DEPOSIT INSURANCE IN CANADA

Recommendations for Reform

FEBRUARY 2024

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INTRODUCTION

The Canada Deposit Insurance Corporation (CDIC) provides deposit insurance (DI) coverage to its member institutions, most of which are federally regulated deposit-taking institutions. Deposit insurance is one part of the financial sector safety net. This safety net also includes strong prudential regulation and supervision, as well as the extraordinary, lender of last resort, liquidity facilities of the Bank of Canada.

Deposit insurance is a critical intervention to protect deposit-holders and prevent bank runs, as shown in the Nobel Prize-winning work of Diamond and Dybvig (1983). The International Association of Deposit Insurers (IADI) has laid out the Core Principles for Effective Deposit Insurers (Nov 2014), which include "limited coverage levels and scope; differential premiums; and timely intervention and resolution by the deposit insurer or other participants with such powers in the safety-net," ensuring that "level and scope of coverage are limited and are designed to be credible…set so that the large majority of depositors across banks are fully protected while leaving a substantial proportion of the value of deposits unprotected."

Since the founding of the CDIC in 1967, there have been several significant changes to the deposit insurance system. The functioning of the framework is monitored and periodically reformed as the market changes. Over time, coverage of eligible deposits has been expanded and limits have been increased. There have also been changes in the CDIC's accountabilities. After the 2008 global financial crisis (GFC) the CDIC's role was broadened to include acting as the resolution authority for bank failures.

In March 2023, the rapid collapse of Silicon Valley Bank (SVB) and Signature Bank sparked contagion fears among other medium and small banks in the U.S. While there were many underlying reasons for these failures, the final precipitating event was the accelerated deposit run on SVB - the fastest in history. (Refer to FDIC[i], IADI[ii], FSB[iii] papers for key lessons learned). Reverberations were also felt across the Atlantic, and the ailing Credit Suisse (CS) needed to be rescued, the first failure of a Global Systemically Important Bank (G-SIB) since 2008.

While these events had a muted impact on the Canadian banking system, we believe they have shone a spotlight on how the operating environment for the banking system has changed, potentially increasing its exposure to deposit runs. These changes include the rapid spread of information through social media and the adoption of digital technology by banks, which enables depositors to move funds with the swipe of a finger. The emergence of AI-driven chatbots has the potential to spread information and misinformation even more rapidly. The deposit run at SVB reflects a DI system that has not kept pace with these rapid changes in the operating environment.

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i https://www.fdic.gov/analysis/options-deposit-insurance-reforms/index.html

ii https://www.iadi.org/en/assets/File/Papers/IADI_2023_Potential_implications_and_emerging_policy_issues_for_DI_.pdf

iii https://www.fsb.org/2023/12/2023-resolution-report-applying-lessons-learnt/

In this paper, we review the DI coverage framework in Canada at the federal level vis-à-vis our international peers, as well as at the provincial level. We note that DI coverage levels for the CDIC are increasingly out of step with those of international peers who typically offer higher coverage limits. Many Canadian provinces also offer higher levels of deposit insurance coverage compared to the CDIC, with western provinces (Manitoba, Saskatchewan, Alberta, and British Columbia) offering unlimited coverage. This gives provincial credit unions a competitive advantage in deposit-gathering over federally regulated banks operating in their province.

Impacts of climate change, demographic shifts and advances in AI and other technologies will likely impact banking stability. In the context of this shifting landscape, and with a view to enhancing financial stability, strengthening depositor protection, and greater alignment between the CDIC and provincial Deposit Insurance Funds (DIFs), we discuss various options to enhance the CDIC coverage framework. Harmonization of coverage across provinces and alignment with the CDIC represents an area of opportunity.

We believe that the status quo is no longer fit for purpose and offer recommendations to enhance the robustness of deposit insurance coverage.[i]

DEPOSIT INSURANCE – AN OVERVIEW

CDIC Today

The CDIC was established as an independent Crown corporation in 1967, by an act of Parliament following a year marked by financial turmoil and a loss of depositor confidence that exposed the fragility of the financial system. At the time, the CDIC insured $17 billion in deposits in all federal banks, trust and loan companies and in participating provincial trust and loan companies. The coverage limit for eligible deposits was $20,000.

The functioning of the framework is monitored and periodically reformed as the market changes. Over time, the CDIC’s coverage limit has increased and in 2005 was set at $100,000 for each insured deposit category, per member institution. After the global financial crisis in 2008, its role was broadened to include acting as the resolution authority in case of a bank failure.[ii] A review in 2014 led to expanded coverage of eligible deposits (e.g., inclusion of foreign currency deposits and deposits with terms greater than 5 years) and separate coverage for additional registered savings plans (RESPs and RDSPs). The coverage was maintained at $100,000. In 2023, coverage for the First Home Savings Account was added (see Appendix A for details). It is important to note that not every person is eligible to open each of the registered account types and contribution limits apply to specific types of registered accounts. Moreover, the limit is the same for individual as well as business accounts.

