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Canada Deposit Insurance Corporation

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Société d'assurance-dépôts du Canada

Remarks from

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Setting Out the Issues
Cross-Border Information Sharing and the Need for Formalized Arrangements

- CHECK AGAINST DELIVERY -

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Introductory remarks

Good morning ladies and gentlemen -- let me take this opportunity to thank the International Association of Deposit Insurers (IADI) for inviting me to speak today and to congratulate the organizers of the conference on their choice of topics.

The importance of international banking is growing and so are the challenges in dealing with problem cross-border banks. Coordinating information flows and decision-making, managing potential conflicts between jurisdictions and deciding how costs should be shared in insolvencies -- are all serious issues. But, they are even more challenging if information is not effectively shared and in an environment where few protocols exist that can be used in a crisis.

With this in mind, I would like to focus my remarks today on the issues and challenges, from the perspective of a deposit insurer, in developing cross-border information sharing agreements.

Challenges

Let me begin by saying that every country has a safety net that underpins its financial system – this typically includes the function of a lender of last resort, prudential supervision, deposit insurance and the government treasury. Information can be shared between deposit insurers and other safety net authorities in a variety of ways -- ranging from informal to formal methods. Informal arrangements can work well in some circumstances. But, given the sensitivity of banking information and the need to maintain open communication channels, it is useful to formalize these agreements either through legislation, memoranda of understanding (MOUs) or other agreements. This approach is stressed in IADI guidance.

As many of you know, information sharing agreements <u>within a country</u> between the deposit insurer and other relevant safety net authorities must address some basic

challenges. One of these is the need to adapt the agreements to the specific mandates, roles and responsibilities of the parties involved. For deposit insurers this means that agreements must take into account the type of mandate a deposit insurer operates under. In a simple pay-box system, for example, the deposit insurer should have the necessary information (typically available from the supervisory authority) to be able to reimburse depositors whenever necessary, including information on the amount of deposits held by individual depositors.

Deposit insurers with broader so-called "risk minimizing" mandates have greater needs for information -- particularly in the early stages of problems -- as they must be able to assess the financial condition both of the industry and of individual banks in order to anticipate problems and to deal with them effectively when they arise.

Another major challenge is confidentiality. Information should be exchanged on a confidential basis between deposit insurers and prudential supervisory authorities. Without confidentiality provisions in agreements, it is unlikely that much information would be provided to a deposit insurer.

Now what about information sharing issues in a cross-border environment? Many of the same issues arise but in a more complex manner. The biggest challenge emanates from the fact that in a cross-border environment the number of safety net authorities multiplies significantly – making it more difficult to establish agreements which effectively manage information flows and coordinate activities.

The fact that each of the safety net authorities may have differing roles, responsibilities and powers is an additional wrinkle. In the case of deposit insurers one can envision the challenge of creating formal agreements between deposit insurers with similar mandates being difficult. But, an even more complex undertaking would be establishing agreements where the insurer is a simple paybox in one country and a risk minimizer in another. If the problem bank is being dealt with in a paybox regime there may not be

much useful information available to the risk minimizer in the other jurisdiction until it's too late!

Another complexity is dealing with intervention and legal insolvency regimes. In a domestic setting there is usually a single set of accepted rules governing intervention and insolvency proceedings. In most cross border environments -- with the possible exception of the EU -- this is not the case.

And, probably the most critical challenge is confidentiality. As I said earlier, it is well recognized that confidentiality is a prerequisite for the sharing of information between a deposit insurers and supervisory authority domestically. But, the provisions of these same agreements can prevent deposit insurers from sharing the information across borders with other deposit insurers. It should be noted that it is only at a certain point in time, fairly advanced in the case of a problem bank, when most deposit insurers become involved. Before this information sharing is primarily an issue between supervisors.

