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Building a Resilient Financial System: Lessons from Canada

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- Sound policy frameworks
- Structural advantages
- A balanced economy
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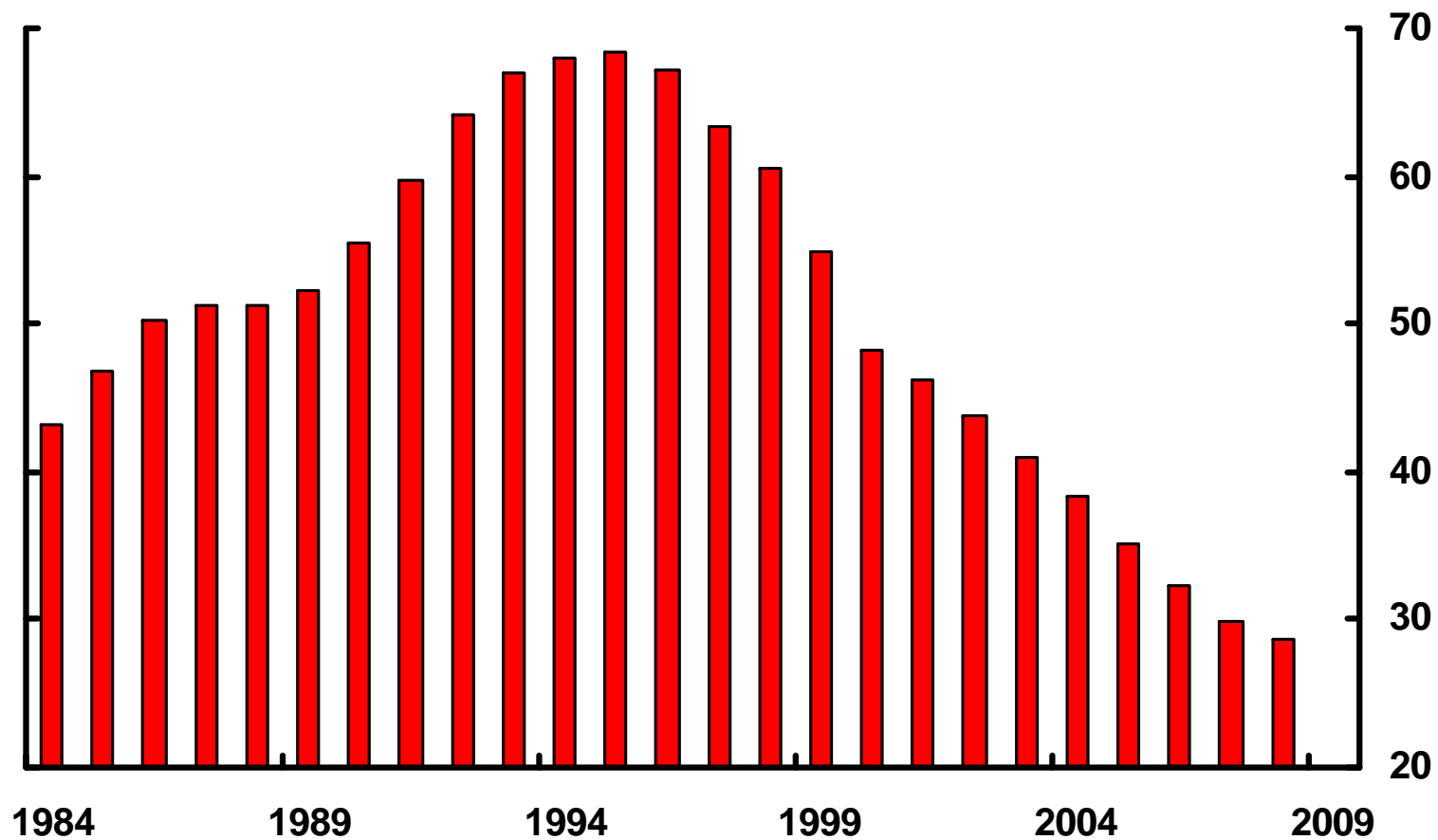
Sound Policy Frameworks

Sound Policy Frameworks

- Macro frameworks
 - Fiscal policy
 - Monetary policy
- Financial regulatory frameworks
 - Resolution mechanisms
 - Bank capital
 - Supervisory

