warning (stage 1); risk to financial viability or solvency (stage 2); future financial viability in serious doubt (stage 3); non-viability/ insolvency imminent (stage 4).[98] Depending on the gravity of situation, OSFI can takes measures commensurate with the risks involved, including:

- Warning the management or the board about the identified deficiencies;
- Entering into a prudential agreement with the institution to improve its safety and soundness;
- Imposing business restrictions;
- Requiring the firm to increase regulatory capital;
- Requiring the firm to incorporate specific remedial measures into its business plan;
- Directing external professionals to assess the firm's business and risk taking; and
- Taking control of the institution's assets or assets under its management.[99]

As at March 31, 2014, there were 35 staged institutions, most of which, with few exceptions, are in the early warning category.[100] While OSFI has vast powers, the agency rarely resorts to formal enforcement. This is not to say that OSFI is a *light-touch* regulator but that its close and intense supervision often triggers voluntary self-corrective action at the troubled institution.[101]

As alluded to above, the primary responsibility for regulating and supervising federal deposit-taking institutions rests with OSFI. Thus, there is normally no interaction between CDIC and federal member institutions in the normal course of business as CDIC generally works through OSFI to address any concerns it may have about an institution.[102] However, as the gravity of the situation escalates, a gradual shift in action from OSFI to CDIC can be observed. In other words, as a firm becomes more likely to fail and the resolution measures appear

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[95] OSFI, "Supervisory Framework" (December 2010) online: http://www.osfi-bsif.gc.ca/eng/fi-if/rai-eri/sp-ps/pages/sff.aspx#fnb4.

[96] International Deposit Insurance Survey- Canada Deposit Insurance Corporation" (20 January 2003) at 11-12, online: http://www.iadi.org/surveys/completed/full/cdic.pdf.

[97] *Ibid*.

[98] OSFI, "Guide to Intervention", *supra* note 94.

[99] *Ibid*.

[100] OSFI, *Annual Report 2013-2014* (2015) at 14, online: http://www.osfi-bsif.gc.ca/eng/docs/ar-ra/1314/eng/ar1314.pdf.

[101] See, e.g., "Remarks by Deputy Superintendent Andrew Kriegler to the National Bank Financial 12th Annual Canadian Financial Services Conference", Montreal, Quebec, March 25, 2014 http://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/sp-ds/Pages/ak20140325.aspx. Kriegler draws a subtle distinction between the *inside rules*, neamley guidelines on how institutions should govern and manage themselves, and *outside rules*, formal standards to which institutions are held. He argues that effective supervision requires significant reliance on the inside rules than strict compliance with regulatory requirements such as capital and liquidity ratios. He also notes that OSFI rarely uses its enforcement toolkit and has no plans for its extension.

[102] OSFI, "Guide to Intervention", *supra* note 94.

necessary, CDIC becomes more involved in the intervention process.[103] So, at stage 3, for example, CDIC is authorized to acquire assets from the institution and make or guarantee loans, and at stage 4 it can cancel the institution's deposit insurance policy and initiate the winding up process.[104] Finally, with the gravity of the situation escalating, the frequency of the FISC meetings also intensifies to coordinate contingency planning and resolution measures.[105]

3. Lender of Last Resort and Emergency Use of Public Funds

In common with central banks around the world, an important function of the Bank of Canada (BOC) is to act as the lender of last resort. S. 18(h) of the *Bank of Canada Act*[106] authorizes the BOC to make loans or advances to financial institutions if three conditions are met. First, the loan or advance must not exceed six months. Second, the financial institution that receives assistance must be a member of the Canadian Payment Association. Third, the loan or advance must be collateralized by a security interest in the property that that the financial institution is authorized to hold.[107]

The BOC's lender of last resort function can take three distinct forms.[108] The first is the Standing Liquidity Facility (SLF) which facilitates the settlement of payments systems by routinely extending overnight credit to the participants in the Large Value Transfer System (LVTS). As such, the SLF covers the temporary end-of-day shortfalls in the settlement balances that can arise in the daily settlement of payments.[109] The Emergency Liquidity Assistance (ELA) is the second liquidity facility offered by the BOC. The ELA supports solvent financial institutions that require more substantial and prolonged credit.[110] This support can be particularly helpful for banks given that their assets are generally illiquid but their liabilities, particularly deposits, are redeemable at very short notice. The statutory conditions set out by s. 18(h), alluded to above, apply to both liquidity facilities (SLF and ELA). However, to be eligible for the ELA, the borrowing institution must also meet the additional requirements that have been set by the *Bank of Canada Lender-of-Last-Resort Policies*: [111]

- The institution is judged to be solvent by its prudential supervisor.
- The institution provides a business plan to its prudential supervisor outlining remedial measures to address its liquidity problems and to provide increased reporting on its evolving situation.[112]

In addition to the SLF and the ELA, in extreme conditions, when the Canadian financial system is under severe and unusual stress, the BOC is authorized under s. 18(g)(ii) to provide liquidity through outright purchase of a wide variety of securities. S. 18(g)(ii) is particularly

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[103] *Ibid*.
[104] *Ibid*.
[105] *Ibid*; IMF, *FSAP: Resolution*, *supra* note 43 at 21.
[106] *Bank of Canada Act*, R.S.C., 1985, c. B-2 [*BCA*].
[107] *Ibid*, s.18(h).
[108] BOC, Bank of Canada, "Lender-of-Last-Resort Policies", *Financial System Review*, at 49.
[109] *Ibid*.
[110] *Ibid*.
[111] *Ibid* at 51-53.
[112] *Ibid*.

