

Update on Canada's Bail-in Regime

MAY 3, 2016 3 MIN READ

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On April 20th, the Canadian Federal Government introduced legislation to implement a bank recapitalization or "bail-in" regime for domestic systemically important banks (D-SIBs). The Office of the Superintendent of Financial Institutions (OSFI) has designated six Canadian institutions as D-SIBs: Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada, and Toronto-Dominion Bank of Canada. The draft legislation provides a framework for the conversion of certain eligible shares and liabilities of the D-SIB into common equity of the bank (or any of its affiliates) in the event the D-SIB becomes non-viable. The purpose of the conversion is to recapitalize the bank and allow it to continue operating without the need for a government bail-out. The initiative is consistent with international efforts to address the potential risks to the global financial system of institutions that are perceived as being "too-big-to-fail."

Bail-in process

The legislation amends the *Canada Deposit Insurance Corporation Act (CDIC Act)* to, among other things, permit the Canada Deposit Insurance Corporation (CDIC) to be appointed as the receiver of the D-SIB and for the CDIC to convert certain shares and liabilities of the D-SIB into common shares of the bank (or any of its affiliates) where the Superintendent of the Office of the Superintendent of Financial Institutions is of the opinion that the bank has ceased, or is about to cease, to be viable, and that its viability cannot be restored through the exercise of the Superintendent's powers.

The types of shares and liabilities subject to the conversion will be set out in regulations to the *CDIC Act*. While these regulations have not yet been prescribed, in its previous consultation paper, the government had proposed that "long-term senior debt" (i.e., senior unsecured debt that is tradable and transferable with an original term to maturity of over 400 days) would be subject to conversion through the exercise of the statutory conversion power (consumer deposits are proposed to be excluded from the application of the bail-in regime). The terms and conditions of the conversion, including its timing, will also be set out in the regulations.

The proposed statutory conversion supplements the existing Non-Viable Contingent Capital (NVCC) regime which requires the contractual conversion of subordinated debt and preferred equity into common equity upon the occurrence of certain trigger events. As of January 1, 2013, all Canadian banks' newly issued non-common capital must be NVCC compliant in order to qualify as regulatory capital.

Minimum “loss absorption” capacity

The draft legislation also amends the *Bank Act* to require D-SIBs to maintain a minimum capacity to absorb losses to be determined by the Superintendent in consultation with the other members of the committee established under Section 18(1) of the *Office of the Superintendent of Financial Institutions Act*. Loss absorption instruments for these purposes include regulatory capital as well as shares and liabilities subject to the statutory conversion power.

Timing and next steps

There is no established timetable for the draft legislation and it will need to go through the normal parliamentary process before coming into force. Much of the detail of the proposed new Canadian bank bail-in regime will be set out in regulations which have yet to be established. The consequences of the mechanics, including tax consequences arising on the conversion of debt to common shares, will need to be examined carefully, including any impact on non-resident investors. For example, we expect that the bail-in regime would require changes to D-SIBs’ domestic and international funding programs. As well, a number of D-SIBs have traditionally issued senior notes in the Canadian market using simple term sheets and note documents and these documents would also need to be reviewed and revised. Osler has considered the implications of bail-in regime in the context of recent transactions and similar instruments.