Fiscal Policy

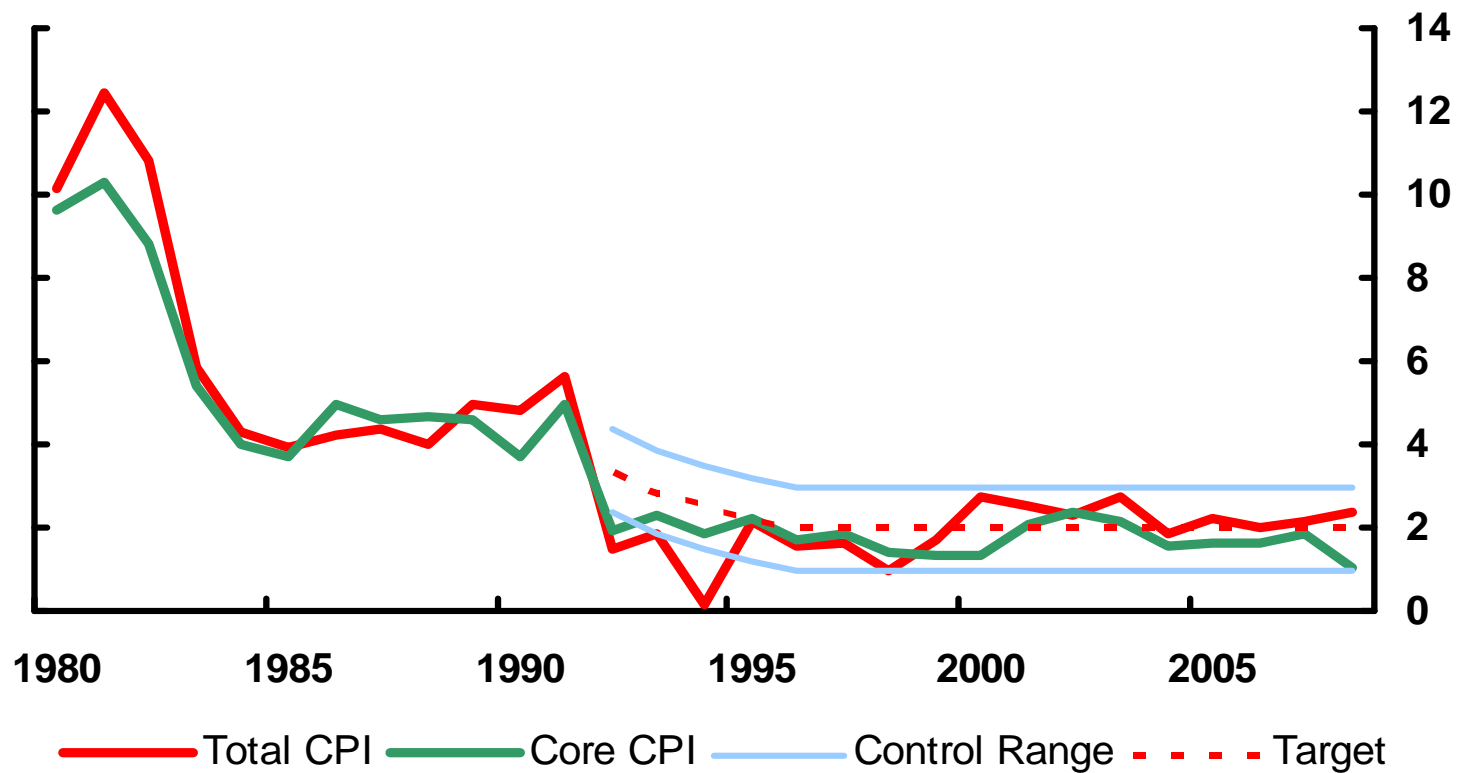
Canadian Federal Debt as a Percentage of GDP