broad in scope as it allows the BOC to provide liquidity to any firm, irregardless of whether it is a financial or non-financial entity and whether it is Canadian or foreign. In order to take action under this provision, the BOC needs to publish a notice in the *Canadian Gazette* that the Governor [of the BOC] has formed an opinion that there is a severe and unusual stress on a financial market or the financial system.[113]

At the onset of the GFC, the BOC responded to liquidity distortions by using its traditional liquidity tools such as conducting overnight buyback operations of the Government of Canada securities.[114] As pressure on the funding markets increased, the Bank gradually expanded its liquidity framework in four areas: terms to maturity, amounts, counterparties, and eligible securities.[115] The most heavily used liquidity facilities, particularly in response to the ABCP market turmoil, were term purchase and resale agreements (PRA). In the fall of 2008, the Bank announced a currency swap arrangement with the Federal Reserve to provide up to USD10 billion funding to domestic firms, though this facility was never relied upon in practice.[116] Throughout the turmoil, the SLF continued to be available to address any shortfalls of settlement balances. As well, the Bank stood ready to offer ELA to solvent banks facing serious and persistent liquidity problems.[117] However, despite this readiness, no banks made use of the ELA facility during the recent crisis.[118]

In addition to the lender of last resort operations by the BoC, recent legislative reforms allow the Minister of Finance (MoF) to support the financial system by providing credit to the financial system or acquiring securities in financial institutions. Specifically, s. 60.2 of the *FAA* allows the MoF to enter into any contracts that are necessary in the view of the Minister in order to promote the stability or maintain the efficiency of the financial system in Canada.[119] The broad scope of such contracts include:

- Acquiring, lending, selling or otherwise disposing of securities of an entity;
- Creating a charge, right, or interest in securities of an entity;
- Making a loan to an entity;
- Providing a line of credit to an entity;
- Guaranteeing any debt, obligation or asset of an entity; and
- Providing loan insurance or credit insurance for the benefit of an entity.[120]

There are also provisions in other legislation which allow the federal government, the MOF as well as other government agencies, to acquire securities in the federally regulated financial

[113] *BCA*, s. 19.
[114] Lorie Zorn et al., Bank of Canada Liquidity Actions in Response to the Financial Market Turmoil, (Autumn 2009) *Bank of Canada Review* at 5.
[115] *Ibid* at 6-7.
[116] *Ibid* at 7-8.
[117] *Ibid* at 5.
[118] IMF, *FSAP: Resolution*, *supra* note 43 at 26.
[119] *FAC*, s. 60.2
[120] *Ibid*.

intuitions namely, banks,[121] cooperative credit associations,[122] insurance companies,[123] and trust and loans companies.[124]

To mitigate the impact of the recent crisis on credit conditions in Canada, the federal government introduced a series of measures called the Extraordinary Financing Framework (EEF), which were announced in the federal budget of 2009.[125] The EEF measures included: the Insured Mortgage Purchase Program; a new 10-year maturity in the ongoing Canada Mortgage Bond program; the Canadian Secured Credit Facility; Small Business Financing Program; and assurance facilities for banks and insurance companies.[126] The EEF was particularly intended to supplement the BOC's short-term liquidity provision with longer-term credit for the financial system.

The most important component of the framework was the Insured Mortgage Purchase Program (IMPP) which was launched in the latter part of 2008. The program authorized Canada Mortgage and Housing Corporation (CMHC), on behalf of the Government of Canada, to purchase up to CAD125 billion in National Housing Act Mortgage-Backed Securities (NHA MBS) from Canadian financial institutions.[127] The IMPP provided funding to eligible financial institutions so that they could continue providing credit to consumers, home buyers, and businesses. The window for the purchases under the program came to an end in March 2010. The CMHC had by then purchased CAD69 billion worth of NHA MBS.[128] On 15 March 2015, the final IMPP securities matured resulting in the successful completion of this program.[129] It was estimated that by the time the final maturity occurred the program had generated CAD2.5 billion in net revenues.[130]

Prior to leaving this discussion, I would like to note that the CDIC has also the power to use public funds to support distressed banks. However, since this power is meant to be utilized as a resolution tool, I will discuss in the next section.

4. The Resolution Process

CDIC is the resolution authority in Canada. Its jurisdiction extends to the six largest banks designated as D-SIB as well as other federal member deposit-taking institutions.[131] With the approval of the Governor in Council, CDIC can also enter into agreement with provincial

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[121] *Bank Act*, S.C. 1991, c. 46, s. 973.2.
[122] *Cooperative Credit Associations Act*, S.C. 1991, c. 48, s. 459.9(14).
[123] *Insurance Companies Act* , S.C. 1991, c. 47, s.1016.7(15)
[124] Trust and Loan Companies Act, S.C. 1991, c. 45, s. 527.9(15).
[125] Department of Finance, "Improving Access to Financing and Strengthening Canada's Financial System" (January 2011) http://www.fin.gc.ca/pub/report-rapport/2011-7/ceap-paec-2f-eng.asp.
[126] *Canada's Economic Action Plan: Budget 2009* (January 27, 2009), at 78-84, online: http://www.budget.gc.ca/2009/pdf/budget-planbugetaire-eng.pdf.
[127] *Ibid* at 79.
[128] CMHC, "CMHC Securitization Activities" (November 2014) online: CMHC http://www.cmhc-schl.gc.ca/en/corp/nero/jufa/jufa_001.cfm.
[129] CMHC, *Quarterly Financial Report-First Quarter* (March 31, 2015) at 6, online: http://cmhc.ca/en/corp/about/core/core_001.cfm.
[130] CMHC, "CMHC Securitization Activities", *supra* note 128.
[131] CDIC, "List of CDIC Members" (accessed on 31 August 2015) online: http://www.cdic.ca/Pages/Members.aspx.

