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A Bridge Over Troubled Waters — Resolving Bank Financial Distress in Canada

Janis Sarra[*]

When times get rough
and friends just can't be found
Like a bridge over troubled water
I will ease your mind

Simon and Garfunkel[1]

I. INTRODUCTION

Effective June 2017, Canada formalized its new resolution regime for "domestic systemically important banks" ("D-SIB"), officially designating the Canada Deposit Insurance Corporation ("CDIC") as the resolution authority.[2] Canada's

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* Dr Janis P Sarra, Presidential Distinguished Professor, University of British Columbia and Professor of Law, Peter A Allard School of Law, UBC. My sincere thanks for very helpful advice from the reviewers of this article. Thank you to Robert Sanderson, Mark Zelmer and Michèle Bourque for additional information and insights regarding the Canadian resolution framework, and to Dr Stephen Madaus for information on the German system. The information in this article is current to September 2017.

1 1969 Words and Music by Paul Simon.

2 Canada *Budget Implementation Act 2017, No 1*, SC 2017, c 20, amending the *Canada Deposit Insurance Corporation Act,* RSC 1985, c C-3, as amended [*CDICA*] and the *Bank Act*, SC 1991, c 46, as amended [*Bank Act*]. CDIC, "CDIC is formally designated as Canada's resolution authority" (22 June 2017), online: <http://www.cdic.ca/en/newsroom/newsreleases/Pages/cdic-is-formally-designated-as-canada-resolution-authority.aspx>. The amendments, part of *Budget Implementation Act 2017*, also require Canada's largest banks to submit resolution plans to CDIC.

six largest banks have been designated as D-SIB.[3] They account for 90% of total assets among Canada's federally regulated deposit-taking institutions.[4] "Resolution" is the restructuring of a financially distressed or insolvent bank by a designated authority. To "resolve" a bank is to use a series of tools under banking and insolvency legislation to address its financial distress in a manner that safeguards the public interest, including continuity of the bank's critical functions. Resolution can provide for an orderly winding-up of the bank or restructuring to restore the viability of all or part of the institution to allow it to continue operating, called open bank resolution. "Bridge bank", a resolution tool discussed in Part IV of this article, is where part or all of the assets, liabilities and/or shares are transferred to a temporary entity until they can be sold to a private-sector third party. "Bail-in" is a tool that allows preferred shares and debt to be converted into equity, placing part of the burden of bank failure on shareholders and creditors of the bank, minimizing costs to taxpayers. Given that banks have a critical intermediary role in the economy, financial difficulties need to be resolved in an orderly and efficient manner, avoiding undue disruption to the bank's activities and instability of the financial system.

This article examines the new resolution regime in the context of the early intervention program by the financial services regulator, the Office of the Superintendent of Financial Institutions ("OSFI"), and the CDIC as both deposit insurance authority and resolution authority. At first glance, the Canadian system seems very patchwork and disorganized. On closer examination, it resembles the

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3 The banks are: Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada, and Toronto-Dominion Bank; see Department of Finance Canada, "Backgrounder: Regulations to Implement the Bank Recapitalization (Bail-in) Regime" (16 June 2017), online: <http://www.fin.gc.ca/n17/data/17-057_1-eng.asp>.

4 OSFI, *Annual Report 2016-2017* (September 2017), online: <http://www.osfi-bsif.gc.ca/eng/docs/ar-ra/1617/eng/ar1617.pdf> at 9 ["OSFI Annual Report 2016-2017"].

architecture of a bridge, with a foundation, substructure and superstructure, offering a complex but integrated set of mechanisms to monitor the financial health of financial institutions, to intervene at an early stage of financial distress, and to resolve the financially distressed bank in a timely manner. However, there remain important issues in respect of financial conglomerate insolvency, in terms of oversight and coordination.

The 2008-2010 global financial crisis highlighted that some banks are so systemically important to the functioning of the financial system and national economies that their failure has far-reaching consequences. In a number of jurisdictions, insolvent banks could not be liquidated under existing insolvency processes without significantly disrupting economic activity and imposing a huge burden on taxpayers.[5] Regulators realized they had inadequate tools to deal with financially distressed banks that were viewed as "too big to fail".[6] The interconnection of banks in their payment systems, credit arrangements, securities settlement systems and currency exchange systems[7] create conditions for systemic

5 For a discussion, see Janis Sarra, "Prudential, Pragmatic and Prescient, Reform of Bank Resolution Schemes", (2012) *International Insolvency Review* 1-54, and Janis Sarra, "Bank Groups and Financial Conglomerates, Retooling Resolution Regimes" (2014) 30 *Law in Cont* 7-50 ["Sarra"].

6 An example is the collapse in September 2008 of the Lehman Brothers Group, a multinational financial services firm comprising 2,985 legal entities that operated in 50 countries, which highlighted the need for an orderly resolution regime for systemically important financial institutions; Alexandra Lai and Adi Mordel, *The Resolution of Systemically Important Financial Institutions, Bank of Canada* (Ottawa: Bank of Canada Financial System Review, June 2012) ["Lai and Mordel"].

7 The Financial Stability Board ("FSB") defines "financial market infrastructure" as "a multilateral system among participating financial institutions, including the operator of the system, used for the purposes of recording, clearing, or settling payments, securities, derivatives, or other financial transactions". It includes payment systems, central securities depositories, securities settlement systems, central counterparties, and trade repositories; see

risk. The size, complexity and lack of substitutes for major banks also contribute to their systemic importance and to challenges in resolving their financial distress. Prior to and during the crisis, there were also incentive effects. Directors and officers had an incentive to take on excessive risk because the banks received any upside potential value and faced limited downside risk because of an implicit backstop guarantee that governments would bail them out.[8] One objective of the global financial reform agenda is to reduce taxpayer-funded capital injections into financially distressed banks as the means to maintain financial stability.[9]

The Canadian *Bank Act*'s preamble recognizes that a strong and efficient banking sector is essential to economic growth and prosperity, and that banks must be able to compete effectively and be resilient in a rapidly evolving marketplace, taking into account the rights and interests of depositors and other consumers of banking services.[10] In turn, a strong banking sector contributes to stability and public confidence in the financial system and is important to the strength and security of the national economy.[11]

FSB, "Key Attributes of Effective Resolution Regimes for Financial Institutions" (15 October 2014), online: FSB <http://www.financialstabilityboard.org/2014/10/r_141015/>, ["FSB, *Key Attributes*"], citing CPSS-IOSCO, *Principles for financial market infrastructures* (April 2012), online: Bank for International Settlements <http://www.bis.org/cpmi/publ/d101.htm>.

8 Lai and Mordel, *supra* note 6; Sarra *supra* note 5.

9 FSB, "Key Attributes of Effective Resolution Regimes for Financial Institutions" (4 November 2011), online: FSB <http://www.fsb.org/wp-content/uploads/r_111104cc.pdf>, updated FSB, *Key Attributes*, *supra* note 7, with Annexes–General Guidance Appendix I, I-Annex 1: Information Sharing for Resolution Purposes; I-Annex 2: Institution-Specific Cross-border Cooperation Agreements; I-Annex 3: Resolvability Assessments; I-Annex 4: Recovery and Resolution Plans; I-Annex 5: Temporary stay on early termination rights. Sector-specific Guidance Appendix II, II-Annex 1: Resolution of FMIs and FMI Participants; II-Annex 2: Resolution of Insurers; and II-Annex 3: Client Asset Protection in Resolution.

10 *Bank Act*, *supra* note 2, preamble.

11 *Ibid*.

The framework for identifying D-SIB is set out by the Basel Committee on Banking Supervision ("BCBS"), which considers bank-specific characteristics of systemic importance, such as size, interconnectedness and substitutability, correlated with the systemic impact of failure.[12] Banks designated as systemically important are subject to higher levels of supervision and higher capital requirements, reducing the likelihood of failure.[13] Canada did not previously have any banks designated as globally systemically important financial institutions ("G-SIFI"),[14] as identified by the Financial Stability Board ("FSB") and BCBS.[15] As this article goes to press, the FSB has designated the Royal Bank of Canada as a global systemically important bank.[16]

OSFI's designation of D-SIB was informed by its own intervention framework, as well as international developments, tailoring what is needed domestically to protect the system, and aligning it with international standards.[17] More rigorous

12 Basel Committee on Banking Supervision ("BCBS"), "A framework for dealing with domestic systemically important banks" (2012), online: Bank for International Settlements ("BIS") <http://www.bis.org/publ/bcbs233.pdf>.

13 *Ibid.*

14 FSB, "Addressing SIFIs" (2017), online: FSB <http://www.fsb.org/what-we-do/policy-development/systematically-important-financial-institutions-sifis/>: "Systemically important financial institutions (SIFI) are financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity".

15 In consultation with national authorities. FSB, "2016 list of global systemically important banks" (21 November 2016), online: FSB <http://www.fsb.org/wp-content/uploads/2016-list-of-global-systemically-important-banks-G-SIBs.pdf>; Basel Committee on Banking Supervision ("BCBS"), "Report and Recommendations of the Cross-Border Bank Resolution Group" (2010), online: BIS <http://www.bis.org/publ/bcbs169.pdf>; BCBS, "Core Principles for Effective Banking Supervision" (2011), online: <http://www.bis.org/publ/ bcbs213.pdf>.

16 Royal Bank of Canada press release, 21 November 2017, online: <rbc.com/newsroom>.

17 Mark Zelmer, "Remarks by Assistant Superintendent to the 2013

disclosure requirements help facilitate greater market discipline.[18] Moreover, the federal government has recognized that Canadian D-SIB could potentially become globally systemically important in the future, as evidenced by the recent announcement regarding the Royal Bank, and therefore resolution of systemically important banks should align with international developments regarding capital adequacy, liquidity and bank resolution. Reform is aimed at creating the ability to resolve the financial distress of a systemically important financial institution, distributing losses more fairly, and stabilizing the financial system.

The FSB has been instrumental in working with the G20 countries to develop international standards that set out the responsibilities, instruments and powers needed to enable national authorities to resolve failing banks in an orderly manner, without exposing taxpayers to losses.[19] Canada has been part of that effort. The Canadian financial system remained resilient during the global financial crisis. Canada did not experience any bank failures, and banks were able to maintain their access to debt and equity markets throughout the crisis.[20] The federal government's approach to financial sector supervision offered some important insights as the international community began to develop new standards post-crisis.[21] Such global

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RBC Capital Markets Canadian Bank Chief Executive Officer Conference, Toronto, Ontario" (8 January 2013), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/sp-ds/Pages/mz20130108.aspx>.

18 OSFI, "Guideline, Pillar 3 Disclosure Requirements" (April 2017, effective 31 October 2018), online: OSFI <http://www.osfi-bsif.gc.-ca/eng/docs/plr3.pdf>. See also OSFI, "Final Guideline D-11 Public Disclosure Requirements for Domestic Systemically Important Banks on Liquidity Coverage Ratio" (16 July 2014), online: OSFI <http://www.osfi-bsif.gc.ca/eng/docs/lcr_let.pdf>.

19 FSB, *Key Attributes, supra* note 7.

20 Department of Finance, "Regulatory Impact Analysis Statement" (17 June 2017), online: *Canada Gazette* <http://gazette.gc.ca/rp-pr/p1/2017/2017-06-17/html/reg4-eng.php> ["Department of Finance, Regulatory Impact Analysis Statement"].

21 Sarra, *supra* note 5.

cooperation is important because major Canadian banks operate internationally and rely heavily on global funding markets. Thus, adopting international standards helps to signal strength of the Canadian system to foreign interests outside of Canada, and facilitates the ability of Canadian banks to operate and borrow abroad.

The Canadian banking sector is a significant part of the Canadian economy. It is healthy overall at the moment, with financial institutions earning a record total net income of $39.1 billion CAD in 2016.[22] Return on equity was 10%. Overall, banks have maintained satisfactory levels of liquid assets in response to the liquidity adequacy requirements set by OSFI, which came into effect in January 2015.[23] Demand deposits continue to comprise approximately 54% of total deposits, while brokered deposits, excluding D-SIB, remain fairly stable at 32% of overall deposits.[24] That mix of deposits means that banks need to carry high levels of liquid assets. Canadian banks continue to report Common Equity Tier 1 ("CET1") capital adequacy ratios well above the minimum CET1 requirements.[25] Return on equity for the industry was approximately 15% in 2016.[26] That puts Canada ahead in return on equity compared to major foreign peers.

22 Canada Deposit Insurance Corporation, "Annual Report 2017" (18 September 2017), online: CDIC <http://www.cdic.ca/en/newsroom/financial-reports/Pages/2017-annual-report.aspx> ["CDIC Annual Report 2017"] at 12.

23 CDIC Annual Report 2017, *supra* note 22 at 14. The Leverage Requirements Guideline and the Basel III Leverage Ratio were implemented by OSFI in Q1 2015, replacing the longstanding asset-to-capital multiple as an additional non-risk weighted measure to constrain leverage at deposit-taking institutions, *ibid* at 15.

24 *Ibid* at 14.

25 Reflecting the 1% D-SIB capital surcharge. Small and medium-sized banks reported capital ratios well above the target level of 7%. OSFI Annual Report 2016-2017, *supra* note 4 at 9-10. Basel III was developed in a response to deficiencies in financial regulation revealed by the global financial crisis, aimed at strengthening bank capital requirements and introducing new regulatory requirements on bank liquidity and bank leverage.

26 OSFI Annual Report 2016-2017, *supra* note 4 at 10.

However, Canada is not immune from potential bank failure, particularly its D-SIB.[27] Macroeconomic events undermining the health of a D-SIB would also undermine small and mid-tier domestic banks and raise questions regarding confidence in the Canadian system generally. Canada's bank resolution regime is aimed at addressing risks both within the country and cross-border systemic risk.[28] Among other resolution tools, the *Canada Deposit Insurance Corporation Act (CDICA)* now provides a new "bridge bank" and "bail-in" conversion regime.[29] Effective June 2017, the CDIC has been formally designated as the resolution authority for D-SIB, as well as its other member financial institutions.[30] The amended statute now requires Canada's biggest banks to develop and submit resolution plans.[31]

Part II of this article briefly examines the "superstructure" that supports the "traffic" on the bridge, such as disclosure, monitoring and deposit insurance. Parts III and IV examine the "substructure", the components that undergird the superstructure, such as early intervention, financial institution restructuring and winding-up of a financially distressed bank.[32]

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27 Department of Finance, Canada, "Backgrounder: Regulations to Implement the Bank Recapitalization (Bail-in) Regime" (16 June 2017), online: Department of Finance <http://www.fin.gc.ca/n17/data/17-057_1-eng.asp> ["Department of Finance, Regulations to Implement Bank Recapitalization"].

28 For example, CDIC signed a memorandum of understanding with the United States Office of the Comptroller of the Currency in 2017. CDIC Annual Report 2017, *supra* note 22 at 16.

29 *CDICA, supra* note 2.

30 CDIC, *ibid* note 2. CDIC also covers loan and trust companies and associations governed by the *Cooperative Credit Associations Act,* SC 1991, c 48, as amended, that take deposits.

31 Bill C-44, *An Act to implement certain provisions of the budget tabled in Parliament on March 22, 2017, and other measures*, 1st Sess, 42nd Parl, 2017 (as passed by the Finance Committee 9 May 2017), online: Open Parliament <https://openparliament.ca/committees/finance/42-1/86/justin-brown-1/>. Presenters: Lisa Pezzack (director), and Justin Brown (chief) from the Department of Finance, Financial Sector Policy Branch.

32 This article does not discuss the Bank of Canada as the "lender of

They discuss proposed regulations under the new bail-in provisions and the contours of the new bridge bank resolution tool. They examine Canada's system against developing international standards, including exploring whether we need a national or lead resolution authority for financial conglomerates. Part V briefly examines the "foundation", Canada's capital adequacy and liquidity regime.

This article focuses on banks, and for ease of reference, uses the terms "bank", "financial institution" and "member institution" interchangeably to refer to banks covered by the *CDICA* insurance and resolution scheme. It should be noted that there are other financial institutions that are member financial institutions of CDIC.[33] There are also provincially incorporated credit unions and caisses populaires that are not part of the federal resolution system. There are separate but aligned resolution systems and insurance funds for insurance companies operating in Canada in both the life insurance and property and casualty insurance sectors.[34] A discussion of these resolution systems is beyond the scope of this article; however, a key difference to note is that insurance sector funds are privately operated and industry funded.[35]

last resort"; Bank of Canada, "Lender-of-Last-Resort Policies" (2017), online: Bank of Canada <http://www.collectionscanada.gc.ca/eppp-archive/100/201/301/bank_can_review/2006/spring/cover/en/financial/llr.html>, which is an important overall function of the central bank.

33 For example, there is one federally regulated credit union. These institutions are subject to some or all of the provisions discussed here, but sometimes with nuanced differences, beyond the scope of this article.

34 See for example, the industry-funded Assuris, which protects policy holders of life insurance, online: Assuris <http://www.assuris.ca/Client/Assuris/Assuris_LP4W_LND_WebStation.nsf/welcome_en.html?ReadForm>; and the industry-funded Property and Casualty Insurance Compensation Corporation, PACICC <http://www.pacicc.com/> ["PACICC"].

35 The reader should look to the *CDICA*, *supra* note 2; the *Winding-up and Restructuring Act,* RSC 1985, c W-11, as amended [*WURA*]; and the *Bank Act, supra* note 2 for information on these other entities and processes.

II. SUPERSTRUCTURE — GIRDERS AND TRUSSES

The girders of a bridge are those parts of its superstructure that are load bearing, supporting the deck on which users travel.[36] Girder sections are typically made from a truss network that increases their resistance to load. The trusses are the structure of connected elements that withstand stress from tension or respond to dynamic loads.[37] If one thinks about the users of financial services: people and businesses making savings deposits, using chequing accounts, clearing and settlement services, etc, banks and other deposit-taking institutions need to be reliable and well-supported. Since liquidity is almost always the biggest challenge for deposit-taking banks, there needs to be confidence by customers in the financial institution's liquidity, or financial services traffic will move elsewhere. In Canada, that confidence is supported by a superstructure of active supervision by a prudential authority on behalf of depositors and other creditors; deposit insurance; and a system of disclosure and monitoring of the financial health of banks by both prudential supervisors and the marketplace more generally. There are mechanisms in place to support the stresses and respond to dynamic changes in financial markets.

1. Deposit Insurance

Although deposit insurance is remedial, it is also a preventive mechanism in terms of confidence in the system and accountability. CDIC provides deposit insurance against the loss of eligible deposits at member institutions in the event of failure, insuring over $770 billion in deposits at 82 financial institutions in Canada.[38] Eligible deposits include: savings

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36 The History of Bridges, "Structure, Components and Parts of Bridge" (2017), online: <http://www.historyofbridges.com/facts-about-bridges/bridge-parts/> ["History of Bridges"].

