

**OSFI Response to the Request for Comments on the Australian  
Study of Financial System Guarantees**

Thank you for giving the Office of the Superintendent of Financial Institutions (OSFI) the opportunity to provide you with some thoughts on the recently released Davis Report on Financial System Guarantees. The introduction of a guarantee scheme would be an important change to the Australian financial safety-net that requires extensive thought and careful construction to maximize benefits while avoiding pitfalls.

As you may know, OSFI is the primary regulator and supervisor of all federal financial institutions and pension funds. This includes all banks operating in Canada, whether Canadian or foreign owned, as well as federal trust companies, life insurance companies, and property and casualty insurance companies. At present, we supervise 130 deposit-taking institutions, 350 insurers, and over one thousand federal pension plans.

We note that requests for comment have also been sent to all the other Canadian financial safety-net players. Hence, we have chosen to confine our comments to questions directly related to OSFI's operations.

**Q.10 The Davis Report Outlined some possible governance arrangements to support an explicit guarantee scheme if one were to be introduced. Comments are invited on which approach should be favoured and why.**

As the Davis Report notes, guarantee schemes can take a range of forms and can be either publicly or privately constituted. The eventual choice of governance structure depends primarily on the circumstances of the country's financial system and the guarantee scheme's relationship to other safety-net players and legislative frameworks such as the rules governing insolvency.

The situation in Canada is somewhat unique in that there is a mixture of public and private guarantee schemes. OSFI's relationship vis a vis a particular guarantee scheme is largely determined by the guarantee scheme's governance structure.

Life insurers fall under the privately operated Compensation Corporation (CompCorp). CompCorp's Board of Directors does not include a representative(s) from the federal government, nor does it include individuals who are employed with a member institution. Because CompCorp is not directly controlled by the life insurance industry, OSFI meets regularly with the CompCorp Board and provides it with certain information pertaining to the supervision and solvency of life insurance companies. Such information sharing is not required by the financial legislation; however, OSFI considers such activities to be beneficial to the soundness of the financial system. All federal life insurance companies are required by Canadian law to be members of CompCorp.

Property and casualty insurers (roughly the equivalent of Australian general insurers) fall under the privately operated Property and Casualty Insurers Compensation Corporation (PACICC). Unlike CompCorp, PACICC's Board of Directors is entirely comprised of individuals who are active/employed by P&C companies, and there is no federal legislative requirement for companies to belong to the guarantee scheme. Due to its governance structure, OSFI does not provide PACICC with confidential supervisory information about the financial circumstances of individual companies. OSFI does, however, maintain an ongoing relationship with PACICC and regularly attends Board meetings and provides feedback regarding PACICC by-laws and proposals.

All deposit-taking institutions with the exception of authorized foreign bank branches are required to be members of the Canada Deposit Insurance Corporation (CDIC). CDIC is established by federal statute as a Crown Corporation. OSFI has an extensive relationship with the CDIC that begins at the Board of Directors level where the Superintendent and an Assistant Superintendent are directors. This relationship extends to regular meetings and information sharing between staff, including pre-examination meetings for CDIC member institutions. While the relationship between CDIC and OSFI is designed to be wide-ranging, this also leads to a higher commitment of time and resources from both organizations. The depth of this relationship is at least partly possible because federal legislation allows the sharing of confidential information between federal safety-net players.

Another important information sharing mechanism involving the CDIC is the legislated Financial Institutions Supervisory Committee (FISC), which is chaired by the Superintendent. Similar to the CDIC Board, the Governor of the Bank of Canada, the Deputy Minister of Finance, and the Commissioner of the Financial Consumer Agency of Canada are also members of FISC. The purpose of FISC is to share information amongst federal safety-net players on matters concerning the supervision and regulation of federal financial institutions. FISC does not include members from outside the federal financial safety-net due to the highly confidential nature of the information discussed. The Bank of Canada also provides regular economic updates to FISC members.

Worth noting as well is that credit unions, which fall under provincial jurisdiction, also have guarantee schemes operated by the province in which they operate. OSFI has very little contact with provincial guarantee schemes.

**Q.11 What is the preferred allocation of functions among the relevant bodies?**

As the Davis Report notes, the functions of the guarantee scheme and those of the regulatory authority will flow from their respective mandates. Hence, the mandates of each organization should be as clearly stated as possible to give effect to the public policy objectives of the government.