authorities to restructure a provincially regulated financial institution.[132] The general obligations of the CDIC as a crown corporation can be found in the *Financial Administration Act* but the Corporation is mainly governed by the *CDICA*.[133] CDIC publishes annual reports, quarterly financial statements, and is accountable to the Parliament.[134]

CDIC has a number of internal departments, including the Information and Methodology Department (IMD) and the Risk Assessment Department (RAD), which collect and review information from member institutions, and monitor and analyse risks posed by them.[135] Higher-risk CDIC members undergo more rigorous monitoring by the RAD which undertakes appropriate intervention measures as required including requests for additional data or special examinations.[136]

In 2011, the CDIC established the Complex Resolution Division (CRD)~~,~~ to ensure that it has the operational capacity to plan, prepare, and effectively implement resolution of large complex financial institutions.[137] As part of its mandate, the CRD develops and maintains resolution plans for D-SIBs. These resolution plans serve as a guide to the use of CDIC's resolution powers in the event that a D-SIB's own recovery measures are not feasible or have proven ineffective.[138] Resolution planning is considered as an evolving process that needs to be integrated alongside the supervisory priorities of other federal safety net agencies, such as OSFI, MoF, and BOC. Important features of resolution planning include: coordination of communication, funding and capacity enhancements, and developing appropriate resolution strategies based on powers and tools available to CDIC.[139] The *Canada Deposit Insurance Corporation Deposit Insurance Policy By-law*,[140] which has been amended in 2014, allows CRD, and more generally CDIC, to request information and analysis that they need to develop resolution plans, including:

- Profiles and analyses of insured and uninsured deposits;
- A detailed list of assets, liabilities, derivatives, as well as on and off-balance sheet assets;
- A current list of each subsidiary, affiliate, and group entity of the member institution, identifying its jurisdiction of incorporation, and describing the businesses it is licensed to carry on;
- The legal corporate structure of the member institution, including information about the ownership of each subsidiary, affiliate, or group entity;
- Detailed information about the legal and regulatory framework applicable to the member institution and the group entities;

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[132] Such agreement can only be entered into with the approval of the Governor in Council. *CDICA*, s.39.38.
[133] *FAA*, Schedule III (Section 2); *CDICA*.
[134] CDIC, "Financial Reports" (accessed on 31 August 2015) online: http://www.cdic.ca/CDIC/FinRpts/Pages/default.aspx.
[135] CDIC, "Overview of CDIC Divisions and Departments" (accessed on 3 August 2015) online: http://www.cdic.ca/CDIC/Management/DeptOverview/Pages/default.aspx.
[136] *Ibid*.
[137] CDIC, *Summary of the Corporate Plan 2013/2014 to 2016/2017*, at 7, online: http://www.cdic.ca/CDIC/FinRpts/Documents/CorpPlan/summaryCorporatePlan12-13_16-17.pdf.
[138] CDIC, "Overview of CDIC Divisions and Departments", *supra* note 135.
[139] *Ibid*; CDIC, *Summary of the Corporate Plan 2013/2014 to 2016/2017*, *supra* note 137 at 14.
[140] *Canada Deposit Insurance Corporation Deposit Insurance Policy By-law*, SOR/93-516, online: http://laws-lois.justice.gc.ca/eng/regulations/SOR-93-516/FullText.html.

- The financial connections between the member institution and its subsidiaries; affiliates, and group entities, particularly, including intra-group exposures, guarantees, cross-group funding arrangements, cross-default clauses, liquidity and capital support;
- Detailed information about the payment, clearing, and settlement systems that support the operation of the institution and other entities in the group;
- The business continuity or crisis management plans of the member institution and group entities together with related communication and employee retention plans;
- Any other reports, documents, or information pertaining to the affairs of the member institution and group entities that relate to the resolution plan of the member institution.[141]

Another focus area of the CRD is coordination of crisis management activities with international resolution counterparts and liaison with important domestic resolution entities that may be impacted in resolution activities.[142] CRD works alongside other federal authorities to ensure that compatible methods and plans are in place to coordinate the resolution of member institutions with cross-border operations.[143] CDIC officials are represented on the *FSB Crisis Management Working Group* and have been involved in discussions on cross-border resolution issues. CDIC relies primarily on non-institution specific Memorandum of Understanding (MoU) to foster cooperation with other resolution counterparts.[144] There has been so far only one MoU with the US Federal Deposit Insurance Corporation (FDIC),[145] though work is underway to enter into other MoU with other jurisdictions where Canadian firms have significant presence, particularly the United Kingdom.[146]

The current MoU between CDIC and FDIC is basically a statement of intent to consult, cooperate, and exchange information on crisis management, contingency planning, and recovery and resolution planning for firms in the US and Canada.[147] The MoU is primarily concerned with exchange of information, with provisions emphasizing a strong commitment to confidentiality and operating within the boundaries of law and regulations of respective jurisdictions.[148] Information that can be exchanged range from approaches to recovery and resolution planning, resolution rules and practices, to financial conditions of cross-border firms.[149] There is also the possibility of submitting requests for assistance. Such requests should be normally made in writing, specifying the information sought, the purpose for the request, and the desired time period for reply.[150] In emergency situations, however, requests can be made in any form, as long as that written confirmation is provided subsequently. The authority receiving the request will strive to provide information as quickly as possible.[151]

