

# Canadian System and the Financial Crisis

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Nothing in this presentation reflects the views of any organization I am associated with.

# We Have Not Been Immune

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- Major losses for certain banks and insurers
- Steep loss in shareholder value
- Bank and insurer capital raising, downgrades
- ABCP market problem
- Fragmented securities regulation
- Some Canadian success factors may not be appropriate elsewhere
- Definite need for improvements

# Macro Factors

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- Sound monetary and fiscal policies
- Mortgage market policies that lessened chance of bubble
  - Government insurance for high ratio mortgages
  - Max LTV ratio
  - Requirements mean less scope for certain mortgage products and recourse to borrower
  - Mortgage brokers regulated provincially

# Industry Factors

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- Structure
  - Retail franchise
  - National scope
  - Major investment banks owned by commercial banks
- Risk management
  - Large investments because of Basel II and other initiatives
  - Push from boards and regulator

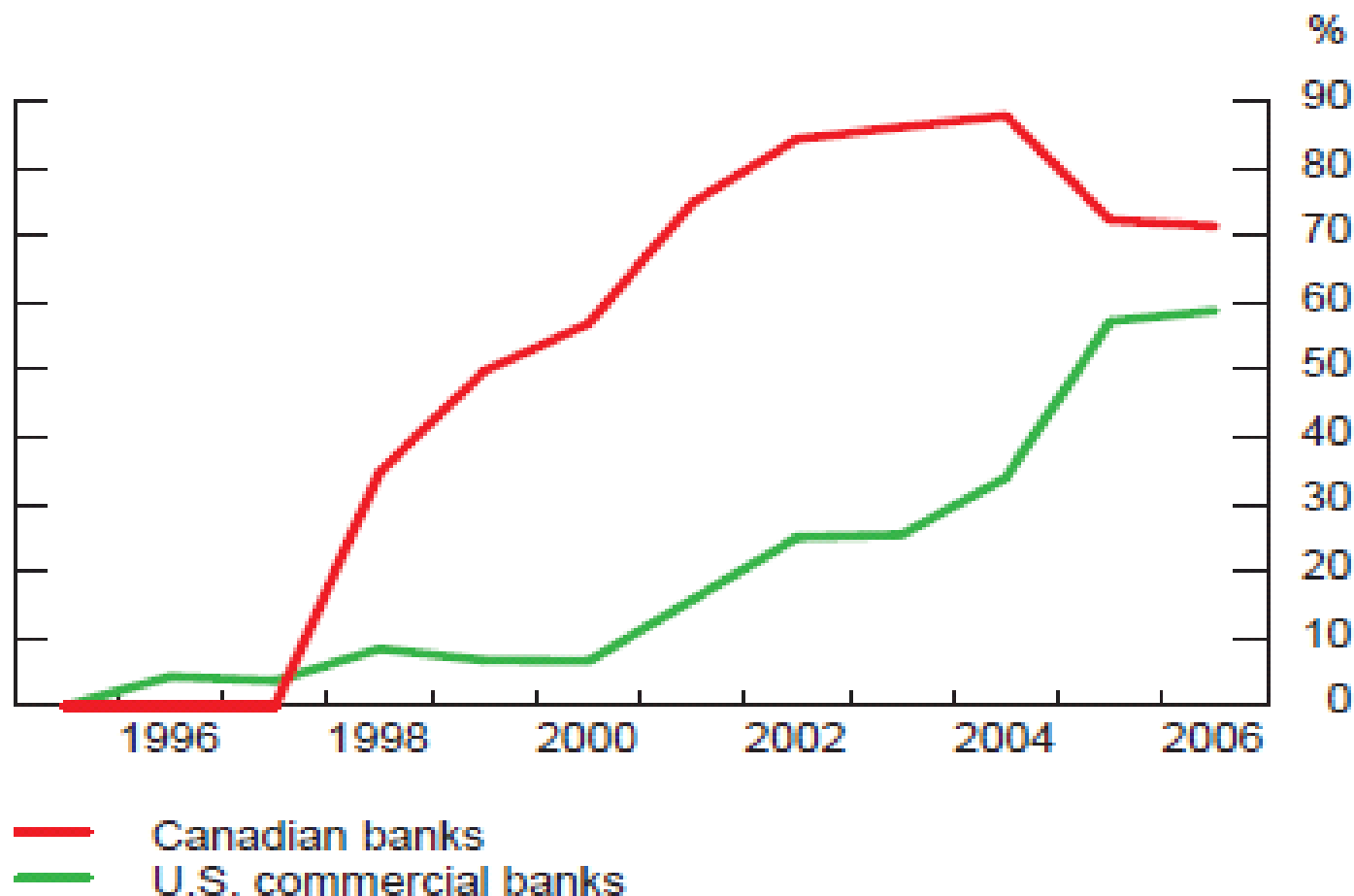
# Industry Factors (2)

