Enhancing the Safety and Soundness of the Canadian Financial System

February 1995

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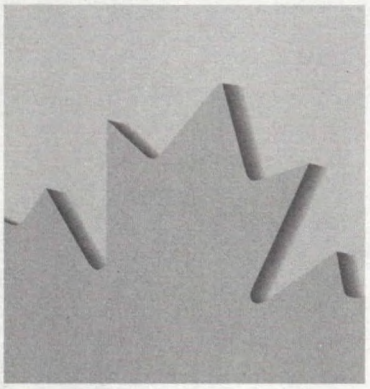

Enhancing the Safety and Soundness of the Canadian Financial System

Changes to the framework regarding:

The supervisory system for federally-regulated financial institutions, the federal deposit insurance system, the arrangements in place for protecting policyholders of life and health insurance companies, and federal oversight of clearing and settlement systems.

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PREFACE

Canadians can be proud of their world-class financial system which provides a full range of competitive financial services to every corner of the country and internationally, as well as employment for many.

Nevertheless, the failures of a few financial institutions have focused public attention on certain aspects of the regulatory and supervisory systems for federally regulated financial institutions and some people have also called for changes to the deposit insurance system. Recently, the Standing Senate Committee on Banking, Trade and Commerce released a major report containing 42 recommendations, many of which are reflected in this proposed package of measures. In the previous Parliament, the Standing House of Commons Committee on Finance reviewed matters related to the deposit insurance system as a result of the failures of some trust companies. These reviews, in addition to numerous other studies, have concluded that the regulatory and supervisory systems in Canada are fundamentally sound, but that there is room for some improvement to protect the interests of Canadians and to enhance the safety and soundness of the system.

It is now time for the federal government to act on these matters and I am doing so by bringing forward proposals for change. The policies that I am proposing in this document will soon be the subject of consultations with interested parties and will be reflected in legislation that will be tabled as soon as possible. Some areas, like the role of the supervisory authorities in the composition of boards of directors of federally regulated financial institutions, need further discussion before work on legislative changes can be undertaken.

The Minister of Finance is responsible for many statutes that affect the operations of financial institutions. Much of this responsibility has been delegated to me in my role as Secretary of State (International Financial Institutions). I am committed to ensuring that the legislation is up-to-date so as to protect the interests of Canadians. This legislative review will enhance the safety and soundness of the Canadian financial system.

Written submissions on this policy direction are invited and should be sent to the Financial Institutions Division, Department of Finance, Ottawa, Ontario, K1A 0G5 by April 12, 1995.

The Honourable Doug Peters
Secretary of State
(International Financial Institutions)

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INTRODUCTION

This paper sets out the government's proposals to improve the supervisory and regulatory systems for federally regulated financial institutions. The proposed changes will help to ensure that the supervision and regulation of Canada's financial institutions remain up-to-date and responsive to the evolving environment in which these institutions operate. With these changes, Canadians can continue to have confidence that our financial sector is safe, sound and efficient.

The government believes the supervisory and regulatory framework for federally regulated financial institutions is fundamentally sound. However, experience with financial institutions that have failed suggests that some refinements should be made. This experience also indicates the need for changes to the compensation mechanisms for depositors and for policyholders of life and health insurance companies. In addition, the government is proposing enhanced disclosure of information by financial institutions and – in order to minimize losses to policyholders, depositors and creditors – more flexible methods of restructuring financial institutions in difficulty.

Finally, the paper contains proposals to reduce systemic risk in major clearing and settlement systems. The proposed measures will enhance the safety and competitiveness of Canada's clearing and settlement systems for financial transactions.

The safety, soundness and efficiency of Canada's financial institutions are essential to our economic success as a nation. Financial institutions facilitate growth in all sectors of the economy and contribute significantly to Canada's overall economic well-being. These institutions provide lending, savings, insurance and payments services to millions of individuals and businesses in the country and facilitate the flow of funds internationally. In addressing issues related to the safety and soundness of financial institutions, it is important to balance the need to protect the funds entrusted to financial institutions by the public with the need to facilitate economic activity.

The great majority of Canadian financial institutions are well capitalized, profitable and able to manage their risks effectively. Canada's financial system has managed to maintain public and market confidence during a period in which financial institutions have been faced with an increasingly competitive environment and added stresses have been created by factors such as the decline in commercial real estate values. But, in a dynamic economy, not all financial institutions will be expected to cope effectively. At the same time, the supervisory and regulatory systems should not, and could not, be so intrusive as to attempt to prevent all failures. Institutions that are unable to meet the challenges will either be purchased by healthy institutions, voluntarily decide to significantly downsize, restructure, leave the industry, or be wound-up by the regulatory authorities. Canadians do not want the government, or the taxpayer, to bear the costs of dealing with financial institutions in difficulty.

The failure of a number of Canadian financial institutions, through liquidations or through mergers with healthy financial institutions, some of which were financially assisted by the Canada Deposit Insurance Corporation (CDIC), has focused public attention on the supervisory system and the system of deposit insurance. The public's attention has been directed at the fact that pressures and tensions on financial institutions are significant and that failures can occur. At the same time, the impact of failures on compensation schemes, on depositors and policyholders of the remaining institutions, and on creditors, who, together, ultimately bear most of these costs, has led to pressure from industry and the public to review how institutions in financial difficulty are dealt with.

In this environment, it is important that the supervisory and regulatory systems and the systems in place for compensating customers of failed institutions be reviewed. This timely review will help ensure that these systems remain effective, while not imposing undue costs on either the public or the financial institutions themselves.

In the previous Parliament, the Standing House of Commons Committee on Finance reviewed matters related to the CDIC in light of recent failures in the deposit-taking sector.

More recently, the Standing Senate Committee on Banking, Trade and Commerce (the Senate Banking Committee) has reviewed extensively matters related to the stability of the financial system and has recommended changes in a number of areas. Many of the proposals put forward in this paper were also recommended by the Senate Banking Committee.

The Canadian experience is not unique – many countries have been faced with these same issues. The government has reviewed other countries' experiences and their approaches in the process of developing a set of policy proposals appropriate for the Canadian context.

BACKGROUND

The supervisory system for federally regulated financial institutions was substantially overhauled in 1987, after the failure of the Canadian Commercial and Northland banks.

In the period leading to the 1987 changes, there was extensive public debate on a variety of issues, including the desirability of merging the functions of the federal financial institutions' supervisor with those of the deposit insurer. It was concluded by the government at the time that it would be advisable to keep the two functions separate. After additional consideration, the government believes that the functions should remain separate, in order to preserve beneficial checks and balances in the system.

In 1992, a sweeping reform of the financial institutions statutes was completed. While the reforms focused primarily on ownership and business powers issues, changes were also made to the framework for prudential regulation.

The Canadian system of prudential regulation is based on a 'tripartite' division of responsibilities for ensuring and monitoring the health of financial institutions among the supervisory authority, the directors of the institutions and the external auditors. The government continues to believe that this tripartite system is appropriate for the Canadian context. In 1992, changes were made which strengthened the role of directors in their institution's operations. Rules affecting external auditors were also introduced, requiring auditors who resign, or are removed from a financial institution, to inform the Superintendent of the reasons for the action. The same rules apply to the appointed actuary of an insurance company. The legislative package also strengthened the powers of supervisory authorities. For example, a new framework for the control of non-arm's length transactions was established. In addition, the Superintendent of Financial Institutions (the Superintendent) was granted the power to obtain information from the owners of financial institutions and investment rules became based on the prudent portfolio principle. This principle was supported by statutory limits on certain forms of investments.

In the fall of 1992, the Department of Finance initiated a deposit insurance review, to explore means of reducing the costs of the federal deposit insurance plan. A public/private sector advisory committee (the deposit insurance advisory committee), chaired by the Deputy Minister of Finance, was struck to obtain views from a number of different perspectives. In addition to considering a number of means to reduce the costs of providing deposit insurance, the committee considered matters such as earlier intervention and the transparency of the supervisory process. The committee, which completed its discussions in the summer of 1994, provided valuable input to the policy development process.

PRINCIPLES AND DIRECTIONS OF CHANGE

There are a number of principles and policy directions underlying the proposals for change.

These are:

- The Canadian financial system overall must remain safe and sound.
- Ownership of a financial institution is a privilege, not a right. This means that the protection of policyholders, depositors and creditors comes before the interests of shareholders.
- Early intervention in, and resolution of, institutions experiencing financial difficulty should occur.
- Financial institutions must operate with sufficient supervisory and regulatory incentives to solve their own problems in a timely manner.
- There must be appropriate accountability and transparency in the supervisory process.

- The costs of supervision and of providing deposit insurance protection should not impose an undue burden on consumers or on financial institutions.
- The framework for protection of policyholders of life and health insurance companies should be enhanced. It need not be the same as for deposit-taking institutions because insurance companies do not pose the same risk to the stability of the financial system.
- Any depositor or policyholder protection system must be paid for by the industry and not pose risks to taxpayers.
- Canada's financial institutions must remain competitive and efficient, both domestically and internationally.
- Canada's clearing and settlement systems must evolve in order to be internationally competitive and to minimize systemic risk.

Within this framework, the following policies are being proposed.

MAJOR ELEMENTS OF THE POLICY PACKAGE

1. An Early Intervention Policy

Early Intervention Policy:

- A legislated mandate for OSFI, which includes prompt action to deal with problem financial institutions.
- Enhanced transparency of the risk assessment and intervention process.
- Legislative changes to facilitate closure of institutions at an earlier stage, to reduce losses to depositors, policyholders and creditors.

The federal supervisory and regulatory framework creates incentives for a financial institution to manage its risks adequately, as failure to do so will result in consequences for the institution, its management and its board of directors. Where an institution does not manage its risks adequately and experiences financial difficulties, it is to the advantage of the depositors, policyholders and creditors of the company that the situation be resolved promptly. This does not necessarily mean that the institution will be closed. For example, in some cases, it may be possible for the institution to develop and implement a business plan to solve its problems and allow it to continue as a viable business entity. Supervisory intervention may provide a further incentive for the company to seek out prudent alternatives such as a merger with a healthy institution or a significant downsizing and restructuring.

In other situations, it may be necessary to take increasingly severe supervisory actions and, ultimately, to close the financial institution in order to protect the interests of the depositors, policyholders and creditors. In such situations, it is important that institutions be closed before they impose substantial losses (relative to the size of the institution) on the depositor and policyholder protection plans and, in turn, on depositors and policyholders, and other creditors.

The government has considered models in other countries involving legislated levels of key financial variables, or 'trip wires', which give rise to mandatory supervisory intervention and, eventually, closure. For example, the United States has established a system under which the supervisory authorities are required to take specific actions at legislated capital levels. Having reviewed these models, and taking into consideration the size and structure of the Canadian financial sector, the government believes that a more flexible framework should be retained for the Canadian marketplace. A flexible framework also allows for very early resolution of an institution's problems, where appropriate.

The government is proposing an early intervention policy with three main elements. The first element would be the introduction of a legislated mandate for the Office of the Superintendent of Financial Institutions (OSFI). This mandate would note the importance of OSFI taking prompt action, or requiring that prompt action be taken by institutions, to deal with financial institutions which are experiencing financial difficulties.

The second element would be enhanced transparency concerning the steps that the authorities could be expected to take if the financial condition of an institution deteriorates. Increased transparency would help clarify when such actions could be expected and the respective roles of OSFI and CDIC. The process would include enhanced examinations of the state of a financial institution's assets, earlier in the process than previously. These examinations, which would be done on various valuation bases, would help guide decision making by the authorities.

The third element of the early intervention policy involves proposals to amend the financial institutions legislation and the *Winding-up Act* to allow institutions to be closed earlier than at present, in order to reduce losses to depositors, policyholders, creditors and compensation funds. Specifically, it would then be easier under the financial institutions legislation for the Superintendent to act to close an institution in financial difficulty even though it still had some capital, and was thus not technically insolvent.

The government is also prepared to consider introducing a more flexible process for the regulatory authorities, under court supervision, to restructure insurance companies in financial difficulty. Changes to the Financial Institutions Restructuring Process for federal deposit-taking institutions would also be considered.

It is recognized that resource requirements at OSFI, which are charged back to the industry, would need to be increased in order to implement the new early intervention framework.

(a) A Legislated Mandate for OSFI

At the present time, OSFI does not have a legislated mandate. OSFI's role, and, therefore, the government's objectives for the supervisory system, must be inferred from specific statutory responsibilities contained in the *Office of the Superintendent of Financial Institutions Act (OSFI Act)* and the financial institutions legislation.

The absence of a clear set of legislated objectives means that there is no defined standard against which OSFI can be held accountable and its performance assessed. It also makes it difficult for the public, financial institutions, and other interested commentators to understand fully what roles OSFI is designed to play, and the manner in which OSFI is expected to carry out these roles.

The government, therefore, proposes to amend the *OSFI Act* to include a legislated mandate. The mandate would acknowledge OSFI's role in monitoring the health of federal financial institutions, in promoting policies which are designed to monitor and control risk, and in taking steps promptly, to deal with problem financial institutions, or ensuring that steps are taken by the institutions themselves. The mandate would also acknowledge the important role played by management and boards of directors of financial institutions in ensuring that procedures are in place to control risks and that measures are taken to correct problems as they emerge. This would serve to clarify that it is the management and the board of directors of an institution which have responsibility for its day-to-day oversight and for the institution's ultimate viability.

