Canada’s Bail-In Regime Now in Force

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Canada’s bank recapitalization (bail-in) regime has officially taken effect.

The bail-in regime—which came into effect on September 23—allows for expedient conversion of certain bank instruments into regulatory capital in the highly unlikely event that a domestic systemically important bank (D-SIB) becomes non-viable. It is aimed at ensuring that: (a) taxpayers are protected from having to bail out a D-SIB in the highly unlikely event of such institution running into financial difficulty; and (b) Canada’s financial system remains strong by clarifying that banks’ shareholders and creditors are responsible for bearing losses, thereby giving them stronger incentives to monitor the bank’s risk-taking activities.

The cornerstone of the regime is that the Government has a statutory power to direct the Canada Deposit Insurance Corporation (CDIC) to convert, in whole or in part, specified eligible instruments into common shares of the D-SIB (or its affiliates). Regulations under the *Canada Deposit Insurance Corporation Act* (CDIC Act) and the *Bank Act* provide details of the conversion, issuance and compensation regimes relating to bail-in instruments issued by D-SIBs.

Bail-in Regime Explained

The Bank Recapitalization (Bail-in) Conversion Regulations, under the CDIC Act, define the scope and conditions for conversion of bail-in-able instruments. In general, any unsubordinated instrument with an initial term to maturity greater than 400 days that is unsecured and assigned a CUSIP or ISIN number will be subject to the bail-in regime. Covered bonds, derivatives, structured notes and certain other liabilities are explicitly excluded from the bail-in regime. Deposits (other than deposit notes) with the D-SIB will also not be subject to the bail-in regime. In the event that the Superintendent of Financial Institutions Canada (Superintendent) determines a D-SIB has ceased, or is about to cease, to be viable, with no hope of being restored or preserved by the exercise of the Superintendent's power under the *Bank Act*, it must report such D-SIB to the CDIC.

On receipt of such a report, the CDIC may request the Minister of Finance to recommend an order be made to carry out a conversion under the CDIC Act, and upon such recommendation, the Governor in Council may direct the CDIC to carry out the conversion. The CDIC must use its best efforts to ensure that a senior bail-in-able instrument is converted into common shares only if all subordinate bail-in-able instruments and any subordinate non-viability contingent capital have previously been converted or are converted at the same time.

Pursuant to the Bank Recapitalization (Bail-in) Issuance Regulations under the *Bank Act*, a D-SIB must ensure that a bail-in-able liability issued by the bank includes each of the following in its terms:

a. the holder of the liability is bound, in respect of that liability, by the CDIC Act (including the conversion of the liability into common shares under the CDIC Act and the variation or extinguishment of the liability in consequence) and by the applicability of the laws of Canada or of a Canadian province in respect of the operation of the CDIC Act with respect to the liability;

b. the holder of the liability attorns to the jurisdiction of courts in Canada with respect to the CDIC Act and those laws; and

c. the terms referred to in (a) and (b) above are binding on the holder of the liability despite any other terms of the liability, any other law that governs the liability and any other agreement, arrangement or understanding between the parties with respect to the liability.

In addition, a D-SIB must ensure that the terms attached to a bail-in-able share issued by the bank provide that the share is subject to conversion into common shares under the CDIC Act. Finally, a D-SIB is required to disclose in a prospectus, information circular, other offering memorandum or similar document related to the share or liability, that the share or liability is subject to conversion into common shares under sections 39.2(2.3) of the CDIC Act, and the D-SIB is prohibited from advertising or otherwise promoting bail-in eligible liabilities as deposits (including in their name) to purchasers in Canada.

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The CDIC Act provides that any shareholders or creditors who are in a worse financial position than they would have been had a federal member institution (including a D-SIB) been subject to a resolution power of CDIC made pursuant to sections 39.13(1) of the CDIC Act are entitled to be paid compensation by CDIC. The Compensation Regulations under the CDIC Act provide the framework for determining the compensation, if any, to which a prescribed person under the regulations is entitled in the event of a bail-in conversion.

Finally, in connection to the bail-in regime, the Office of the Superintendent of Financial Institutions also published a Total Loss Absorbing Capacity (TLAC) Guideline, which is meant to ensure that D-SIBs have sufficient loss absorbing capacity to support the recapitalization of a non-viable D-SIB. The Superintendent issued orders to each D-SIB on August 21, 2018, setting the minimum risk-based TLAC ratio at 21.5% of risk-weighted assets and the minimum TLAC leverage ratio at 6.75%.

For more detailed information about the bail-in regime, please read bulletins "Bill C-15 Implements Bank Recapitalization Regime," "Government of Canada Publishes Bail-In Regulations," "Final Bail-In Regulations and Related Guidelines Published," and "Bail-In Implementation Update."