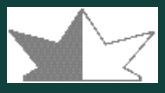


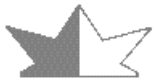
Task Force on the Future of the Canadian Financial Services Sector

Deposit Insurance and Other Compensation Arrangements

by
A. Warren Moysey

Research Paper Prepared for the Task Force on the Future of the Canadian Financial Services Sector

September 1998



Task Force on the Future of the Canadian Financial Services Sector

Deposit Insurance and Other Compensation Arrangements

by
A. Warren Moysey

September 1998

Research Paper Prepared for the Task Force on the Future of the Canadian Financial Services Sector

The views expressed in these research papers
are those of the authors and do not necessarily reflect
the views of the Task Force on the Future of the
Canadian Financial Services Sector

Cat No.: BT22-61/3-1998E-13
ISBN 0-662-27152-1

For additional copies of
this document please contact:
Distribution Centre
Department of Finance
300 Laurier Avenue West
Ottawa K1A 0G5

Telephone: (613) 945-2855
Facsimile: (613) 996-0518

Also available through the Internet at
http://finservtaskforce.fin.gc.ca

Cette publication est également disponible en français.

Table of Contents

1. Introduction

The report deals with compensation arrangements. This term includes Canada Deposit Insurance Corporation (CDIC), The Canadian Investor Protection Fund (CIPF), the Canadian Life & Health Insurance Compensation Corporation (COMPCORP), the Property & Casualty Insurance Compensation (PACICC), and a variety of arrangements in the various Provinces for the protection of Credit Union members.

As requested by the Task Force the report specifically reviews the following public policy concerns and makes recommendations.

I. Market Mechanism

Does CDIC Deposit Insurance detract from the efficient operation of the market and therefore from the efficiency of the financial sector? Would coinsurance or some alternative technique help resolve the problem?

II. Funding Mechanisms

Are the different funding mechanisms which are in place for the various compensation arrangements adequate? Are there public policy issues that flow from these differences and if so, should the arrangements be made more uniform and what might be the desirable uniform approach?

III. Public Confusion

Is there public confusion flowing from the fact that some instruments are protected by compensation arrangements and others are not, and flowing from the differences among the various compensation arrangements? Assuming there are concerns, will they likely be exacerbated through developments in an increasingly technological and international era, when Canadian consumers may be expected to have greater access to products of off-shore financial institutions not regulated in Canada?

VI. Relationships with Primary Regulators

The activities of regulators range along a spectrum from active intervention in the affairs of insured institutions to a passive role where the compensation arrangement functions only as an insurer. At a broad level, are there public policy concerns that arise from these differences among the compensation arrangements and are there possible recommendations the task force should put forward to address those public policy concerns?

I also propose to review the following:

V. Rationale for Deposit Insurance

There are a number of different reasons that have been cited in the literature for having deposit insurance. In Canada, the focus has changed over the years, and I suggest it is highly relevant that the task force determine the rationale that currently is most appropriate as it looks to the future. The decision as to which rationale is relevant, really determines what changes, if any, are necessary in current arrangements. This broader question was posed in a slightly different way in the Task Force's Discussion Paper of June 1997:

"Are there changes that should be made in the nature of compensation arrangements provided in Canada for the customers of financial institutions and in the way these arrangements are administered."

Presumably, the question should be posed in light of the most relevant rationale looking forward rather than looking at circumstances today, or in the past.

VI. Conglomeration

There are a number of issues which flow from conglomeration which create potential overlap between the various compensation arrangements. How should these issues be dealt with.

I have updated the tabular material provided in the March 4, 1993 report, "Compensation Plans in the Canadian Financial Sector: A Comparison provided by Brent Sutton and Michael Andrews of the Conference Board of Canada. This material is enclosed for reference as Appendix 1.

I have attempted to contact, and where appropriate, meet with all interested parties including various trade associations, many individual financial institutions, a number of individuals with private sector backgrounds, members of the academic community, and those representing the interests of consumers. A listing of those with whom I've met, is attached as Appendix 2. I am grateful for their interest and input.

A tabular comparison of credit unions and their insurance plans across the country is included as Appendix 3.

As set out in my mandate, this is a preliminary review. There are some areas where the Task Force, may, in my view, quite properly feel additional research is warranted.

2. Deposit Insurance Background

What does Deposit Insurance Do? Exactly what are its characteristics?

The perception in some quarters is that Deposit Insurance eliminates risk. While it may eliminate risk for some depositors, it does not eliminate risk overall. In the words of a respected Canadian academic:

> "Yet deposit insurance does not eliminate risk, but only repackages it. The risk associated with the institution's risky asset portfolio is transferred to those agents who ultimately underwrite the deposit insurance. These would include sound or low risk financial institutions, and, possibly tax payers at large."[1]

As a matter of interest, in Canada the perception of many is that the taxpayer does foot the bill for deposit insurance. This is not the case. The low risk financial institutions do, mainly the banks and large trust companies, as suggested by James Pesando. Presumably ultimately the cost is passed on to the consumers of financial services to the extent those financial institutions are able to do so. The CDIC, a Federal crown corporation does have funding access from the consolidated revenue fund, but as this access is via loans and the loans are paid back by the CDIC from its recoveries or from premiums it generates from its members there is no ultimate cost to tax payers.

Deposit insurance has considerable beneficial impact and this will be reviewed in detail below. However, it also serves to skew incentives.

As the congressional budget office of the Congress of the United States stated when it reviewed necessary changes in U.S. deposit insurance:

> "the major drawback of deposit insurance is that it creates a "moral hazard" . . . . that is financial institutions, especially those in trouble, have an incentive to undertake riskier investments with depositors' funds when those funds are insured. In the absence of deposit insurance, the threat of withdrawals by depositors curbs the degree of risk that a depository is willing to take and still be able to service any claims." [2]

Kauffman and Litan a year or so later expanded on the same point basing their comments on their view of the problems with U.S. deposit insurance in the late 1980's:

> "Owners and managers faced (and continue to face) "moral hazard" - the tendency for insurance to encourage the persons insured to take greater risks than they would without insurance. Under the old system, all institutions paid premiums at exactly the same rate, meaning that safe institutions subsidized risky institutions. Moreover, deposit insurance and the related policy of treating some banks as 'too big to fail' impaired market

[1] James E. Pesando, the Wyman Report: An Economist's Perspective - Canadian Business Law Journal, Volume 11, 1986.
[2] Congressional Budget Office - Reforming Federal Deposit Insurance, September 1990, page xii.

> discipline, permitting weak institutions to remain open and compete aggressively with healthy institutions. Weak institutions tended to pay higher than average rates to attract deposits, and to channel the proceeds into riskier than average investments. This behavior was a rational response to the incentives created by the combination of flat rate deposit insurance, limited liability, and low capital: if the risk taking paid off, the institutions' owners kept the profits and their managers kept their jobs; if it failed, the insurance fund bore the loss.
>
> But this behaviour harmed healthy institutions. It squeezed net interest margins both by increasing the cost of funds and by decreasing interest rates on loans. It undermined credit standards by making credit more freely available to marginal borrowers . . . The erosion of credit standards increased loan losses and depository institution failures. The failures depleted the insurance funds, necessitating higher premiums that further undercut healthy institutions' profitability."[3]

Undoubtedly the same general influences apply in Canada as they have in the U.S.A.

[3] Assessing Bank Reform - FDICIA 1 Year Later, Kauffman and Litan - Richard Scott Carnell, The Brookings Institute.

3. Deposit Insurance: International Experience

Most first world countries have some type of deposit insurance. Exceptions include Australia, New Zealand and Hong Kong. Of the nineteen countries in the E. U. and G10 countries, deposit insurance was first introduced in the U.S.A. in 1933 and by 1995 all 19 countries had deposit insurance.

There are differences. Governance varies considerably. In seven countries the deposit insurance schemes are administered by the government (including Canada, the U.K. and U.S.A.) In seven countries they are administered by the banking industry and the remaining five countries they are administered jointly by industry and government.

Funding arrangements are also different. Thirteen of the nineteen countries have ex-ante (i.e. a reserve fund established in advance) funding arrangements and six have ex-post funding arrangements. In the case of the ex-ante funding arrangements, no country makes explicit the source of funding to deal with catastrophic losses that could overwhelm the reserve fund, and/or the ability of the financial institutions to cover the losses. As a matter of interest, two situations could cause such a catastrophe. First, a permanent structural change in the depository industry to a more competitive environment could cause many depositories to leave the industry. Secondly, a temporary, but system-wide financial calamity that is caused by events beyond the immediate control of the depository, would put a large number of them in jeopardy. In the U.S.A. in the late 80's/early 90's, the thrift crisis was described as such a catastrophe. Just as clearly the then existing deposit insurance plan was inadequate to deal with the catastrophe.

Of the nineteen countries, there are only three with risk based premiums, Portugal, Sweden and the U.S.A.

Four countries have co-insurance or an element of co-insurance. The U.K. and Ireland have made co-insurance part of their deposit insurance scheme, starting at the first dollar. Italy and Portugal have co-insurance after a certain maximum amount is reached.

For further detail, a tabular review of deposit insurance schemes for commercial banks in the EU & G-10 Countries: 1995 is attached as Appendix 7.

4. Rationale for Deposit Insurance

Throughout the literature on deposit insurance in Canada and the U.S.A. the following are the main reasons cited for having deposit insurance.

(i) Protection against runs, i.e. protection against systemic problems.

(ii) To protect the interests of the small unsophisticated depositor.

(iii) To ease entry to the financial services sector and thereby foster competition.

(iv) To mitigate the pressure on government to provide an implicit 100% guarantee.

In Canada, the rationale has varied depending upon the source.

1995 Federal Government White Paper stated the following reasons for deposit insurance:

- protection against runs on deposit taking institutions leading to the destabilization of the financial system
- to facilitate the entry of new firms into the deposit taking market
- to protect small retail depositors against the loss of funds in deposit institutions

CDIC 1994/1995 Annual Report - Appendix 1

"The original rationale for having deposit insurance was to guarantee the nominal value of the greater part of the domestic money supply, i.e. deposits. Put another way, deposit insurance was intended to ensure that the public could have as much confidence in a Canadian dollar on deposit in a bank or trust company as a dollar in its wallet . . . As a result, . . . runs on banks would be eliminated since the safety or otherwise of the institution in which the deposit was held, was irrelevant to the safety of the nominal value of the deposit to its holder."

Senate Report - November 1994

"The primary public policy rationale for deposit insurance is to protect the integrity of Canada's payments system by minimizing the possibility of "runs" on deposit taking institutions. Deposit insurance is also designed to achieve two secondary objectives:

1. Protect depositors, especially unsophisticated depositors; and
2. Enhance competition among deposit taking institutions".

Ensuring Failure

Professors Quigley, Mathewson, and Carr in 1994 espoused a totally contrary perspective:

> "Deposit insurance was introduced because it represented an expedient way to provide a subsidy to certain politically important types of financial institutions. In the spirit of Stigler (1971), the political hypothesis submits that deposit insurance was introduced to provide subsidies to institutions that, because of their high risk, lack of diversification, or poor management quality, would not be attractive to uninsured depositors. . . . The deposit insurance scheme amounts to a tax on less risky firms and a subsidy to more risky firms."[4]

Quigley, Mathewson and Carr have developed a thesis that is quite contrary to most of the "conventional wisdom" regarding deposit insurance today. Their approach is thought provoking and, in my view, logically consistent and their book "Ensuring Failure" could productively be read by the Task Force Members.

In summary their research shows that from 1923 (when the Home Bank failed) until 1967 when CDIC was formed there were no bank failures in Canada. In their view, bank failures during the pre-deposit insurance period were avoided because:

- there was no 100% deposit insurance and so the market mechanism was able to function efficiently
- independent audits conducted on behalf of the government and the shareholders provided safeguards
- the government sanctioned market driven mergers.

They believe that deposit insurance was established in 1967 largely for political reasons as noted above. They state that since 1967:

> "the evidence clearly shows that deposit insurance increased both insolvencies and the instability of the Canadian financial system . . .the incentive for imprudence provided by deposit insurance has outweighed any of the claimed beneficial effects and has reduced – rather than increased – the number of viable and independent competitors for the large chartered banks".

The Task Force will wish to consider which rationale is most relevant for Canada in the future. I believe that provision of protection to small retail depositors should be the only major rationale my reasoning is set out below.

---

[4] Ensuring Failure: Financial System Stability and Deposit Insurance in Canada. J.L. Carr, G.F. Mathewson, N.C. Quigley, C.D. Howe Institute.

Political Hypothesis

Quigley, Mathewson, Carr are probably accurate in their assessment of the original rationale for deposit insurance being introduced in Canada in 1967. Certainly the Porter Royal Commission of 1964 considered deposit insurance and did not recommend it. So the conventional economic/financial wisdom of the time saw no need. Probably the motivation was largely political.

I suggest the historical background, while interesting, is not very relevant to the Task Force's deliberations today. Future needs surely are more relevant and important and should drive the Task Force's recommendations.

Protect Against Runs

It is generally accepted within the U.S. that the introduction of deposit insurance in 1933 was a very positive and important structural change. It did restore confidence in many deposit taking institutions and therefore was highly conducive to monetary stability. In the U.S. at the time, something in the order of 1/3 of all banks had failed and there was a threat to the viability of the whole financial system.

In Canada, our financial history is different. There have been no broadly based withdrawals of funds by depositors in Canada in the past 100 years. There are no documented cases where a well managed Canadian institution has been forced into insolvency via a run and no evidence of system wide problems.

In summary, runs in the 30's were a major problem in the U.S.A. In Canada they were not.

It has been argued there were major systemic problems in the 1980's in the U.S.A. in view of the severe problems thrifts and other deposit taking institutions experienced. In Canada in the 1980's, a number of deposit taking institutions experienced difficulty but the relative magnitude of the problem was much less than in the U.S.A. In my opinion, there was not a systemic problem in Canada. Confidence was certainly lost in certain high risk deposit taking institutions but unlike the U.S.A. there was no indication that depositors were losing confidence in the system overall.

It is important to differentiate between problems that an individual financial institution may be experiencing and systemic problems. Systemic problems occur when customers of deposit taking institutions prefer to maintain their resources in cash or elsewhere outside of depositories. This has not occurred in Canada.

Looking to the future, it is the opinion of the Bank of Canada

> "that there has been a significant improvement in the oversight of payment and other clearing and settlement systems in which systemic risk could be present. Eliminating, or significantly reducing systemic risk reduces the costs of individual entity failures, perhaps

> making it more palatable for governments to increase the use of disclosure and market discipline".[5]

Other informed observers whom I have met agree that potential systemic risk has been greatly reduced in recent years.

So in the view of our central bankers systemic risk has been eliminated or at least greatly reduced.

In summary we have not had a past history of systemic problems and the likelihood of "runs" on the entire system in the future has been minimized. While "protecting against runs" has a nice ring to it, particularly when viewed from a political perspective, it probably has not been a relevant primary rationale based on financial/economic experience in Canada and will not be a relevant rationale in the future.