Role of Deposit Insurance

Deposit insurance was primarily designed as a microprudential tool to protect individual depositors and maintain confidence in individual banking institutions. However, it also has significant macroprudential implications. As a macroprudential measure, DI can play a role in maintaining the stability of the broader financial system in the following ways:

i It is worth noting that in February, 2023, the CDIC launched its Deposit Insurance Study to assess opportunities to continue to strengthen the CDIC’s deposit insurance protection framework, focusing on three areas: Changes to the Deposit Environment, Structure and Coverage of the CDIC Deposit Insurance Framework, and Consumer Awareness and Understanding. The lessons learned from the March 2023 banking failures in the US, UK and Switzerland are informing the analysis under the Study, and assessment options to further strengthen the deposit insurance framework going forward. These options will be shared with the Minister of Finance for consideration later this year.

ii https://www.cdic.ca/wp-content/uploads/our-history.pdf

Prevention of Bank Runs: One of the main macroprudential roles of deposit insurance is to deter bank runs. In the absence of deposit insurance, any hint of financial trouble at a bank could prompt depositors to rush to withdraw their funds, fearing losses. Such bank runs can quickly spread, leading to a broader banking crisis. Deposit insurance reassures depositors that their deposits are protected up to a certain limit, making them less likely to engage in panic withdrawals.

Maintaining Financial Stability: By preventing potential bank runs, deposit insurance contributes to the overall stability of the financial system. A systemic loss of confidence can have cascading effects, leading to credit crunches, reduced lending activity, and economic downturns. By providing a safety net for depositors, deposit insurance helps maintain the smooth functioning of financial intermediation and credit provision.

Indirectly Influencing Bank Behaviour: While deposit insurance can introduce moral hazard (i.e., banks might take on excessive risks knowing that depositors are less likely to withdraw due to the insurance), it comes with additional regulatory oversight. Deposit insurance schemes typically have stipulations and standards that banks must meet, indirectly promoting safer and more sound banking practices.

Promotion of Trust in the Banking System: Public awareness and understanding of deposit insurance and its role can enhance public trust in the banking system. This trust is crucial, especially during economic downturns or financial crises, as it ensures that consumers and businesses continue to utilize banking services, deposit funds, and take out loans.

Facilitating Effective Resolution of Troubled Banks: Deposit insurance agencies often have the authority to monitor and assess risk to facilitate timely intervention and orderly resolution of troubled banks. This authority can help prevent the disorderly failure of banks, which could have systemic implications.

Interbank Market Stability: The knowledge that deposits are insured can stabilize the interbank market. When banks trust the solvency of other banks due to the presence of deposit insurance, they are more likely to lend and transact with each other. This trust can be essential, especially in times of financial stress.

However, for deposit insurance to serve effectively as a macroprudential tool, it is essential to appropriately design and manage the system. Setting clear limits on coverage, regularly reviewing and updating those limits, ensuring adequate funding of the insurance fund, and coordinating with other financial regulators are all crucial components of a successful deposit insurance scheme with macroprudential benefits. Public awareness/education, early detection of risk and preparedness to intervene are also important.

OPERATING ENVIRONMENT HAS CHANGED - DEPOSIT INSURANCE MUST EVOLVE

The CDIC framework was designed over 50 years ago primarily to protect small, less sophisticated retail depositors. While significant regulatory reform was undertaken following the 2008 global financial crisis, the coverage framework of DI has essentially remained unchanged. In the last few years, there has been a significant change in the operating environment for banks and we believe deposit insurance has not kept pace with these changes. To continue to remain fit for purpose, deposit insurance must be reformed. In the following sections, we highlight a few important changes in the operating environment that are relevant to deposit insurance.

Technological Changes Have Increased the Risk of Bank Runs

Information sharing today is much easier, faster, and scalable than in the past. At the click of a button, information can be shared on social media platforms with thousands or millions of people. Trending posts spread exponentially, as interested individuals share them further and automated algorithms promote them to viewers.

In parallel, digital technologies adopted by banks allow for large financial transactions to occur with unprecedented ease. Depositors can easily set in motion the transfer of millions of dollars, open and close accounts, link bank accounts with other financial accounts, and move funds across asset classes.

The speed with which information, or misinformation, is disseminated and the speed with which depositors can withdraw funds may contribute to faster, and more costly, bank runs. The spread of information on private channels such as WhatsApp and Slack and the ability of depositors to transfer funds outside of business hours (overnight and on weekends) make it more challenging to promptly intervene in a bank run.

The loss of USD $42 billion (CAD $57 billion) in deposits within an accelerated period at SVB on March 9, 2023 (or almost a quarter of all deposits) resulted in the Federal Deposit Insurance Corporation (FDIC) taking over the bank on March 10. The announcement that uninsured depositors at SVB would not be fully protected reverberated through the financial markets and Signature Bank lost 20% of its deposits in a matter of hours, resulting in its failure. The impact was also felt at other regional banks as large uninsured depositors started withdrawing funds.

Just after Silicon Valley Bank collapsed, a team of American economists embarked on the daunting task of crunching 5.4 million tweets and, after perusing all tweets mentioning bank stocks since 2020, they concluded that ***"social media exposure led to bank run risk rather than simply reflecting it".***[i]

While social media and mobile banking are on 24x7, the Fed window operates during traditional banking hours. The time available to regulators and bankers to respond to a crisis or near-failure situation has fallen dramatically since the GFC.

