Ottawa, November 14 2016

Financial Systems Division
Financial Sector Policy Branch
Department of Finance Canada
90 Elgin Street
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Object: Review of the deposit insurance regime

The Public Interest Advocacy Centre and Option consommateurs are grateful for the opportunity to provide comments regarding the review of Canada's federal deposit insurance regime. While we agree with the Department of Finance that the current framework is a key element of consumers' financial safety net and is generally adequate, we also agree that it may be improved in order to better protect depositors, support financial stability and promote efficient and competitive markets. We suggest that the current framework may be unduly rigid and that, in the near future, further discussion should be fostered in order to make it more flexible and adaptable to rapidly evolving markets.

The stakeholders

The Public Interest Advocacy Centre ("PIAC") is a non-profit organisation based in Ottawa that provides legal and research services on behalf of consumer interests concerning the provision of important public services. Its primary concern goes to consumers, and especially vulnerable consumers, but we seek to understand the ecosystem as a whole. PIAC has been interested in payment and other issues related to financial services issues for many years. Individuals associated with PIAC are currently members of FinPay and of the Canadian Payments Association's Stakeholder Advisory Council.

Option consommateurs is a Montréal-based non-profit consumer organisation founded in 1983 that provides direct services to consumers through activities such as budget counselling, in addition to research and advocacy work. It has been keenly interested in issues related to financial services since 1990 and has participated actively in numerous consultations, including the process which led to the 2001 legislative review of the financial sector and the implementation of consumer protection provisions[1] in the *Bank Act* at the time the Financial Consumer Agency of Canada was created.

Our comments are intended as specific observations regarding some of the issues raised by the Consultation Paper[2] and are generally presented in the order used in the Paper. We also address some matters not discussed in the Paper. We provide in the Appendix synthetic answers to some of the specific questions proposed in the Paper.

Of course, the fact that we have not commented at this point on any issue raised in the Paper should not be construed as meaning either agreement or disagreement with any position on such issue.

We hereby consent to the disclosure or posting of our comments online or otherwise by the Department of Finance, provided of course that the source is identified.

The landscape

Two aspects of the landscape are in our view insufficiently developed in the Paper. First and while it is noted that the value of insured deposits has "been steadily increasing over time" (p. 7), the Paper does not discuss a problem that is both important and relevant to the development of public policy in this area: generally speaking, Canadian consumers' savings are at or near their lowest point in years. In the second quarter of 2016, the household saving rate was 4.1%[3]; the national saving rate has plummeted, going from 4.1% in the first quarter of 2015 to 0.8% in the second quarter of 2016[4]. Policy measures that, even indirectly, sustain household savings are likely to be economically helpful and improve households' financial health, and measures addressed at low-risk saving instruments are likely to be especially important for lower-income households, which generally could not afford and do not invest in higher-yield, but higher-risk vehicles. The relevance to public policy governing insurance deposit is therefore obvious.

In addition and while it may still seem to be a small-scale phenomenon, we would be remiss if we did not call attention to the emergence of new providers and new mechanisms offered to consumers so that they can keep their funds where they are both reasonably available, and, hopefully, reasonably safe. The Paper underlines that the promotion of efficient and competitive financial services is a broad policy objective guiding this review (p. 6). In that context, the emergence of new types of providers and products should be assessed much more attentively than it is.

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1 In particular, Option consommateurs played a crucial role in the adoption of legislative provisions regarding access to basic banking.

2 Department of Finance Canada. *Deposit Insurance Review – Consultation Paper*. Ottawa, Department of Finance, September 16 2016. 15 p. Available at https://www.fin.gc.ca/activty/consult/dir-ecad-eng.pdf (hereinafter the "Paper").

3 Statistics Canada. *Table 380-0072 – Current and capital accounts – Households*. Ottawa, Statistics Canada, August 30 2016. Consulted at http://www5.statcan.gc.ca/cansim/pick-choisir?lang=eng&p2=33&id=3800072.

4 Statistics Canada. *The Daily – Gross domestic product, income and expenditure, second quarter 2016*. Ottawa, Statistics Canada, August 31 2016. Table 5 Consulted at http://www.statcan.gc.ca/daily-quotidien/160831/t005a-eng.htm .