Monetary Policy

Canadian CPI Annual Averages

Year-over-year percentage change

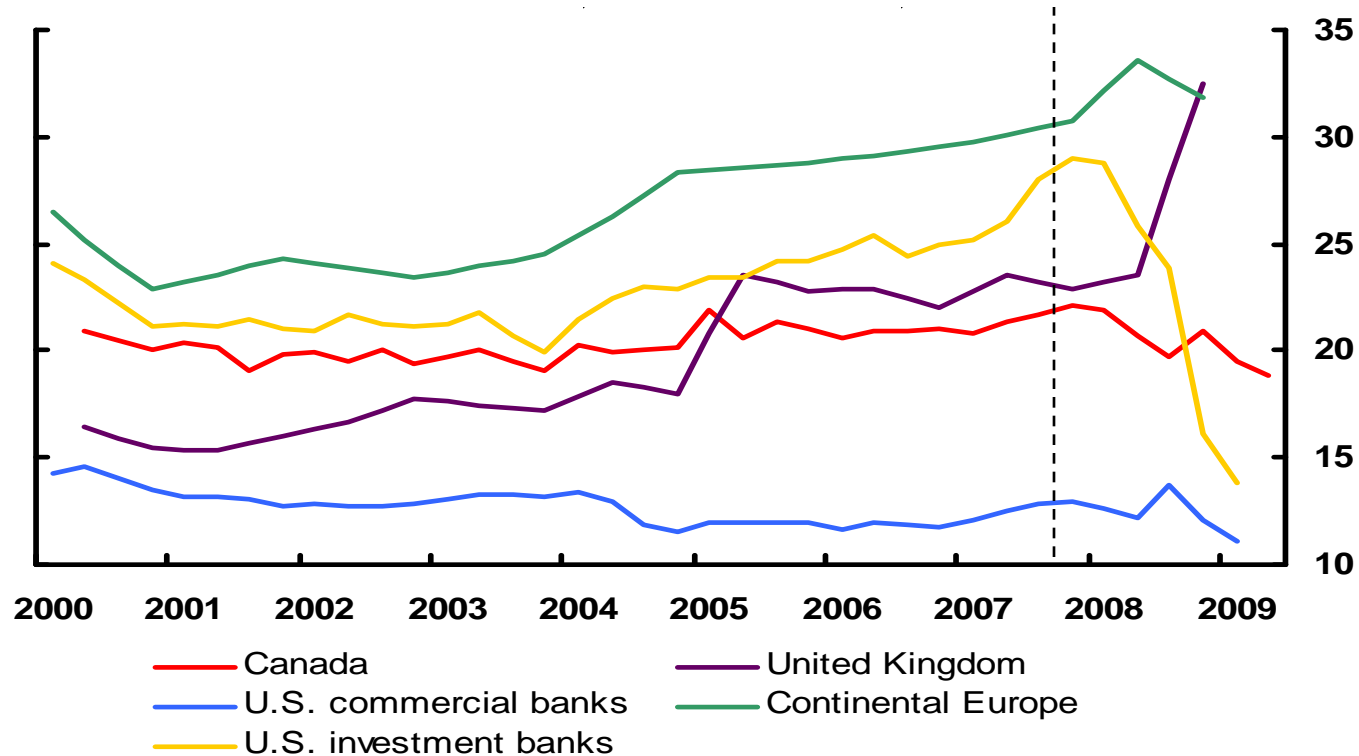


Financial Regulatory Frameworks

- Independent, clearly mandated agencies
- Opportunities for regulatory arbitrage constrained
- Good inter-agency communications
- Structured settings for discussion and information sharing

