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The Canadian Lenders Assurance Facility (Canada GFC)

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Canadian Lenders Assurance Facility[1]

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Yale Program on Financial Stability Case Study
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Abstract

Following a meeting of Group of Seven leaders in October 2008, the Canadian Minister of Finance announced the creation of a new Canadian Lenders Assurance Facility (CLAF). The facility enabled federally regulated deposit-taking financial institutions to access government insurance of up to three years on newly issued senior unsecured wholesale debt. This mirrored similar programs in other countries to ensure that Canadian financial institutions were not competitively disadvantaged in the wholesale debt market at a time when most developed countries were guaranteeing their banks' debt. This competitive disadvantage never materialized, and the facility was allowed to expire on December 31, 2009, without ever being used.

Keywords: backstop, wholesale debt, insurance

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[1] This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering the responses to the global financial crisis that pertain to bank debt guarantee programs.

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Canadian Lenders Assurance Facility

At a Glance

In early October 2008, leaders from the Group of Seven (G-7) countries met to establish a plan of action that aimed to stabilize financial markets, restore the flow of credit, and support global economic growth. In line with these goals, the Canadian Minister of Finance announced that the government would begin guaranteeing Canadian banks' medium- and long-term borrowing through a new program, the Canadian Lenders Assurance Facility (CLAF). Though CLAF emerged as a result of the G-7 meeting, the driving concern that led to the facility's creation was that similar programs in other countries would inhibit Canadian banks' ability to secure financing in international credit markets.

Fearing this "competitive disadvantage," the Minister of Finance announced CLAF on October 23, 2008. The facility allowed any federally regulated Canadian financial institution to purchase a guarantee for up to three years on newly issued debt instruments with a minimum three-month maturity. Fees for the CLAF were based on participants' credit ratings. If participating financial institutions failed to meet obligations under the terms of the guaranteed instrument, investors could immediately demand payment from the Canadian government.

Summary of Key Terms	
Purpose: To ensure that financial institutions in Canada are not put at a competitive disadvantage when raising funds in wholesale markets to lend to consumers and businesses.	
Announcement Date	October 23, 2008
Operational Date	February 25, 2009
Date of First Guaranteed Debt Issuance	N/A
Issuance Window Expiration Date	Originally April 31, 2009; later extended to December 31, 2009
Program Size	No cap
Usage	Unused
Outcomes	N/A
Notable Features	Initially funded through alternative purchase commitments prior to formal legal authority; fee lowered to make CLAF more competitive

CLAF was formally opened on February 25, 2009. In January 2009, before the program took effect, the facility issuance window was extended from April 31, 2009 to December 31, 2009. It was always intended to serve as a temporary backstop and was allowed to expire on December 31, 2009. During this time, Canadian banks were successful in raising funds in international credit markets without a government guarantee, so the facility was never used.

Summary Evaluation

CLAF has not been studied or written about extensively, likely due to its lack of use. Despite this, the Canadian government has argued that its existence nonetheless supported confidence in the market.

Canadian Lenders Assurance Facility: Canada Context	
GDP (SAAR, Nominal GDP in LCU converted to USD)	$1,636.5 billion in 2007 $1,339.2 billion in 2008 *Source: Bloomberg*
GDP per capita (SAAR, Nominal GDP in LCU converted to USD)	$44,543.0 in 2007 $46,594.0 in 2008 *Source: Bloomberg*
Sovereign credit rating (5-year senior debt)	As of Q4, 2007: Fitch: AAA Moody's: Aaa S&P: AAA As of Q4, 2008: Fitch: AAA Moody's: Aaa S&P: AAA *Source: Bloomberg*
Size of banking system	$2,248.8 billion in total assets in 2007 $1,825.6 billion in total assets in 2008 *Source: Bloomberg*
Size of banking system as a percentage of GDP	137.4% in 2007 136.4% in 2008 *Source: Bloomberg*
Size of banking system as a percentage of financial system	Data not available for Canada *Source: World Bank Global Financial Development Database*
5-bank concentration of banking system	88.7% of total banking assets in 2007 92.9% of total banking assets in 2008 *Source: World Bank Global Financial Development Database*