Of course, this raises complex issues; in particular, the fact that deposit insurance is currently only available for products offered by the fairly narrow classes of institutions admissible as members of the Canada Deposit Insurance Corporation ("CDIC") has sustained the deposit insurance regime's resiliency and relative affordability, but it may in the future provide those members with a competitive advantage that would be increasingly unfair, while leaving consumers who maintain funds with other providers offering comparable services without protection.

This question therefore goes to the basic architecture of the deposit insurance regime and, more broadly, of the whole financial sector's regulatory framework: should the basis for coverage be institutional, as it currently is, or should it be functional, so that a given type of financial service or product would be covered, notwithstanding the identity of the provider? We suggest that the latter solution would provide a regulatory regime that would be simpler, fairer and more conducive to innovation; we do not underestimate the complexity of the legal and policy-related issues this suggestion raises, and we acknowledge these issues are significantly broader than the ones discussed in the Paper. However, we suggest both that they should be fully assessed in the near future, and that they should already be kept in mind in the context of the discussion of the questions raised in the Paper.

Streamlining categories

We now turn to the discussion of coverage categories. As to these issues, we are concerned with potential collateral effects of the proposed elimination of the mortgage tax deposit account category and generally support more flexibility regarding registered products.

While the declining use of mortgage tax deposit accounts may appear to justify the abolition of that specific deposit category, as argued in the Paper, we are somewhat concerned with the impact it may have on some consumers. Having an account dedicated to property-related taxes and other expenses may well help a number of consumers to keep control of their monthly budget, ensure they can pay those essential expenses and avoid overdraft fees if, for instance, taxes were to be in the future drawn by preauthorised debit from the household's multi-purpose chequing account at a moment where that account is insufficiently funded. Before it eliminates a tool that may simplify and secure consumer budgeting, if only for a limited number of households, we recommend that the Department analyze how mortgage tax deposit accounts are currently used, and by whom, at a more "micro" level and ensure at the very least that CDIC members will continue to offer their customers distinct accounts dedicated to paying property-related taxes, even if such accounts no longer enjoy a specific coverage category.

Regarding registered products, we incline to the view that new deposit categories should indeed be added. We also believe having separate categories for different products, each with the same coverage limit, would simplify consumers' understanding of the regime.

More broadly, however, we note the rigidity of the current regime. Insured product categories are defined in the Schedule to the *Canada Deposit Insurance Corporation Act*[5].

[5] R.S.C., c. C-3.

As a result, any adaptation of the regime to a quickly-evolving market requires a legislative modification. While we are aware such a significant change exceeds the purview of the current review, we query whether the system might not be made significantly more flexible, and more able to adapt to increasingly competitive and changing markets, if matters such as the coverage categories could in the future be adapted through Orders-in-Council or CDIC by-laws, for instance.

Updating the scope

Six questions are raised in this section of the Paper, which we will touch upon briefly; we will, however, add another issue, which we believe will be of increasing importance.

Travellers' cheques

It is proposed that travellers' cheques would no longer be eligible for deposit insurance, as "CDIC member institutions no longer issue" such instruments (p. 11). The implication of the latter statement is that even American Express travellers' cheques offered in Canada are not issued by Amex Bank of Canada, which may come as a surprise to many consumers[6].

As a practical matter, travellers' cheques have become a substitute for access to a current account (and debit transactions) and should therefore arguably be insured. The problem is that the insurance deposit regime is based on an institutional framework and on the liability of the issuing institution, while the average consumer obtains an instrument such as a traveller's cheque from a CDIC member and is most likely unaware that membership is insufficient to make all instruments the member offers insurable. We therefore deplore that such financial products as travellers' cheques are currently uninsured in Canada and that consumers are not more clearly made aware of the risk they run when obtaining a "safe" product from their own financial institution.

The decision to remove travellers' cheques as eligible deposits raises another issue: it assumes that CDIC members will not decide to issue again such products in the future; if they did, those instruments would not be covered by deposit insurance until the regime is modified again to re-include them as eligible deposits[7]. We therefore see no merit in removing them from coverage at this point.

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[6] We note in passing that financial institutions' websites tend not to provide much information regarding the identity of American Express travellers' cheques' issuer or their insurability: see for instance http://www.rbcroyalbank.com/products/deposits/travelers-cheques.html,; TD's and BMO's websites are (very) slightly more informative, although we strongly suspect that the average consumer would not understand the subtleties in the information provided: see https://www.tdcanadatrust.com/products-services/banking/foreign-currency-services/taking-a-trip/trip.jsp and https://www.bmo.com/home/personal/banking/everyday/travel-services/travellers-cheques.

