

The Irish Economy

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A Canadian Model?

This post was written by [Karl Whelan](#)

In Saturday's Ardfeis [speech](#), the Taoiseach announced:

I will create a new central banking commission. This will incorporate both the responsibilities of the Central Bank and the supervision and regulatory functions of the Financial Regulator. This will build on best international practice similar to the Canadian model. And it will provide a seamless powerful organization with independent responsibility. It will have new powers for ensuring the financial health, stability and supervision of the banking and financial sector.

I interpreted this statement as implying that Canada has something called "a central banking commission" which incorporates both central banking and financial supervision. It turns out, however, that Canada does not have such a structure. Financial supervision in Canada is undertaken by a body called the [Office of Supervision of Financial Institutions](#) (OSFI). Canada's central bank is the Bank of Canada. [Here](#) is a link to a page describing the role that the Bank of Canada plays in the Canadian financial system. It does not regulate banks.

Perhaps what the Taoiseach means is that our new central banking commission will adopt the same approach to banking regulation as the OSFI. This would constitute a substantial change. Canadian banks are subject to much tighter capital adequacy standards and so are much less leveraged than Irish banks. The Canadian government also intervenes to maintain far higher mortgage downpayment rates than seen here. [This](#) website explains how it works: There is a minimum downpayment of 5% and everyone who has a downpayment of less than 20% must purchase mortgage default insurance. This tighter approach to regulation has meant that the Canadian banking system has survived the recent turmoil without requiring government re-capitalisation.

Without doubt we are going to need stricter banking regulation in the future. It should be stressed, however, that a transition from the leverage ratios and lending standards that have characterised our banking system in the recent past to those that prevail in Canada would be quite painful. In particular, it would likely lead to a period of very tight credit that would make it harder for the economy to recover from the current recession.

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13 Responses to "A Canadian Model?"

1. [karl deeter](#) Says:
[March 2nd, 2009 at 2:09 pm](#)

the 'canadian model' - if inferring that they want to replicate the system in canada because it is fairing relatively well - is not due to regulation, but due to the number of banks and how they are spread across different markets.

Paul Volcker recently gave a talk there and specifically mentioned that 'national presence' was one of the reasons no one bank was being particularly punished. It had little to do with regulation. Banks in canada know greed as well as the rest of the world.

We already have Mortgage Indemnity Guarantees/ Mortgage Bonds (default insurance for higher LTV's) in Ireland.

An element of the whole issue isn't how you fix the bust, but rather how you prevent the bubble in the first place, is it better to find ways to put out fires or better to not start them? Regulation will have a roll in that but the obstacle is how you make this meaningful when rates go into historically low cycles [that tend to drive up asset prices] or when money supply is manipulated.

2. [John Kehoe](#) Says:
[March 2nd, 2009 at 2:40 pm](#)

When my wife and I moved to Canada (Windsor, Ontario) in early 1989, we bought a house as soon as we could. We did not have a 20% downpayment and had to pay for mortgage insurance from the CMHC (Canada Mortgage and Housing Corporation). This wasn't as onerous as it might seem. The general practice here is to enter into a 5 year fixed rate mortgage agreement. The mortgage is amortized over 20 or 25 years. (That was in 1989, longer terms have become available now as interest rates have come down. Our first mortgage here was at 12.5%, a rate that seems incredible now.) When the 5 years is up you get a new mortgage for the remaining principal with the same bank or another bank after

shopping around. If the remaining principal is less than 80% of the appraised value of your house then you don't have to buy mortgage default insurance. So for most people the insurance requirement probably only applies in the early years of a first mortgage. Canada has also been lucky in that it has escaped a house price bubble except in some of the big cities (Vancouver, Calgary, Edmonton, Toronto) and even those have been mild by comparison with other countries.

3. *colm mccarthy* Says:
[March 2nd, 2009 at 3:14 pm](#)

In Ireland, it is the lender who takes out mortgage indemnity insurance, not the borrower, although the latter may pay. I am a little out of date on this, but it appears to have been voluntary for the lender, and some self-insured. The practice had been to insure the portion from 75% to about 90% of the property value. The business is written by commercial insurance companies.

Has anyone got up-to-date info on mortgage indemnity in Ireland? Were all mortgage lenders insuring with third parties through 2002 to 2007, for example, and did indemnity terms change to reflect rising LTVs?

4. *Patrick Honohan* Says:
[March 2nd, 2009 at 3:24 pm](#)

Yes, I was puzzled by the reference to Canada. Maybe he means that our new model will, like Canada, avoid bank failures.

But actually, Karl, the Canadian OSFI does regulate banks. Indeed, the architecture of the Canadian model seems to be more like the much-maligned UK model (and the model that was advocated by Michael McDowell?) rather than having prudential regulation integrated within the Central Bank.

(I listened to the interview with Regulatory Consultant Peter Oakes on Morning Ireland today and he ducked a question on the architecture of the Canadian model — possibly as puzzled as we are.)

