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From: Duncan Munn

To: Canada's Financial System Regulators

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Re: **Toward a Real-Time Framework for Bank Supervision**

Much ink has been spilled over the past few weeks regarding the turmoil in the banking industry following the collapse of Silicon Valley Bank. Now, another regional bank, First Republic Bank has failed after $100 billion of deposits went out the door.

Canadians must maintain a watchful eye. Disorder in US regional banks represents a potential macroeconomic risk to which we are not immune. We all continue to watch our policymakers and regulators for lessons learned and the course ahead. The C.D. Howe Institute has offered comments on the cause of the SVB failure, six early lessons, along with an examination of the future of deposit insurance and on the continued importance of competition.

It will be tempting to impose new regulations on smaller financial institutions, from bail-in debt (also known as AT1 debt or Coco bonds), to capital requirements, or more stringent stress testing or recovery guidance. The US experience teaches us that while smaller institutions themselves may not be systemic, collectively they might be, so there is a certain logic and impetus for more regulation.

But there are other approaches, including improvements in supervision that are needed and might help ward off any heavier regulation need. Put simply, supervision must evolve in the face of increased velocity. With the digitization of the sector and the real-time movement of information – or disinformation – events can develop and overtake an institution at lightning speed. A bank run is just a click of the mouse away as the SVB collapse demonstrated.

Supervision must keep pace. In today's rapidly changing financial landscape, real-time data analysis is essential for supervisory authorities to rapidly identify potential sources of stress.

Implementing advanced data collection and analysis tools that can provide regulators with real-time insights into the financial health of small institutions. By leveraging cutting-edge technologies such as machine learning and artificial intelligence, supervisors can more swiftly analyze vast amounts of data from a variety of sources, including balance sheets, transaction records, and customer feedback, to identify potential risks and vulnerabilities.

This real-time approach to data analysis can help supervisors detect emerging patterns and trends that may indicate potential stress or instability. For example, sudden spikes or collapses in customer activity, or an explosion of negative online chatter, could represent early warning signs that require regulators to be alert and dig deeper. Banking is a game of confidence and anything that materially shakes it is worth attention.

Traditional monitoring activities are episodic and represent point-in-time analysis. This is insufficient today, and supervisors must adopt a more real-time approach.

After the SVB collapse, Canada's Office of the Superintendent of Financial Institutions (OFSI) did just that. The Superintendent moved quickly to daily monitoring of the liquidity positions of regulated financial institutions. This is precisely the sort of real-time data collection and analysis required. OFSI deserves credit for taking a step in this direction. On April 1 it also published updated guidelines on liquidity adequacy requirements, which included an outline of maximum time lags under normal conditions during which liquidity must be reported, leaving OSFI power to accelerate reporting where circumstances warrant. Canada's Big Six systemically important banks must maintain operational capacity to report a variety of liquidity measures monthly, weekly or daily when under stress conditions, and other institutions weekly under stress scenarios.

All of this is positive but a full movement to real-time monitoring at the federal and provincial level is needed. In addition to the advanced data collection and regulators' analytical tools, a real-time posture would see institutions efficiently update key data to regulators on a nightly basis. This is not without its burdens to institutions, but it could foster collaborative efforts to comply. By helping regulatory bodies better monitor data trends in real time, supervisors have the opportunity to address an issue and prevent a larger crisis. Such a result might obviate calls for tighter capital regulation or other costly regulatory burdens.

Canadian consumers have a stake as well. More capital in the system, as opposed to sitting on financial institution balance sheets, increases economic activity. If our smaller institutions are forced to hold more capital, it might hurt competition and economic dynamism. Improved real-time monitoring and supervision can help maintain a careful balance between stability and efficiency.

There is one important caveat. An early warning system is meaningless without the fortitude of supervisors to act when needed. This failure to act was certainly a feature of the SVB collapse where the significant asset-liability mismatch was obvious.

The recent turmoil in the banking industry has many features, but its breathtaking speed makes one thing clear: Monitoring and supervision need to keep pace. As the entire financial system is moving towards a more real-time posture, (payments and clearing come to mind), supervisors must have the same mindset.

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