[7] For instance, Canadian financial institutions might conceivably decide in the future to issue and offer to customers MasterCard or Visa travellers cheques. It is our understanding that, in the United States, travelers' checks (as they are spelled south of the border) are still defined as insurable deposits by the Federal Deposit Insurance Corporation: see below, note 16.

Extended maturity

It is suggested that the maturity of eligible term deposits could be extended beyond the current period of five years. The Paper notes that there is an increasing volume of longer-term products. Given in particular that this trend contributes to a higher and more stable level of household savings, we support the extension of coverage to terms of maturity greater than five years. Whether there should be a maximum term from the perspective of deposit insurance leads to a very simple question: what would be the purpose of a term? Insofar as the concern is to avoid insuring "pure" investment products, the relevant criteria would probably be the risk associated with the product and its yield, rather than the term itself; these issues are unlikely to arise regarding the types of products concerned here. We would also question why, say, a ten-year term deposit would not be insurable while a consumer could have kept the same sum, fully insured, in her chequing account over the same period; is the fact that she may have received a slightly higher yield on her term deposit reason enough to justify not insuring the same funds? We think not. Insofar as we are concerned with supporting savings habits and there are only marginal risk and yield differences[8] between term deposits and demand deposits, we see no policy rationale for capping the maturity of insurable term deposits and similar instruments.

Foreign currency deposits

We note that Canada's population is increasingly diverse, that Canadians are increasingly traveling both for leisure and business purposes and that our economy is increasingly globalized. We therefore see no obvious rationale, from a deposit insurance policy perspective, to exclude coverage of foreign currency deposits, and very good reasons to expand coverage in order to protect consumers. According to data in the Paper (pp. 7, 12), foreign deposits currently represent 5.4% of insured deposits – but the Paper provides no data as to the proportion of these foreign deposits which would actually be insurable, which we suspect would be significantly lower[9]. The risk associated with adding foreign currency deposits to insurance coverage should therefore be quite manageable for the system[10].

Given their importance (p. 12), it seems obvious that deposits in United States dollars should benefit from this extension of coverage. Arguably, other currencies included by the International Monetary Fund in the basket used to establish the value of Special drawing rights could also be added with minimal risk[11]. We suggest that CDIC members

[8] For instance, as of October 31st 2016, RBC's High interest eSavings account offers an interest rate of 0.550%, while the same bank's Rate Advantage guaranteed income certificate offers a tiered rate that grows from 0.750% in the first year to 2.75% in the fifth. The yield difference does not adequately compensate for the risk associated with losing the capital should the bank become insolvent.

[9] We hypothesize that a non-trivial proportion of foreign deposits are held by corporate customers, and especially large corporates, in amounts far exceeding the $100 000 threshold; if so, the value of insurable deposits in foreign currency would not equal the value of foreign deposits.

[10] As the Paper acknowledges (p. 7), total deposit liabilities have increased by 51% since 2011, which implies that the liability attached to eligible deposits has probably grown by approximately 10% per year. A one-year increase of, most likely, less than 5% should therefore not be unmanageable.

[11] These currencies are the United States dollar, the euro, the renminbi, the yen and the British pound: see for instance International Monetary Fund. *Special Drawing Right SDR*. Washington, International

could also be authorized to offer insurable deposits in other currencies provided that, if it is established this raises higher risk, such members would pay a special premium to CDIC to compensate for that risk. We acknowledge this suggestion implies meaningful modifications to the way differential premiums are currently established, but it would also allow for competition in providing a broader range of safe services to Canadians while putting members, which are best equipped to do so, in the position of assessing the risk-benefit ratio associated with offering insured deposits in a specific currency.

Temporary high balances

While the coverage maximum limit of $100 000 remains adequate for most Canadians in most situations, there can be specific circumstances where even consumers with limited savings will suddenly come in possession of significant assets. Such situations will become increasingly frequent as baby boomers' children and grand-children have to manage inheritances. Consumers cannot always plan for these occurrences and certain circumstances, such as psychological distress or legal impediments, may prevent them from immediately moving these assets into fully insured financial products. There is therefore a sound policy rationale for insuring temporary high balances.