Promote Competition

Undoubtedly the Quigley, Mathewson, Carr thesis is correct, and there has been a political rationale for encouraging the start up of smaller regional financial institutions. Over the years since 1967 there has been pressure to develop new financial institutions particularly in the West. Supporters of smaller financial institutions have also agreed strongly, in their own self-interest, that smaller institutions require the deposit insurance umbrella to compete effectively with the large institutions.

Most of those I met with have argued that the costs of promoting competition via a system of deposit insurance have been too high. Generally they consider the costs to include:

- The cumulative costs to CDIC less recoveries of $5 billion due to the failure of 30 financial institutions since 1967 (when CDIC was established)

- The misallocation of resources that high risk deposit taking institutions have created before their demise via reduced net interest margins or erosion of credit standards.

They have suggested that if there is a public policy objective to encourage development of smaller and/or regional deposit taking institutions that objective could be achieved via direct subsidies at considerably lower cost (albeit higher public visibility) than via deposit insurance.

One senior financial services executive suggested the $5 billion cost was a reasonable price to pay for Canada to have a healthy and competitive financial sector. He is very much in the minority.

I side with the majority view. Deposit insurance is a very costly, inefficient way to encourage the development of smaller financial institutions. In fact, it seems possible as suggested by Quigley,

---

[5] The Financial Services Sector: Past Changes and Future Prospects (a Background Document for the Ditcheley Canada Conference, October 3-5, 1997) C. Freedman & C. Goodlet, Bank of Canada, p. 18.

Mathewson and Carr, that due to the crowding out effect, the current system has reduced rather than increased number of viable and independent financial institutions operating in Canada - i.e. deposit insurance has reduced rather than fostered competition.

Protect the Small and Unsophisticated Retail Depositor

There has been substantial debate as to the type of protection required for the small retail investor, and this will be covered in further detail below in the section headed co-insurance. Some have argued that the smaller depositor would be better off with a Canadian system with no deposit insurance. However, we have had deposit insurance in Canada for 30 years and it now is generally accepted by most observers that some type of deposit insurance is appropriate in Canada because the small unsophisticated retail investor requires some protection. The debate centres more on the quantum of the protection provided, rather than whether or not it is necessary. In my view, given the consensus on the need for some type of Canadian deposit insurance, protection of the smaller depositor should be the main rationale for deposit insurance in Canada in the future.

Minimize Pressure for Implicit 100% Government Guarantee

In Canada, there has been a lengthy history of 100% payment either made directly by government at the Federal or Provincial level or encouraged through an agency by government. For example, according to research by Smith and White, from 1968 to 1987 of 24 distress situations involving CDIC members, full repayment of uninsured depositors was made by Federal or Provincial governments in 17 cases.[6] If one public policy objective is to ensure efficient operation of the Canadian financial sector, then it would be productive to take all action possible to remove the expectation in the mind of the public that the government will invariably bail them out regardless of the circumstances. To the extent that deposit insurance can reduce this expectation, it is a valid rationale. As noted above, deposit insurance costs are not paid for by the taxpayer. A 100% bail out by Federal or Provincial governments is paid for by the tax payer to the extent that the CDIC or similar compensation arrangement does not pick up the costs.

In summary then, my view is that protection of small retail depositors should be the primary rationale for deposit insurance. Minimizing pressure for an implicit 100% government guarantee is a valid secondary rationale. There are significant implications if one accepts this conclusion.

If ‘protection against runs’ is thought to be the major rationale for deposit insurance, as has been the case in the past, then it has been reasonable to conclude that deposit taking institutions, (banks, trust cos. and credit unions) should have access through their compensation plans to ultimate government support. Only government by its reputation and stature and by its ultimate access to the printing press or its equivalent, can effectively protect against a systemic problem. Credit unions do have this access largely via Provincial governments today and banks and trust companies have it through the CDIC via its access to the Consolidated Revenue Fund.

---

[6] Smith, B. and R. White (1988), "The Deposit Insurance System in Canada: Problems and Proposals for Change", *Canadian Public Policy 14, 4 (December): 31-346.*

Once one accepts the view that potential systemic problems should no longer be considered to be the primary rationale for deposit insurance, it becomes difficult to conclude that access to the Consolidated Revenue Fund is either necessary or appropriate. My reasoning is set out below.

Virtually all parties with whom I met agreed that access to the Consolidated Revenue Fund does create an unlevel playing field in terms of the public's perception of the quality of products offered. Strong evidence of this can be seen in Section 7 of this paper. A 1997 Compas Research Study, showed that a CDIC backed product was favoured more than three to one over a non-CDIC backed product. So government backing does provide a competitive advantage for those products the public perceives have it.

The life insurance industry has recognized this and in the early 90's made arguments proposing that COMPCORP should have equivalent access to the CRF as does CDIC. They felt, correctly I believe, that such access would be beneficial in two ways.

1. The ultimate consumer of the product would feel safer and more comfortable if there was a government guarantee, either real or implied.

2. In case of need, access to the CRF would provide instant liquidity.

I believe their analysis of the benefits of the current situation is a valid one. However, their proposal would increase federal government involvement in an area where it does not need to be involved. An equally effective way to level the playing field would be to put the deposit takers on a parri passu basis with the life companies, and others who do not have access to CDIC coverage. To do this would involve removing CDIC access to the CRF and removing CDIC's crown corporation status, i.e. disengaging the federal government from its currently intricate association with deposit insurance.

Eliminating access to the Consolidated Revenue Fund would go part way, but would not completely level the playing field. As CDIC is a crown corporation, it is therefore perceived by the public to be intimately associated with the government, whether or not it has access to the Consolidated Revenue Fund. So such an approach would also require that the CDIC no longer be a crown corporation.

One solution could be to establish it privately as is COMPCORP with mandatory membership requirements and an independent board. The COMPCORP model is set out in some detail in Appendix 1 to this paper. If it was used, the "new CDIC" would then become a federally incorporated non-profit organization rather than a crown corporation of the Government of Canada. To avoid the perception that the large banks were running and controlling the "new CDIC" its board could be structured along similar lines to COMPCORP. The Board of Directors could consist of nine independent directors who are not affiliated with any member depository. The industry could have more input than it has today, via an industry advisory committee as is the case with COMPCORP.

Funding would be via its members i.e. it would be totally independent of the Consolidated Revenue Fund.

This change would require that federal government involvement in CDIC be completely eliminated including board involvement. Currently, as indicated in Appendix 1, the Board of Directors of CDIC includes the Deputy Minister of Finance, the Governor of the Bank of Canada, the Superintendent of Financial Institutions, and the Deputy Superintendent of Financial Institutions. Once CDIC was no longer a crown corporation, it would be inappropriate for those directors to continue as board members.

It has been suggested to me that the involvement by senior federal government civil servants on the CDIC Board provides them with a forum to not only assess what is going on in the financial sector of the economy, but also to provide strong guidance in difficult situations where they feel this is warranted. While the CDIC board provides a convenient opportunity for such assessment and guidance to occur, it seems to me that such activity does not necessary have to occur within the structure of the CDIC.

In summary, there are a number of reasons why it would be appropriate for the federal government to totally disengage itself from its involvement in deposit insurance.

(i) potential systemic problems do not represent the threat they once were perceived to represent.

(ii) disengagement would, over a period of time, moderate public pressure for an implied government guarantee.

(iii) the current structure does create a very real competitive advantage for the members of the CDIC vis-à-vis other financial institutions, i.e. the playing field is not level.

(iv) the public appears to perceive that the federal government is providing preferential treatment to the large banks as a result of its involvement in CDIC.

If the CDIC were made independent, would there be a role for a crown corporation in the deposit insurance area? Possibly there could be in the reinsurance area.

One interviewee suggested that an appropriate role for a Crown Corporation is to act as a reinsurance vehicle. His suggestion is that a crown corporation provide reinsurance for catastrophes for deposit taking institutions, life companies, property and casualty companies, investors and credit unions. The reinsurance concept has some advantages from a public policy perspective because it might enable the federal government to get paid for risks it currently does not get paid for assuming.

The property and casualty insurance industry can be used to illustrate the concept. The P & C industry realized a number of years ago, that the negative financial impact of a major earthquake in B.C. or in Quebec, would be extremely serious:

> "We find that insurance companies writing in B.C. are vulnerable to a $9 billion to $10 billion loss, while in Quebec, they are exposed to an earthquake loss of somewhere around $3 billion to $4 billion . . . These studies all confirm that Canada is vulnerable to a catastrophic earthquake loss, and we are not ready. Claims of

> $9 billion or $10 billion are not the problem if you have arranged $9 billion or $10 billion of financing, but we haven't. After considering licenced reinsurance and retained exposure, we found that the industry could access only about $3.4 billion of capacity. Further payment obviously would impair capital now in place to support other coverages in force."[7]

Mr. Gunn went on to point out that significant activity was underway involving cooperation between the industry and government to deal with the situation.

In his opening remarks at the same conference, John Phelan, President, Munich Reinsurance Company of Canada, stated in part:

> "Prior to KOBE, how many of us would have contemplated an economic loss of approximately US$100 billion? I suspect not many, but it is now a reality we cannot afford to ignore, and it is exactly this reality - indeed, the inevitability - of a major earthquake in a large urban centre, for which we in Canada, are not financially prepared. And by 'we', I am referring mainly to the Canadian public and Canadian governments, and, only partly to the insurance industry. This is because, under current purchase patterns for property insurance, the Canadian public and governments have assumed responsibility for most of the damage, that will result from the next major earthquake, whether they know it or not."[8]

The situation is now presumably more in hand than it was in May, 1996, but for purposes of discussion, let us assume it is not completely in hand. Assume an earthquake did occur and that the impact was sufficient to drive most of the industry into bankruptcy. What would the likely reaction of the federal government be? Would it be prepared to let most of the P & C industry go out of business and let millions of Canadians suddenly have no car, home or other similar insurance for 6 months or a year while the industry somehow was rationalized and reconstituted?

The proposer of this approach suggested it is highly likely the federal government would intervene to provide liquidity and other support because such action would be perceived to be beneficial to a large number of Canadians. In summary, the federal government probably does provide implicit support to customers of the P & C industry in the event of a major disaster.

At the moment they are not being paid for the provision of this (implied) support. If there were a crown corporation to reinsure the risk, that is not being reinsured in commercial markets, and if the reinsurance were handled on an actuarially sound basis, the federal government would generate some income.

A similar scenario could possibly be drawn for each of the deposit taking, life insurance and securities industries. In none of them is the appropriate industry fund well designed to deal with a

---

[7] Bob Gunn, President and CEO, Royal Insurance Canada, and Chairman, Insurance Bureau of Canada, "Proceedings from an Industry Symposium: Canadian Earthquake Exposure and the Insurance Industry, Toronto, Ontario, May 29, 1996. p. 16.

[8] Ibid. J. Phelan, opening remarks, p. 9.

major systemic disaster. The CDIC with its access to government funding is the best positioned but even the CDIC as currently funded could not deal with a major systemic problem without additional government support.

Although the proposal is an interesting one, I am personally not convinced that reinsurance represents a bona fide role for the federal government. In the property area, commercial reinsurance is available to bridge the 1996 gap and actions are underway by the industry and by the regulators to deal effectively with the situation. In the other industries, deposit taking, life insurance and securities the probability of a disaster scenario seems much lower than in the P & C industry so federal government reinsurance backstop does not seem necessary to the writer.

5. Market Mechanism

The question here is whether deposit insurance (i.e. that provided by CDIC) detracts from the effective operation of the market mechanism and therefore from the efficiency of the financial sector.

There is no doubt that deposit insurance does detract from the effective operation of the market mechanism and from the efficiency of the financial sector. That generally is the view throughout the literature in Canada and the U.S. on deposit insurance and has been the view of most of those to whom I have spoken.

The relevant question for the Task Force to consider is whether the costs of the current deposit insurance system, however defined, are greater than the benefits it generates. If the costs are greater, then presumably the system should be amended.

It is widely accepted in the U.S. that in the 1980's and early 1990's deposit insurance caused major aberrations in financial markets there and as a result, significant changes were required. There are a number of ways in which deposit insurance seems to detract from the effective operation of the market mechanism.

(i) as noted earlier, deposit insurance creates a "moral hazard", that is a tendency for insured institutions to take greater risks than they would without insurance. This generally allows them to grow faster than they would absent deposit insurance.

(ii) net interest margins of all financial institutions are squeezed as weak institutions bid up deposit rates in their efforts to become viable.

(iii) credit standards erode as high risk institutions make funding more easily available than otherwise would be the case to higher risk borrowers. This in turn leads to higher deposit insurance premiums and ultimately to lower profitability for healthy financial institutions.

(iv) deposit insurance creates a 'free lunch' philosophy. Depositors feel for their deposits within the insured limits, that they need to take minimal-to-no responsibility for their own funds, as they are 100% covered. In an era when the tendency has been to devolve responsibility upon individuals and away from government, deposit insurance encourages a dependency which is quite contrary to the trend.

The issue then, is how to deal with both the "free lunch" philosophy and with the excessive risk taking that deposit insurance, by its very nature, encourages. There are a number of possible ways:

(i) raise capital requirements. If capital requirements are raised high enough, the debt equity ratio will fall and at some point, management of financial institutions will internalize most of the risk associated with its investment decisions.

(ii) mandate stricter regulation and supervision.

(iii) implement a co-insurance scheme whereby, above some level, depositors bear some of the risk

(iv) introduce risk-based premiums. This has occurred in the U.S.A.

(v) take a narrow bank approach.

These alternative approaches are not mutually exclusive. In fact some may be used in conjunction with others. In the U.S.A. a number of these approaches have been implemented concurrently since 1990 with mixed results.

Although the effective operation of the market mechanism in Canada does not seem to have been impacted to the same degree as in the U.S.A. because we have not had major systemic problems there is little question it has been negatively impacted and changes are required. As requested, I comment below on the co-insurance, risk based premiums and the "narrow bank" approach.

Co-Insurance

As noted earlier in this report, four countries currently utilize some system of co-insurance. In the U.K. and Ireland, the depositor assumes part of the risk starting at the first dollar deposited. In Italy and Portugal, the depositor assumes part of the risk after a certain minimum deposit level has been reached.

In Canada, currently coverage at CDIC is 100% up to the current maximum of $60,000. In practice as noted earlier, 100% payment by government has been provided in a significant number of cases for all deposits regardless of size.

The following studies of deposit insurance in Canada during the past 15 years have recommended the implementation of co-insurance:

- Wyman Report, 1985 - The Final Report of the Working Committee on the CDIC
- Dupré Report, 1985 - Ontario Task Force on Financial Institutions
- Standing Senate Committee on Banking, Trade and Commerce, 1986
- Report of the Standing Senate Committee on Banking, Trade and Commerce, 1994.