Leverage in Canadian Banks Well Managed

Banking Sector Leverage*

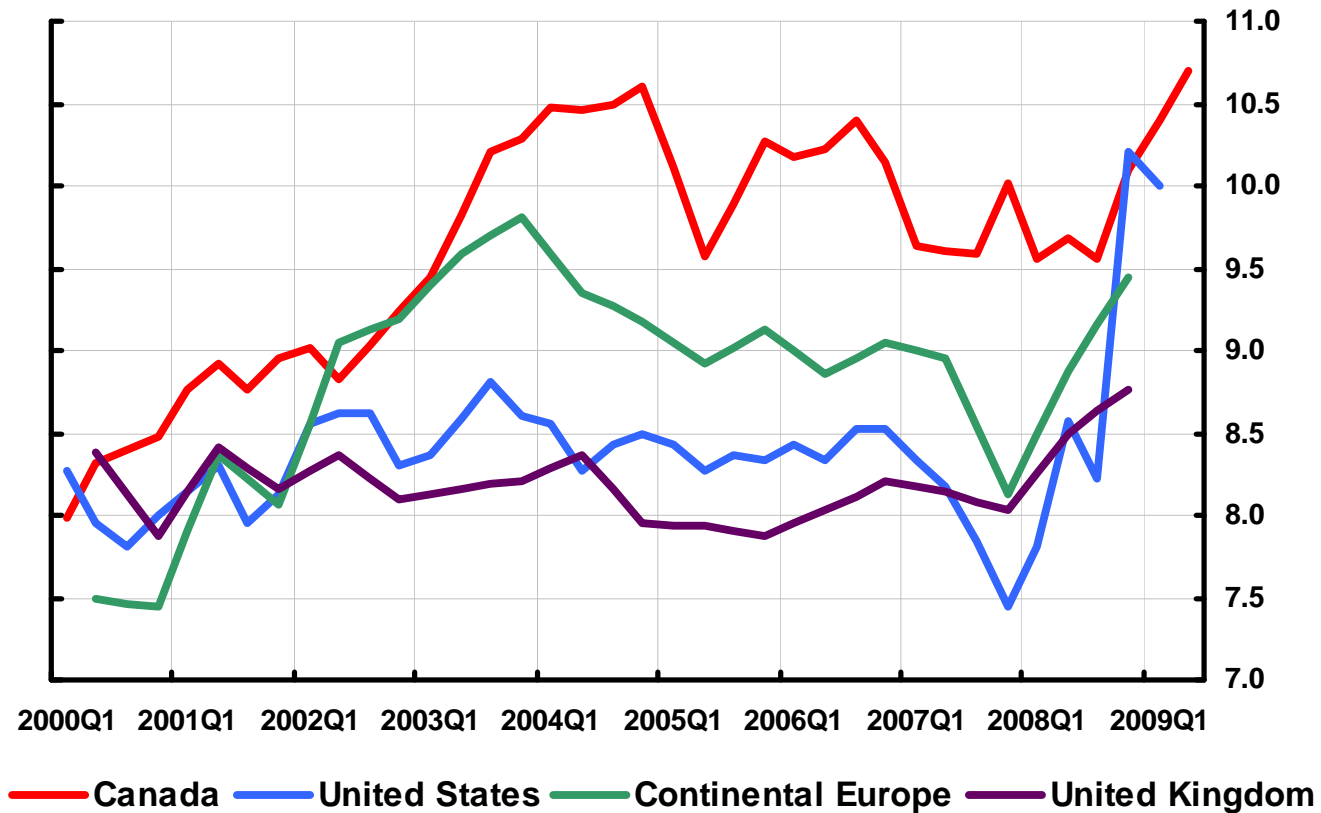


* Ratio of on-balance-sheet assets to total shareholders' equity

Sources: Bloomberg and banks' financial statements

Canadian Bank Capital Well Managed

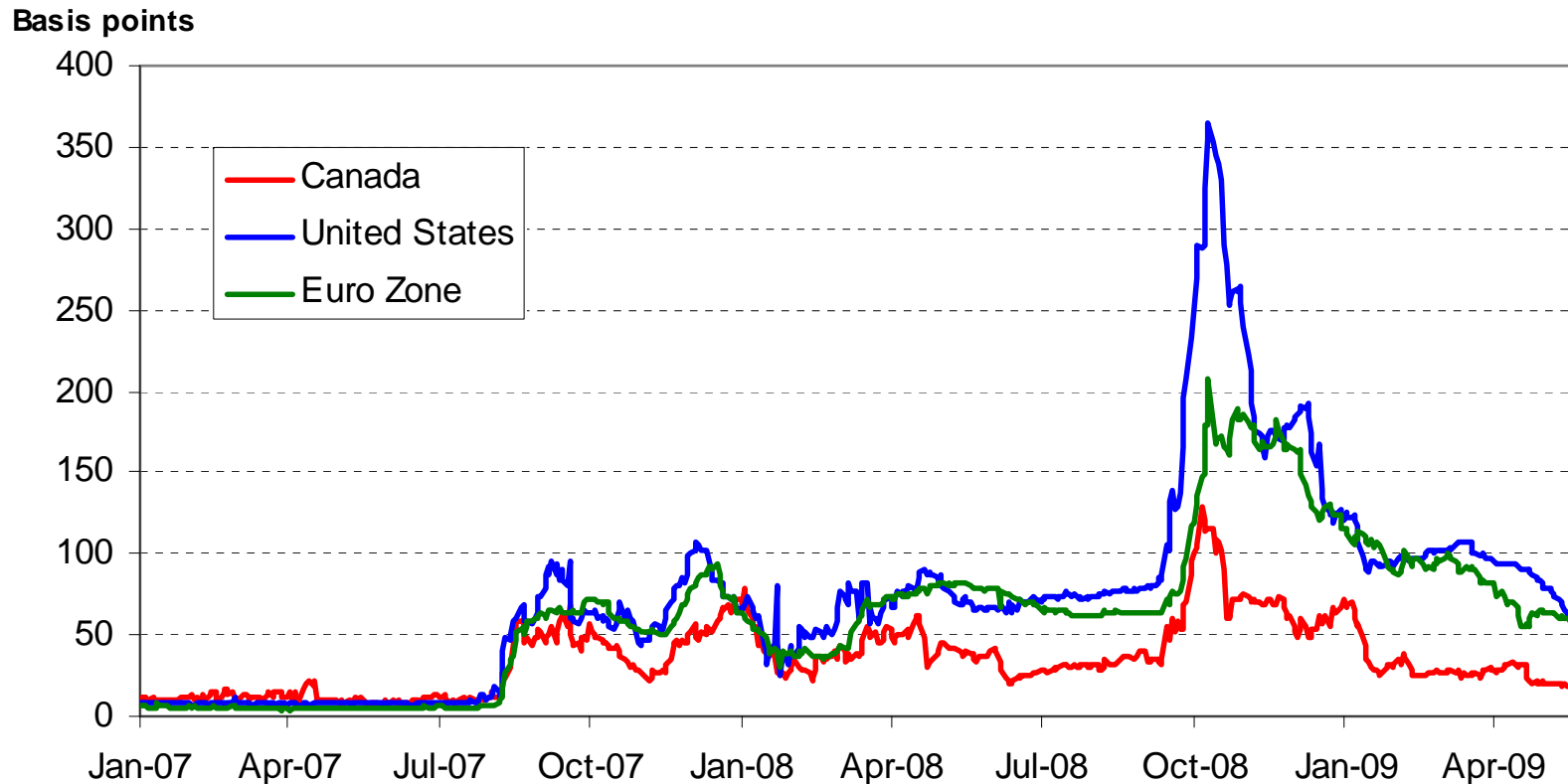
Tier 1 Capital Ratio



Sources: Bloomberg and banks' financial statements

Canada Outperforms in Interbank Markets

Spreads between 3-month LIBOR and Overnight Index Swaps*

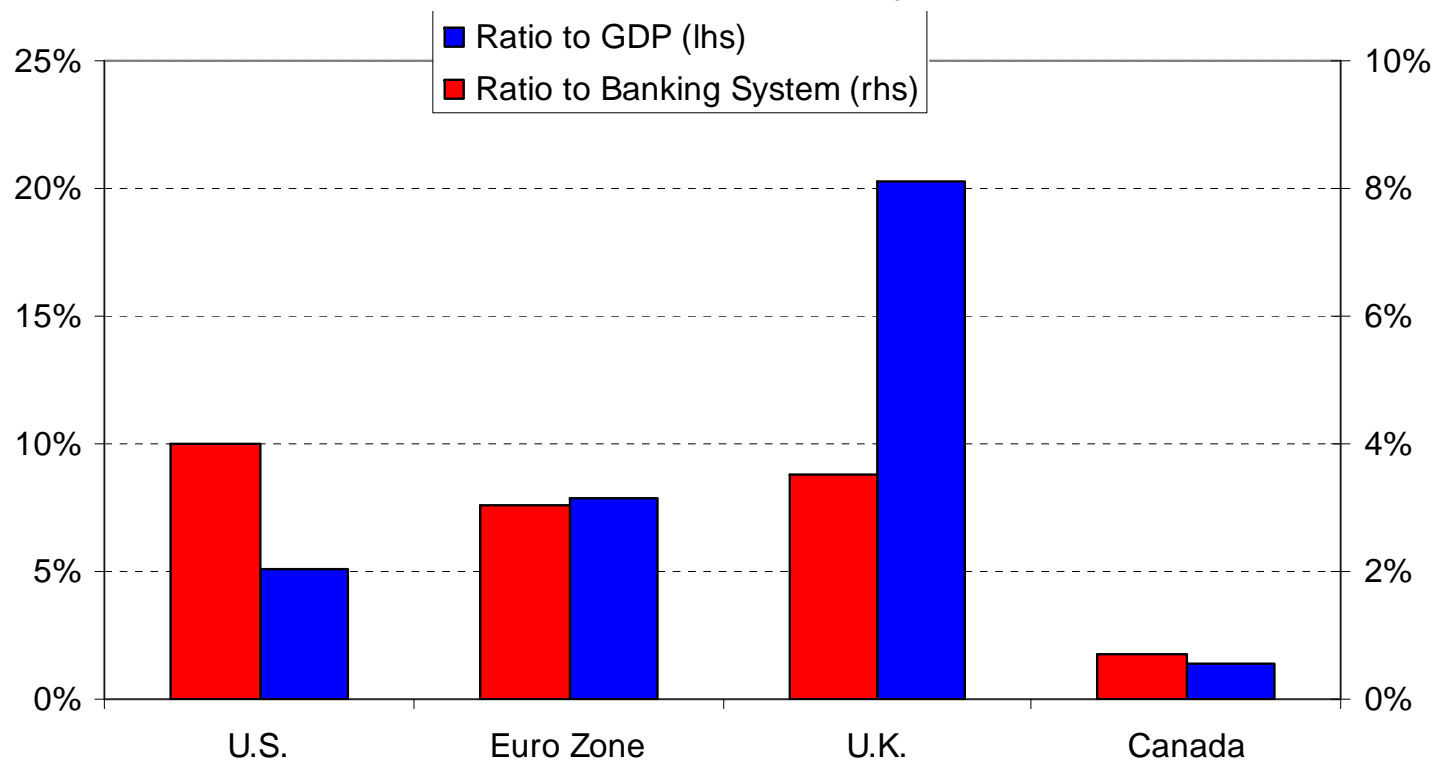