The Paper discusses two objections to such a measure: additional risk and exposure, and increased administrative difficulties. We suggest both objections can be overcome. First and regarding the level of risk, additional insured balances would likely represent a fairly small proportion of total insured liabilities and, instead of trying to measure precisely real risk on an ongoing basis, we incline to believe that actuarial methods could provide CDIC and members with sufficient data to modulate premiums as required on an ongoing basis; any *ex post* adjustment, if required, would therefore be minimal.

As for the administrative challenge of verifying the eligibility of deposits in case of member insolvency, immediate payout of the basic indemnity ($100 000) should not raise any problem, and depositors claiming reimbursement of an additional high balance should be able to demonstrate fairly easily that they had sold a house, or come into an inheritance, a short time before a member's insolvency; such a process would admittedly delay somewhat the reimbursement of the additional balance, but we surmise consumers would be happy to wait a few additional weeks if that is the price for recovering an additional $200 000 or half a million and if the process, and the rationale for it, are clearly explained to them.

We suggest that temporary high balances resulting from inheritances, insurance settlements and real estate should be covered. They would be identified *ex post* as depositors present a claim with appropriate justification. The definition of "temporary" may vary according to the type of transaction: a real estate transaction is predictable and usually does not cause undue stress, so a consumer should be able to redirect funds within (say) sixty days, while an inheritance may be encumbered by legal difficulties and cause distress, justifying a longer period during which a temporary high balance would remain insured. Further investigation directed at CDIC members and legal professionals in this field could support the determination of the most apposite period in cases of inheritance and estate management.

Monetary Fund, September 30 2016. Consulted at http://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR.

Issues surrounding trusts and brokered deposits

The Paper implicitly raises three issues regarding the management of insurable trusts: assessing the total value of insurable deposits held by a member when a trust is held for multiple beneficiaries (hence risk and, potentially, premium to be paid by that member), ensuring that all beneficiaries will be fully compensated and ensuring that they will be compensated quickly. The Paper seems to propose improvements to the quality of beneficiary information available to CDIC as the best avenue to address those issues. We would respectfully caution CDIC to be careful what it wishes for.

It is a trite principle of personal information that one should not collect more information than is necessary for accomplishing a given purpose[12]. In order to assess insurable liabilities and premiums of a member, all CDIC needs to know about a trust (or similar device) is that there are beneficiaries with a total exposure of a given amount[13]. For those purposes, the exception allowing certain professionals not to disclose beneficiaries' identities even to their financial institution should actually be broadened to all trustees or similar service providers. This mechanism provides CDIC with the data it needs, while limiting the circulation of personal information.

It is only when a member becomes insolvent and CDIC is required to distribute funds that the identity of beneficiaries may become relevant to CDIC, assuming distribution cannot be done through the trustees themselves or other intermediaries. At that point, and at that point only, the acquisition of additional personal information becomes necessary.

An approach based on increasing the disclosure and circulation of personal information would increase all participants' administrative burden, would significantly increase security and other issues related to personal information protection and would contravene personal information protection principles and, arguably, applicable legislation[14]. While it may seem to be the simplest and most obvious solution, it may well in fact be a perilous and inefficient way to address the issues that are raised in the Paper. We would therefore recommend to the Department and CDIC that they seek solutions that would actually minimize risks to personal information, rather than increase them.

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[12] See for instance the *Guidelines on the Protection of Privacy and Transborder Flows of Personal Data* adopted in 1980 (and updated in 2013) by the Organisation for Economic Cooperation and Development, at https://www.oecd.org/sti/ieconomy/oecdguidelinesontheprotectionofprivacyandtransborderflowsofpersonaldata.htm.

[13] Assuming for instance ten million dollars in deposits held in one trust, all CDIC needs to know is that there are for instance twenty depositors with individual balances of $50 000 and nine depositors with individual balances of one million dollars; insured deposits would therefore amount to $1 900 000, which is all the information CDIC needs to assess risk and premium and requires no data directly relatable to any individual.

[14] We query in particular how CDIC would comply with sections 5 and 6 of the *Privacy Act*, R.S.C., c. P-21, which require *inter alia* that an institution collect information directly from the individual to whom it relates, that it informs such person of the collection's purpose and that it ensure information is up-to-date, provisions which we understand apply to CDIC..

Stored value instruments

We finally regret that the Paper does not address issues raised by stored value instruments, including prepaid cards. Option consommateurs, for instance, regularly receives enquiries and complaints from consumers who have lost funds kept in such instruments, and had already canvassed some of the issues associated with them in a 2008 research paper[15].