Nominal Amounts Have Not Kept Pace with Real Values

Taking 2005 as a base year (when the current CDIC limit of $100,000 was last reset), we note that wealth levels and asset values have increased substantially. Adjusting for inflation, the same limit would be $155,000 today.[ii] Calibrating the amount based on changes in average Canadian home price during that period would give us an amount of CAD $173,000,[iii] while using average Toronto home prices would give us an amount of $354,000.[iv] In the same period, Canada's GDP doubled from USD $1.02 trillion in 2005 to USD $2.1 trillion in 2022 and the TSX index went up by 72%.

Based on the above, an adjustment to the base amount for the CDIC appears warranted.

We note that during the 2008 global financial crisis, in which a number of U.S. financial institutions failed, the FDIC temporarily increased the base coverage from USD $100,000 to USD $250,000. This temporary increase was made permanent in 2010.

i https://on.ft.com/3GZL14D

ii https://www150.statcan.gc.ca/n1/pub/71-607-x/2018016/cpilg-ipcgl-eng.htm

iii https://www150.statcan.gc.ca/n1/en/subjects/housing/housing_price_indexes

iv https://trreb.ca/files/market-stats/market-watch/historic.pdf

Business Accounts with Large Uninsured Balances Can Have Adverse Cascading Impacts

Deposits of business accounts (defined here to include governments, municipalities, corporations, small and medium businesses, universities, foundations, etc.) receive no special consideration and are covered up to the same $100,000 limit.

On the other hand, higher governance standards imply that board directors, governors or trustees of these institutions must ensure that payroll is maintained at all times.

Inability to access funds through these business accounts can result in issues with meeting payroll and forced layoffs. This could have a significant downstream impact on small businesses, their vendors and their employees, contributing to lost wages, business closures, and job losses.

While SVB was somewhat of an outlier with a high proportion of business deposits relative to total deposits (94% of deposits were uninsured), the issue of uninsured business deposits is not uncommon across most banks.

Transmission of Non-Financial Shocks

The COVID-19 pandemic spread within weeks from China to Europe and North America. In an interconnected world, with the faster movement of information, people and goods, financial and non-financial shocks also get transmitted rapidly.

As we look ahead, global issues such as climate change and its impacts (both physical risks and transition risk) will have profound implications for the banking system globally. Geopolitical instability, demographic shifts, a decline in societal trust levels, and impact of AI-based technologies are some of the other trends that suggest we should continue to bolster the robustness of the financial system to prevent contagion.

In our view, the SVB failure, while an extreme case, reflects a system that has not kept pace with the aforementioned changes. While the focus of regulatory reforms post-GFC was on systemically important banks (“Too big to fail”), the failure of SVB (with assets of USD $200 billion) illustrates that a minuscule part of the U.S.’s $23 trillion banking system has the potential to trigger contagion.

The collapses of SVB and Signature Bank and reports of deposits leaving other regional banks prompted U.S. federal officials to invoke the “systemic risk exception” for the banks, as normal procedures would have “serious adverse effects on economic conditions or financial stability”. Based on public interest, they announced that uninsured depositors at SVB and Signature Bank would be fully protected.

This resulted in losses to the DIF (or "the fund") and in May 2023, the FDIC proposed to cover its losses on SVB and Signature Bank with a special assessment levied on large banks' uninsured deposits, arguing these banks indirectly benefited from the decision to cover all uninsured deposits at the two failed banks. The special assessment would raise USD $15.8 billion from 113 of the more than 4,000 banks insured by the FDIC.

It is worth noting that the mere fact that deposits are insured does not suffice to prevent a bank run. In the case of Home Trust Bank in Canada in 2017, 94% of deposits were insured and sourced primarily through broker channels (not direct relationships) and faced a run when allegations of fraud were reported and the broker channel stopped renewing deposits with the bank. Nonetheless, proactively updating the DI framework to minimize losses from bank failures benefits the whole system.

DEPOSIT INSURANCE IN CANADA vis-À-vis INTERNATIONAL PEERS

In the below table, we compare the coverage provided by a number of international jurisdictions as well as across various provinces in Canada.

Table 1

COUNTRY	COVERAGE TYPE	BASIC COVERAGE	ADDITIONAL COVERAGE
Canada	CDIC – most of which are federally regulated FIs Per depositor per separately insured category per member institution	Non- Registered Accounts (Separate coverage for, accounts held in individual name, Joint accounts, Accounts held in trust) $100,000	Registered Accounts $100,000 per category of registered account (Six categories of registered accounts are covered)
United States	FDIC- banks. Per depositor, per bank	Non-Registered Accounts $250,000 (CAD $ 337,000*)	Retirement Accounts $250,000
	NCUSIF- federal and state-chartered credit unions Per depositor, per credit union	Non-Registered Accounts $250,000	Retirement Accounts $250,000
United Kingdom	Covers banks, building societies and credit unions Per depositor, per institution	£85,000 (CAD $145,000)	Temporary High Balances Total £1,000,000 (CAD $1,700,000) for up to 6 months
France	Covers banks Per depositor, per institution	€100,000 (CAD $146,000)	Temporary High Balances €500,000 (CAD $729,000) for up to 3 months for each life event
Germany	Statutory- Per depositor, per bank	€100,000	Temporary high deposit €500,000 for up to 6 months
	Voluntary As of Jan 1, 2023 As of Jan 1, 2025 As of Jan 1, 2030	Individuals/Foundations €5 million (CAD $7.3 million) €3 million (CAD $4.4 million) €1 million(CAD $1.5 million)	Companies €50 million (CAD $73 million) €30 million (CAD $44 million) €10 million (CAD $15 million)
Australia	Per depositor, per bank, credit union, building societies	$250,000 (CAD $220,000)	

* Conversions as of February 22, 2024

We highlight a few salient points:

- In the U.S., the coverage limit is the same for both banks and credit unions, which are covered by two different regulators - the FDIC for banks and the National Credit Union Share Insurance Fund (NCUSIF) for federal and state-chartered credit unions.