Foreign involvement in banking system	4% of total banking assets in 2007 4% of total banking assets in 2008 *Source: World Bank Global Financial Development Database*
Government ownership of banking system	0% of banks owned by the state in 2007 0% of banks owned by the state in 2008 *Source: World Bank BRSS*
Existence of deposit insurance	Data not available for relevant time frame in Canada *Source: World bank Deposit Insurance Dataset*

I. Overview

Background

On October 10, 2008, finance ministers and central bank governors of the Group of Seven (G-7) met to address the global financial crisis (GFC) and to formulate a collective plan of action that would inform each country's policy response. Though Canada was weathering the GFC better than other G-7 countries, its Minister of Finance, in a statement following the G-7 meeting, expressed concern that interventions abroad could affect Canadian markets. As a result, he announced that "the Government stands ready to take appropriate action to avoid unintended consequences from policy measures by other countries that would put wholesale borrowing in Canada at a competitive disadvantage." (Government of Canada 2008b). At the time of the announcement, programs to backstop the wholesale debt market existed in multiple countries, including the United States, Australia, and Sweden (Carmichael 2008). Although Canadian financial institutions were still able to access wholesale funding at this time, authorities worried that the demand for non-guaranteed debt might dry up, given the widespread use of government guarantees for bank debt elsewhere.

Program Description

In an effort to proactively avoid Canadian banks' being disadvantaged in international wholesale debt markets, the government of Canada announced the Canadian Lenders Assurance Facility (CLAF) on October 23, 2008. The facility, which was voluntary, allowed Canadian banks to access insurance for up to three years on newly issued wholesale debt instruments. Participation was limited to federally regulated deposit-taking institutions, which were automatically deemed eligible up to a specified participation limit determined by their maturing wholesale debt or deposits. This limit was used to determine a minimum issuance size per instrument eligible for guarantee. The government charged a guarantee fee based on the institution's credit rating. Insurance was available for debt instruments denominated in Canadian dollars, US dollars, euros, pounds sterling, or Japanese yen, but any insurance issued on non-Canadian-dollar-denominated debt incurred an additional fee. Payment to investors by the Canadian government was triggered by any missed payment of a guaranteed obligation, at which point investors were required to give notice to the Department of Finance in writing. CLAF was designed to be temporary, and initially insurance was only to be issued through April 2009 (Department of Finance Canada 2008a).

In its 2009 budget, the Canadian Department of Finance announced a new stimulus plan, the Canadian Economic Action Plan (CAEP). This included the Extraordinary Financing Framework (EFF), which budgeted up to $200 billion to support lending to households and businesses.[3] The newly created CLAF was absorbed into the EFF as part of the government's larger stimulus efforts. At this time, the Department of Finance also announced that CLAF's issuance window would be extended through the end of 2009 (Department of Finance Canada 2009a). In March 2009, the Canadian Parliament passed the Budget Implementation Act 2009, which allowed the Minister of Finance to make payments under the terms of CLAF out of the Consolidated Revenue Fund (Parliament of Canada 2009). Previously, any payments made to investors were required to be made through alternative purchase commitments (Canadian Lenders Assurance Facility Guarantee – Section 3.5).

[3] All dollar amounts in this case study are referring to Canadian dollars, unless specified otherwise.

Outcomes

CLAF was allowed to expire on December 31, 2009. It was never used. In closing the facility, the Canadian government cited improved conditions in funding markets and Canadian banks' ability to access debt financing without government insurance (Department of Finance Canada 2009b).

II. Key Design Decisions

1. The CLAF was part of a broader package of crisis response measures, called the Canadian Extraordinary Financing Framework.

The CLAF was one component of the broader $200 billion Canadian EFF, which sought to "strengthen the capacity of Canadian financial institutions to expand credit and to respond to gaps in credit markets." Other programs in the EFF included the Insured Mortgage Purchase Program, in which the government expressed intent to buy National Housing Act Mortgage-Backed Securities, the Canadian Secured Credit Facility, which the government could use to purchase up to $12 billion of term asset-backed securities backed by loans and leases on vehicles and equipment, and other budgetary increases to expand access to financing for Canadian businesses (Department of Finance Canada 2009a).

2. The CLAF was initially funded by alternative purchase commitments pending the passage of the Budget Implementation Act 2009 by Parliament.