This is a point to which I will return, later in my remarks. In many respects, agreements amongst deposit insurers are a subsidiary matter. The reality is, to be truly effective, we need a set of comprehensive agreements bringing to the table all financial safety net participants, within and across jurisdictions.

Addressing the challenges

As you can see the challenges of cross-border information sharing between deposit insurers are formidable. So where does one begin? As the saying goes "…every great journey must begin with a first step…" So let us examine some steps we can take to address these challenges.

To begin with let me start by proposing some general principles that formal information sharing arrangements should follow in a cross-border environment. While there may be others, I would suggest four key principles need to be addressed in such arrangements.

First, they should clearly specify the roles and responsibilities of the respective parties. Obviously, the roles and responsibilities specified would reflect to a great extent the roles and responsibilities granted to the deposit insurer and other parties. Specifying who is responsible for what within each country is critical for setting the parameters of information sharing and the actions which can be taken in a crisis. I think we must also keep in mind that as national entities, in many jurisdictions deposit insurers are typically charged with protecting domestic deposits and not foreign deposits. This is one of main reasons leading to potential disputes between jurisdictions.

The second principle I would like to put forward is that formal agreements should set out what information is to be shared and by whom. This needs to include specifics on the type, level of detail and frequency of information to be exchanged between deposit insurers. It can also be beneficial to share information on the failure resolution method proposed and timing.

Third, the confidentiality of information exchanged between parties must be respected at all times. As I stressed earlier, without confidentiality provisions in agreements, it is unlikely that deposit insurance and supervisory authorities in each country would be able to share information even if they wanted to.

Fourth, it is important to ensure that when material problems develop all parties are informed as soon as possible, and that the necessary actions are taken promptly. This last point is particularly important. I do not have to remind you all that the natural tendency in these situations is to be reluctant to share information – again, in part due to concerns about confidentiality. But, also perhaps because of the fear that counterparts in other countries could force action themselves. The fact that different

authorities will have different views on prompt corrective action must be taken into consideration.

Moving on from these principles, I would observe that other issues which need to be considered relate to how cross border banks are structured and the insolvency regimes present in each country. Some nations require foreign banks to operate within their borders as subsidiaries while others allow foreign bank branching. In Canada, we require foreign banks wishing to conduct retail-deposit taking to do so through a foreign bank subsidiary (which is insured by CDIC). Foreign banks can operate through a branch structure (which we do not insure) provided they only accept wholesale deposits. This is a critical distinction. It is much easier for deposit insurers and supervisors to deal with a separate legal entity like a subsidiary than with a foreign branch operation.[1]

Insolvency regimes can also vary greatly. So, it is very important to understand the steps involved in closing banks and the order in which proceedings can be initiated. In a failure, the least complex situation would be one in which there was a single set of bankruptcy proceedings and the equal treatment of all creditors. Unfortunately, this is rarely the case. The reality is that proceedings can be initiated at different times in different jurisdictions and that local creditors are treated differently than foreign creditors. Moreover, how local creditors are treated can vary significantly – sometimes there is a universal approach to asset disposition but in most cases "ring-fencing" of assets occurs. Some countries provide priority for their depositors (or deposit insurance agency) while others do not. This has a direct bearing on a deposit insurer's costs and burden sharing between countries.

[1] Under the EU Directive on Deposit Insurance the operation of foreign branches is governed by the "home" country principle while the operations of subsidiaries come under the "host" country principle. Branches can, however, purchase top-up insurance coverage from the host country.

Practical examples

Are there examples of agreements which reflect the principles I have outlined? Outside the sphere of deposit insurers, progress has been made in addressing information sharing amongst supervisors and central bankers by organizations such as the Basel Committee and the European Central Bank. And, there has been increasing cooperation on a bilateral level between home and host country supervisory and regulatory authorities in the development of MOUs. These typically look at which jurisdiction will have authority to supervise a cross-border bank, the information that will be shared between them and how intervention activity will be coordinated. These MOUs usually incorporate confidentiality clauses.

