

September 29, 2017

Director, Financial Institutions Division, Financial Sector Policy Branch
Department of Finance Canada, James Michael Flaherty Building
90 Elgin Street, Ottawa, Ontario, K1A 0G5
fin.legislativereview-examenlegislatif.fin@canada.ca

Re: Unclaimed Balances Policy and Practice

In response to *Potential Policy Measures to Support a Strong and Growing Economy: Positioning Canada's Financial Sector for the Future* (Stage Two of the Federal Financial Sector Framework Review)

Dear Director,

We appreciate the chance to comment on the federal unclaimed balance regime.¹ We focus our comment on the holding period and on the use of unclaimed balances after the holding period. We suggest that the Department distinguish between the claim period and the holding period (as done in BC, the UK and Japan). By recognizing that most balances will remain unclaimed forever and by setting money aside only for claims actually expected, the Department can put unclaimed balances to public good immediately without shortening the claim period.

The Department's current policy does not maximize public value. The attached model estimates the net present value of all recorded² balances held at the end of 2016 by the Bank of Canada. At a 3% discount, the net present value of those balances falls far short of their value today.

We recommend investing most unclaimed balances in a wholesale impact investor. Wholesale impact investors invest in funds and other intermediaries that both earn a return and accomplish social and environmental goals. The intermediaries invest in social enterprises and other organizations that solve public problems through business models.

The UK directs England's unclaimed balances to Big Society Capital, the first wholesale impact investor and one of the core components of the UK's thriving social finance market. Japan will soon establish a wholesale impact investor financed by unclaimed balances. By investing in a wholesale investor, the Department can preserve the value of unclaimed balances, attract private capital into public priorities, and build fuller lives and stronger communities.

¹ We would like to thank Jon Faulkner for supplying data to fill the model and for offering his excellent insight on its calculations.

² As explained in the Appendix, the Bank of Canada's unclaimed balance database records \$516,265,414. The Bank holds \$678,000,000 in unclaimed balances. The gap belongs to balances too small to record or without enough information to identify their owners.

In setting the holding period's length, the Department should distinguish between a balance's claim period and its holding period.

The claim period is the length of time a balance's owner may claim the balance. The holding period is the length of time the custodian holds the balance. The Bank of Canada currently holds an unclaimed balance for the entire length of its claim period. That practice and the consultation questions appear to equate the claim period and the holding period.

Other jurisdictions do not equate the two periods. For example, BC's unclaimed property regime extends the claim period forever but, each year, donates a portion of its unclaimed property to the Vancouver Foundation.³ The fact that BC's Unclaimed Property Society no longer holds a particular sum does not extinguish the claim against that sum.

Owners can claim their balances from the UK's Reclaim Fund forever, yet every year the Reclaim Fund distributes some of its money to good causes.⁴ The Reclaim Fund has distributed £360 M to good causes since 2011.⁵ Japan passed the *Dormant Deposit Utilization Act* in December 2016. Owners will be able to claim their balances forever, but some balances will support public interest organizations.⁶ About ¥120 B (\$1.3 B) becomes dormant every year and about ¥50 B (\$550 M) is claimed, leaving a very large amount for public purposes.⁷

By differentiating between the holding period and the claim period, these jurisdictions have freed a great deal of money for public purposes without impinging on the owner's right to claim her property.

Equating the holding period and the claim period costs the public a great deal in lost opportunity.

The attached model estimates the net present value of the balances held at the end of 2016. It assumes status quo policy and practice for the next hundred years. See the Appendix for the model's details.

The Bank held \$678,000,000 in unclaimed balances at the end of 2016. The Bank's database lists \$516,265,414. The model calculates the net present value of the database's balances. The

³ BC Unclaimed Property Society. (September 18, 2017). *Frequently Asked Questions*. Retrieved from <https://unclaimedpropertybc.ca/about-bcups/faqs/>

⁴ Commission on Dormant Assets. (2017). *Tackling dormant assets: Recommendations to benefit investors and society*. Retrieved from Civil Society: <https://www.civilsociety.co.uk/uploads/assets/uploaded/efc8684a-4ba2-4e6e-96a0c2858913303d.pdf>

⁵ Reclaim Fund. (2017). *Annual Reports and Accounts 2016*. Retrieved from <https://www.reclaimfund.co.uk/financial-reports/>

⁶ Uo, M. (May 1, 2017). Japan Moves to Us Dormant Bank Accounts for Socially Beneficial Activities. *Nippon.com*. Retrieved from <http://www.nippon.com/en/currents/d00298/>

⁷ Outline of the Act on Utilization of Funds Related to Dormant Deposits to Promote Social Purpose Activities (Tenative). (n.d.). Retrieved from http://www5.cao.go.jp/kyumin_yokin/english/201704outline_e.pdf

model sums and discounts cash flows to the federal government between 2017 and 2116. The cash flows comprise expired balances and interest earned on balances invested by the Bank.