When the CLAF was first announced, the Canadian Parliament had not yet authorized the Minister of Finance to make payments under the guarantee from the Consolidated Revenue Fund, as required by sections 26 and 29(1) of the Financial Administration Act. However, Canadian authorities believed that they possessed existing authority to purchase guaranteed instruments. To ensure that payments could be made even if the facility opened before Parliament had acted, the legal documentation of the CLAF included a provision allowing payments through alternative purchase commitments. Through these commitments, if an investor made a demand for payment under the guarantee, the Minister of Finance would purchase from the investor "all or an undivided interest in the related Guaranteed Instrument… for a purchase price equal to the amount required to be paid under the Demand" (Canadian Lenders Assurance Facility Participation Agreement).

The need for alternative purchase commitments under the terms of CLAF was rendered obsolete by the passage of Bill C-10, "an Act to implement certain provisions of the budget tabled in Parliament on January 27, 2009 and related fiscal measures" (Parliament of Canada 2009). This act, which was passed on March 12, 2009, amended the Financial Administration Act to allow the Minister of Finance to guarantee any debt, obligation, or financial asset in an effort to promote financial stability, and to pay any amounts owed resulting from such a guarantee out of the Consolidated Revenue Fund (Parliament of Canada 2009).

3. There was no cap on the amount CLAF could guarantee.

The Canadian government did not establish a cap for the amount of guarantees that could be issued through CLAF. CLAF was part of the larger Extraordinary Financing Framework, which was granted $200 billion under Canada's Economic Action Plan, but there was no amount specifically allocated for CLAF (Department of Finance Canada 2009a).

4. Only federally regulated deposit-taking institutions were automatically eligible, while provincially regulated institutions had to be approved.

All federally regulated deposit-taking financial institutions were deemed eligible for participation in the facility. Any provincially regulated financial institution had to be specifically approved by the Minister of Finance (Department of Finance Canada 2008d). One provincially regulated central cooperative credit society, Caisse Centrale Desjardins, did apply and was deemed eligible shortly after CLAF was announced. As part of the deal reached with the Minister of Finance for Quebec, Caisse Centrale Desjardins could participate under the same commercial terms as the federally regulated institutions, but the Government of Quebec would be liable for any losses incurred by the Canadian government as a result of issuing any insurance on the bank's debt (Government of Canada 2008a).

Regardless of eligibility, any financial institution wishing to access CLAF had to apply to participate. The application's focus was on establishing the maximum amount of instruments issued by an institution that could be guaranteed through the facility (Department of Finance Canada 2008d).

Once a financial institution's application was granted and its participation limit established, it was required to apply for a separate guarantee certificate for each eligible instrument it sought to guarantee. Once the guarantee certificate was granted, the institution had to issue the instrument within 30 days, otherwise the guarantee would be withdrawn (Department of Finance Canada 2008d)

5. CLAF could guarantee new senior unsecured marketable wholesale debt instruments and had to adhere to certain minimum issuance requirements based on participation limits and currency denomination.

Under the terms of the CLAF, the government agreed to guarantee new senior unsecured marketable wholesale debt instruments, including newly issued commercial paper, bearer notes and senior unsecured bonds and notes, and Bankers Acceptances (Department of Finance Canada 2008d).

The government also set a minimum issue size for instruments, which was tied to the maximum participation limit established by the financial institution's application to CLAF and the currency denomination of the instrument, as outlined in Figure 1 (Department of Finance Canada 2008d).

Figure 1: CLAF Participation Limits and Minimum Issuance Size, by Currency of Instrument

Currency of Instrument	**Institution's Approved Participation Limit**	**Minimum Issuance Size per Instrument**
Canadian dollar	≥ $10 billion	$10 million
	$5 billion – $10 billion	$5 million
	< $5 billion	$1 million
US dollar, euro, pound sterling, Japanese yen	All	$10 million

Source: Department of Finance Canada, Terms of Canadian Lenders Assurance Facility.

6. Eligible instruments had to have maturities of at least three months, and the guarantee lasted for a maximum of three years.

Instruments were eligible for guarantee only if they had a minimum three-month maturity. Instruments were guaranteed through their maturity, unless they had a maturity of more than three years, in which case the guarantee covered only the first three years (Department of Finance Canada 2008d).

7. Guarantees were restricted to instruments denominated in Canadian dollars, US dollars, euros, pounds sterling, and Japanese yen.