In Canada, OSFI is the regulatory/supervisory authority overseeing federal financial institutions. The three guarantee schemes (CompCorp, PACICC and CDIC) have

different governance and funding structures, which have led to the adoption of different mandates. The mandates of CompCorp and PACICC (industry-run schemes) are relatively narrow in scope -- focusing on a limited range of activities such as asset management and making or arranging for payments to eligible policyholders in the event of an insolvency. As well, both CompCorp and PACICC can participate in going concern solutions when warranted by circumstances.

The mandates of CDIC and OSFI are not as clearly delineated with respect to the supervision of CDIC member institutions. In particular, CDIC's legislated mandate to promote Standards of Sound Business and Financial Practices as well as minimizing losses to the deposit insurance fund has led it to undertake activities with respect to risk minimization. OSFI and CDIC have attempted to deal with some of these coordination issues through interagency agreements such as the Strategic Alliance Agreement and the Intervention Guide for Federal Financial Institutions. The Intervention Guide in particular articulates the respective responsibilities and activities of both OSFI and CDIC from monitoring to taking steps to wind-up a problem company. Also, each organization's governing legislation with respect to the establishment of new deposit taking institutions has caused OSFI and CDIC to develop ways of collaborating on applications.

While this structure has generally reflected the Government's policy objectives for the financial safety-net, it is worth noting that the Government recently announced that it will be exploring ways to streamline the functions of CDIC and OSFI to reduce overlap and duplication.

**Q.12 The Davis Report examined a number of possible regulatory implications that may arise from introducing a guarantee scheme. The Government invites comment on the following issues:**

- **Under a pre-funded model, would it be feasible for the guarantee scheme funds to be available to achieve least-cost failure resolutions (for example, a transfer of business) if that might be less expensive than compensating eligible customers in a liquidation?**

The experience in Canada is that it makes sense to have the widest range of resolution options available when a financial institution is no longer viable. The design of a guarantee scheme would need to be considered in the context of the government's policy objectives in this regard. Should those objectives include the ability to make guarantee scheme funds available to support (for example) transfer of business resolution options, this would need to be taken into account when drafting the guarantee scheme's mandate, powers, and governance structure, as well as its relationship to other safety-net players.

- **Guarantee schemes and priority arrangements (for example, depositor preference and insurance "cut-through" provisions) might be seen as alternative or complementary policy instruments to guarantees for protecting certain stakeholders in the event of financial institution failures.**

OSFI is not in a position to comment on the specifics of Australian insolvency law. However, there is no question that creditor ranking is a very important consideration in the design of a guarantee scheme. Creditor ranking affects the magnitude of the guarantee scheme's exposure to the risk of financial loss, and it can have an important impact on the behaviour of financially sophisticated creditors, who at least partly assess their own risk based on the likelihood of assets being available to pay their claim on an insolvent institution.

- **Could a guarantee scheme provide an opportunity for removing or reducing restrictions on branches of foreign ADIs accepting deposits from retail customers in Australia? Your views may differ depending on whether you think foreign ADIs would be within or outside of the scope of a guarantee scheme.**

This decision would have to reflect the policy objectives of the Australian Government. In Canada, foreign bank branches are restricted in the ability to deal with retail, or less financially sophisticated depositors. This reflects the Government's policy position that foreign bank branches would be subject to a somewhat less onerous supervisory regime. While including foreign bank branches in a guarantee scheme could be seen as a precursor to allowing them into retail deposit markets, we would also suggest that this change could entail changes to the way the Australian regulatory authority supervises foreign bank branches.

- **Would the introduction of a guarantee scheme allow or require changes to other financial sector regulations and arrangements?**

In Canada, like Australia, the formulation of regulations and legislation is always done in a way that considers the responsibilities and functions of all safety-net players. Introducing an explicit guarantee scheme would likely have an impact on the activities of the other safety-net players and require the development of new relationships and regimes. The scope of the changes required would likely be related to the mandate and functions of the new guarantee scheme.

We hope you find the above comments useful in your consideration of whether to introduce a guarantee scheme in the Australian financial system. Canada has many years of experience with explicit guarantee schemes and, like all other countries, must constantly revise and update the financial safety-net to address the challenges of an ever changing financial system. Please do not hesitate to contact Greg Cowper ([greg.cowper@osfi-bsif.gc.ca](mailto:greg.cowper@osfi-bsif.gc.ca)) if you or your colleagues would like additional insights on the Canadian situation.