



VersaBank
Choice Through Innovation

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Financial Sector Policy Branch
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I am pleased to provide my views on potential policy measures to support a competitive and innovative Financial sector, to modernize the legislative framework and to safeguard a stable and resilient Financial sector.

By way of background, I am the founder, President & CEO of VersaBank. I developed the original concept for VersaBank in the early 90s to provide banking services to niche markets that for various reasons were not being well-served by the large banks. I used emerging information technology to create a new banking model, one that would be able to operate without an expensive branch network. At that time, this model had not been seen in Canada or in the world.

In August, 2002, pursuant to the Liberal Government's policies to encourage new entrants into the Financial Services Industry and to promote innovation and more choice for Canadians, I received the first Schedule 1 Bank licence under this new legislation. Our board, staff, shareholders and customers were all very excited about what the future held for our new Bank and the improvements we hoped to make in the lives of Canadians for whom we would be providing banking. One of our first niche markets we targeted was Canada's North. We were particularly proud to be able to provide financing for numerous Northern infrastructure projects so that our Indigenous Peoples could have more schools, hospitals, electrical power and communications.

Unfortunately for various reasons, since the liquidity crisis bank regulation seems to be at cross purposes to the previous Liberal government's policies and your newly stated policy objectives.

My proposed recommendations below would hopefully realign CDIC's and OSFI's conduct and behaviour back in line with your Department's policy objectives.

1. Banks need a formal avenue to appeal an OSFI ruling (or expectation) to facilitate timely resolution to disagreements. An appeal structure similar to that used by Ontario credit unions would likely work well.
2. OSFI should re-focus on the purpose for which it was created, i.e. OSFI Act 3.1: The purpose of this Act is to ensure that financial institutions and pension plans are regulated by an office of the Government of Canada to contribute to public confidence in the Canadian financial system. OSFI seems to have forgotten their 'raison d'être'. Domestic Systemically Important Banks (DSIBs) have doubled in size since the liquidity crisis and some small FIs have grown to the extent that they cannot fund themselves without the cooperation of the brokerage firms owned by these DSIBs. This increased dependency on the DSIBs has placed public confidence in the financial services industry in a precarious position. Home Trust's recent liquidity troubles illustrated this.
3. OSFI should set up a team of technology specialists that are capable of understanding new innovative ideas quickly, so FIs that propose new ways to reach and serve their clients are not subject to lengthy delays in executing their plans or penalized with high capital requirements and CDIC fees, while OSFI gradually becomes comfortable with the new concept. New technological ideas are arriving at an ever increasing pace and OSFI should be in a position to deal with them quickly.
4. OSFI should be strictly a rules based regulator. They have far too much latitude as a 'principle' based regulator and they tend to use this latitude to favour the DSIBs and penalize the smaller banks.
5. OSFI should not be able to institute new rules without first having them approved by an oversight committee that insures they are in line with OSFI's governing legislation.
6. OSFI's 'weighing in' into areas of a Bank's business not explicitly provided for in the governing legislation should be discontinued. OSFI, has little expertise in areas such as human resources and should not be allowed to regulate these areas.

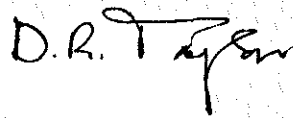
7. OSFI should have a separate division devoted to the small Canadian FIs that does not include subsidiaries of large corporations, whether they be Canadian or international. This division should be located as close to the centre of Canada as possible. Winnipeg would be ideal, as it is centrally located in Canada and is not subject to a "Bay street bias", which tends to favour big banks and corporations (both foreign and domestic) and to dismiss small FI's that are mainly located in smaller communities throughout Canada.
8. CDIC should only be allowed to charge a flat fee for deposit insurance. CDIC has no statistical basis for their 'risk' based premiums. DSIBs should pay insurance on all their deposits as they have been designated as 'too big to fail' and accordingly they will be bailed out should they get into trouble, which means that all their depositors will always be made whole. They should have to pay for this privilege. CDIC insurance on all DSIBs' deposits, would likely augment public confidence in troubled times.
9. An independent actuarial study should be conducted to determine if CDIC is appropriately funded. If there is an excess, it should be rebated to the FIs they have over charged. CDIC should focus simply on administering deposit insurance and let OSFI oversee the regulation. This would likely result in a reduction of CDIC's overheads and result in a reduction in the deposit insurance fees CDIC charges, which should be passed on to bank customers.
10. Banks' capital requirements should be ultimately determined by the 'leverage percentage'. Capital ratios based on risk weighted assets should only be used for advisory purposes. DSIB's use their own models that are based on complicated and difficult to verify math, and standardized FIs sometimes 'game the system'. For example, the present capital regime promotes risky sub prime mortgage lending (that has a risk weighting of 35%), and penalizes low risk commercial lending (that has a risk weighting of 100%). This capital regime has given rise to extraordinary growth and profits for the DSIBs, unprecedented increases in sub prime mortgage financing, and a severe reduction in small business financing.

11. Banks should be able to make passenger automobile leases. This would provide more choice for consumers and perhaps more economical financing.

12. Canadian DSIBs should have their non-Canadian operation 'financially ring fenced' so if they get into trouble they cannot burden Canadian taxpayers with their foreign problems.

Should you have any questions about these recommendations, I would be pleased to discuss them with you in person. Please do not hesitate to call me.

Yours truly,

A handwritten signature in black ink that reads "D.R. Taylor". The signature is written in a cursive style with a prominent initial "D" and a long, sweeping tail on the "y".

David R. Taylor