At a 3% discount and under the conditions of the last ten years, the model gives a non-inflation-adjusted net present value of \$394,610,856. Adjusted for inflation, the model gives a net present value of \$256,132,421. Even at a modest discount, the current value of unclaimed balances far exceeds their net present value.⁸

The Department should invest most unclaimed balances into a wholesale impact investor able to leverage private capital into Canada’s social and environmental goals.

The consultation paper asks what should be done with an unclaimed balance after the end of its holding period. If the Department distinguishes between the claim period and the holding period, the holding period on most balances may not last long. The Department may decide that the Bank should hold only enough to cover expected claims. The Department may then direct the remainder of the balances to public purposes.

We recommend that the Department channel the remainder into a wholesale impact investor. Wholesale impact investors invest in funds and other intermediaries that aim both to earn a return and to accomplish a social or environmental goal.

A growing number of intermediaries – such as the Chantier de l’Économie Sociale, Renewal Funds, New Market Funds, Social Enterprise Fund, The Atmospheric Fund, Resilient Capital and InvestEco – invest in impact. Renewal Funds has raised more than \$100 M to support early-stage clean technology companies.⁹ New Market Funds’ \$25 M Rent Housing Fund invested \$11 M into four Vancouver projects that will yield 358 affordable housing units.¹⁰ The Réseau d’investissement social du Québec (better known as RISQ) turned \$11 M into \$186 M total investment and 5,680 jobs created or maintained.¹¹

Big Society Capital, the first wholesale impact investor, invests England’s unclaimed balances. Big Society Capital will eventually hold £400 M in unclaimed balances and £200 M in bank

⁸ The future, of course, may not replicate the low-interest policy dominant over the last ten years. The Bank has already begun to raise the overnight rate. See the sensitivity analysis in the Appendix for net present values under alternative parameters.

⁹ Visscher, J. (January 11, 2017). Canadian investor profiles. *Corporate Knights*. Retrieved from

<http://www.corporateknights.com/channels/responsible-investing/canadian-investor-profiles-14841144/>

¹⁰ Pollon, C. (July 26, 2017). Tapping ‘Patient Capital’ to Fund Affordable Rental Housing. *The Tyee*. Retrieved from <https://thetyee.ca/News/2017/07/26/Patient-Capital-Affordable-Rental-Housing/>

¹¹ Bourdeau, R. (May 18, 2017). De grandes retombées pour un tout petit prêteur. *LaPresse.ca*. Retrieved from <http://affaires.lapresse.ca/economie/services-financiers/201705/18/01-5099158-de-grandes-retombees-pour-un-tout-petit-preteur.php>

equity investments.¹² To date, it has signed social finance deals worth \$340 M and drawn co-investment worth another \$553 M.¹³

The Real Lettings Property Fund, into which Big Society Capital invested £15 M, buys housing units and leases them to a homelessness charity. The charity rents the units to people at risk of homelessness and supports its tenants in independence.¹⁴ The Nesta Impact Investment Fund, into which Big Society Capital invested £8 M, finances social ventures. The ventures apply technology to help youth find work, elderly people age well and communities build sustainable futures.¹⁵

Japan's unclaimed balance law will direct up to ¥70 B (~\$750 M) every year into a wholesale impact investor that will both invest in intermediaries and grant to social purpose organizations.¹⁶

A Canadian wholesale investor will not look the same as a wholesale investor in the UK, Japan or any other country. But Canada can learn from efforts elsewhere. In partnership with the Global Steering Group for Impact Investing, the MaRS Centre for Impact Investing is writing a research paper that profiles the four wholesale impact investors either established or in design (Big Society Capital, Japan's investor, Portugal's Portugal Inovação Social and the EU's Social Impact Accelerator). That paper will shed light on how to design a wholesale investor to match Canada's context.