The 1994 Senate Report:

> "proposes co-insurance at a level that should not negatively affect the unsophisticated saver - 10% for deposits greater than $30,000 up to a maximum of $65,000 (a ceiling of $65,000 with 10% co-insurance yields the same amount as a ceiling of $60,000 without

> co-insurance). The recommendation may be modest, but if implemented, the principle it would establish will be a very important first step." [9]

This co-insurance proposal is fairly similar to other recommendations over the years. The Senate's rationale is also reasonably typical of reasons favouring co-insurance.

> "The Committee is convinced that depositors must accept some responsibility for decisions they make with respect to the institutions in which they place their money ... The Committee determined that, despite its record in recent years of strongly and consistently recommending co-insurance, supported by the economics profession in general, by senior government officials, such as the Chairman of CDIC and the Superintendent of Financial Institutions, and by many from the banking life and health insurance industries - there remains opposition to the principle from others - including consumer groups and the Trust Companies Association."[10]

The general principles cited by those supporting co-insurance is that once depositors understand that some portion of their funds is at risk, they will take more care in determining which financial institution to use in placing their deposits. Additionally, once management of a financial institution contemplating a high risk strategy, realizes that depositors will be taking more care in placing their deposits, they are likely to adopt a lower risk approach for fear that the high risk strategy will either prove too costly to them in attracting deposits or alternatively may not enable them to attract deposits at any price.

The 1995 Department of Finance White Paper opposed co-insurance for two reasons. First it pointed out there was opposition to the introduction of co-insurance. Secondly, it stated that some consumers were unable independently to assess the riskiness of a financial institution.

With regard to the first point it is not surprising that the beneficiaries of the existing 100% deposit insurance scheme (up to the $60,000 limit), strongly support the status quo. Maintenance of the status quo optimizes their return. From a public policy perspective maintenance of the status quo undoubtedly has a negative impact based on the assessment of the economics profession and the other (presumably unbiased) professionals cited in the Senate report. Surely this overall negative impact is more relevant than the concerns of a small special interest group.

I believe the uninformed depositor argument also is not a valid one.

> "The fact that many depositors are unsophisticated about the financial position of deposit taking institutions, is no justification for rejecting co-insurance. People who are not construction engineers invest substantial portions of their net worth in a home without a government guarantee of the capital value of the asset. Similarly, co-insurance simply gives depositors an incentive to use the information they do have, or to employ professional advisors, in the same way they do when they purchase a house. In addition,

---

[9] Regulation and Consumer Protection in a Federally Regulated Financial Services Industry: Striking a Balance. Report of the Standing Senate Committee on Banking Trade and Commerce, Nov. 1994, p. 27.
[10] Ibid., p. 26.

> co-insurance encourages individual institutions and their regulators to increase the flow of credible information to depositors and to invest in building a reputation for prudent policies." [11]

Technology has created another reason for increased reliance in the future on market discipline. It is likely that governments in all countries, Canada included, will be unable to prevent the sale of financial services or products to their residents by financial service providers located outside of the country and thus not subject to regulation. The best way to protect consumers against problems arising from the sale of products/services by unregulated entities may be to use disclosure to ensure the customers understand the unregulated nature of the institutions they are dealing with. Governments may have no alternative. Reliance on direct supervision will become less relevant and reliance on improved disclosure and increasing personal responsibility by customers will become more relevant of necessity. Coinsurance encourages increased self reliance by customers and acceptance of their responsibility for their own actions. Use of coinsurance would thus be completely consistent with a trend that governments will likely have to encourage whether or not it suites their domestic political agenda.

In summary, implementation of co-insurance would have the following advantages:

1) it would sharply reduce the problems created by "moral hazard" by allowing the market mechanism to work more effectively.

2) it would reduce misallocation of resources and so reduce the high costs of the current system.

3) it would encourage depositors to accept some responsibility for their own actions, i.e. it would moderate the 'free lunch" philosophy.

4) it would be consistent with trends being forced upon Canada by technology.

Risk Based Premiums

Risk based premiums have been suggested as an alternative to co-insurance as a technique for ensuring that depository institutions better internalize their risks. The concept is that rather than having a flat premium structure for all financial institutions as currently is the case that the insurer charge premiums that, to some degree, reflect the risk profile of each financial institution.

Instead of paying its depositors high rates which would occur in the absence of deposit insurance, a riskier institution, under the proposal, would pay deposit insurance premiums reflecting the higher risk. Risk based premiums were first recommended by the Economic Council of Canada in 1975 and were adopted by the Department of Finance in its 1995 White Paper headed "Enhancing the Safety and Soundness of the Canadian Financial System". Appendix 4 encloses annex 6 from that 'White Paper' outlining the proposed approach in detail.

---

[11] Policy Options, June 1995, Financial Institutions Need More Mareket Discipline, Not More Regulation, by J.L. Carr, G.F. Mathewson, and N.C. Quigley.

Risk based premiums seem to be viewed as a perfect alternative to co-insurance. They are not. Major differences are:

- risk based premiums are intended to impose discipline (through the penalty of higher premiums for riskier behaviour) on the financial institution itself while a co-insurance approach is directed at the consumer and then via the consumer's informed choice, to the financial institution. Co-insurance therefore places greater reliance on the effective working of the marketplace.

- implementation of a risk based premium's approach is considerably more complex than would be the implementation of co-insurance. There are a series of issues that are not easily dealt with.

    1) Who makes the assessment? Should it be bureaucrats or rating agencies?

        Bureaucrats now do it in most countries, including Canada as risk rated capital requirements have been adopted in one form or another throughout first world countries by regulators. Another proposed solution to the question of who makes the assessment is to require each deposit taking institution to issue subordinated debt in the public markets and then tie the risk rating to the market assessment of that debt.

    2) Will any type of assessment really be effective? In a risk based premium model, the assessment/evaluation is normally done after the fact (i.e. after high risk assets have been acquired and the high risk strategy has been embarked upon). At that point, is it not too late to impose discipline by raising premiums on the high risk institution?

    3) Should the riskiness of each institution be made public? If it is not, will the effectiveness of the entire approach not be impaired? If there is no threat of negative publicity, would there be less incentive for financial institutions to refrain from adopting a high risk strategy?

    4) Given the political and other considerations, can a broad enough range in premiums be introduced to actually affect the behavior of potentially high risk financial institutions.

In the U.S. the Federal Deposit Insurance Corporation (FDIC) implemented a system of risk based premiums effective January 1, 1993. Details are set out in Appendix 4 to this document. The jury is still out as to how effective that system presently is, but one criticism is that the range of premiums was much too narrow. Initially, the premiums ranged from 23¢ to 31¢ per $100.00 of insured deposits. The range is very narrow and the level of premium is not publicized so critics contended there was insufficient incentive for high risk depositories to change their high risk ways.

In Canada, the CDIC Act has been amended and CDIC says it will be introducing differential premiums. Currently all CDIC members pay the same 1/6th of 1% of insured deposit premiums. Once differential premiums are introduced, the lower rated category of member will likely pay 1/3 of 1% - the maximum permitted by law. Even so, differential premiums will not be expected to be an actuarially based measure of the risk posed to CDIC by each individual institution, but

rather to be an early warning signal. Full details of what's intended is set out as Appendix 5 to this report taken from pages 21 and 22 of the 1996 - 1997 CDIC Annual Report.

In summary then, the implementation of risk based premiums in Canada is proceeding and should enhance the operation of the market mechanism. In the view of the writer, implementation of a co-insurance approach, above a certain minimum threshold would be much more effective, however, implementation of a risk based premium approach will be much better than the arrangements currently in force.

Narrow Bank

An alternative to co-insurance and to risk-based premiums, that has been suggested by various economists including Friedman and Tobin over the years, is described as "narrow banking". The concept is that for "payments deposits" financial institutions must maintain 100% reserves in Federal government treasury bills or the equivalent, i.e. guaranteed deposits cannot be lent out. This would eliminate the instability inherent in the current fractional reserve system. Any financial institution wishing to make loans, would do so through another subsidiary which would be funded in the marketplace and whose liabilities would not be guaranteed.

The proponents of the narrow bank approach suggest there are the following benefits:

- It avoids the problems of moral hazard because all guaranteed deposits must be backed by safe market instruments. Any financial institution following a high risk investment strategy would have to fund it with non-insured deposits or market instruments. That institution would therefore have to convince the market its approach was reasonable and/or would have to pay a risk premium.

- It would allow depositors to choose how they wished to invest their resources. Those who were highly risk averse, could place their funds in the guaranteed deposits. Those who had a greater risk preference and wished higher returns could acquire non-insured deposits and/or assets (this assumes depositors are reasonably well informed).

- It would allow a bank holding company approach to work because a financial institution could own subsidiaries that issue guaranteed deposits and also subsidiaries that issue non-guaranteed obligation.

This approach has been considered in the U.S.A. and was the subject of considerable interest in the early 1990's. It has lost appeal now, we understand due to complications raised by the Community Reinvestment Act in the U.S.A. Such complications would not apply in Canada.

As a matter of interest, this type of approach is one that our Canadian regulators might consider in their determination in how to manage risk for small depositors in the case of a credit card issuing subsidiary of a commercial institution. Assume the credit card subsidiary issues smart cards and that 200,000 of their customers prepay $100 each into their smart cards. The credit card subsidiary will then have the equivalent of $20 million in deposits. To ensure these 'deposits' are not diverted elsewhere in the organization, and thereby to protect the owners of the smart cards,

the regulators could consider a requirement that the funds, so generated, be invested in short term, extremely low risk paper.

In Canada, if the narrow bank concept were implemented, it would involve a major change to our existing financial system and would require massive public education. It would also place small depositors at higher risk than does the current system because some of them would utilize non-insured deposits. Under this arrangement, the market mechanism would be allowed to function more efficiently than under co-insurance or a risk-based premiums approach. The incidence of losses for the insurer, would also be sharply reduced.

6. Funding Mechanisms

As can be seen from the overview of compensation schemes (Appendix 1), there are significant differences across the various compensation arrangements in almost every respect including funding mechanisms.

The most significant differences relate to sponsorship, coverage, and the authority to deal with member institutions. CDIC is a crown corporation of the Federal government and has considerable powers in dealing with insolvent members. COMPCORP is a Federally incorporated non-profit organization. It has limited powers to monitor the activities of members and supervision is the responsibility of government regulators. CIPF is an industry sponsored trust and participating Self-Regulatory Organization's (SRO) are the primary supervisors of member firms, although CIPF is active in the establishment of minimum standards and in assessing the adequacy of SRO supervision. PACICC is a federally incorporated non-profit organization and as with COMPCORP participating regulators are responsible for the inspection of member institutions.

Coverage varies although both COMPCORP & CIPF match the CDIC $60,000 limit for cash. COMPCORP for example has $200,000 life insurance protection and $2000 per month for annuities. CIPF has maximum basic insurance coverage of $500,000 which includes the $60,000 coverage for cash balances. PACICC has a maximum of $250,000. Levels of coverage in each case have evolved based on the needs of the buyers of the different products being covered.

Payout in the case of CDIC, COMPCORP, and CIPF, can be very different, as indicated by the following:

Consumer Protection - Comparison of Loss Determination

The following example illustrates CIPF's effective coverage compared to that of CDIC and COMPCORP.

Consider the following situation. Customer A has a $150,000 free credit balance with a securities firm. Customer B has $150,000 on deposit with a deposit-taking institution. Customer C has $150,000 in cash available for withdrawal in a life insurance company.

The securities firm, deposit-taking institution and life insurance company all become insolvent. In each case, the trustee liquidates the assets and, after administrative expenses, is able to pay a dividend to all creditors of 60 cents on the dollar. The following table shows how much Customers A, B, and C would receive from the trustee and he applicable customer protection plan.

Customer	A	B		C	
Protected by	**CIPF**	**CDIC**		**COMPCORP**	
Cash insured for	$60,000	$60,000		$60,000	
Cash balance	$150,000	$150,000		$150,000	
		Insured	**Not Insured**	**Insured**	**Not Insured**
		$60,000	$90,000	$60,000	$90,000
Dividend from trustee at 60 cents per dollar equals	$90,000	$36,000	$54,000	$60,000	$30,000
Loss before coverage	$60,000	$24,000	$36,000	$0	$60,000
Paid by consumer protection plan	$60,000	$24,000	$0	$0	$0
Final loss	$0	$0	$36,000	$0	$60,000

In this example, the total amount of funds recovered by the customer (from the compensation plan and the liquidator) is highest under CIPF ($150,000), followed by CDIC ($114,000) and COMPCORP ($90,000). The reason for the different results is that CIPF insures losses of up to $500,000, of which $60,000 can be for the cash component (as illustrated), CDIC insures a deposit of up to $60,000 and applies the dividend from the liquidator to the insured and the uninsured amounts pro rata, and COMPCORP insures an amount of up to $60,000 but applies the dividend from the liquidator to the insured amount first

Source: VSE Review, August 8, 1990, p. 8.

There are also significant differences in size. For example, in 1996 premiums collected ranged from $538 million by CDIC to $45 million at COMPCORP, $14 million at CIPF and $10 million at PACICC.

Turning to funding both liquidity and annual cash flow are possible measures of adequacy.

The availability of cash resources in case of immediate need is very different across the compensation arrangements. As noted earlier, CDIC has access to the Consolidated Revenue Fund and so, in case of need, presumably has ready access to cash totaling billions of dollars.

CIPF has operated a pre-assessment plan since inception and currently has in excess of $130 million in cash reserves. In addition, it has a line of credit of $40 million and the ability to borrow $112 million from its members. Based on CIPF's loss experience of the past decade, this should be adequate to cover any insolvency encountered in the normal course.

COMPCORP and PACICC have just recently moved to a pre-assessment basis and therefore their existing cash resources are relatively modest, although both have access to substantial lines of credit and funding from their members. For example, in 1995, COMPCORP was significantly

strengthened so that its compulsory borrowing powers were increased from 1% of covered premiums (which gave COMPCORP access to up to $200 million from member institutions) to 3%. As a result of this increased borrowing power, there is now up to $600 million available from member companies.

Measured against the loss experience in each industry over the past few years from a liquidity perspective, it seems that consumers are relatively well protected in each case. If one assumes a major systemic disaster, unlikely as this might be, then in each case, additional support would be required as suggested earlier in this paper.

As for the credit unions, Appendix 3, a Summary Table of Deposit Protection for Credit Unions indicates that the scope of the coverage is at least as substantial as that provided by CDIC with a maximum limit of $60,000 in Ontario and all points east of Ontario, with 100% guarantee on deposits in the three Prairie provinces and with $100,000 per credit union in British Columbia. Support from provincial governments is provided in most provinces directly, or indirectly.

Turning to annual cash flow, CDIC appears today to be adequately funded. Premiums collected in 1996 were $538 million and claims paid in the same period, were $42 million. The CDIC deficit during 1996/1997 decreased by $125 million to $1.176 billion and the current expectation is that the CDIC deficit should be very substantially reduced, possibly even eliminated by 1999. In any case, access to the Consolidated Revenue Fund ensures CDIC will remain adequately funded.