- In the UK, depositors are eligible for a higher amount if they can demonstrate that certain life events could have caused a temporary high balance in their bank accounts. Examples include (but are not limited to):

  · Real estate transactions (purchase/sale proceeds- relating to primary residence)

  · Benefits payable under an insurance policy

  · Personal injury compensation (unlimited amount)

  · Claim for compensation for wrongful conviction or unfair dismissal

  · Redundancy (voluntary or compulsory)

  · Marriage or divorce related

  · Benefits payable on retirement or death, etc.

  Depositors are required to provide supporting documents for temporary high balance claims.

- In France, similar to the UK, "temporary high balances", are covered for up to 3 months and the level of coverage is increased by an additional €500,000 for each of the eligible events.

- The German model is unique in that it is backed by the banking industry (i.e., not government guaranteed) and offers two layers of protection. The first layer is statutory, with amounts of €100,000 per depositor (similar to banks in other EU countries) and covers all types of banks in Germany. The second layer is voluntary, and is offered only by private sector banks in Germany. Note the substantial coverage for individuals and foundations (currently €5 million) and the much higher limit for corporations (currently €50 million). The coverage for the voluntary layer is gradually being brought down to €1 million and €10 million respectively, under reforms announced in 2021.

It is important to note that the above table only provides a high-level overview of the coverage amounts - details of eligible accounts and calculations vary across each jurisdiction (Refer to Appendix A for further details).

Based on the above review, we can conclude that the CDIC coverage amount is on the lower side compared to international peers.

CANADA - FEDERAL vs. PROVINCIAL COVERAGE

Another point to note is that in peer countries reviewed, the statutory coverage for banks, credit unions and building societies is uniform. In Canada, provincially regulated credit unions have vastly different coverage compared to banks and federally regulated credit unions. Each province has varying levels of coverage as shown in the table below:

Table 2

JURISDICTION	COVERAGE
CDIC- Federal	$100,000 per depositor, per separately insured category, per member institution- includes registered and unregistered accounts
Quebec	$100,000 per account- includes registered and unregistered accounts
Ontario	$250,000 per account for unregistered accounts Unlimited for registered accounts
Alberta, British Columbia, Saskatchewan, Manitoba	Unlimited for all account types
Nova Scotia, Newfoundland and Labrador, New Brunswick	$250,000 per account type, both registered and unregistered
Prince Edward Island	$125,000 per account for unregistered accounts Unlimited for registered accounts

We note the wide disparity of coverage, from western provinces offering unlimited coverage, to Quebec, which is most closely aligned with the CDIC. This disparity drives customer behaviour and has the potential to create an uneven playing field. For example, a company that places a $10 million deposit with a BC credit union would get full coverage, but would only be covered for $100,000 by an institution with CDIC coverage.

Given provincial credit unions are no longer constrained by physical branch locations and have the ability to offer digital services across their province, this creates potential for an uneven playing field for deposits between institutions with CDIC coverage and institutions covered by provincial deposit insurance.

It is worth noting that there are a few large credit unions that have voluntarily migrated from the provincial system to the federal system (e.g., Coast Capital Savings Federal Credit Union of BC, Innovation Federal Credit Union of Saskatchewan). While deposit insurance is now capped at a lower level, the change allows them to be part of the larger CDIC-backed deposit insurance pool and to expand business activities across Canada.

We also note the wide disparity in the liquidity resources and explicit government guarantees available to the federal and provincial deposit insurance schemes. In addition to ex-ante funding of $8.1 billion, the CDIC also has a legislative capacity to borrow up to $32 billion from the federal government,[i] and its obligations are explicitly guaranteed by them. Additional borrowing could be authorized by Parliament and additional loans can be provided by the Government of Canada when deemed necessary. On the other hand, we note that many of the provincial DIFs lack access to committed provincial funding and do not have explicit guarantees from the provincial government.

i https://www.cdic.ca/wp-content/uploads/cdic-2023-annual-report.pdf

DEPOSIT INSURANCE IN CANADA - OPTIONS FOR REFORM

GOALS:

The events of March 2023 have shone a light on shortcomings of the design of DI programs. We believe that any changes to the deposit insurance program must keep the following objectives in mind:

- Build greater customer confidence - history has shown that bank runs are triggered by a lack of customer confidence.
- Right-size coverage so that a sufficient level of coverage is provided. The goal is not to prevent all or any bank failures but to avoid a financial contagion that would require a bail-out by taxpayers or widespread losses to the banking system/deposit insurance funds.
- Consider the impact on the specialized requirements of business accounts - most business accounts cannot be accommodated with the current deposit insurance levels. The downstream impact of financial contagion resulting in harm to the general economy must be mitigated.
- Promote greater competition among Canadian banks. The Canadian banking system is dominated by six large banks. Any changes must consider the impact on small and medium-sized banks (SMBs).
- Harmonization between federal and provincial deposit insurance frameworks is a worthy goal, given the wide variability among provincial frameworks.