Some very good examples in this area come from Europe. The European Central Bank (ECB) has created an MOU on high level principles for cooperation between banking supervisors and central banks in a crisis. The EU has created a Directive on the Reorganization and Winding-Up of Credit Institutions which stresses equal treatment of creditors and the concept of universality. And, the Nordic countries have created a series of MOUs on crisis management intervention procedures and information sharing concerning the Nordea financial group.

When looking at formal agreements between deposit insurers, there are only a few examples we can draw upon. Some of these include recent MOUs signed between insurers in Taiwan, Japan and Vietnam, although they appear to focus on the exchange of personnel, knowledge and expertise for capacity building. Although a very welcome step, confidentiality restrictions can often limit the degree to which these agreements can allow for information obtained from their respective supervisory authorities to be exchanged.

In the case of the Canada Deposit Insurance Corporation (CDIC), we have not yet signed any MOUs with other deposit insurers but we have developed a useful set of protocols on information sharing between ourselves and our primary supervisor

authority -- the Office of the Superintendent of Financial Institutions (OSFI). These protocols could serve as potential models for future MOUs between CDIC and deposit insurers in other countries.

The protocols are contained in the CDIC/OSFI Strategic Alliance Agreement and it provides a framework for CDIC and OSFI to co-ordinate their activities and share information. It addresses: the mandates, roles and responsibilities of the two agencies, incorporation and licensing, risk assessment and management processes, termination or cancellation of insurance, intervention and winding-up processes, the development of regulations, guidelines, policies, and other initiatives, the reporting of information and the training and development of personnel.

To support the Agreement further, an OSFI/CDIC Liaison Committee was established to provide a forum for communicating on issues arising from the Agreement.

Once developed, information channels established between supervisory authorities and deposit insurers within a country may be leveraged to gain relevant information in other countries on foreign banks and their operations. In addition to our inter-agency agreement, OSFI has established MOUs with a number of countries where cross-border banking relationships exist. This is helpful to us because at CDIC we rely heavily on OSFI for information on cross-border banks, where OSFI has agreements allowing it to share information in confidence.

Looking ahead

Even the best MOUs are deficient because they are not legally binding, can be breached and they are difficult to enforce. Moreover, if the deposit insurer is not given access to information internally, or the ability to share information with insurers in other jurisdictions, then little can be accomplished.

As I stated earlier, certainly in an ideal world the solution to information sharing would be a set of comprehensive formal cross-border agreements bringing to the table all the financial safety net participants – a network of international and national agreements. That is, formal (legally binding) agreements between central banks and supervisors; formal agreements within each jurisdiction to share this information with deposit insurers at an early stage; and formal cross-border agreements between deposit insurers to share information so we can do our job.

Unfortunately, we have to live in the real world and make progress where we can. So where should we start?

Let's begin by pressing ahead for the best possible cross-border cooperation between supervisory and central banking authorities.

Second, we need to get our own houses in order by ensuring that information within our own jurisdictions gets transmitted to deposit insurers in a timely fashion.

And, third, we should work more with the excellent tools we have at our own disposal -- such as IADI -- to help share information, knowledge and expertise among deposit insurers so we can develop better cross-border agreements among ourselves.

Finally, my recommendation for the more distant future is to think about building multilateral agreements among deposit insurers. An example I would like to point to is the creation in 2002 of the International Organization of Securities Commissions (IOSCO) Multilateral MOU. This MOU involves 30 securities and derivative regulators and its signatories agree to provide information related to brokerage records, to permit use of that information in enforcement matters, and otherwise to keep confidential such shared information.[2]

[2] Membership in the MMOU requires a showing of a jurisdiction's legal authority to comply with the key provisions which IOSCO verifies through the application review process.

I believe that with its expertise, contacts and growing influence IADI would be well placed to lead such an initiative for deposit insurers.

Leaving you with that idea, let me end and thank you for your kind attention.

[THE END]