COMPCORP collected assessments in 1996 of $44.9 million and paid claims of $5.1 million. Total claims incurred in 1992-1996 were $409 million, or an average of $68 million per year. Given the company's substantial borrowing capacity, of up to $600 million, the company appears adequately funded based on its historic experience.

CIPF collected premiums in 1996 of $14 million and paid claims of $0. Accumulated losses over the past 10 years, peaked at $41 million and now are under $25 million as a result of recoveries. CIPF has in excess of $130 million in cash resources and very substantial borrowing capability as noted above. CIPF therefore appears to be adequately funded.

PACICC collected assessments in 1996 of $10.0 million and paid claims of $9.4 million. PACICC has a provision in place to have a prefund of $30 million for liquidity that will be collected in the years 1998, 1999 and 2000. In addition, PACICC's Board of Directors is required to have a $10 million line of credit with a Schedule "A" bank. Major changes therefore are underway at PACICC which will result in PACICC being adequately funded in comparison to its past loss history, by the year 2000.

With regard to the Credit Unions, the Stabilization Fund or Deposit Guarantee Corporation, or Deposit Insurance Corporation, in each province, is generally a crown corporation, or is guaranteed by the government. In most provinces, the corporation has a surplus (Ontario is the exception), and given the support of the various provincial governments, one can conclude that funding is adequate.

In the commentary above, "adequacy" has been analyzed in connection with recent history which is not totally satisfactory. The writer attempted to define a more quantifiable measure of adequacy and was unable to do so. The U.S. authorities have experienced a similar problem:

> "During our review we determined that no quantifiable measure exists to assess the exposure of the SIPC Fund and the adequacy of its reserves (such as the ratio of reserve to insured deposits, which FDIC uses to assess the exposure of the bank insurance fund.
>
> As a result, we based our conclusions about the SIPC Fund's ability to protect its customers and maintain public confidence in the markets on such factors as SIPC's past expenses, current trends in the securities industries, the regulators enforcement of the net capital and customer protection rules, and SIPC's policies and procedures."[12]

Are funding arrangements adequate? Based on liquidity and cash flow measures they are unless as outlined above a major systemic problem occurs in any one of the industries covered.

The funding arrangements are very different. Are there public policy issues that flow from these funding differences and if so, would making the funding arrangements more uniform help deal with the public policy issues?

Payout arrangements on cash deposits or cash balances are different as illustrated in the table above. Are these differences somehow unfair? Are some consumers likely to be disadvantaged as a result of them? Certainly in some circumstances holders of life products will receive a lower payout and holders of cash balances covered by CIPF will receive a higher payout than holders of deposits covered by CDIC. Should the federal government mandate that all coverage be exactly the same and so remove potential "unfairness"?

My recommendation is that uniformity not be mandated. The marketplace is working pretty well in that all coverages are roughly comparable. It is in the self interest of each industry to have products that meet customer needs and are competitive. Coverage at CIPF and COMPCORP has been improved over the years in response to the demands of the marketplace.

It comes down to a matter of philosophy. Those with an interventionist bias might favour precise uniformity. The Task Force has stated its desire to rely upon the working of the marketplace. In this case the market is working fairly well.

[12] U.S. General Accounting Office, Securities Investor Protection, Report to Congressional requesters: "The Regulatory Framework has minimized SIPC's Losses", Sept. 1992, p. 19.

7. Public Perception

There are widespread concerns as to public confusion flowing from the fact that some instruments are protected by compensation arrangements and others are not. There are less concerns flowing from the differences among the various compensation arrangements.

> "Intense competition in the financial services sector, combined with regulatory constraints on business activities, has resulted in the development of many different products targeted at the same consumer needs. For instance, the term deposits offered by deposit taking institutions compete with single premium annuities, money market mutual funds, small denomination t-bills, and even Canada Savings Bonds. Differences in the degree of protection, backing these products would affect consumer acceptance of them…
>
> Financial conglomeration creates the prospect of an increasing diversity of products being sold from a single branch, brokerage or agent. With different compensation plans potentially covering products offered by the same financial institution, customers may not be fully aware of which plan covers the product, nor the limits of that coverage".[13]

Similar concerns were expressed in the 1994 Senate Report. In fact, at the time, the Deputy Superintendent of Financial Institutions indicated, based on a recent survey, that over 50% of people buying mutual funds thought the funds were insured by the CDIC.

Although the CDIC, over the years, has undertaken expensive education campaigns to raise consumer awareness, spending $3 million per annum or more, there still is a considerable amount of confusion and lack of understanding in the marketplace.

This confusion may have been exacerbated in part because of the "gag rule", which was implemented in 1987 in the wake of the failure of Principal Trust, when depositors complained that they had been given incorrect information. Since then, employees of deposit taking institutions have been prohibited from providing information about deposit insurance at the place of sale. If customers have inquired about deposit insurance, they have been referred to the CDIC toll free telephone number and mailing address.

This legislation changed in December 1996, and effective March 1998, employees of member institutions will be permitted to discuss all deposit products that are approved for CDIC insurance. In addition, each CDIC member will be required to display prominently in each of its places of business, both the CDIC information brochure and a register of deposit products approved for CDIC insurance.

The removal of the "gag rule" and the encouragement of CDIC members to become more pro-active will certainly help.

---

[13] Compensation Plans in the Canadian Financial Sector: A Comparison. A report prepared for the Department of Finance, Deposit Insurance Review, Sutton & Andrews, March 4, 1993.

The perception of all those whom I interviewed, was that there was still substantial public confusion although most of them had very little hard data to back-up these perceptions.

All hard data that is available confirms there is a significant level of public confusion as to which products are covered and the level of coverage:

- as noted above in 1994, the Deputy Superintendent of Financial Institutions had evidence that 50% of people buying mutual funds thought the funds were insured by the CDIC;

- a 1997 survey commissioned by CDIC reflected a low level of awareness. Some examples:

> "Only one in ten was able to identify CDIC as the organization responsible for deposit insurance without any prompting . . . Only one quarter of Canadians were able to correctly identify "60,000 as the maximum limit . . .Only 16% were able to correctly identify Canadian funds as being the only currency that is insurable… Only 6% of respondents were able to identify the maximum length of term deposits as five years . . . In the case of mutual funds, one in four respondents believed them to be insurable by CDIC, and another 51% did not know". [14]

The Canadian Life and Health Insurance Association Inc. also provided some hard evidence as set out below in a monthly Angus Reid National Omnibus Survey (sample size 1,525). After a preamble explaining CDIC and COMPCORP respondents were asked: "If you have a choice between investing your money in a financial product guaranteed by CDIC, or in an identical product guaranteed by the life insurance industry's COMPCORP, which would you prefer?" The results are set out below, together with previous findings from a January, 1995 COMPAS Research Study.

CONSUMER PREFERENCES

Preference	**March, 1997 (%)**	**January, 1995 (%)**
CDIC-Backed Product	67	68
COMPCORP-Backed Product	20	17
No Difference/Depends on other factors	7	8
Don't Know	6	7

The same Angus Reid survey provided another example of public confusion. Mutual funds are not covered by CDIC. Nor are deposits longer than 5 years, covered by CDIC. In that survey 50%

[14] Public Awareness Research in Support of CDIC Information By-Law Changes -- Ekos Research Associates Inc.; July 25, 1997, pp. VI and VII.

of those surveyed believed mutual funds were covered, and 81% believed 10 year term deposits were covered.

Based on the above public awareness remains at a relatively low level. I think it is likely that such confusion will be exacerbated in the future through developments in an increasingly technological and international world.

Two policy approaches may help enhance public knowledge.

- Continued public education should be encouraged by CDIC and the other compensation arrangements. It may however, be extremely difficult to change public perceptions unless governments at the Provincial and Federal level remain willing to step back and allow CDIC and/or the other compensation arrangements to deal with future failures. This did occur in the case of Confederation Life. My perception is that it has occurred more frequently since the middle eighties.

- The Task Force could also recommend action that will create increased individual self reliance. Policy action could be taken to eliminate, or at least moderate, the "free lunch" philosophy that many depositors appear to have. Coinsurance would be a major help in this regard, as noted earlier, because depositors who have at least some of their resources at risk within the limits would, in all probability, be more careful and make greater efforts to educate themselves as to which products were covered, and which were not.

8. Impact of Technology

Technology has been, and will continue to be the most important factor driving change. It has impacted every area of the financial services industry. To cite just a few examples:

Short term money market funds - technology has allowed funds to be "swept" from deposit accounts into short term money market accounts on a daily basis. It has also allowed for prompt (24 hour) conversion back from money market funds to deposit accounts. From the perspective of deposit insurance, then, technology has allowed the creation of a substantial deposit position during the day, which is reduced or even eliminated at the end of the day, when the funds are swept into the money market account. One could argue that the deposit insurance plan has a daylight exposure that is greater than the position shown at the end of each day, i.e. it is collecting insufficient premiums based on the maximum level of daylight exposure.

Electronic money - provides another example of how technology can create a deposit substitute. Technological changes have now made it feasible to develop the stored value card (SVC). There are a number of groups currently involved in developing SVC projects, most notably MONDEX, VISA, and PROTON. Earlier in this paper, I noted that the regulators might consider a 'narrow bank' approach to protect customers who have resources tied up in SVC's. Also evolving is network money, or digital cash. This involves funds (i.e. the liability of an issuer) held on computer software, but could be used to pay for purchases on the Internet. So far, it has been software companies, rather than major financial institutions who have been involved in such schemes.

Delivery mechanisms - are also changing as a result of technology. Customers are interfacing with their financial institutions much less through bricks and mortar, and much more through electronic means. Branch systems may soon become an 'albatross', i.e. they may become a too high cost delivery system.

Technology is also impacting on regulation as noted earlier. It may not be possible for regulators to effectively supervise non-financial institutions as well as financial institutions, foreign institutions, as well as domestic institutions, and 'virtual' institutions, in addition to more conventional institutions. It will likely be that governments and regulators will have to rely increasingly upon disclosure and market discipline rather than direct supervision as has been the case in the past to ensure that the consumer is adequately protected. Simply put, technology will give the consumer the opportunity to access substantially improved information regarding products and services offered. Its impact will likely also be that consumers will have to be become increasingly self reliant in managing their financial affairs, because governments will be unable to 'protect' them as easily via direct intervention and supervision as they have in the past.

9. Relationship with Regulators

As can be seen from the detailed material in Appendix 1, Relationships with Regulators vary considerably from compensation plan to compensation plan. There is quite a close and formal relationship in the case of both CDIC and CIPF and in the case of credit unions (with the Provincial governments), and a much less formal relationship in the case of COMPCORP and PACICC.

Starting first with corporate governance, CDIC has, on its Board, four senior Federal government officials, the Deputy Minister of Finance, the Governor of the Bank of Canada, the Superintendent of Financial Institutions, and a Deputy Superintendent of Financial Institutions. The senior regulators are therefore on its board. In the case of CIPF, each of the five participating SROs is entitled to appoint one governor (out of a total of 12), so regulators have a significant influence on CIPF. Neither COMPCORP nor PACICC are required to have regulators on their board. In the case of COMPCORP any participating regulator is entitled to attend a meeting of the Board, but is not entitled to cast a vote. With PACICC, each regulator is invited to each meeting. The federal regulator is invited even though the federal government is not a party to the contract with PACICC. The regulators are not encouraged to vote, but are encouraged to take part in the discussion.

With regard to rights to order members to take specified actions, CDIC has this right. CIPF's Board of Governors may direct a participating SRO to order a member considered to be in financial difficulties to take a particular action. Neither COMPCORP nor PACICC have the right to issue orders. In terms of other related powers, CDIC is in an extremely strong position as is CIPF. The rights of COMPCORP and PACICC are substantially limited.

With regard to the right of inspection, CIPF has the right to inspect members and the right to access any information SROs hold on members. CDIC has the right to inspect provincial members and OSFI conducts annual examinations of federal members. Neither COMPCORP or PACICC have the right to inspect member companies.

With regard to obligations of regulators to the compensation scheme, the regulators undertake examinations on CDIC's behalf, and thus must report this information. The examiner must also report to CDIC if there has been any significant change in the member institution being examined.

Turning to CIPF, SROs must ensure that all requirements laid down by CIPF are met by members. In addition, SROs must notify CIPF of any situation that could give rise to payments being made out of the fund and every case where minimum standards are not being met. There are also other significant formal requirements. With regard to COMPCORP and PACICC, formal requirements are not as onerous, although in the case of COMPCORP, participating members are required to inform COMPCORP of members placed on a solvency 'watch list' and may enter into confidential discussions regarding the status of these firms. The management of PACICC exchanges confidential information with the superintendent on suspect companies and is generally advised of companies which are on the Superintendent's 'watch list'.

Turning to standards required by the compensation schemes, members must comply with standards of sound business and financial practices, set by CDIC. CIPF has worked with the SROs and the CSA to develop minimum standards for member firms, and the SROs have primary responsibility for ensuring member compliance with CIPF minimum standards. COMPCORP members are expected to comply with primary regulators Minimum Continuing Capital and Surplus Requirements. Standards of sound business and financial practices are under development with regulators. PACICC is working with the Insurance Bureau of Canada on industry standards.

The legal situation varies across plans. CDIC is obliged to make payment when a winding up order of a member institution is issued. Neither COMPCORP, CIPF, nor PACICC are under legal obligations to provide compensation. (See Appendix I, Section II for further details). However, in the case of CIPF, the courts have held that CIPF must provide coverage in a consistent manner with publicly disclosed guarantees of compensation.

Finally, in terms of regulatory liability, regulators have no statutory liability in the event of a failure in connection with CDIC, COMPCORP, or PACICC. The SRO having the prime audit responsibility is liable to reimburse the CIPF for the lesser of $2 million, and an amount which is equal to 10% of the total amount paid out of the CIPF, subject to some other conditions.

Regarding credit unions as is evidenced in Appendix 3, they are all intimately connected with their provincial governments.

Are there broad policy concerns? On balance, no there are not because the relationships appear to be working reasonably well in each case. However, it would be appropriate for the task force to explore the legal situation. As noted above, only CDIC is legally obligated to make payments. The other plans have no apparent legal obligation, although as a practical matter, it appears to the writer they have no option but to meet the obligations they have publicly committed to meeting.

10. Conglomeration

Financial conglomeration, as noted in the quotation in Section 7 of this report, from Sutton and Andrews, is a term that has been developed to describe what can occur as increasing numbers of financial services are marketed by one financial or non-financial organization. Financial services covered by different compensation plans are now being sold from a single branch, or corporate entity or sales person. As outlined earlier, there is confusion in the mind of the consumer as to what coverages exactly are and in fact, what products are covered, and what products are not covered.

Conglomeration has also been highlighted by CIPF in connection with the potential wind-up of a large financial conglomerate. If a large financial conglomerate were to fail, and be wound up, which regulator would have jurisdiction?

