

# Study on Measures to Enhance Credit Availability and the Stability of the Canadian Financial System

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for

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**CHECK AGAINST DELIVERY**

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Good morning.

It is my pleasure to be here today to participate in the Committee's discussions of the Canadian banking and financial sector. I am joined by my colleagues from the Canadian Bankers Association – Terry Campbell, Vice President of Policy and Darren Hannah, Director, Banking Operations. We also have for you an information package on the issues that we will be discussing this morning.

The CBA represents our 50 member banks, including domestic chartered banks, foreign bank subsidiaries and foreign bank branches operating in Canada. We are a source of public information and research on banks in Canada, we provide a forum for discussion on issues of common interest to our members and we advocate for banks at the municipal, provincial and federal government levels.

Our member banks are present in virtually every community across the country, and are key contributors to local and provincial economies, as well as to the national economy.

### **Significance of banks to the economy**

To help set the stage for our discussion this morning, I will take a few minutes and share with you some helpful information about our banks and also talk about their role in this time of economic turmoil.

To begin, I would like to highlight a few statistics about the contribution of banks to the Canadian economy.

In terms of employment, banks and their subsidiaries employ a quarter of a million Canadians – this is an increase of 16 per cent over the past ten years. In fact, banks account for 1.5 per cent of total employment in Canada.

When it comes to Gross Domestic Product, banks contribute 3.3 per cent to the nation's output.

As well, most Canadians are shareholders in Canadian banks either directly or through the Canada Pension Plan (CPP), other pension and mutual funds. Pension funds and RRSPs are the main beneficiaries of the billions of dollars that the banks pay in dividends each year.

Our banks are also active overseas and this again is good for Canada and our economy. Approximately 34 per cent of bank net income (2007) was generated outside Canada while 78 per cent of employees were located in Canada and 85 per cent of taxes paid in Canada.

And speaking of taxes, in 2007 banks paid \$8.7 billion to governments in Canada, supporting social and economic programs that Canadians value.

I highlight these figures to point out that banks in Canada are part of the economic fabric of local communities, the provinces and Canada as a whole.

### **Strength of Canadian banking sector**

As important as these contributions are to our economy, the real message is that Canadians continue to have confidence in their banking sector – they know that our banks are at the heart of Canada's economic recovery and that our banks will be there to ensure Canada's economic well-being in the long term.

When we reflect on what is happening to the global financial system and the unprecedented turmoil it has been going through for the past several months, we need to remember that this turmoil did not originate in Canada. Furthermore, even though it is having an impact on banks in Canada, they have largely avoided the difficulties that banks around the world are now facing.

Why is that? Most observers point to the following four reasons.

### **Number 1: A national system with well-diversified banks**

In Canada we have a national banking system, with many banks offering services and products throughout the country. In fact, each of the five largest Canadian banks has branches in all ten provinces. This benefits Canadian consumers and businesses. By contrast, no American bank has branches in all 50 states.

Canada's large banks are highly diversified organizations with investment banks part of a larger bank financial group and anchored by a solid, deposit-taking commercial bank. Even our smaller regional banks are balanced in their mix of activities.

This stands in stark contrast to what we have seen, at least until recently, in the US where the large investment banks were not part of, or linked with, commercial banks and were subject to a different regulatory regime.

### **Number 2: Well-capitalized and well-managed**

Banks in Canada are among the best-capitalized in the world, exceeding the Bank for International Settlements' norms by significant margins. Even before the turmoil began, the Department of Finance referred to the capitalization levels of our banks as "conservative by international standards", and our banks have significantly increased their capital levels since then. And Canadian banks were the first in the world to adopt the advanced approaches to risk management under the new Basel II capital framework.

As I mentioned, banks in Canada have been strengthening their capital levels lately. This is, by the way, *new* capital being raised from investors in the marketplace.

Why is it so important to have a strong capital base?

First, it helps ensure that banks are able to do things that they do best, such as lending. Put simply, the more capital you have, the more you can lend, and as I'll mention in a moment, Bank of Canada statistics show that the growth in our lending is very strong. In other countries, a lack of capital is forcing banks to curtail lending.

Second, in a downturn where some borrowers are unable to pay their debts and loan losses begin to mount, a strong capital base provides a cushion so that the bank does not get into the kind of trouble that we have seen with banks in other jurisdictions.

Canada's banks are also prudent and well-managed. Canadians themselves recognize this. A Strategic Counsel poll late last year found that 81 per cent of respondents understood that prudent lending was a key reason Canadian banks have performed better than their international counterparts.

"Prudent and well-managed" also means that we balance our lending by ensuring that we are fully protecting our depositors' money, funds that have been entrusted to us. And, it means that we operate our businesses profitably, so that we can continue to have the ability to support economic development in communities across the country, and to support government and company pension funds relied upon by individual Canadians for their retirement. Again, we have seen the consequences of less-than-prudent, and less than well-managed institutions elsewhere in the world.

### **Number 3: Strong regulatory system**

Canada's regulatory system is robust, and is suitable to the Canadian industry and marketplace. Unlike the wide array of different regulators who oversee banks in the US for example, bank financial groups in Canada are federally regulated by the Office of the Superintendent of Financial Institutions (OSFI) for prudential matters and the Financial Consumer Agency of Canada (FCAC) for consumer matters.

Canada has received international recognition for our regulatory system. The International Monetary Fund's Financial Sector Assessment Program does comprehensive reviews of the national financial systems and rates a country's implementation of a range of regulatory standards and practices. The IMF recently concluded such a study of Canada and found that "Canada has a highly effective regulatory and supervisory framework, in which OSFI plays the primary role."