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[141] *Ibid*, ss. 15, 16, 16.1.
[142] *Ibid*.
[143] CDIC, *Summary of the Corporate Plan 2013/2014 to 2016/2017, supra* note 137 at 14.
[144] *Ibid* at 14-15.
[145] *Memoranda of Understanding Concerning the Resolution of Insured Depository Institutions and Certain Other Financial Companies with Cross-border Operations in the United States and Canada* (11 June 2013) online: https://www.fdic.gov/news/news/press/2013/pr13051.html. [hereinafter, CDIC & FDIC MoU]
[146] Author's written communication with the CDIC officials. On file with the author.
[147] CDIC & FDIC MoU, Art. 1.
[148] *Ibid*, Arts 4 & 6.
[149] *Ibid*, Art 4.
[150] *Ibid*, Art 5.
[151] *Ibid.*

The bank resolution process in Canada launches when OSFI determines that a bank has ceased, or is about to cease, to be viable. Such determination is made when a bank experiences significant financial difficulties and can no longer meet its regulatory capital requirements. Moreover, it has failed to implement an acceptable business plan to take remedial actions and OSFI can no longer restore the bank's viability through exercising its legislative powers. Under s. 39.1 of the *CDICA*, OSFI can take into account all the relevant circumstances in forming an opinion about whether the bank is non-viable. The Superintendent, however, should pay particular attention to the following questions:

- Is the institution is excessively dependent on loans, advances, guarantees, or other forms of financial assistance to sustain its operations?
- Has the institution lost confidence of depositors and the public?
- Is the bank's capital buffers about to become substantially deficient?
- Has the bank failed or is about to fail to pay any liability that has or will become due and payable?[152]

The non-viability determination allows OSFI to take temporary control of the assets of the bank as well as assets under the bank's management. The statutory conditions for taking control have been set out in s. 648(1.1) of the *Bank Act*. As long as any of the following conditions are met, OSFI is authorized to take control:

- The bank has failed or is unable to meet its liabilities as they become due;
- The assets of the banks are not sufficient to protect the claims of depositors and creditors;
- The assets on the bank's books or records are not satisfactorily accounted for;
- The regulatory capital of the bank has reached a level or is deteriorating in a manner that may detrimentally affect the bank's depositors or creditors;
- The bank has failed to comply with a Superintendent's order;
- The bank's deposit insurance has been terminated by the CDIC;
- Any other state of affairs that in the Superintendent's opinion may be materially prejudicial to the interests of the bank's depositors or creditors or the owners of any assets under the bank's administration.[153]

The Superintendent provides the bank with a reasonable opportunity to make representation and then informs CDIC of its opinion in writing.[154] Following the receipt of the Superintendent's report that the bank is non-viable, CDIC activates the Financial Institution Restructuring Provisions (FIRP) of the *CDICA*. The activation process involves an order from the Governor in Council, on MoF's recommendation, to vest shares and subordinated debt of a member institution in CDIC.[155] The vesting order extinguishes all other adverse claims in the shares and subordinated assets of the bank except those held by secured creditors.[156] The Governor in Council can also issue an order to appoint the CDIC as the receiver, thereby allowing it to carry out necessary transactions for restructuring the bank's business.[157] The receivership order suspends all powers, duties, functions, rights, and privileges of the directors

[152] *CDICA*, s. 39.1(2).
[153] *Bank* Act, s. 648(1.1).
[154] *CDICA*, s.39.1(3); OSFI, "Guide to Intervention", *supra* note 94.
[155] *Ibid*, ss. 39.12 & 39.13.
[156] *Ibid*, s.39.13.
[157] OSFI, "Guide to Intervention", *supra* note 94.

and managers of the institution.[158] Furthermore, the order stays any civil proceedings against the institution before a judicial, quasi-judicial or arbitration body.[159] There is no automatic stay of eligible financial contracts, such as derivatives. Counterparties of such contracts can therefore continue to exercise their rights in respect of termination, netting, set off, and collateral.[160] However, CDIC, as the receiver, can assign all eligible financial contracts to a third party or to a bridge bank and such assignment effectively stays early terminations rights of counterparties.[161]

CIDC's resolution toolkit is vast and far-reaching. By activating the FRIP provisions, CDIC can undertake restructuring transactions, including: disposal of the bank's shares and subordinated assets; amalgamation with another institution; and the sale of all or part of the bank's assets and liabilities.[162] If CDIC cannot find a buyer for the bank, an order can be made by the Governor in Council, upon MoF's recommendation, to incorporate a bridge bank to preserve the critical functions of the failing bank.[163] CDIC would then transfer the insured deposits, other key liabilities, and most assets into the CDIC-owned bridge bank until a buyer can be found.[164] The assets not acquired by bridge bank, normally shares and subordinated debts, would be placed into liquidation.[165] The bridge bank will be dissolved when all, or substantially all, assets of the failing bank are disposed and all, or substantially all, of the failing bank's liabilities are assumed or discharged.[166] If the closure of failing bank is not desirable but resolution tools such as forced sale or bridge bank cannot be used, CDIC can keep the bank open by providing financial assistance in the form of deposits, loans, advances, and guarantees.[167] Finally, if the CDIC is of the opinion that the bank is or about to become insolvent, it can apply for a winding up order under the *Winding-up and Restructuring Act*, unless the MoF advises the Corporation that it is not in the public interest to do so.[168] The CDIC would return the insured depositor's money and liquidate the bank's estate under a court-supervised winding-up process.[169]

