



Department of Finance
Canada Ministère des Finances
Canada



Deposit Insurance Review

Consultation Paper

September 16, 2016

Canada

Invitation for Comments

Written comments should be forwarded by November 30, 2016,
to: DepositInsuranceReview-ExamenDuCadreDAssuranceDepots@canada.ca.

In order to add to the transparency of the consultation process, the Department of Finance Canada may make public some or all of the responses received or may provide summaries in its public documents. Therefore, parties making submissions are asked to clearly indicate the name of the individual or the organization that should be identified as having made the submission.

In order to respect privacy and confidentiality, when providing your submission please advise whether you:

- consent to the disclosure of your submission in whole or in part;
- request that your identity and any personal identifiers be removed prior to publication
- wish any portions of your submission to be kept confidential (if so, clearly identify the confidential portions).

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1. Introduction

Deposit insurance protects depositors' savings in the unlikely event that a deposit-taking institution (for example, a bank) fails. Deposit insurance is a key element of the financial safety net – it contributes to maintaining public confidence in the financial system and promotes financial stability.

The Canadian financial system was resilient during the 2008 financial crisis and modifications to the deposit insurance framework were not needed to maintain confidence in the financial sector. Since the crisis, the global banking landscape has changed significantly, including the introduction of financial regulatory reforms aimed at reducing the probability of a future financial crisis. For this reason, Budget 2014 announced the launch of a comprehensive review of Canada's deposit insurance framework to ensure that it provides adequate protection for the savings of Canadians.

Three broad policy objectives guide the deposit insurance review:

- **Protect depositors** - The deposit insurance framework should protect depositors by ensuring that it provides an adequate scope and level of coverage.
- **Support financial stability** - The deposit insurance framework should contribute to the stability of the financial system in Canada and act as a disincentive for bank runs to develop.
- **Promote efficient and competitive financial services** - The deposit insurance framework should encourage market discipline and should not act as an impediment to competition.

The Government is seeking views on possible improvements to the deposit insurance framework and will actively engage with stakeholders.

2. The Deposit Insurance Framework

Canada's deposit insurance framework is administered by the Canada Deposit Insurance Corporation (CDIC), which was established in 1967 by the *Canada Deposit Insurance Corporation Act*. CDIC's objectives are to:

- provide insurance against the loss of part or all of deposits;
- promote and otherwise contribute to the stability of the financial system in Canada;
- act for the benefit of depositors while minimizing loss.

CDIC membership is comprised of banks, federally incorporated trust and loan companies, federal credit unions, provincially incorporated trust and loan companies, and cooperative retail associations. CDIC currently has 80 members. CDIC is funded by premiums paid by member institutions and does not receive public funds to operate.

Canada's deposit insurance coverage framework consists of three main elements:

- The coverage limit;
- The seven coverage categories; and
- The scope of eligible deposits.

Figure 1: Canada's Deposit Insurance Coverage Framework

CDIC Coverage Limit Maximum of \$100,000

Extends to **Eligible Deposits** held in CDIC member institutions **in each** of the following seven categories:

- Deposits held in one name (individual)
- Deposits held in more than one name (joint deposits)
- Deposits held in trust for another person
- Deposits in Registered Retirement Savings Plans
- Deposits in Registered Retirement Income Funds
- Deposits in Tax Free Savings Accounts
- Deposits held in mortgage tax accounts

Eligible Deposits are (only if payable in Canada in Canadian Currency):

- Savings and chequing accounts
- Guaranteed Investment Certificates (GICs) and other term deposits of five years or less
- Money orders, travellers' cheques and bank drafts issued by CDIC members and cheques certified by CDIC members
- Debentures issued by loan companies that are CDIC members

The Canadian deposit insurance framework applies equally to personal and corporate deposits. The deposit insurance coverage provided under the framework extends to eligible deposits up to a maximum of CAD \$100,000 for deposits held in a CDIC member institution in each of the seven categories. This means that by holding deposits in more than one category, and with more than one CDIC member institution, depositors are able to access coverage above \$100,000. The deposit insurance limit of \$100,000 was raised to its current level in 2005. It had previously been a \$60,000 limit which had been in place since 1983.

Only eligible deposit products are covered in each of the seven categories. Investment products that do not fall within the definition of eligible deposits would not be covered by CDIC. For example, a 4-year term deposit held within a Registered Retirement Savings Plan would be covered, while 10-year term deposit would not. In order for coverage to apply, deposits must be eligible deposits, payable in Canada, in Canadian currency.