37 *Ibid.*

38 Deposits must be payable in Canada, in Canadian currency. CDIC Annual Report 2017, *supra* note 22 at 3.

accounts and chequing accounts, term deposits such as guaranteed investment certificates ("GIC") of five years or less, money orders and bank drafts issued by CDIC members, and cheques certified by CDIC members. Foreign currency deposits or deposits with a term limit greater than five years are not eligible for deposit insurance.[39] Eligible deposits are protected up to a maximum of $100,000 per depositor per insured category.[40]

As a federal Crown corporation created in 1967, CDIC's goal is to help maintain stability of the Canadian financial system by providing insurance against the loss of deposits, and helping to maintain financial services in a manner that minimizes exposure of CDIC to loss.[41] Member institutions include banks, federally regulated credit unions and other designated entities.[42] The D-SIB group of six banks represents 87% of the total insured deposits.[43]

The Canada Deposit Insurance Fund is funded by premiums received from member institutions.[44] Premium rates are a key

39 *Ibid.*

40 Section 12, *CDICA*, *supra* note 2

41 Section 7, *CDICA*, *ibid.*

42 *Ibid,* including loan and trust companies and associations that take deposits and are governed by the *Cooperative Credit Associations Act, supra* note 30. Of note is that Concentra Financial Services Association, the sole retail association under the *Cooperative Credit Associations Act*, restructured as a bank in January 2017, and the federal government reports that there are no active institutions currently subject to the *Cooperative Credit Associations Act*. The Department of Finance in 2017 is seeking views on the merits of maintaining or repealing the *Cooperative Credit Associations Act*. Department of Finance, "Potential Policy Measures to Support a Strong and Growing Economy: Positioning Canada's Financial Sector for the Future" (11 August 2017), online: Department of Finance <https://www.fin.gc.ca/activty/consult/pssge-psefc-en-g.asp>. As noted in the introduction, references to member institutions in this article are a reference to banks, although the discussed provisions may also refer to these other member institutions; see *CDICA, supra* note 2.

43 CDIC Annual Report 2017, *supra* note 22 at 12: MD&A.

44 Section 20, *CDICA, supra* note 2. See also CDIC Annual Report

determinant of how quickly CDIC's *ex ante* funding is building towards a minimum target of 100 basis points of insured deposits.[45] CDIC annually assesses and collects premiums from each member institution.[46] In the failures of 43 financial institutions from 1970 to 1996, affecting some 2 million Canadians, no one lost any money from insured deposits.[47] Another girder supporting the system is the incentive created by the funding structure. The *ex ante* funding comes exclusively from the member financial institutions themselves, not taxpayer dollars.[48] Thus, there is greater incentive among the institutions to monitor market developments, capital adequacy and liquidity, because one bank failure will have an impact on other banks, as previously noted.[49] The CDIC's provision for deposit insurance losses was $1,600 million as at 31 March 2017, which is CDIC's best estimate of the losses it is likely to incur as a result of insuring deposits at member institutions, based on the level of insured deposits, the expectation of default

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2017, *supra* note 22 at 27: MD&A. In the 2016/2017 fiscal year, premium revenue was $420 million. Increases in the premium rates, changes in the categorization of member institutions and the growth in insured deposits contributed to the increase in premium revenue. CDIC has developed a funding plan that contemplates a series of measured increases in premium rates to reach the minimum target level by 2024/2025.

45 CDIC Annual Report 2017, *supra* note 22 at 27: MD&A. "Premiums are based on the total amount of insured deposits held by members as of April 30th each year, calculated in accordance with the [*CDICA*, *supra* note 2], and its *Differential Premiums By-law*, which classifies member institutions into one of four premium categories. Classification is based on a mix of quantitative and qualitative factors. The increase in premium rates for 2016/2017, as compared to 2015/2016, is consistent with CDIC's strategy to achieve its minimum target *ex ante* funding level."

46 Section 21(1), *CDICA, supra* note 2.

47 CDIC, "History of Member Institution Failures" (2017), online: CDIC <http://www.cdic.ca/en/about-cdic/resolution/Pages/history.aspx> ["CDIC, History of Failures"].

48 However, tax dollars would be used until such time as funds could be recovered through *ex post* assessments of surviving banks over time.

49 Appreciating that these costs will likely be passed on to deposit holders.

derived from probability statistics, the risk profile of specific member institutions, and an expected loss given default.[50]

The partial pre-funding of deposit insurance means that depositors of a failed small or medium-sized bank can receive their money in a timely manner in the event of a bank failure. There may not be sufficient pre-funding to cover the losses at a major bank, which is why CDIC has access to government funding if needed to cover depositor claims until costs can be recovered through *ex post* insurance premiums on surviving financial institutions.

Yet the pre-funded insurance scheme does not necessarily ensure depositor confidence. The recent run on Home Capital Group Inc is illustrative. Once news of the mortgage lender's financial distress spread in early 2017, depositors rapidly withdrew their savings and brokers stopped recommending the bank's services, destabilizing the bank further.[51] The bank had $2 billion in deposits in March 2017 and two months later, only an estimated $150 million remaining.[52] Notwithstanding public education on deposit insurance, there was lack of confidence in the system for depositors to stay.[53] It is human nature to want to move quickly to protect one's savings; and no doubt images still resonate from the global financial crisis of depositors lined up at UK and other European banks, unable to get their money out. Perhaps more important than individual

50 CDIC Annual Report 2017, *supra* note 22 at 24. The loss given default estimate is based on the cumulative unweighted average loss sustained by CDIC in member failures since 1987, adjusted for measurement uncertainty as required by IFRS.

51 Tyler Durden, "Home Capital Bank Run Accelerates as Company Scrambles to Find Additional Liquidity" (8 May 2017), online: Zero Hedge <http://www.zerohedge.com/news/2017-05-08/home-capitals-bank-run-accelerates-company-scrambles-find-additional-liquidity>.

52 Niall McGee and Andrew Willis, "Home Capital gets lifeline by selling off up to $1.5-billion in mortgages" (9 May 2017), online: *Globe & Mail*, <https://beta.theglobeandmail.com/report-on-business/home-capital-sells-15-billion-in-mortgages/article34929147/?ref=http://www.theglobeandmail.com&>.

53 In part, likely also due to allegations by the Ontario Securities Commission of disclosure violations.

depositors withdrawing savings, broker dealers were pulling their accounts. Whether they did it on at their own discretion or were given instruction by clients is unknown, but it was a significant part of the run on the bank.

The CDIC can collect a special premium from member institutions, or a class of institutions, in order to cover any loss CDIC incurs as a result of pursuing its statutory objects or identifying a more systemic problem with banks.[54] CDIC is expressly authorized to "do all things necessary or incidental", including: to acquire assets from a member institution; to make or guarantee loans or advances, with or without security, to a member institution; to make or guarantee a deposit or assume liabilities of a member institution; to enter into an agreement with a provincial government or its agent respecting any matter relating to the insurance of deposits;[55] and to make any investment and enter into any transaction needed for the financial management of CDIC.[56] Its resolution authority is discussed in Part III below.

In terms of assessing Canada's deposit insurance fund against international standards, Canada's pre-funded protection is, arguably, commensurate with similarly situated jurisdictions. However, the monetary amount protected is considerably less than other countries, as illustrated in Table 1.[57] Some of the higher limits in other countries, such as the United States ("US"), may be the result of governments trying to forestall bank runs.

54 Section 7.3, *CDICA, supra* note 2.
55 With provincial institutions in that province.
56 Section 10(1), *CDICA, supra* note 2.
57 One source suggested that the federal government periodically scans all deposits and finds that current insurance limits would cover about 90% of the population, but the author could not find any data or public disclosure that verifies this assertion.

Table 1: Comparison of Bank Deposit Insurance, 2017[58]

Jurisdiction	**Amount of deposit protection**	**Pre-funded in conjunction with governmental backup funding available?**
Canada	$100,000 CAD	Yes
United Kingdom	£85,000 [$137,226 CAD]	Yes
United States	$250,000 USD [$314,657 CAD]	Yes
Australia	$250,000 AUD [$248,730 CAD]	No pre-funding, but government funding available
European Union	€100,000 [$147,929 CAD]	Yes
Germany	€100,000 [$147,929 CAD], plus voluntary secondary scheme that protects up to €1 million per client	Yes

Notwithstanding that one issue during the financial crisis was that numerous deposit insurance schemes were not pre-funded, the FSB report, *Key Attributes of Effective Resolution Regimes for Financial Institutions,* does not require pre-funding. It only specifies that jurisdictions should have in place privately-financed deposit insurance or resolution funds, or a funding mechanism with *ex post* recovery from the industry of the costs of providing temporary financing to facilitate resolution.[59] While both types of truss protect depositors, purely *ex post* funding can be untimely and place pressure on public funds that pay out depositors' savings and then try to collect from the bank sector. However, as Table 1 illustrates, many jurisdictions now ensure that the deposit insurance is at least partially pre-funded, with access to government support if needed.

58 Currency conversion as at 22 August 2017.
59 FSB, *Key Attributes, supra* note 7 at 6.3.

In the United Kingdom ("UK"), as of 30 January 2017, the deposit compensation limit is £85,000 per eligible deposit of each person per firm.[60] This amount varies each year as it is dependent on compliance with European Union ("EU") Directive 2014/49/EU *Deposit Guarantee Schemes*, which sets a harmonized level of €100,000.[61] The UK amount is thus affected by currency exchange rates.[62] The insurance funds of EU member states are pre-funded, as there is a requirement that all EU deposit protection schemes be funded *ex ante*.[63] The UK Financial Services Compensation Scheme ("FCSC") is funded by an annual levy on authorized financial services firms, the levy varying each year depending on the amount required to protect deposits.[64]

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60 Financial Services Compensation Scheme ("FSCS"), "Deposit Limits" (2017), online: FSCS <https://www.fscs.org.uk/what-we-cover/compensation-limits/deposit-limits/>.

61 Directive 2014/49/EU *Deposit Guarantee Schemes* (16 April 2014), online: EUR-Lex Access to European Law <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0049> ["Directive"] at paras 21, 23, Article 6.

62 Tim Wallace, "Savers hit as Bank cuts protection on deposits to £75,000 for first time since financial crisis" (3 July 2015), online: *The Telegraph*, <http://www.telegraph.co.uk/finance/bank-of-england/11715807/Banks-to-cut-protection-on-deposits-to-75000-from-January.html>. In 2016, this amount was £75,000.

63 Directive, *supra* note 61 at para 27 and Articles 10, 14(4); FAQ, "A European Deposit Insurance Scheme" (24 November 2015), online: European Commission Press Release Database <http://europa.eu/rapid/press-release_MEMO-15-6153_en.htm>.

64 FSCS, "Funding", online: FSCS <https://www.fscs.org.uk/industry/funding/>. The amount levied is the compensation paid out, plus an estimate of compensation costs for the 12 months following the levy date, plus the management expenses for the FSCS; FSCS, "Cost Structure", online: FSCS <https://www.fscs.org.uk/industry/funding/cost-structure/; FSCS, "Levy Information", online: FSCS <https://www.fscs.org.uk/industry/funding/levy-information/>, FSCS, "Levies Raised", online: <https://www.fscs.org.uk/globalassets/levy-information/20170810-levies-raised-since-2009-10.pdf>. Consultation Paper, "Reviewing the funding of the FSCS" (December 2016), online: Financial Conduct Authority ("FCA") <https://www.fca.org.uk/publication/consultation/cp16-

In the US, the Federal Deposit Insurance Corporation ("FDIC") covers up to $250,000 USD per depositor, per insured bank, for each account ownership category.[65] The US Deposit Insurance Fund is funded *ex ante* by the banking industry,[66] and can also borrow up to $100 billion USD from the US Treasury.[67] In Australia, deposits are protected up to a limit of $250,000 AUD for each account holder at each bank that is incorporated in Australia and authorized by the Australian Prudential Regulatory Authority.[68] Australia's deposit insurance, the Financial Claims Scheme, is funded *ex post,* with the Australian Government providing the funds and then reclaiming them after liquidating the institution. If the institution's assets are insufficient, the government can place a levy on the entire industry to recover the difference.[69]

42.pdf> at para 1.2. The FCA determines the extent of the protection provided by the FSCS, and how it is funded.

65 Federal Deposit Insurance Corporation ("FDIC"), "Deposit Insurance at a Glance" (2014), online: FDIC <https://www.fdic.gov/deposit/deposits/brochures/deposit-insurance-at-a-glance-english.pdf>.

66 FDIC, "Deposit Insurance Funding: Assuring Confidence" (November 2013), online: FDIC <https://www.fdic.gov/deposit/insurance/assuringconfidence.pdf> at 3 [Deposit Insurance Funding]; FDIC, "Who is the FDIC?" (2017), online: FDIC <https://www.fdic.gov/about/learn/symbol/>; Aaron Klein, "A primer on Dodd-Frank's Orderly Liquidation Authority" (5 June 2017), online: Brookings <https://www.brookings.edu/blog/up-front/2017/06/05/a-primer-on-dodd-franks-orderly-liquidation-authority/>.

67 Deposit Insurance Funding, *ibid* at 7.

68 Financial Claims Scheme ("FCS"), "About the Financial Claims Scheme", online: Australian Prudential Regulation Authority ("APRS") FCS <https://www.fcs.gov.au/about-apra>; APRS, "Financial Claims Scheme", online: APRA <http://www.apra.gov.au/CrossIndustry/FCS/Pages/default.aspx> ["APRS, Financial Claims Scheme"]; Government of Australia, "Financial System Inquiry Final Report" (November 2014), online: Financial System Inquiry <http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf> ["FSI Final Report"] at 37.

69 FSI Final Report, *ibid* at 82-83; Tarek Dale, "Funding the Financial Claims Scheme" (30 March 2015), online: Parliament of Australia <http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/FlagPost/2015/March/Funding-The-Financial-Claims-Scheme>; Federal Register of Legislation,

In Germany, every depositor has a legal right to repayment of up to €100,000 as part of the statutory scheme complying with the EU Directive.[70] However, Germany has an additional voluntary secondary scheme that can protect at least €1 million up to the amount of 20% of their own capital per bank and client.[71] All statutory and voluntary deposit guarantee schemes in Germany are pre-funded by a tax on all institutions belonging to the scheme. The fund is required to raise, by 2024, up to 0.8% of covered deposits.[72] If there are insufficient funds, the scheme can levy extraordinary contributions to make up the shortfalls.[73]

FSB's *Key Attributes* report specifies that resolution plans should protect insured depositors and insurance policy holders and ensure the rapid return of segregated client assets.[74] CDIC primarily utilizes two methodologies to assess required *ex ante* funding. The first is "discretionary analysis", under which CDIC considers the profile of its membership and determines the ability of a specific level of funding to address the hypothetical failure of member institutions. The second methodology is "loss estimation", which utilizes statistical techniques to estimate multiple theoretical loss scenarios, which then permit a calibration of funding levels.[75] As part of its

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"Financial Claims Scheme (ADIS) Levy Act" (2008), online: Government of Australia <https://www.legislation.gov.au/Details/C2008A00103> at Articles 4, 5.

70 Deutsche Bundesbank, "Deposit Protection in Germany" (December 2015), online: Deutsche Bundesbank, <https://www.bundesbank.de/Redaktion/EN/Downloads/Publications/Monthly_Report_Articles/2015/2015_12_deposit_protection.pdf?__blob=publicationFile> ["Deutsche Bundesbank"] at 53.

71 Bankenverband, "The Deposit protection scheme", online: Bankenverband <http://en.bankenverband.de/tasks/deposit-protection-scheme/> ["Bankenverband, Deposit protection scheme"].

72 Deutsche Bundesbank, *supra* note 70 at 53.

73 *Ibid* at 53-54.

74 FSB, *Key Attributes, supra* note 7 at 11.6.

75 CDIC Annual Report 2017, *supra* note 22 at 25. The inputs to a loss estimation scenario include the level of insured deposits, probability of default statistics and loss given default assumptions.

regular assessment of sufficiency, CDIC stress tests model assumptions to evaluate how changes in probability of default and loss given default affect funding requirements.[76]

While the intention in Canada is to have all deposits covered by the deposit insurance fund through *ex ante* funding, CDIC has legislative authority to borrow up to $22 billion as a financial backstop to insurance or resolution, subject to ministerial approval, and additional borrowings, if required, could be authorized by Parliament through an appropriation act.[77] Since CDIC ranks *pari passu* with uninsured creditors, including depositors, for any amount for which it must pay that is not covered by the insurance fund, it has an incentive to intervene early in the monitoring, intervention and resolution system.

2. Monitoring Banks' Financial Health

The second supporting girder is the federal regulator, OSFI or "the Superintendent".[78] OSFI supervises and regulates federally registered banks and insurers, trust and loan companies.[79] In the mid-1990s, its constating legislation, the *Office of the Superintendent of Financial Institutions Act* (*OFSIA)*,[80] and the *CDICA* were amended to more clearly define OSFI's role as prudential regulator, eliminating some duplication in the oversight and governance roles of OSFI and CDIC.

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76 *Ibid.*

77 *Ibid.* The borrowing limit increases with the growth in insured deposits.

78 OSFI, *Superintendent* (17 October 2017), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/Pages/default.aspx>.

79 *Ibid.* Federally regulated banks and insurers, trust and loan companies, as well as private pension plans subject to federal oversight.

80 *Office of the Superintendent of Financial Institutions Act,* RSC 1985, c 18 (3rd Supp), as amended [*OSFIA*].

OSFI conducts risk-based assessments of the safety and soundness of financial institutions.[81] There is a detailed process for reporting and acting on breaches of the *CDICA*.[82] OSFI has developed guidance on risk management and mitigation, intervening when corrective actions need to be taken.[83] OSFI monitors and evaluates developments that could have a negative impact on the bank's financial condition, considering how a bank may be vulnerable to different types of direct and indirect exposures. It also monitors potential changes in the nature and size of exposures; whether new or evolving practices or products may be making institutions more vulnerable; and whether the risk is isolated to a specific sector, the specific bank, or is more systemic.[84] OSFI monitors whether control functions developed by a bank appropriately correspond to the risks, including whether stress testing has been done.[85]

OSFI has an early intervention system, which includes a "pre-stage", after which there are four stages of intervention, as discussed in Part III. The pre-stage is where monitoring reveals normal activity and no significant problems.

i. No significant problems/normal activities

In monitoring a bank's financial condition, OSFI assesses whether the bank's policies and practices, controls and

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81 Section 27(1), *CDICA, supra* note 2, or as CDIC might require.

82 Section 30, *CDICA, ibid.*

83 Jamey Hubb, Assistant Superintendent, "Risk and Resilience – Preparing for the Unforeseen" (8 June 2017), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/sp-ds/Pages/jh20170608.aspx> ["Hubb"]. OSFI collects data and analytics from the institutions, regulatory partners in government, and other international regulators and agencies; the data gives risk specialists a broad cross-sector perspective when analyzing and identifying potential risks that could have a material impact on Canadian financial institutions.

84 *Ibid.*

85 *Ibid.* Hubb uses the example of when oil prices started declining in 2014, institutions' responses were monitoring their direct and indirect exposures, stress-testing their related portfolios and taking prudent measures in their underwriting and loan management.

circumstances are sufficient through both continuous assessment and formal discussion on an annual basis of supervisory activities over the previous year.[86] OSFI determines whether the combination of the bank's overall net risk, capital and earnings makes it resilient to most normal adverse business and economic conditions.[87] It assesses the financial condition and operating performance of the institution, reviews information obtained from statutory filings, financial reporting requirements, and management reporting to the board.[88] OSFI also undertakes cross-sector reviews for specific issues involving multiple institutions, in some cases, across banking and insurance sectors. OSFI will meet with a board of directors, or provide the bank and chair of the audit committee with a supervisory letter regarding composite risk ratings. A composite risk rating is OSFI's overall assessment of an institution's safety and soundness.[89] Even where the institution's performance has been satisfactory, with most key indicators comparable to or exceeding industry norms, OSFI can still request the bank to take corrective measures.[90] OSFI's expectations are tied to the risks to which a bank is exposed, which can vary across institutions. It also assesses the adequacy of the internal governance, risk management practices and control systems for managing those risks. OSFI then monitors compliance with its requests, often requiring additional information and/or conducting follow-up supervisory reviews.