In the following paragraphs, we discuss some options to reform the CDIC framework.

Options for Increased Deposit Insurance Coverage:

A. Maintain the current structure, but raise the limit from the current $100,000 per account

B. Extend unlimited deposit insurance to all depositors

C. Banks voluntarily opt in for higher coverage

D. Offer different deposit ceilings for different types of accounts with significantly higher ceilings on business payments accounts

E. Offer the option to individual depositors to purchase higher coverage

Option A: Higher Coverage Across the System

One of the options is to maintain the CDIC framework as is, while increasing the coverage limit to a higher amount - say $150,000, $200,000, $250,000, $500,000 or another amount.

A higher limit may be justified on the basis that the current limit of $100,000 has not been changed since 2005 and has not kept pace with real values as discussed above on page 4.

From a depositor point of view, a $100,000 limit feels less substantial than before, resulting in depositors and brokers having to actively spread out deposits across multiple banks. A higher amount would also better align with coverage in international jurisdictions (Table 1) as well as provincial DIFs (Table 2).

Significant regulatory reforms since the 2008 crisis, including higher capital and liquidity requirements, have made the banking system safer. Hence, from a banking supervisory standpoint, higher coverage may be justified given that probabilities of default have been reduced since the last change.

According to a report released by DBRS Morningstar in March 2023, about 65% of deposits at the big six Canadian banks are uninsured and around 25% of deposits with SMBs are uninsured, indicating the reliance depositors place on DI while placing deposits with SMBs.

It was reported[i] in March 2023 that the Bank and Trust Companies Association (BATCA), representing SMBs, had written to the federal Finance Minister, requesting that the CDIC coverage limit be raised to $200,000.

A higher limit would help SMBs garner a higher proportion of deposits, and make their offering more competitive, not just vis-à-vis the Domestic Systemically Important Bank (D-SIBs) but also align better with provincial credit unions.

Negative consequences under this scenario would be a higher cost to the system due to an increase in assessments across the board. Potentially there may be resistance from the D-SIBs ("the big six") who are already subject to higher regulatory capital and costs related to higher supervisory standards, and benefit from the perception of “too big to fail”.

We note that this option also does not address the issue of business accounts as a higher limit of say $200,000 would offer insufficient protection to many.

Option B: Unlimited Coverage

Extending unlimited DI coverage to all deposits is a second option for the CDIC. This would align with many of the western provincial DIFs and remove liquidity risk in the systems, addressing financial stability concerns.

Given the higher cost to the system, and potential for moral hazard, we do not consider this to be a viable option. This option also does not align with the principles set out by IADI.

Option C: Voluntary Higher Coverage at the Bank Level

In addition to basic CDIC coverage, an individual bank could have the option to voluntarily choose a higher level of coverage (e.g., $200,000, $500,000 or $1 million). Under this option, banks seeking greater stability are encouraged to opt in for higher coverage.

Although the cost to the bank would be higher, this would also create an incentive for them to improve their CDIC risk rating under the Differential Premium System (DPS).[ii] We note that in July 2023, following a public consultation, the CDIC announced that it will make the following key changes to the DPS:

- Increase the sensitivity/granularity of the risk rating by raising the number of premium categories from four to five
- Increase the frequency of risk assessments from annual to semi-annual
- Enhance the DPS scorecard, which measures financial and regulatory criteria, to capture a broader set of risks posed by member institutions to the CDIC.

We believe the above changes are constructive to the CDIC’s ability to provide different coverage limits to different institutions or to a class of institutions (e.g., higher coverage for SMBs).

A bank seeking additional coverage may be viewed negatively by the market as a sign of weakness at the bank and this could inadvertently lead to withdrawal of deposits, potentially triggering a run. On the other hand, a bank may opt for a higher limit just ahead of it experiencing stress or near failure conditions - leading to risk of adverse selection and moral hazard. These issues may be mitigated by implementing appropriate safeguards in the process– such as appropriate

i https://www.reuters.com/markets/canadas-deposit-insurer-reviewing-insurance-deposit-limits-trade-group-2023-03-21/

ii https://www.cdic.ca/newsroom/news/cdic-concludes-differential-premiums-system-review/

communication to the market by the bank prior to seeking higher coverage, comprehensive risk assessment by the deposit insurer prior to approving higher coverage and implementing a sufficiently long wait period prior to qualifying a bank for a higher limit.

A benefit of this scenario is that this has the potential to foster competition and create a more level playing field – for example SMBs with higher coverage vis-à-vis D-SIBs and provincial counterparts. At the system level, this option has the potential to enhance financial stability and customer protection, without an across-the-board cost increase.

We note that Germany has a similar voluntary insurance program that has been adopted by its private sector banks and is operated separately from the statutory program. Nearly all private banks in Germany participate.

We believe that if a voluntary program is considered for Canada, it would likely be cost-effective to implement it within the operational capabilities of the CDIC. That means the CDIC would offer not just basic coverage to all banks, but also the option for banks who want to voluntarily opt for higher coverage.

It would be critical to have appropriate education to consumers so they can understand the benefits of the voluntary coverage program.

Option D: Targeted Coverage by Account Type

Further refinement may be made by setting a higher coverage for certain account types such as business, institutional and escrow accounts, while maintaining a lower limit for other accounts.

