



Ottawa to guarantee interbank lending

KEVIN CARMICHAEL >

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Canada's government has pledged to temporarily guarantee banks' medium and longer term borrowing in a bid to keep pace with the multi-billion dollar financial rescues offered by other countries over the past couple of weeks.

Finance Minister Jim Flaherty said Thursday that he will establish the Canadian Lenders Assurance Facility, which will offer financial institutions insurance on any debt they issue with terms greater than three months.

"We are being proactive," Mr. Flaherty said at a news conference. "I've had the concern expressed directly to me, and certainly through our officials, that this potential downside could become a reality and it could happen fairly quickly."

Canada's decision to offer a backstop for interbank lending comes almost two weeks after it signed a pledge by Group of Seven nations to work together to restore confidence in the global financial system. At least a dozen other countries have already offered some form of backstop for the wholesale debt market, including the United States, Australia and most recently Sweden.

The worry in Ottawa was that all these rescue packages would make it more difficult for Canada's banks to secure money abroad. While there's little evidence that this is happening now, the risk is that international lenders will opt to do business with counterparties that are backed by their government's treasuries. That could force Canadian banks to offer higher yields, an extra cost that would eventually be absorbed by consumers and businesses.

"This is a proactive step," Mr. Flaherty told reporters. "There is this concern that our institutions could be disadvantaged competitively."

Canada's government has had to do less than other nations to salvage the financial system because the countries banks are relatively sound. Institutions such as Royal Bank of Canada largely avoided the frenzy for the now toxic assets linked to U.S. subprime mortgage market, and stronger regulations forced banks to keep plenty of cash in reserve.

Mr. Flaherty repeated Thursday that Canada's banks are "sound."

The government didn't attach a cost to the program. With international credit markets calmer, there's a chance the program won't be used. At the same time, if conditions worsen, the government could potentially be responsible for billions of dollars worth of loans.

When asked to further define Canada's potential liability, Mr. Flaherty said "zero to a lot."

Canada's response to the credit crisis is modest compared with programs in the U.S. and Europe, where governments have used billions of taxpayers' funds to take stakes in financial institutions and guarantee all deposits.

Mr. Flaherty suggested Thursday that he feels he's done enough for now, saying Canada's banks are well capitalized and that he's satisfied with Canada's current guarantee on deposits of up to \$100,000.

Bank of Canada governor Mark Carney endorsed Mr. Flaherty's insurance plan, calling the program "sensible."

Mr. Carney, who spoke at a separate press conference in Ottawa, also backed Mr. Flaherty's assertion that no further measures are needed to support Canada's banks at this time.

Taking a question on whether Canada should buy stakes in banks, Mr. Carney said the reason countries such as the U.S. are injecting liquidity into their banks is to bring capital ratios up to Canadian standards. "We're already at the finish line," Mr. Carney said.

Two weeks ago, Mr. Flaherty set up a program that will allow Canadian financial institutions to swap up to \$25-billion of mortgages in return for cash to bolster their balance sheets.

The insurance program will start early next month, and remain in place until April 30, 2009. All federally regulated deposit-taking institutions are eligible to apply for insurance on each issuance of debt with terms longer than three months.

The Canadian Bankers Association said it welcomed the move.

"Canada's banks are well capitalized and financially sound, with or without this federal government loan insurance," said its head, Nancy Hughes Anthony.

"Governments around the world have guaranteed loans between banks and our federal government has recognized that, without a similar move in Canada, our strong banks could find it more difficult to compete for loans on the international market, which ultimately could affect borrowing for consumers and businesses."

- With files from Tara Perkins

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351 King Street East, Suite 1600, Toronto, ON Canada, M5A 0N1

Phillip Crawley, Publisher