The mandate would also recognize that a balance must exist between the role of the supervisor to minimize risks and the role of financial institutions, which must take reasonable risks to meet the demands of the market place and to prosper. Thus, the objectives set out in its mandate would clarify that, while OSFI must protect the rights of depositors, policyholders and creditors of financial institutions, OSFI would have regard to the need to allow financial institutions to compete effectively and take reasonable levels of risk.

The mandate would recognize that, while supervision can reduce the risk that a financial institution will fail, the supervisory system cannot, in all circumstances, prevent failures from occurring. In so doing, the mandate would help clarify that the failure of a financial institution does not in itself imply the failure of the regulatory and supervisory systems. This aspect of the mandate, along with the emphasis of the role of management and boards of directors, would serve to enhance public awareness of the basic design of these systems. It would also help establish the basis for establishing OSFI's accountability to Parliament and the Canadian public.

The mandate would also note the important role of OSFI in monitoring general industry trends which may have a detrimental impact on the operations of federal financial institutions.

A draft OSFI mandate is contained in Annex 1.

(b) Transparency of the System of Intervention

A system of intervention is most effective when it is clearly and readily understood by those it affects. The federal financial institutions legislation contains a range of supervisory measures which may be taken by OSFI in respect of the financial institutions it supervises. In order to fulfil its legislated 'objects', control risk to the deposit insurance fund and minimize the exposure of CDIC to loss, CDIC may also take certain measures in respect of its member institutions. However, the measures which OSFI and CDIC may take cannot always be readily identified and understood from reading the financial institutions legislation, the *OSFI Act*, or the *Canada Deposit Insurance Corporation Act (CDIC Act)*. The government believes, therefore, that there would be an advantage to describing in a separate document the range of regulatory measures which may be taken.

The stages of intervention are described in Annex 2. This document will be updated periodically or where appropriate, for example, to elaborate on the circumstances under which action may be taken. Among other matters, the document makes clear that institutions in financial difficulty must have acceptable business plans that will address their difficulties. As well, such institutions will face, and pay for, enhanced regulatory examinations to evaluate their financial condition under various assumptions.

In addition to enhancing the transparency of the regulatory system, a clear statement of what regulatory actions may be taken by OSFI or CDIC, and when these actions are likely to be taken, constitutes an important element of 'due process' or fairness for supervised financial institutions. It will also make clear to institutions the consequences of failing to rectify problems expeditiously.

It is also desirable that the process of intervention by the authorities be better understood. One anticipated benefit of increased understanding is that financial institutions and analysts will understand that increased OSFI examination of, or intervention in, an institution in financial difficulty does not in itself signal that the institution will fail.

Finally, as noted earlier, increased transparency will comprise part of the early intervention policy.

(c) Changes to the Framework for Closing Financial Institutions

The government is proposing to amend the financial institutions statutes to allow the Superintendent to take control of an institution earlier than at present and to make amendments to the *Winding-up Act* to allow the Superintendent to ask the Attorney General to seek a winding-up order at the

same time. The grounds under which the Superintendent could take this action would include situations where a company has not complied with an order to increase its capital or where capital has reached a level (or is eroding in a manner) that may detrimentally affect depositors, policyholders or creditors. This would permit closure before capital is depleted. Companies would have the opportunity to make representations to the Superintendent before any such action is taken. It is also proposed that the role of the Minister of Finance be refocused so that, unlike under the current system, the Minister would not be legally required to come to an independent view regarding the grounds on which the Superintendent proposes to take such action. The Minister may, however, prevent the closure of an institution in exceptional circumstances if, in the Minister's view, it is in the public interest to do so.

Proposed amendments to the financial institutions legislation and to the *Winding-up Act* to effect this policy direction are contained in Annex 3.

Other technical changes to the *Winding-up Act* would also be proposed in addition to those required for the early resolution framework. A technical change to the *Companies' Creditors Arrangement Act* is also being proposed. These changes are described in Annex 4.

2. Greater Disclosure of Financial Data

Federal government involvement in disclosure issues over the last year has focused largely on a legislative provision in the *Insurance Companies Act* and the *Cooperative Credit Associations Act* that limited the publication of information about a company's financial condition to the Canada Gazette. In the summer of 1994, a provision of the *Miscellaneous Statutes Law Amendment Act* (MSLAA) removed the restriction on disclosure, thereby allowing financial condition information to be released by any means, including in electronic form. In the fall of 1994, the Secretary of State (International Financial Institutions) took steps which led to the release of information from the statutory information returns of banks, trust and loan companies, life and health insurance companies, property and casualty insurance companies and cooperative credit associations. This information became available through an independent database in November 1994.

During this time, public attention focused on the failures of some financial institutions and, more specifically, on the adequacy of disclosure of information by those institutions. Analysts, and others, who interpret complex financial information and its implications for customers and creditors of financial institutions, have sought broader and better disclosure with access to a set of comparable information, where warranted, on all financial institutions. Consumers, too, have expressed a need for reasonable access to more information on financial institutions. This trend is also being experienced internationally.

There are compelling reasons for enhancing disclosure and the consistency of information being disclosed: for example, legislation providing similar powers to financial institutions both in-house and through subsidiaries makes the

separation of financial institutions by function less evident today; and federally regulated financial institutions have the same supervisor and are generally subject to a common set of regulations. Thus, the existence of disparities in the level of detail of information being publicly released requires that additional work be done to enhance the consistency of financial institution disclosure.

The process of establishing improved reporting standards began in 1988 with the Financial Institutions Supervisory Committee (FISC). At that time, the FISC, a statutory committee consisting of the Superintendent, Governor of the Bank of Canada, Chairman of CDIC and the Deputy Minister of Finance, set up a subcommittee to review financial information requirements. This subcommittee began its work with the development of a set of common reporting forms for federally regulated deposit-taking institutions for filing on a monthly, quarterly, or annual basis. Implementation of the reporting framework began in 1993 for the chartered banks and reporting will be fully implemented by 1996. Implementation for federally regulated trust and loan companies will begin within the next 12 months.

The government's proposed direction for enhancing disclosure includes two thrusts. First, there would be increased requirements on financial institutions to disclose information. This would include the release of information concerning regulatory capital and executive compensation levels (including by those institutions not already disclosing executive compensation levels as publicly traded companies) and requiring that all federal financial institutions, including those which are not currently doing so, release annual statements. Secondly, there would be further disclosure, through OSFI, of regulatory information obtained from institutions on statutory information returns. This would mean some additional reporting requirements and more consistency across types of financial institutions. More detail on the proposals is provided in Annex 5.

These proposals will require elaboration and consultation with the industry in order to ensure that appropriate account is taken of the costs associated with the enhanced disclosure requirements, and to identify realistic time frames for implementation. Consultation with the industry will also be undertaken to identify customer sensitive and potentially other non-disclosable information. Consultation with the analytical and professional communities and consumer associations will also take place in order to ensure that information needs will be better met.

The government has decided that enhanced disclosure should be implemented expeditiously. The Superintendent, in consultation with other members of the FISC, will be responsible for moving forward the process of enhanced data collection and dissemination. The Superintendent will also be responsible for preparing an implementation plan on disclosure for presentation to the Minister of Finance, taking into account the views of the industry and analysts. In addition, the Superintendent will report to the Minister annually on the progress made in meeting the plan.

3. Deposit Insurance Changes

Proposals affecting the Federal Deposit Insurance System:

- risk-based deposit insurance premiums for CDIC member institutions;
- reduced ability to multiply deposit insurance coverage in affiliated CDIC member institutions;
- no coinsurance.

Over time, a variety of reasons for having public deposit insurance have been cited. One is that deposit insurance protects deposit-taking institutions against 'runs', or rapid withdrawals of demand deposits, caused by the perception that an institution is not in good financial health. Such runs may lead to the closure of the institution and ultimately spread to other institutions, thereby destabilizing the financial system and detrimentally affecting the integrity of the payments system.

A second argument in favor of deposit insurance is that it facilitates the entry of new firms into the deposit-taking market. A third reason is to protect small, retail depositors against the loss of funds entrusted in deposit-taking institutions. Proponents of this view point out that many small depositors cannot be expected to come to an independent view on the creditworthiness or condition of their financial institution.

Given the history of deposit insurance in Canada, and the reliance of Canadians on the right to deposit insurance coverage, the government is of the view that it is not possible to now cite only a single public policy rationale, and to redesign the deposit insurance system on that basis. The government has also concluded that the current $60,000 limit for deposit insurance protection should be retained. At the same time, the government recognizes that the costs to CDIC of failures of its member institutions has led to the highest deficit in the deposit insurance fund in CDIC's history and to a significant level of borrowings from the Consolidated Revenue Fund. While these loans are paid back with interest, the government believes that additional means must be implemented in order to reduce the costs of the deposit insurance system.

Earlier supervisory intervention, as described earlier in this paper, is one means through which the costs of failures will be reduced. In addition, CDIC has already made a number of changes to reduce costs, which the government supports. For example, as permitted under its current legislation, CDIC has changed its policy on paying discretionary interest, so that interest paid to insured depositors does not accrue beyond the date of the granting of a winding-up order for a member institution. Other examples include the

authority to levy a premium surcharge on a member institution which fails to follow certain practices (for instance, in cases of non-compliance with CDIC's standards of sound business and financial practices) and a policy of charging back to a member institution the costs of special, in-depth, examinations carried out on that institution.

The deposit insurance advisory committee considered measures in three main areas to reduce the costs of deposit insurance. One was the reduction or elimination of 'stacking'. This refers to the ability of depositors to have a number of insured deposit accounts in an individual financial institution and within a group of related deposit-taking institutions. Stacking serves to increase the deposit insurance limit for individuals beyond what was originally intended.

A second area is that of risk-based deposit insurance premiums for CDIC member institutions. At the present time, all CDIC members pay the same rate of deposit insurance premiums – one-sixth of one per cent of insured deposits – regardless of their different risk profiles. Thus, the deposit insurance system does not provide incentives to reduce the risk that certain institutions may bring to the deposit insurance fund.

A third area is that of coinsurance. In particular, the committee reviewed the advisability of an 'administrative charge', which would be levied on depositors as a small percentage of their insured deposits in a failed institution.

Recently, the Senate Banking Committee has recommended the adoption of all three approaches – the elimination of stacking, the implementation of risk-based premiums and the implementation of a system of coinsurance which would provide full protection for the first $30,000 of deposits and 90 per cent protection for the next $35,000.

Other commentators have expressed views on the means through which deposit insurance coverage can be altered. The public, too, has written to the government to express its views. In general, due to diverse interests, there is little consensus around an 'optimal' package of changes. Many approaches strongly favored by some are strongly opposed by others and all have advantages and disadvantages.

Of all deposit insurance issues, coinsurance has engendered the broadest public debate. Proponents of coinsurance have historically emphasized the need for greater market discipline in order to force consumers to be more vigilant in their choice of financial institutions and to alter the behaviour of the institutions. Other arguments in favor of coinsurance note that the cost of deposit insurance is currently borne by all depositors, in the form of deposit insurance premiums which are largely passed on to depositors by CDIC member institutions. These arguments also suggest that cost competitiveness in the system would be increased if relatively more costs were borne by depositors of failed institutions, and less by depositors generally. Opponents of coinsurance have noted that coinsurance imposes costs on consumers who, realistically, are unable to independently assess the riskiness of a financial institution. Critics also note that coinsurance increases the potential

for instability in the financial system, as depositors may shift funds to larger institutions which may be perceived as less risky. The government, having taken account of all views expressed, has decided not to proceed with coinsurance at this time.

The government proposes to make two changes to the deposit insurance system. The first change would be the elimination of stacking of insured deposit accounts within a group of affiliated financial institutions. There would be measures to ensure consumer awareness of the change. This change would also be accompanied by reasonable transitional arrangements which, for example, take into account the fact that some depositors will have locked-in term deposits, the insured status of which may change as a result of the proposal.

This proposal would reduce the amount of deposit insurance coverage available within related companies (i.e. in a bank, its mortgage loan subsidiary and its trust subsidiary). Limits for deposit insurance coverage would continue to be applied separately for products such as ordinary deposits, joint accounts, RRSPs and RRIFs. Thus, individuals would continue to have $60,000 of deposit insurance protection for each of these types of eligible deposits, whether these deposits are made in an individual institution or spread among related companies.

Example of the proposal to limit stacking of deposit insurance

It is proposed that the $60,000 deposit insurance limit apply to the sum of a person's deposits of a given type (e.g., personal, joint, or RRSP) placed in all institutions within an affiliated group of companies. Consider the following example of an individual's deposits at two affiliated institutions:

	ABC Bank	ABC Mortgage
Personal deposits	$50,000	$15,000
Aggregate value of personal deposits	$65,000	
RRSP deposits	$50,000	$15,000
Aggregate value of RRSP deposits	$65,000	

In the above example, if *either* ABC Bank *or* ABC Mortgage failed, personal deposits and RRSP deposits would be fully covered by CDIC, as each type of deposit in the failed institution would be below CDIC's $60,000 limit. If *both* ABC Bank and ABC Mortgage failed at the same time, CDIC coverage would be limited to $60,000 on the aggregate value of personal deposits and an additional $60,000 on the aggregate value of RRSP deposits held in both affiliated institutions, for a total coverage of $120,000 in this example.

