



Healthy Canadian Banks

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Nicolas Schmitt, economics professor at Vancouver's Simon Fraser University, shows that, thanks to their national regulator, Canadian banks operate in a way that has protected them from the crisis.

The Canadian financial market is a bit like the country: low-key and a little boring. Today, it is the envy of the rest of the world. Its biggest bank, the Royal Bank of Canada, is now the 11th biggest bank in the world by market capitalization. Its market capitalization is about three times that of Citigroup and 30 percent higher than that of UBS or Credit Suisse. There are now three Canadian banks among the 30 largest in market capitalization in the world. Obviously, this is due to the fact that their American, English and Swiss counterparts' capitalization has melted away like snow in the sunshine. Of course, the Canadian banks' profits have dropped considerably, but they remain positive. Why is the Canadian financial system considered the most solid in the world at the present time?

The answer is simple: It's the result of a government that did not allow itself to be influenced by the banks and of a regulator that remained conservative [with a small "C"]. The Canadian financial regulator has the reputation of being the most conservative among its American and European equivalents. For example, Canadian banks must hold Tier 1 capital of 7 percent of their assets (weighted by risk) and bank indebtedness may not exceed 20 times capital. The Canadian regulator is also attentive to the quality of bank capital, in particular with respect to the proportion of ordinary shares. In Switzerland, a financial regulator and an

independent surveillance authority (Finma) have just been born and new rules introduced. However, the big banks' level of indebtedness is significantly more than 30 times their capital.

The second difference is in the treatment of bank mergers. As in several developed countries, Canadian banks have wanted to merge and form a few global banks to better participate in the global growth of financial markets. The Canadian government has always rejected these mergers. As elsewhere, it had to weigh up the advantages connected with greater size and presence at an international level against the costs related to a reduction of competition in the domestic market. In 1998, the Canadian Competition Bureau clearly indicated that such mergers would decrease competition for several financial products (portfolio management, credit cards, loans etc.) in a significant number of submarkets. Consequently, it indicated what disinvestments by merger participants would be necessary to compensate for those reductions in competition. The banks quickly understood that the requirements were such that, by merging, they would risk losing an important advantage in the domestic market for an uncertain share of the international financial market.

At that time, the merger that formed the present UBS was taking place and other global banks were forming, as in the Netherlands, for example. The result is that in 2007, UBS total assets represented 480 percent of Swiss GDP and Credit Suisse's assets 286 percent, the number one and number three in this global classification according to the OECD (an Icelandic bank pacing between UBS and Credit Suisse), while the total assets of the largest Canadian bank represented only 40 percent of Canadian GDP. The size of the big Swiss banks and the economic concentration in that sector have become such that, in its 2009 report on Switzerland, the IMF worried about the authorities' intervention and surveillance abilities in that domain.

These differences are critical because the Canadian financial regulator and the country's merger policy have led Canadian banks to adopt a more traditional and less risky model than that adopted by the big Swiss banks. That may be observed, for example, in the fact that the Swiss interbank market (loans and borrowings between banks) is nine times greater than in Canada. Not only are the consequences for the banks not the same when the market freezes up, as it did in 2008, but, above all, that shows that

Canadian banks depend far more than do their Swiss counterparts on traditional and stable sources of funds, such as individuals' deposits. Moreover, a bank hesitates more to form units specializing in financial tools that only a few experts master when it must remain relatively small and debt free. And even if it wanted to hire such specialists, how could it attract them, when global banks snatch them up for a fortune? So then, it's not very surprising that Canadian banks should have stayed largely outside those markets.

Today, the Canadian government is congratulating itself on its choices. For Switzerland, the consequences are altogether different, since, additionally, many financial institutions that intend to keep a reasonable size to better benefit from the advantages of the Swiss financial center must be beginning to ask themselves what shall become of them. For the race to attain a global size is a factor that today gives other countries levers of influence to modify the banking secrecy situation.

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