The Canadian government permitted guarantees of instruments issued in Canadian dollars, US dollars, euros, pounds sterling, and Japanese yen. However, instruments issued in eligible currencies other than Canadian dollars were subject to additional requirements. No matter the institution's participation limit, the minimum issuance size for instruments denominated in these currencies was set at $10 million. Additionally, any institution applying for insurance on instruments issued in a currency other than Canadian dollars were charged a 20 bps surcharge (Department of Finance Canada 2008d).

8. Institutions' maximum allowed amount was either (i) 125% of wholesale debt maturing during the six months beginning November 1, 2008, or (ii) 20% of Canadian deposits as of October 31, 2008.

These limits all had to be approved by an outside auditor.

9. The government charged a risk-based guarantee fee that varied by credit rating.

For all institutions, the base pricing of the guarantee fee was the product of 110 bps, the term of the guarantee, and the gross proceeds of the instrument. This base pricing was augmented based on the institution's credit rating.

Institutions with senior unsecured medium-term debt obligations that had a set minimum credit rating from at least two rating agencies paid the base price (see Figure 2).

Figure 2: Minimum Credit Ratings for Senior Unsecured Medium-Term Debt Obligations

DBRS	Moody's	Standard & Poor's	Fitch
A low	A3	A–	A–

Source: Department of Finance Canada, Terms of Canadian Lenders Assurance Facility.

Those institutions that did not have credit ratings from two agencies that met these standards were required to pay an additional 25 bps fee. As stated, additional fees were charged for instruments issued in currencies other than Canadian dollars (Department of Finance Canada 2008d).

This guarantee fee calculation reflects a change introduced in early November 2008, shortly after the program was announced. At that time, the government sought to make CLAF more competitive by reducing the base commercial pricing by 25 bps and waiving an across the

board 25 bps surcharge. This had the effect of lowering the base price to 110 bps from 160 bps. The surcharge for institutions unable to meet the credit rating requirement and for debt issued in foreign currency remained in effect (Parappally 2008).

The calculation of guarantee fees under CLAF reflected the government's desire to offer guarantees to lenders on commercial terms, which would not result in any fiscal cost to the government (Department of Finance Canada 2008c). This was consistent with the government's desire that the EFF, of which the CLAF was one component, generate a positive return and not result in any losses for the Canadian government (Department of Finance Canada 2009a).

10. There do not appear to have been any further conditions for participation.

Program documents contained no other references to conditions for participation.

11. Payment was triggered by an institution's failure to pay a guaranteed obligation and the investor's written demand submitted to the Department of Finance.

Under the terms of the guarantee, the government agreed to pay any investor in the event that an issuer participating in CLAF failed to pay any guaranteed obligation under the terms of the instrument guaranteed by the program (Schedule 1.1(16), Canadian Lenders Assurance Facility Guarantee, Article 2). The payment was triggered by the investor's demand of payment under CLAF made in writing to the Department of Finance (Canadian Lenders Assurance Facility Participation Agreement). This "timely payment" replaced the initial proposal by the government for a 30-day waiting period between the demand and payment to investors (Cotnoir et al. 2009).

12. The issuance window closed on December 31, 2009, after being extended from April 30, 2009.

Originally, the government would only accept guarantee applications until April 30, 2009. In January 2009, the terms of the CLAF were amended to extend this deadline to December 31, 2009 (Department of Finance Canada 2009a). The Minister of Finance had the authority to terminate the facility before this deadline with 30 days' notice, but the facility was allowed to expire at the end of 2009 (Department of Finance Canada 2008d).

III. Evaluation

Since the CLAF was not used, it has not been evaluated in secondary scholarship. In the 2010 budget for Canada's Economic Action Plan, the Canadian government argued that though the CLAF was never used, it "helped to support market confidence and contain borrowing spreads for Canadian financial institutions" (Department of Finance Canada 2010).

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V. Key Program Documents

Summary of Program

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Media Stories

Ottawa to Guarantee Interbank Lending (Globe and Mail – 10/23/2008) – *Globe and Mail story on CLAF.* https://ypfsresourcelibrary.blob.core.windows.net/fcic/YPFS/Ottawa_to_guarantee_interbank_lending.pdf.

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