Conclusion

The unclaimed balances now in the Bank of Canada's vault have accumulated since 1944. While new balances arrived every year, the sum collected to date can only be used once. That use should reflect the source. A self-sufficient entity, charged to build a sustainable market designed to crack some of our most pressing social and environmental problems, fits the bill.

We would welcome the opportunity to discuss these ideas in more detail. Please contact Duncan Farthing-Nichol (dfarthing-nichol@marsdd.com) to learn more.

¹² Big Society Capital. (September 26, 2017). *Governance*. Retrieved from <https://www.bigsocietycapital.com/about-us/governance>

¹³ Big Society Capital. (September 22, 2017). *Key Performance Indicators*. Retrieved from <https://www.bigsocietycapital.com/about-us/key-performance-indicators>

¹⁴ Big Society Capital. (September 22, 2017). *Real Lettings Property Fund*. Retrieved from <https://www.bigsocietycapital.com/what-we-do/investor/investments/real-lettings-property-fund>

¹⁵ Big Society Capital. (September 22, 2017). *Nesta Impact Investment Fund*. Retrieved from <https://www.bigsocietycapital.com/what-we-do/investor/investments/nesta-impact-investment-fund>

¹⁶ What are Dormant Bank Accounts? (n.d.). Retrieved from http://www5.cao.go.jp/kyumin_yokin/english/201702siryoushu_e.pdf

Appendix: Model Methods

Summary

The attached model estimates the net present value of unclaimed balances held at the end of 2016 by the Bank of Canada. It assumes current policies and practices will last until 2116.

The model relies on the Bank's database. The database lists \$516,265,414 in unclaimed balances, about \$161,000,000 less than the Bank's \$678,000,000 unclaimed balance total. The \$161,000,000 gap consists of very small balances and balances without enough information to identify their owners.

As the same policies and practices apply to all balances, we expect that the model's analysis and conclusions would not change very much with a full dataset.

The database records each balance's transfer year. Knowledge of the transfer year allows the model to forecast the annual sum of expired unclaimed balances. (Expired balances enter the Consolidated Revenue Fund.) Knowledge of the transfer year also allows the model to estimate how much balance owners will claim before their balances expire. The model combines the expiry forecast and the claim estimate to trace how the 2016 sum of unclaimed balances will decline to zero between 2017 and 2116.

The Bank invests unclaimed balances as part of its global portfolio. Unclaimed balances therefore earn the same return as the global portfolio. Between 2007 and 2016, the Bank earned 2.45% gross interest on average on its global portfolio (see the 'Return' tab of the spreadsheet). Inflation averaged 1.85% over the same period.

The model estimates the return the Bank will earn each year on the declining stock of 2016 unclaimed balances. The model adds that return to each year's expired balances to give the annual cash flow to the federal government. (Each year, the Bank remits its profit to the federal government. The model assumes that all investment returns on unclaimed balances flow as profit to the federal government.)

In its final stage, the model discounts the federal government's cash flows between 2017 and 2116. At a 3% discount rate, 2.45% investment return and 30% claim rate, current policies and practices return a non-inflation-adjusted net present value of \$394,610,856. At the same parameters and a 1.85% inflation rate, current policies and practice return an inflation-adjusted net present value of \$256,132,421.

Sensitivity Chart

Discount	Parameters			Non-Inflation-Adjusted NPV	Inflation-Adjusted NPV
	Return	Claim	Inflation		
3%	2.00%	30%	1.85%	\$336,873,448	\$217,289,482
3%	3.00%	30%	1.85%	\$465,178,800	\$303,607,124
3%	4.00%	30%	1.85%	\$593,484,153	\$389,924,765
3%	2.45%	20%	1.85%	\$408,918,184	\$264,577,604
3%	2.45%	40%	1.85%	\$380,303,529	\$247,687,238
3%	2.45%	30%	1.00%	\$394,610,856	\$305,973,132
3%	2.45%	30%	2.00%	\$394,610,856	\$249,084,951
3%	2.45%	30%	3.00%	\$394,610,856	\$209,831,478

Details

Discount Rate. We pulled the discount rate from the return earned or sought by a subset of impact-first investors. Big Society Capital aims to earn between 4% and 6%.¹⁷ New Market Funds aims to return 6% to investors.¹⁸ CoPower pays 5% on its community clean energy bonds.¹⁹ The Social Enterprise Fund intends to pay investors between 5% and 6%.²⁰ The Community Forward Fund intends to pay investors 3.5% on its portfolio of loans to charities and nonprofits.²¹

All of these entities invest in exempt market organizations, some quite small. Investments in such organizations, of course, carry much greater risk than Government of Canada securities. Social finance markets do not yet offer enough public data to quantify that extra risk. To account (very roughly) for the extra risk, we set the discount rate below the expected returns listed above.