We acknowledge that in cases where Canadian consumers lost funds related to such instruments, the issuers were not CDIC members. To that extent, the issues related to the protection of those funds exceed the range of this review and will also have to be addressed in the context of the current review of the Federal framework for retail payments. However, CDIC members do currently issue stored value instruments and are likely to do so increasingly often in the future, hence the relevance of discussing these issues here.

We note that in the United States, the Federal Deposit Insurance Corporation issued in 2008 a revised General Counsel's opinion that confirmed the insurability of "all funds underlying stored value cards and other nontraditional access mechanisms" [16], provided some requirements were met. While we would dispute the details of some of those requirements, we believe FDIC is fundamentally right when it opines

> "that the funds underlying stored value cards and other modern access mechanisms are no different, in substance, than the funds underlying traditional access mechanisms such as checks, official checks, traveler's checks and money orders" [17].

Yet in Canada CDIC members are quite clear that prepaid cards they issue are not insured by CDIC[18].

In effect, our policy is now nearly a decade behind the United States', with potential detriment to innovation and competition, as new forms of access mechanisms are deemed

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[15] Vinet, Jean-François. *La protection des consommateurs utilisant des cartes de paiement prépayées: un instrument laisse aux forces du marché*. Montréal, Option consommateurs, June 2008. 101 p. Available at http://option-consommateurs.org/documents/principal/fr/File/rapports/services_financiers/oc_ic_cartes_prepayees_200806.pdf.

[16] Federal Deposit Insurance Corporation. *Insurability of Funds Underlying Stored Value Cards and Other Nontraditional Access Mechanisms*. New General Counsel's Opinion No. 8. Washington, Federal Deposit Insurance Corporation, October 31 2008. Published in Federal Register, vol. 73, No. 220, November 13, 2008, p. 67155 and consulted at https://www.gpo.gov/fdsys/pkg/FR-2008-11-13/pdf/E8-26867.pdf.

[17] *Ibid*., subsection "Deposits".

[18] See for instance RBC Royal Bank. *Royal Bank® Standard Visa Prepaid Incentive Card Agreement*. Montréal, Royal Bank of Canada, March 2012. 2 p. Section "Your rights and duties", subsection "Using your card", (d). Consulted at http://www.rbcroyalbank.com/corpprepaid/_assets-custom/documents/English-Agreement-03-2012.pdf.

uninsurable, and to consumers who may not realize that products they obtain from CDIC members are in fact uninsured[19].

In conclusion

We believe the Canadian insurance deposit regime should become more encompassing and more flexible, in order to better adapt to evolving markets and provide broader protection to consumers.

Of course, we look forward to further discussions with the Department regarding these issues and will be happy to answer any questions the Department may have.

Sincerely yours,

John Lawford,
Executive Director,
Public Interest Advocacy Centre

Maryse Guénette,
Responsable, Service de recherche
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Option consommateurs

[19] In real life, disclosure through a provision such as the one mentioned in footnote 17 is unlikely to be effective, as consumers generally do not read, and would be hard put to analyze, such documents.

Appendix

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

Mortgage tax accounts are useful to some categories of consumers and the category should not be removed without carefully assessing the impact on those consumers and the offer of adequate products and services to those consumers.

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

We support the addition of new deposit categories, rather than amalgamation, and suggest that the regulatory framework should be made more flexible so that new categories can be added or modified as required by Order-in-Council or By-law, rather than by legislative modification.

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

We do not believe travellers' cheques should be removed as a type of eligible deposits and question whether consumers are currently aware that travellers' cheques they obtain from CDIC members are not insured products.

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?

We support the extension of coverage to deposits with terms of maturity greater than five years and see no rationale at this point to establish a maximum term.

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?

We support the inclusion of foreign currencies. Currencies such as those included in the International Monetary Fund's basket used to establish the value of Special drawing rights should raise no particular issue. If it is deemed that deposits in other currencies could raise more risk, members should be allowed to offer them provided their premium to CDIC is adjusted to cover such risk.

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

We support the extension of coverage to temporary high balances resulting from real estate transactions, insurance settlement and inheritance. Such transactions would be identified *ex post* by a claimant in case of member insolvency. More research is likely required to define appropriate duration of coverage, which would likely vary according to the type of transaction.