Conceptually, deposits have two distinct purposes: payment services and investment. Deposits used for payments are essential for businesses and households to manage cash inflows and outflows. Losses to deposits used for payments—or a delay in access to deposit funds—can abruptly debilitate daily operations. As observed during the SVB failure, the existing CDIC limit may be insufficient for business accounts and could lead to stress/instability in the system, as well as have adverse contagion impact on businesses, their employees and vendors. Similarly, the current limit may be insufficient for escrow transactions such as good faith deposit for a house purchase/sale, given the substantial increase in average house prices in Canada since 2005.

While deposits for investment purposes may be easy to split across multiple banks to get deposit insurance coverage, it is operationally difficult to split payment accounts and escrow accounts across multiple banks. Additionally, smaller businesses may have difficulty using sweeping accounts which transfer end of day balances to treasury bills or other short term money market instruments that are used by larger businesses to reduce risk.

Consideration may be given to higher limits for registered accounts, as splitting registered accounts across multiple banks may be administratively burdensome for both the depositor and banks. This would also align better with the coverage provided by provincial DIFs.

One of the challenges is to clearly communicate and operationally manage accounts that merit higher coverage. This may be complicated but feasible. European and UK-based systems have the carve-out for “temporary high deposits” that protect individual depositors impacted by life events. A review of how the system has played out and any fine-tuning in the Canadian context would be a worthwhile endeavor.

Such an approach has advantages including the ability to tailor deposit insurance to meet the specific needs of various customers. This could benefit individuals with temporary high balances, businesses, government entities and not-for-profits (e.g., payroll purposes), ultimately contributing to improved financial stability.

This tailoring approach is also sensitive to system costs as the higher limit need not be extended to large deposits held for investment purposes which could be split across different banks.

Option E: Excess Deposit Insurance Coverage by Customer

Individual depositors may voluntarily opt-in to buy coverage for deposits in excess of that provided by their financial institution.

From a depositor perspective, they may be willing to pay a small premium for the benefit of having protection on their large deposits. This may be beneficial for individuals and institutions that operate with a low risk appetite - examples may include seniors, foundations, not-for-profits, universities, and others. This option may also allow them to simplify their operations and not require them to deal with multiple banks to get DI.

From a bank's perspective, this is beneficial as it reduces the depositors' incentive to run. This is another form of tailoring and provides the benefits as noted in Option D.

Coverage for such a system may be administered by a private insurance company or within the CDIC itself. An advantage of having it within the CDIC is that they already have a risk and operational infrastructure to underwrite and administer such a scheme.

Operational Circuit Breakers:

The Basel III regulatory framework only asks banks to hold enough liquidity to protect themselves from a scenario in which they lose 5% of their deposits each day, for 30 days, or a quarter of their deposits-SVB lost that in a few hours.

Information moves so fast in cyber space that it is hard to detect what is accurate and what is not. Banks and regulators must update the crisis management playbooks to reflect the new realities and take steps to slow down the flow of deposits before a stress situation develops.

One way would be to implement appropriate gating provisions to restrict large withdrawals (above coverage limit) of deposits, especially outside of business hours and by staggering withdrawals over several days in case of a shock.

For mismanaged and undercapitalized banks, limiting the liquidity of the largest accounts is unlikely to prevent a bank failure. Similarly, limiting withdrawals will not necessarily prevent the contagious spread of concerns about a bank's health. Instead, by slowing the run, the CDIC would have time to resolve the bank through an orderly resolution process, rather than through a costly bank run.

RECOMMENDATIONS

We note that while we have discussed various options separately, we do not view them to be mutually exclusive. They have been presented separately to help identify features and benefits that are most important under each option. In fact, we believe that each of the options has its merits (except Option B) and that they can be layered to provide greater flexibility to depositors and banks in a cost-effective way.

Today, as consumers, when we buy day-to-day products such as airline tickets, or make hotel reservations, we have a large number of options vis-à-vis flexibility (refund/no refund, change or cancellation fees) as well as features (choice of seating, choice of views, meals, etc.). We have the opportunity to tailor the product per our personal preferences and circumstances and are charged accordingly.

When it comes to DI, we are essentially operating off a structure that was designed in the 1960s, with a "one size fits all" approach. Today, we have the opportunity to design a structure that is more flexible and responsive to the needs of banks, individuals, and companies, while contributing to overall stability of the banking system.

Below we suggest a straw man approach that combines essential elements of the various options discussed above.

Table 3

	SUGGESTED COVERAGE	COMMENTS
Statutory/Basic Coverage	$250,000 per account	Per Option A above
Voluntary Coverage by Bank	$500,000 per account for personal accounts $5,000,000 per account for business accounts (includes foundations, not-for-profits, corporations, etc.)	Per Option C and D above Offered by the CDIC
Excess Coverage by Customer	Unlimited; to be determined by insurance provider	Offered by the CDIC or a Private Insurer

Discussion around operational circuit breakers concurrently with changes to DI coverage would be useful.

We recognize that such changes would represent a significant shift in how we think about DI today.

The amounts shown above are only a reasonable guess. Prior to implementing any change, substantial quantitative analysis would be required to understand the distribution of deposits today and to project changes based on customer behaviour in response to these changes.