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86 OSFI, "Supervisory Framework" (December 2010), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/fi-if/rai-eri/sp-ps/Pages/sff.aspx>.

87 *Ibid.*

88 *Ibid.* OSFI reports to the Minister of Finance on an annual basis.

89 *Ibid.* There are four ratings for composite risk: "low", "moderate", "above average" and "high", guided by a set of assessment criteria that were developed in consultation with the industry. OSFI can request that the bank's management provide a copy of the supervisory letter to external auditors.

90 *Ibid.* For example, the financial institution may have access to additional capital and is able to address supervisory concerns that might arise.

At this pre-stage, CDIC is also monitoring selected individual banks *via* information available from member institutions, OSFI, the Bank of Canada, and the Financial Institutions Supervision Committee ("FISC"). FISC is a statutory committee under the *OFSIA*, chaired by the Superintendent, with representatives from the Department of Finance, the Governor of the Bank of Canada and head of CDIC.[91]

CDIC examines rating agency results, the results of OSFI's annual examinations of institutions and other sources, monitoring for compliance with the *CDICA* and CDIC by-laws. OSFI and CDIC regularly exchange information and discuss any remedial measures that either agency has requested the institution to undertake.[92] This monitoring enables OSFI and CDIC to identify areas of concern regarding specific banks at an early stage and intervene effectively to minimize losses to depositors and the exposure of CDIC to loss.[93]

III. SUBSTRUCTURE — EARLY INTERVENTION

The substructure of a bridge is comprised of those parts of the structure, such as piers and abutments, that support the superstructure and transfer the structural load to the foundation.[94] There are three primary components to the substructure of Canada's bank resolution regime. First is the early intervention process by OFSI.[95] Second is the series of measures that CDIC can take as resolution authority,

91 FISC is comprised of five federal financial safety net agencies — the Department of Finance, OSFI, the Bank of Canada, the Financial Consumer Agency of Canada, and CDIC.

92 For example, OSFI provides CDIC with copies of risk assessment summaries and any supervisory letters. OSFI, "Guide to Intervention for Federally Regulated Deposit-Taking Institutions" (4 February 2014), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/fi-if/rai-eri/sp-ps/Pages/gid.aspx> ["OSFI, Guide to Intervention"].

93 *Ibid.*

94 History of Bridges, *supra* note 36.

95 *OSFIA, supra* note 80.

including, as discussed in this part, financial restructuring, bridge bank and bail-in measures. These abutments in the financial system are aimed at ensuring, where possible, open bank resolution, avoiding outright liquidation and working to protect deposits and banking activity through a variety of mechanisms discussed in this Part. The third component of the substructure is the liquidation regime, under the *Bank Act* for solvent banks and the *Winding-up and Restructuring Act* (*WURA*) for insolvent financial institutions.[96] The liquidation regime is aimed at winding-up the financial institution in a manner that protects, to the greatest extent possible, depositors and creditors. Many of these tools are used together in various combinations.

To set the context, the FSB has reported that there are nine key attributes for an effective bank resolution regime, attributes that are being adopted internationally.[97] Bank resolution regimes should ensure continuity of systemically important financial services, and payment, clearing and settlement functions. They need to protect, where applicable and in coordination with the relevant insurance schemes, depositors, insurance policy holders and investors covered by such schemes and arrangements, ensuring the rapid return of segregated client assets. Bank resolution should allocate losses to equity investors and unsecured and uninsured creditors in a manner that respects the hierarchy of claims. The regime should not rely on public solvency support and should not create an expectation that such support will be available.

The FSB also reports that resolution regimes should avoid unnecessary destruction of value, and therefore seek to minimize the overall costs of resolution in home and host jurisdictions, including, where consistent with the other objectives, losses for creditors.[98] Bank resolution systems

96 *Bank Act*, *supra* note 2; *WURA*, *supra* note 35.
97 FSB, *Key Attributes, supra* note 7.
98 *Ibid.*

should provide for speed, transparency, and as much predictability as possible through legal and procedural clarity and advanced planning for orderly resolution. The law governing bank resolution should mandate cooperation, information exchange and coordination domestically and internationally with relevant resolution authorities. Such cooperation is required before and during resolution. Bank resolution must ensure that non-viable firms can exit the market in an orderly way, thereby enhancing market discipline and providing incentives for market-based solutions.[99] These key attributes assist in assessing Canadian developments.

1. Canada's Early Intervention Process

A hallmark of the Canadian regime is its early intervention process. The financial institutions' statutes provide a wide range of discretionary intervention powers that allow OSFI and CDIC to require federally-regulated deposit-taking institutions to address viability concerns.[100] The intervention process assesses the unique circumstances of the financial institution, including its nature, scope, complexity, and risk profile.[101] There are four stages of intervention, from early warning to more intrusive action at the point of non-viability. OSFI's "Guide to Intervention" outlines the circumstances under which certain measures may be deployed.[102] There is flexibility in that intervention tools described at one stage can be used at multiple or different stages. OSFI updates risk assessments and stage ratings as needed during the year as part of its continuous oversight. OSFI has, under the *Bank Act,* critically important powers to issue capital and liquidity directives, replace the board and senior management, and/or

99 *Ibid.*

100 *Bank Act, supra,* note 2; *CDICA, supra* note 2; *OSFIA, supra* note 80; *Trust and Loan Companies Act,* SC 1991, c 45, as amended [*Trust and Loan Companies Act*]; and the *Cooperative Credit Associations Act, supra* note 30.

101 OSFI, Guide to Intervention, *supra* note 92.

102 *Ibid.*

take control of an institution if needed.[103] These extraordinary powers give OSFI great authority to promote adherence by financial institutions to its guidelines and its supervisory expectations and directions.

i. Stage 1 — early warning

Where OSFI has identified deficiencies in the institution's financial or other conditions, policies or procedures, it may place the bank into the Stage 1 early warning process. Stage 1 can be initiated where the combination of the institution's overall net risk and its capital and earnings compromises the institution's resilience; or the institution has risk management issues or control deficiencies that, although not serious enough to threaten financial viability, should be addressed. OSFI may formally notify the directors, officers and the bank's external auditor by way of a supervisory letter that the institution is at Stage 1, requiring the bank to take measures to mitigate or rectify the identified deficiencies. OSFI may also meet with management, directors and/or the external auditor to outline concerns about the bank's safety and soundness and discuss remedial action.

OSFI can send a notice assessing a surcharge on the institution;[104] monitor it on an escalating basis by increasing the frequency of reporting requirements and/or expanding the detail of information that the institution is required to submit. It can conduct enhanced or more frequent supervisory reviews, or direct the institution's internal specialists to conduct reviews that focus on areas of concern, such as asset or loan security valuations. OSFI can enter into a prudential agreement with

103 *Bank Act, supra* note 2.

104 OSFI, Guide to Intervention, *supra* note 92. "A Notice of Assessment Surcharge is a notice in writing that is sent by the Superintendent to an institution advising that an assessment surcharge has been issued to the institution. The assessment surcharge is a surcharge that is assigned to an institution that has been assigned a 'stage' rating pursuant to the *Guide to Intervention for Federally Regulated Deposit-Taking Institutions* or in accordance with the principles set out in the Guide. The amount of the assessment surcharge is determined by regulation."

the institution for the purpose of implementing measures designed to improve the bank's safety and soundness;[105] require the bank to increase its capital; impose business restrictions in appropriate circumstances, and/or issue a direction of compliance.[106]

CDIC would not normally intervene at Stage 1, but it may request additional information from OSFI or the bank, communicate its concerns, and place the bank on a watchlist. In some circumstances, CDIC may conduct or commission a special examination to assess the extent of the institution's problem and CDIC's exposure. It may levy a premium surcharge, after consulting with the Superintendent and giving the bank an opportunity to make written representations.[107] CDIC can require the bank to have in place appropriate, effective and prudent practices with respect to corporate governance and risk management.[108] CDIC may also request that the bank or entity that controls the bank provide an undertaking to rectify areas of concern. There is ongoing

105 *Ibid.* "A prudential agreement is an agreement between the institution and the Superintendent for the purpose of implementing any measure designed to maintain or improve the safety and soundness of the institution."

106 *Ibid.* "A Direction of Compliance is a direction issued to an institution, or a person with respect to an institution, by the Superintendent where in its opinion, the institution or person is committing, or is about to commit, an act that is an unsafe or unsound practice in conducting the business of the institution or is pursuing or is about to pursue any course of conduct that is an unsafe or unsound practice in conducting the business of the institution. A Direction of Compliance may direct an institution or person to: cease or refrain from committing an act or pursuing a course of conduct; and/or perform such acts as in the opinion of the Superintendent are necessary to remedy the situation."

107 *Ibid.* "A premium surcharge is an additional premium charged to a member institution, where, in the opinion of CDIC, the member is engaging in a practice that is prescribed in the CDIC by-laws as warranting such an additional premium. The amount of the premium surcharge must be fair in the circumstances and in no case, can it exceed an amount equal to one sixth of one per cent of the member's insured deposits for the year."

108 *Ibid.*

cooperation between the financial regulator and resolution authority.[109]

ii. Stage 2 — risk to financial viability or solvency

A bank is placed in Stage 2 if OSFI has determined that it poses material safety and soundness concerns and is vulnerable to adverse business and economic conditions.[110] It has identified problems that could deteriorate into a serious situation if not addressed promptly, although there is not an immediate threat to solvency. OSFI considers whether the following are present: the combination of the institution's overall net risk, capital and earnings makes it vulnerable to adverse business and economic conditions or there are risk management issues that, although not serious enough to present an immediate threat to financial viability or solvency, could deteriorate into more serious problems if not addressed promptly.[111]

At this stage of risk, OSFI may enhance monitoring of remedial measures through imposing more frequent or expanded reporting requirements and supervisory reviews. OSFI can require the bank to incorporate in its business plan appropriate remedial measures aimed at rectifying problems within a specified time frame. It may require the institution's external auditor to enlarge its scope of review of the financial statements and/or to perform other procedures and prepare a report. It can require a special audit to be performed by an auditor other than the institution's external auditor.[112] OSFI informs CDIC of results and data obtained from enhanced monitoring and audits.

109 OSFI informs CDIC that it is staging the institution, the reasons why, and action that OSFI is planning to take, sending it intervention reports. CDIC notifies OSFI if it places a bank on the watchlist and/or contemplates that it will apply remedial measures to the institution. OSFI and CDIC hold frequent meetings to discuss the risk profile of the institution. *Ibid.*

110 *Ibid.*

111 *Ibid.*

112 *Ibid.*

CDIC's role is more active at Stage 2. It may send the chief executive officer or the board chair a formal report pursuant to section 30 of the *CDICA* if the bank is not in compliance with a CDIC by-law or is in breach of its policy of deposit insurance. It can require that the institution has in place appropriate, effective and prudent practices with respect to corporate governance, risk management, liquidity, and capital management and controls.[113] If CDIC is not satisfied with progress made in rectifying the situation, CDIC must inform the member institution and the Minister, and CDIC may, subject to the Minister's advice that it is not in the public interest to do so, terminate the member institution's policy of deposit insurance on 30 days' notice. This ability to terminate gives CDIC more authority in working with the at-risk bank, as it prevents the bank from seeking new deposits. Deposits existing pre-cancellation of insurance are still protected by the deposit insurance fund if a bank's deposit insurance policy has been cancelled.

CDIC may also conduct a preparatory examination if it believes that making a payment in respect of deposits held by a bank is imminent and that it would be in the best interest of the depositors.[114] It can apply to court for an order directing the bank to comply with, or restrain from breaching, the *CDICA*, CDIC's by-laws and/or the policy of deposit insurance.[115] OSFI and CDIC may also commence contingency planning to enable the regulator or the resolution authority to be ready to take control of the bank's assets or the bank itself in case of rapid deterioration. The Superintendent takes control, temporarily or permanently, and then hires an agent, usually an accounting firm with resolution skills, who takes actual control as liquidator, usually simultaneously seeking a winding-up order from the Minister. Liquidation is discussed in Part IV below. The statute allows for return of control to the bank, but that power is unlikely to be exercised because, by the

113 *Ibid.*
114 With the approval of the Superintendent, *ibid.*
115 *Ibid.*

time the situation is serious enough to take control, it is unlikely that there is any confidence left in the pre-intervention governance of the bank.

iii. Stage 3 — future financial viability in serious doubt

If the institution has failed to remedy problems identified at Stage 2 and the situation is deteriorating, OSFI can place the bank at Stage 3. The bank now has severe safety and soundness concerns and is experiencing problems that pose a material threat to its future financial viability.[116] One or more of the following conditions are present: the combination of the institution's overall net risk, capital and earnings makes it vulnerable to adverse business and economic conditions or there are management or control deficiencies that pose a serious threat to its financial viability or solvency unless corrective action is promptly undertaken.[117] At Stage 3, OSFI may direct external specialists to assess the quality of loan security, asset values and sufficiency of reserves; enhance the scope of business restrictions that have already been imposed and/or require the bank to submit more detailed information.[118] OSFI staff may be placed at the institution to monitor the situation on an ongoing basis. OSFI may expand contingency planning and communicate to the bank's management and board of directors the importance of considering resolution options such as restructuring or seeking a prospective purchaser.[119]

CDIC at Stage 3 can act to minimize its exposure to loss by taking such measures as acquiring assets from the member institution, or making or guaranteeing loans or advances, with or without security.[120] CDIC and OSFI communicate more often and have regular meetings of the FISC to discuss the evolving situation and undertake contingency planning.[121]

116 *Ibid.*
117 *Ibid.*
118 *Ibid.*
119 *Ibid.*
120 *Ibid.*
121 *Ibid.*

iv. Stage 4 — non-viability / insolvency is imminent

Most serious is Stage 4, where OSFI has determined that the bank is experiencing severe financial difficulties and has deteriorated to such an extent that it has failed to meet regulatory capital requirements, has failed to develop and implement an acceptable business plan to address capital requirements, and is unable to rectify the situation immediately. At this stage, the statutory conditions for taking control have been met.[122] OSFI has determined that the financial institution will become non-viable on an imminent basis. OSFI may assume temporary or permanent control of the bank's assets or assets under administration or the institution itself once the statutory conditions for taking control of assets exist.[123] However, if the Minister advises OSFI that it is not in the public interest to do so, OFSI will not take control. Where the assets and/or the institution are under OFSI's control, it can ask the Attorney General of Canada to make a winding-up order.[124]

At Stage 4, in addition to actions available at earlier stages, CDIC may cancel the banks' policy of deposit insurance if it determines that the bank is, or is about to become, insolvent, after notifying OSFI and subject to the Minister's advice that it is not in the public interest to do so.[125]

CDIC can also initiate its financial institution restructuring authority or seek a winding-up of the bank, meeting certain specified requirements, as discussed in Part IV. Here, there is some overlap, in that OSFI and CDIC can both take over control of the bank. How it will work in practice is not

122 *Ibid.*
123 *Ibid.*
124 *Ibid.* CDIC, "Working with other members of the Canadian government's financial safety net", online: CDIC <http://www.cdic.ca/en/about-cdic/partners/Pages/financial-safety-net.aspx>.
125 CDIC may give public notice of the termination or cancellation of the bank's policy of deposit insurance through any news media that it considers appropriate, if, in CDIC's opinion, it is in the public interest to do so. *Ibid.*

particularly transparent. OSFI could take control and hand it over to CDIC to resolve the bank with support from OSFI and other agencies as needed.

The few times that OSFI has exercised this authority involved smaller banks and it took control as a means of quickly winding-up the bank. The CDIC resolution authority may be aimed more at D-SIB where going-concern bank resolution is least harmful to the overall financial system. OSFI and CDIC must cooperate, and the fact that OSFI and the Department of Finance have statutorily designated representatives on the CDIC board of directors makes it less likely that there are decision gaps or lack of information exchange. However, it is unclear as to what body is to act at Stage 4 and when. There can also be a tension between the regulators and the largest creditors of the bank, in that secured creditors may want a different process depending on the speed at which they may get paid out.

As at 31 March 2017, there were 20 staged institutions. With a few exceptions, most of the staged institutions were in the early warning Stage 1 category.[126]

IV. CANADA'S BANK RESOLUTION REGIME — SUPPORTING STRUCTURE

Unlike many countries in which the regulator is also the bank resolution authority, that authority is now officially vested in CDIC effective June 2017. The change occurred in a budget amendment bill, as opposed to the result of the usual parliamentary process. It may be that the federal government missed an important opportunity to discuss whether or not there needs to be a national resolution authority for financial conglomerates, rather than having it located in many different entities.

The reason for lack of public policy discussion was likely because CDIC was the *de facto* bank resolution authority prior to it becoming named as such. In the five years prior to

126 OSFI Annual Report 2016-2017, *supra* note 4 at 12.

the 2017 amendments, enhanced financial restructuring powers, bridge-banks and bail-in were added to its tool kit.[127] CDIC had resolved mid-tier bank failures such as Central Guaranty Trust Company and North American Trust Company.[128] Thus it had resolution experience, but lacked tools such as the bail-in and bridge bank power that it now has.[129] CDIC's broad authority authorizes it to act as liquidator, receiver or inspector of a member institution or its subsidiary, and it can appoint qualified and competent persons to carry out these functions.[130] CDIC can acquire assets and assume liabilities of a bank from its liquidator or receiver; acquire, by way of security or otherwise, shares and subordinated debt of a bank, and hold and dispose of that equity and subordinated debt.[131] CDIC repays the deposits and then subrogates to the deposit claim. CDIC can acquire, hold and alienate real and personal property; settle or compromise any claim by or against CDIC; and do anything else necessary for exercising its authority.[132] In

127 See the discussion of these tools in Part IV.

128 CDIC, "History of Failures", *supra* note 47.

129 See also the discussion, *infra* note 180, where CDIC was given some resolution authority under a special statute in 1986 when Bank of British Columbia failed.

130 OSFI Annual Report 2016-2017, *supra* note 4.

131 *Ibid.* As noted above, it can also make advances to pay a claim against an institution for which CDIC is acting as receiver or liquidator, in respect of any insured deposit, and become subrogated as an unsecured creditor for the amount of the advance.

132 *CDICA, supra* note 2. Subsidiary corporations:

> (2) For the purposes of facilitating the acquisition, management or disposal of real property or other assets of a member institution that the Corporation may acquire as the result of its operations, the Corporation may, when authorized by order of the Governor in Council, (a) procure the incorporation of a corporation, all the shares of which, on incorporation, would be held by, on behalf of or in trust for the Corporation; or (b) acquire all of the shares of a corporation that, on acquisition, would be held by, on behalf of or in trust for the Corporation.
>
> (3) A corporation described in paragraph (2)(a) or (b) is deemed not to be an agent of the Corporation or of Her Majesty in right of Canada.
>
> (3.1) A corporation described in paragraph (2)(a) or (b) may acquire assets and assume liabilities of a member institution from that institution or from its liquidator or receiver.

carrying out its mandate, CDIC directors have inspection powers.[133] The costs of receivership come out of the assets of the estate. What is significant about its new resolution authority is that, effective June 2017, CDIC has become responsible for the D-SIB resolution regime.

1. Domestic Systemically Important Banks ("D-SIB") Resolution Plans

In the aftermath of the global financial crisis, the FSB's *Key Attributes* report sets out the responsibilities and powers that countries should have in place to resolve the financial distress of large complex banks in a way that protects eligible deposits, maintains the flow of critical financial services, protects the economy, and minimizes risk to taxpayers.[134] In November 2015, the FSB finalized the international Total Loss Absorbing Capacity ("TLAC") standard for all global systemically important banks. The TLAC framework is aimed at ensuring that a systemically important bank has sufficient loss absorbing capacity to support its recapitalization in the event of failure and facilitates an orderly resolution of a bank to allow it to remain open and operating without requiring public funds or threatening financial stability.