This occurred in the case of Confederation Life. Apparently CDIC successfully mandated that the parent life company purchase approximately $200 million in low quality assets from its trust subsidiary. The transfer had the effect of moving ultimate responsibility for recovery of those low quality assets in the wind-up from CDIC to COMPCORP.

CIPF makes the point that for reasons of cost reduction, large deposit taking institutions have the financial incentive to move the back office operations of their brokerage subsidiaries into one location, so that the back office of both the deposit taking institution and its brokerage subsidiary is, in effect, run by the same group of personnel. Similarly there is an incentive to move the securities safekeeping into one master account, as costs can be lower. CIPF points out in the event of an insolvency, it would be significantly impeded in its efforts to protect the interests of customers at the brokerage operation which it insures. CIPF would be unable to locate any physical back office within the premises of the institution it insures. It might also have significant difficulty in establishing control of the broker's securities, as they could be co-mingled with the securities of the depository.

CIPF's concern, I believe, is that CDIC would be in a strong position to protect the interests of depositors of the depository, possibly to the exclusion of customers of the brokerage subsidiary, life subsidiary, P & C subsidiary, etc.

Is it equitable that those customers protected by CDIC enjoy some type of priority over those customers protected by the other compensation arrangements? From a public policy perspective, I suggest it is not equitable.

The question then is, how can the interests of customers of different financial institutions covered by different protection plans be somehow balanced in the event of a wind up. The situation becomes even more challenging if the financial institutions in question are subsidiaries of a financial holding company that is being wound up. The functional regulation approach has been suggested as a methodology which may produce a more "equitable" result than the current approach. There are a number of functional models which could be considered. The most broadly discussed model proposes to regulate certain lines of business in the same way regardless of the institutional or corporate nature of the provider. Thus a bank or trust company, or stored value

card issuer, or insurance company, or money market mutual fund, would all be regulated in the same way, if they were perceived to be providing "deposit" services to the public. The Task Force is already reviewing this approach in depth.

A major problem with this approach occurs in the event of an insolvency because an insolvency is an institutional and not a functional phenomenon. It is the bank or money market mutual fund, or insurance company, etc. that fails, and not the deposit function. Therefore, the functional approach has the appeal that it treats all players in a similar line of business in the same way, but it does not, by itself, deal with the issue of institutional failure. Modification of the approach would be necessary if institutional failure were to be effectively handled.

Another type of functional model has been proposed in the Wallis report in Australia. This model is closer to the more traditional regulatory approach than is the functional approach outlined above. It proposed that different regulators deal with the different functions of regulation. So for example, one regulator would be responsible for financial stability and payment system issues, another for consumer protection and another for prudential regulation (solvency etc.) While this has the advantage of putting all institutions that are to be regulated under a single regulator for each regulatory function, it seems to me there is a likelihood of duplication, overlap and therefore relatively high regulatory cost.

Given the blurring of business lines that will be escalated by technology and by the other trends reviewed earlier, I believe sticking with the status quo is not a viable option. I favour continuation of the traditional regulatory approach only if concurrently changes are made to ensure consumers become more responsible for their own financial assets, financial institutions are required to disseminate more comprehensive, timely information and there is greater reliance on the marketplace.

If these changes do not occur then some type of functional model would be preferable to continuation of the status quo.

11. Conclusion

My major conclusions are as follows:

1. Protection of the small depositor should be considered as the primary rationale for having deposit insurance in Canada and not protection against runs as has been the case in the past. Minimizing pressure for a 100% government guarantee of deposits remains a good secondary rationale.

2. By concluding that protection against runs is not a valid rationale for having deposit insurance in the future, one is driven to the conclusion that there should be major changes to the CDIC. To create a more level playing field, the CDIC access to the Consolidated Revenue Fund should be terminated as should CDIC's status as a Crown Corporation. Regardless of the model used, the new CDIC will be very different than CDIC today including major changes to its current governance structure.

3. Coinsurance should be implemented in Canada. The rationale supporting coinsurance is extremely compelling and clear. The rationale provided in the 1995 White Paper against coinsurance, does not stand the test of rational analysis. Virtually all independent experts, who have looked at the issue over the past 15 years, have recommended coinsurance as being an approach to substantially improve the working of the market mechanism, and significantly reduce costs.

4. The various compensation plans are different. However, they all seem to work. Where there have been deficiencies, the plans have evolved to remedy these deficiencies and therefore they should be left as is.

5. Funding arrangements are adequate unless any one of the plans is required to deal with a major systemic shock.

6. There is considerable confusion in the mind of the public as to what financial products are covered by the various compensation plans. This confusion will create a major problem in the event of a failure. A partial solution is to mandate some continued public education and for the Task Force to recommend all action that will increase self-reliance by the public including the adoption of coinsurance.

7. Technology will remain the main driver of change. Change will likely occur more quickly than regulators will be able to keep up with it. Regulators will therefore be driven to rely increasingly on disclosure, an informed responsible public and market discipline to ensure the financial sector functions effectively.

8. Relationships with regulators are generally reasonable and in some cases are extremely smooth and close. I note that the Task Force requested that I <u>not</u> comment on the OSFI/CDIC relationship as they will be reviewing that separately.

9. Conglomeration will cause major problems, particularly in the event of a failure of a company holding financial subsidiaries. The changes proposed in this paper would help dealing with these problems within the current institutional regulatory structure. If these changes are not acceptable then utilization of some type of functional regulatory model would be productive.

APPENDIX I

1. OVERVIEW OF COMPENSATION SCHEMES

Design Features	CDIC	CompCorp	CIPF	PACICC
Enabling documents	• Canada Deposit insurance Corporation Act. • Canada Deposit Insurance Corporation By-laws.	• Canadian Life and Health Insurance Compensation Corporation By-law No. 1, as Amended and Restated (May 1996). • The Memorandum of Operation as Amended and Restated (May 1996). • Bilateral memoranda of agreement with participating jurisdictions. (These have been signed with all jurisdictions except Nova Scotia and Ontario.)	• Amended and Restated • Agreement and declaration of Trust (1997). • Memorandum of Understanding between the Canadian Securities Administrators (CSA) and the CIPF (July 1991). The CSA is comprised of the authority in each jurisdiction with statutory responsibility for the securities industry.	• Amended By-law No. 1. • The Memorandum of Operation as Amended. • Bilateral agreements with participating jurisdictions.
Legal basis	• CDIC is a crown corporation of the Government of Canada.	• CompCorp is a federally incorporated non-profit organization.	• The CIPF is a trust established by the MSE, TSE, VSE, ASE and the IDA. Each SRO is a sponsor of a member of the CIPF, entitling the securities dealers regulated by that SRO to be covered by CIPF. The TFE is an affiliated member and the WSE is about to become an associate member*.	• PACICC is a federally incorporated non-profit organization.

Note: Figures relating to staff; expenses, members, premiums and claims fluctuate from year to year so that 1996 is not necessarily representative.

* Awaiting a governance review

Design Features	CDIC	CompCorp	CIPF	PACICC
Staff	• Number of staff in 1996: 88 • Operating expenses in 1996: $14.0 million. This figure includes consulting and special examination staff.	• Number of staff in 1996: 27 • Operating expenses in 1996: $4.7 million	• Number of staff in 1996: 8.4 • Operating expenses in 1996: $1.7 million	• Number of staff in 1996: 3 • Operating expenses in 1996: $0.5 million
Other	• Number of members in 1996: 115 • Premiums collected in 1996: $538 million • Claims paid in 1996: $42 million	• Number of members in 1996: 197 • Assessments collected in 1996: $44.9 million • Claims paid in 1996: ($5.1) million • Claims incurred 1991-1996: $409 million	• Number of members in 1996: 192 • Premiums collected in 1996: $14.0 million • Claims paid in 1996: $0	• Number of members in 1996: 232 • Assessments collected in 1996: $10.0 million • Claims paid in 1996: $9.4 million

2. OBJECTIVES

Design Features	CDIC	CompCorp	CIPF	PACICC
Mission and objectives	• The statutory objectives of CDIC are: (1) to provide insurance against the loss of part or all of deposits (2) to be instrumental in the promotion of standards of sound business and financial practices for member institutions and to promote and otherwise contribute to the stability of the financial system in Canada and (3) to pursue these objectives for the benefit of persons having deposits with member institutions and in such a manner as will minimize the exposure of CDIC to loss.	• CompCorp's objective is to protect, within limits, Canadian policyholders against loss of benefits should a member of CompCorp become insolvent and wound-up. • CompCorp is to pursue all its actions for the benefit of policyholders in such a manner that will minimize loss.	• CIPF's objective is to foster a healthy and active capital market in Canada. This is accomplished by protecting the investing public and maintaining investor confidence in the Canadian capital markets. • The CIPF, and its sponsoring SROs, will seek to establish national standards for financial responsibility and monitor members' compliance in order to minimize exposure to loss.	• PACICC's objective is to make voluntary compensation payments in respect of covered claims and unearned premiums and to provide a reasonable level of compensation to claimants who have suffered losses in circumstances where a member company has become insolvent.

3. COVERAGE

Design Features	CDIC	CompCorp	CIPF	PACICC
Limits	• Maximum basic insurance of $60,000 per person, including principal and interest. The $60,000 maximum applies to all the insured deposits a person has with the same member (subject to multiple coverage). • Proceeds from liquidation are distributed to CDIC, uninsured depositors and other creditors on a pro rata basis.	• Class A (life insurance and money accumulation policies): $200,000 life insurance protection; $60,000 in cash withdrawal for registered policies and $60,000 in cash withdrawal for unregistered policies (separate limits for group and individual contracts). Class B (life annuities and disability income policies): $2,000 per month. Class C (health benefits): $60,000 in total payments (other than disability income). • Coverage in each class applies to all of an insured's policies with the same member. • On cash balances exceeding $60,000, CompCorp applies dividends from insolvent members to *insureds* first.	• Maximum basic insurance coverage of $500,000 per person. The amount of coverage for cash balances (included in the $500,000 limit) may not exceed $60,000. • On cash balances exceeding $60,000, CIPF applies dividends from insolvent members to *uninsured* amounts first.	• Maximum claim of $250,000 in respect of direct loss or damage. The $250,000 maximum applies to all claims arising out of the same occurrence. • The amount of coverage for unearned premiums may not exceed $700 per policy.

Design Features	CDIC	CompCorp	CIPF	PACICC
Accounts covered	• Deposits repayable in Canada in Canadian dollars with an original term to maturity of not more than 5 years.	• Most types of life, health and annuity policies. • Canadian dollar policies written in Canada (or shown on the Canadian books of a member insurer).	• ClPF covers "general" and "separate" accounts. General accounts include cash, margin, short sale, options, futures and foreign currency accounts and are combined and (treated as one account. Separate accounts include: RRSPs, RRIFs, RESPs, joint accounts, testamentary accounts, inter-vivos trusts and trusts imposed by law, guardians (etc.), personal holding companies, partnerships, and unincorporated associations.	• Most types of property and casualty instance are covered. Exceptions are life, accident and sickness insurance for which there is a separate fund and specialty lines such as aviation, marine, etc.

Design Features	CDIC	CompCorp	CIPF	PACICC
Multiple coverage	• Separate protection of $60,000 is provided for each of the following: joint accounts, trust deposits and eligible deposits held in RRSPs and RRIFs. • Separate protection is provided for deposits in each member institution.	• Separate protection is provided for policies under each insurance class and, within Class A, life insurance, registered accumulation policies and unregistered accumulation policies (separate limits for group and individual cash withdrawals). Separate protection is provided for policies in each member institution.	• Separate accounts are each covered to a maximum of $500,000, unless combined with other separate accounts because they are held by a customer in the same capacity or in the same circumstance. Separate protection is provided for securities in each member institution.	• Separate policies are each covered to respond to claims to a maximum of $250,000 unless a customer has multiple policies with the same company which becomes insolvent and both policies cover the loss with protection for unearned premium not exceeding $700 per policy.

Design Features	CDIC	CompCorp	CIPF	PACICC
Exclusions	• Foreign currency deposits. • Deposits with an original term to maturity exceeding 5 years. • Principal and interest exceeding $60,000. • Bearer deposits.	• Unallocated pension funds. Segregated funds without a company guarantee. • Administered services only contracts. • Reinsurance. • Foreign currency policies. • Policies which do not correspond with reasonable actuarial and commercial practices may have compensation levels adjusted. Adjustments may be appealed.	• The Board has discretion concerning the validity and payment of claims against publicly-disclosed criteria*. Customer losses that result from the changing market value of their securities are not covered. Customers with business relations with or ownership of failed members are not covered; neither are SRO members, foreign securities dealers or clearing corporations.	• Reinsurers, farm mutuals which have their own separate fund, reciprocals and other insurers designated in a regulation as being adequately covered in another plan.

* Discretion is necessary so that CIPF is not subject to provincial insurance acts. CIPF plans to remove this provision once provincial legislation is amended to grant CIPF an exemption

4. PREMUMS

Design Features	CDIC	CompCorp	CIPF	PACICC
Pre or post-assessment?	• Pre-assessment • Semi-annual payments based on insured deposits. Assessments are to cover all expenses (including insurance payments).	• An annual administration fee is required of all members. • Where outstanding obligations are satisfied, a pre-fund will be established equivalent to one year's assessment.	• Pre-assessment. • Firms provide funding to CIPF through quarterly assessments levied by SROs and SROs must make a contribution to CIPF in an amount equal to aggregate amounts due from all members within a specified period.	• A provision is in place to have a pre-fund of $30 million for liquidity that will be collected in the years 1998, 1999, and 2000. An annual administration fee is required of all members.

Design Features	CDIC	CompCorp	CIPF	PACICC
Premium level	• Current annual premium level of 1/6th of 1 percent of insured deposits. • Minimum annual premium of $5,000. • Maximum statutory level of 1/3rd of 1 percent of insured deposits.	• Members pay an annual "administration assessment" that is not to exceed $6,000; any excess administrative costs are handled by a specific administrative assessment in proportion to 5-year covered premiums. • Maximum level for "specific" and "advanced" assessments of 0.5% of average annual premiums of covered classes of business (determined on a 5-year basis). In extraordinary circumstances, an additional 0.35% can be available for 7 years on a fast-track basis.	• Quarterly assessments of 3/16ths of 1% of gross revenues of members. Maximum annual assessment of 1% of aggregate gross revenues, unless an additional amount is required for repayment of obligations under the bank line of credit. Minimum annual assessment of $5,000 ($500 for introducers).	• Maximum annual assessment not to exceed $1,500. This is determined by a sliding scale ($800 for insureds with Direct Written Premiums (DWPs) not exceeding $1 million; $1,600 for insureds with DWPs between $1 million and $50 million; $4,000 for insureds with DWPs exceeding $50 million; and total amount not to exceed $500,000 per year). • For insolvencies, maximum assessment for an insurer in any jurisdiction is the greater of 0.75% of its DWPs in that jurisdiction, and its proportionate share for that jurisdiction of $10 million subject to a maximum of 1% of its DWPs in that jurisdiction.