5. The Proposed Bail-in Regime

In order to further strengthen the regulatory regime for the Canadian systemically important banks, the federal government has proposed a new bail-in regime.[170] The Taxpayer Protection and Bank Recapitalization Regime is consistent with the *bail-in powers* recommended by the Key Attributes and allows for the expedient conversion of certain bank liabilities into common regulatory capital when a D-SIB becomes non-viable.[171] The proposal has not yet passed into law and therefore remains to be seen how it will be integrated into the CDIC's

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[158] *CDICA*, s. 39.14.
[159] *Ibid*, s. 39.15 (1)
[160] *Ibid*, s. 39.15 (7).
[161] *Ibid*, s. 39.15 (7.1).
[162] *Ibid*, s.10.
[163] *Ibid*, s.39.1330.
[164] Bourque, *supra* note 74 at 5.
[165] *CDICA*, s. 39.3717.
[166] *Ibid*, s. 39.3715.
[167] *Ibid*, s.10.
[168] OSFI, "Guide to Intervention", *supra* note 95.
[169] Bourque, *supra* note 74 at 7; IMF, *FSAP: Resolution*, *supra* note 43 at 30.
[170] Department of Finance, "Taxpayer Protection and Bank Recapitalization Regime: Consultation Paper" (August 2014) online: Department of Finance Canada http://www.fin.gc.ca/n14/14-099-eng.asp. [hereinafter, "Bail-in Consultation Paper"]
[171] *Key Attributes*, *supra* note 4 at 9.

existing resolution toolkit. As the title suggests, the driving policy objective is to preserve financial stability while minimizing taxpayers' exposure to loss.[172] The authorities can only exercise the conversion power when two preconditions are met: 1) In OSFI's judgment, the bank has become non-viable; and 2) the bank's Non-Viability Contingent Capital (NVCC) instruments have been fully converted.[173] NVCC refers to non-common capital instruments that include contractual provisions for automatic conversion into common shares upon OSFI's determination of non-viability.[174] The new bail-in regime is therefore similar to NVCC with the main differences being that it comes in after depletion of NVCC cushion and that CDIC maintains discretion on whether to exercise it. It also needs to be remembered that the new proposal only applies to D-SIBs. Banks that are not designated as systemically important are, therefore, excluded from the bail-in regime. Once the conversion is triggered, it only targets long-term senior debt, or more technically, unsecured debt that is tradable and transferrable with an original term to maturity over 400 days.[175]

The proposal also provides for conversion of long-term senior debt on a pro-rata basis, which would allow creditors would have the same portion of (up to 100 percent) of the par value of their claims converted to common shares.[176] The conversion formula will be market driven and tied to factors such as the market value of the bank's shares at or right before the time the conversion is triggered.[177] It would also respect the hierarchy of claims in a relative way. Thus, long-term senior debt holders will receive common shares at better terms than those offered to the NVCC subordinated debt holders.[178]Finally, conversion will be subject to the no-creditor worse off principle unless the governing contractual terms provide otherwise.[179] Public consultation on the proposal was ended in September 2014 and the government expressed its intention in April 2015 to introduce the legislative amendments.[180]

IV. THE ROCKY ROAD TO ORDERLY RESOLUTION OF CROSS-BORDER BANKS

There can be no doubt that the bank resolution regimes are undergoing important improvements due to international reforms initiated after the crisis. This progress is particularly noteworthy on two interrelated fronts: recognizing that banks are unique entities given their crucial role in the payment system and credit intermediation as well as the systemic risk they can pose to the wider economy; and, equipping the regulators with the necessary powers and tools to resolve banks. During the recent crisis, many national authorities did not have the necessary legal

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[172] "Bail-in Consultation Paper", *supra* note 170 at 3.
[173] *Ibid* at 6.
[174] OSFI, *Capital Adequacy Requirements (CAR)* (December 2014) at para 43, online: http://www.osfi-bsif.gc.ca/eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/CAR_chpt2.aspx#ToC22NonViabilityContingentCapitalRequirementsNVCC.
[175] Bail-in Consultation Paper", *supra* note 170 at 6.
[176] *Ibid* at 7.
[177] *Ibid* at 8.
[178] *Ibid*.
[179] *Ibid* at 7.
[180] *Economic Action Plan 2015* (April 2015) at 253, online: Government of Canada: http://actionplan.gc.ca/sites/eap/files/budget2015-eng.pdf.

tools to deal with the failure of domestic or international banks. As a result, they often had to rely on general corporate insolvency regimes that required slow, court-based proceedings and in some cases the consent of shareholders and creditors. For example, in 2008, the Belgian government sold a substantial interest in the failing Fortis Bank Belgium, a member of the larger Dutch/Belgian financial conglomerate, Fortis, to the BNP Paribas. The Brussels Court of Appeal, however, suspended the sale on the ground that the sale had to be submitted for approval by the general assembly in order for it to be valid under the Belgian law.[181]

Another key example of the inadequacy of pre-crisis resolution powers was financial contracts and particularly derivatives. In most jurisdictions the initiation of the formal insolvency or resolution process could trigger the simultaneous closing out of large volumes of derivative contracts. The exercise of such contractual rights, often under the ISDA Master Agreements, could destabilize the financial markets and undermine the orderly resolution of financial institutions.[182] However, the recent reforms, assuming they are implemented, authorize the resolution authorities to temporarily stay the operation of early termination clauses in order to complete transfer of derivatives to a bridge institution or another solvent entity. Important progress has also been achieved in regard to recovery and resolution plans. These plans can be particularly helpful in establishing a broad picture of the distributions of a bank's cross-border distribution of assets and liabilities, including an understanding of where the liquid assets are located and how the subsidiaries, branches and affiliates are connected to one another through, *inter alia*, intra-group guarantees. The banks' management and the resolution authorities can, therefore, achieve a common understanding of the implications of a bank's failure for each entity that is part of the larger group.