In designating a D-SIB, OSFI is to take into account all relevant factors, "including whether the distress or failure of the bank could have a significant adverse impact on the financial system in Canada".[135] In creating its new regime, Canada adopted many of the FSB recommendations.[136] Canadian D-SIB must have resolution plans that describe how they could be resolved in an orderly manner, while ensuring the continuity of critical financial services. Consistent with the FSB recommendations,[137] these resolution plans are to protect

133 Section 11(3), *ibid.*
134 FSB, *Key Attributes, supra* note 7.
135 Section 484.1(3), *Bank Act, supra* note 2.
136 CDIC, *supra* note 2.
137 FSB, *Key Attributes, supra* note 7.

eligible deposits and maintain the flow of critical financial services.[138] CDIC is to provide guidance and work with the banks to: ensure the plans are realistic and meet the objectives of resolution; review and assess resolution plans for feasibility; address any obstacles that would prevent the orderly resolution of the bank in a crisis event; and ensure its own capacity to implement the plan if needed.[139] The purpose of a resolution plan is to allow CDIC to resolve a financial institution in an orderly manner that will maintain stability of the economy and protect taxpayers from exposure to loss.[140] The D-SIB submitted their first resolution plans in late 2016, and CDIC reviewed and assessed these plans, providing feedback regarding gaps in potential resolvability.[141] CDIC conducts simulations to enhance preparedness to carry out a resolution. CDIC is working with D-SIB to ensure that all have robust resolution plans in place by 2020.[142] In fall 2017, it will lead crisis management group meetings to discuss cross-border impediments to D-SIB resolvability.[143]

CDIC has set out the following principles to guide D-SIB in the development of their resolution plans:

> *Accountable:* The bank's board of directors is responsible for ensuring that a credible and feasible resolution plan is in place and can be operationally implemented.

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138 *Ibid.* See also FSB, "Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies" (16 July 2013), online: FSB <http://www.fsb.org/wp-content/uploads/r_130716b.pdf?page_moved=1> ["FSB, Guidance on Developing Effective Resolution Strategies"].

139 CDIC, "Resolution Plan Guidance (Summary)", online: CDIC <http://www.cdic.ca/en/financial-community/legislation-bylaws/Documents/summary-cdic-resolution-plan-guidance.pdf> ["CDIC, Resolution Plan Guidance"]. CDIC also works closely with its foreign counterparts via the International Association of Deposit Insurers by contributing to the development of best practices.

140 *Ibid.*

141 CDIC Annual Report 2017, *supra* note 22 at 16.

142 *Ibid* at 19.

143 *Ibid* at 30.

> *Strategic:* The plan must be strategically focused, reflecting senior management's conclusions about implementation, given the bank's legal, financial and operational structure.
>
> *Comprehensive:* Resolution plans must take into account the specific characteristics of the bank, including its size, complexity and geographic footprint.
>
> *Implementable:* Each plan must demonstrate practical implementation, including the extent to which crisis management capabilities have been, or can be, tested.
>
> *Current:* Resolution planning is an iterative process that requires regular updating to reflect the current state of the bank, as well as the legal and regulatory environment in which it operates. Banks must detail and remedy any major impediments to the successful implementation of their plans.[144]

If a D-SIB fails, CDIC is responsible for selecting and implementing a resolution strategy, taking into account the circumstances.[145] CDIC's guidance is a "blueprint" for a comprehensive resolution plan, and each bank's resolution plan serves as a guide to help achieve an orderly resolution in the event the bank is at risk of non-viability or insolvency. The banks are required to ensure that the resolution plans are robust and current in terms of feasibility.[146] The D-SIB must provide CDIC with extensive information about their operations to assess the means by which their legal, financial and operating structure can facilitate an orderly resolution of a range of severe but plausible events. This information includes corporate profile, strategies to ensure continuation or wind-down of material operations, scenario analysis, and operational feasibility of the strategies outlined in the plan.[147]

It is unclear if OSFI or CDIC has the authority to compel significant structural changes to a D-SIB if there are concerns about resolvability identified through the process of crafting resolution plans. However, the other tools at their disposal under the early intervention authority, such as requiring the

144 CDIC, Resolution Plan Guidance, *supra* note 139.
145 *Ibid.*
146 *Ibid.*
147 *Ibid.*

bank to carry more capital in Canada, are an effective tool for getting the D-SIB to take seriously the need for a resolution strategy.

The Canadian legislation and guidance align with FSB guidance on operational continuity, loss absorbency, funding, cross-border cooperation, effective resolution strategies, and the removal of obstacles to resolvability.[148] CDIC's goal is also to develop and roll out resolution plans for mid-tier banks by 2018.[149]

2. CDICA Resolution Tools

CDIC's resolution tools undergird the stability of the financial system. They include reimbursement of insured deposits, and financial institution restructuring powers, including forced sale, bridge banks and bail-in. Its open bank resolution approach reflects a strong commitment to continuing the bank's financial services and protecting depositors' savings, whether or not the bank continues in its current form or its business is transferred to another bank.

CDIC's *ex ante* funding is a measure of its ability to fund interventions; the balance stood at $3.8 billion as at 31 March 2017.[150] CDIC has developed a funding plan that builds the *ex ante* funding to a minimum funding target in approximately eight years.[151]

i. Reimbursement of insured deposits

When a failed bank is closed, it ceases to operate, all contracts are terminated and its critical financial services are no longer available. CDIC has what it calls a "rapid reimbursement

148 FSB, Guidance on Developing Effective Resolution Strategies, *supra* note 138, British Bankers' Association, "Recovery and Resolution Planning: Making the Key Attributes Requirements Operational", online: FSB <http://www.fsb.org/wp-content/uploads/c_121218d.pdf>.

149 CDIC Annual Report 2017, *supra* note 22 at 17-18.

150 *Ibid* at 23, plus the borrowing power discussed earlier.

151 *Ibid* at 25. As at 30 April 2016, the 100 basis point minimum target level would amount to $7,413 million.

process" so that insured depositors receive their money as soon as possible, without depositors having to file a claim.[152] Its target for rapid payment is within one week. As noted earlier, CDIC will reimburse insured deposits up to $100,000, including interest.[153] Registered retirement savings plan ("RRSP") accounts will take longer, as a ruling will be required from Canada Revenue Agency in order to transfer the RRSP to another financial institution without losing the tax benefits.[154] Speedy payment drives confidence in the deposit insurance scheme, and in this respect, the pre-funding of the deposit insurance fund is very important.

Depositors with funds that are not protected by CDIC file a claim as a creditor in the bank's liquidation.[155]

ii. Financial institution restructuring powers

The *CDICA* authorizes financial institution restructuring power ("FIRP").[156] Whether or not there exists a willing buyer

152 CDIC, "Resolution Tools", online: CDIC <http://www.cdic.ca/en/about-cdic/resolution/Pages/tools.aspx> ["CDIC, Resolution Tools"].

153 The reimbursement is per insurance category in accordance with the following payment schedule: CDIC would aim to reimburse chequing and savings accounts, joint accounts and mortgage tax accounts within three business days from the date of failure. Deposits in valid trusts are protected to $100,000 per beneficiary. CDIC would contact broker-trustees to inform them of its process to reimburse insured deposits. CDIC would remit payment to broker-trustees within seven business days of receiving wire transfer/payment information. Payment would be based on CDIC calculations and deposit information at the failed institution. CDIC would hold registered deposits in RRSP, RRIF and TFSA for several days while it works with the Canada Revenue Agency to ensure they remain tax-sheltered. CDIC would contact these depositors directly to inform them of next steps.

154 These accounts have special identifiers, to ensure they are appropriately protected in the transfer.

155 CDIC, Resolution Tools, *supra* note 152.

156 Section 39.1, *CDICA, supra* note 2. FIRP means the institution restructuring provisions of the *CDICA* whereby an order may be made by the Governor in Council, on the recommendation of the Minister, to vest the shares and subordinated debt of a federal

for all or part of a non-viable bank, CDIC can take control of and operate the bank for a short period of time to complete its sale, amalgamation or restructuring without shareholder approval. It allows continuation of critical banking operations and protects insured deposits until a private sector transaction is complete.[157]

CDIC reports that a forced sale would be used when shareholder consent of the transaction is not expected or the time to obtain consent would take too long.[158] CDIC can initiate a FIRP following receipt of OSFI's report that a bank has ceased, or is about to cease, to be viable, and viability cannot be restored by exercise of OSFI's powers under the *Bank Act*.[159] The bank must be given a reasonable opportunity to make representations before any action is taken.[160] Factors that the OSFI will consider are: whether the bank is dependent to an excessive extent on loans, advances, guarantees or other financial assistance to sustain its operations; whether it has lost the confidence of depositors and the public; whether the bank's regulatory capital, within the meaning of the *Bank Act*, is about to become substantially deficient; or the bank has failed to pay or will not be able to pay its liabilities as they become due and payable.[161]

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member institution in CDIC and/or appoint CDIC as receiver of the member for purposes of carrying out a transaction or a series of transactions to restructure a substantial part of the business of the member. The tools include bridge bank provisions.

157 CDIC, "Forced Sale—Financial Institution Restructuring Powers", online: CDIC <http://www.cdic.ca/en/about-cdic/resolution/Pages/forced-sale-financial-institution-restructuring-powers-firp.aspx> ["CDIC, Financial Institution Restructuring Powers"].

158 *Ibid.*

159 Sections 39.1(3), (4), *CDICA, supra* note 2. The report can be written or oral, depending on the urgency.

160 Section 39.1(1), *ibid.*

161 Section 39.1(2), *ibid.* CDIC can then, if it determines that a transaction referred to in s 39.2 is reasonably likely to be expeditiously carried out after the making of the order, request the Minister to recommend that one or more orders be made under s 39.13.

CDIC's board reviews options to address the bank's non-viability, considering whether a restructuring transaction is likely to be quickly carried out, and whether such transaction is consistent with CDIC's statutory objectives.[162] CDIC recommends the best resolution approach for the failing bank to the Minister of Finance; who in turn recommends a resolution approach to the Governor in Council ("GIC"). The GIC makes an order authorizing the FIRP if it is likely that a restructuring transaction can be expeditiously entered into.[163] The order can vest the shares and subordinated debt of the bank in the receiver, can place a D-SIB under the bridge bank provisions, or require CDIC to apply for a winding-up order if it is in the public interest.[164] There are two forms of FIRP, a "share FIRP" or an "asset FIRP".[165] The GIC may make orders for one or both types of FIRP.

In a share FIRP, the shares and subordinated debt of the distressed bank are vested in CDIC and CDIC has temporary share ownership and control of the bank. CDIC can transfer the shares to an acquirer or agree to the amalgamation of the bank with another financial institution.[166] These transactions could be preceded by restructuring or other measures to stabilize the bank's operations. As sole shareholder, CDIC can replace the existing board of directors, which in turn can select replacements for senior management as appropriate. CDIC

162 CDIC's Board is made up of a Chairperson, five private sector directors and five *ex officio* directors: the Governor of the Bank of Canada, the Deputy Minister of Finance, the Commissioner of the Financial Consumer Agency of Canada, the Superintendent of Financial Institutions, and a Deputy Superintendent of Financial Institutions or another officer of OSFI appointed by the Minister of Finance. CDIC Annual Report 2017, *supra* note 22 at 69.

163 CDIC, Financial Institution Restructuring Powers, *supra* note 157. CDIC may also apply for a winding-up order under the *WURA, supra* note 35, where it believes the bank is or is about to become insolvent, unless the Minister advises that it would not be in the public interest to do so, as discussed in Part IV.

164 Sections 39.12, 39.13, 39.22, *CDICA, supra* note 2.

165 Sections 39.1, 39.12, 39.13, *ibid.*

166 Section 39.2, *ibid.*

can also exercise the powers of directors and officers. During CDIC's temporary control, a separate workout company can be created to purchase "impaired" assets and to assume certain liabilities of the member institution. The workout company could be a subsidiary of CDIC. The institution would transfer such assets and liabilities to the workout company under the terms of a "purchase and assumption agreement".[167]

CDIC's ability to take control does not extend to the bank's subsidiaries if they are not also CDIC members, nor do CDIC's resolution powers apply to holding companies of CDIC member institutions that are not themselves member institutions.[168] However, CDIC can transfer, or cause to have transferred, the shares and assets of direct and indirect subsidiaries, subject to regulatory and other third-party approval.[169]

In an asset FIRP, CDIC is appointed receiver in respect of the distressed bank.[170] Temporary control is taken to stabilize the financial institution's operations and then effect a transaction. The powers and duties of directors and officers of the financial institution, and the rights and privileges of shareholders to vote or give approvals, are also suspended. CDIC can exercise these powers. Existing shareholders and subordinated-debt holders continue to own shares and subordinated debt in the financial institution.[171] As receiver, CDIC has broad authority to take possession and control. It can sell the unsecured assets; sell or otherwise dispose of any secured asset to any person who agrees to assume the obligation secured by the security interest. It can arrange for assumption by another person or entity of all or part of its liabilities, or both. CDIC can conduct an amalgamation. It can carry on the business to the extent it deems is necessary or beneficial, sue for, defend, compromise and settle, in the name

167 Sections 39.1 (3), 39.14, *ibid.*
168 Section 39.15, *ibid.*
169 *Ibid.*
170 Section 39.13, *ibid.*
171 Section 39.2(1), *ibid.*

of the bank, any claim made by or against it;[172] and undertake any other transactions that restructure the bank's business.[173] On notice, the CDIC can convert shares and liabilities, setting the timing, terms and conditions of the conversion.[174] As receiver, CDIC can exercise its powers, rights, privileges and immunities without approval of the court, but may seek the assistance of the superior court to give effect to those powers, rights, privileges and immunities.[175] The costs of the receivership come from the assets of the bank.[176]

As with a share FIRP, in an asset FIRP, CDIC has authority to cause the financial institution to transfer assets and liabilities to a workout company. CDIC could also leave some part of the failing bank's business behind in a stub entity,

172 Section 39.22, *ibid.* As well as do what is necessary or incidental to the exercise of the CDIC's rights, powers, privileges and immunities as receiver.

173 Sections 39.2(2), 39.2(2.1), *ibid.*

174 Sections 39.2(2.3), (2.4), (2.5), *ibid.*

> Novation (6) Any person who assumes a liability of the federal member institution under a transaction referred to in subsection (1) or (2) becomes liable—instead of the federal member institution—to discharge the liability, on approval of the transaction by the Minister or as soon as the person assumes the liability if the transaction does not require the Minister's approval.
>
> (7) Subsection (6) does not apply to the bridge institution's assumption of any portion of the federal member institution's liability that is not insured by the Corporation.
>
> (8) A trust company within the meaning of subsection 57(2) of the *Trust and Loan Companies Act* that is designated as a bridge institution may become a trustee in substitution for the federal member institution without formality or the consent of any beneficiary of the trust.
>
> (9) The conversion of shares or liabilities under subsection (2.3) (a) subject to paragraph (b), extinguishes any claim, interest or right in respect of the shares or liabilities, or part of them, that were converted; and (b) does not extinguish any claim to the extent that the claim is a personal claim against a person other than the Corporation, the federal member institution or a person claiming under the Corporation or the federal member institution.

175 Section 39.13(5), *ibid.* Section 39.13 also includes environmental liability and remediation and successor employer provisions.

176 Section 39.13, *ibid.* Shares and subordinated debt that are subject to the receivership that are vested in a trustee under the *Bankruptcy and Insolvency Act,* RSC 1985, c B-3, as amended [*BIA*] are vested in CDIC.

with the result that it would be liquidated, while other parts of the business would be continued by a third-party acquirer. CDIC control is terminated on completion of the restructuring transactions or the expiration of the statutory period of 60 days, with possible extension up to a maximum of 180 days. CDIC applies for a winding-up order in respect of the bank under the *WURA,* as discussed in Part IV.3, if it believes the transactions cannot be substantially completed before the end of that period.

The FIRP authority is extensive, because unlike a *Companies' Creditors Arrangement Act (CCAA)*[177] restructuring proceeding, the CDIC does not have to seek court approval for a whole range of actions. That authority allows it to act quickly if needed. In terms of the accountability check that a court-supervised process would normally provide, underpinning the regime is the principle that no creditor should be worse off as a result of the resolution strategy. The FSB has suggested that the safeguards to the bank resolution framework are "respect of creditor hierarchy" and "no creditors worse off" principle.[178] However, that broad principle may be a recipe for litigation if the accountability check and balance on decision making is not clear. In the US, there has been considerable litigation over the valuation of bank assets that may be available to creditors, often

177 *Companies' Creditors Arrangement Act,* RSC 1985, c C-36, as amended [*CCAA*].

178 FSB, *Key Attributes, supra* note 7 at 11:

> 5.1 Resolution powers should be exercised in a way that respects the hierarchy of claims while providing flexibility to depart from the general principle of equal (*pari passu*) treatment of creditors of the same class, with transparency about the reasons for such departures, if necessary to contain the potential systemic impact of a firm's failure or to maximise the value for the benefit of all creditors as a whole. In particular, equity should absorb losses first, and no loss should be imposed on senior debt holders until subordinated debt (including all regulatory capital instruments) has been written-off entirely (whether or not that loss-absorption through write-down is accompanied by conversion to equity).
>
> 5.2 Creditors should have a right to compensation where they do not receive at a minimum what they would have received in a liquidation of the firm under the applicable insolvency regime ("no creditor worse off than in liquidation" safeguard).

involving a "battle of valuators", consuming considerable time and resources of all parties.[179]

Although the FIRP power is extensive, the current statutory provisions have not yet been used by the CDIC, and thus are untested. However, similar financial restructuring powers were used when the federal government permitted HSBC to acquire the assets of the Bank of British Columbia when it failed in 1986. CDIC did not have express FIRP powers at the time, so Parliament enacted special legislation, the *Bank of British Columbia Business Continuation Act*, as an "Act to facilitate the continuation of the business of the Bank of British Columbia".[180] The statute provided that, on the approval by the GIC of a sale agreement, the purchasing bank was to pay into a trust account designated by CDIC and the failing bank the amount of money payable under the sale agreement by the purchasing bank.[181] The sale agreement had to be submitted to the shareholders of the distressed bank at a special meeting called for the purpose of determining whether shareholders approved the consideration obtained for the assets sold.[182] Failing majority shareholder approval, the GIC could appoint an assessor to assess the net realizable value of assets, taking into account the likelihood of viability of the bank absent completion of the sale.[183] Where the assessor determined that

179 Daniel C Hardy, "IMF Working Paper 13/172: Bank Resolution Costs, Depositor Preference, and Asset Encumbrance" (July 2013), online: IMF <https://www.imf.org/external/pubs/ft/wp/2013/wp13172.pdf>.

180 *Bank of British Columbia Business Continuation Act,* SC 1986, c 47, assented to 27 November 1986.

181 *Ibid,* s 7.

182 *Ibid,* s 8(1). Section 9(1) specified that at the meeting of the shareholders, the resolution referred to carried by a majority of the votes cast by the shareholders present in person or represented by proxy at the meeting, the trust amount would forthwith be released to the bank.