The second proposed change would allow CDIC to vary premiums on member institutions based on factors such as the capitalization and supervisory ranking of the member institution. The introduction of such risk-based premiums would be in addition to, and would not replace, the existing authority of CDIC to levy a premium surcharge on a member institution. The purpose of introducing risk-based premiums would be to provide a signal – with financial consequences – to boards of directors and management of member institutions concerning the risk rating of their institution. Additional detail on the options for developing a risk-based premium system is contained in Annex 6.

Given that the Quebec Deposit Insurance Board (QDIB) operates a separate deposit insurance system which is to some extent integrated with the federal system, consultations will take place on the implementation of these proposed changes.

The government also proposes to refine the existing mandate of CDIC. As is currently the case, CDIC's legislated 'objects' would be to provide deposit insurance, and to promote standards of sound business and financial practices and promote and otherwise contribute to the stability of the Canadian financial system within a least cost framework. These are appropriate roles for CDIC and they should continue to be reflected in its objects. However, in order to streamline the matters which CDIC must take into consideration in exercising its powers and duties, the current reference to promoting and otherwise contributing to the competitiveness of the financial system would be removed.

Submissions have also been received about allowing deposit-taking institutions which do not take retail deposits to 'opt out' of membership in CDIC. The government is considering these submissions.

Further changes to the *CDIC Act* are also being proposed. Some of the changes would simplify administrative processes within CDIC; others are of a technical or 'housekeeping' nature, or effect other cost-saving measures. These amendments are described in greater detail in Annex 7.

4. Protection of Policyholders of Life and Health Insurance Companies

Policyholder Protection Board (PPB):

- to protect policyholders and annuitants of life and health insurance companies;
- legislated requirement for member institutions to pay assessments, to facilitate borrowing by the PPB in public markets;
- could enter into going concern solutions for institutions in financial difficulty, where cost effective;
- information sharing with OSFI, facilitated by an appropriate corporate governance process;
- all federal life and health insurance companies to be members; membership open to provincial companies.

In 1990, the life and health insurance industry established the Canadian Life and Health Insurance Compensation Corporation (CompCorp). CompCorp's objective is to protect, within limits, Canadian policyholders against loss of benefits should a member of CompCorp become insolvent and wound-up. All federally incorporated life and health insurance companies are required to be members by a Ministerial order under the *Insurance Companies Act*. Most provinces have similar requirements in place. Since then, CompCorp has successfully handled two insolvencies, and is being instrumental in protecting policyholders of Confederation Life.

The government has considered the protection system for policyholders in the context of the protection that now exists for depositors, through CDIC and provincial deposit insurance plans, in the context of the degree and nature of competition between the various parts of the financial services industry and in the context of the protection system for policyholders in other countries. Deposit-taking institutions and insurance companies compete, but often only at a general level with one another. Each offers a significant range of products that the other does not. Each also offers products that compete with other parts of the financial system. Deposit-taking institutions, however, are the only ones that are both part of the payments system and offer products that are cashable on demand. Taking this all into account, the extent of government backing for compensation schemes need not be similar between the two industries. An argument for government backing for policyholder protection would have to be centred primarily on consumer protection, rather than on other rationales applicable in the case of deposit-taking institutions, such as the avoidance of 'runs' leading to systemic problems. The government has examined the possibility of a full Crown corporation, which would include access to loans from the Consolidated Revenue Fund, and does not consider it to be appropriate in the circumstances, particularly when the government is reconsidering and lessening its role in a range of areas.

The Senate Banking Committee conducted an extensive review of the adequacy of the arrangements in place for protecting policyholders of life and health insurance companies. The Committee concluded that an entity is needed with appropriate access to information regarding financially troubled companies and with the ability to effect 'going concern' solutions (e.g., mergers) for companies in financial difficulty. The committee also concluded that a legislated arrangement is the best way to provide these tools and, therefore, has recommended that the government introduce such legislation.

The government is responding to this recommendation and is proposing to protect policyholders and annuitants of life and health insurance companies through a new entity named the Canadian Life and Health Insurance Policyholder Protection Board (the PPB). The PPB would have enhanced features over CompCorp's current structure. Its design would closely follow the recommendations of the Senate Banking Committee in key areas such as improving the system of corporate governance over the policyholder

protection fund and strengthening the capacity of the fund to participate in 'going concern' transactions. The obligations of the fund would not be backed by the federal government. The details of the proposal will be the subject of discussion in the consultations process.

The PPB's primary purpose would be to administer a protection fund for policyholders and annuitants in life and health insurance companies. Its mandate would also allow it to support what it judges to be cost effective 'going concern' solutions. All federal companies would be required to be members of the PPB, while provincially regulated companies could also become members of the PPB.

A Special Act of Parliament will be proposed to provide the legislative framework for the operation of the PPB. The PPB would be administered by a board of directors, comprised of seven individuals (including a Chairman), appointed by the government. None of the directors could be active in the affairs of an insurance company but the board of directors would have insurance expertise. The precise process for selecting directors will be determined after consultations with the life and health insurance industry. The Superintendent would also be an ex-officio member of the board of directors, but with no voting rights.

The legislative framework for the PPB would give the board of directors the power to set the method and rates of assessment on its members. The board of directors would also have the right to determine the benefits which the fund will pay to policyholders and annuitants of failed institutions.

Expenditures of the PPB would be financed principally through assessments on member companies. The PPB would be authorized to collect such assessments under its legislative framework. It would also be able to borrow in financial markets, but not as an agent of Her Majesty or with the guarantee of the Government of Canada. The PPB would be able to meet its obligations to policyholders and annuitants only to the extent that it can finance those payments, first, through assessments on its members, and then, by borrowing on the strength of its future stream of assessment revenues.

The design of the PPB will take into account the assessments which its members will need to make so that CompCorp can continue to fulfil its obligations arising from past failures. To enable the PPB to deal with future problem company situations, it may be necessary to raise the total assessments on the industry from the current maximum which CompCorp has set for itself. Details of how members of the PPB will meet any continuing obligations to CompCorp and the method and levels of the PPB's assessments can be determined only after further discussions with the industry, CompCorp, and other interested parties.

Legislative changes will be proposed to allow the Superintendent and OSFI to share confidential information on life and health insurance companies with the PPB. Having the Superintendent on the board of directors of the PPB would provide an additional avenue to facilitate the flow of information on problem companies between OSFI and the PPB.

From time to time, the PPB may decide that it needs additional information on a member facing financial difficulties. To provide for this, the PPB would be able to contract with OSFI to conduct more in-depth, specific purpose examinations of a problem institution on a cost recovery basis, or to carry out a special examination of a company on its own.

The PPB would represent an improvement over the current policyholder protection plan run by CompCorp. First, assessments established by statute would provide greater assurance to lenders that the PPB will have the funding needed to meet its debt obligations; second, the fact that none of the directors would be active industry participants will enable the Superintendent to share confidential information with the PPB and ensure that directors will not face conflicts when making decisions on matters related to the PPB's mandate; third, to deal with the financial needs of the PPB, directors would have substantially greater flexibility in setting the levels and method of assessments.

The government has reviewed models in other countries. Most countries do not have compensation corporations for policyholders of life and health insurance companies. The United States and the United Kingdom provide the most comprehensive examples of models which have been in operation for some time. Though the overall situation in these countries is somewhat different, the design of the proposed PPB is comparable to these models.

5. Developing a Stronger Prudential Framework for Federal Financial Institutions

Although OSFI does not need expansive new powers, some improvements in existing supervisory standards and new supervisory tools are warranted. In particular, the following measures are being proposed:

- that the Superintendent have the authority to obtain an independent actuarial review of a federally regulated insurance company (i.e. a review conducted by an actuary other than the company's appointed actuary) at the company's expense;
- in recognition of the important role of the actuary in respect of insurance companies, that OSFI review, along with the Canadian Institute of Actuaries, the possibility of developing, and making public, a list of questions which boards of directors of federally regulated life insurance companies would ask of the company's appointed actuary;
- that the appointed actuary of a federal insurance company not also hold the position of chief financial officer;
- that the Superintendent have the authority to designate certain directors of federal regulated financial institutions as being affiliated with the institution, for purposes of the 'unaffiliated director' requirement. This would be similar to the existing power of the Superintendent to designate a person as a related party of the institution;

- that the unaffiliated directors who serve on the board of directors of a federal financial institution not be directors who also serve on the board of its unregulated parent company;
- that OSFI consult with federally regulated financial institutions concerning the rules regarding capital that must be available in Canada;
- that OSFI work with the audit profession and the industry to refine the standards of financial reporting for financial institutions;
- that OSFI, together with the industry, develop standards of sound business and financial practices for federally regulated insurance companies.

There are other areas which have been raised and for which further discussion is warranted.

It has been suggested that regulatory authorities should have direct involvement in the composition of boards of directors and senior management of federal financial institutions. Jurisdictions such as the United Kingdom (U.K.) have a regime which requires that directors and officers be 'fit and proper'. In the U.K., this involvement of the supervisor is well accepted, does not appear to require large compliance or administrative costs and substitutes, in part, for more detailed examination and supervision of institutions by the authorities. Also in the U.K., there is also a well-developed cadre of professional non-executive directors who help to exercise oversight of institutions. Further development of such a cadre in Canada would be desirable.

It has also been suggested in Canada that the Superintendent should have the authority to veto appointments of directors and senior officers of a problem financial institution. This would be a limited provision, in that it would apply only at the appointment stage. It would address the situation, for example, where there is potential for deterioration of the quality of the board of directors as a result of the resignation of previous board members for reasons such as liability concerns. This provision would require a definition of a problem institution. In addition, it would not give the Superintendent the authority to intervene before the institution formally became a problem. Further, having the Superintendent involved at the appointment stage means that there could be no influence in situations where a director was already in office.

The Senate Banking Committee has recommended an approach which would allow both the veto of appointments and the removal of incumbent directors, but only in respect of problem institutions.

One important issue in designing any such measure is the extent to which there would be a positive duty on directors to provide information on their own fitness, or whether the onus would be on the Superintendent to act if information came to the Superintendent's attention that suggests the need for action.

The government believes that some additional involvement of the Superintendent in the governance of a financial institution, along one of the lines outlined above, is desirable. Consultations will occur with interested parties on the various options.

6. Initiatives to Reduce Systemic Risk in Major Clearing and Settlement Systems

New Clearing and Settlement Legislation to:

- Provide a legislative role for the Bank of Canada to ensure that the design and operation of the major clearing and settlement systems controls systemic risk effectively. Systemic risk is the risk that problems experienced by an institution will spread to others and be destabilizing to the financial system as a whole.
- Ensure that clearing and settlement systems contribute to the international competitiveness of Canadian financial institutions.

The Canadian payments system is one of the most efficient paper-based payments systems in the world. Canada is now looking increasingly to electronic payment methods to achieve further gains in efficiency and reductions in risk. The payments system in Canada is operated principally by the financial institutions themselves through the Canadian Payments Association (CPA).

Clearing and settlement systems are important channels for the interaction of financial institutions and, as such, contribute to the security, efficiency and competitiveness of the financial system as a whole. If clearing and settlement systems are not properly designed, however, they can result in considerable systemic risk – that is, the risk that problems experienced by one financial institution will spread to other financial institutions and be destabilizing to the financial system as a whole. Ensuring that these systems are properly risk proofed, effectively designed, and competitive in terms of the speed and cost with which payments are cleared and settled, will ensure that Canadian financial institutions will be able to compete effectively on a global basis.

Canada is currently the only G-10 country without a system that provides finality of payment on the same day for large value payments. This means that recipients of Canadian payments cannot know for certain that a payment item has been irrevocably processed, or is 'final', until at least the day after it is submitted in the clearings.

Canadian financial institutions are working through the CPA to develop a Large Value Transfer System (LVTS) to offer intra-day finality of payments for its users. The implementation of the LVTS will enhance financial system stability by limiting systemic risk. The Bank of Canada and the Department of Finance have participated with industry in the development of this system.

A new system for clearing transactions of government debt securities, known as the Debt Clearing Service (DCS), was implemented by the Canadian Depository for Securities last summer and incorporates risk-containment features accepted by federal and provincial authorities. The DCS currently handles transactions of Government of Canada bonds. Federal government Treasury bills are scheduled to move to the DCS this year. Placing all government debt on this system reduces costs for the government, as issuer, as well as for other participants in the system.

A system for clearing and settling foreign exchange transactions is also being developed by the private sector with the close involvement of the Bank of Canada.

It is proposed that federal legislation be developed to give the Bank of Canada a more explicit role in the oversight of clearing and settlement systems from the point of view of controlling systemic risk. It would build on the Bank of Canada's existing informal role in this area and its role in the settlement of payments obligations between financial institutions. Enhanced powers for the Bank of Canada are consistent with the current focus of central banks around the world on these matters. They are also consistent with the coordination by central banks of efforts to limit the international transmission of risk through clearing and settlement systems. The explicit oversight power would mean that private sector operators of clearing and settlement systems that have potential systemic risk implications would be required to obtain the approval of the Bank of Canada regarding the mechanisms designed to monitor and control these risks.