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- Material Governance improvements over time
  - Separate Chair and CEO
  - Risk Committees
  - Smaller more focused boards
  - Strengthened CRO-IA-EA relations with boards
  - Board renewal
  - Say on pay currently
  - Compensation systems—changes necessary but differ from some other markets (chart for example)
- Pushed by governance community, institutional investors, private sector blue ribbon panels, and regulators

# Minimum Requirements for Share Ownership as a Share of Total Compensation

(From bank of Canada Financial System Review)



# Regulatory Structure

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- Comprehensive consolidated regulation and supervision of banks (which includes major investment banks) and insurers
  - Essential success factor
  - So leverage ratio applied to banks and major investment banks—less leverage than in some other markets
- Single federal prudential regulator for banks and insurers (OSFI)
- Up to date capital rules for banks and insurers
- Leverage ratio—resisted pressure to eliminate with Basel II

# Regulatory Structure (2)

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- Clear mandate for OSFI since 1995: focus on prudential not market conduct, and early intervention
- Principles based, risk based, reliance based supervision
  - “Trust but verify”
- Canadian rules and bank behavior toward rules tend to be more principles based

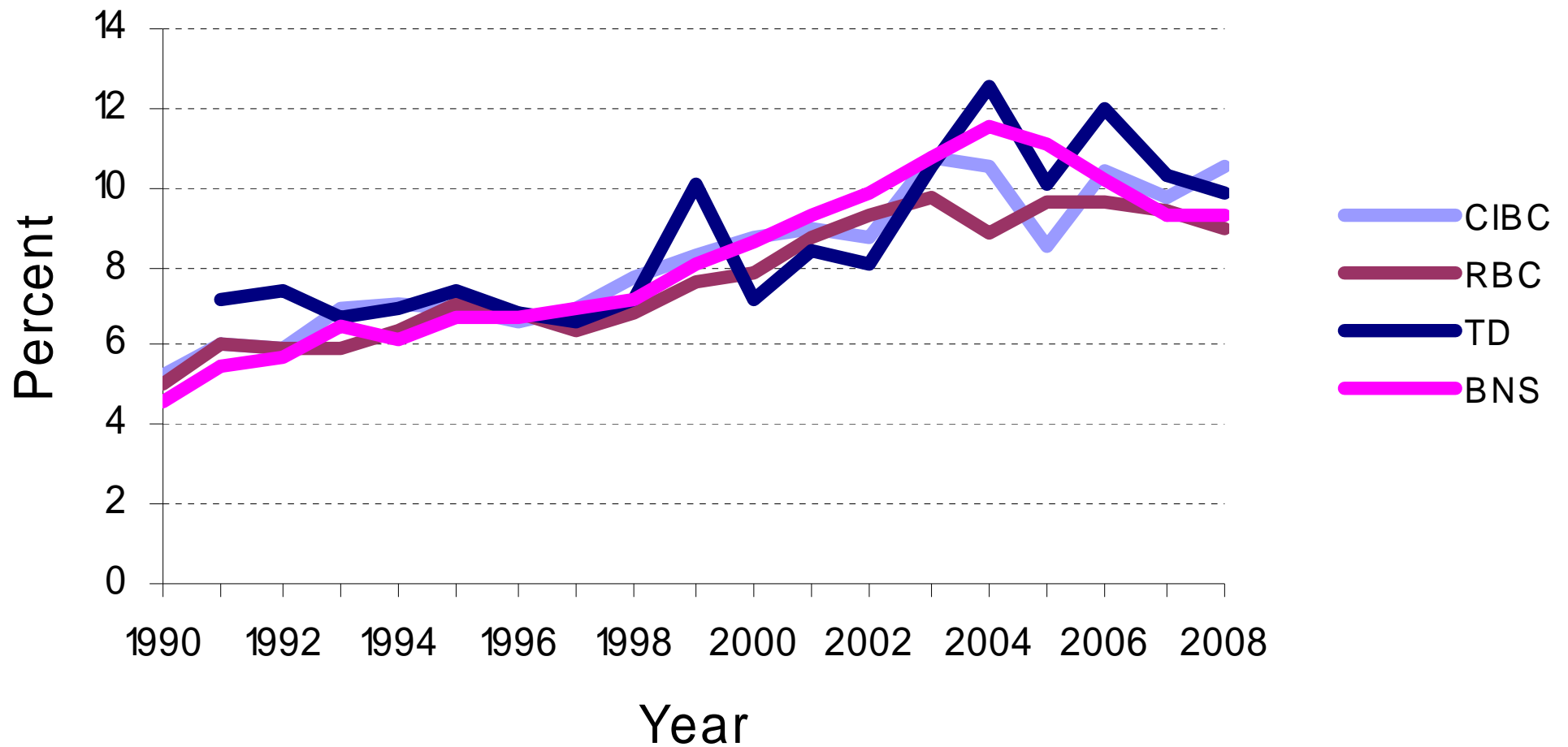


# Regulatory Actions

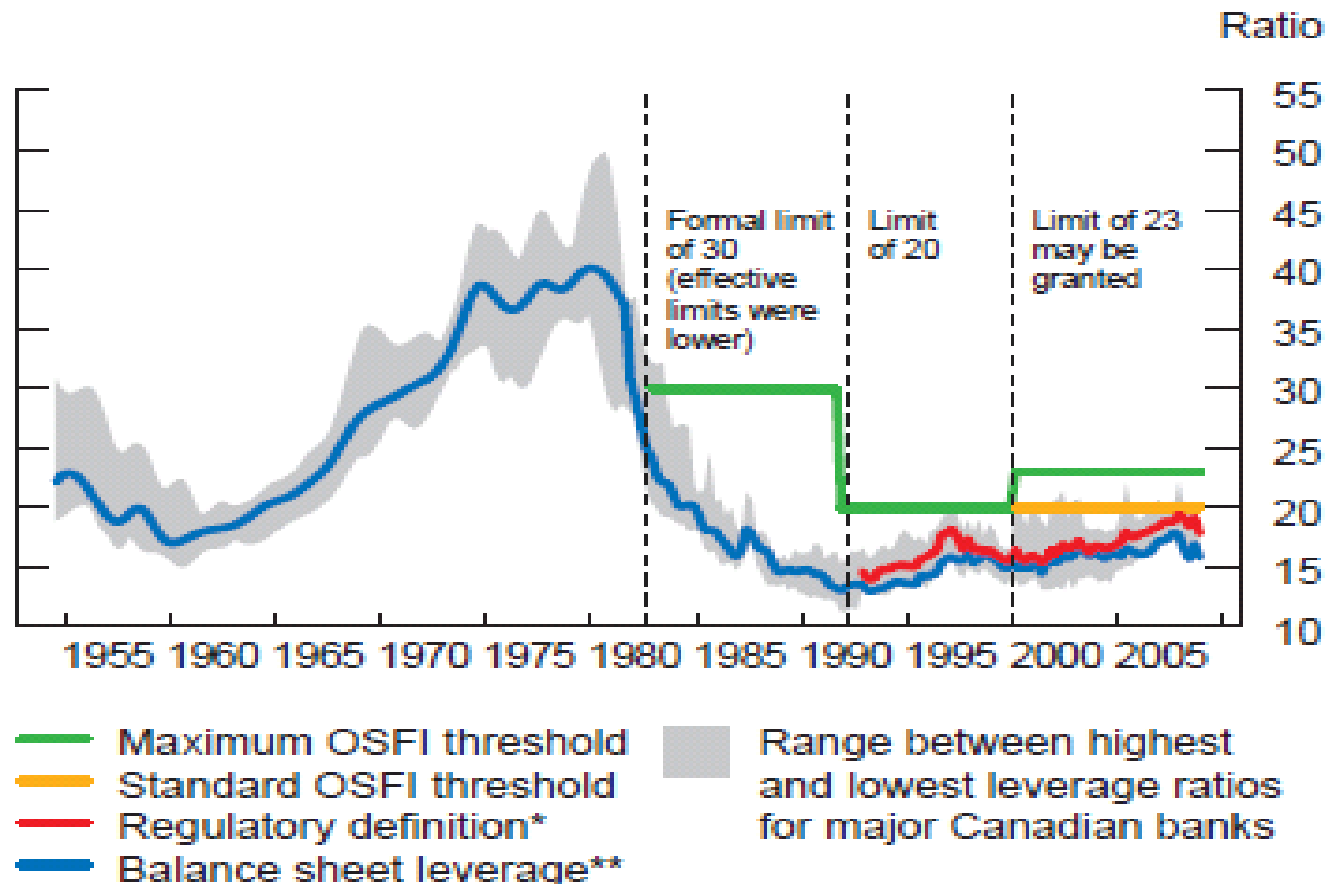
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- Regulatory and Supervisory focus on quality of risk systems and risk governance for some time
- Action in mid-late 1990's to strengthen capital and provisions—because of worry about possible downturn (charts)
- Supervisory actions vis a vis our (small) version of sub-prime