183 *Ibid,* s 9(3):

> As soon as practicable after his appointment, the assessor shall determine (a) as of the day immediately before this Act comes into force, the net realizable value, if any, of the assets less the obligations of the Bank,

the net value was an amount equal to or greater than the aggregate of the trust amount plus the net retained value, the amounts in the trust were paid out to the distressed bank and CDIC was responsible for paying any difference in the value. If the assessment was less than amounts in trust, the bank was given the portion of the trust amount determined to be the net value less the net retained value and the remaining amounts were to be paid out to CDIC.[184] The Minister then authorized dissolution of the old bank. Pursuant to this statute, the bank's financial activities and the deposits were stabilized and HSBC (then "HBC") acquired an additional $2.6 billion in assets and 41 branches in British Columbia and Alberta.[185]

It is an early example of bank resolution using financial restructuring powers in a speedy and effective way where shareholders of the failing bank do not agree to a sale. However, the use of these powers was not without controversy. During parliamentary debates, concern was expressed about the office of the Inspector General's failure to provide early warning of

> hereinafter in this section referred to as the "net value"; and (b) any net realizable value of the assets and obligations retained by the Bank under the sale agreement, hereinafter in this section referred to as the "net retained value."

Under s 9(4), the assessor is to take account of the likelihood, in the absence of the sale agreement, of profitability and continuing viability of the bank as an independent bank; of sale of the assets of the bank other than to the purchasing bank; and of the appointment of a curator or the winding-up of the business of the bank.

184 *Ibid,* s 9(8). Where the assessor determined that the net value was an amount equal to or greater than the aggregate of the trust amount plus the net retained value, (a) the trust amount was to be forthwith released to the Bank; and (b) to the extent that it was greater than that aggregate, the Corporation was to forthwith pay to the Bank the difference between the greater amount and that aggregate.

(9) Where the assessor determines that the net value is an amount less than the aggregate of the trust amount plus the net retained value, there shall forthwith be released, (a) to the Bank such portion of the trust amount as was determined to be the net value less the net retained value; and (b) to the Corporation the remainder of the trust amount.

185 Patricia Chisholm, "End of a dream for Bank of BC", *Financial Times of Canada* (1 December 1986) at 8, 59.

the Bank of British Columbia's unsound bank loan portfolio; concern that a foreign bank was receiving significant assets, including CDIC insurance of $200 million, without being asked for any commitment; and concern about CDIC's independent decision-making given the public nature of the transaction in terms of government cash injections.[186]

iii. Bridge banks

The bridge bank provisions are another tool in the FIRP authority. When OSFI determines that a bank is non-viable, CDIC can establish a bridge institution for a temporary period, also referred to as a bridge bank in this article.[187] The bridge bank is aimed at preserving going-concern value when there is no buyer or private-sector solution available at the time of the bank's failure. Bridge bank resolution spans the time from when a bank fails to completion of a sale of the bridge bank or its assets.

186 *House of Commons Debates*, 33rd Parl, 2nd Sess, Vol 2 (26 November 1986) at 1552-1570 (Hon Tom Hockin, Minister of State (Finance), *et al*), online: Canadian Parliamentary Historical Resources <http://parl.canadiana.ca/view/oop.debates_HOC3302_02/162?r=0&s=3>. The initial debate considering Bill C-27, *An Act to facilitate the continuation of the business of the Bank of British Columbia*, put forward in response to the Bank of British Columbia's ("BBC") financial issues. The House debated the role of CDIC in the BBC crisis as well as with other banks in the recent past. *House of Commons Debates*, 33rd Parl, 2nd Sess, Vol 2 (27 November 1986) at 1573-1584, 1598-1609 (Hon Jean-Robert Gauthier, *et al*), online: Canadian Parliamentary Historical Resources <http://parl.canadiana.ca/view/oop.debates_HOC3302_02/183?r=0&s=3>.

187 *Ibid*. CDIC, "Bridge Bank Resolution", online: CDIC <http://www.cdic.ca/en/about-cdic/resolution/Pages/bridge-bank.aspx> ["CDIC, Bridge Bank Resolution"]. CDIC illustrates how a bridge bank scenario would likely unfold: CDIC would be appointed as receiver of the failed institution; the Minister would be directed to incorporate a bridge bank; the letters patent incorporating the bridge bank would be made on a Friday night after the close of the Large Value Transfer System clearing cycle. The bridge bank, which would be a new legal entity wholly owned by CDIC, would be authorized by the Superintendent to commence and carry on business immediately on Friday. The GIC may exempt a bridge institution from the application of any provision of the *Bank Act* or certain other statutes.

CDIC can use a bridge bank to transfer all or part of the failing bank's business. The bank is temporarily owned by CDIC.[188]

Without delay after an order is made to designate a bridge institution and specify the date and time as of which the distressed bank's deposit liabilities are assumed, the Minister is to issue letters patent incorporating it as a federal institution.[189] Then the Superintendent makes an order approving the commencement and carrying on of business by the bridge bank. CDIC must provide the financial assistance that a bridge bank needs to discharge its obligations as they become due, drawing from its investment portfolio, and, if needed, exercising its borrowing authority under the *CDICA*.[190]

In such cases, CDIC must transfer all insured deposits and can transfer other assets and liabilities of the failing institution to the bridge bank to aid in the bridge bank's viability or preserve financial stability. A bridge bank is colloquially the "good bank", leaving the stub of the failing financial institution. Other assets and liabilities, including "bad assets" that are not critical, and certain liabilities such as subordinated debt, can be left behind in the failed bank, which is subsequently liquidated in a court-supervised process. Creditors left behind in the bank would receive their proportionate share of the value of assets recovered on liquidation. CDIC could decide to only transfer the assets and liabilities necessary to preserve essential services, or could transfer all assets and liabilities to keep the institution whole. Once CDIC has substantially transferred the assets and liabilities to a bridge bank, it would apply for a winding-up order of the failed institution under the *WURA*.[191]

188 CDIC, Financial Institution Restructuring Powers, *supra* note 157.

189 Section 39.371, *CDICA*, *supra* note 2. The letters patent are issued under whichever statute regulates the federal member institution, *supra* note 2; the *Cooperative Credit Associations Act, supra* note 30; or the *Trust and Loan Companies Act, supra* note 100.

190 Section 39.3713, *CDICA*, *ibid*, except for its obligations to the CDIC.

191 Section 39.22(1), *ibid*. CDIC is to apply for a winding-up order in respect of a federal member institution under the *WURA*, *supra*

The key objectives of a bridge bank are to maintain critical financial services, ensure deposits are protected, and continue operations that are important for financial stability, minimizing disruption to the financial system.[192] CDIC has the authority to remove and replace the failing bank's board of directors.[193] It can give directions to the board of directors of a bridge bank, and the directors must ensure the directions are implemented in a prompt and efficient manner, notifying CDIC when implemented.[194] CDIC may direct the board of directors of a bridge bank to, or the board may, on its own motion with approval of CDIC, make, amend or repeal any by-law.[195]

The objective is to return the bridge bank to the private sector as soon as possible through one or more transactions such as sale of the bank to a third party or amalgamation with an existing bank.[196] The return to private control must happen

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note 35, if a notice has not been published under s 39.2(3) in respect of the institution on or before the 60th day after the day on which the order is made under s 39.13(1); or the day on which any extension of that period ends. Extensions of that time can be granted in some circumstances under s 39.22:

> (3) The Governor in Council may, by order made on the recommendation of the Minister, grant one or more extensions of the period set out in subsection (1)—of up to 30 days each—but the last extension must expire not later than 180 days after the day on which the order is made under subsection 39.13(1).
>
> (4) The Governor in Council may, by order made on the recommendation of the Minister, grant one or more extensions of the applicable period set out in subsection (1.1)—of up to one year each—but the last extension must expire not later than five years after the day on which the order is made under subsection 39.13(1).

Under s 39.22(1.1), where an order is made under ss 39.13(1)(d) or 39.13(1.3), CDIC is to apply for a winding-up order in respect of the institution under the *WURA*.

192 CDIC, Financial Institution Restructuring Powers, *supra* note 157.

193 CDIC, Bridge Bank Resolution, *supra* note 187.

194 Section 39.3721, *CDICA, supra* note 2.

195 Section 39.3722, *ibid.*

196 Given its temporary nature, it is expected that the pricing of loans and deposits at the bridge bank and various fees would be roughly equivalent to industry norms. Sections 39.371-39.3722, *ibid,* Creation and Operation of Bridge Institutions.

within two years,[197] although the GIC can grant up to three extensions of one-year each, to a maximum existence of five years.[198] The time period allows for "cleaning-up" and marketing the institution, and provides a reasonable window for prospective acquirers to conduct their due diligence. However, the UK experience with major banks shows that it can take longer than five years. After the end of the relevant time period, the bank would cease to be designated as a bridge bank. The tool is available when it is determined by the CDIC board, the Minister of Finance and the GIC that it is important that the bank not be closed, considering financial stability and confidence in the financial system, execution risks, costs, and exposure to and size of the loss.[199]

The bridge bank as a resolution tool is suited for banks that deteriorate rapidly with little notice, a potential buyer has not emerged and there are financial stability concerns.[200] The bridge bank can stabilize deposits and stabilize the situation for all creditors that are passed to a bridge bank.[201] All creditors passed to the bridge bank are to receive full and uninterrupted access to their funds. CDIC is to establish the terms and conditions of the transaction, the consideration to be paid for assets acquired, and which liabilities the bridge bank will assume and the consideration to be paid for the liabilities

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197 Section 39.3711 (1), *ibid.*

198 Section 39.3711 (1) and (2), *ibid*:

> (1) Subject to section 39.3715, the federal institution referred to in subsection 39.371(1) is designated as a bridge institution for a period of two years.
>
> (2) The Governor in Council may, by order, on the recommendation of the Minister, grant up to three extensions—of one year each—of the period referred to in subsection (1).
>
> Section 39.3715: A federal institution's designation as a bridge institution terminates if (a) the Corporation is no longer the sole shareholder; or (b) the federal institution is amalgamated with a body corporate that is not a bridge institution.

199 *Ibid.*

200 CDIC, Bridge Bank Resolution, *supra* note 187.

201 *Ibid.*

assumed.[202] Consideration is to be reasonable in the circumstances.[203]

Where created, a bridge bank *must assume* the member institution's deposit liabilities that are insured by CDIC and posted in the bank's records, assuming any interest accrued.[204] The statute also deems deposits and withdrawals made but not posted in the transition to be the responsibility of the bridge bank.[205] If the bridge bank assumes any portion of a bank's liability that is not insured by CDIC, the bridge bank is subrogated to all the rights and interests of the creditor against the institution in relation to the liability, and may maintain an action in respect of those rights and interests in its own name or in the name of the creditor.[206] In this situation, as soon as the bridge bank receives an amount equal to the liabilities CDIC assumed that are not insured, the rights and interests in respect of the balance remaining revert to the creditor.[207] Specified security rights are transferable.[208]

When an order is made to establish a bridge bank, the *CDICA* imposes a broad general stay of proceedings, similar to the stay available under insolvency legislation.[209] The stay

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202 Section 39.201(1), *CDICA, supra* note 2.
203 Section 39.201(2), *ibid.*
204 Sections 39.202(1) and (1.1), *ibid.*
205 Sections 39.202(1.2) and (1.3), *ibid.*
206 Section 39.202(2), *ibid.*
207 Section 39.202(3), *ibid.*
208 Section 39.21, *ibid*:

> If the assets that are sold under a transaction described in section 39.2 or by a bank designated as a bridge institution include any outstanding security under section 426 or 427 of the *Bank Act*, the buyer of the assets may hold the security for the life of the loan to which the security relates and all the provisions of that Act relating to the security and its enforcement continue to apply to the buyer as though the buyer were a bank.

209 Section 39.15(1), *ibid,* including a stay on civil proceedings, other than a proceeding under the *WURA*, *supra* note 35; on attachment, garnishment, execution or other method of enforcement of a judgment; creditor remedies; most rights of set-off (except in the normal course of clearing and settlement processes); on terminating agreements and conversion of shares.

allows sufficient time to stabilize the situation and set up the bridge bank. The scope of the stay is very broad and includes a stay on all civil proceedings, arbitration, termination of agreements, acceleration of payments, garnishment, execution or other method of enforcement of a judgment, all creditor actions and remedies, and many rights of set-off.[210] The stay is for a period of 90 days from the day on which the bridge bank acquires the asset or assumes the liability.[211] If an agreement with a bank is assigned to or assumed by a bridge bank or a third party, the counterparty is prohibited from terminating or amending the agreement, or claiming an accelerated payment or forfeiture under the agreement, by reason only of insolvency or deteriorated financial condition of the bank, an order creating a bridge bank, specified monetary and non-monetary defaults, or the assignment or assumption of the agreement to or by a bridge institution.[212] The *CDICA* specifies that any stipulation in an agreement is of no force or effect if it has the effect of not allowing the bridge bank to have the rights to use or deal with assets that it would otherwise have on the insolvency of the bank.[213]

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210 Sections 39.15(7), (7.01), (7.1), *ibid.* Nothing prohibits a person from requiring payments to be made in cash for goods, services, use of leased or licensed property or other valuable consideration provided after the making of the order; or as requiring the advance to a federal member institution in respect of which an order is made under s 39.13(1) of money or credit after the making of the order; or requiring the provision to a federal member institution specified services, such as cash management, services related to the redemption of debt instruments or issuance of letters of credit or guarantees, funds transfer services, electronic funds transfer at point of sale services, etc, where to do so would be likely, in the reasonable opinion of the person providing the service, to result in that person advancing money or credit to the federal member institution after the making of the order or to give rise, after the making of the order, to a claim of that person against the federal member institution.

211 Section 39.151, *ibid.* The bridge institution may waive the stay.

212 Section 39.152, *ibid.* Eligible financial contracts as defined in subsection 39.15(9).

213 Section 39.15(2), *ibid.*

Unlike insolvency legislation, eligible financial contracts ("EFC") are temporarily stayed. Pre-global financial crisis, an identified inadequacy in resolution was EFC. That is because the initiation of a resolution process could trigger the simultaneous closing out of large volumes of derivative contracts.[214] 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. A solution is to authorize 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.[215] Canada has adopted such a stay, but only on an extremely limited basis.

A counterparty of an EFC cannot terminate, amend, accelerate or forfeit a term under the contract by reason only of the bank's insolvency or deteriorated financial condition, during the period beginning when an order is made appointing the CDIC as receiver of the distressed bank or an order is made directing incorporation of a bridge bank, and ending on the following business day at 5:00 pm.[216] Any stipulation in an EFC is of no force if it has the effect of providing for or permitting anything that is contrary to provisions of *CDICA,* with the exception that it does not apply in respect of an EFC between the bank and a clearing house.

The stay does not prevent a member of the Canadian Payments Association from ceasing to act as a clearing agent for a federal member institution in accordance with the *Payment Clearing and Settlement Act*[217] and the *Canadian*

214 Basel Committee on Banking Supervision ("BCBS"), "Report and recommendations of the Cross-border Bank Resolution Group" (March 2010), online: BIS <http://www.bis.org/publ/bcbs169.htm> at 40-41.

215 *Ibid.*

216 Sections 39.15(7), (7.01), (7.1), *CDICA*, *supra* note 2.

217 *Payment Clearing and Settlement Act,* SC 1996, c 6; ss 39.15(3.2), (3.3), *ibid.*

Payments Act.[218] However, where CDIC gives an undertaking to provide the financial assistance that the institution needs in order to discharge its obligations to the clearing house as they become due, the clearing house is to continue to act in that capacity for the bank.[219] If an EFC is assigned to or assumed by a bridge bank or a third party, CDIC must assign all of the bank's obligations arising from the EFC, and the bridge bank or third party must assume those obligations. The failed bank's interest or right in property that secures its obligations under the EFC is transferred to that bridge institution or the third party.[220]

While the stay for EFC is a very short period, it is better than the lack of any stay of EFC under the *Bankruptcy and Insolvency Act (BIA)*[221] and the *CCAA*. It allows CDIC a very brief period to determine which EFC it will adopt, where the bank "is in the money", which EFC to assign to a bridge bank or third party, and which to terminate. In the Confederation liquidation in 1994, the liquidator obtained court approval of a one week stay on EFC, which allowed it to collect $400 million in value from counterparties.[222] Arguably, the next day stay in the *CDICA* is not sufficient, and Parliament should consider a longer stay of one to two weeks to allow meaningful decision making.

The bridge bank provisions appear to be well suited for small and medium sized banks, as they allow rapid action to preserve banking services and address the financial distress. Their

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218 *Canadian Payments Act,* RSC 1985, c C-21; s 39.15(3), *CDICA*, *supra* note 2.

219 Section 39.15(3.3), *CDICA*, *ibid.*

220 Sections 39.15(7), (7.2), (7.3), *ibid*. There are extensive and detailed provisions outlining the rights and remedies in assigning EFC.

221 *BIA*, *supra* note 176.

222 *The Attorney General of Canada and Confederation Life Insurance Company*, Court File RE 4315/94, Order of Justice Houlden, Ontario Court of Justice (Gen Div) 15 August 1994 at para 22(d). *In the Matter of Confederation Life Insurance Company*, Court File RE 4315/94, Order of Justice Houlden, Ontario Court of Justice (Gen Div) 15 August 1994. Interview, 21 August 2017, liquidator KPMG, on file with author.

effectiveness as a tool for D-SIB is less clear, in that their structures may be too complex for rapid resolution. However, the statutory framework recognizes that credit must keep flowing in the economy, and the bridge bank tool is an important mechanism for helping that to happen.

iv. Exit from bridge bank resolution

There are three avenues to exit from the bridge bank resolution provisions. One is a share recapitalization, whereby shares of the bridge bank are sold to a third-party purchaser that injects additional capital, subject to ministerial approval and ownership concentration issues being addressed.[223] Another is purchase and assumption, where the assets and liabilities of the bridge bank are transferred to or assumed by one or more purchasers.[224] There also could be an amalgamation of the bridge bank with another financial institution, subject to ministerial approval and provided ownership concentration issues are addressed.[225]

CDIC may hold shares in a bridge bank only if it is the sole shareholder.[226] The bridge bank's designation as a bridge institution terminates if the bank is amalgamated with another financial institution, CDIC is no longer sole shareholder, or when all or substantially all of the bridge bank's assets have been sold or disposed of, and all or substantially all of its liabilities have been assumed or discharged.[227] Once the transfers of assets and liabilities of the distressed bank to a bridge bank are substantially completed, CDIC must apply for a winding-up order under the *WURA* in respect of the financially distressed bank. CDIC is deemed to be a creditor for purposes of *WURA*.[228] CDIC may hold any of the bank's

223 CDIC, Bridge Bank Resolution, *supra* note 187.
224 *Ibid.*
225 *Ibid.*
226 Section 39.3714, *CDICA, supra* note 2.
227 Sections 39.3715, 39.3716, *ibid.*
228 Section 39.3717, *ibid.* The exception is where OSFI has taken control of the distressed bank or its assets and has applied for a winding-up order.

shares that it acquires in the course of a sale or other disposition of its shares of the bridge bank or that a bridge bank acquires in the course of a sale or disposition of its assets for a period of no more than five years from the day on which they are acquired.[229]

v. Financial assistance — "Bail-in"

Bail-in is an important tool for resolution of financially distressed D-SIB. The FSB observes that bail-in, as a resolution tool, is the authority to convert some of a failed bank's debt into equity to recapitalize the bank and help restore it to viability, without the use of government bailout funds.[230] Effective 2016, the Canadian Government introduced bail-in to Canada's bank resolution toolkit, following developments internationally.[231] The conversion of preferred shares and subordinated debt into common shares had already been addressed by OSFI through its capital guidance a couple of years previously. Under that guidance, conversion features for preferred shares and subordinated debt are set in contractual form in the legal documents governing the instruments at time of issuance. That way,

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Sections 39.203(1) and (2), *ibid*. If there is a liquidator of the distressed bank appointed under the *WURA*, *supra* note 35, it is bound by the terms and conditions of any transaction that involves sale or disposition of assets or the assumption by a bridge institution of any portion of the institution's liabilities and it must carry out those transactions or cause them to be carried out, with all related costs payable by the bridge institution.