New clearing and settlement legislation would help ensure that Canada keeps pace with the developing international standards for the design of secure clearing and settlement systems. In some countries, the central bank runs many of these systems. Canada, by contrast, has chosen to leave the development of such systems largely to the private sector. Nevertheless, certain legislative changes are warranted to provide the Bank of Canada with the capacity to participate in these clearing and settlement systems, to provide services to these systems, and to ensure that these systems are operated in a safe and sound manner.

Under the proposed legislation, oversight of clearing and settlement systems by the federal authorities would be exercised by the Bank of Canada with a view to ensuring that appropriate arrangements are in place so that systemic risk is minimized. In particular, clearing and settlement system participants should have both the ability and incentives to recognize and control the risks they face. With respect to the LVTS, for which financial institutions themselves will be posting sufficient collateral to cover the single largest possible default, the Bank of Canada would have the power to guarantee settlement of transactions on the system in the extremely unlikely event that the collateral posted by the institutions is insufficient to cover losses arising from multiple participant failures at the same time. This guarantee means that all eventualities are covered, thus allowing participants in the systems to offer intra-day finality of payment to customers, which will be part of the arrangements. This level of

risk containment would meet internationally-agreed-upon standards. These legislative changes would also permit the Bank of Canada to pay interest on deposit liabilities associated with the LVTS, to open deposit accounts for clearing houses and to act as a settlement agent.

With respect to the scope of the proposed legislation, it would be framed to establish federal oversight, through the Bank of Canada, of all clearing and settlement systems that are sources of systemic risk in the payments system. In practical terms, federal involvement would be limited to clearing and settlement systems where the potential exposures have very large dollar values and where financial institutions are participants. The legislation would be directed at the clearing arrangements and not at the underlying transactions. Thus, clearing and settlement systems for foreign exchange or securities could come under the legislation – if warranted by systemic risk concerns and with respect to these concerns – without implying federal regulation of these markets.

Finally, a key component of this initiative would be to give statutory recognition to 'netting arrangements' in payment and other clearing and settlement systems and in certain types of financial instruments. In the context of these systems, netting refers to the process by which participants in a system can offset amounts owed to them by other participants against their obligations to others to arrive at a net obligation. Netting can dramatically reduce the credit exposures of participants and make the settlement of obligations more efficient. Confirming that netting arrangements are legally valid (and unassailable in a liquidation or restructuring) is essential to securing the benefits of netting.

7. Other Proposals

(a) Changes to the Financial Institutions Statutes and Other Legislation

In addition to the prudential measures noted in Section 5, the following changes to legislation are being proposed:

- Consistent with the situation regarding federal deposit-taking institutions, the Superintendent would no longer be the liquidator of a federally regulated insurance company. As is currently the case, the Superintendent may seek standing with the courts when considered appropriate in a particular liquidation process.
- Regulations made pursuant to the *Insurance Companies Act* currently allow for the demutualization of all but the largest mutual companies. However, members of the insurance industry and other commentators have expressed concerns that these regulations may not provide sufficient flexibility to allow insurance companies in financial difficulty to demutualize as a means of raising additional capital. In general, and having regard to the experiences of other jurisdictions such as the United States, the demutualization process is by necessity time-consuming and complex for a number of reasons, including the need to ensure the fair and equitable

treatment of affected policyholders and to allow for due consideration by the regulatory authorities. Accordingly, demutualization is inherently only an effective route to deal with problem financial institutions if it is started well before serious problems begin. The government will consider specific proposals for streamlining the regulations concerning the demutualization of federally regulated life insurance companies from the industry or other commentators.

- Federally regulated financial institutions would be prohibited from being affiliated with entities, other than regulated financial institutions, which use 'Trustco', 'Lifeco' or other similar words in their corporate name. This change would help ensure that the public is not misled concerning whether a particular entity is, in fact, a regulated financial institution.
- The *Investment Companies Act* is unnecessary as a means to serve its original purpose of protecting investors in investment companies. Accordingly, the government proposes to repeal the *Investment Companies Act*.

(b) Restructuring of Insurance Companies

The Senate Banking Committee has recommended that 'rehabilitation' be considered for insurance companies.

'Rehabilitation' is a tool that has been used in the United States when dealing with failing insurance companies. It is typically used as a way of preserving a company while business is transferred to healthy institutions and the company itself is downsizing significantly. The advantage of such a process is that policyholders benefit from continued protection, though the terms of the policies themselves may be adjusted.

In Canada, CompCorp and the liquidator work in much the same fashion – once a company has been placed into liquidation, policies may be reinsured, with the resulting benefit that policyholders continue to be protected (though the coverage may be lower depending on what the liquidator can arrange, for example).

The government believes that it is desirable to provide for additional flexibility in statutory powers for the authorities regarding insurance companies, subject to court approval, to restructure insurance policies, including the possibility of altering policies as necessary, and to arrange for the sale of blocks of business with protection to prevent undue loss of value during the process. These provisions could be used to effect a significant downsizing or winding-up of the company with the additional flexibility providing more value to policyholders and, in some case, creditors. Accordingly, these would be appropriately regarded as restructuring, as opposed to rehabilitation, provisions. The government does not believe that it is realistic to 'rehabilitate' an insurer in financial difficulty, in the sense of temporarily putting an insurance company in 'limbo', altering its operations, and having it emerge largely unchanged as a viable operation. The evidence from the United States supports this conclusion.

The government is examining, together with the industry, how more flexibility could be provided, either to enhance the liquidator's ability to transfer policies, or to enhance the ability of the regulator and the PPB to work together to facilitate transactions prior to a company being put into liquidation, for example. As part of this process, consultations will be held with interested parties on the particulars of a restructuring proposal.

(c) Asset-Based FIRP

The Financial Institutions Restructuring Process, or FIRP, is a process set out in the *CDIC Act* whereby the shares and subordinated debt of a non-viable federal deposit-taking institution can be seized by CDIC, with government approval, and sold to a healthy institution. It has been suggested that the existing FIRP provisions do not facilitate transactions in situations where buyers are more interested in acquiring the deposit liabilities and marketable assets than they are in buying the shares of the financial institution.

To respond to this concern, and in line with the Senate Banking Committee's recommendation, it is proposed that the *CDIC Act* be amended to allow CDIC, under certain circumstances, to act as receiver and transfer the deposit liabilities and marketable assets of a non-viable institution to a healthy institution. Such flexibility would allow CDIC to realize the best possible price for a non-viable institution, as the price that a prospective buyer would be willing to pay is much greater if parts of the business can be purchased without the institution having first gone into formal liquidation. As well, such a process minimizes disruption to clients of the non-viable institution. Creditors of the non-viable institution would also benefit to the extent that they were entitled to share in the proceeds of the sale of the assets. Shareholders and creditors would have the option of seeking a financial remedy through the court if they believed that CDIC, as receiver, did not act in a commercially reasonable manner.

It is proposed that consultations with CDIC members and other interested parties be undertaken to explore the merits of such a change to the FIRP power, the appropriate redress mechanisms, as well as whether additional changes to these provisions should be considered.

CONSULTATIONS PROCESS AND NEXT STEPS

Most of the areas covered in this paper have been the subject of extensive consultations already, through the processes described earlier. The results of these consultations have been taken into account in drafting this policy paper. In a number of areas, however, the details of the proposals have not previously been considered fully in the course of consultations. Annexes to this paper provide details on a number of the technical aspects of the proposals. Consultations will occur immediately on a number of the proposals, as noted in the paper, so that the legislation required to implement the proposals can be drafted expeditiously. Written comments are invited and should be directed to the Financial Institutions Division, Department of Finance, by April 12, 1995.

ANNEX 1

OSFI ACT: PROPOSED PREAMBLE AND MANDATE

The following represents the proposed preamble for the *OSFI Act* and the mandate for the Office of the Superintendent of Financial Institutions. These proposed new additions to the *OSFI Act* will complement section 6 of the Act, which requires the Superintendent to perform the duties required in the statutes listed in the schedule to the *OSFI Act*, which include the *Bank Act*, the *Trust and Loan Companies Act*, the *Insurance Companies Act*, and the *Cooperative Credit Associations Act*.

Preamble

Whereas it is desirable to establish an office to regulate federally incorporated financial institutions so as to contribute to public confidence in the Canadian financial system, there is hereby established an office of the Government of Canada called the Office of the Superintendent of Financial Institutions, over which the Minister of Finance shall be responsible.

1. The objects of OSFI respecting financial institutions are to:

   (a) supervise financial institutions to determine whether they are in sound financial condition and in compliance with statutory and other supervisory requirements;

   (b) promptly advise management and boards of directors of financial institutions when they are not in sound financial condition or in compliance with requirements and take, or require them to take, the necessary corrective measures or series of measures to deal with the situation in an expeditious manner;

   (c) promote the adoption by management and boards of directors of financial institutions of policies and procedures designed to control and manage risk; and

   (d) to consider system-wide or sectoral issues which may have a negative impact on the financial condition of financial institutions.

2. In pursuing its objects, the Office shall protect the rights of depositors, policyholders, and ordinary creditors of financial institutions, with due regard to the need to allow financial institutions to compete effectively and take reasonable risks.

3. While regulation and oversight by the Office can reduce the risk that financial institutions will fail, boards of directors are responsible for managing financial institutions, financial institutions operate in a competitive environment requiring the management of risk, and financial institutions can experience financial difficulties that can lead to their failure.

ANNEX 2

GUIDE TO INTERVENTION FOR FEDERAL FINANCIAL INSTITUTIONS

Introduction

The Office of the Superintendent of Financial Institutions (OSFI) was established in 1987 and is responsible, among other things, for regulating and supervising banks, federally incorporated trust companies and loan companies, and federally incorporated or registered insurance companies. OSFI has primary responsibility for supervisory actions with respect to an institution.

The Canada Deposit Insurance Corporation (CDIC) is a federal crown corporation that insures deposits in both federal and provincial deposit-taking institutions (banks, trust companies and loan companies) that are its members. In order to fulfil its legislated 'objects', control risk to the deposit insurance fund and minimize the exposure of CDIC to loss, CDIC may take certain measures in respect of its member institutions.

Insofar as federally incorporated deposit-taking institutions are concerned, the intervention aspects of OSFI and CDIC are closely intertwined and a high level of coordination and cooperation between the two agencies is expected. It should be stressed that OSFI is the regulator and is responsible for taking supervisory actions and CDIC is the insurer. OSFI is a primary source of information for CDIC and CDIC relies on OSFI to examine and report annually on the financial condition of CDIC's member institutions.

Insurance companies supervised by OSFI include domestic life insurance companies, property and casualty insurance companies and fraternal benefit societies as well as foreign insurance companies and fraternal benefit societies operating in Canada on a branch basis. The Canadian Life and Health Insurance Compensation Corporation (CompCorp) and the Property and Casualty Insurance Compensation Corporation (PACICC) are industry run compensation corporations set up to protect policyholders of life and health insurers and property and casualty insurers respectively. These organisations are not federal government agencies, therefore this document does not describe their activities.

The financial institutions statutes administered by OSFI and the *Canada Deposit Insurance Corporation Act* provide a wide range of discretionary intervention powers to address situations that give OSFI and, when one of CDIC's member institutions is involved, CDIC cause for concern. The objective of the intervention process is to identify areas of concern early and intervene effectively to minimize problems and losses to depositors and other creditors, as the case may be, of financial institutions.

The document that follows provides an outline of the intervention processes applied to federally regulated deposit-taking institutions by OSFI and CDIC. It incorporates the measures proposed in the policy paper. A simplified schematic is also appended to assist those who are not familiar with the process. Similar processes are followed by CDIC in dealing with provincial deposit-taking institutions.

The objective of this document is to promote awareness and enhance transparency of the system of intervention for federal deposit-taking financial institutions and other interested parties. The document summarizes the circumstances under which certain intervention measures may be expected, and it describes the coordination mechanisms in place between OSFI and CDIC when dealing with federally regulated deposit-taking institutions.

Over time, this document will be updated, to expand, where appropriate, on the circumstances under which action may be taken, including the authorities' risk-rating systems, for example. In addition, more detail on the nature of extended and special exams carried out by OSFI and CDIC will be considered.

This outline does not specifically describe the system of intervention for life or property and casualty insurance companies supervised by OSFI, nor the coordination mechanisms in place between OSFI and the two insurance compensation funds. However, they are similar to those described for deposit-taking institutions. A similar document will be produced for insurance companies that will incorporate new elements proposed in this policy paper such as the Policyholder Protection Board, and new legislative powers to restructure insurance companies in financial difficulty.

This document outlines what financial institutions can normally expect from OSFI and CDIC. However, circumstances can vary significantly from case to case, and this document should not be interpreted as limiting the scope of action that may be taken by OSFI or CDIC in dealing with specific problems or institutions. It is important to note the OSFI's and CDIC's intervention process is not a rigid regime under which every institution or every situation is necessarily addressed with a predetermined set of actions.

No problems/Normal activities – Routine supervisory and regulatory activities pursuant to mandates of OSFI and CDIC. In addition, both agencies conduct research and analyse industry-wide issues and trends, appropriate to their respective functions.