# Tier 1 Capital Ratio



# Leverage History of Canadian Banks



\* On-balance-sheet assets plus certain off-balance-sheet items as a ratio of regulatory capital

\*\* On-balance-sheet assets to shareholders' equity plus subordinated debt

Source: OSFI

# Why Did this Occur?

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- Regular Policy Focus at Ministerial level and ongoing adjustments
  - Since 1987 supported by policy branch in Finance ministry
  - Sunset provisions in legislation
  - Post mortems on even mid-size failures/issues and adjustments
- Good division of responsibilities between independent agencies and policy process

# Why Did this Occur (2)

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- Policy Choices
  - In mandate of prudential system (more safety and soundness less promotion of competitive position of sector)
  - In certain macro policies (e.g. mortgage market support)
- But not clear that we sacrificed a lot of innovation and competitiveness
  - Spreads, profitability, service charge comparison, retail and wholesale payment system innovation

# Why Did this Occur (3)

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- Coordinating mechanisms and Checks and Balances that work (FISC/SAC/Board of the deposit insurer--CDIC\*)
  - Clear mandates and accountabilities
  - Honed and adjusted to achieve constructive tension
    - (e.g. OSFI-CDIC)
- Challenge to keep workable as add macro-prudential
  - One thing to have better, focussed macro-prudential input, and macro stability input in broad policies
  - Another matter to generate automatic formula driven overrides of capital rules
  - \* FISC is the Financial Institutions Supervisory Committee with OSFI(Chair) , Bank of Canada, CDIC, and Finance which focusses on financial institution issues. SAC is the Senior Advisory Committee to the Minister, with the same members (Finance Chair) to focus on policy issues.

# Why Did this Occur (4)

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- Investment in coordinating mechanisms (FISC)
  - Senior level attendance no matter what the times
  - Openess and complete access to information
  - Continuity of people
- Promote Will to Act
  - FISC mandate and accountability, post mortems
  - Agencies understanding of mandates
- Quality Interaction Banks and Authorities
  - OSFI dealings with Board of Directors
  - Bank of Can/OSFI/Finance and Bank CEOs