5. *Sarah* Says:
[March 2nd, 2009 at 3:37 pm](#)

more light shed here

<http://www.irishelection.com/03/we-are-all-canadians-now/>

6. *Karl Whelan* Says:
[March 2nd, 2009 at 3:39 pm](#)

Just to clarify, Patrick. Perhaps I was unclear, but I was attempting to say that the Canadian model is that the OSFI regulates banks and that the Bank of Canada does not. This indeed seems to me to be essentially the opposite of the structure that is being proposed for Ireland. I fear that there may indeed be an element of just pointing to Canada as an example of somewhere that has avoided bank failures and saying that we're going to do the same, even though we aren't.

It's hard to know whether this is just (another) poorly communicated policy announcement or whether the confusion here (are they adopting a Canadian model or not and, if so, in what sense?) reflects a lack of clarity in the government's thinking on this issue. Given its importance, it would be very disappointing if it was the latter.

7. *Karl Whelan* Says:
[March 2nd, 2009 at 3:59 pm](#)

Thanks Sarah for the link which has some good stuff (I'm not sure why being hip to the details of Canadian financial regulation requires hiding behind the anonymous P. O'Neill byline!)

I had thought about writing about how the Canadians have this overall Financial Institutions Supervisory Committee where all the institutions get together but decided that was getting too into the weeds. Frankly, I think that what's actually being proposed—a proper unitary organisation—beats separate organisations that meet every so often in a committee.

8. *Mark Dowling* Says:
[March 2nd, 2009 at 4:18 pm](#)

For the OSFI, I can't speak to that directly but in my mind the "Canadian difference" was political as much as regulatory if not more so - the Chretien and Martin governments refused to allow the Big Six to merge with each other or be taken out by a US bank back when bankers seemed to benchmark their prowess based on their M&A activity.

The Canadian different in the housing market is not just CMHC but that unlike Ireland and US, [primary residence mortgage interest is NOT deductible](#).

@ColmMcCarthy - the Canadian government has, through the CMHC, bought C\$1.25bn of mortgages insured by the Corporation from their issuing institutions. This allowed the government to pump money into the banks on the pretext that if the loans defaulted they were on the hook anyway but at least the loans would be removed from the bank's books. The

difference being that CMHC insured mortgages are less likely to be reckless from a public policy standpoint if the banks were using the CMHC requirements when issuing mortgages, at least compared to uninsured Irish ones, so the likelihood of total default is lower than Irish banks dumping their unperforming uninsured loans into a bad bank.

Is there any way that the Irish private mortgage default insurers could be leveraged in the current situation? Should the Irish government just set up their own MHC instead? Or neither?

9. [Mark Dowling](#) Says:
[March 2nd, 2009 at 4:19 pm](#)

BTW - don't imagine that everything is rosy in the financial garden here. We STILL have 10 provincial securities regulators rather than a single federal one...

10. [Patrick Honohan](#) Says:
[March 2nd, 2009 at 6:25 pm](#)

Karl, I agree with you: much better (for our context) to have all in one entity.

The over-elaborate structure that was created here may not have contributed much to the problem, but it cannot have helped and may have muddied the lines of responsibility a bit.

Often the argument is made that, when the regulator is within the Central Bank, regulatory matters take a back seat to monetary policy. Our current problems makes that much less likely for the foreseeable future; besides, monetary policy is decided in Frankfurt.

11. [karl deeter](#) Says:
[March 2nd, 2009 at 8:50 pm](#)

@colm

most of the indemnity bonds were done at LTV's over 75-80% in fact, the reason many lenders are moving back to this being the maximum loan is because bonders will no longer insure them, GE were probably the biggest provider in Ireland. For amounts above certain LTV's there was unbonded lending, which meant (not in every case) that a 100% mortgage would have say, 10% not covered by the bonding. Having said that, banks tried not to do too much of this or it would affect their moody's treasury rating and they would have to pay more for their money.

usually 100% mortgages were really a first charge on the main mortgage then a second charge on the deposit, so you were getting 100% of the money but not 100% from one source. eg: EBS might do 90% and GE the other 10% etc. [just as an example]

12. [Patrick Honohan](#) Says:
[March 2nd, 2009 at 8:58 pm](#)

Colm, There's some discussion of recent Irish experience with Mortgage Indemnity Insurance [here](#). Looks like at least some banks were still using this to cover the additional risks of LTV over 75% or 80%. Others, no doubt, were self-insuring.

13. [Peter Oakes](#) Says:
[March 10th, 2009 at 11:07 pm](#)

Patrick Honohan Says "I listened to the interview with Regulatory Consultant Peter Oakes on Morning Ireland today and he ducked a question on the architecture of the Canadian model — possibly as puzzled as we are."