In spite of the progresses made, however, the resolution of large and complex banks that operate across borders remains a daunting challenge. Indeed, Marvin King's observation that global banks are global in operation but national in death still has resonance seven years after the GFC.[183] Global banks are massive in size and operate through a complex web of entities which are legally separate but financially and operationally interdependent. A recent report by the Federal Reserve, for instance, indicates that the seven largest banks in the United States have more than 19,600 subsidiaries around the world and hold assets exceeding USD14.3 trillion.[184] This complex organization often serves various purposes, including; compliance with regulatory burdens, limiting taxation, and securing or limiting the claims of various stakeholders on the firm in the case of bankruptcy.[185] When such large complex banks fails, significant instability and uncertainty arises. National authorities are then confronted with very hard choices and have to act based on misaligned and or possibly conflicting national interests. Since their legal mandates hold them accountable to their domestic constituencies, it is likely that national authorities have

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[181] BCBS, *Report and Recommendations of the Cross-border Bank Resolution Group* (March 2010) at 10-11.
[182] *Ibid* at 40-41.
[183] Dirk Schoenmaker, *Governance of International Banking: The Financial Trilemma* (Oxford University Press, 2013) at 2.
[184] Dafna Avraham, Patricia Selvaggi & James Vickery, "A Structural View of U.S. Bank Holding Companies" (July 2012) *FRBNY Economic Policy Review* 65 at 71.
[185] *Ibid* at 70,

to pursue crisis management and resolution measures which are unilateral as opposed to the cooperative solution recommended internationally.[186]

Although it is true that orderly resolution requires a comprehensive arsenal of powers and tools, toolkits on their own cannot enable orderly resolution in a cross-border context. National jurisdictions have, to date, primarily relied on MoU to achieve cooperation. These agreements, however, clearly reflect weak incentives for cooperation given they are non-binding, and risk being abandoned in times of crisis. In fact, supervisory MoU on exchange of information existed at the outbreak of the GFC. Yet, they failed to facilitate cooperation as national authorities were reluctant to allow free and timely flow of information to their counterparts. Moreover, the MoU do not set out any specific resolution strategy and leave out important issues such as sharing the burden of providing public funds.

Burden sharing is particularly important as systemically-important operations of a bank cannot be maintained unless the firm has access to a source of liquidity to meet its liabilities as they fall due.[187] However, while a firm can be systemic to one jurisdiction, it may not be so to another. [188] Home and host countries therefore can have conflicting incentives and interests when it comes to providing the much needed liquidity to the firm. *Ex ante* agreements on sharing the burden for public support are rare.[189] The only example can be found in the Nordic-Baltic region where the economies of the countries are interwoven through the operation of a few large banks, such as Nordea, Swedbank.[190] Contagion effects of bank failures can be therefore large and spread swiftly through the region. As a result, the Nordic and Baltic authorities have chosen to share the costs of financial stability reflecting the joint exposure to externalities. The non-binding agreement that was entered into 2010 shares the costs of a possible bank failure among minsters of finance based on the importance of the bank to a particular country and the supervisory responsibility for the bank.[191] Beyond closely-knit countries in the Nordic Baltic region, however, *ex ante* sharing agreements have not proven feasible as national jurisdictions are reluctant to make commitments to such *ex ante* public funding schemes, even if they are non-binding.

Recent monitoring exercises by the FSB have also identified significant challenges and uncertainties regarding the implementation of resolution reforms.[192] As of November 2014, few jurisdictions have resolution regimes which are fully or almost fully in line with the Key Attributes.[193] Most jurisdictions have not even yet adopted resolution powers such as bail in and

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[186] IMF, "Cross-Border Bank Resolution: Recent Developments" (June 2014) at 5, online: http://www.imf.org/external/np/pp/eng/2014/060214.pdf [hereinafter, IMF, "Recent Developments on Cross-border Resolution"].

[187] BCBS, *supra* note 181 at 14.

[188] Veinna Initiative, "Observations on Bank Resolution Practices and the EU Proposal" (January 2013) at 5, online: IMF https://www.imf.org/external/np/sec/pr/2013/pdf/pr1316.pdf.

[189] IMF, "Recent Developments on Cross-border Resolution", *supra* note 186 at 17.

[190] Dirk Schoenmaker, "Burden Sharing: From Theory to Practice" (*DSF Policy Paper Series*, No.6. October 2010) at 11.

[191] *Ibid* at 11-12.

[192] FSB, *Towards full implementation of the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions— Report to the G20 on Progress in Reform Of Resolution Regimes and Resolution Planning for Global Systemically Important Financial Institutions (G-SIFIs)* (November 2014) online: http://www.financialstabilityboard.org/wp-content/uploads/Resolution-Progress-Report-to-G20.pdf.

