CCUA | ACCF
Canadian Credit Union Association
Association canadienne des coopératives financières

151 Yonge Street / rue Yonge
Suite 1000 / bureau 1000
Toronto, ON M5C 2W7
Tel: / Tél. : 416.232.3422
Fax: / Téléc : 416.797.0563

ccua.com

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Mr. Glenn Campbell
Director, Financial Institutions Division
Financial Sector Policy Branch
Department of Finance
Ottawa, Ontario

Dear Mr. Campbell,

We are pleased to provide you with the following response to the federal Government's consultation on the review of the deposit insurance policy framework.

We have developed our response, and the recommendations therein, in consultation with a group of credit union representatives who have a particular interest in the evolution of the federal deposit insurance scheme either because they are already federally regulated (i.e., League Savings, Concentra, and UNI Financial Cooperation) or are giving serious thought to the federal option. A draft of our response was also shared more widely among the Canadian Credit Union Association (CCUA's) 293 members for their comments.

Coverage

While we understand that the federal Government has decided that coverage will remain at $100,000 for the foreseeable future, a discussion in the Appendix explores what we believe are some compelling arguments for at least considering a coverage increase. Our hope is that these points may be of some use should the federal Government revisit the issue in the future. For the ensuing discussion, however, we take as given that coverage will remain at its current $100,000 level.

Mortgage Tax Accounts (Escrow)

We have no objections to eliminating this coverage category. Our members share the view expressed in the consultation document that there has been a decline in the use of these accounts.

Registered Plans

We support the creation of new deposit insurance categories for registered education savings plans (RESPs) and registered disability savings plans (RDSPs). We believe this is both fair – in that it provides equal coverage to individuals with non-trust plans – and simple in that it accords with coverage more generally.

Further, from a consumer protection perspective, we prefer this approach over a new amalgamated category out of a concern that members could confuse a registered-plan amalgamated coverage category with coverage more generally (e.g., the $100,000 available for unregistered deposits).

Travellers' Cheques

We also support the Department's proposal to remove coverage for travellers' cheques. Credit union members generally no longer use these products.

Term Deposits

The credit union system does not object to increasing coverage for deposits with maturities greater than five years provided the increase does not lead to higher premium costs. Our members tell us that there is little or no demand for this type of product.

Foreign Balances

While a number of credit unions offer US dollar accounts, that exhausts their "foreign currency" account offerings. Outside perhaps of the U.S. dollar, the credit union system does not see any pressing need for extending coverage to other foreign currency deposits, particularly if it leads to premium increases.

If coverage is extended to other currencies – and notably the U.S. dollar, we think it prudent to clearly anchor the expectation that, as the consultation document notes, payouts would be made in Canadian dollars. This is prudent from a macro-economic and premium perspective.

Temporary High Balances

Our members struggled with this proposal. On the one hand, we support the principle of providing expanded coverage to persons who find themselves with temporary windfall gains. These are precisely the individuals who may not appreciate how they can protect themselves by stacking accounts or who have the ability to monitor risks as they arise in their deposit-taking institution (we elaborate on these points in the Appendix).

On the other hand, we are concerned about the administrative burden of expanding coverage in these situations – what constitutes a windfall gain? How would member institutions know that it was a windfall gain? How long would the coverage last? How would member institutions explain this to customers? What kind of tracking and compliance regime would be required to administer this coverage from a regulator perspective? Could this proposal create confusion about coverage more generally?

Since the consultation document is silent on the extent of the problem, and given the potential administrative burden plus communication challenges, we do not support expanding this coverage. Also, assuming it is a relatively isolated problem, we would suggest that CDIC work with the Financial Consumer Agency of Canada (FCAC) to focus on ensuring that financial institutions are offering financial literacy advice and planning to individuals when these types of events occur. If it is a more widespread issue, we would suggest that a more efficient solution would be to consider a broad-based increase in coverage that meets the needs of most people experiencing these kinds of windfall gains

(within reason of course). Again, we recognize that the federal Government is not contemplating an increase in coverage but would suggest that foreclosing this possibility tends to invite administratively complex approach to addressing weaknesses with the current coverage scheme.