* For the United States, LIBOR; Euro area, EURIBOR; and for Canada, CDOR

Source: Bloomberg

Need for Liquidity Extension Lower in Canada

Total Public Sector Liquidity Extension

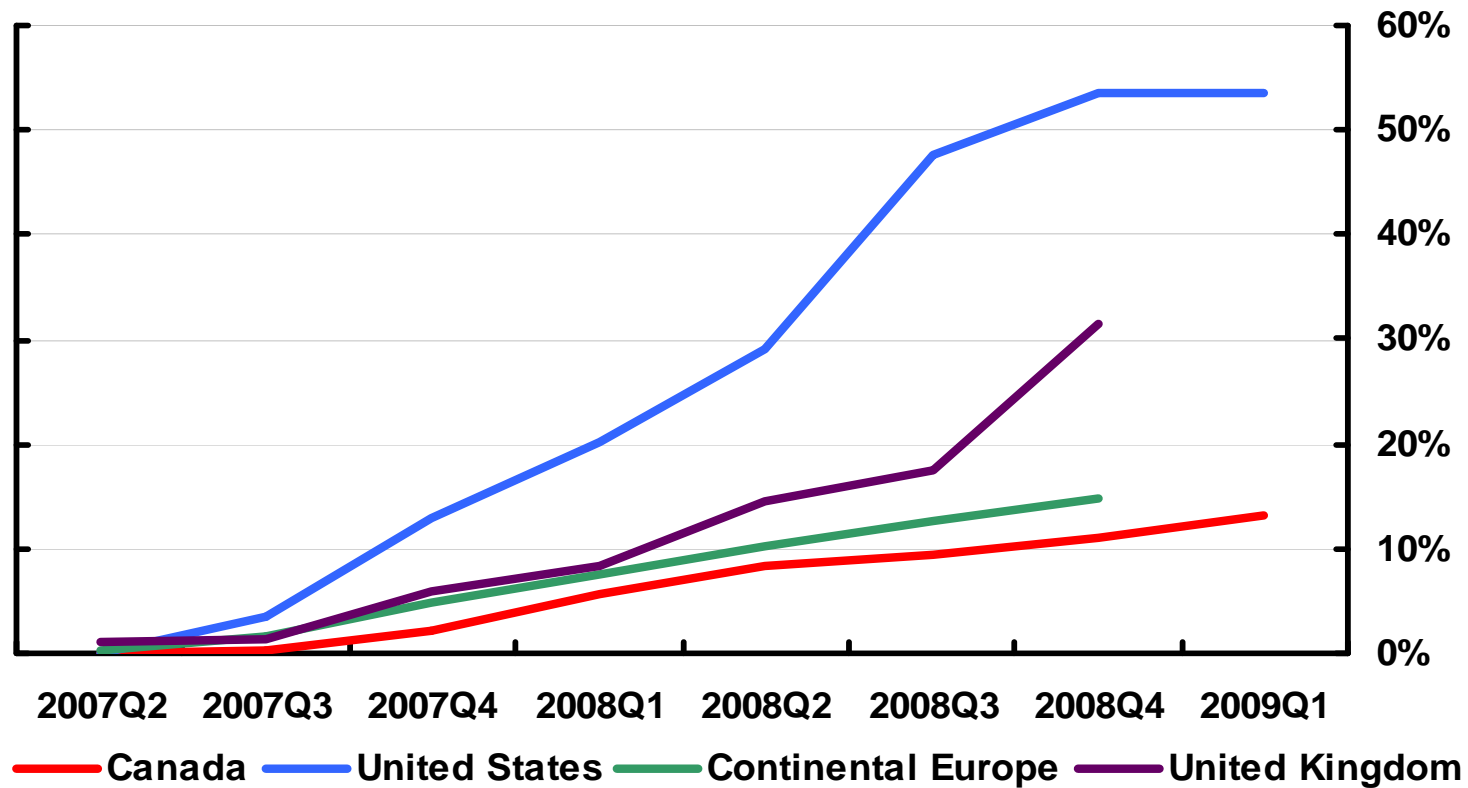


Note: Liquidity Extension refers to central banks' liquidity-providing operations, as well as foreign currency swaps with other central banks, but excludes outright securities purchases.

Sources: Bank of Canada, U.S. Federal Reserve, Bank of England, and European Central Bank

Relatively Conservative Risk Appetite of Canadian Banks

Cumulative Writedowns as a Share of Shareholder Equity



Sources: Bloomberg and banks' financial statements

High-Quality Mortgage Market

- Banks required to have insurance if loan-to-value > 80%
- Mortgagors personally liable for loans
- Mortgage interest not tax deductible
- Most mortgages originated by banks for own balance sheets; higher underwriting standards
- Securitization primarily for liquidity rather than risk transfer