## **Number 4: Character of Canada's mortgage market**

Since so much of the trouble internationally has its roots in the US mortgage market it may be worthwhile to reflect on the different character of the Canadian mortgage market in contrast.

Canada does not have the same problems with sub-prime mortgages that are at the heart of the problem in the US. In Canada, by far the majority of mortgage loans are prime. As well, in Canada only 20 per cent of mortgages are securitized. In contrast to the US model where that percentage is far greater, Canadian banks 'originate to hold' their mortgages on-balance-sheet, providing an incentive in the system to be far more prudent about lending decisions.

In Canada high-ratio mortgages with less than 80 per cent down must be insured. This is not the case in the US.

Mortgage arrears remain very low in Canada – close to historic lows in fact. For Canada's seven largest banks, the percentage of mortgage arrears is a third of one per cent. All of this together puts the Canadian mortgage market in a different league than that of our American cousins.

Clearly, each of these attributes of the Canadian banking system has served us well through difficult times. And just as importantly, having a strong and stable banking system is essential to helping Canada get through the tough economic times that we now face.

### **Government response**

So what does all this mean to Canada and Canadians?

It means that unlike so many other countries, Canadian taxpayers have

- not had to bail out financial institutions,
- not had to inject capital into our institutions,
- and not had to set up public entities to buy toxic assets.

In contrast, in order to inject liquidity into a market affected by the global credit freeze, the federal government chose to purchase sound, insured mortgages at commercial rates through the Canada Mortgage and Housing Corporation (CMHC) – an investment by the government that will turn a profit for the Canadian taxpayer.

### **Access to and cost of credit**

Let me now turn to the issue of credit – something that we and our members are hearing a lot about from customers and from talking with Members of Parliament.

We know that Canadians are concerned about access to credit and the cost of credit. We know this is a challenging economic time for Canadians and for many businesses. Banks want customers to succeed just as much as customers do.

Banks have a long history of helping their customers through difficult economic periods. In the agricultural area, for instance, over the past decade our clients have had to manage problems such as drought, BSE, avian influenza and flooding. Banks worked in partnership with these clients through those challenging events.

Today, banks are doing the same with their business and personal customers. We understand that some customers are going through difficult times, and we're asking those customers to come in and talk with their banker to see what solutions can be worked out. We deal with situations on a case-by-case basis, and we want our customers to succeed. Indeed, we succeed when our customers succeed.

We also emphasize consumer education and choice, and encourage consumers to make the most of the wide range of choices available in a competitive marketplace.

Banks are continuing to lend to credit-worthy customers. On the consumer side, for instance, the latest Bank of Canada figures show that consumer credit continues to grow at a respectable pace – 14 per cent increase year over year.

An important part of that credit is on the residential mortgage side, and here mortgage interest rates have been declining for the last several months and are near historic lows.

What about businesses? We know that the recession is hitting some businesses hard. We know that there has been a serious slowing of business credit from some non-bank sources of credit. And we know that, as a result, some businesses are reporting that they are having a hard time finding credit.

What is the role of banks in Canada in this issue? It's important to remember banks are traditionally about half of the business credit marketplace and only about a quarter of the total financing marketplace. Our response has been to try to fill in the gap left by non-bank providers (such as auto leasing firms) who have slowed the growth of their lending or pulled out of the market altogether. Again, the latest Bank of Canada data tells the story – year-over-year, bank financing of businesses is up almost 11% - well in excess of the 4.2% growth in financing by all providers.

And, the banks share in business lending is up some 8 percentage points over the same period, as banks have stepped up to the plate to fill the gap left by others. While we are trying to fill that gap, we can't do it all.

The government recognized this and in Budget 2009 it took steps to address this issue. Funding was increased for Business Development Bank of Canada and Export Development Canada, both of whom provide financing options that complement bank lending. Our banks are working closely with these crown lenders to make credit available to credit-worthy businesses, and we are looking forward to continued cooperation.

That's the situation on access to credit. What about the cost of credit?

We have also had many questions from MPs as well as our customers about the cost of loans, and other products.

When we look at the cost of credit there are some challenges facing banks as well. The fact is there is a new reality in the international credit marketplace. Certain types of credit – like commercial paper, the securitization market – are no longer functioning properly around the world, while others are available at relatively higher cost than in the past. This affects the banks' overall cost of borrowing and therefore, has an impact on the consumer.

Another factor that affects the rates that banks set for their loans is risk. We are in a recession, and that has an impact on the creditworthiness of customers – both retail and business. As prudent lenders, banks need to adjust their pricing to reflect this new risk reality.

But it's important to remember that banks are open for business and credit remains available for creditworthy customers.

Before I conclude my remarks, I would like to briefly mention our work on financial literacy. The CBA has been involved in financial literacy for high school students for over a decade. Last year we redeveloped our program, now called *YourMoney*, in close collaboration with the FCAC. Through the *YourMoney* program we are working with 1,000 banker volunteers in communities across Canada and have reached almost 175,000 high school students. The goal is to help students with practical information about budgeting, saving, borrowing, investing and keeping their money safe.

## **Conclusion**

In closing, I want to go back to where I started – Canada’s banks are strong, secure and Canadians remain confident in their banking system. This is an advantage for Canada that other countries do not have. Keeping that advantage will be crucial to the recovery of Canada’s economy and to the long-term prosperity of Canadians.

Each of us has a responsibility to maintain the confidence of Canadians in our banking system.

Our banks will do their part. They will continue to loan prudently and protect their depositors’ money. They will also be there to ensure individuals and businesses continue to have access to credit and are able to afford to repay their loans. We will do this because we know that consumers and businesses are the drivers of the Canadian economy.

Thank you to the Committee for inviting me here today.

I will be pleased to respond to your questions.