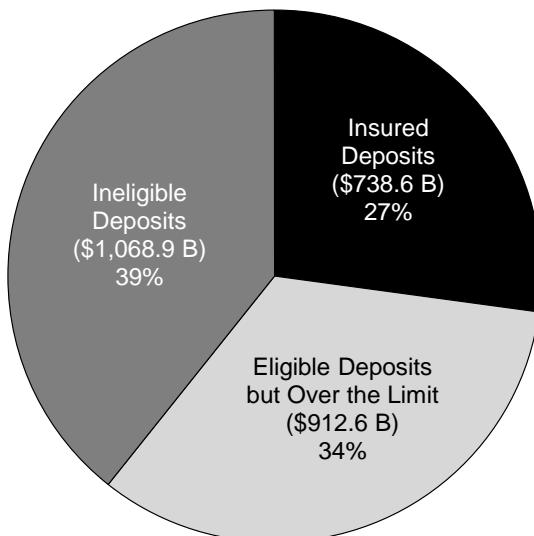
Deposits in Canada have been steadily increasing over time. As of April 30, 2016, total deposit liabilities held at CDIC members totaled \$2.72 trillion; a 51% increase since 2011. Approximately 97% of all eligible deposit accounts are fully covered under the current framework. In terms of total dollars deposited, 27% of the total value of deposits held by CDIC member institutions is covered.

The coverage framework has three broad classes of deposits, not all of which are protected by deposit insurance:

- **Insured deposits** - Deposits that are fully covered under the coverage framework.
- **Deposits eligible for insurance but over the limit** - Deposits that are eligible for protection under the coverage framework, but in amounts greater than the \$100,000 deposit insurance limit. Amounts of the deposit above the limit are not insured.

- **Ineligible deposits** - Deposits held by a CDIC member institution that are ineligible for insurance include: deposits payable in a foreign currency; deposits payable outside Canada; deposits payable to the Government of Canada; and deposits with a term of more than five years.

Deposit Liabilities Held with CDIC Member Institutions as of April 2016



3. Canadian Deposit Insurance Landscape

Analysis undertaken for the deposit insurance review, including analysis of data from CDIC member institutions, has helped to determine how well the deposit insurance regime is meeting the needs of Canadians. The findings suggest that deposit insurance coverage is largely functioning well and meeting its primary objectives. The current framework:

- **Provides sufficient coverage for the savings of Canadians.** Approximately 97% of all eligible deposit accounts are fully covered under the current framework.
- **Supports depositor confidence and financial stability.** CDIC surveys indicate depositor confidence in the safety of Canada's banking system remains high (80 %). In addition, there have been no member failures since 1996 and no evidence of bank runs.
- **Promotes efficient and competitive financial services.** Deposit insurance coverage is provided to all eligible deposits in the same manner at every CDIC member institution.

The review indicates that major changes to the framework are not required and that the current \$100,000 limit remains appropriate. The analysis undertaken for the review indicates that raising the deposit insurance limit would not enhance protection to the savings of the vast majority of individuals in Canada, whose deposit accounts are currently covered under the framework. In line with international best practices, Canada's framework covers the large majority of depositors but leaves a substantial amount of deposits exposed to the possibility of loss in the event of a bank failure. Therefore, uncovered depositors have an interest in the risk management practices of the member institution.

Increasing the limit would provide a proportionally higher benefit to corporate depositors, while increasing CDIC exposure which would need to be offset through additional premiums paid by CDIC member institutions. This would not further the objectives of deposit insurance, and could shift the existing balance between financial stability and market discipline, contrary to international best practices.

However, the Government has identified some areas of potential improvement to the framework and some areas that merit further consideration, which are the focus of these consultations.

4. Policy Questions

The deposit insurance framework should adequately reflect the nature of the products offered by CDIC members. To ensure that Canada's deposit insurance system remains relevant, products covered by the deposit insurance framework are being reviewed to reflect the evolving marketplace in the Canadian financial sector. Any increase in the scope of the framework would result in a proportionate increase in CDIC exposure, which would need to be offset through additional premiums paid by CDIC member institutions, thereby potentially affecting the cost of financial services.

The Government is seeking views on possible improvements to the deposit insurance framework set out below. These enhancements fall into three broad categories: streamlining deposit categories; updating the scope of eligible deposits; and addressing the complexity of trust deposits.