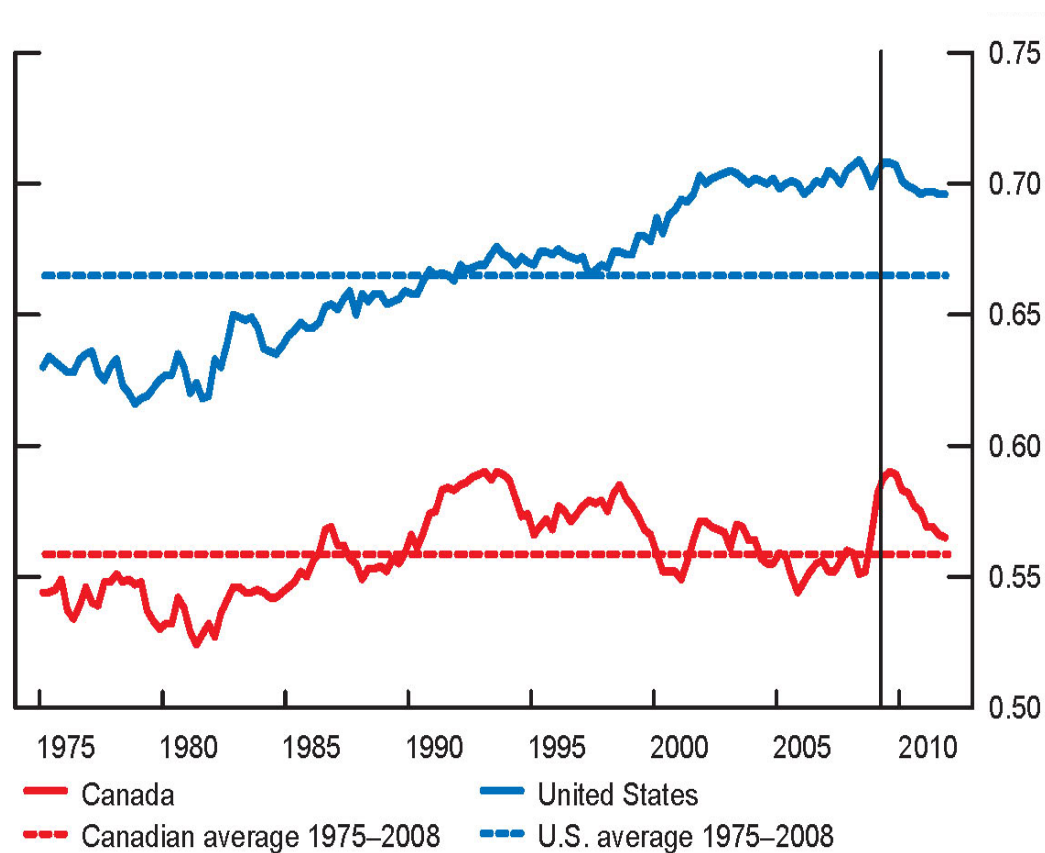


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A Balanced Economy

Canadian Consumption Consistent with Long-Run Average

Ratio of Nominal Consumption to GDP



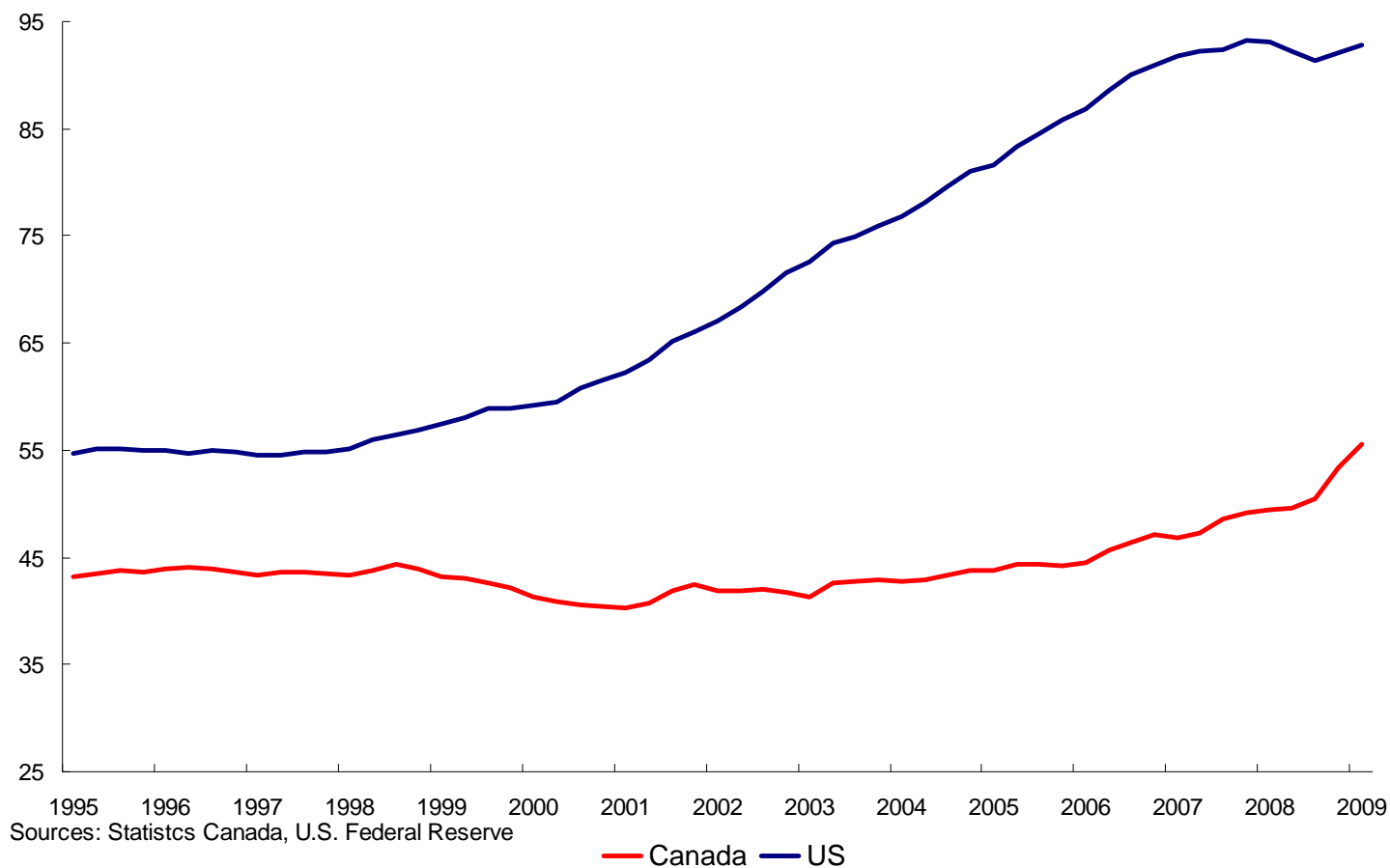
Note: 2009Q2 to 2011Q4 are base-case projections.