OSFI Activities	Statutory and Inter-Agency Activities/Responsibilities	CDIC Activities
Incorporation of new financial institutions and issuance of orders to carry on business: • review and assess all relevant documents and information • make recommendation to Minister. Review and assess wide range of applications and requests for regulatory consents required by statutes including • corporate reorganizations • changes in ownership • acquisitions of other financial institutions • transfers of business. Ongoing monitoring of supervised institutions via information obtained from statutory filings and financial reporting requirements: • consider compliance with statutory and other regulatory requirements • assess financial situation and operating performance. Periodic on-site examinations of supervised institutions as required by statutes: • inform management and board of directors of findings • management requested to provide copy of report to external auditors • require that concerns be addressed by institutions • monitor remedial measures if required.	OSFI informs Minister of status of supervised institutions. OSFI reports to the CDIC on post examination results for individual deposit-taking member institutions and confirms material compliance with standards of sound business and financial practices. Monthly OSFI-CDIC inter-agency meeting held to discuss corporate governance and activities of member institutions.	Process application for policy of deposit insurance and obtain appropriate guarantees and undertakings. Ongoing risk assessment of selected individual institutions via: • information available from OSFI, the Bank of Canada and, where necessary, individual financial institution reports • contacts with regulators • rating agency results • review and analysis of results of annual examinations of federal member institutions carried out by OSFI • other sources. Ensure compliance with *CDIC Act* and standards of sound business and financial practices by-laws, policy of deposit insurance and CDIC by-laws.

Stage 1 – Early warning – Deficiency in policies or procedures or the existence of other practices, conditions and circumstances that could lead to the development of problems described at Stage 2. Situation is such that it can be remedied before to deteriorates into a Stage 2 problem.

OSFI Activities/Intervention	Statutory and Inter-Agency Activities/Responsibilities	CDIC Activities/Intervention
Management and board of directors of financial institution are formally notified of concerns and are requested to take measures to rectify situation. Monitoring of remedial actions may involve requests for additional information and/or follow-up examinations. OSFI may require that institution's external auditor enlarge scope of examination of institution's financial statements or that external auditor perform other procedures, and prepare a report thereon. OSFI may assign cost of external auditor's work to institution.	Activities below are in addition to those previously mentioned. OSFI and CDIC coordinate on requested remedial measures to deal with concerns and on establishment of time frame within which situation should be remedied. OSFI's post-examination report to CDIC identifies issues requiring remedial measures, including any material breaches of standards of sound business and financial practices, regardless of whether such issues are treated as formal qualifications to OSFI's report. The status of such issues is reviewed at monthly inter-agency meetings. CDIC notifies OSFI of contemplated intervention measures, discusses results of special examinations with OSFI, and coordinates communications with the institution about its status and placement on 'watchlist'.	CDIC risk assessment and interventions listed here are in addition to those mentioned previously. Depending on CDIC's assessment of situation • CDIC may request additional information from OSFI if available, or from the institution if necessary • CDIC may communicate its concerns to institution and may place it on its preliminary 'watchlist' and inform institution of that fact • If circumstances warrant CDIC may conduct or commission a special examination to obtain more information on the member institution and to be in a position to assess the extent of the institution's problem and CDIC's exposure • Institution may pay higher CDIC premiums, related to increased risk. CDIC may levy a premium surcharge if the institution does not remedy any of the following: • failure to follow CDIC's standards of sound business and financial practices • failure to comply with its governing statute • failure to fulfil the terms of an undertaking provided to CDIC • failure to maintain records and information pursuant to provisions of the policies of deposit insurance. CDIC may request an undertaking from institution or from entity that controls the institution to rectify areas of concern.

Stage 2 – Risk to financial viability or solvency – Situation or problems that, although not serious enough to present an immediate threat to financial viability or solvency could deteriorate into serious problems if not addressed promptly, as evidenced by:

- concerns over the institution's ability to meet capital and surplus, or vesting requirements on an ongoing basis
- deterioration in the quality or value of assets, or the profitability of the business undertaken by the financial institution
- undue exposure to off-balance sheet risk
- poor earnings or operating losses or questionable reporting of earnings or expenses
- low level of accessible liquidity or poor liquidity management in context of the institution's situation
- less than satisfactory management quality or deficiency in management procedures or controls (including material breaches of standards of sound business and financial practices)
- other concerns arising from:
  - a financially weak or troubled owner
  - non-compliance with regulatory requirements
  - systemic issues
  - rapid growth
  - credit rating downgrades.

OSFI Activities/Intervention	Statutory and Inter-Agency Activities/Responsibilities	CDIC Activities/Intervention
Senior OSFI officers meet with management and board of directors of financial institution and with external auditor of institution to outline concerns and discuss remedial actions. Management and board of directors are formally notified of the fact that institution is being placed on the regulatory 'watchlist'. External auditor of institution may be required to perform a particular examination relating to the adequacy of the institution's procedures for the safety of its depositors, other creditors or shareholders, or any other examination that may be required in the public interest, and report thereon to OSFI. OSFI may assign cost of external auditor's work to institution. Scope of on-site examination and/or frequency of onsite examinations may be enlarged or increased. Monitoring of financial institution is enhanced as to frequency of reporting requirements and/or the level of detail of information submitted.	Activities below are in addition to those previously mentioned. CDIC and OSFI coordinate communications with the institution. OSFI immediately notifies CDIC of situation when uncovered, with a formal report to follow. Institution is placed on 'watchlist'. OSFI sends a 'watchlist' progress report at least monthly to CDIC and Minister; report is discussed in regular meetings with Minister. Progress on remedial measures discussed at monthly OSFICDIC interagency meeting. Institution may be discussed at Financial Institutions Supervisory Committee. Contingency planning commences.	CDIC risk assessment and intervention listed here are in addition to those previously mentioned. CDIC informs management and board of directors of member insitution of situation and of the fact that institution is being placed on CDIC's 'watchlist' leading to more vigorous monitoring. If institution is in breach of CDIC's standards of sound business and financial practices, policy of deposit insurance, bylaws, CDIC may send the CEO or the Chairman of the institution a formal report pursuant to Section 30 of the CDIC Act. CDIC may advise institution that if CDIC is not satisfied with progress made in rectifying the situation referred to in the abovenoted formal report, CDIC may seek (federal institutions) Minister's permission to terminate the institution's policy of deposit insurance.

Stage 2 – Risk to financial viability or solvency (Cont'd)

OSFI Activities/Intervention	Statutory and Inter-Agency Activities/Responsibilities	CDIC Activities/Intervention
Institution must produce a business plan acceptable to both OSFI and CDIC that reflects appropriate remedial measures that will rectify problems within a specified time frame. Business restrictions appropriate to circumstances may be imposed on institution via undertakings provided by the institution, restrictions on the institution's order to carry on business or via direction of compliance covering such matters as: • payments of dividends or management fees • lending or investment powers • level of deposits and other indebtedness • interest rates paid on deposits • other restrictions tailored to circumstances. Progress of remedial measures is monitored via reporting requirements and/or follow-up examinations.		

Stage 3 – Future financial viability in serious doubt – Situations or problems described at Stage 2 are at a level where, in the absence of mitigating factors such as unfettered access to financial support from a financially strong financial institution parent, unless effective corrective measures are applied promptly, they pose a material threat to future financial viability or solvency.

OSFI Activities/Intervention	Statutory and Inter-Agency Activities/Responsibilities	CDIC Activities/Intervention
Management, board of directors and external auditor of institution are informed of problems. A special audit may be required from an auditor other than the institution's own external auditor if OSFI is of the opinion that it is required. OSFI may assign cost of external auditor's work to institution. If financial institution is a deposit-taking institution, examination and monitoring responsibility is transferred to an internal special work-out group within OSFI. Enhanced examinations may be carried out focussing on particular areas of concern such as asset or loan security valuations. Such examinations may involve any of the following: • substantial increase in sampling of credit files • more in-depth review of files • engagement of specialists or professionals to assess certain areas such as quality of loan security, asset values, sufficiency of reserves, etc. Depending on situation, OSFI examination staff may be posted at financial institution to monitor situation on an ongoing basis. Business plan must reflect appropriate remedial measures that will rectify problems within a set time frame so as to avoid triggering impaired viability or impaired solvency procedures (See Stage 4).	Activities below are in addition to those previously mentioned. OSFI immediately notifies CDIC of any material new findings or developments, with a formal report to follow. Results and data from enhanced examinations, expanded audits, etc. and from enhanced monitoring are discussed with CDIC. If financial institution is a deposit-taking institution and it is deemed to be, or is about to become, non viable, OSFI sends a formal report to CDIC to that effect.	CDIC risk assessment and interventions listed here are in addition to those mentioned previously. CDIC may seek Minister's permission to terminate the institution's policy of deposit insurance. In order to minimize risk to deposit insurance fund, CDIC may provide institution with temporary financial assistance or provide support for a restructuring transaction by such measures as: • acquiring assets from the institution • making or guaranteeing loans or advances with or without security, to the institution • making or guaranteeing a deposit with the institution. Following receipt of formal OSFI report to the effect that institution has ceased, or is about to cease, to be viable, CDIC may initiate a restructuring by asking the Minister of Finance to recommend that the Governor in Council issue a "FIRP" order, under the financial institutions restructuring provisions of the *CDIC Act*.

Stage 3 – Future financial viability in serious doubt *(Cont'd)*

OSFI Activities/Intervention	Statutory and Inter-Agency Activities/Responsibilities	CDIC Activities/Intervention
OSFI may order institution to increase its capital. Monitoring of institution may be further enhanced as to frequency of reporting requirements and/or the level of detail of information submitted so as to monitor progress of remedial measures. Follow-up examinations may be carried out as required. Depending on circumstances, business restrictions may be enhanced or additional ones imposed on institution. Depending on circumstances, pressures may be exerted on management and board of directors to restructure institution or to seek out an appropriate prospective purchaser. OSFI develops contingency plan in order to be able to take rapid control of the assets of the financial institution if changes in circumstances so warrant.		

Stage 4 – Nonviability/ insolvency imminent – Severe financial difficulties resulting in

- failure or imminent failure to meet regulatory capital and surplus requirements in conjunction with inability to rectify the situation within a short period of time

  OR

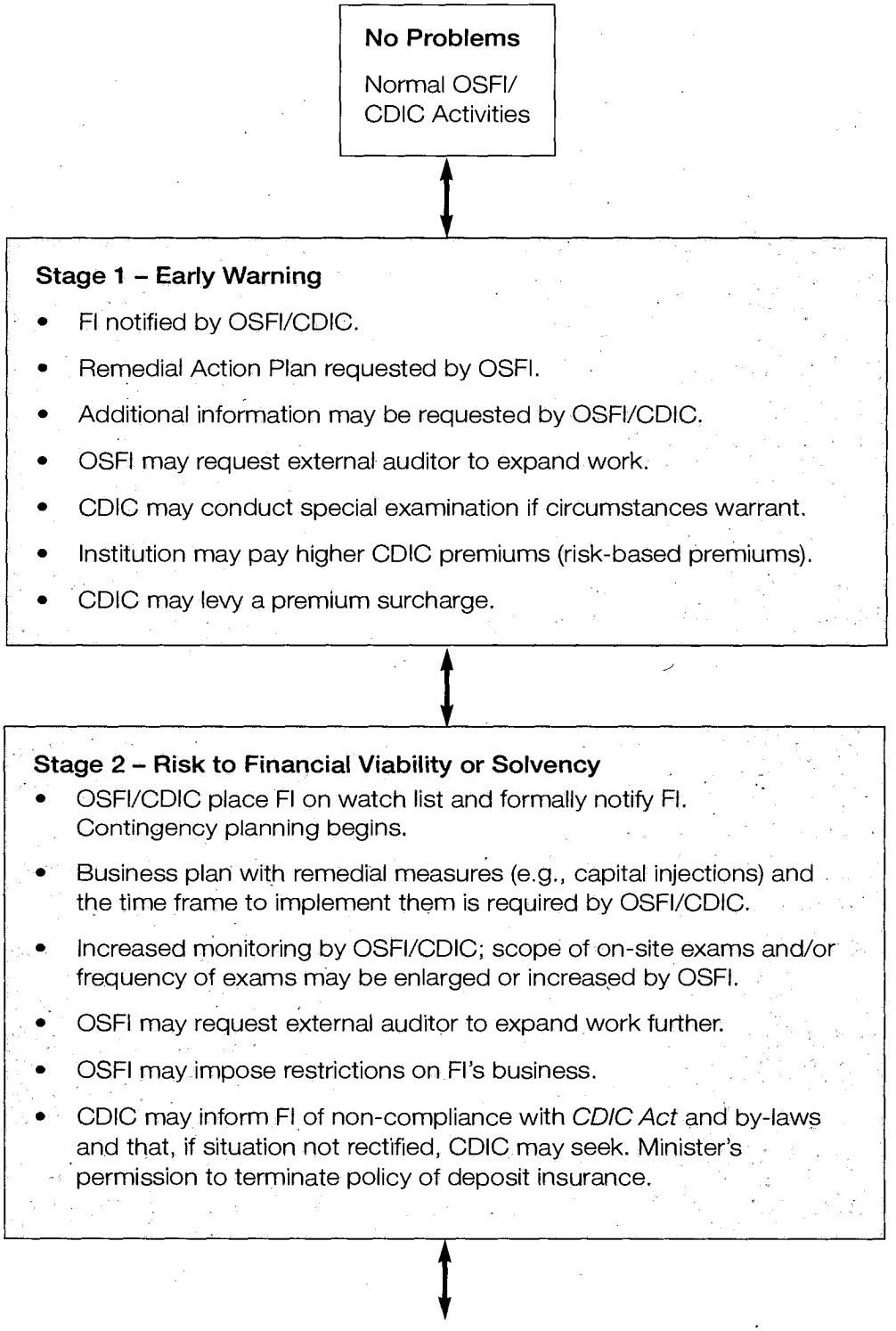
- statutory conditions for taking control being met

  OR

- failure to develop and implement an acceptable business plan, thus making either of the two preceding circumstances inevitable within a short period of time.