Ok, this Peter Oakes of Compliance Ireland. I appreciate that Patrick is not having a dig at me. However let me: (a) answer his observation regarding the issue of ducking a question; and (b) throw some more light on the topic.

On Morning Ireland (see <http://www.complianceireland.com/Press.html> for links to download recent press coverage) I in fact made the point that the structure of the two systems is not totally dissimilar, and then went onto say that the one thing that makes the Canadian system different to ours is that its regulator has an obligation to initiate an immediate response when a threat to financial stability arises. I then went onto say that our Irish Central Bank did make statements about problems on the horizon (as far back as 2004 but nothing was done by the Financial Regulator.

This is not ducking the question. I answered it head-on. I was very glad to hear John Hurely, Governor of the Central Bank, make the same point today (10/03/2009) before the Oireachtas Committee on Economic Regulatory Affairs. Watching RTE tonight I saw and heard Mr Hurley pretty much say oh well we made the warnings, but the banks didn't listen, so we better fix the regulations to make sure that they pay attention next time. I nearly fell off my chair! It is a complete nonsense for any central bank to hold that position. Irish laws/regulations do not wholesale and radical reform, but those who administer our laws/regulations do if this is the mindset.

It is hard to find evidence of willpower at the Financial Regulator. But the same criticism applies against the Irish Central

Bank. Now the last time I looked at the Central Bank Acts, there was ample power to address the scenario of the Central Bank stating that an iceberg lays dead-ahead and the Financial Regulator keeping course towards it. If the Central Bank was concerned that the Financial Regulator was not doing its job properly (which is my inference) then it was incumbent upon the Central Bank to fiercely lobby the Minister to do the very thing which the Financial Regulator appeared not to do - i.e. enforce appropriate bank conduct so as to ensure financial stability. Better still, the Central Bank, like a disgruntled director should have made public criticism of its 'co-director' to the stakeholders (i.e. us, the public) and the chairman (i.e. Brian Lenihan) to use a crude 'plc' analogy. Who cares if one government agency is embarrassed by another if the outcome is to protect the public? Folks, I am an Australian (and an Irishman). But Australia is where I spent my formative years and where it was drilled into me to 'call a spade a spade'! So forgive my frankness.

Now here are my legal reasons for the above points:

(i) "The Bank also has the following objectives: (a) contributing to the stability of the financial system" see 7 of the 2003 CBFSAI Act.

(ii) Section 33C of the Central Bank Act (inserted by CBFSAI Act 2003) states "If any matter relating to the financial stability of the State's financial system arises in connection with the performance or exercise by the Regulatory Authority of its functions or powers, that Authority shall consult the Governor on that matter. Where the Regulatory Authority considers it prudent in the circumstances it may send a report to the Minister on any matter to which this subsection relates."

So it seems to me that there are powers in place for all relevant parties to protect the public interest – even if they could be tweaked in hindsight. But unfortunately you cannot legislate against a lack of character quality in those who administer the laws/regulations.

I do agree that I did duck one question asked of me on Morning Ireland. That dealt with criticising the Financial Regulator, in particular Patrick Neary. I answered that question by saying (a) the Oireachtas didn't get the regulatory result it desired despite having a (satisfactory) set of laws in place; (b) that other regulators got it wrong; and (c) no jobs for life for public servants in terms of being appointed to top regulatory roles – but rather we should have appointees appointed on a per term basis. I don't believe that my answers were a ringing endorsement of the Financial Regulator or Central Bank though! But equally I have no intention of throwing to the wolves lower level regulatory staff who (i) in their hearts know that what their superiors did was arguably negligent, (ii) want to do better, (iii) are capable of doing more, and (iv) will do more, if an independent non-entrenched (i.e. Irish bank/financial services operative) is appointed to lead them and most importantly engender a new way forward.

Yet from my experience of working in Ireland, I do not hold out much hope for the right appointment.

I have worked as a lawyer and regulator in Australia and the UK. I trained as lawyer in Australia and worked for the ASIC, before worked for a straight-talking judge. I moved to London, re-qualified in the UK and worked with the FSA before jumping ship into the world of those who manage and structure investments and CDOs. I then moved to Ireland, qualified as a lawyer here and worked for an Irish firm (owned by Americans). These experiences led me to conclude that I could do more as an independent consultant than working for a financial institution simply towing the corporate line. But I am no anti-capitalist – I am a non-executive director of large investment company and advise many others. This experience, across many different regulatory systems, has taught me that regulatory architecture is not the sole foundation of a good financial system. Rather what is important is that those whom we trust to supervise the system are of the right calibre, have the tenacity and the willpower to serve the public interest in the face of adversity from financial heavyweights and lax regulatory colleagues. Using a building analogy – it is hardly ever the case that a building collapses because of poor design/architecture, but rather does so because of a lack of building skills and quality material.

All the best.

Peter Oakes
Compliance Ireland
<http://www.complianceireland.com/PBProfile.html>

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