Sources: U.S. Bureau of Economic Analysis, Statistics Canada, and Bank of Canada calculations

Quarterly data

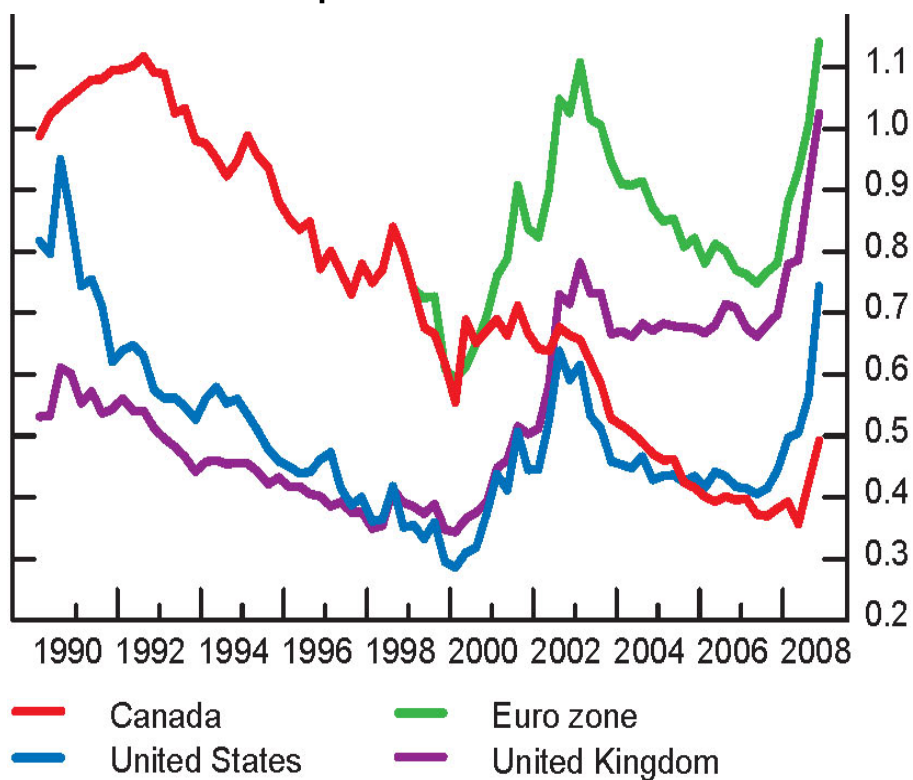
Canadian Housing Market More Conservative

Mortgage Debt as Per Cent of Nominal GDP



Canadian Corporate Leverage Below Its Peers

Non-Financial Corporate Sector: Debt-to-Equity Ratio*



* For international comparability, data for Canada are measured at market value rather than at book value.

Sources: Statistics Canada, U.S. Federal Reserve, U.K. National Statistics, ECB
Last observation: 2008Q4



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Priorities for a More Resilient Financial System

Five Imperatives

- Continuously open funding markets
- Sustainable securitization
- New bank capital requirements
- Macroprudential approach to regulation
- A system that can withstand failure

Continuously Open Funding Markets

- Crisis clearly exacerbated by seizure of interbank and repo markets
- Core funding markets should be made more efficient and less susceptible to extreme price movements
- Robust and efficient financial system needs interbank, commercial paper, and repo markets that are continuously open, even under stress
- Needs robust infrastructure, transparency, central bank liquidity

Sustainable Securitization

- Transparency should be increased so risk can be identified more effectively and priced more efficiently
- Models and data underlying securities should be published
- Standardization of terms
- Skin in the game (retain similar products or first loss)

New Bank Capital Requirements

- **Higher:** Overall capitalization in regulated financial system will rise, once economy recovers
- **Better quality:** Greater focus on loss-absorption capacity
- **Simpler:** Use of leverage caps
- **More dynamic:** Countercyclical capital buffers
- **Less procyclical:** Through-the-cycle approaches

Macroprudential Approach to Regulation

- Not enough for prudential regulators to adopt new measures within their current frameworks
- Need for oversight of the system as a whole—including both systemically important institutions and systemically important markets
- **Macroprudential surveillance:** Identify buildup of risks to financial system
- **Macroprudential regulation:** Strengthen resilience of financial system

Building a System that can Withstand Failure

- Robust systemic markets that are independent of core counterparties
- Staged intervention regimes
- Bank capital requirements consistent with business risk
- Deeper international coordination



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