229 Section 39.3718, *ibid*. The Minister may, by order, extend the period if general market conditions so warrant.
Section 39.372, *ibid*. The bridge bank does not become liable as a successor employer of the financially distressed bank's employees, but that does not affect the liability of a successor employer other than the bridge bank.
Section 39.3719, *ibid*. CDIC employees do not receive any remuneration or benefits from a bridge bank for being a director or officer of that institution.

230 FSB, *Key Attributes, supra* note 7.

231 Legislation relating to Canada's bail-in regime received Royal Assent in June 2016.

investors have certainty as to how they will be treated in the event a bank encounters distress, which facilitates the debt to equity conversion on a timely basis and reduces some of the risk of legal challenge over conversion ratios and other terms and conditions.

The new bail-in regime allows authorities to convert preferred shares and liabilities of a failing D-SIB into common shares to recapitalize the bank.[232] This conversion is aimed at restoring the bank to viability by reducing the liabilities of the bank and increasing the bank's common equity. Recapitalizing the bank in this way can allow the bank to continue operating, and provide assurance to the market, customers, credit rating agencies, and regulators that the bank will be able to remain viable. Arguably, government guarantees will be required to support the recapitalized institution until it can demonstrate that it has corrected the underlying business issues that caused problems in the first place. CDIC can undertake any other restructuring measures necessary to restore the bank to viability, as discussed previously.[233] After completion of the bail-in conversion and restructuring measures, CDIC returns the bank to private control.[234]

The objective of bail-in is to preserve financial stability by authorizing CDIC to quickly restore a failed systemically important bank to viability, allowing it to remain open and

232 Department of Finance, Regulatory Impact Analysis Statement, *supra* note 20; CDIC Annual Report 2017, *supra* note 22: MD&A; once established, further work and consultations will be undertaken with respect to the operational aspects of executing a bail-in conversion. CDIC will also develop by-laws to set out procedural elements, as necessary.

233 The Taxpayer Protection and Bank Recapitalization Program would allow for the permanent conversion of eligible liabilities of a non-viable D-SIB into common shares. It would allow a failing bank to be restructured so that it can keep operating and maintain its critical services, without taxpayer bail-outs: CDIC Annual Report 2017, *supra* note 22 at 77. See also Department of Finance, Regulatory Impact Analysis Statement, *supra* note 19.

234 Department of Finance, Regulatory Impact Analysis Statement, *ibid.*

operating, even where the bank has experienced severe losses.[235] It is aimed at reducing the likelihood of failure of a D-SIB, and reduces government and taxpayer exposure on such a failure. Another objective is to increase market discipline by alerting shareholders and creditors to the fact that they bear the risks of bank failure. CDIC can stabilize a large bank in financial difficulty and ensure losses are to banks' shareholders and creditors in the event of failure, rather than depositors and taxpayers.[236] It does not affect the deposit protection offered by CDIC.

Following resolution, CDIC has authority to offer compensation to prescribed creditors and shareholders if they have been made worse off as a result of CDIC's actions. Compensating them for the liquidation value of their claims mirrors a fundamental principle in insolvency restructuring that creditors should receive at least what they would receive in bankruptcy liquidation.

Implementation of the bail-in regime is expected to result in higher funding costs for D-SIB by reducing the implicit subsidy associated with bank creditors' expectation that they will not suffer losses in the event of a failure. Creditors can no longer expect taxpayers to bear losses instead of them. Banks may be required to pay higher interest rates on long-term senior debt eligible for bail-in, relative to the interest rates paid on existing equivalent senior debt securities.[237]

The federal government has proposed three regulations that will undergird the bail-in tool.[238] The bail-in recapitalization conversion regulations and the bail-in issuance regulations

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235 *Ibid.*
236 *Ibid.*
237 *Ibid.*
238 Legislation introducing the Bank Recapitalization (Bail-in) Regime received Royal Assent on 22 June 2016. The regulations pre-published in June 2017, *ibid*, are important to implementing the bail-in regime: proposed "Bank Recapitalization (Bail-in) Conversion Regulations"; proposed "Bank Recapitalization (Bail-in) Issuance Regulations", proposed "Compensation Regulations".

apply only to systemically important banks; and the compensation regulations apply to all CDIC member institutions.[239] The proposed regulations were published in June 2017 and are expected to be promulgated late 2017.[240]

vi. Bank Recapitalization (Bail-in) Conversion Regulations

The proposed "Bank Recapitalization (Bail-in) Conversion Regulations", pursuant to the *CDICA,* set out the scope and terms of bail-in recapitalization.[241] CDIC must take into consideration *Bank Act* requirements that banks maintain adequate capital and ensure that creditor hierarchy is respected. Regarding order of conversion, bail-in eligible instruments can only be converted after all subordinate ranking bail-in eligible instruments and non-viability contingent capital ("NVCC") preferred shares have been converted.[242] Holders of equally ranking instruments should be treated equally; equally ranking bail-in eligible instruments must be converted in the same proportion, *pro rata,* and receive the same number of common shares per dollar of the claim that is converted.[243] Finally, in recognizing the relative creditor hierarchy, holders of bail-in eligible instruments must receive more common shares per dollar of the claim that is converted than holders of subordinate ranking bail-in eligible instruments and NVCC that have been converted.[244] The

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239 *Ibid.*

240 *Ibid.* The proposed "Bail-in Scope and Conversion Regulations" and "Bail-in Issuance Regulations" would come into force 180 days after the day on which they are registered. The proposed "Compensation Regulations" would come into force on the day that is the later of the day on which they are registered or the day on which the amendments to the *CDICA*, *supra* note 2, come into force.

241 *Ibid.*

242 *Ibid.*

243 *Ibid.*

244 *Ibid.* Through existing powers, the GIC and CDIC would also be able to ensure that senior bail-in debt holders are better off than holders of legacy capital instruments, *ie*, the ones that are not NVCC and that would not be eligible for conversion under the bail-in power. For example, resolution actions could result in holders of legacy capital

bail-in power is not retroactive, and thus the conversion regulations will only apply to instruments that were issued, or amended to increase their principal value or extend their term, after the Regulations come into force.

The bail-in conversion is the first avenue to recapitalize the financially distressed bank. The preferred shares are the first to be subordinated by conversion into common shares, but it is the conversion of subordinated debt next that is the more effective tool to recapitalize, as there will no longer be that debt owed by the bank. Once the conversion procedure starts to access more senior debt, there could be litigation challenging the conversion tool. The terms of conversion are not yet clear; nor is the relationship between terms of conversion in contractual arrangements going forward and the conversion regulation.

vii. Bank Recapitalization Issuance Regulations

The *Bank Act* authorizes the GIC to make regulations respecting the conditions that systemically important banks must meet in issuing or amending bail-in eligible shares and liabilities. The proposed "Bank Recapitalization (Bail-in) Issuance Regulations", pursuant to the *Bank Act,* set out requirements that D-SIB must follow when issuing bail-in eligible securities.[245] The proposed Regulations are aimed at allowing CDIC's bail-in conversion powers to be exercised and enforceable with respect to all bail-in eligible shares and liabilities, even where these shares and liabilities are governed by foreign law. They allow investors to have greater clarity as to which bank issuances are eligible for CDIC's bail-in conversion powers.[246] To facilitate enforceability of the bail-in power, particularly in a cross-border context, the proposed Regulations require that

instruments incurring losses where those instruments are vested in CDIC by the GIC, pursuant to s 39.13(1)(a), *CDICA, supra* note 2.

245 Section 39.2(2.4), *CDICA*, *ibid*, specifies that the terms, conditions and timing of a bail-in conversion shall be set by CDIC, subject to any regulations and CDIC by-laws.

246 Department of Finance, Regulatory Impact Analysis Statement, *supra* note 19.

shares and liabilities within the scope of bail-in indicate in their contractual terms that the holder of the instrument is bound by the application of the *CDICA*, including the conversion of the instrument into common shares under the bail-in power.[247] The proposed Regulations require that these new contractual terms be governed by Canadian law, even where the rest of the contract is governed by foreign law, and will require disclosure to investors that an instrument is eligible for a bail-in conversion in the prospectus or other relevant offering or disclosure document.[248]

All newly issued instruments that are long-term (400 or more days), unsecured senior debt that is tradable and transferable would be eligible for a bail-in conversion.[249] Newly issued preferred shares and subordinated debt are also eligible for bail-in if they are not NVCC preferred shares.[250] NVCC instruments are not included in the scope of bail-in, given that they are already convertible into common shares pursuant to their contractual terms. Secured liabilities such as covered bonds, EFC such as derivatives, or structured notes are not eligible for conversion under bail-in.[251] A key point of uncertainty is the conversion ratio for senior debt into common shares. While it needs to be at least as generous as the ratio used for subordinated debt and preferred shares, how much more generous? That legal uncertainty may hinder the ability to deploy this tool on a timely basis without excessive litigation risk. There is also a question of what will happen to

247 *Ibid.*

248 *Ibid.* Failure to meet these requirements for a given issuance would not exempt that issuance from being eligible for bail-in.

249 *Ibid.* An instrument is considered tradable and transferable if it has a Committee on Uniform Securities Identification Procedures ("CUSIP") number, International Securities Identification Number ("ISIN") or other similar identification.

250 *Ibid.* The briefing note says: "However, in practice, banks are not expected to issue any such instruments, as preferred shares and subordinated debt are almost exclusively issued in the form of NVCC in order to have them count towards existing regulatory capital requirements set by OSFI."

251 Proposed "Bail-in Issuance Regulation", *supra* note 238, pursuant to the *Bank Act*, *supra* note 2.

the funding markets for banks after it has been deployed. It may cause banks to destabilize sooner if markets become jittery faster, which could reduce the effectiveness of the remedy for other banks.

The goal is to minimize the practical and legal impediments to exercising a bail-in conversion in a timely fashion and to minimize potential adverse impacts on banks' access to liquidity under stress.

viii. Compensation Regulations

The proposed Compensation Regulations, pursuant to *CDICA,* set out a process for providing creditors and shareholders of financial institutions with compensation from CDIC following a resolution process. The compensation process involves a test of whether the resolution transaction undertaken by CDIC was reasonable in the circumstances.[252] The June 2017 legislative amendments revised the compensation process by setting out a test for entitlement to compensation consistent with international standards and best practices, and moving most elements of the process into regulations and CDIC by-laws.[253] The goal is to provide greater flexibility as experience is gained with the new resolution regime.

The new compensation test is whether the relevant shareholders and creditors have been made worse off as a result of CDIC's actions than they would have been if the bank had been liquidated.[254] "Prescribed persons" entitled to compensation are persons who hold the following claims in the bank at the time of entry into resolution: shares of the institution; subordinated debt instruments that were vested in

252 Sections 39.23 to 39.37, *CDICA*, *supra* note 2. *CDICA* sets out detailed procedural requirements.

253 Department of Finance, Regulations to Implement Bank Recapitalization, *supra* note 27.

254 Adapting or repealing and replacing ss 39.23 to 39.37, *CDICA*, *supra* note 2. These amendments would be brought into force concurrently with the proposed Regulations.

CDIC; liabilities that were subsequently converted into common shares pursuant to their contractual terms and conditions, such as NVCC; liabilities that were subsequently converted into common shares pursuant to the bail-in power; any liability of the bank if it was wound up at the end of the resolution process; and any liability of the bank that was assumed by either a CDIC-owned workout company or bridge bank that was subsequently liquidated or wound up.[255]

Individuals who hold liabilities of the bank at the time of entry into resolution that were subsequently assumed by a solvent third party or a bridge bank are not entitled to compensation because they continue to have a claim of the same value and type against a solvent going-concern entity, for example, the bank restored to viability, a third party or a bridge institution.[256] If amounts owing are subsequently paid off in full during the resolution process, there is no need for, and thus no right to compensation.

The right to compensation is a personal right, not transferable. This limitation is intended to reduce the potential role of speculators in the compensation process, support administrative simplicity of the process, and ensure greater alignment between individuals entitled to compensation and the creditors and shareholders affected by CDIC's resolution actions.

Compensation will be based on the difference between an estimate of what prescribed persons would have received if the institution had been wound up, *ie*, the liquidation value, and an estimate of the resolution value, *ie*, what they receive through the resolution process.[257] In practice, it may be difficult to calculate this value; it is thus far untested.

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255 Department of Finance, Regulations to Implement Bank Recapitalization, *supra* note 27.

256 *Ibid.*

257 *Ibid.* If there is no difference, there is no entitlement to compensation.

Fairness underpins the compensation scheme. CDIC must make the same offer of compensation to prescribed persons who held shares or liabilities of the same class in proportion to their claim. Shares or liabilities are deemed to be in the same class if they would rank equally in the event of a winding-up and received equivalent treatment in the resolution. The proposed Regulations set out certain assumptions that CDIC must take into account when determining the offer of compensation.[258] Since resolution, as with restructuring plans under regular insolvency law, is aimed at preserving more than the liquidation value of a bank, the government believes that the amount of compensation owing is likely to be little or none in most cases.[259]

Notice is to be given within a reasonable period of time following the completion of the resolution process. "Reasonableness" is likely to vary with the size and complexity of the resolution process. The offerees will have 45 days to notify CDIC of their acceptance of, or objection to, the offer received; and failure to notify CDIC will be deemed acceptance of the offer.[260] This "scream or die" approach assists with expediting the process, as failure to respond counts as approval. CDIC is to pay the entitled compensation to the creditors and/or shareholders within 90 days of expiry of CDIC's offer of compensation, if the offer was accepted, or the final determination of an assessor, where used.[261]

The proposed regulations specify the conditions under which the GIC is required to appoint a judge as an assessor to review CDIC's determination of compensation for prescribed

258 *Ibid.* For example, in estimating the liquidation value of shares or liabilities, CDIC would be required to assume that in the counter-factual scenario of the bank being liquidated, the bank would not have received any financial assistance or support from CDIC, the Bank of Canada, the Government of Canada or a province in the process.

259 *Ibid.*

260 *Ibid.*

261 *Ibid.*

persons.[262] The threshold for requiring an assessor to be appointed is persons who held 10% of the value of debt or 10% of the shares of a given class objecting to CDIC's offer. Those objecting persons would be entitled to have their compensation determined by the assessor.[263] Those persons who accepted CDIC's offer would receive the amount set out in the offer.[264] In reviewing CDIC's offer of compensation, the assessor will consider whether CDIC's offer was reasonable and consider the same factors CDIC was required to apply when making its initial determination of compensation. Pursuant to *CDICA,* the assessor's decision regarding compensation owed is final and conclusive.

The three proposed regulations offer more detail regarding how the bail-in recapitalization tool is to work and what the permissible compensation will be for its use. One area that is likely to be litigated is how one determines the "no less than liquidation value" in the conversion of debt to equity. While creditors will be alerted to the possibility of conversion in contracts going forward, the amount of compensation to which the debt is entitled on conversion could be highly contested.

3. Liquidation of a Bank

Bank exit is an important feature of the bank resolution regime. The previously-discussed recent developments build on existing provisions under the *Bank Act* and the *WURA* for wind-up of banks. While the goal of the new regime is to resolve without winding-up, where possible, a brief description of the liquidation regime completes the picture of the structural supports in the bank resolution regime in Canada. Depending on whether a bank is solvent or insolvent, different statutory frameworks must be accessed.

262 Section 39.26, *CDICA, supra* note 2, requires the appointed third-party assessor to be a federal judge. *Ibid.*

263 Department of Finance, Regulatory Impact Analysis Statement, *ibid.*

264 *Ibid.*

i. Liquidation pursuant to the Bank Act

The *Bank Act*'s liquidation and dissolution provisions allow for voluntary liquidation and court-supervised liquidation of solvent banks, which can include at-risk banks that are not yet insolvent. A liquidator is appointed to wind-up the business.[265] A "simple liquidation" procedure is available where the bank has no property and no liabilities.[266] Directors or shareholders of a bank may propose a voluntary liquidation and dissolution.[267] Shareholders of a bank can vote by special resolution for liquidation, requiring votes by class where there are different classes of shares.[268] Ministerial approval of the liquidation is required, after which there is a process for giving notice to known claimants and creditors, as well as public notice.[269] Following ministerial approval, the bank can proceed to collect and dispose of property; liquidate the business; adequately provide for the payment or discharge of all its obligations; and distribute its remaining property, either in money or in kind, according to shareholders' respective rights.[270] The bank cannot carry on business except to the extent necessary to complete liquidation.[271] Where the voluntary process is not contested before a court, and once the Minister is satisfied that the provisions of the *Bank Act* have been complied with, the Minister will issue letters patent to

265 Section 341, *Bank Act*, *supra* note 2:

> 341 A liquidator appointed under this Part to wind up the business of a bank shall provide the Superintendent with such information relating to the business and affairs of the bank in such form as the Superintendent requires.

266 Section 342, *Bank Act*, *ibid.*

267 Section 343, *Bank Act*, *ibid.* "Bank" here includes federal credit union.

> 343(2). A notice of any meeting at which the voluntary liquidation and dissolution of a bank is to be proposed must set out the terms of the proposal.

268 Section 344, *Bank Act*, *ibid,* as well as members and shareholders of a credit union for a credit union liquidation.

269 Section 345, *Bank Act*, *ibid.*

270 Section 345(4), *Bank Act*, *ibid.*

271 Section 345(3), *Bank Act*, *ibid.*

declare the bank dissolved, at which time the bank ceases to exist.[272] The *Bank Act*'s liquidation and dissolution provisions are stayed if the bank is at any time found to be insolvent within the meaning of the *WURA*.[273]

Under the court-supervised liquidation process, OSFI or any interested person may, at any time during the liquidation of a bank, apply to a court for an order for continuance of the voluntary liquidation under supervision of the court, stating the reasons why court supervision is needed.[274] The court must be satisfied that the bank is able to adequately provide for the discharge of all its obligations. Pursuant to the *Bank Act,* the court can order notice, order liquidation, appoint a liquidator, with or without security, validate claims, impose a stay on activities of directors and officers, determine duties or liabilities of any present or former director, officer, or shareholder, distribute property, or make any order it thinks fit.[275]

When a liquidation order is made, the bank continues in existence but must cease carrying on business, except as the liquidator decides is required for an orderly liquidation.[276] The powers of the directors and shareholders are vested in the liquidator, except as specifically authorized by the court.[277] The liquidator's duties are extensive, and include giving broad notice,[278] receiving claims, taking custody and control of the

272 Section 346, *Bank Act*, *ibid.*
273 Section 340(2), *Bank Act*, *ibid*; *WURA*, *supra* note 35.
274 Section 347, *Bank Act*, *ibid.* Verified by an affidavit of the applicant. Section 347(3), *Bank Act*, *ibid.* The applicant must give notice to the Superintendent, who has a right to be heard.
275 Sections 348, 349, *Bank Act*, *ibid.*
276 Section 350, *Bank Act*, *ibid.*
Section 351, *Bank Act*, *ibid.* The Court can appoint any person, including a director, an officer, a shareholder or a member of the bank or any other bank, as liquidator of the bank.
277 Section 350, *Bank Act*, *ibid.*
278 Section 353(1)(b), *Bank Act*, *ibid.* Notice to every claimant, creditor and the Superintendent, publishing notice in all jurisdictions where the bank has transacted any business within the preceding 12 months.

bank's property, collecting assets, opening and maintaining trust accounts, keeping accounts, and reporting periodically to the Superintendent and the court.[279] Claims must be made within 60 days after first publication of the notice.[280] If, at any time, the liquidator determines that the bank is unable to discharge its obligations, it must apply to the court for directions.[281] Subject to the rights of secured creditors, the *Bank Act* sets out a hierarchy of priority claims.