[193] *Ibid* at 1.

the power to stay financial contracts, or mechanisms to recognize foreign resolution measure.[194] This last point is particularly important given that cross-border resolution of banks cannot work unless the resolution action taken in one jurisdiction is able to be recognized in other jurisdictions. However, adopting a statutory regime for cross-border recognition requires significant legislative changes in many jurisdictions. Consequently, the FSB has decided to pursue alternative contractual solutions which will most likely be in the form of bilateral MoU and subject to the shortcomings that I just discussed. The IMF has also recently noted that recovery and resolution planning for cross-border groups has proven challenging.[195] As previously explained, the Key Attributes require firm specific CMG to be in place for G-SIB so that preferred resolution strategies, such as Single Point of Entry (SPE), Multiple Points of Entry (MPE) or hybrid, are being discussed and made operational.[196] However, firm-specific cooperation agreements, which are currently at various stages of development, remain limited to procedural aspects of cooperation, such as exchange of cooperation and do not include any details on resolution strategies to be pursued.[197]

Finally, it needs to be noted that if capital buffers of a bank are not sufficient to absorb losses, the emergency use of public funds can still appear inevitable. Private funding is very hard to secure in times of crisis when a solution needs to be found in the shortest period of time. Furthermore, confidence in the banking sector, particularly distressed institutions, is at the lowest during crisis. As a result, national authorities may not be able to sell the failing bank unless they use public money to provide assurances or guarantees to a potential buyer. Banks bailouts, therefore, whether in explicit forms, such as direct capital injection, or implicit forms, such as guarantees, can prove to be the only feasible option to deal with bank failures.[198]

V. RETOOLING THE RESOLUTION REGIME IN CANADA

Canada enjoys an excellent reputation internationally for the resilience of its financial system and a sound regulatory regime. Recent international assessments confirm that financial institutions remain resilient to credit, liquidity and contagion risks from severe stress scenarios. While elevated housing prices and high levels of household debt have been concerning, targeted prudential and macroprudential measures have so far proved to be effective. Canadian banks are well capitalized, profitable and continue to report low non-performing loans. Canada has also made significant progress in improving its crisis management and resolution regime. Appointment of the CDIC as the resolution authority, establishment of an extensive resolution toolkit, and the proposed bail-in regime all suggest that Canada has been a forerunner in implementing global financial reforms.

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[194] *Ibid*.
[195] IMF, “Recent Developments on Cross-border Resolution”, *supra* note 186 at 9.
[196] *Key Attributes*, *supra* note 4 at 14-15.
[197] *Ibid* at 9.
[198] It needs to be noted that debtor in possession financing is not available under many legal regimes. Post insolvency creditors cannot therefore gain priority over the pre-insolvency creditors. As a result, they will be disinclined to provide the much-needed liquidity to the failing bank. For example, the PWC, the bankruptcy administrator of the UK subsidiary of Lehman Brothers, had to struggle to find money to maintain the most basic services such as the employee cafeteria. Richard Herring, “The Challenge of Resolving Cross-Border Financial Institutions” (2014) 31 Yale J. on Reg. 853 at 870.

While I certainly share praise for Canada's strong track record on banking regulation, I would like to comment on a number of areas that where concerns exist or improvements can be made. It is best to start by taking a moment to reflect on the historical evolution of the financial system in Canada. In the 1990s and earlier, this system was characterized by distinct financial institutions, including chartered banks, insurance companies, trust and loan companies, and securities intermediaries.[199] For example, chartered banks were mainly involved in extending commercial loans whereas trust and loan companies specialized in residential mortgage business. Gradually, however, the legislative changes removed the traditional barriers between the institutions and allowed them to engage in one another's business.[200] Over time, chartered banks emerged as the pillar of the Canadian financial system. As I noted earlier, the six largest banks, not only dominate the banking system but also have significant presence in other financial sectors. In addition to retail banking, the operations of these nation-wide conglomerates span across capital markets, including securities dealership and investment banking, as well as wealth management including retail brokerage and mutual fund products. In spite of the significant changes in the structure and business of the banks, however, the regulatory regime has substantially remained the same as it was two decades ago.

No authority is assigned with macro-prudential supervision or monitoring the systemic risk in the whole financial system. One may be tempted to think of BoC as the macro prudential regulator, given its broad oversight of financial system and economy. However, the BoC does not have a legal mandate to perform macro prudential regulation and is therefore unable to take any *direct* regulatory action to address systemic vulnerabilities or threats to the safety and soundness of the financial system.[201] The recently-proposed *Capital Markets Stability Act* may appear to have more potential given that it adopts effective detection, prevention and management of systemic risk to Canada's financial system as a core mandate;[202] however, the proposed *Capital Markets Regulatory Authority* embodies the traditional sectoral approach to systemic risk as well. Its function cannot be truly seen as macroprudential given that it only concerns itself with capital markets rather than the entire financial system.[203] In the absence of a legally-mandated macroprudential regulator, the Canadian authorities have to rely on informal channels of cooperation such as the FISC and HOA as discussed above. These informal forums are not however, properly institutionalized; they do not have any budget or staff and are not engaged, or even designed to engage, in monitoring systemic risk in a continuous and systemic manner. They just convene from time to time to allow regulators to learn from each other and deliberate policy issues with common implications. In sum, the current regulatory regime, which is highly-sectoral in nature, is not in line with the modern financial system in Canada where the traditional boundaries between institutions and markets have long disappeared. Canada needs a properly institutionalized and legally mandated macroprudential regulator that takes a holistic approach to systemic risk. Such a body should identify vulnerabilities across markets, institutions, and products and be able to take regulatory action when needed.

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[199] David Xiao Chen, et al., "Canadian Bank Balance-Sheet Management: Breakdown by Types of Canadian Financial Institutions" (Bank of Canada Discussion Paper 2012-7, September 2012) at 34-35.
[200] *Ibid*.
[201] *BCA*, s. 18.
[202] Department of Finance, *Capital Markets Stability Act — Draft for Consultation* (2014) at 7, online: http://www.fin.gc.ca/drleg-apl/2014/cmsa-lsmc-eng.asp.
[203] *Ibid*, Part II.