OSFI Activities/Intervention	Statutory and Inter-Agency Activities/Responsibilities	CDIC Activities/Intervention
New business restrictions may be imposed on institution or existing restrictions may be expanded. Pressure to rectify situation is exerted on management and board of directors of financial institution through frequent meetings with senior OSFI officers. OSFI notifies management and board of directors of institution of intended regulatory intervention measures that will be taken unless situation is rectified imminently. If statutory conditions for taking control of assets exist and if circumstances are such that there is an immediate threat to the safety of depositors and other creditors, OSFI may take control of the assets of the institution for a short period. If statutory conditions exist, such as failure to comply with order to increase capital, and subject to representation to the Superintendent, OSFI may maintain control of assets or take control of the institution.	Other relevant regulatory agencies (provincial or foreign) are notified of proposed regulatory intervention measures to be applied to institution. If the institution meets any of the conditions that would make it eligible to be wound up pursuant to the *Winding-up Act*, the institution itself may voluntarily seek a winding-up order. Alternatively, either OSFI or CDIC, working in collaboration with the other agency, may seek a winding-up order. Minister may overrule this decision on grounds of public interest only. All intervention measures applied to deposit-taking institutions at this stage, whether initiated by OSFI or CDIC, are the subject of close coordination between the two agencies.	If CDIC is of the opinion that the institution is or is about to become insolvent, CDIC may seek Minister's approval to cancel the institution's policy of deposit insurance.

Simplifying Schematic of the Intervention Process for Federal Financial Institutions



Stage 3 – Future Financial Viability in Serious Doubt

- OSFI may require independent auditor to examine FI.
- Business plan specifying remedial measures needed to avoid moving to Stage 4 and time frame to implement them is required by OSFI.
- Increased monitoring/OSFI staff may be posted at FI.
- Enhanced exams with possible sampling of credit files, in-depth reviews of files, specialists hired to assess assets, etc.
- OSFI may issue an order to FI to increase capital.
- Further restrictions on FI's business may be imposed.
- FI is pressured to find a purchaser.
- FIRP Order possible.
- OSFI contingency plan developed to expedite taking control, if necessary.
- CDIC may pursue various failure resolution processes including seeking the Minister's approval to terminate deposit insurance.

Stage 4 – Insolvency Imminent

- Winding-up order sought or other resolution found while FI still has positive capital.
- CDIC may seek Minister's approval to cancel the FI's policy of deposit insurance.

Notes:

- This is a summary only. Full details of the intervention process are on the preceding pages.
- CDIC may conduct or commission a special in-depth examination at any stage depending on its views about the risk posed to the deposit insurance fund. Such an exam would likely take place at Stage 3, but could be done earlier if there were a high level of concern.
- CDIC may seek permission to terminate the policy of deposit insurance if the financial institution is in breach of CDIC Standards. Permission would likely be sought at Stage 3.
- CDIC may levy a premium surcharge at any stage.
- The proposed Policyholder Protection Board could potentially exercise similar powers to those outlined above for CDIC.

ANNEX 3

CLOSURE REGIME

Summary of Regime

The new closure regime will replace the existing regime in the *Bank Act*, the *Trust and Loan Companies Act*, the *Insurance Companies Act* and the *Cooperative Credit Associations Act* regarding the Superintendent's taking control of assets and taking control of a financial institution and the Minister's involvement in the process.

It will no longer be the Minister's role to form an opinion about the solvency or financial condition of the institution, prior to the Superintendent's taking control of the institution. Instead, the Superintendent, as regulator of the institution will be the key person responsible for reaching an opinion about the financial condition of the institution and whether such condition warrants supervisory intervention. The proposed regime will permit the Superintendent to intervene at an earlier stage, by authorizing him to take control of the assets of a financial institution or to take control of the financial institution where, for example:

- the Superintendent is of the opinion that the financial institution will not be able to pay its liabilities as they become due and payable;
- the Superintendent is of the opinion that the assets of the financial institution are not sufficient to adequately protect depositors, policyholders, or creditors;
- the Superintendent is of the opinion that the regulatory capital of the financial institution has reached a level (or is eroding in a manner) that may detrimentally affect depositors, policyholders or creditors;
- the financial institution has not complied with an order of the Superintendent for additional capital within the time specified in the order;
- a property and casualty insurance company or a branch of a foreign insurance company has not complied with an order for additional assets within the time specified in the order.

The document outlined in Annex 2 will set out the steps which the Superintendent will normally follow prior to the issuance of an order for additional capital or additional assets. This document will form an important part of the new regulatory regime for financial institutions.

The Superintendent will be authorized to take control of the assets of a financial institution (for a period greater than 16 days) or to take control of a financial institution unless the Minister is of the opinion that it is not in the public interest. The financial institution shall be given the opportunity to make written representations to the Superintendent prior to the Superintendent's taking control of the institution or taking control of the assets for an extended period of time.

When the Superintendent is in control of the financial institution, the Superintendent may request the Attorney General of Canada to seek a winding-up order in respect of that institution. If the Superintendent is in control of the assets of a financial institution or in control of a financial institution for a period exceeding 30 days, the Board of Directors of the financial institution may request that the Superintendent relinquish control of the assets or relinquish control of the financial institution, in which case the Superintendent would be required within a specified period of time to either relinquish control or to request the Attorney General of Canada to apply for a winding-up order.

Section 10 of the *Winding-up Act* would be amended to permit the granting of a winding-up order where the Superintendent has taken control of the financial institution on grounds that:

- the Superintendent is of the opinion that the financial institution will not be able to pay its liabilities as they become due and payable;
- the Superintendent is of the opinion that the assets of the financial institution are not sufficient to adequately protect depositors, policyholders, or creditors;
- the Superintendent is of the opinion that the regulatory capital of the financial institution has reached a level (or is eroding in a manner) that may detrimentally affect depositors, policyholders or creditors;
- the financial institution has not complied with an order for additional capital within the time specified in the order;
- a property and casualty insurance company or a branch of a foreign insurance company has not complied with an order for additional assets within the time specified in the order.

PROPOSED STATUTORY AMENDMENTS

1. Amendments to the *Bank Act*, the *Trust and Loan Companies Act*, the *Insurance Companies Act* and the *Cooperative Credit Associations Act*

Amend the applicable provisions of the *Bank Act*, the *Trust and Loan Companies Act*, the *Insurance Companies Act* and the *Cooperative Credit Associations Act* to provide the following:

"1. (1) The Superintendent may take control of the assets of a financial institution for a period not exceeding 16 days in any of the circumstances described in subsection (3).[1]

[1] In the case of a foreign insurance company, the Superintendent would take control of the assets in Canada of the foreign company together with its other assets held in Canada under the control of its chief agent, including all amounts received or receivable in respect of its policies in Canada.

(2) Notwithstanding subsection (1) and subject to subsection (4) and section 3, the Superintendent may, unless the Minister is of the opinion that it is not in the public interest,

(a) take and maintain control of the assets of a financial institution for a period in excess of 16 days, or

(b) take control of a financial institution

in any of the circumstances described in subsection (3).

(3) The Superintendent may take control of the assets of a financial institution or take control of a financial institution where:

(a) in the opinion of the Superintendent, there exists any practice or state of affairs that may be materially prejudicial to the interests of the depositors, policyholders or creditors of the financial institution;

(b) the financial institution has failed to pay any liability that has become due and payable;

(c) in the opinion of the Superintendent, the financial institution will not be able to pay its liabilities as they become due and payable;

(d) in the opinion of the Superintendent, the assets of the financial institution are not sufficient to give adequate protection to all the depositors, policyholders or creditors of the financial institution;

(e) in the opinion of the Superintendent, any asset appearing on the books or records of the financial institution is not satisfactorily accounted for;

(f) a notice of the termination of the financial institution's deposit insurance has been sent to the financial institution by the Canada Deposit Insurance Corporation;

(g) the financial institution has not complied with an order of the Superintendent made pursuant to subsection 485 (3) of the *Bank Act*, subsection 473 (3) of the *Trust and Loan Companies Act*, subsection 515 (3) of the *Insurance Companies Act* or subsection 409 (3) of the *Cooperative Credit Associations Act* for the financial institution to increase its capital, within the time specified in the order;

(h) in the opinion of the Superintendent, the regulatory capital of the financial institution has reached a level (or is eroding in a manner) that may detrimentally affect depositors, policyholders or creditors; or

(i) in the case of a property and casualty insurance company or a foreign insurance company, the company has not complied with an order of the Superintendent made pursuant to subsection 516 (4), 608 (3) or 609 (2) of the *Insurance Companies Act* for the company to increase its assets, within the time specified in the order.

(4) Prior to taking any action pursuant to subsection (2), the Superintendent shall notify the financial institution of its right to make written representations to the Superintendent and the financial institution shall be given a period not exceeding 10 days within which to make these representations.

2. The Superintendent shall relinquish control of the assets of the financial institution or relinquish control of the financial institution where the Superintendent is of the opinion that the financial institution has substantially corrected the matter giving rise to the Superintendent's taking control of the assets of the financial institution or the Superintendent's taking control of the financial institution and that it is otherwise proper for the financial institution to resume control of its assets or control of the conduct of its business.

3. The Superintendent may, where the Superintendent is in control of the financial institution (or in the case of a foreign insurance company, where the Superintendent has taken control of its assets in Canada, pursuant to subsection 1(2)) request the Attorney General of Canada to apply to the court for a winding-up order.

4. (a) At any time later than 30 days from the time the Superintendent has taken control of the assets or control of the financial institution, the Board of Directors of the financial institution may serve a notice on the Superintendent requesting that the Superintendent relinquish control of the assets of the financial institution or control of the financial institution.

(b) Not later than 12 days after receipt of the notice, the Superintendent shall

(i) relinquish control of the assets of the financial institution or control of the financial institution or

(ii) request the Attorney General of Canada to apply to the court for a winding-up order."

2. Amendments to the *Winding-up Act*

Amend section 10 of the *Winding-up Act* to provide additional grounds for obtaining a winding-up order in respect of a financial institution.

"10. A court may make a winding-up order in respect of a financial institution (or in the case of a foreign insurance company, in respect of its insurance business in Canada)

(f) where the Superintendent has taken control of a financial institution (or in the case of a foreign insurance company, where the Superintendent has taken control of its assets in Canada, pursuant to subsection 1 (2)) in the circumstances described in paragraph 1 (3)(c), (d), (g), (h) or (i) of the *Bank Act*, the *Trust and Loan Companies Act*, the *Insurance Companies Act* or the *Cooperative Credit Associations Act*."

Amend section 11 of the *Winding-up Act* to provide that paragraph 10(f) only applies where the Attorney General of Canada has applied for the winding-up order.

3. Additional Amendments to the *Bank Act*, the *Trust and Loan Companies Act*, the *Insurance Companies Act* and the *Cooperative Credit Associations Act*

Amend subsection 485 (3) of the *Bank Act*, subsection 473 (3) of the *Trust and Loan Companies Act*, subsection 515 (3) of the *Insurance Companies Act* and subsection 409 (3) of the *Cooperative Credit Associations Act* by adding the words "or Guidelines" after the word "regulations". This amendment is intended to enable the Superintendent, by order, to direct the financial institution to increase its capital where, in the opinion of the Superintendent such additional capital is necessary to protect depositors, policyholders or creditors, notwithstanding that the financial institution is complying with the regulations or Guidelines made in respect of adequate capital.

Amend subsection 516 (4), 608 (3) and 609 (2) of the *Insurance Companies Act* by adding the words "or Guidelines" after the word "regulations". This amendment is intended to enable the Superintendent, by order, to direct a property and casualty insurance company or a foreign insurance company to increase its assets where, in the opinion of the Superintendent such additional assets are necessary to protect policyholders or creditors, notwithstanding that the property and casualty insurance company or the foreign insurance company is complying with the regulations or Guidelines made in respect of adequate assets.

ANNEX 4

PROPOSED AMENDMENTS TO THE *WINDING-UP ACT*

The following list of amendments to the *Winding-up Act*, which will be proposed to Parliament, is organized according to section numbers as found in the Act. Some amendments, however, involve adding a section and are listed under the heading "New Section". A brief description and explanation are provided for each amendment.

Section 6 — Application

Amendment: Clarify that the *Winding-up Act* applies to federally incorporated and insolvent provincially incorporated trust companies.

Explanation: Currently section 6 of the *Winding-up Act* does not specifically refer to trust companies, although the courts have found that trust companies are subject to the Act.