The powers accorded the liquidator under the statute are broad, including bringing or defending any action on behalf of the bank, hiring financial and legal expertise, and borrowing money on the security of the property of the bank.[282] After the final accounts are approved by the court, the liquidator distributes any remaining property among shareholders according to their respective rights.[283] The court approves distributions of remaining property, final accounts, and giving a final order directing the bank to apply to the Minister for letters patent dissolving the bank, directing the custody or disposal of records and registers of the bank, and discharging the liquidator.[284]

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279 Section 353, *Bank Act*, *ibid.*
280 Section 353(1)(b)(iii), *Bank Act*, *ibid.*
281 Section 353(1)(g), *Bank Act*, *ibid.*
282 Section 353, *Bank Act*, *ibid.*

> 355(1) Where a liquidator has reason to believe that any property of the bank is in the possession or under the control of a person or that a person has concealed, withheld or misappropriated any such property, the liquidator may apply to the court for an order requiring that person to appear before the court at the time and place designated in the order and to be examined.
>
> 355(2) Where an examination conducted pursuant to subsection (1) discloses that a person has concealed, withheld or misappropriated any property of the bank, the court may order that person to restore the property or pay compensation to the liquidator.
>
> 356 A liquidator shall pay the costs of liquidation out of the property of the bank and shall pay or make adequate provision for all claims against the bank.

283 Section 353(1)(i), *Bank Act*, *ibid.*
284 Sections 357, 358, *Bank Act*, *ibid.*

The *Bank Act* sets out rights to distribution or to exchange of all or substantially all of the remaining property of the bank for securities of another entity that are to be distributed to the shareholders.[285] If one of these parties requests the distribution in money, the court must fix a fair value on the share of the property of the bank attributable to the person, and can appoint one or more appraisers to assist the court.[286] Similar to voluntary liquidation, the Minister, on receipt of a court order, may issue letters patent dissolving the bank, and the bank ceases to exist on the date of the issuance of the letters patent.[287]

The liability standard for the liquidator is similar to other insolvency statutes. A liquidator is not liable if it exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances, including reliance in good faith on financial statements of the bank represented to the liquidator by bank officers or auditor reports of the bank fairly reflecting the financial condition of the bank; or a report of a person whose profession lends credibility to a statement made by them.[288]

ii. Bank liquidation under the Winding-up and Restructuring Act

If a bank is insolvent, liquidation proceedings are brought pursuant to *WURA*. A company is deemed insolvent under *WURA* if it is unable to pay its debts as they become due;[289] if it calls a meeting of its creditors for the purpose of

285 Section 353, *Bank Act*, *ibid*.
286 Section 353, *Bank Act*, *ibid*.
287 Section 360, *Bank Act*, *ibid*.
288 Section 354, *Bank Act*, *ibid*.
289 Sections 3, 4, *WURA*, *supra* note 35:

> 4 A company is deemed to be unable to pay its debts as they become due whenever a creditor, to whom the company is indebted in a sum exceeding two hundred dollars then due, has served on the company, in the manner in which process may legally be served on it in the place where service is made, a demand in writing, requiring the company to pay the sum due, and the company has, for sixty days next after the service of the demand, neglected to pay the sum or to secure or compound for the sum to the satisfaction of the creditor.

compounding with them; if it exhibits a statement showing its inability to meet its liabilities; or if it has otherwise acknowledged its insolvency.[290] It is also deemed insolvent if it assigns, removes or disposes of any of its property with intent to defraud, defeat or delay its creditors, or attempts to do so; or if it has procured money, goods, chattels, land or property to be seized, levied on or taken, by any process of execution with intent to defraud, defeat or delay its creditors. It is also deemed insolvent if it has made any general conveyance or assignment of its property for the benefit of its creditors; or if it is unable to meet its liabilities in full, it makes any sale or conveyance of the whole or the main part of its stock in trade or assets without the consent of its creditors or without satisfying their claims.[291] The winding-up is deemed to commence at the time of the service of the notice of presentation of the petition for winding-up.[292]

A court may make a winding-up order in respect of a bank or foreign authorized bank where the bank is insolvent or where OSFI has taken control of a bank or its assets pursuant to the *Bank Act*.[293] The directors, officers and employees are required to make disclosures that allow "a just estimate of the affairs" of the bank.[294] From the time of the winding-up order, the bank is to cease carrying on its business, except in so far as the

290 Section 3, *WURA, ibid.*

291 Section 3, *WURA, ibid.* It is also deemed insolvent if it meets one of a long list of conditions under s 3.

292 Section 5, *WURA, ibid.*

293 Sections 10, 10.1, *WURA*, *ibid.*
Section 6, *WURA*, *ibid.* The Act applies where a corporation is in liquidation or winding-up and, on petition by any of its shareholders/members or creditors, assignees or liquidators, asks to be brought under this Act; or if it is a financial institution, is under the control, or its assets are under the control, of the Superintendent and is the subject of an application for a winding-up order. Part II Authorized Foreign Banks applies only to the winding-up of the business in Canada of authorized foreign banks and to the liquidation of their assets. Part III of *WURA* addresses the restructuring of insurance companies.

294 Section 15, *WURA*, *ibid.*

liquidator deems necessary for the beneficial winding-up.[295] The effect of a winding-up order is that no suit, action or other proceeding can be commenced or continued against the bank, except with leave of the court. All transfers of shares are void, except transfers made with approval of the liquidator under the authority of the court.[296] Any attachment or execution against the order is void, but there is a carve out for EFC.[297]

The liquidator is either the CDIC or a licensed insolvency trustee under the *BIA*.[298] OSFI and CDIC confer on who the liquidator should be, and CDIC enters into nomination agreements with the liquidator, setting terms of engagement, including frequency of reporting, billing rates and other expectations. On appointment of a liquidator, all powers of the directors cease, except in so far as the court or the liquidator approves continuance of those powers.[299] A liquidator takes custody and control of all property, effects and choses, and winds-up the business.[300] It can also, on notice and with approval of the court, bring or defend any action or other legal proceeding; sell or transfer the real and personal property, effects and choses in action of the company by public auction or private contract; and act in the name and on behalf of the company on a number of financial matters.[301]

295 Section 19, *WURA*, *ibid.*

296 Sections 20, 21, *WURA*, *ibid.* See also ss 17, 18, *ibid*: The *WURA* allows the court to make an order staying further proceedings in any action, suit or proceeding against the company, on such terms as the court thinks fit, or staying proceedings in respect of the winding-up.

297 Sections 22, 22.1, *WURA*, *ibid.*

298 Sections 23, 25, 26, *WURA*, *ibid.*

> 27 The court shall determine what security shall be given by a liquidator on [its] appointment.

299 Section 31, *WURA*, *ibid.*

300 Section 33, *WURA*, *ibid.*

301 Section 35, *WURA*, *ibid.* See also:

> 37 A liquidator may, with the approval of the court, compromise all calls and liabilities to calls, debts and liabilities capable of resulting in debts, and all claims, demands and matters in dispute in any way relating to or affecting the assets of the company or the winding-up of the company, on the receipt of such sums, payable at such times, and generally on such terms, as are agreed on.

A liquidator may, with approval of the court, make any compromise or arrangements that it considers appropriate with creditors.[302] A court may appoint one or more inspectors, whose duty it is to assist and advise a liquidator in the liquidation of a company.[303]

There are provisions for identifying contributories who may be liable to contribute assets.[304] A court may, if it thinks expedient, direct meetings of the creditors, contributories, shareholders or members of a company for the purpose of ascertaining their wishes.[305] In particular, the court can order a creditors' meeting where any compromise or arrangement is proposed in the course of the bank being wound-up.[306] If a majority in number representing three-fourths in value of the creditors or classes of creditors, present or by proxy, agree to any arrangement or compromise, it may be sanctioned by the court, and is binding on all the creditors, the liquidator and contributories of the company.[307] Clerks and other employees have a limited priority of three months of salary due and unpaid to them at the time of the making of a winding-up order.[308] Set-off applies.[309] The court can fix a date for claims to be filed; the liquidator sends a notice to creditors and can ask claimants to furnish more proof. Creditors can request to have disputed claims determined by the court.[310] After notice and the claims process, the liquidator may distribute the assets of the bank among persons entitled to them.[311]

302 Section 38, *WURA*, *ibid.*
303 Section 41, *WURA*, *ibid.*
304 Sections 50 to 62, *WURA*, *ibid.*
305 Section 63, *WURA*, *ibid.*
306 Section 65, *WURA*, *ibid.*
307 Section 66, *WURA*, *ibid.*
308 Section 72, *WURA*, *ibid.*
309 Section 73(1), *WURA*, *ibid.*
310 Sections 74, 75(1) to (3), *WURA*, *ibid.*
311 Sections 76, 77, *WURA*, *ibid.* See also s 71(1): All debts and other claims against the bank in existence at the commencement of the winding-up, certain or contingent, matured or not, and liquidated or unliquidated, are admissible to proof against the bank, and the amount of any claim admissible to proof is the unpaid debt or other

Secured creditors must specify the nature and amount of their security, and, on oath, put a specified value on the security.[312] The liquidator, under the authority of the court, may either consent to the retention by the creditor at the value specified in the security documents, or may require from the creditor or person an assignment and delivery of the security, property and effects at the specified value, to be paid by the liquidator out of the estate as soon as the liquidator has realized the security.[313] If the secured creditor retains the asset, the difference between the value at which the security is retained and the amount of the claim is the amount for which the creditor may rank in any future distribution of assets.[314] The *WURA* also has provisions for where a person holds security on the assets of an authorized foreign bank, other than assets in respect of its business in Canada.[315] The liquidator, in preparing the dividend sheet, must have due regard for the rank and privilege of every creditor, and no dividend can be paid to any secured creditor until the amount for which it may rank with respect to dividends is established.[316]

Objections to any claims must be filed in writing with the liquidator, together with supporting evidence, and the claimant has six days to answer the objections, or such further time as the court allows. The contestant (objecting party) has three days to reply, or such further time as the court allows.[317] The court hears and decides the matter.[318]

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liability outstanding or accrued at the commencement of the winding-up.
See also s 71(2), *WURA*, *ibid*: If the claim is subject to any contingency or for unliquidated damages, the court is to determine the value of the claim and the amount for which it shall rank.

312 Section 78, *WURA*, *ibid.*

313 Section 79, *WURA*, *ibid*: Together with interest on the value from the date of filing the claim. See also s 78: In the case of an authorized foreign bank, this duty is one of the creditor or person who holds security of the property and effects constituting the security or on which it attaches.

314 Section 80, *WURA*, *ibid.*

315 Sections 81.1, 82, 83, 84, *WURA*, *ibid.*

316 Section 85, *WURA*, *ibid.*

All costs, charges and expenses properly incurred in the winding-up of a company, including the remuneration of the liquidator, are payable out of the assets of the company in priority to all other claims.[319] There are a series of fraudulent preference provisions, including gratuitous contracts, contracts made with intent to defraud or delay creditors, and sales in contemplation of insolvency.[320] If a company has paid a dividend within 12 months prior to commencement of the winding-up, other than a stock dividend, or redeemed or purchased for cancellation any of the shares of the capital stock, the court may, on application of the liquidator, determine if the payment, redemption or purchase occurred when the company was insolvent or if it rendered the company insolvent.[321] Directors can be held personally liable, jointly and severally, where the court finds that the transaction occurred when the company was insolvent or it rendered the company insolvent; and the directors did not have reasonable grounds to believe the company was solvent or the transaction would not render the company insolvent.[322] The court is to consider whether the directors acted as prudent and diligent persons would have acted in the same circumstances and whether the directors in

317 Sections 87, 88, *WURA*, *ibid.*
318 Section 89, *WURA*, *ibid.*
319 Section 94, *WURA*, *ibid.* Section 95 specifies that after the satisfaction of the debts and liabilities of the company and the winding-up charges, costs and expenses, any residual value is distributed among the shareholders according to their rights and interests in the company.
320 Sections 96-101, *WURA*, *ibid.*
321 Section 102.1, *WURA*, *ibid.*
322 Section 102.1(2), *WURA*, *ibid.*

140 If it appears in the course of the winding-up that any past or present director, manager, officer or member of the company is guilty of an offence in relation to the company for which he [or she] is criminally liable, the court may, on the application of any person interested in the winding-up, or of its own motion, direct the liquidator to institute and conduct a prosecution or prosecutions for the offence and may order the costs and expenses to be paid out of the assets of the company. *WURA*, *ibid.*

good faith relied on financial or other statements of the company represented to them by its officers or auditor.[323]

All dividends deposited in a bank by the liquidator after the final winding up of the bank, and remaining unclaimed are to be left for three years, subject to the claim of the persons entitled; and then if unclaimed, paid over, with interest accrued, to the Minister of Industry. If such dividends are afterwards claimed, they are to be paid, with that interest, to the persons entitled to them.[324]

Thus, the liquidation regime for banks offers a clear exit when a non-viable or insolvent bank cannot be resolved using other tools in the resolution tool box. It is the last resort action that offers certainty to creditors on failure of the bank.

4. How Canada Measures against International Developments

As the discussion illustrates, Canada's bank resolution regime meets most of the FSB's key attributes for an effective resolution regime, including a resolution authority with power to: replace directors and officers, appoint an administrative authority, operate and resolve the bank on a going-concern basis, ensure continuity of essential services, transfer or sell assets and liabilities, establish a bridge bank, and use bail-in to more fairly allocate the costs of failure. It does not establish one resolution authority nationally for all financial institutions.[325]

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323 Sections 102.1(3), (7), *WURA*, *ibid.* The onus is on the directors and officers to prove the bank was not insolvent or rendered insolvent, and that there were reasonable grounds for the decision, by written reports of the auditor to fairly reflect the financial condition of the company; or a report relating to the company's affairs prepared pursuant to a contract with the company by a lawyer, notary, an accountant, engineer or appraiser or other person whose profession gave credibility to the statements made in the report.

324 Sections 138, 139, *WURA*, *ibid.*

325 FSB, *Key Attributes*, *supra* note 7 at 5-6. The FSB recommends that each jurisdiction should have a designated administrative authority or authorities responsible for exercising the resolution powers over firms. It notes, however, that where there are multiple resolution authorities within a jurisdiction their respective mandates, roles and

In 2016, the FSB published a study summarizing a series of peer reviews regarding timely and consistent implementation of the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions*.[326] It found that six EU jurisdictions and Switzerland have the full range of resolution powers; and the US has all the resolution powers except explicit power for the resolution authority to require continued provision of critical shared services by group companies. Canada was one of six jurisdictions to have put in place most of the recommended powers.[327] However, the FSB identified one gap: the lack of explicit power in Canada to ensure continuity of shared services and functions by other entities, whether or not regulated, within the same financial group as the bank in resolution.[328] It also noted the limited resolution power of CDIC, in that it only covers member institutions, not related entities that are not member institutions.[329]

The FSB peer review expressed general concern about jurisdictional divergence in conditions relating to deterioration, risk of default and non-viability risks that could impede coordinated resolution action across

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responsibilities should be clearly defined and coordinated. The FSB *Key Attributes* report also specifies that where different resolution authorities are in charge of resolving entities of the same group within a single jurisdiction, the resolution regime of that jurisdiction should identify a lead authority that coordinates the resolution of the legal entities within that jurisdiction.

326 FSB, "Second Thematic Review on Resolution Regimes" (18 March 2016), part of the commitment by FSB member countries to undergo periodic peer review. FSB <http://www.fsb.org/2016/03/second-thematic-review-on-resolution-regimes/> ["FSB, Second Thematic Review"].

327 *Ibid*. The remaining ten jurisdictions have four or fewer of the required resolution powers. The powers lacking are continuity powers, bail-in or a stay on the exercise of early termination rights. A number of jurisdictions still rely largely on supervisory powers or sector-specific insolvency law without a designated administrative resolution authority with a broad range of powers they can exercise without prior shareholder or creditor approval.

328 *Ibid* at 18-19.

329 *Ibid* at 26.

jurisdictions in relation to a cross-border bank.[330] While Canada has signed memoranda of understanding ("MOU") with the US and the UK regarding resolution cooperation, the MOU are non-binding. There continues to be a risk that such agreements are abandoned in favour of foreign domestic priorities in times of financial crisis, particularly where views differ as to who should bear the costs of resolution of a cross-border insolvent bank.[331]

The FSB report observed that the temporary stay on EFC in Canada is only available where there is a transfer to a bridge bank, not under the other resolution tools.[332] It also noted that resolution plans were limited at that time to D-SIB, a mid-sized bank, one Canadian subsidiary of a G-SIB and one small domestic bank, but could be ordered by OSFI on a case-by-case basis.[333]

Thus, while Canada measures relatively well against the international standards, there are several gaps in its resolution framework.

5. Should There be One National Bank Resolution Authority?

A completely under-explored question in the Canadian public policy landscape is whether or not there should be one national resolution authority for all financial institutions in Canada. This article is not suggesting there should be, but rather, the public policy discussion never occurred and thus it is unknown. What is evident is that there is a risk of fragmentation in approaches to resolution where the distressed bank is part of a conglomerate with banks, broker dealer entities, investment funds, and other financial services

330 *Ibid* at 22.

331 The IMF observes that home and host jurisdictions can have conflicting interests when required to provide liquidity to the cross-border bank; IMF, "Cross-Border Bank Resolution: Recent Developments" (June 2014), online: IMF <http://www.imf.org/external/np/pp/eng/2014/060214.pdf> at 20.

332 FSB, "Second Thematic Review", *supra* note 326 at 28.

333 *Ibid* at 33.

entities. There is lack of clarity of leadership in decision and resolution authority, given the complex processes, and both federal and provincial oversight and resolution authorities. No one authority can expeditiously monitor and resolve financial conglomerates covering several types of financial institutions.

In the resolution regime, there is overlap of authority at various points in bank distress, including OSFI, CDIC, the Investment Industry Regulatory Organization of Canada, provincial securities regulators and provincial financial services commissions. While it appears from the 2017 amendments to *CDICA* that CDIC is the lead decision authority on bank resolution, there remains some lack of clarity in the law, given the retention by OSFI of take-control powers. In addition, OSFI's authority to require a restructuring is unclear under the current legislation. The current statutory framework is likely to be tested in the future. While it is likely that the entity most at risk in the conglomerate will be a bank and thus the CDIC could take the lead, there are potential contagion effects both ways between the bank and the other entities. There could be billions of dollars in underwriting, bonds or derivatives between the entities, or between the entities and third-party counterparties, with a lack of clarity of which entity books what. A serious issue with a broker dealer entity could contaminate the related bank financially or reputationally very rapidly. Any cross-contagion may be exacerbated while authorities figure out how to work together effectively to resolve the situation. While the current system is messy, but arguably manageable, it could be improved, given the importance of our financial institutions to the economy.

One thing that Parliament could do now is to clarify what entity is the lead macroprudential authority when there is a conglomerate that has a deposit-taking bank, a brokerage entity and/or an investment fund, as the non-viability of one entity can cause stress or solvency issues in the related entities. Even though some entities within one business enterprise group

can be federally regulated and others provincially regulated, designation of a lead authority on insolvency is unlikely to cause problems under current paramountcy tests. That leadership could assess the risk across the bank enterprise group, and take preventive and early intervention measures as required, with a full range of resolution powers.

