

Dear Sir/Mme,

Re: Response to Consultation Document:
“Financial stability and depositor protection: Strengthening the framework”
(January 2008)

I am a Canadian academic specializing in banking and financial law.

I read the tripartite consultation “Financial stability and depositor protection: Strengthening the framework” (January 2008) and with your permission, would like to provide comments, in the nature of an ‘outsider’s view’, on two aspects.

Surely, these views are my own; they do not represent the view of my Law School or any other organization or group with which I am involved.

Comments below relate to Chapter 5 and 6. First set of comments relates to Chapter 5 dealing with consumer confidence and compensation arrangements. I thought the chapter was thoughtful and yet did not provide a full picture of the entire possible role for a Financial Services Compensation Scheme.

Certainly, the discussion on direct investor protection aspects, such as compensation, coverage and payments, as well as on funding and liquidity, was comprehensive; at the same time, may I encourage you to consider also the role of the insurance fund in failure resolution. To that end, may I outline the basic features of the Canadian deposit insurance scheme for your review and consideration. I trust you will not consider my intervention to be presumptuous.

Thus, in Canada the Deposit Insurance Corporation is a Crown Corporation (CDIC), privately funded through premiums levied against its member institutions. Its operations are funded also by earnings on investments, and through borrowing from the federal Consolidated Revenue Fund; the CDIC is also authorized to borrow in private capital markets through the issuance and sale of bonds, debentures and notes. Other than making deposit payouts, the CDIC (i) requires insured institutions to follow standards of sound business and financial practices; (ii) extends loans to and acquires assets from institutions in distress; and (iii) provides assistance to enable institutions in distress to be merged with or acquired by healthy institutions.

Generally speaking, on the basis of Canadian law and practice, failure resolution methods, other than deposit payouts, to be considered, are (i) agency agreements, under which a healthy institution acts as an agent of the deposit insurer and takes over (for a fee paid by the deposit insurer) the running of the failed institution; (ii) financial assistance to a failing institution; (iii) the facilitation of the sale of a troubled institution by lending or guaranteeing to a purchaser a portion of the principal and income losses (‘deficiency coverage agreement’); and (iv) the purchase and operation of a failing institution, either directly, or by means of the establishment of a “bridge bank”, temporarily acquiring taking over operations of a failed institution, and maintaining banking services to customers.

Canada recently abandoned the flat rate premium structure and moved to a differential premium risk-based structure. Change has not been welcomed by all; according to one view, the differential premium risk-based structure has raised entry barriers and has not been adequate in internalizing all costs associated with added risk, so as, in the final analysis, to affect very little, if at all, the moral hazard associated with any insurance. See

e.g. an article by BW Keefe and JP Robinson, (2000), 15 Banking and Finance Law Review 111.

Another aspect on which I would like to comment is regarding Chapter 7 on the strengthening of the Bank of England. I fully endorse the need to formalize in statute the Bank's role in the area of financial stability. First, this is a matter of the rule of law; all public authority's powers and jurisdiction must be provided by law. Second, and more specifically, 'monetary stability' has been linked to price stability; at the same time, the scope and meaning of 'financial stability' has been far from clear, and hence ought to be addressed by legislation.

Indeed, the growing complexity of the financial system has given rise to 'financial stability' as a new area of financial regulation, relating to the financial system as a whole, and covering the entire scope of financial intermediation as a much broader area than banking. In an important recent book, Dr. Rosa M. Lastra, *Legal Foundations of International Monetary Stability* (Oxford: Oxford University Press, 2006), describes (at p. 92; see also p. 302) financial stability as "a broad and discretionary concept that generally refers to the safety and soundness of the financial system and to the stability and of payment and settlement systems." It is "an evolving concept" denoting "the absence of stability" and "encompasses a variety of elements ... such as a good licensing policies, good supervisory techniques, adequate capital and liquidity, competent and honest management, internal controls, early warning systems, transparency, and accountability. It also refers to the stability of the payment system." (ibid. at 1). She further cites Tommaso Padoa-Schioppa to describe financial stability as a "land between monetary policy and supervision".

In a book review [(2007) 45 Canadian Business Law Journal 325], I expressed my own preference to the adherence to a distinction between the broad and narrow sense of 'financial stability'. In the broad sense I would not treat it as "land between" but rather, in the footsteps of Dr. Lastra's own definition as immediately above, as an overreaching concept covering the orderly operation of the entire financial system. More narrowly 'financial stability' refers to the prevention and containment of risk in the inter-institutional domain, or to the smooth operation of transactions among financial intermediaries, including payment and settlement systems (for both funds transfers and securities). In my view, when financial stability is assigned to a central bank, it is financial stability in the narrow sense; what is assigned is the responsibility for the inter-institutional activity (such as in settlement systems and clearing houses) as opposed to the supervision and regulation of the institutions as 'stand-alone' organizations.

I would urge that serious consideration of this definitional aspect be given in conjunction with the statutory formalization of the role of the Bank of England in the area of financial stability.

I trust these comments are of some assistance to you; could you be kind enough to acknowledge receipt in good order and please let me know if you have any question or comment or require further clarification.

Best wishes for success in the review process,

Sincerely,

Professor Benjamin Geva