Section 11 — Application for winding-up order

Amendment: Clarify that the Attorney General of Canada may apply for a winding-up order and specify the grounds on which the application may be made.

Explanation: Although not specifically provided for in the *Winding-up Act*, a petition for a winding-up order is brought by the Attorney General of Canada where the company has been subject to the supervisory intervention of the Superintendent of Financial Institutions.

Section 12 — How and where made

Amendment: Allow an application to be made in the court of any province of any of the company's principal places of business.

Explanation: Under the *Winding-up Act*, a petition must be filed in the jurisdiction where the head office of the company is located. The location of the head office of the company, however, is often a formality and is not the locality of the persons primarily interested in the liquidation – creditors, shareholders, customers.

Amendment: Allow the courts the discretion to shorten the four-day notice requirement.

Explanation: Currently, the petitioner must serve notice to the company four days before applying to the courts for a winding-up order. There is some doubt whether this period can be shortened by the court, even where the company consents to the winding-up order. This amendment will authorize the court to abridge the four-day period where it is appropriate in the circumstances.

Section 17 Actions against company may be stayed

Amendment: Provide that a liquidator or any person who could petition for a winding-up order may apply for an interim stay of proceedings against the company.

Explanation: Currently only the company, a creditor or contributory may apply for an interim stay of proceedings. There is no reason for not allowing other classes of petitioners or a liquidator the right to apply.

Section 18 Court may stay winding-up proceedings

Amendment: Allow a liquidator or any person who could petition for a winding-up order to apply for a stay of the winding-up proceedings.

Explanation: Typically, a perpetual stay of the winding-up proceedings is requested when the claims of the creditors of the company have been settled by compromise. Since it is proposed to amend section 65 of the *Winding-up Act* to allow the liquidator to propose a compromise, the liquidator should be granted the ability to request a perpetual stay of the winding-up proceedings.

New Section

Amendment: Add a provision that allows counter-parties to "Eligible Financial Contracts" to terminate contracts and net amounts payable by or to the company.

Explanation: Financial institutions use a number of different types of contracts to hedge interest rate, currency, and other risks. Because of the volatility in these markets, certainty in the ability to terminate these contracts is necessary to reduce the market risk. This provision would be similar to subsections 65.1 (7), (8) and (9) of the *Bankruptcy and Insolvency Act*.

Sections 23 to 25 — **Liquidator (s. 23); If more than one liquidator (s. 24); Additional liquidators (s. 25)**

Amendment: Allow a court to allocate responsibilities among co-liquidators, or permit co-liquidators to do so themselves.

Explanation: In many estates, it could be advantageous to have specialist liquidators for some aspects of an estate. While the *Winding-up Act* contemplates that more than one liquidator may be appointed for an estate, there is no authority for the court to allocate responsibilities among co-liquidators, or to permit the co-liquidators to divide responsibilities among themselves. Without such an allocation, they must act jointly on all matters.

Section 26 — **Notice**

Amendment: Give the courts the discretion to dispense with notice to creditors and shareholders in appropriate circumstances.

Explanation: This section currently requires that notice be given to all creditors and shareholders of a company before the courts can appoint a permanent liquidator. In some cases this is time-consuming and costly without any real purpose.

Section 34 — **Liquidator to prepare statement**

Amendment: Extend from 60 to 120 days the period in which liquidator must prepare an initial financial statement.

Explanation: The current period is too short to complete adequate initial financial statements. Some time is required for the liquidator to examine the books of companies being wound-up.

Section 40 — **Documents to Chief Statistician of Canada**

Amendment: Repeal the requirement for a liquidator to provide a true copy of the winding-up order, petition and other information to Statistics Canada.

Explanation: This provision is obsolete and no longer serves a useful purpose as Statistics Canada does not use the information.

Sections 44, to 47, 69, 70 144 and 150

Moneys to be deposited in bank (s. 44)
Separate accounts (s. 45)
Balance on hand by liquidator (s. 46)
Penalty for neglect (s. 47)
Bank-book of liquidator (s. 69)
Other times (s. 70)
Failure to deposit in bank money of estate (s. 144)
Failure to produce passbook (s. 150)

Amendment: Repeal these sections.

Explanation: These sections deal with banking by a liquidator and are unnecessary; every liquidator is subject to court supervision.

Section 65

Court may summon creditors to consider any proposed compromise

Amendment: Clarify that a liquidator may propose an arrangement or compromise.

Explanation: Sections 65 to 68 are a condensed version of the *Companies' Creditors Arrangements Act* allowing for settlement of claims against an estate binding on all creditors through majority voting. It is appropriate that a liquidator have the power to propose a compromise or arrangement.

Section 71

What debts may be proved

Amendment: Provide expressly that claims are to be calculated as of the date of the commencement of the winding-up.

Explanation: The *Winding-up Act* does not state whether creditor's claims are to be proved as of the date the winding-up order is made or the date the winding-up commenced. This amendment will clarify the question.

Section 73

Law of set-off to apply

Amendment: Provide that set-off applies between a liquidator and a depositor regardless of whether the obligations by the parties to be set off arise in respect of the guaranteed trust fund or the company fund.

Explanation: Section 73 of the *Winding-up Act* provides that the ordinary law of set-off applies in a liquidation; at present it is unclear whether set-off applies where the deposit is received by a trust company in trust. There is no reason why depositors in a trust company should be in a better position than a depositor in a bank.

Section 95 **Distribution of surplus**

Amendment: Provide that any surplus shall be applied in payment of interest from the date of commencement of the winding-up on all claims proved in the liquidation in the order of priority of proven claims. Interest will be calculated by reference to a market sensitive rate (e.g., 91-day Treasury bills).

Explanation: At present there is no provision in the *Winding-up Act* similar to section 143 of the *Bankruptcy and Insolvency Act*, which authorizes the payment of post-bankruptcy interest accruing on creditor's claims in priority to any payment to shareholders.

Section 100 **Sale or transfer in contemplation of insolvency**

Amendment: Abolish the defence of pressure.

Explanation: In brief, the defence of pressure is that where a payment is made by a debtor under pressure from a creditor, the payment was held to be valid and not a preference. This defence was removed from the *Bankruptcy and Insolvency Act* some time ago. There is no reason to retain it in the *Winding-up Act*.

New Section

Amendment: Incorporate in the *Winding-up Act* section 100 of the *Bankruptcy and Insolvency Act* relating to reviewable transactions.

Explanation: This provision would allow the liquidator to inquire into any non-arm's length transfers of property in the 12-month period preceding the commencement of the winding-up. The amendment would prove useful in overcoming and discouraging abusive insider transactions on the eve of failure.

New Section

Amendment: Incorporate section 101 of the *Bankruptcy and Insolvency Act* relating to retrieving from shareholders an unlawful distribution of capital or dividends.

Explanation: This amendment will authorize a liquidator to sue recipients of an unlawful distribution of capital or dividends made in the 12-months preceding the commencement of the winding-up.

Sections 152 to 55	**Creditor to apply (s. 152)** **Chairman at meetings of shareholders (s. 153)** **Voting at shareholders' meetings (s. 154)** **Report to court and appointment of liquidators (s. 155)**
Amendment:	Repeal these sections.
Explanation:	These sections are obsolete. They were enacted at a time when shareholders of a bank were subject to double liability on the failure of a bank. Double liability was removed in 1954.
Sections 157 and 158	**Reservation of dividends (s. 157)** **Publication of notices (s. 158)**
Amendment:	Repeal these sections.
Explanation:	These sections are obsolete since banks no longer issue currency.
Section 159	**Application of Part**
Amendment:	Expand definition of "assets" to include assets under the control of the Chief Agent.
Explanation:	A foreign insurance company is required to maintain an adequate margin of assets in Canada and those assets must be vested in a Trustee. The definition will be expanded to include not only assets held in trust but also all other assets under the control of the Chief Agent in Canada.
New Section	
Amendment:	Provide that the Superintendent of Financial Institutions may not be appointed the liquidator of an insurance company.
Explanation:	Consistent with the situation regarding federal deposit-taking institutions, the Superintendent will no longer be the the liquidator of a federally regulated insurance company.

Section 161 Order of priority for payment of claims

Amendment: Give priority to the life and health insurance sector consumer protection plan ahead of policyholders for amounts advanced by the protection plan to the liquidator in excess of the protection plan's obligations to policyholders.

Explanation: In the recent failure of two life insurance companies, the life and health insurance sector consumer protection plan advanced funds to the liquidator, based on estimations of its' obligations to compensate policyholders. In the event the protection plan's obligations were overestimated, the *Winding-up Act* should specify that repayment of the amount overpaid by the protection plan ranks ahead of policyholders' claims.

Amendment: Remove "super priority" in sub-paragraph (1)(c)(ii) for claims made prior to reinsurance being effected.

Explanation: The sub-paragraph gives first priority to "claims that have arisen under the policies of the company, in accordance with the terms thereof, of which notice is received by the company prior to the date the reinsurance is effected...". This provision has the potential to cause unfairness where reinsurance is effected since some policyholders may be paid their claims in full while other policyholders may only receive reinsurance of a portion of their claims.

Amendment: Remove reference to the Treasury Board in subsection (4).

Explanation: The references to the Treasury Board are obsolete and court approval is sufficient.

Section 162 Reinsurance of contracts by liquidator

Amendment: Allow for reinsurance with provincially regulated insurance companies where the insolvent company is provincially regulated.

Explanation: An integral element of the approach adopted to protect policyholders of an insolvent insurer is to reinsure the policies with another insurer. The *Winding-up Act*, however, does not permit the reinsurance of the business of an insolvent insurer with provincially-regulated companies, even where the insolvent insurer is a provincially-regulated insurance company.

Amendment: Allow for reinsurance of less than all the policies where the dividend to other policyholders would be equal to the same portion of the policies to be reinsured.

Explanation: Sometimes the reinsurer does not wish to reinsure all the policies of an insolvent insurer. While the courts have permitted the reinsurance of some policies, as opposed to all policies, in cases where the life and health insurance sector consumer protection plan guaranteed the same level of proportional recovery to holders of policies not reinsured by the reinsurer, the *Winding-up Act* should clearly permit this type of reinsurance proposal.

Amendment: Remove reference to the Treasury Board in subsection (3).

Explanation: The references to the Treasury Board are obsolete and court approval is sufficient.

Sections 163 and 165

Holders of unmatured policies to claim for value computed (s. 163)
Transfer to British or foreign liquidator (s. 165)

Amendment: Remove references to the Treasury Board and replace with the Superintendent.

Explanation: The references to the Treasury Board are obsolete as this function is now carried out by the Superintendent.

New section

Amendment: Clarify that liquidator may carry on business of the insolvent insurance company (e.g., accept premiums and pay claims) where liquidator has agreement with the life and health insurance sector consumer protection plan that it will i) reimburse policyholders for unearned premiums paid after the winding-up order and ii) reimburse liquidator for any overpayment on claims paid prior to realization of assets.

Explanation: Ordinarily in an insolvency, the life insurance company would cease to accept premiums and to pay claims until an orderly distribution could be accomplished. This inevitably results in serious inconvenience to policyholders, particularly uninsurable policyholders. The amendment would clearly specify the authority of the court to approve arrangements for liquidator to carry on business of insolvent insurance company.

PROPOSED AMMENDMENT TO THE *COMPANIES' CREDITORS ARRANGEMENT ACT*

New Section

Amendment: Add a provision that allows counter-parties to "Eligible Financial Contracts" to terminate contracts and net amounts payable by or to the company.

Explanation: Financial Institutions use a number of different types of contracts to hedge interest rate, currency, and other risks. Because of the volatility in these markets, certainty in the ability to terminate these contracts is necessary to reduce the market risk. This provision would be similar to subsections 65.1 (7), (8) and (9) of the *Bankruptcy and Insolvency Act.*

ANNEX 5

DISCLOSURE OF FINANCIAL CONDITION INFORMATION

The federal government is proposing that more information on the financial condition of federally regulated financial institutions be disclosed on a more frequent basis. The kind of information that could or should be disclosed is outlined below. Much of this information is already disclosed by some publicly traded financial institutions or by OSFI, however there is a subset of information which is collected by OSFI and not disclosed. Additionally, the items below include some entirely new reporting requirements which will also be considered for disclosure, e.g., assets pledged as security.

The proposed disclosure framework will require comparable disclosure by all insurance companies and deposit-taking institutions where possible. It is also proposed that reporting occur at the level of the federally regulated entity. In some cases, data collected on statutory information returns need not be disclosed. For example, data will be suppressed or aggregated where it could lead to disclosure of transactions with specific customers.

Consolidated versus non-consolidated financial reporting is also an issue because financial reporting is not done on the same basis by all institutions. Life and health insurance companies, for example, report detailed asset information on a non-consolidated basis and basic financial information on a consolidated basis. Banks report all information on a consolidated basis. The value of consolidated/non-consolidated information as an input into a good analytical assessment of an institution's financial condition will have to be reviewed before a final set of measures can be put forward. This may involve some changes to the existing reporting requirements.