Any such changes, once carefully studied, would require an act of Parliament and would likely take many years to implement.

Further, there is an opportunity to harmonize DI coverage across the federal system and various provincially regulated systems.

The goal of this paper is to stimulate discussion in the industry, including regulators, banking industry groups, and financial risk professionals, to examine the outlined approaches and associated benefits and drawbacks, and set the stage for future changes.

CONCLUSION

Since the 2008 financial crisis, banks in Canada have spent billions of dollars to strengthen their liquidity risk management frameworks. OSFI has implemented several new liquidity management guidelines and banks have restructured their balance sheets and introduced new deposit products to reduce the likelihood of a liquidity crisis (e.g., business deposit accounts with 31-day notice for withdrawals, personal savings accounts with premium rates for 30 or 90 day lock-in).

However, the operating environment has changed for banks, driven by technological changes including the impact of social media and mobile banking. Looking to the future, we anticipate further shocks from impacts of climate changes, demographic shifts and advances in AI and other technologies. The DI system designed to protect small, less sophisticated depositors is no longer fit for purpose.

The events of March 2023 showed that mid-sized banks have the potential to trigger systemic risk and at the same time a G-SIB, fully compliant with Basel III and other requirements, is not too big to fail.

Our review of the structure of DI schemes in several peer countries and the variance between the CDIC framework and those of the provincial deposit insurance programs across Canada suggests the need to reform the Canadian system.

We discuss various options to reform the CDIC framework, with a view to enhancing financial stability while increasing flexibility and protection for customers and banks in a cost-effective manner. Finally, we propose a straw man approach that combines elements of the options discussed.

We strongly believe that a framework that was first implemented over 50 years ago is due for reform and our goal is to stimulate further discussion among industry participants.

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APPENDIX A- COVERAGE ACROSS PEER COUNTRIES

CANADA

CDIC Coverage

Maximum $100,000 for each of the following categories:

- Deposits held in one name.
- (Chequing, Savings accounts, Term Deposits, GICs).
- Deposits held in more than one name.
- Co-owned (i.e. joint) deposits (in the names of two or more people) are protected separately from those held in their individual names.
- Deposits held in Registered Retirement Savings Plan (RRSP).
- Deposits held in Registered Retirement Income Fund (RRIF).
- Deposits held in a First Home Savings Account (FHSA).
- Deposits held in a Tax-Free Savings Account (TFSA).
- Deposits held in a Registered Disability Savings Plan (RDSP).
- Deposits held in a Registered Education Savings Plan (RESP).
- Deposits held in Trust.

The total is insured to a limit of $100,000 per beneficiary if the trustee meets CDIC's disclosure rules.

UNITED STATES OF AMERICA

FDIC

https://www.fdic.gov/resources/deposit-insurance/brochures/insured-deposits/

The standard deposit insurance amount is $250,000 per depositor, per insured bank, for each account ownership category.

The FDIC insures deposits that a person holds in one insured bank separately from any deposits that the person owns in another separately chartered insured bank.

Ownership Categories include:

- Single Accounts
- Certain Retirement Accounts
- Joint Accounts
- Revocable Trust Accounts
- Irrevocable Trust Accounts
- Employee Benefit Plan Accounts
- Corporation/Partnership/Unincorporated Association Accounts
- Government Accounts

NCUA (National Credit Union Administration)

https://ncua.gov/files/publications/guides-manuals/NCUAHowYourAcctInsured.pdf

The standard share insurance amount is $250,000 per share owner, per insured credit union, for each account ownership category.

UNITED KINGDOM

Financial Services Compensation Scheme

https://www.fscs.org.uk/what-we-cover/banks-building-societies/

Banks, building societies, Credit Unions

- up to £85,000 per eligible person, per bank, building society or credit union.
- up to £170,000 for joint accounts.

We protect certain qualifying temporary high balances up to £1 million for 6 months from when the amount was first deposited.

Certain life events could have caused a temporary high balance in your bank account, including:

- Real estate transactions (property purchase, sale proceeds, equity release- relating to your main residence only. This does not have to be a UK property but must relate to your main residence).
- Benefits payable under an insurance policy.
- Personal injury compensation (unlimited amount).
- Disability or incapacity (state benefits).
- Claim for compensation for wrongful conviction.
- Claim for compensation for unfair dismissal.
- Redundancy (voluntary or compulsory).
- Marriage or civil partnership.
- Divorce or dissolution of their civil partnership.
- Benefits payable on retirement.
- Benefits payable on death.
- A claim for compensation in respect of a person's death.
- Inheritance.
- Proceeds of a deceased's estate held by their personal representative.

FRANCE

https://www.garantiedesdepots.fr/en/discover-my-guarantees

French deposit insurance and resolution Fund

All deposits eligible for coverage are added together to determine the amount the bank owes to its customer. The FGDR pays compensation in this amount, up to €100,000 per customer, per institution.

Temporary high balances

The deposit guarantee scheme may be extended to cover and compensate temporary high balances received less than three months prior to the banks failure which come from:

- the sale of residential property belonging to you.
- a lump-sum payment of compensation for harm sustained by you.
- a lump-sum payment of a retirement benefit, an estate, a bequest or a donation.
- a compensatory benefit, a settlement or contractual indemnity following the termination of an employment contract.