Questions have been provided below to facilitate these consultations.

4.1 Streamlining Deposit Categories

Mortgage Tax Deposits

A mortgage tax account (sometimes called an escrow account) can be set up by a mortgage lender to pay certain property-related expenses on a borrower's behalf, like property taxes or homeowner's insurance.

Deposits held in mortgage tax accounts are an insured deposit category. Based on data from April 2014, there are 2.2 million mortgage tax accounts at CDIC member institutions. Of this, 99.99% of the personal deposit accounts contain less than \$10,000. Mortgage tax accounts containing over \$100,000 have decreased by 95.6% from 2010 to 2014. The number of depositors using mortgage tax accounts has also decreased by 16.7% from 2010 to 2014.

Issues for Consultation

Given the declining use of mortgage tax accounts, mortgage tax deposits may no longer warrant their own separate category of deposit insurance. In order to keep the deposit insurance framework current, the Government is considering removing mortgage tax accounts as a separate insured category of deposit. Funds held in mortgage tax accounts could still receive coverage under another coverage category (e.g., as an individual or joint deposit) as long as it is held as an eligible deposit.

What are your views on removing the mortgage tax account as a deposit category?

Registered Products

Deposit insurance categories have evolved over time, typically in response to the introduction of new deposit products, including new registered tax-advantaged products. Currently, eligible deposits in certain registered products (Registered Retirement Savings Plans (RRSPs), Registered Retirement Income Funds (RRIFs), and Tax-Free Savings Accounts (TFSAs)) receive separate coverage under the framework, while eligible deposits held in other types of registered plans (Registered Education Savings Plans (RESPs) and Registered Disability Savings Plans (RDSPs)) are covered under the trusts or individual coverage category.

RESPs

Education savings plans have existed as a financial product since the early 1960s, but in 1972 the Government of Canada allowed them to be registered as tax-advantaged savings vehicles in the form of RESPs. There is no annual contribution limit and the lifetime contribution limit is \$50,000 for each beneficiary. Savings in an RESP can be held in a variety of forms (e.g. savings deposits, Guaranteed Investment Certificates, and mutual funds).

RESPs may be structured as a trust. If the plan assets are held by a trustee, eligible deposits receive coverage under the trusts deposit category. Eligible deposits held in RESPs that are not structured as trusts are protected under the individual coverage category.

RDSPs

Implemented in December 2008, the Canada Disability Savings Program helps increase the long-term financial security of people with disabilities. The program is comprised of three components: the RDSP; the Canada Disability Savings Grant; and the Canada Disability Savings Bond. There is no annual RDSP contribution limit but there is a maximum lifetime contribution limit of \$200,000. Savings in an RDSP can be held in a variety of forms (e.g. savings deposits, Guaranteed Investment Certificates, and mutual funds).

RDSPs are required by the *Income Tax Act* to be structured as a trust. Eligible deposits held in RDSPs therefore receive coverage under the trust deposit category.

Issues for Consultation

RESPs and RDSPs do not currently receive the same coverage as other registered products. The Government is considering the addition of two new deposit categories for RESPs and RDSPs. This approach would ensure that every registered product would be equally covered up to the same \$100,000 limit.

As an alternative, all registered products could be amalgamated into one deposit category (RRSPs, RRIFs, TFSAs, RESPs, and RDSPs), with a higher insurance limit. However, such a change would add an element of complexity, as it would introduce multiple limits to the deposit insurance framework (one for registered products, another for all other categories).

What are your views on adding RESPs and RDSPs as new deposit categories or the amalgamation of all registered products into one deposit category?

4.2 Updating the Scope of Eligible Deposits

Travellers' Cheques

Travellers' cheques are an alternative to cash and are marketed as a safe way to carry funds for travel. Travellers' cheques are issued in a specific currency. They are typically short-term products, without market based interest rates or a defined maturity. They are not designed as long-term or large-sum investment products.

Travellers' cheques issued in Canadian dollars, by CDIC member institutions, are eligible for deposit insurance. CDIC member institutions no longer issue travellers' cheques. Instead, member institutions offer third party travellers' cheques, which are not covered by deposit insurance.

Issues for Consultation

Given that CDIC member institutions no longer issue travellers' cheques, the Government is considering modernizing the deposit insurance framework by removing travellers' cheques as an eligible deposit.

What are your views on removing travellers' cheques as eligible deposits?