Design Features	CDIC	CompCorp	CIPF	PACICC
Basis of assessment of premiums among members	• Flat rate applied to insured deposits. • CDIC may also assess and collect a surcharge from member institutions that, in CDIC's opinion, are engaging in "such practice as may be prescribed by the By-law as warranting a premium surcharge". The application of the surcharge cannot cause the total premium to exceed 1/3rd of 1 percent. CDIC has not yet assessed a premium surcharge against a member institution.	• Assessments required to cover the losses of an insolvent firm are on the basis of national premium income.	• Member assessments are based on gross revenues. • SROs are liable for up to $2 million for losses from firms in their jurisdiction. • Members that are capital deficient are assessed a risk premium payable for the subsequent 4 quarters. • The risk premium may not exceed the regular premium.	• Assessments are done on a jurisdiction-by-jurisdiction basis. • Companies licensed for the covered classes in the jurisdictions ni which the insolvent company had written business are liable for the assessment. • If sufficient funds are not available, money may be borrowed from the pre-fund.
Other	• Recent legislative changes to the CDIC Act will permit CDlC to assess different premiums against member institutions. This section of the CDIC Act will come into force once a CDIC By-law has been made. CDIC is in the process of developing a By-law.		• CIPF must notify CSA 30 days prior to making any changes in the method of assessing member firms. • The Fund balance is currently $130 million, while a $40 million line of credit is present. • SROs contribute their respective shares of the net income of CIPF from the immediate preceding year.	

5. ADMINISTRATIVE STRUCTURE

Design Features	CDIC	CompCorp	CIPF	PACICC
Composition of the Board of Directors	• The Board of Directors is composed of a Chairman (appointed by Governor in Counci), four ex officio members (the Deputy Minister of Finance, the Governor of the Bank of Canada, the Superintendent of Financial Institutions, and a Deputy Superintendent of Financial Institutions) and four members of the private sector. The Chairman and the private sector directors may not be a member of the federal or a provincial legislature, or a director, officer or employee of a bank or a federal or provincial trust or loan company.	• The Board of Directors consists of independent directors, including the President, who are not "affiliated" with any member company. The Chairman is elected by the directors. • The President of the CLHIA is an ex officio non-voting member. • A seven-member Industry Advisory Committee to advise the Board on By-law changes and non-confidential issues with a financial impact on members is elected by the members, within three size groupings. Large-sized members (each accounting for more than 5% of total assessment) elect three. Medium-sized members (each accounting for between 1% and 5% of total assessments) elect two. Small-sized members (each accounting for less than l% of total assessments) elect two.	• There are 12 governors on the Board. Board members are selected by participating SROs and are trustees of the Fund. Each of the 5 participating SROs is entitled to appoint one governor (normally its chairman). The President of ClPF is an *ex officio* voting governor. One-third of the Board of Governors must be "public" governors (there are 5 at present). • Public governors must be independent of member firms, SROs and government and are there to represent the investing public. They are selected by the Board.	• The Board of Directors is appointed at an annual meeting. The Board itself is required, by its By-laws, to put forward the names of 15 individuals but member companies themselves are entitled to submit other names that must be filed with the Secretary 5 days before the annual meeting. The number of votes that a company may cast is based on its premium income. A total of one million votes may be cast at a meeting. • The Chairman and Secretary-Treasurer require to be elected by the Director each year and, normally, a Vice-Chairman is also elected.

Design Features	CDIC	CompCorp	CIPF	PACICC
Meetings of the Board of Directors	• Meetings are at such time and place as determined by the Chairman with at least 7 days notice (some exceptions apply). • The Chairman may call a meeting at the request of any 2 directors. Quorum is reached with the majority of directors in attendance. Decisions are taken by simple majority. In the case of equality of votes, the Chairman has a casting vote.	• Meetings are called by the Chairman with at least 10 days notice; any participating regulator may convene a Board meeting on 14 days notice. • Any participating regulator is entitled to attend a meeting of the Board, but is not entitled to cast a vote. • Quorum is reached with the majority of directors in attendance. Decisions are taken by simple majority.	• The Board of Governors meets at least 4 times per year (more if necessary). • Meetings are normally called by the Chairman and notice of a meeting must be given at least 48 hours in advance (although shorter periods are permitted in some circumstances). • Quorum is a minimum of four SRO governors and one public governor. Decisions normally require a 2/3^{rds} majority, although in some cases higher majorities are required. Each SRO has a veto with respect to changes in minimum standards.	• Meetings are called by the Chairman on 10 days notice. • Each regulator is invited to each meeting. The Federal regulator is invited even though the federal government is not a party to the contract with PACICC. • The regulators are not entitled to vote but are encouraged to take part in the discussion. • Quorum is a majority of directors. Decisions are taken by simple majority.

Design Features	**CDIC**	**CompCorp**	**CIPF**	**PACICC**
Rules to change compensation scheme	• Major changes to CDIC, including limits and coverage, require legislative amendments. • By-laws can be amended or introduced by the Board of Directors (subject to Ministerial approval where applicable).	• The Memorandum of Operations may be amended by Board resolution, unless opposed by a participating regulator. • By-laws may be enacted, repealed or amended by a majority of directors and sanctioned by a 2/3^{rds} affirmative vote by members, unless opposed by a participating regulator.	• CIPI policies may be amended by Board resolution. • CSA must be notified in advance of changes in CIPF policies and method of assessment. In addition, some amendments, such as changes to the proportion of public governors on the Board, would require CSA approval.	• For changes, the By-law requires the approval of a majority of the Board and 2/3^{rds} of the membership, the regulators, and the Federal Minister of Industry. • The Memorandum of Operations may be amended by the Board with the approval of each provincial and territorial regulator. In practice, management refers changes made to the Memorandum to a meeting of the members for an affirmative vote by them.

6. BORROWING AUTHORITY

Design Features	CDIC	CompCorp	CIPF	PACICC
Limits on borrowing	• The Minister of Finance is authorized, subject to the approval of the Governor in Council, to make interest bearing loans to the CDIC out of the Consolidated Revenue Fund up to a value of $6 billion.	• No explicit limits. • CompCorp may require its members to lend up to 6 years of assessment (3% of covered premiums) to cover cash flow need.	• The Board of Governors (or 2 delegated representatives) may authorize CIPF to borrow a maximum of 1.5% of the prior year's aggregate gross revenues of all SRO members. (Based on 1996 figures, this should equal $112 million in 1997.) CIPF maintains a $40 million line of credit with a Canadian chartered bank.	• No explicit limits. • The Board of Directors is required to have a $10 million line of credit with a Schedule 1 Bank.

Design Features	CDIC	CompCorp	CIPF	PACICC
Sources of credit	• The Consolidated Revenue Fund (CRF) of the Government of Canada. Loans are made in the form of debentures issued by CDIC. • CDIC must pay a credit enhancement fee (or interest rate supplement) for the Crown's borrowing guarantee. • CDIC may borrow from sources other than the CRF including issuance and sale of bonds, notes, debentures, and other evidence of indebtedness.	• The Board of Directors is authorized to borrow from any source.	• CIPF is limited to borrowing money from Canadian chartered banks.	• The Board is authorized to borrow from banks and may assess its members. It may also access the pre-fund of $30 million that will be in place at the end of the year 2000.

7. POWERS IN DEALING WITH MEMBER ORGANIZATIONS

Design Features	CDIC	CompCorp	CIPF	PACICC
Rights to documents and explanations	• CDIC can require officers, directors and auditors of provincial members to furnish information and explanations. With respect to federal institutions, CDIC generally obtains member information from OSFI but can obtain it directly from members. • Through preparatory examinations, CDIC can examine books, records and accounts of member institutions relating to its deposit liabilities. • Through special examinations, CDIC can examine a member institution for any purposes.	• CompCorp may obtain directly from members (or via a participating regulator) information that is relevant to the assessment calculation or compliance with prudential criteria (MCCSR).	• The President of CIPF has the right to request any information from members and SROs relevant to CIPF interests. • If payment from the Fund appears imminent as a result of the financial difficulties of a member, the President of CIPF has the authority to enter that member's premises to under take any appropriate investigation.	• PACICC may obtain from each province the relevant information that is required for assessment purposes.

Design Features	CDIC	CompCorp	CIPF	PACICC
Right to order members to take specified actions	• Sanction is the threat of special or preparatory examination, premium surcharge, or termination of membership. For federal institutions, termination may proceed unless the Minister is of the opinion that it is not in the public interest to do so.	• CompCorp does not have the right to issue orders.	• The Board of Governors may direct a participating SRO to order a member considered to be in financial difficulties to take a particular action. Failure of the SRO to carry out this direction could result in its expulsion from CIPF.	• PACICC does not have the right to issue orders.
Right to take control and/or acquire assets of member institutions	• CDIC may make an application to have an institution wound-up or petition for a receiving order where a member is, or is about to become, insolvent. • FIRP permits CDIC to restructure a member institution when OFSI is of the opinion that a member has ceased or is about to cease to be viable, and the Minister recommends to the Governor in Council a FIRP order. • CDIC may acquire member assets in order to reduce a risk to CDIC or avert/reduce a threatened loss to CDIC.	• CompCorp may not take control of a member or have it petitioned into bankruptcy. • CompCorp may enter into "arrangements" with a member under the control of regulators to support benefits to policyholders.	• Under changes to Bill C-5 effective this fall, CIPF may petition for a receiving order or request a securities commission to appoint a receiver. • CIPF does everything to avoid having an insolvent firm placed into bankruptcy as the Bankruptcy Act is unable to accommodate the special nature of CIPF.	• PACICC does not have the right to take control or acquire assets of member institutions.

Design Features	CDIC	CompCorp	CIPF	PACICC
Other commercial arrangements available in dealing with members	• CDIC may take many actions with members to reduce risk to CDIC including: (1) acquire assets (2) make or guarantee loans or advances with or without security (3) make or guarantee a deposit (4) act as a, receiver or inspector (5) assume winding up costs (6) guarantee the payment of fees to a liquidator or receiver and (7) acquire, hold and allocate real and personal property and (8) do all things necessary or incidental to fulfill its objects.	• CompCorp may make a financial arrangement with a member to assume responsibility for the policies of an insolvent member or a member under the control of a regulator, or a troubled member (under certain constraints and with the agreement of the regulator).	• CIPF may pay out the loans or acquire the assets from an insolvent member providing it can be shown that such actions would minimize CIPF loss exposure. • CIPF can guarantee the payment of fees to a receiver of trustee.	• PACICC does not have the right to enter into other commercial arrangements. • PACICC only comes into operation at the point at which a wind-up order has been made.

8. INSPECTION

Design Features	CDIC	CompCorp	CIPF	PACICC
Responsibility for inspection	• The Superintendent of Financial Institutions examines federally incorporated members on behalf of CDIC annually, or at such times as CDIC may require for a "specified purpose". • CDIC may inspect provincially incorporated member institutions or may appoint an agent to do it on behalf of CDIC. CDIC may also enter into agreements with provincial authorities to provide for the exchange of information obtained from their examinations. • Through special examinations, CDIC can itself (or through an agent) examine member institutions for any purposes.	• Participating regulators are responsible for the inspection of member institutions.	• Inspection is the prime responsibility of the SROs. CIPF, working with the SROs and the CSA, has established minimum standards of members with which SROs must ensure compliance. • CIPF is required to conduct annual financial examinations on a rotational basis of members (10% per year) to ensure compliance with minimum standards and to evaluate SRO financial surveillance of members. • CIPF receives annual audited financial statements, quarterly operational questionnaires and monthly financial reports from all members.	• Inspection of member companies is the responsibility of the regulators.

Design Features	CDIC	CompCorp	CIPF	PACICC
Right of inspection	• CDIC has the right to inspect provincial members. OSFI conducts annual examinations of federal members on behalf of CDIC. • CDIC may inspect federal and provincial institutions through "preparatory or special" examinations.	• CompCorp does not have the right to inspect member institutions.	• CIPF has the right to inspect members and the right to access any information SROs hold on members.	• PACICC does not have a right to inspect its member companies.

Design Features	CDIC	CompCorp	CIPF	PACICC
Obligations of regulators to compensation scheme	• Regulators undertake examinations on CDIC's behalf and thus must report this information. • The examiner of a member institution must report to CDIC, at a minimum, that (1) the returns made by the institution and on which its premiums were based are substantially correct (2) the operations of the member institution are being conducted in accordance with the standards of sound business and financial practices prescribed by the By-law (3) the institution is in sound financial condition and (4) report to CDIC if there has been any change in the circumstances of the member institution that might materially affect the position of CDIC as an insurer and (5) is in compliance with statutes governing the member institution.	• Participating regulators are only obliged to provide information relevant to the calculation of assessment bases or compliance with prudential criteria. (Normally this information is provided directly by members.) • Participating regulators are required to inform CompCorp of members placed on a "solvency watch list" and may enter into confidential discussions regarding the status of these firms.	• SROs must ensure that all requirements laid down by CIPF are met by members. In addition, SROs must notify CIPF of any situation that could give rise to payments being made out of the Fund and every case where minimum standards are not being met. • SROs must provide CIPF with quarterly reports as to the status of field examinations. Details of any material problems uncovered must be reported promptly to CIPF. • SROs must notify CIPF of any members being suspended or expelled or with capital deficiencies. • SROs must notify CIPF why a member did not file a required audited statement or interim questionnaire and when it is likely to be filed.	• The management of PACICC exchanges confidential information with the Superintendent on suspect companies and is generally advised of companies which are on the Superintendent's watch list.

9. MEMBERSHIP

Design Features	CDIC	CompCorp	CIPF	PACICC
Who can become a member?	• Banks, and federally or provincially incorporated trust and loan companies. • With the exception of Quebec, CDIC membership is a condition of license in all jurisdictions.	• Membership is open to all insurance companies that are licensed to sell life and/or health insurance. Fraternal or mutual benefit organizations would not normally be members, nor would prepaid hospital, medical or dental service organizations. • CompCorp membership is a condition of license everywhere except Nova Scotia and Ontario.	• CIPF is a membership of SROs; securities dealers are automatically covered by CIPF by being a member of a participating SRO. Firms that are members of more than one SRO are assigned a primary jurisdiction by the Board of Governor. • SRO members are CIPF “members".	• All property/ casualty insurers that are licensed for any of the covered classes are required to be members. • Membership may either be achieved as a condition of licensing or it may be deemed by statute.

Design Features	CDIC	CompCorp	CIPF	PACICC
Approval of membership	• Institutions must submit an application to CDIC and membership is subject to the approval of the Board. (This is done concurrently with incorporation.) • Provincial institutions must also: (1) be authorized by the province of incorporation to apply for deposit insurance and (2) not exercise powers substantially different from those of federally incorporated members.	• An institution becomes a member only by virtue of: (1) a requirement of license by participating jurisdictions or (2) signing an agreement directly with CompCorp. • Membership must be approved by the Board of Directors, but rejections can occur only under limited specified circumstances.	• SRO membership of CIPF must be unanimously approved by the Board of Governors. A new participating SRO must provide an initial contribution to CIPF and agree to be subject to and bound by the Agreement and Declaration of Trust.	• PACICC has no role in the approval of membership; when a company is licensed it is either a member by virtue of the Insurance Act or because it is a condition at its license that it be a member.