Trust Accounts

While we understand the policy rationale for having easy access to information for fast-payout in the event of a failure at a member institution, we are under the impression that CDIC already effectively has access to this information in the case of member institutions. Our understanding is that CDIC sends a reminder each spring to member institutions asking them to (quoting from one such reminder) "provide the names, addresses and details of the balance attributed to each beneficiary (actual amount or percentage of the entire deposit) as at April 30th." That said, and assuming our understanding is incorrect (as implied in the consultation document), we would be supportive of measures to make it a reporting requirement in some standard electronic format consistent with other CDIC information requirements.

Brokered Deposits

We would support the proposal to require brokers to provide better beneficiary information again, for the valid policy objective of ensuring fast payment and stalling any insipient run. If this were done, there would be less need to consider whether "consumers are aware" of the beneficiary issue (unlikely in our view) since CDIC would be, sufficiently, aware and payments would flow when and if required.

Conclusion

On balance, and with some exceptions, we are largely supportive of the proposed changes conditional on the assumption that the proposals to expand coverage do not lead to higher premium costs. Specifically, we support the proposed expansion in coverage for RESPs, RDSPs and term deposits greater than five years on the assumption that the higher costs are roughly offset by the proposal to remove coverage for mortgage tax accounts and traveller's cheques.

In closing, we wish to thank you for consulting with stakeholders on the future of the federal deposit insurance scheme. On behalf of credit unions across the country, CCUA is appreciative of the Government's willingness to open up a dialogue on this important policy matter. Please do not hesitate to contact me if you wish to have any follow-up discussion.

Best regards,

Marc-André Pigeon
Director, Financial Sector Policy

APPENDIX

Before addressing some of the arguments in favour of increased coverage, we begin by laying out our understanding of the rationale for keeping coverage constant.

Our Understanding of the Argument

To substantiate its argument in favour of continuing with the current coverage, the consultation document draws on the three deposit insurance policy objectives. First, from the vantage point of "protecting depositors," the consultation document notes that 97% of eligible deposit *accounts* are fully covered under the current scheme. This statistic also speaks to the second "financial stability" objective since the holders of those accounts are less likely to withdraw funds in the event of a disruption at their deposit-taking institution knowing that they will be made whole if there is a problem. CDIC points to survey data on "confidence in the banking system" and the absence of deposit runs in recent memory to suggest that the current coverage is achieving these objectives.

These policy objectives, however, are at odds with the idea that depositors are, ultimately, creditors and should behave and be treated accordingly. The consultation document resolves this tension in a way that is consistent with standard practice by indicating that those who have deposits exposed to potential losses – presumably sophisticated investors whose deposits exceed the available coverage – should "have an interest in the risk management practices of member institutions." Elsewhere, but of relevance, the consultation document notes that 27% of the dollar value of deposits are covered by the current framework and that 34% (close to $1 trillion) of deposits at member institutions are eligible but over the limits.

Finally, with respect to efficiency and competition, the consultation document draws on a "level playing field" argument and says that the current framework treats all parties in the same manner with equal coverage.

Some Critical Reflections

Assuming we have correctly understood the Government's position, we wish to offer some critical reflections again with the aim of nurturing a rich discussion in any future of the deposit insurance framework.

First, we believe there is reason to question whether "coverage of 97% deposit accounts" is the appropriate test – as implied – for determining the coverage amount by asking the obvious: why 97%? Why not some other percentage and is this the low bar, high bar or in a range? Indeed, there is reason to believe that given the effects of inflation, the percentage of eligible deposit accounts covered in full was likely higher when coverage was increased to $100,000 in 2005 and probably higher still when it increased to $60,000 in 1983 or was introduced at $20,000 in 1967. While the Department may have access to the data (via CDIC) to substantiate or invalidate this assumption, the inflation effects are clear and suggestive: the Bank of Canada's inflation calculator, for example, shows that $100,000 in 2005 is worth close to $120,000 today, that $60,000 in 1983 is worth about $131,000 and that $20,000 is worth slightly more than $141,000.[1]

Absent empirical evidence and discussion of that evidence, we have to assume that the increase to $100,000 or the past increases – which, again, plausibly (without the data) captured more than 97% of accounts – were aiming at the "appropriate" benchmarks since the changes must have been motivated by some implicit or explicit policy target. There is likely some appropriate target coverage amount – or range of coverage amounts – but it's not clear what that is from this consultation document.