Another closely related area of concern relates to the nature and scope of the bank resolution regime in Canada. As I have said above, CDIC is the designated resolution authority for the six largest banks or D-SIB. This designation is consistent with the *CDICA* and the CDIC's expertise in dealing with failure of deposit taking institutions. However, a closer look at the CDIC's mandate and resolution toolkit suggests that the Corporation's jurisdiction does not apply to the entire banking group. In particular, the securities intermediaries of the D-SIB remain outside the crisis management and resolution powers of the CDIC and are hence subject to the court-based bankruptcy regime under the *Bankruptcy and Insolvency* Act (*BIA).* As a result, important powers and tools such as staying financial contracts, creating a bridge institution, overriding the rights of shareholders, and sale or transfer to assets and liabilities do not apply to securities dealers. The problem again seems to be the lack of a holistic approach to the systemic risk and the failure to appreciate the importance of cross-sectoral linkages between banking and securities. While the securities intermediaries appear as independent legal entities, they are to a great extent an integrated part of the bank group. From a governance perspective, the bank's board of directors and senior management sets the tone at the top.[204] Risk management and regulatory compliance are enterprise-wide and conducted on a consolidated basis. Similarly, it is the bank's board of directors and senior management that set the liquidity policies for the entire firm and funds can be borrowed and lent between the subsidiaries and branches.[205] This consolidated nature of governance and risk management of the bank groups in Canada has not yet made its way to the corresponding regulatory and resolution regime. The current situation can also give rise to coordination problems among multiple applicable resolution and insolvency regimes as no *lead* authority for resolution has yet been designated. Finally, the absence of a holistic approach to resolution does not sit well with CDIC's recent initiatives such as the establishment of the Complex Resolution Division which is exactly meant to prepare the Corporation for resolution of large and complex financial institutions.[206]

The last area that I need to address relates to specific characteristics of the resolution regime in Canada where further legislative and regulatory reforms are desirable. First is the cross-border coordination of cross-border resolution. Important steps have been taken to date to facilitate cooperation among Canadian authorities and their counterparts. Both CDIC and OSFI can share member specific information with their international counterparts, subject to confidentiality safeguards. Indeed, OSFI has entered into formal information sharing and supervisory cooperation arrangements with over 30 foreign supervisory authorities.[207] CDIC has also entered into MoU with other jurisdictions and is allowed to share certain information about its member institutions with international counterparts. Nevertheless, there is still no legislative or contractual framework for the recognition of foreign resolution measures. The establishment of such a framework will be consistent with the cross-border nature of banking in modern markets. It can contribute to orderly resolution by setting out the road map as well as procedures for recognition of resolution measures where mutual national interests for such recognition exist. Second, CDIC's resolution powers should be extended to the Canadian branches of foreign banks. When performing systemically important operations, the failure of foreign branches, can

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[204] See for example, *Royal Bank of Canada Annual Report 2014* (2015) at 49, online: http://www.rbc.com/investorrelations/annual-meeting-reports.html.
[205] *Ibid* at 72-79.
[206] CDIC, "Overview of CDIC Divisions and Departments", *supra* note 135.
[207] IMF, *FSAP: Resolution*, *supra* note 43 at 54.

cause systemic risk.[208] There is therefore no reason to leave the supervision of systemically-important foreign branches to their home authorities, excluding them from the Canadian resolution regime. Third, Canada still does not have a resolution fund. As a result, the authorities may have no choice but to use public funds to contain the contagion effects of bank failures. An industry-based resolution fund can remove or at least mitigate the need to use taxpayers' money. While CDIC enjoys *ex ante* funding for deposit insurance, such funding should not be used to finance bank resolution as it is specifically intended to protect bank depositors. Finally, Canada needs to reform the statutory regime governing the hierarchy of claims. Currently depositors have the same rank as unsecured depositors.[209] Contagion can therefore arise from depositors' run on the bank in the event of stress. Giving preference to depositors would be in line with the Key Attributes and the can reduce the cost of bank failures to depositors, CDIC and the government.[210]

VI. Conclusion

An extensive agenda for reforming resolution regimes has been established. Although progress has been made, the orderly resolution of global banks still remains an elusive objective. The main challenges relate to the substantial differences between national regimes as well as the absence of incentives and a legal basis for cross-border cooperation. As a result, the resolution regimes have not yet been able to achieve their underlying objective, namely ending the too-big-to-fail conundrum. Strong prudential requirements, such as high common equity buffers, continue to be the best strategy to prevent bank failure or the moral hazard accompanying the resolution of banking crises with taxpayers' money.

Canada has not experienced a large bank failure in recent years, partly because of favourable macroeconomic conditions and a strong banking supervision. Such failures are, however, likely, and can develop quickly. Canada therefore needs to prepare for future crises by taking holistic and modern approaches to systemic risk and by extending the scope of its resolution regime to embrace all the systemically-important components of the banking system. The fact that Canada has weathered the financial crisis is itself no reason for complacency and unpreparedness for future.

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[208] For example, Chase Paymentech Solutions is the primary merchant processing entity in Canada. In spite of its systemically important function, however, the subsidiary remains outside the CDIC's resolution authority. See, JPMorgan Chase, "Resolution Plan Public Filing" (July 2014) at 6, online: Federal Reserve http://www.federalreserve.gov/bankinforeg/resolution-plans.htm.

[209] IMF, *FSAP: Resolution*, *supra* note 43 at 56.

[210] *Ibid* at 56-57; IMF, "Recent Developments on Cross-border Resolution", *supra* note 186 at 15.