Products with Terms Greater than Five Years

Term deposits and Guaranteed Investment Certificates (GICs) are cash investments held at financial institutions for an agreed rate of interest over a fixed term. Depositors can only withdraw term deposits after the term has ended or by giving a predetermined number of days' notice. Depositors closing a term deposit before the end of the term will lose interest on the principal.

Term deposits with original terms to maturity of five years or less are eligible for CDIC insurance. When term deposits were initially insured, deposits with maturity terms greater than 5 years were not commonly used. In recent years, term deposits with periods longer than 5 years have been introduced to the retail market, particularly for inclusion in RRSPs. As at the first quarter of 2016, personal depositors held \$2.88 billion in term deposits greater than 5 years at CDIC member institutions, four times the amount held in 2005.

Issues for Consultation

In order to better reflect today's marketplace, the Government is considering the removal of the current qualification that only deposits with terms of five years or less are eligible for coverage.

What are your views on extending deposit insurance coverage to term deposits with terms of maturity greater than five years?

Should there be a maximum term?

Foreign Currency Deposits

Deposits held in currencies other than the Canadian dollar are ineligible for coverage under the current deposit insurance framework. In 2014, a survey of Canadian households done by CDIC indicated that a significant growing portion of households and small and medium-sized enterprises indicated they held U.S. dollar (USD) accounts. CDIC members hold approximately \$148 billion CAD worth of various foreign currencies in Canadian branches, of which \$141 billion (95%) is held in USD. The addition of foreign currency as an eligible deposit would represent a significant increase in CDIC exposure.

Issues for Consultation

Given that foreign currency deposits are widely held in Canada, the Government is considering the addition of foreign currency as an eligible deposit. To reduce the complexity in the case that CDIC has to make a payout, any funds paid out to depositors holding eligible foreign currency accounts could be paid in Canadian dollars.

What are your views on the inclusion of foreign currency as an eligible deposit?

Should only certain foreign currencies be insured? If so, which currencies should be covered and why?

Temporary High Balances

Temporary high balances could include large lump sum payments such as those received from an inheritance, an insurance payout, a divorce settlement or the proceeds from the sale of private property. The intent of temporary high balance deposit coverage is to protect depositors from a bank failure occurring as they transition through major life events. Accordingly, it would apply to natural persons only. This would be a departure from the Canadian deposit insurance framework, which it is not designed to differentiate personal depositors from corporate depositors.

Extending deposit insurance coverage to temporary high balances would create additional exposure and introduce new elements of complexity into the deposit insurance framework. The level of covered deposits would fluctuate based on factors such as the state of the housing market or volume of inheritance transfers. These factors are difficult to measure and charge the appropriate premium to CDIC members in advance. While the premiums could be charged *ex post*, applying such a funding model would be a departure from the current deposit insurance framework. It would also be inconsistent with deposit insurance best practices, as it passes the costs of a bank failure to surviving institutions or the public. There would also be difficulties in verifying the eligibility of deposits for the additional temporary high balance coverage, which could delay the timing of payout.

Issues for Consultation

The creation of temporary high balance coverage in Canada would add complexity to the deposit insurance framework and increase CDIC exposure. The funds necessary to cover temporary high balances under deposit insurance could likely only be collected after a bank failure, which is inconsistent with best practice and the stability objective of the deposit insurance review. Despite significant implementation challenges, the Government is seeking stakeholder views on coverage for temporary high balances.

What are your views on extending deposit insurance coverage to include temporary high balances?

If you would like to see coverage extended to temporary high balances, which transactions would you propose be covered (e.g., real estate, insurance settlement, inheritance)? How would these transactions be identified? What would be the appropriate definition of “temporary” (e.g. 45 days, 90 days, 180 days)?

4.3 Addressing the Complexity of Trusts

In addition to the coverage issues presented above, the Government is seeking views on how to address the complexity of trusts, in particular, how to address brokered deposits and improve the disclosure of beneficiary information.

A trust is a relationship whereby property is held in trust by one party (trustee depositor) for the benefit of another (beneficiary). Trusts are complex and can take a variety of forms. Some examples of trusts are RESPs, RDSPs, professional trust accounts (e.g., lawyers, real estate brokers), brokered deposits, and charitable trusts. Trusts vary from being regulated in form, such as RESPs or RDSPs, to having no set form, such as charitable trusts. Some types of deposits can be made either as a trust or as a personal account, such as RESPs or brokered deposits.

