Study on issues pertaining to the management of systemic risk in the financial system, domestically and internationally

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ASSOCIATION DES BANQUIERS CANADIENS

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Good afternoon and thank you for the opportunity to come here today and participate in this committee's important study on systemic risk.

The financial crisis was an incredible demonstration of the strength and skill of the Canadian banking system – both the way that banks are managed and the merits of Canada's principles-based regulatory regime. Despite very challenging financial market conditions that saw numerous banks internationally fail or need equity injections, no Canadian banks failed and none needed to be bailed out. Canadian banks increased the amount of credit authorized to small and medium sized businesses, each and every quarter of the financial crisis with authorized business credit for SMEs growing 7% from the beginning of 2007 till the end of 2009.

Since the financial crisis, a great deal of work has been done internationally and domestically to make financial institutions stronger and more resilient to financial stress events. As a result, financial institutions are now better capitalized and more liquid than they would have been ten years ago. Complementing measures to increase capital have been standards designed to ensure that banks have sufficient liquid assets to meet their business obligations during times of financial stress. Canadian banks, which were already strong and stable before and through the financial crisis, are now holding even more and better capital than they did before and have bolstered their resilience even further by holding larger amounts of liquid assets.

One of the lessons that regulators took from the financial crisis was that particular attention needed to be paid to the largest and most interconnected financial institutions, and that ensuring their strength and stability was particularly important given their role in the national and international financial system. This led regulators to create new designations for large, interconnected institutions. Those banks that are the largest and most interconnected internationally are designated as “Global Systemically Important Banks”, or G-SIBs. Designation as a G-SIB brings with it a set of enhanced regulatory requirements to increase financial strength and resilience, as well as enhanced regulatory reporting requirements. National regulators were also encouraged to designate “Domestic Systemically Important Banks”, or D-SIBs, at a national level. OSFI treats our D-SIBs as G-SIBs, requiring that they comply with the same enhanced requirements and subjecting them to more intense oversight.

In addition to implementing measures to improve the financial strength of institutions, processes have been put in place to give regulators greater insight into how large banks would manage through a period of financial turbulence. Regulators have put in place requirements for large financial institutions to develop plans on how they would return to financial health if they were to find themselves in a stress situation. These plans are developed in collaboration with CDIC and reviewed by CDIC on an annual basis to ensure they are evergreen. OSFI and the Bank of Canada require DSIBs to undertake a biennial macroeconomic stress test that simulates an economic shock to measure how the bank's financial structure would stand up to such an event.

Complementing the resolution planning requirements of banks, regulators have been given new tools to help them resolve a financial institution that is in financial trouble without having to resort to the ultimate step of closing and liquidating it. The government formally designated CDIC as the resolution authority for banks in Canada. Furthermore, the Bank of Canada has been designated the resolution authority for "financial market infrastructures", which are the payments clearing and settlement systems that underpin the entire financial system.

While much has been done to increase financial strength and stability, and that is certainly an important goal, we need to be conscious of the importance of balancing these measures with the need for economic growth. Requiring financial institutions to hold excessive amounts of capital to backstop their loan book can deter or slow growth in lending, which dampens economic growth and new business formation. Likewise, requiring excessive amounts of liquidity deters banks from putting funds into economically productive uses such as personal and commercial lending. While this tradeoff has been less visible in Canada because of the strength of its banking system, policy makers from regions with financially weaker banking systems such as some in western Europe voiced concerns that further capital measures will materially dampen economic growth. Balance and vigilance are key.

We also need to be conscious to ensure that regulation does not inadvertently cause risk to migrate from the regulated sector to the unregulated, shadow banking sector. The intent of the post-crisis measures was to reduce overall risk in the system, and in large part they have done that, but we need to be monitoring for signs that risk is migrating from the regulated space to unregulated lenders and service providers, which would be counterproductive.

Thank you for your time and I'm happy to answer any questions.