[1] The calculator is available at: http://www.bankofcanada.ca/rates/related/inflation-calculator/. These figures were calculated on November 25th, 2016.

The second consideration is a behavioural one. We would suggest that given that coverage is being held constant, and given the effects of inflation, we could reasonably predict an increased tendency for deposit holders – especially sophisticated ones – to "stack" their accounts, resulting in the relative stability of the "accounts fully covered" measure.[2] Is this the desired policy outcome? Perhaps, but this point is not discussed.

This, in turn, points to the importance of deploying a "competitive balance" approach to this policy instead of the "level playing field" metaphor implicitly invoked on the efficiency/competition policy objective.[3] That is, large banks have a greater ability to offer large depositors "stacking" opportunities because they own separately chartered trust and bank subsidiaries that can effectively multiply overall coverage "in house." The result is a lower cost of funding to the banks relative to their smaller counterparts. While the obvious rejoinder might be that federal credit unions and other smaller entities could simply avail themselves of similar opportunities, this is no simple matter nor does it seem appropriate that regulatory policy should, in effect, favour a certain business model (e.g., a large universal bank).

From the same "competitive balance" perspective, we note that the consultation document does not reference the discussion around the Domestic Systemically Important Bank (D-SIB) bail-in scheme and its exclusion of *all* deposits – small and large, retail or commercial – from the scope of that policy, a stance at odds with the actions of other jurisdictions (e.g., EU). If, as the Government implies in *this* consultation, at-risk depositors are capable of monitoring their deposit-taking institutions (*and* arguably are better able to take advantage of stacking opportunities), then it is difficult to understand why the bail-in scheme exempts eligible but uninsured deposits (e.g., at risk deposits) from the scope of the scheme? As we noted above, all depositors are creditors but finite deposit insurance schemes are premised on the idea that only some creditors need protecting while otherwise do not from a utility and stability perspective. How then can some depositors be at once sophisticated enough to not need extended coverage while simultaneously excluded from suffering the consequences of any lapse of monitoring in the case of a potential trigger event for D-SIBs?[4]

The competitive implication is then clear: applying the level playing field metaphor to formulating deposit insurance policy creates a competitive balance problem when interacted with the bail-in framework – simply put, there will be an incentive for large sophisticated depositors to put their at-risk funds at D-SIBs *knowing* these balances are safe from the first line (and last line in most scenarios) of the D-SIB recovery-resolution process but would not be equally safe from a recovery/resolution were they held at a smaller entity that encountered difficulties.

To conclude, we raise these points recognizing that there is no appetite to increase coverage but in the hope that future conversations could scope in these considerations. Had they been scoped in for consideration in *this* particular consultation, it would have necessarily influenced our response to the proposed changes – for example, there might be less of a need to consider changes to coverage around registered plans or income windfalls. As it

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[2] Interestingly, sophisticated investors are most likely to be aware of the "inflation effect" on coverage. These individuals, who are by assumption well placed to monitor risk at their deposit-taking institution for exposure, are also best equipped to "stack" coverage and even purchase federal Government bonds which are a risk-free alternative to deposits *if held to maturity*. This will likely be less true for less sophisticated depositors including those who experience sudden and one-time cash influxes. Borrowing from the tax policy domain, there is potentially a "vertical equity" issue at stake here.

[3] The "competitive balance" idea is that in some instances, the use of a "level playing field" metaphor – which intuitively connotes "fairness" – can lead to unfair outcomes. In sports, the use of a "competitive balance" perspective leads to revenue sharing between large market and small market teams. It can similarly be used to "handicap" players in sports (e.g., golf). In policy, the concept is often deployed in the telecommunications field where, not dissimilarly to banking, a few large entities have entrenched incumbent network advantages that make it difficult for competitors to enter and compete effectively. The deployment of the "competitive balance" invariably emphasises a pro-competition policy outcome.

[4] We understand that the federal Government retains some discretion around exactly the bail-in scheme will work but we note that it has consistently noted and emphasized the exclusion of deposits from its application.

is, and as noted, we formulated our response to the proposed changes by taken as given that there is no appetite for an increase in broad coverage.