Another issue arises in respect of cross-border bank resolution. Where the resolution authority is seeking endorsement of bank resolution in a foreign jurisdiction, it cannot take advantage of the UNCITRAL Model Law on Cross-border Insolvency, as financial institutions have been excluded from those provisions where they have been enacted into law. A government agency may have better chance of initial recognition in an outbound proceeding, or in dealing government to government on the failure of a systemically important bank that operates in multiple jurisdictions. The current provisions do not expressly address this issue and it may not be clarified until the first litigation. On the in-bound side, where a Canadian court is being asked to recognize a foreign or cross-border bank resolution plan, there may be an issue as to who would serve in a role similar to a court-appointed officer, to provide the court with an informed opinion as to the fairness and reasonableness of what the court is being asked to approve.

Canada has chosen the deposit insurance corporation as the resolution authority for banks. When the CDIC was originally created 50 years ago, Parliamentary debates record that "the legislation was intended to prevent a run or attempted run on a federal institution".[334] Three purposes were given for CDIC's creation: to protect the public by ensuring the safety of the bank savings of individuals; to act as a lender of last resort for member institutions, a role to be shared with the Bank of Canada; and to provide regular inspections and some control of

334 Canada Hansard, *Senate Debates,* 27th Parl, 1st Sess, Vol 2 (16 February 1967) at 1452-1460 (Hon John J Connolly, Hon Allister Grosart), online: Parliament of Canada <http://parl.canadiana.ca/view/oop.debates_SOC2701_02/439?r=0&s=1>. Second reading of Bill C-261, which established the CDIC.

the financial affairs of member institutions, with the objective of bringing about gradual improvement in the minimum financial standards.[335] The creation of CDIC was also intended to stimulate confidence in deposit-taking institutions.[336]

When the *CDICA* was amended in 2016, the focus of the parliamentary discussion was to make creditors and equity holders responsible for the bank's risks, not taxpayers.[337] The government highlighted that the changes were driven by developments internationally at the G20 and many international organizations to maintain stability in the financial sector and address the fact that taxpayers should not bear the costs of recapitalization.[338] The purpose of the amendments was to designate the CDIC as the bank resolution authority for its members, the Department of Finance advising Parliament that it was mostly a formality, since CDIC was already able to resolve a bank in the case of a failure.[339] The changes were also intended to provide transparency regarding CDIC's activities as the resolution authority for its members.[340]

335 *Ibid.*

336 *Ibid.*

337 *Bill C-15, An Act to implement certain provisions of the budget tabled in Parliament on March 22, 2016, and other measures*, Hansard 49, 1st Sess, 42nd Parl, (5 May 2016), online: Parliament of Canada <https://openparliament.ca/debates/2016/5/5/francesco-sorbara-1>. Presenter: Francesco Sorbara, MP for Vaughan-Woodbridge, ON, described as: "Bill C-15 introduces a bail-in regime that applies to Canada's domestic systemically important banks, overseen by regulators including the CDIC. Under the new regime, regulators would be allowed to recapitalize a failing bank by converting eligible long-term debt into shares."

338 *Ibid.*

339 *Bill C-44, An Act to implement certain provisions of the budget tabled in Parliament on March 22, 2017, and other measures*, Finance Committee (9 May 2017), online: Parliament of Canada <https://openparliament.ca/committees/finance/42-1/86/justin-brown-1/> ["*Bill C-44*"]. Presenters: Lisa Pezzack (director), and Justin Brown (chief) from the Department of Finance, Financial Sector Policy Branch.

340 *Bill C-15, An Act to implement certain provisions of the budget tabled in Parliament on March 22, 2016, and other measures*, *part 4, division 5, the bank recapitalization regime,* Finance Committee (10 May 2016), online: Parliament of Canada <https://openparliament.ca/

The amendments accounted for additional risk to the economy posed by systemically important institutions, justifying additional supervisory and regulatory oversight, including additional capital buffers, constraints on risk management and overall supervision.[341] The amendments were aimed at providing "stability and transparency in the financial sector: to keep big banks operating, keep their customers protected, retain deposits and attract new ones" and to "align risk to its appropriate return and ensure that incentives are aligned for prudent management by putting creditors and shareholders ahead of the taxpayer in a recapitalization scenario".[342] The parliamentary statements align with policy discussions internationally.

However, there appears to have been no discussion in Parliament on whether there should be one coordinated or lead resolution authority. In many developed countries, there is one national resolution authority, and the EU is moving towards a pan-European single resolution authority, with a board that oversees the Single Resolution Fund, which can be used for banking recovery, resolution and other acts to help stabilize the financial system. Arguably, Canada should have an informed public policy discussion on what structure would be most effective

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committees/finance/42-1/19/glenn-campbell-10/>. Presenter: Glenn Campbell (director) from the Department of Finance, Financial Sector Policy Branch; *Bill C-44, ibid.*

341 *Bill C-15, An Act to implement certain provisions of the budget tabled in Parliament on March 22, 2016, and other measures*, *part 4, division 5, the bank recapitalization regime bail-in*, Finance Committee (18 May 2016), online: Parliament of Canada <https://openparliament.ca/committees/finance/42-1/22/glenn-campbell-14/?page=3>. Presenter: Glenn Campbell (director) from the Department of Finance, Financial Sector Policy Branch.

342 *Ibid*. The debates note that long-term debt security is in regulations as well as legislation because the industry must be consulted on two matters: firstly, as to what precisely constitutes a long-term debt security, the definition of which can shift and may need to be adjusted over time; and secondly, under which instruments they can be issued — currently banks issue non-viability contingent capital under contract law, but the industry is looking for more certainty.

in resolving financial institution financial distress or insolvency and best protect depositors, policy holders and creditors.

i. Should the resolution authority be the insurance fund?

Moreover, there is little or no public policy discussion on whether it is prudent to have the insurance fund as the resolution authority, or what benefits or conflicts might arise from that dual role. Here, there is little scholarly literature that examines the pros and cons of such a conflation under bank resolution frameworks, notwithstanding that there was public outcry at the height of the global financial crisis that deposit insurance funds should not be used to bail-out banks.

It is important that the deposit insurance fund in Canada is separated from the oversight regulator, as it reduces the potential risk of having those funds directed away from protecting depositors. However, with the new resolution authority given to CDIC, is there a risk of pressure on the deposit insurance fund if a systemically large bank were to fail? One way that CDIC is trying to prevent that situation is to build up capital reserves to deal with resolution, as discussed previously.

A brief canvas of other jurisdictions reveals mixed views as to whether the insurance fund should also be the resolution authority. In the UK, for example, the Financial Services Compensation Scheme[343] is responsible for the deposit insurance fund; and the Bank of England is the responsible authority for bank recovery and resolution.[344] In the EU more

343 Set up under the *Financial Services and Markets Act 2000* (UK), c 8.

344 Lucy Chennells and Venetia Wingfield, "Bank failure and bail-in: an an introduction" (2015), online: Bank of England <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2015/q302.pdf>; "Carrying out a bail-in", online: Bank of England <http://www.bankofengland.co.uk/financialstability/Pages/role/risk_reduction/srr/carryingbail.aspx>; HM Treasury, "Consultation outcome: Bail-in powers implementation" (12 December 2014), online: Government of the UK <https://www.gov.uk/government/consultations/bail-in-powers-implementation-including-draft-secondary-legislation/bail-in-powers-implementation>.

generally, there is a plan to move to a pan-European system of deposit guarantees envisaged for 2024 in order to better protect against EU-wide shocks. There is discussion that the European Deposit Insurance Scheme would be administered by the EU Single Resolution Board, but that option is still being debated. It is possible that some funds from a EU member state's deposit guarantee scheme might be used, though it is unlikely, as it is to be the last source of funding to be drawn upon in the event of a bail-in. The deposit insurance scheme would only make a contribution if all other potential sources of bail-in funding are insufficient to bail in the bank.[345]

In Germany, the deposit insurance schemes and recovery bodies are different entities. There are two main deposit insurance funds. The statutory scheme is the *Entschädigungseinrichtung deutscher Banken GmbH* (Compensation Scheme of German Private Banks), operated by the Association of German Banks.[346] The second fund, the *Einlagensicherungsfonds* (Deposit Protection Fund of German Private Banks), is an additional voluntary scheme operated by the Federal Association of German Banks.[347] It is the *Bundesanstalt für Finanzdienstleistungsaufsicht* (Federal Financial Supervisory Authority), also known as BaFin, that is the authority for bank recovery in Germany.[348] They

345 First, shareholders are bailed in and then there is a "liability cascade" where holders of debt instruments are exposed to losses according to the hierarchy of creditors. The contribution from the deposit insurance scheme is the very last of these creditors. The size of the contribution that could be made by the deposit insurance scheme is the amount that the covered deposits would have been written down had they not been excluded from the bail in.

346 Compensation Scheme of German Private Banks, online: EdB <http://www.edb-banken.de/en/about-us/> ["EdB"].

347 Bankenverband, Deposit protection scheme, *supra* note 71; Dr Hendrik Haag and Jan Letto Steffen, "Banking regulation in Germany: overview" (1 April 2017), online: Thomson Reuters <https://uk.practicallaw.thomsonreuters.com/w-007-4084?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1>.

348 Federal Financial Supervisory Authority, "Recovery and resolution", online: BaFin <https://www.bafin.de/EN/Aufsicht/BankenFinanzdienstleister/Massnahmen/SanierungAbwicklung/sanierung_abwicklung_node_en.html>.

supervise the funds but do not manage them themselves.[349] In Germany, similar to the rest of Europe, it is possible that some of the bail-in would come from the German deposit fund; however, it is also quite unlikely as covered deposits are the very last source of bail-in funds.

In Australia, since deposit insurance is not funded *ex ante*, no funds can come from it to assist in bank recovery. The deposit insurance scheme, the Financial Claims Scheme, is run by the Australian Prudential Regulation Authority when the scheme is activated by the Australian Government.[350] The Australian Prudential Regulatory Authority has the power to investigate, take control, or appoint an administrator to take control of an authorized deposit-taking institution if it is insolvent.[351] In the US, the Federal Deposit Insurance Corporation is empowered by Title II of the *Dodd-Frank Act* to resolve financial conglomerates and uses a single-point of entry approach to do so. The primary purposes of the Deposit Insurance Fund are to insure the deposits and protect the depositors of insured banks and to resolve failed banks.[352]

The FSB has observed that insurance funds should implement *ex ante* funding mechanisms to have available the financial capacity to carry out their mandates effectively; they should determine the appropriate target level of the deposit insurance fund on the basis of clear and well-developed criteria that are consistent with their mandate.[353] Deposit insurers

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349 EdB, *supra* note 346; "Deposit protection in Germany: Article from the Monthly Report" (December 2015), online: Deutsche Bundesbank Eurosystem <https://www.bundesbank.de/Redaktion/EN/Downloads/Publications/Monthly_Report_Articles/2015/2015_12_deposit_-protection.pdf?blob=publicationFile>.

350 APRS, Financial Claims Scheme, *supra* note 68.

351 *Banking Act 1959,* S 13A Consequences of inability or failure of ADI to meet obligations, online: Commonwealth Consolidated Acts (Australia) <http://www.austlii.edu.au/au/legis/cth/consol_act/ba195972/s13a.html>.

352 FDIC, "The Deposit Insurance Fund" (22 August 2017), online: FDIC <https://www.fdic.gov/deposit/insurance/>.

353 FSB, "Enhanced guidance for effective deposit insurance systems —

should set a reasonable time frame to achieve the expected target level of deposit insurance fund; and the level of *ex ante* funds should not be static. The FSB recognizes that liquidity funding is a critical component of a deposit insurer's funding framework, and such arrangements should be explicitly set out in law or regulation; the objectives and strategy for fund management should be clearly set out and aligned with the deposit insurer's mandate.[354] The FSB observes that deposit insurance funds can be utilized for many purposes, depending on legislated mandates, including the reimbursement of depositors' claims in the event of bank failures and the recapitalization of banks.[355]

In Canada, CDIC's *ex ante* fund was established to make deposit insurance payments or for resolution purposes, similar to deposit insurers in several jurisdictions. There are both upside benefits and downside risks to having CDIC as both resolution authority and responsible for the deposit insurance fund. Open bank resolution helps protect depositors. CDIC, in the exercise of its monitoring and early intervention powers to protect the deposit insurance system, has acquired expertise in identifying potential bank failure and what may be necessary to undertake financial restructuring. However, if one of the D-SIB were to fail, there could be considerable pressure to use funds from the deposit insurance fund to help resolve the bank's financial distress. The objective of the insurance fund is to protect depositors' savings, not to resolve the bank, and there is potential for conflicts of interest. The ability to borrow up to $22 billion from the federal government, as noted previously, does assist, but it places Canada's regime partially back on the continuum of bail-out more than bail-in. What remains to be seen is whether the bridge bank and bail-in provisions work such that the costs of bank failure are paid by equity holders and

Ex-ante funding" (1 June 2015), online: FSB <http://www.fsb.org/2015/06/enhanced-guidance-for-effective-deposit-insurance-systems-ex-ante-funding/>.

354 *Ibid.*

355 *Ibid.*

creditors, rather than accessing either deposit insurance funds or public tax dollars.

V. FOUNDATION — CAPITAL ADEQUACY AND LIQUIDITY

The final aspect of bank resolution is the foundation on which the financial system rests. The foundation of a bridge is the component that transfers loads from the substructure to the bearing strata, and depending on the geotechnical properties of the bearing strata, shallow or deep foundations are adopted. For bank resolution, the foundation needs to be deep, particularly for D-SIB. Thus, capital adequacy and liquidity are essential parts of the foundation of the Canadian financial system. If a financial institution cannot meet the standards of capital adequacy and liquidity, it must be wound-up as quickly and effectively as possible without weakening Canada's financial system.

OSFI fully implemented the Basel III capital rules in 2013, at which time banks began reporting new CET1 capital adequacy ratios.[356] OSFI reports that smaller Canadian banks' CET1 capital ratios are above the target level of 7%, while the six D-SIB remain above the higher 8% capital requirement.[357]

The Basel Committee has strengthened its liquidity framework by developing two minimum standards for funding and liquidity. First, the liquidity coverage ratio ("LCR") promotes the short-term resilience of an institution's liquidity risk profile by ensuring that it has sufficient high-quality liquid assets to survive a significant stress scenario lasting for 30 days.[358] Second, the net stable funding ratio ("NSFR") reduces funding risk over a longer time horizon by requiring institutions to fund their activities with sufficiently stable sources in order to mitigate the risk of future funding stress.[359] In Canada, OSFI's liquidity adequacy framework,

356 OSFI Annual Report 2016-2017, *supra* note 4.
357 Reflecting the 1% capital surcharge, *ibid.*
358 *Ibid.*
359 *Ibid.*

which includes the Basel III LCR requirement, came into effect in January 2015.[360] Canadian banks continue to report ratios above the minimum requirements established for these metrics.[361]

The 2016 *Bank Act* amendments defined D-SIB as part of the provisions on capital adequacy and liquidation.[362] The *Bank Act* grants authority to make both guidelines and regulations respecting the maintenance by banks of adequate capital and adequate and appropriate forms of liquidity.[363] Even where a bank is complying with regulations or guidelines, the Superintendent can direct the bank to increase its capital or provide additional liquidity.[364] Written notice must be given where the Superintendent's appraisal and valuation of an asset of a bank or any of its subsidiaries varies materially from the value placed on the asset by the bank or subsidiary.[365] The GIC may make regulations respecting the conditions that D-SIB must meet in issuing, originating or amending prescribed shares or liabilities.[366]

The Canadian system of risk management and strong capital and liquidity shock absorbers is aimed at addressing emerging risks and shocks to the financial system.[367]

360 At the same time, the Basel III leverage framework and associated minimum 3% Leverage Ratio ("LR") requirement replaced the Assets to Capital Multiple ("ACM") leverage constraint. *Ibid.*

361 *Ibid* at 11.

362 Section 2, *Bank Act*, *supra* note 2, "domestic systemically important bank" means a bank that is designated as a domestic systemically important bank under s 484.1. See also Part X, Adequacy of Capital and Liquidity, *Bank Act,* especially s 484.1(1): As noted above, the Superintendent of Financial Institutions ("Superintendent") may, by order and notice, designate a bank as a D-SIB unless the Minister advises that it is not in the public interest to do so; s 484.1(1), *Bank Act*, *ibid.*

363 Sections 485(1), 485(2), *Bank Act*, *ibid.*

364 Section 485(3), *Bank Act*, *ibid.*

365 Section 485(5), *Bank Act*, *ibid.*

366 Section 485.01, *Bank Act*, *ibid.*

367 Hubb, *supra* note 83.

Proportionality and a risk-based approach are the lenses through which OSFI sets Canadian capital standards.[368] It works on a "trust but verify" approach.

However, there are a number of highly contested issues that remain in international standard setting with respect to banks, including issues regarding the net stable funding ratio standard,[369] liquidity adequacy requirements,[370] total loss absorbing capacity,[371] and standards to calibrate risk weights in proportion to risk.[372] OSFI Superintendent Rudin has observed that Basel III delivered substantial improvements in the design and calibration of minimum capital requirements, but the agreement left some significant unfinished business, the negotiations for which have now stalled.[373] Rudin observes that an effective capital regime should provide healthy incentives for banks in both good times and bad, and support confidence in the banking system.[374] In good times, banks should be discouraged from taking excessive risk by requiring higher capital for riskier assets; and in downturns, an effective regime encourages banks to maintain adequate capital without resorting to fire sales of assets or drastic reductions in lending.[375] These issues are highly relevant to the foundation

368 *Ibid.*

369 *Ibid.*

370 *Ibid.*

371 Department of Finance Canada, "Government of Canada Pre-Publishes Regulations to Promote a Sound and Resilient Financial System" (16 June 2017), online: Government of Canada <https://www.fin.gc.ca/n17/17-057-eng.asp>. The TLAC requirement is to be set by the Superintendent: see Department of Finance, Regulatory Impact Analysis Statement, *supra* note 19.

372 Jeremy Rudin, "Waiting for Basel? Next steps for Canada's bank capital regime — Remarks" (6 April 2017), online: OSFI <http://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/sp-ds/Pages/jr20170406.aspx>.

373 *Ibid.*

374 *Ibid.*

375 *Ibid.* The Superintendent reports that Canada has not made sufficient progress on improving the incentives that the capital regime provides to banks, and that banks should be required to hold more loss absorbing capacity if the assets that they own are riskier. In turn, incentives should discourage banks from loading up on

of the Canadian banking system, but are beyond the scope of this article.

VI. CONCLUSION

The discussion in this article illustrates that, while Canada is considered a leader in bank safety, security and resolution, there are both overlaps and gaps in the system that could be remedied. The system relies on the continuing cooperation of multiple entities, and there are still outstanding questions regarding resolution of financial institutions that cross-sectors within Canada and that cross borders in their ownership, assets and activities. As Canada continues to reform its oversight and resolution of the financial system, it would do well to consider how its framework could address the gaps and reduce the overlap. Parliament could clarify the role of regulators and financial institutions in ensuring the system is fundamentally strong and can withstand high winds and global financial storms. In the interim, Canada's bank resolution regime does offer a "bridge over troubled waters", as it should work to ensure going-concern resolution of banks whenever possible.

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risk, and ensure that they have enough capacity to absorb the losses that they could plausibly experience.