Design Features	CDIC	CompCorp	CIPF	PACICC
Termination/cancellation	• Deposit insurance may be cancelled where, in the opinion of CDIC, the member is or is about to become insolvent. • Deposit insurance may be terminated if members are: (1) not following a standard of sound business and financial practices (2) breaching any By-laws of CDIC or (3) breaching any conditions of CDIC insurance policy.	• CompCorp has no authority to terminate a company's membership or to discontinue coverage, except when members are no longer licensed by a participating jurisdiction and there are no covered policies outstanding.	• A participating SRO may be expelled by a majority vote of SRO governor for: (1) failing to have its members comply with minimum standards (2) failing to pay into CIPF its share of any additional contribution determined by the Board to be payable (3) failing to comply with a Board directive with respect to a member in financial difficulty and (4) failing to pay the quarterly assessments of members under its primary jurisdiction.	• PAClCC has no authority to terminate a member's membership or to discontinue coverage except when members are no longer licensed by a participating jurisdiction and there are no policies outstanding. Even when a member withdraws from a particular jurisdiction it would still continue to be a member of PACICC provided it is licensed in any other jurisdiction.

Design Features	CDIC	CompCorp	CIPF	PACICC
What happens to coverage after termination or cancellation?	• Deposits on the day of termination or cancellation continue to be insured for up to 2 years (or to the end of the maturity in the case of term deposits). • An institution must notify depositors when it is no longer a member of CDIC.	• Only terminated or cancelled if no coverage exists.	• Securities with a firm that resigns (or is expelled) from CIPF and surrenders its registration to the commission are covered for 6 months. • Securities with a firm that resigns (or is expelled) from CIPF but continues to operate are not covered, unless the firm was insolvent at the time of resignation/ expulsion, in which case losses are covered for 6 months based on customer equity at the resignation/ expulsion date.	• Where a member ceases to be licensed in all jurisdictions in Canada, membership continues for 6 months thereafter.

10. MINIMUM ONGOING MEMBERSHIP STANDARDS

Design Features	CDIC	CompCorp	CIPF	PACICC
Standards required by compensation schemes	• Members must comply with standards of sound business and financial practices in the areas of: (1) liquidity management (2) credit risk management (3) interest rate risk management (4) foreign exchange risk management (5) security portfolio management (6) capital management and (7) internal controls and (8) real estate appraisals. • Members must report annually (through self-assessment) on how well they are following CDIC standards.	• Member are expected to comply with primary regulators' Minimum Continuing Capital and Surplus Requirements (MCCSR). Standards of Sound Business and Financial Practices under development with regulators.	• CIPF worked with the SROs and the CSA to develop minimum standards for member firms in the areas of: (1) capital requirements (2) operation of client accounts (3) audits and questionnaires (4) field examinations (5) books and records (6) insurance (7) finance surveillance monitoring (i.e., early warning systems) and (8) segregation. • SROs have primary responsibility for ensuring member compliance with ClPF minimum standards. SROs must report every case of non-compliance with minimum standards to ClPF.	• Minimum capitalization requirements are $3 million. In Newfoundland, the statutory obligation is $1 million but the jurisdiction has confirmed that no new companies will be allowed to operate without the minimum $3 million requirement being met. Existing companies not meeting this requirement are given time to come up to this standard. • PAClCC is working with IBC on the development of standards of Sound Business Practices.

Design Features	CDIC	CompCorp	CIPF	PACICC
Other	• Members must be in good standing with regulators.	• Members must be licensed by a Canadian regulator.	• Members must be registered with a securities commission and adhere to provisions of the appropriate Act. • Securities dealers that are members of more than one SRO must adhere to the most stringent rules of each SRO for all minimum standards.	• Members must be licensed.

11. CLAIMS PROCEDURES

Design Features	CDIC	CompCorp	CIPF	PACICC
Obligations of compensation schemes	• CDIC is obliged to make payment when a Winding-up Order of a member institution is issued, although CDIC may make payment in other circumstances.	• CompCorp is under no *legal* obligation to provide compensation. Obligations stem from its good faith in meeting publicly disclosed promises to provide compensation, within specified limits, in the event of loss from an insolvent member.	• CIPF is under no *legal* obligation to provide compensation; payments are at the discretion of the Board of Governors. However, courts have held that CIPF must provide coverage in a consistent manner with publicly-disclosed guarantees of compensation.	• PACICC is under no *legal* obligation to provide compensation. Obligations stem from good faith in meeting publicly-disclosed promises to provide compensation, within specified limits, in the event of loss from an insolvent member.

Design Features	CDIC	CompCorp	CIPF	PACICC
Trigger mechanism	• The issuance of a Winding-up Order of a member institution. • Section l4(2.l) (CDIC Act).	• The issuance of a Winding-up Order of a member institution. • CompCorp may support a controlled member before a Winding-up Order has been issued. With certain constraints, CompCorp may support the transfer of business to another carrier or owner without a control order or Winding-up Order, if this is the most cost-effective way of providing policyholder support.	• Bankruptcy or being determined to be insolvent by CIPF or a receiver.	• The issuance of a Winding-up order of a member institution.

Design Features	CDIC	CompCorp	CIPF	PACICC
Payment procedure	• CDIC will make compensation available to claimants in the form of transferred deposits or cash. • CDIC is subrogated to the right of depositors after a depositor payment is made. CDIC may withhold payment until it receives assignments in writing. • Proceeds from liquidation are distributed to CDIC, uninsured depositors and other creditors on a pro rata basis.	• The liquidator will look for another member company of CompCorp to take on responsibility for the policies of the failed company. • It is likely that the liquidator would have to reduce the policies in amount; CompCorp will ensure that the policies are not reduced below CompCorp's limits, which will mean in many cases that the policies are not reduced at all. • Except for any reduction in amount, the policies will continue to be honoured according to their terms, except in exceptional circumstances when some of the terms may be changed.	• Claims by a customer of an insolvent/ bankrupt member must be made directly to the receiver/trustee in accordance with the requirements for providing claims. For a claim to be considered by CIPF, it must first be recognized by the receiver/trustee as a legal obligation of the insolvent member. • Customers must file their claims within 180 days of the date of the bankruptcy or the date of the insolvency as determined by CIPF or the receiver. • Customers with eligible claims for repayment that are not accepted may appeal to the Board of Governors. • Proceed from liquidation are distributed to uninsured customers first, with CIPF receiving any remaining firms.	• Claimants must agree the amount of their claim with the liquidator. For payments over $25,000, PACICC generally reserves the right to review the matter. • Claimants must assign their rights against the estate of the insolvent insurer before PACICC makes any payment and must certify that they have no access to any other insurance to cover the loss. • For claims exceeding the $250,000 limit, PACICC will be reimbursed for this amount from the estate and then makes any additional payment it receives from the liquidation to the claimant.

Design Features	CDIC	CompCorp	CIPF	PACICC
Payout period	• CDIC is obliged to make payments "as soon as possible". • In practice payments are made within 6 to 8 weeks or less.	• It is likely that the liquidator would freeze policy payments until the policies can be moved to another insurer, CompCorp will ensure that during the period of the freeze there are funds available to pay death claims and annuity incomes up to CompCorp's limits, and to allow voluntary withdrawals where it can be demonstrated that the funds are needed to prevent hardship. • Where withdrawal of policy benefits is frozen, CompCorp will ensure that the policies are continued generally according to their terms, up to CompCorp's limits until the freeze is lifted; that means, for example, that on an RRSP interest will continue to be credited on the amount covered by CompCorp at the wind-up date, even if the amount eventually exceeds $60,000.	• CIPF has no specified minimum period for claims to be settled (except that all claims must be filed within 180 days of the date of insolvency/ bankruptcy). • In practice, claims on members placed into receivership are usually paid within 4 to 8 weeks, longer in the cases of bankruptcy.	• PACICC attempts to settle claims within 45 days of the date of insolvency.

Design Features	CDIC	CompCorp	CIPF	PACICC
Interest	• CDIC may pay interest on claims on the period between the date of the wind-up order and payment of claims. Claims, including interest, may not exceed $60,000. But, as a matter of policy does not pay such interest. • The rate of interest to be used is the simple annual rate of interest on 90 day Government of Canada T-bills.	• Interest is continued at full contractual rates following date of wind-up to next interest renewal date, at which time contract is renewed at close to current market rates and interest continues to accumulate.	• CIPF does not usually pay interest on cash balances. (Fixed-income securities continue to accrue interest at their specified rate.) However, when business and accounts are purchased by another member, the firm may pay interest as a sweetener to help the accounts.	• Interest is not applicable to PACICC insurers.
Regulatory liability	• Regulators have no liability in the event of a failure leading to the payment of compensation by CDIC.	• Regulators have no liability in the event of a failure leading to the payment of compensation by CompCorp.	• The SRO having the prime audit responsibility is liable to reimburse the CIPF for the lesser of $2 million and an amount which is equal to 10% of the total amount paid out of the CIPF, subject to a minimum liability equal to the lesser of $1 million and the total amount paid out by the CIPF.	• Regulators have no liability to PACICC.

APPENDIX II

Scotia McLeod Inc.
David W. Wilson, President and Deputy CEO
T. Hugh McNabney, Chief Financial Officer

The Trust Companies Association of Canada
Chris Barron, Chairman
Joseph P. Chertkow, Director

CDIC
Grant Reuber, Chairman
J. P. Sabourin, President & CEO

ManuLife Financial
Domenic D'Alessandro, President and CEO

University of Waterloo
Dr. Bob Curtain

University of Toronto
Dr. Jim Pesando
Dr. Frank Mathewson
Dr. Jack Carr

Canadian Life & Health Insurance Association Inc.
Mark. R. Daniels, President
Greg Traversty, Senior Vice President

Canadian Imperial Bank of Commerce
A. L. Flood, Chairman and CEO
Derek Hayes, Senior Vice President

Bank of Nova Scotia
Peter C. Godsoe, Chairman & CEO
John Crean, Senior Vice President

National Bank of Canada
André Berard, Chairman and CEO

Toronto Dominion Bank
W. Brock, Vice Chairman
D. Maringeli, Senior Vice President

Bank of Montreal
Drew White, Chief Operating Officer, Mbanx
Dean Kriele, Senior Vice President

The Royal Bank of Canada
Brian Davies, Senior Vice President, Corporate Affairs
Harry Hassanwalia, Deputy Chief Economist
J. Anne Lamont, Vice President

C.D. Howe Institute
Tom Kierans

Credit Union Central of Canada
Susan Murray, Director Government Affairs

Tory Tory Delauriers & Binnington
David Baird
John Crow

OSFI
John Palmer

COMPCORP
Alan Morson, President

General Accident Assurance Co. of Canada
Len Perry, Senior Vice President

Insurance Bureau of Canada
Geo Anderson, President
Alex Kennedy, Vice President, Secretary

Canadian Investor Protection Fund
Donald A. Leslie, President & CEO

Canadian Banking Association
R.J. Protti, President & CEO
R. Alan Young, Vice President

APPENDIX III

	Organization	Deposits Covered	Scope of Coverage	Funding	Government Guarantee	Structure	Relation to Government	Contact
PEI	*Credit Union Deposit Insurance Corporation*	Savings and chequing accounts, term deposits, membership share accounts, money orders, drafts and certified drafts and cheques (in Canadian currency), term not exceeding five years	$60,000 per individual for insured deposits (including accrued interest); $60,000 for each separate RRSP, RRIF, joint deposits and trust deposits	Fees: 1/7 of 1% of insurable deposits Fund: Surplus of $1.4M (0.7% of insurable deposits) Target: 2% of insurable deposits	Government guaranteed	Incorporated under the Companies' Act of PEI (part of CU Central)	5 board members, appointed by government: 3 nominated by CU Central of PEI and 2 by the government	Gerard Dougan (902) 566-3350
New Brunswick	*New Brunswick Credit Union Deposit Insurance Corporation* *Credit Union/Caisses Populaires Stabilization Funds*	Savings, chequing, and term deposits; trust deposits; RRSPs; RRIFs; joint deposits; equity shares and term deposits for more that 5 years not covered	$60,000 per individual for insured deposits (including accrued interest); $60,000 for each separate RRSP, RRIF, joint deposits and trust deposits	Fees: ¼ of 1% of total liabilities Fund: *CU Stab. Fund*: Surplus of $7.1M. *Caisses Pop Stab. Fund*: Surplus of $30.3M (2.4% of system assets) Target: *CU Stab. Fund*: none *CP Stab. Fund*: 3% of system assets	Government guarantee	NBCUDIC is a crown corporation. Funding currently provided through industry's Stab. Funds.	NBCUDIC's board is constituted of 5 directors – Chair is the superintendent; each Stab Fund appoints 2 members Stabilization funds are controlled by the industry.	*Credit Union*: Gerard Adams / Dennis Robertson (506) 853-7474 *Caisses Pop.*: Gilles Ménard (506) 727-1302

	Organization	Deposits Covered	Scope of Coverage	Funding	Government Guarantee	Structure	Relation to Government	Contact
Newfoundland	*Credit Union Deposit Guarantee Corporation*	All deposits, including demand accounts, RRSPs, RRIFs, trust accounts and joint accounts; member share not protected	$60,000 limit per type of deposit account, $180,000 limit per member; includes accrued interest	Fees: 1/6 of 1% total insured deposits with capital adequacy reserve of at least 5% 1/5 of 1% for capital adequacy reserve of less than 5% Reserve fund: $4M Target: None	Government provides 100% guarantee of the corporation	Crown corporation	6 directors appointed by government; 3 of 6 directors nominated by CUC of Newfoundland	Bill Langthorne (709) 753-6489
Nova Scotia	*Credit Union Deposit Insurance Corporation*	Savings, chequing, term deposits, trust deposits, joint accounts	$60,000 per individual $60,000 for RRSPs, RRIFs, (per contract), joint deposits and trust deposits; includes accrued interest	Fees: 20 basis points on average assets (next year – probably 15 basis points) Fund: Surplus of $7M Target: Equity reserve of 1% of system assets	No government guarantee (application for loan or loan guarantee – at government's discretion)	Independent corporation (employees are not public servants)	7 directors appointed by government; 3 nominated by the CUC of Nova Scotia	Elaine Benoit / Barry Bennett (902) 422-4431
Manitoba	*Credit Union Deposit Guarantee Corporation*	All money placed in a savings or deposit account in a credit union (excluding equity interests)	100% guarantee on deposits, including accrued interest	Fees: 3/20 of 1% (0.15%) of average monthly balance of total amount of members' deposits Fund: surplus of $35M (0.8%) of members' assets) Target: 1% of members' assets	No government guarantee (application for loan or loan guarantee – at government's discretion) (current negotiated government guarantee expires in next months)	Crown agency incorporated under the provincial Credit Union and Caisses Populaires Act (employees are not public servants)	5 person board appointed by government with input from credit unions on possible appointees	Alan Curd (204) 942-8480