Trusts have been a deposit insurance category since 1977. The fact that the account is a trust must be disclosed on the records of the member institution for the deposit to be covered separately from personal deposits of the beneficiary and those of the depositor. As each trust is treated separately for the purposes of coverage, a beneficiary may be covered up to \$100,000 for more than one trust account.¹ If a trust has multiple beneficiaries, and the disclosure requirements are met, each beneficiary will receive separate coverage of up to \$100,000.

Disclosure Requirements for Trustees

Trustees are required, before the date that a member institution fails, to disclose the following information for inclusion in the member institution’s records:

- That the account is a trust;
- The name and address of the trustee/co-trustee depositors;

¹ However, if CDIC determines that the trust was established solely for the benefit of obtaining deposit insurance coverage, this coverage can be revoked.

- Whether the trust account is held for single or multiple beneficiaries;
- The name and address of the beneficiary/beneficiaries; and,
- In the case of multiple beneficiaries, the amount or percentage of beneficial interest of each beneficiary within 30 days after April 30 each year.

If this information on record changes, the trustee has to provide updated information within 20 days after the member institution fails.

Professional Trust Exclusion

CDIC by-laws allow certain listed professionals to provide an alpha numeric identifier in lieu of providing beneficiary information, which must correspond to an up to date record held by the trustee containing the same beneficiary information required by the by-laws. Examples of professionals to whom the exemption is available are lawyers; public trustees; federal, provincial, or municipal governments; and regulated federal or provincial trust companies.

Disclosure Requirements for Member Institutions

Member institutions are required to provide to CDIC the following information with regards to trusts:

- That the account is a trust;
- The identity of the trustee depositor; and,
- Whether the trust account is held for single or multiple beneficiaries.

The member institution is not obligated to report to CDIC on beneficiary information such as names and addresses or the percentage interest of each beneficiary, and unless a member institution fails, CDIC does not possess any beneficiary information.

Issues for Consultation

Beneficiary Information

Beneficiary information is the basis for the determination of separate deposit insurance coverage of trust deposits. In order for CDIC to be able to quickly and accurately pay out deposit insurance, they need to have ready access to beneficiary information.

Insufficient or incorrect beneficiary information may result in a reduction in coverage available to beneficiaries. For example, if the required beneficiary information is not submitted, an amount in trust held for multiple beneficiaries may be subject to a single \$100,000 coverage limit, rather than \$100,000 per beneficiary as otherwise permitted. Currently, trustees are not required to provide beneficiary information on a regular basis, and CDIC member institutions are not required to provide any beneficiary information they have to CDIC. CDIC member institutions are also not required to provide this information in a prescribed form (i.e. electronic format). This could compromise payout to beneficiaries in the event of a member institution failure.

Given the importance of beneficiary information, the Government is seeking views on how to improve the quality of beneficiary information available to CDIC.

Brokered Deposits

In this context, a particular issue arises with respect to brokered deposits. A deposit broker is an individual who receives funds from an investor and, acting as an intermediary, conveys these funds to a deposit-taking institution for investment. Deposit brokers can deposit funds either as an agent (in which case the account is in their client's name) or in their own name in a trust for their client. Brokered deposits receive coverage differently depending on the approach the broker chooses.

If the deposit broker acts as agent, the amount is considered part of the client's \$100,000 limit in the individual category of deposit insurance. If the deposit broker acts as a trustee, the amount is considered a trust for the beneficiary and may be insured separately in the trusts category. In the trust form, the client is a beneficiary, and coverage is dependent on the provision of accurate beneficiary information by the trustee to the member institution before the institution fails (as deposit brokers must comply with the same disclosure requirements as other trustee depositors). However, brokers may be reluctant to provide client information to CDIC member institutions who are potential competitors.

Depositor protection is a key policy objective of the deposit insurance review and in order to protect depositors, accurate beneficiary information must be available to CDIC. The current framework does not support this key objective of the deposit insurance review. Therefore the Government is seeking views on how to ensure beneficiaries of brokered trustee deposits retain their coverage, through improved disclosure of beneficiary information. This includes considering whether brokered trustee deposits should have tailored disclosure requirements to facilitate the provision of client information.

In your view, how can the quality of beneficiary information be improved?

In your view, how should brokered deposits be treated under the deposit insurance framework?

Are beneficiaries aware of the consequences of their broker not providing beneficiary information?

Are the reporting and record keeping requirements for professional trusts clear?