Expiry Forecast. Unclaimed balances less than \$1,000 expire 30 years after transfer to the Bank. Balances \$1,000 or more expire 100 years after transfer to the Bank. The Bank's database lists each balance's amount. The model is therefore able to calculate how much from each transfer year will expire after 30 years and how much will expire after 100 years.

¹⁷ Big Society Capital. (2017). *2016 Annual Review: Social Investment Refocused*. Retrieved from http://www.bigsocietycapital.com/sites/default/files/annual_report/BSC_AR_2016_WEB.pdf

¹⁸ Pollon, C. (July 26, 2017). Tapping 'Patient Capital' to Fund Affordable Rental Housing. *The Tyee*. Retrieved from <https://thetyee.ca/News/2017/07/26/Patient-Capital-Affordable-Rental-Housing/>

¹⁹ CoPower. (September 22, 2017). *Green Investments*. Retrieved from <https://copower.me/en/products>

²⁰ New Market Funds. (2014). *Eight Tracks: Impact Investing in Canadian Communities*. Retrieved from <http://newmarketfunds.ca/wp-content/uploads/2014/12/Eight-Tracks-Impact-Investing-in-Canadian-Communities-English-version.pdf>

²¹ New Market Funds. (2014). *Eight Tracks: Impact Investing in Canadian Communities*. Retrieved from <http://newmarketfunds.ca/wp-content/uploads/2014/12/Eight-Tracks-Impact-Investing-in-Canadian-Communities-English-version.pdf>

Before sending a year's expired balances to the Consolidated Revenue Fund, the model deducts an estimate of the amount that balance owners will claim.

Claim Estimate. In response to an emailed question, the Bank explained that owners submit most claims within eight years of a balance's transfer. To simplify, the model assumes that owners only claim balances within the first eight years after transfer. Once nine years old, the model says that a balance will stay in the Bank until it expires.

We do not know the exact rate at which balance owners claim their balances. Between 2006 and 2016, however, the Bank each year paid in claims about 26% of the money received that year from financial institutions. We suggest 30% as a high estimate of the actual claim rate. At 30%, the model estimates a 2017 claim total worth about 2.2% of all recorded balances.

Return on Investment. We derived the return on investment from data reported in the Bank's annual financial statements. From 2007 to 2016, the Bank reported total investments and total loans and receivables (which together comprise the vast majority of the Bank's assets and nearly all its financial assets). The Bank also reported gross interest revenue (defined as revenue excluding other revenue and interest expenses on deposits). The Bank earns the vast majority (if not the entirety) of its gross interest revenue from its investments and its loans and receivables.

To estimate the Bank's return on its global portfolio, we divided the gross interest revenue by the sum of investments and loans and receivables. The number may not perfectly reflect the Bank's actual return on its global portfolio, but it should approximate the true number.

Inflation Rate. We calculated average inflation between 2007 and 2016 from CANSIM Table 326-0023.

Excluded Element – Interest Paid on Claimed Balances. The Bank of Canada pays 1.5% a year on unclaimed interest-bearing savings accounts (it does not pay interest on any other unclaimed balances). It pays interest only for the first ten years after transfer. The Bank adds interest to a balance when an owner claims the balance. The model does not incorporate interest paid on claims. A small interest rate applied only to a fraction of claimed balances would play only the most minor role in a model that assumes claims end after eight years and that does not forecast balance inflows.

Excluded Element – The Bank of Canada's Operational Costs. The Bank of Canada's Unclaimed Balances team administers the unclaimed balance regime. The Bank, of course, must pay the team's costs. The model does not incorporate these operational costs (the costs would count against cash flows to the federal government). Under most alternative scenarios (including the wholesale investor scenario), the Bank will remain custodian of some balances and will continue to manage and pay all claims. Even if most balances no longer reside at the Bank, the Bank's operational costs may not change a great deal. Uncertainty as to how operational costs will change counselled in favour of simplifying the model by excluding those costs.