Intelligence MEMOS

From: Mark Zelmer

To: Policymakers in Ottawa

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Re: **ENHANCING PUBLIC ACCOUNTABILITY FOR PRUDENTIAL SUPERVISION**

Canadian prudential supervision, the oversight of Canada's financial institutions, has traditionally operated behind a veil of secrecy.

While the federal Office of the Superintendent of Financial Institutions (OSFI) and its provincial counterparts have published the frameworks within which they conduct prudential supervision, in practice there is scope for supervisors to exercise judgment as to how prudential requirements are applied to the specific circumstances of individual financial institutions.

Specifically, risks to those institutions and how they are managed can vary significantly from one institution to another. The need for such a veil has traditionally been defended on the grounds of the social costs that might arise if supervisory ratings were publicly disclosed as well as the commercial sensitivity of the information and the discussions supervisors have with the financial institutions they oversee.

As such, it is not unique to Canada but is also prevalent in other jurisdictions. Canada has been blessed with few failures of financial institutions in recent decades. This suggests that prudential supervision at both the federal and provincial levels has largely operated well behind this opaque veil. While this track record indicates that there is no burning need to change current arrangements, it nevertheless makes sense to ensure that Canadian supervisory practices keep pace with those of other jurisdictions.

My recent C.D. Howe Institute Commentary looks at current Canadian prudential supervision practices and considers how we can strengthen further the public accountability for those engaged in the supervision of deposit-taking institutions and insurance companies.

Improvements in this area could have the salutary benefit of reducing some of the uncertainty that currently exists in the financial community as to how prudential supervisors exercise their judgment. In turn, that would set the stage for more disciplined discussions between financial institutions and their supervisors that might help foster quicker remediation of any supervisory concerns. This Commentary begins by explaining the prudential supervisory frameworks used by OSFI and its provincial counterparts. Then, using OSFI as a case study, it delves into the current accountability arrangements surrounding prudential supervision and the accompanying economic rationales for secrecy. That sets the stage for surfacing some gaps in those arrangements and offering some recommendations for reform. The recommendations can be summarized as follows:

- While there is merit in maintaining the confidentiality of supervisory ratings and their supporting information, more details should be publicly disclosed about the supervisory process.
- Financial institutions would benefit from more detailed information on the factors underpinning their supervisory risk ratings. That could help facilitate more disciplined conversations between financial institutions and their supervisors and encourage quicker remediation of any risk-management concerns.
- The results of comparative or benchmarking supervisory reviews should be shared with all relevant financial institutions to help them improve their risk-management practices and help motivate the need for any new or updated guidelines.
- Independent reviews should be commissioned whenever there has been a failure or near failure of a financial institution. The purpose of these reviews would be to ascertain whether there has been a regulatory failure that contributed to the situation and, if so, to draw lessons on how to enhance the supervisory process.
- OSFI's public accountability could be strengthened by having the Superintendent of Financial Institutions regularly participate with the Governor of the Bank of Canada in the discussion of financial stability issues with parliamentarians.

Mark Zelmer, a senior fellow at the C.D. Howe Institute, is a former Deputy Superintendent of Financial Institutions (OSFI).

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