The €100,000 coverage level is increased by the amount of the exceptional transaction, up to an additional €500,000 for each of the above events (except for bodily injury, for which there is no coverage limit). Thus, for the sale of a residential property in the amount of €200,000, the coverage level is increased by €200,000 to €300,000 for three months. For a sale in the amount of €700,000, the coverage level is increased by €500,000 to €600,000 for three months.

GERMANY

https://www.bafin.de/EN/Verbraucher/Schieflage/Einlagensicherung/einlagensicherung_node_en.html

https://riskandcompliance.freshfields.com/post/102hes1/reforms-of-the-german-voluntary-deposit-protection-scheme-on-the-horizon

Deposit protection in Germany is based on two pillars: The statutory deposit guarantee scheme on the one hand and a voluntary deposit guarantee scheme on the other.

If a compensation event occurs, the statutory guarantee schemes ensure legal entitlement to compensation amounting to no more than €100,000 per depositor and bank, including any claims to interest on their part. A higher level of protection of up to €500,000 for a period of up to six months following the crediting of deposited amounts applies to deposits considered particularly worthy of protection.

The statutory deposit guarantee schemes are supplemented by the voluntary deposit insurance schemes established by the Federal Association of German Banks.

AUSTRALIA

https://www.apra.gov.au/deposit-checker-are-your-deposits-protected

Deposits are protected up to $250,000 for each account holder at each licenced bank, building society or credit union incorporated in Australia.

APPENDIX B - PROVINCIAL DEPOSIT INSURANCE

BRITISH COLUMBIA

https://www.bcfsa.ca/public-resources/credit-union-deposit-insurance/about-cudic

The deposit insurance guarantee covers the full value of money on deposit with a B.C. provincially regulated credit union. There is currently no limit on the deposit amount guaranteed. This 100 per cent guarantee has been effective since 2008.

ALBERTA

http://www.cudgc.ab.ca/docs/Depst%20Protection%20Brochure.pdf

The Credit Union Deposit Guarantee Corporation provides a 100% guarantee of all deposits with Alberta credit unions. This protection includes accrued interest to the date of payout.

SASKATCHEWAN

https://www.cudgc.sk.ca/the-guarantee/

Deposits held in Saskatchewan credit unions are fully guaranteed. There is no limit to the size of deposit covered by the guarantee.

MANITOBA

https://dgcm.ca

An unlimited guarantee of all deposits in a Manitoba credit union or caisse including accrued interest to date of payout.

ONTARIO

https://www.fsrao.ca/consumers/credit-unions-and-deposit-insurance

The maximum basic coverage for insurable deposits held in non-registered accounts is $250,000 (principal and interest combined) per depositor in each Ontario credit union and caisse populaire and unlimited for insurable deposits held in registered accounts.

Foreign currency deposits are not covered.

QUEBEC

https://lautorite.qc.ca/en/general-public/compensation-and-deposit-protection/deposit-protection

Your deposits are protected up to a maximum of $100,000 per category of deposit, per authorized deposit institution, including principal and accrued interest.

NEW BRUNSWICK

https://www.nbcudic.ca/sites/default/files/2022-06/Your%20Deposits%20Are%20Safe.pdf

All money in eligible deposits with a protected credit union is guaranteed up to $250,000 per category of coverage, including foreign currencies and accrued.

Categories include: Deposits held in Single Name; Joint Names; RRSP, RRIF, TFSA, RESP, RDSP.

NOVA SCOTIA

https://www.nscudic.org/coverage/

You are insured up to $250,000 on a range of accounts. This includes coverage for your primary savings and chequing accounts, money held in a joint savings account, funds held in a trust account, and all of your TFSA, RRSP, RRIF or RESP contracts up to $250,000 each.

NEWFOUNDLAND AND LABRADOR

https://www.cudgcnl.com/coverage/

The Credit Union Deposit Guarantee Corporation insures deposits of Members and Associate Members of credit unions in Newfoundland and Labrador up to $250,000 per type of deposit. The types of deposits insured include Basic Deposits (non-equity shares, chequing and savings accounts, term deposits, guaranteed investment certificates, etc.),joint deposits, registered savings plans (RRSPs, RRIFs, and TFSAs), and trust accounts.

PRINCE EDWARD ISLAND

https://www.peicudic.com/faqs.php

Basic Protection: The maximum basic deposit insurance protection that you can have with the same credit union is $125,000 (principal and interest combined).The $125,000 maximum, therefore, applies to all of the insurable deposits that you have with the same member credit union.

Joint Deposits: If you have a deposit in your name as well as a deposit that is owned jointly with someone else, the deposit is insured separately. The maximum deposit insurance for the same joint owners with the same credit union is $125,000.

Registered Plans: CUDIC insures the full value of deposits held in registered retirement savings plans (RRSPs), registered education savings plans (RESPs), registered retirement income funds (RRIFs), registered disability savings plans (RDSPs) and tax-free savings accounts (TFSAs).

ADDITIONAL READINGS

FDIC- Options for Deposit Insurance Reform

https://www.fdic.gov/analysis/options-deposit-insurance-reforms/index.html

European Commission- Bank crisis management and deposit insurance

https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI(2023)749798

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https://www.bu.edu/econ/files/2012/01/DD83jpe.pdf

International Association of Deposit Insurers, *IADI Core Principles for Effective Deposit Insurance*. November 2014.

https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf