Resolution Schemes for US and Canadian Banks

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Resolution Schemes

“Objective of an effective resolution regime is to make feasible the resolution of financial institutions without severe systemic disruption and without exposing taxpayers to loss, while protecting vital economic functions through mechanisms which make it possible for shareholders and uninsured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation”

(Key Attributes of Effective Resolution Regimes for Financial Institutions, Financial Stability Board)
Financial Stability Board Principles

• FSB issued Key Attributes of Effective Resolution Regimes for Financial Institutions in 2011 (updated in 2014)

• Endorsed by the G-20 in November 2011

• Sets out 12 essential features that should be part of the resolution regimes for all jurisdictions

• Both the Canadian and US regimes are guided by these Key Attributes
12 Key Attributes

1. Scope
2. Resolution Authority
3. Resolution Powers
4. Set-off, netting, collateralisation, segregation of client assets
5. Safeguards
6. Funding of firms in resolution
7. Legal framework conditions for cross-border cooperation
8. Crisis Management Groups (CMGs)
9. Institution-specific cross-border cooperation agreements
10. Resolvability assessments
11. Recovery and resolution planning
12. Access to information and information sharing
US Resolution Scheme

• Single Point of Entry
• Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act
• Applies resolution concepts developed for banks to:
  • Bank Holding Companies
  • Non-Bank financial institutions supervised by the Federal Reserve Board—SIFIs
  • Other companies predominantly engaged in financial activities
  • Any subsidiary of the above that is predominantly engaged in financial activities that is not a bank or an insurance company
US Resolution Scheme

• Trigger

• Secretary of the Treasury determination
  • Recommendation on 2/3 vote by Federal Reserve Board (FRB) and Federal Deposit Insurance Corporation (FDIC)
  • Broker or dealers 2/3 vote of FRB and Securities and Exchange Commission (SEC)
  • Insurance companies 2/3 vote of FRB and approval of the Director of the Federal Insurance Office
US Resolution Scheme

• Resolution Authority is the FDIC
• Key requirements:
  • Purpose financial stability and not preservation of the company
  • Shareholders get paid last
  • Unsecured creditors bear losses in accordance with priority scheme
  • Management responsible for the failed condition is removed
  • Board of directors members responsible for the failed condition are removed
  • The FDIC will not take an equity interest in the company
US Resolution Scheme

- FDIC has broad receivership powers
- FDIC can create a bridge financial company
  - Transfer selected assets and liabilities, other than capital, to the bridge company
  - Other liabilities remain in the receivership
- FDIC Single Point of Entry Strategy
  - Payment of some creditors in a securities for claims exchange
    - No express bail in authority
    - Avoids liquidation of assets to pay claims
- Financial Stability Board proposal on Total Loss Absorbing Capital would provide liabilities for the securities for claims exchange
Canadian Resolution Scheme

• Department of Finance issued in August 2014 the Taxpayer Protection and Bank Capitalization Regime, setting out a proposed “bail-in regime” for Canada
  • Regime seeks to limit taxpayer exposure in connection with failure of systemically important banks - losses to be imposed on creditors and shareholders prior to taxpayers
  • Complements existing resolution powers set out under the Canadian Deposit Insurance Corporation Act

• April 21 2015 federal budget: Government announced intention to expand resolution powers relating to systemically important banks, including by implementing Taxpayer Protection and Bank Capitalization Regime
Canadian Resolution Scheme (cont.)

- **Scope**: D-SIBs (BMO, BNS, CIBC, National Bank, RBC, TD)

- **Resolution authority**: Bail-in proposal identifies the Canada Deposit Insurance Corporation (the “CDIC”) as the responsible regulatory authority and as the entity that would be appointed as receiver of an affected financial institution.
  - OSFI leads on recovery planning, CDIC on recovery planning
  - CDIC has committed significant new resources to recovery planning process

- **Trigger**:
  - OSFI must have determined that the bank has ceased or is about to cease being viable AND
  - Full conversion of the bank’s non-viable contingent capital (NVCC) instruments must have occurred
Canadian Resolution Scheme (cont.)

- Resolution powers:
  - Power to permanently convert “eligible liabilities” of the D-SIB into common equity
    - “Eligible liabilities” means “long-term senior debt” - senior unsecured debt that is tradable and transferable with an original term of over 400 days
    - Secured debt, short term debt (less than 400 days) and deposits are excluded
    - Conversion will be based on a conversion formula with a specified multiple of the most favourable conversion formula for the bank’s outstanding NVCC instrument
    - Will apply only to debt that is issued after implementation of the regime, with no retroactive application to existing debt
  - Power to permanently cancel existing shares
Canadian Resolution Scheme (cont.)

- **Effect on creditors:**
  - Any creditors and shareholders made worse off than in a traditional liquidation are entitled to compensation under existing processes under the CDIC Act

- **Additional capital requirement:**
  - Bail-in proposal sets out an additional “Higher Loss Absorbency Requirement” – to be based on the sum of the bank’s regulatory capital and long-term senior debt
  - Will be subject to a uniform and public minimum requirement administered by OSFI
  - New capital requirement is in addition to existing capital requirements
• **Bridge institution:**
  - Bail-in proposal does not require the creation of a bridge institution
  - However, since 2009, the CIDC has had the power under the CDIC Act to establish a bridge institution should it choose to do so, and transfer assets and liabilities to such bridge institution which would operate for up to 5 years.

• **Holding company structure:**
  - Holding company structure not used in Canada, instead the bank acts as the top entity
  - Finance requested input in the proposal with respect to potential benefits of instituting a holding company structure in Canada
  - 2015 federal budget – holding company structure will not be required
Cross-Border Resolution (Canada)

- **Contractual recognition terms**
  - Proposed bail-in regime requires that contracts governing any “eligible liability” must include clause providing express submission to the bail-in regime, notwithstanding any provision of foreign law to the contrary.

- **Cross-border cooperation**
  - 2013 Memorandum of Understanding between FDIC and CDIC
    - Agreement re exchange of information and cooperation re monitoring for resolution purposes, crisis management, recovery and resolution planning
US vs. Canadian Resolution Schemes

- Holding company structure
- Triggering conditions
- Bridge institution
- Affected stakeholders
- Effect on capital and debt structure
- Cross-border resolution