The areas where it is proposed that disclosure standards be enhanced are as follows:

- historical summaries of balance sheet and income statement information;
- executive compensation levels;
- information regarding the geographic location of assets, liabilities, income and off-balance sheet items;
- information regarding the institution's sensitivity to changes in interest rates or foreign exchange rates;
- credit exposures associated with off-balance sheet items;
- information on the investment and lending portfolio and on liabilities: for example, loans described by broad business class/sector or annuities described by product type, and information regarding loan impairment and loss provisions;

- information regarding regulatory capital and its components, e.g., the risk-based capital BIS ratios and its components (Tier 1 and Tier 2) used by deposit-taking institutions, the Minimum Asset Test (MAT) with assets available and required for property and casualty insurance companies, and the regulatory capital available and required in the Minimum Continuing Capital Surplus Requirements (MCCSR) for life and health insurance companies;
- information on reinsurance risk (gross liabilities before reinsurance).

In addition to the areas described above, it is also proposed that some information be disclosed by insurance companies regarding the valuation methods used with respect to actuarial liabilities. Currently, the company actuary releases an opinion on the appropriateness of the valuation. Often this is the only information regarding the actuary's work that is disclosed and there is little background information made available concerning the key assumptions and the provisions for adverse deviations used. The actuary's valuation affects an insurance company's financial results and, it is therefore intended that disclosure be expanded. This will require consultation with the actuarial profession.

Financial institutions will continue to be responsible for the accuracy of information which is reported to OSFI and disclosed by OSFI. Financial institutions themselves will be responsible for disclosing certain types of information, such as audited annual statements, executive compensation levels, and information on actuarial valuations. OSFI will make available disclosable information from the statutory information returns, which will be updated to accommodate the requirements for additional data collection, to data services enterprises. Thus, anyone wishing to obtain disclosable information on a federal financial institution will be able to obtain it either from the institution itself, or from the provider of the data service, depending on the type of information in question. The exact division of the responsibility for disclosure will form part of the consultations process.

The additional disclosure requirements will affect all financial institutions differently. For example, with respect to capital adequacy, the Canadian banks and larger trust and loan companies already release BIS capital ratio information voluntarily in their annual reports. Most foreign bank subsidiaries and the smaller trust companies do not release this information and they will be required to do so under the new reporting scheme. Many property and casualty insurance companies currently make information regarding their MAT available. Disclosure of available and required capital is currently optional for life and health insurance companies. Disclosure for all insurance companies will be a new requirement.

It is equally important to ensure that information is released on a consistent and frequent basis by all financial institutions. Currently, reporting periods differ among institutions. Property and casualty insurance company data is collected and reported on a quarterly basis, for example, and deposit-taking institutions report most information quarterly. It is therefore anticipated that revisions to the reporting and disclosure requirements will be minor for many institutions.

Life and health insurance companies, however, will be subject to some additional reporting requirements. Life and health insurance companies currently report financial condition data on an annual basis and it is proposed that these institutions provide quarterly information comparable both in content and in frequency to that provided by deposit-takers. Shifts to reporting and disclosure on a quarterly basis will have to consider that certain information, for example, reserves and reinsurance data is often difficult to compute more frequently than once a year. The merits of increasing the frequency of disclosure of these items will have to be considered and more specifically the merits of using an estimate or proxy in financial analysis. This will require consultation with the industry and with industry analysts and other professionals.

It will take some time before all of this additional information will be available. The enhanced disclosure of information will likely occur in stages. In order to initiate the process, it is proposed that the Superintendent, in consultation with the other members of the FISC, prepare an implementation plan for presentation to the Minister of Finance which addresses the level of disclosure by financial institutions and takes into account the information needs of the industry and analysts. In addition, the Superintendent will report to the Minister annually regarding the progress made in meeting the plan.

ANNEX 6

RISK-BASED DEPOSIT INSURANCE PREMIUMS

Section 3 of this policy paper proposes the introduction of risk-based premiums.

The risk-rating system to be employed will be consistent with the Guide to Intervention for Federal Financial Institutions contained in Annex 2. Risk-based premiums are intended to send an early warning signal to the management and board of directors of CDIC members, and as such they are not an actuarially-based measure of the risk brought to the deposit insurance fund by an individual institution.

The U.S. Model

The Federal Deposit Insurance Corporation (FDIC) in the U.S. implemented a system of risk-based premiums, effective January 1, 1993. Under this system, FDIC divided deposit-taking institutions into nine categories based on their capital levels, and the supervisory evaluation of the riskiness of each institution provided by the institution's primary federal regulator. In forming its judgement, the FDIC generally relies on the primary federal regulator's composite rating. For most deposit-taking institutions, CAMEL is the most common composite indicator. Under the CAMEL system, institutions are evaluated in five broad categories (Capital, Asset quality, Management, Earnings and Liquidity) that correspond to ratings from 1 (good) to 5 (bad).

In the U.S., premiums are linked to an institution's capital relative to the regulatory minimum capital requirement and to the supervisor's judgement of its overall strength. Premiums range from 23 cents to 31 cents per $100 of insured deposits, with an overall premium range of eight basis points and correspondingly small inter-category increments. This model could be adopted in Canada.

THE U.S. PREMIUM MATRIX

Capital group	A Healthy financial institutions (FIs)	B FIs with weaknesses	C Troubled FIs
	(cents per $100 of insured deposits)		
Well capitalized	23	26	29
Adequately capitalized (meets minimum capital standards sets by regulator)	26	29	30
Less than adequately capitalized	29	30	31

Another Possible Model

A model, that takes into account aspects of the Canadian system (such as CDIC's Standards of Sound Business and Financial Practices), could also be developed for use in Canada. The risk-rating methodology, described below, is intended to provide the basis for discussion.

(a) Risk rating methodology

Under this possible model, CDIC would assign member institutions a risk-rating based on a number of different factors (all or some of the following factors: capital adequacy, CAMEL ratings, compliance with the CDIC Standards of Sound Business and Financial Practices, asset quality, diversification, sustainable earnings/profitability, assets/liability management, management, strategic and business plans, ratio/trend analysis and monitoring tools). Financial institutions would be rated on each of these factors and a composite score developed. The exact list of factors taken into consideration will affect the amount of discretion and the amount of information required to operate the system.

Based on the outcome of this exercise, institutions would fall into one of a number of categories – for example, healthy institutions, institutions where financial viability or solvency is at risk and institutions where future financial viability is in serious doubt. Institutions would then be assigned a deposit insurance premium, depending on which category they fall into.

The risk-based scheme would be authorized in legislation and elaborated on through CDIC by-laws.

(b) Setting of premiums

As indicated above, different premiums would be set, based on an underlying assessment of an institution's risk ratings. A base premium rate would be set by the Governor in Council each year as is currently the case. CDIC would recommend a base premium level based on CDIC's financial planning objectives and loss experiences. The notion of a statutory maximum would be retained and would act as a ceiling on the highest rate that an institution could pay. The adoption of the system of risk-based premiums would be expected to be revenue neutral, while redistributing premiums paid among institutions. The question of how the premiums would be collected remains to be resolved.

Transition from Current System

Consultations will occur on the risk-based premium proposals, following which a new premium schedule would be developed expeditiously, recognizing the need to provide CDIC member institutions with a reasonable notice period prior to implementing new premium rates.

ANNEX 7

CDIC ACT AMENDMENTS

The following are technical amendments to the *Canada Deposit Insurance Corporation Act*. They do not cover the stacking and risk-based premium proposals outlined in Section 3 of this paper, for example.

Section 7(b) Mandate

Amendment: Remove CDIC's mandate to promote and otherwise contribute to the competitiveness of the financial system in Canada.

Explanation: As is currently the case, CDIC will have objects to provide deposit insurance, and to promote standards of sound business and financial practices and promote and otherwise contribute to the stability of the Canadian financial system, within a least cost framework. These are appropriate roles for CDIC. The removal of the current reference to promoting and contributing to the competitiveness of the financial system will streamline the matters CDIC must take into consideration in exercising its powers and duties.

Section 13 (3) Transfer of All or Substantially All / Deemed Amalgamation

Amendment: Provide that where deposits of one member institution are assumed by another member, insured deposits that an individual had in both institutions continue to be insured until they mature or a withdrawal is made (even if, as a result of the amalgamation, the deposits amount to more than $60,000).

Explanation: The current Act provides for such treatment only where one member assumes "all or substantially all" of the liabilities (deposits) of another member institution.

Section 13 (4) Assumption of Deposits / Premium Payment

Amendment: Add a new provision to the Act to make it clear that, when a member institution assumes deposits from another member, it has to pay premiums on them.

Explanation: Such a change will remove an anomaly in the statute.

Sections 14 (2.3) and 14 (2.5.1) Conformity with the *Winding-up Act*

Amendment: Clarify that where the CDIC Act refers to the payment of interest (including the case of discretionary payments), such a payment shall be included in the payout only to the date of notice of the petition to wind-up.

Explanation: Currently, the relevant date is the date of a winding-up order. This amendment will bring the CDIC Act in conformity with the *Winding-up Act*.

Section 14 (2.8) Cost of examination

Amendment: Add a new provision to allow CDIC to sell to the liquidator information gathered or produced at its expense in connection with a payout (such as a verification and reconciliation of the member's deposit liabilities).

Explanation: Currently, CDIC provides this information for free, which is a direct benefit to the uninsured depositors and creditors.

Section 14 (2.9) Conformity with the *Winding-up Act*

Amendment: Add a new provision to clarify that "insurance" is to be measured at the date of notice of the petition to wind-up.

Explanation: This modification will assist CDIC in preventing problems regarding the aggregation of principal sums on payout and will assist the Corporation in its proof of claims.

Section 14 (4) Time Limitation for Depositors

Amendment: Clarify that, in case of a liquidation, CDIC gives insured depositors a time limitation of 10 years from the date of commencement of the winding-up to exercise their claim.

Explanation: This clarification will greatly simplify administration for CDIC.

Section 14 (4.1) and Schedule, Section 2 (2)(d) CPA Priority / Definition "Deposit"

Amendment: Clarify that, when CDIC pays the holder of a priority payment instrument, for example certified cheques, money orders and bank drafts, CDIC then inherits a priority claim for the corresponding amount.

Explanation: Currently, the same item may benefit from the *Canadian Payments Association Act* priority and CDIC coverage.

Section 14 (5) Subrogation (Technical amendment)

Amendment: Bring this section into conformity with s. 14 (4.1) – assignment of depositors rights and interests in respect of deposit.

Explanation: This change will clarify the intent of the Act which is to provide CDIC with the same priority claim as holders of payments instruments.

Section 21 (2.1) Premium / QDIB

Amendment: Provide that where a financial institution switches from provincial to federal jurisdiction to become a CDIC member, it shall pay a premium on its deposits pro rata for the portion of the year it is a federal institution.

Explanation: This amendment is necessary as a result of the CDIC/QDIB Inter Agency Agreement.

Section 22 (2)(b)Premium Instalments

Amendment: Modify the Act to provide for payment of premiums on the 15th day of June and on the 15th day of December.

Explanation: Currently, premiums must be paid on the 30th day of June and on the 30th day of December. By moving the payment ahead, CDIC will have greater flexibility to invest the premiums collected.

Section 26 (2) Deposit Insurance Fund

Amendment: Eliminate the necessity to report the Accumulated Net Earnings as a separate item in the financial statements of the Corporation. The requirement that there be a Deposit Insurance Fund to which all premiums shall be credited will be retained, however.

Explanation: The current practice of reporting the Accumulated Net Earnings as a separate item runs counter to generally accepted accounting principles.

Section 27 (2) Chargebacks of costs of special exams

Amendment: Allow CDIC to charge back to a member the costs incurred by CDIC for any special exams.

Explanation: This amendment will permit CDIC to reduce its costs.

Section 31.1 (1)(a)	**Notice of Termination of Insurance (Technical amendment)**
Amendment:	Delete the word "further" from s. 31.1 (1)(a).
Explanation:	The relative word "further" used in connection with the word "deteriorated" may be restrictive as it assumes that there was deterioration before the giving of notice of termination. Failure to follow standards need not relate to a deterioration in financial condition.
Section 34 (2)	**Effect of Termination or Cancellation**
Amendment:	Add a new provision stating that the continuing coverage of deposits following termination or cancellation of insurance does not apply to deposits that have been assumed by – and are thus insured by – another member.
Explanation:	Currently, the continuing coverage of deposits following termination or cancellation of insurance extends for a period of two years or to maturity.
Sections 46, 47, 47.1, 48, 49, 52 and 53	**Penalties**
Amendment:	Add new provisions to modernize the statute. These will include: – enabling a court to order compliance with the Act, by-laws, or the policy of deposit insurance; – providing for director, officer liability for offences by members; – providing for a penalty for failure to provide information to CDIC in accordance with the Act, the by-laws, or the policy of deposit insurance. Include all information provided by a member or an applicant for membership on which CDIC might rely to its detriment and to provide for fines in lieu of imprisonment which are consistent with the maximum fines in the FI legislation and allow for forfeiture of any profits made through the commission of the offence.
Explanation:	These changes will bring the statute into line with the federal financial institutions legislation.

Schedule, Section 3 (6)	**Registered Retirement Income Fund (Technical amendment)**
Amendment:	Fix an incorrect reference to "registered retirement savings plans" and replace it by the expression "registered retirement income fund" (RRIF).
Explanation:	This reference is an error. This section is intended to deal with RRIFs throughout the section.