	Organization	Deposits Covered	Scope of Coverage	Funding	Government Guarantee	Structure	Relation to Government	Contact
Ontario	*Deposit Insurance Corporation of Ontario*	Canadian currency, deposits, payable in Canada, less than 5 year term; separate deposit coverage for joint deposits trust	Insured to a maximum of $60,000 for combined principle, interest, and dividends; RRSP, RRIF and OHOSP (per contract), joint and trustee accounts insured separately; does not include membership shares	Fees: 2.10$ per thousand dollars of assets – until deficit is eliminated Fund: Deficit of $58.3M Target: remain competitive with CDIC Exploring possibility of risk-oriented premiums	Long guarantee from government (Ontario Devp. Corp.) which expires in 1997, meetings ongoing with Ministry of Finance about financing deficit.	Crown corporation; government agency (employees are not public servants)	Directly accountable to Legislative Assembly of Ontario through Ministry of Finance. Board of Directors (maximum of 11 members); 4 nominated by industry; the balance nominated by government (mostly individuals independent from gov't)	John Mikloska (416) 325-9444 Andrew Poprawa (416) 325-9580
Québec	*Régie de l'assurance-dépôts du Québec*	Canadian currency deposit accounts (within Québec) including savings and chequing, term deposits, deposit certificates, and GIC (not exceeding 5 years)	Insured to a maximum of $60,000 per person, per institution; $60,000 for combined total of all deposits in one or more RRSP, RRIF, joint deposits, and trust deposits (separate from other deposits)	Fees: 1/15 of 1% of insurable deposits (relief for some caisses of 1/30 of 1%) Fund: surplus of $118.4M Target: none	Legislative right to request special contribution of $700,000,000 from government Depositors have claims against the Stabilization Fund as well. (Desjardins)	Crown corporation, government agency	5 directors: Sous-ministre des Finances, Inspecteur général des I.F., Inspecteur général adjoint des I.F., two other members (external to public service) appointed by the government	Normand Côté (418) 694-5014

	Organization	Deposits Covered	Scope of Coverage	Funding	Government Guarantee	Structure	Relation to Government	Contact
B.C.	*British Columbia Credit Union Deposit Insurance Corporation*	All deposits or money invested in non-equity shares – trust deposits, RRSPs, RRIFs, joint accounts with same joint depositors (combined total)	$100,000 per account, per credit union	Fees: 13 basis points of total deposits and non-equity shares Fund: surplus of $14M (invest income 8M + assessments 8M – admin. Expenses 2M) Target: none	No government guarantee (application for loan or loan guarantee – at government's discretion) Depositors have claims against the Stabilization Fund as well.	Independent government corporation (employees are public servants)	Corporation administered by Financial Institutions Commission (gov't agency) Board is a sub-committee of FICOM; 5 members appointed by government	Tom Omidei (604) 660-0100
Alberta	*Credit Union Deposit Guarantee Corporation*	All deposits (excluding non-deposit investments: mutual fund, common and investment shares)	100% guarantee on deposits, including accrued interest Covers foreign currency deposits and term deposits exceeding 5 years	Fees: 19 basis points of total deposits and borrowings Fund: surplus of $45.3M (1.11% of total credit union assets) Target: at least 1% of credit union assets	Government guaranteed	Provincial corporation (employees are not public servants)	Board of Directors reports to government's Treasury Dept. (however, independent from government) Board appointed by government; at least one director nominated by CUC	Bill Saunders / Jim Laitner (403) 428-6680

	Organization	Deposits Covered	Scope of Coverage	Funding	Government Guarantee	Structure	Relation to Government	Contact
Saskatchewan	*Credit Union Deposit Guarantee Corporation*	All deposits, including RRSPs and RRIFs in Canadian currency	100% guarantee on deposits, including accrued interest	Fees: 11 basis points of deposits Fund: surplus of 1% of system assets (+all credit union reserves below 5%) Target: 1% of system assets (+ all credit union reserves below 5%)	No government guarantee (standby liquidity loan agreement with CDIC)	Incorporated under the provincial Credit Union Act (employees are not public servants)	Regulator: provincial Justice Department (however, independent from government) 5 Board members appointed by positions in legislation – 3 appointed by CU system (CEO Central, Member of Board of Central & Other system rep.) and 2 by government (DM of Finance, DM of Justice)	Ken Burgess (306) 566-1296

APPENDIX IV

ANNEX 6

RISK-BASED DEPOSIT INSURANCE PREMIUMS

Section 3 of this policy paper proposes the introduction of risk-based premiums.

The risk-rating system to be employed will be consistent with the Guide to Intervention for Federal Financial Institutions contained in Annex 2. Risk-based premiums are intended to send an early warning signal to the management and board of directors of CDIC members, and as such they are not an actuarially-based measure of the risk brought to the deposit insurance fund by an individual institution.

The U.S. Model

The Federal Deposit Insurance Corporation (FDIC) in the U.S. implemented a system of risk-based premiums, effective January 1, 1993. Under this system, FDIC divided deposit-taking institutions into nine categories based on their capital levels, and the supervisory evaluation of the riskiness of each institution provided by the institution's primary federal regulator. In forming its judgement, the FDIC generally relies on the primary federal regulator's composite rating. For most deposit-taking institutions, CAMEL is the most common composite indicator. Under the CAMEL system, institutions are evaluated in five broad categories (Capital, Asset quality, Management, Earnings and Liquidity) that correspond to ratings from 1 (good) to 5 (bad).

In the U.S., premiums are linked to an institution's capital relative to the regulatory minimum capital requirement and to the supervisor's judgement of its overall strength. Premiums range from 23 cents to 31 cents per $100 of insured deposits, with an overall premium range of eight basis points and correspondingly small inter-category increments. This model could be adopted in Canada.

THE U.S. PREMIUM MATRIX

Capital group	A Healthy financial institutions (FIs)	B FIs with weaknesses	C Troubled FIs
	(cents per $100 of insured deposits)		
Well capitalized	23	26	29
Adequately capitalized (meets minimum capital standards sets by regulator)	26	29	30
Less than adequately capitalized	29	30	31

Another Possible Model

A model, that takes into account aspects of the Canadian system (such as CDIC's Standards of Sound Business and Financial Practices), could also be developed for use in Canada. The risk-rating methodology, described below, is intended to provide the basis for discussion.

(a) Risk rating methodology

Under this possible model, CDIC would assign member institutions a risk-rating based on a number of different factors (all or some of the following factors: capital adequacy, CAMEL ratings, compliance with the CDIC Standards of Sound Business and Financial Practices, asset quality, diversification, sustainable earnings/profitability, assets/liability management, management, strategic and business plans, ratio/trend analysis and monitoring tools). Financial institutions would be rated on each of these factors and a composite score developed. The exact list of factors taken into consideration will affect the amount of discretion and the amount of information required to operate the system.

Based on the outcome of this exercise, institutions would fall into one of a number of categories – for example, healthy institutions, institutions where financial viability or solvency is at risk and institutions where future financial viability is in serious doubt. Institutions would then be assigned a deposit insurance premium, depending on which category they fall into.

The risk-based scheme would be authorized in legislation and elaborated on through CDIC by-laws.

(b) Setting of premiums

As indicated above, different premiums would be set, based on an underlying assessment of an institution's risk ratings. A base premium rate would be set by the Governor in Council each year as is currently the case. CDIC would recommend a base premium level based on CDIC's financial planning objectives and loss experiences. The notion of a statutory maximum would be retained and would act as a ceiling on the highest rate that an institution could pay. The adoption of the system of risk-based premiums would be expected to be revenue neutral, while redistributing premiums paid among institutions. The question of how the premiums would be collected remains to be resolved.

Transition from Current System

Consultations will occur on the risk-based premium proposals, following which a new premium schedule would be developed expeditiously, recognizing the need to provide CDIC member institutions with a reasonable notice period prior to implementing new premium rates.

APPENDIX V

For analysis purposes, CDIC groups the deficiencies into the following categories:

- Absence of board of directors oversight (pertaining to the review/approval of policies/procedures, ensuring the selection/appointment of qualified and competent management, and outlining the content and frequency of reporting, but excluding internal inspection/audit responsibilities);
- Shortcomings in internal inspection/audit;
- Deficiencies with respect to missing policy or control elements;
- Deficiencies in management information/reporting systems; and
- Other deficiencies (including risk measurement and miscellaneous activities).

The greatest improvement since the first SARP in 1995 has been in internal inspection/audit. Since an effective internal inspection/audit function is one component of the Internal Control Standard, one might expect deficiencies in the Internal Control Standard overall to show significant improvement. It is clear that, although deficiencies in internal inspection/audit may have received a great deal of attention, the other areas of the Internal Control Standard were not addressed as promptly.

CDIC will continue to monitor the self-assessments and examiners' reports closely to ensure that members are addressing outstanding deficiencies and following the Standards. To date, member institutions and CDIC have taken a co-operative approach to correcting Standards and related SARP deficiencies, and it is hoped this will continue. In the future, however, member institutions failing to address deficiencies in a timely fashion will be given shorter deadlines and, failing that, will face progressively more stringent action by CDIC. This may include the levying of premium surcharges and the termination of the policy of deposit insurance, if deemed necessary.

Adapting to Changes in the Legislative Environment

CDIC Premium By-law

Recent amendments to the CDIC Act require CDIC to make a premium by-law:

(a) to establish a system for classifying member institutions into different categories;

(b) to outline the criteria to be taken into account or the procedures to be followed by the Corporation in determining the category in which a member institution is classified; and

(c) to fix the amount of, or provide for the manner of determining the amount of, the annual premium applicable to each category.

To this end, CDIC is developing a differential premium system. Under this proposed system, member institutions would be classified into one of four categories according to a number of factors, which can be grouped into three broad categories: capital adequacy, other quantitative measures, and a CDIC qualitative rating. CDIC would assess different premiums for each category. However, the annual deposit insurance premiums would be limited to a maximum of one-third of one percent, as set out in the CDIC Act.

Differential premiums are not intended to be an actuarially based measure of the risk posed to the Corporation by an individual institution. Rather, they are intended to send an early warning signal—with financial consequences—to the management and board of directors of members institutions. The difference in premiums between

Differential premiums are intended to send an early warning signal to the management and board of directors of members institutions.

One of the most important aspects of the new legislation is a provision for eligible institutions to opt out of CDIC membership.

category 1, the best category, and category 4, the worst category, is intended to provide a meaningful incentive for member institutions to avoid excessive risk-taking. This incentive will be accomplished in two ways:

- Lower-rated institutions will pay higher premiums.
- Management discipline will be brought to bear on an institution's management and board of directors as a result of the knowledge respecting the categorization for differential premium purposes of their institution.

Given the present deficit circumstances, CDIC is proposing that initially, under the new premium by-law system, the annual deposit insurance premiums equal the revenues presently generated under the current, flat-rate system—even though different premiums would be charged to members in different categories.

CDIC is proposing an initial range of premiums from one-sixth of one percent of insured deposits for institutions in category 1 to one-third of one percent of insured deposits for institutions in category 4.

Once CDIC is in a position to reduce premium levels, consideration will be given to reducing the premium rates for institutions in category 1 while maintaining the maximum rate of one-third of one percent for institutions in category 4. This will increase the difference in premiums between categories, providing an even greater incentive for members to be classified in the best category.

Given the significance and impact of differential premiums on member institutions, the proposed premium by-law system will give member institutions the opportunity to appeal their rating and supply additional information to CDIC. As with other CDIC initiatives, the new system is being developed in consultation with regulators, member institutions and their associations, and other interested parties.

The premium by-law will be considered a regulation within the meaning of the *Statutory Instruments Act*. As such, the by-law will require review by the Department of Justice, Regulations Division, registration with the Clerk of the Privy Council, and publication in the Canada Gazette. In addition, the by-law must be approved by the Minister of Finance.

Policy and Legislative Environment Developments

CDIC played an active role in the development of new legislation for financial institutions during the past year as part of the 1997 review of financial sector legislation. From CDIC's perspective, one of the most important aspects of the new legislation is a provision for eligible institutions to opt out of CDIC membership. Under the new legislation, banks that, for all intents and purposes, serve only the wholesale market will be permitted to opt out of CDIC coverage, provided they are not affiliated with another CDIC member. As a result, these institutions will no longer have to fulfil the reporting requirements associated with CDIC membership. The impact on CDIC premiums is expected to be minimal since most of the institutions that may decide to opt out take few, if any, retail deposits and pay the minimum of $5,000 or only a small amount of premiums to CDIC.

CDIC is also participating in the Department of Finance's Payments System Advisory Committee during the next year to examine the key issues facing the payments system and to assist the government in determining whether adjustments to the system should be made.

References

Baillie, James C., “Investor Protection Plans”. Law Society special lectures, 1988 or 1990.

Canadian Banker, November/December 1994.

Canadian Life and Health Insurance Compensation Corporation, Annual Report 1996.

Canadian Investor Protection Fund, 1995 Annual Report.
Carr, J. L., Mathewson, G. F., and Quigley, N.C., “Financial Institutions Need More Market Discipline, Not More Regulation”. Policy Options, June 1995. Published by the Institute for Research on Public Policy.

Carr, J. L., Mathewson, G. F., and Quigley, N.C., “Ensuring Failure: Financial System Stability and Deposit Insurance in Canada”, Observation 36, C.D. Howe Institute.

CDIC, Annual Report 1996-1997.

CDIC, Annual Report 1994-1995.

Chant, John F. “Canada Should Consider Narrow Banking”. Policy Options, June 1995. Published by the Institute for Research on Public Policy.

Congress of the United States, Congressional Budget Office, “Reforming Federal Deposit Insurance”, September 1990.

Crean, John F., Senior Executive Vice President, The Bank of Nova Scotia,”Issues in Canadian Payments Systems”. Paper presented at the Queen’s Annual Business Law Symposium, November 23, 1996.

Department of Finance, Canada “Enhancing the Safety and Soundness of the Canadian Financial System”, White Paper, February, 1995.

The Economist, December 1992. “Deposit Insurance: Euro-muddle.

Evans, John, President and Chief Executive Officer, Trust Companies Association of Canada, “Some Observations on Deposit Insurance” C. D. Howe Studies and Others, March 23, 1994.

Gordon, Sheldon, “Deposit Insurance: It’s Safe, but is it Sound?”.

Heifer, Ricki, “Remarks before the Bank Administration Institute”, December 1996. Kaufman, George G. and Litan, Robert E., “Assessing Bank Reform: FDICIA One Year Later”, The Brookings Institution, Washington, D.C.

Kirby, Senator M. J. L., “Canada’s Financial Services Sector: 1997 and Beyond”. Policy Options, June 1995. Published by the Institute for Research on Public Policy.

Lederman Q. C., Lewis T., Corporate Secretary and General Council, CDIC “Regulation of Financial Institutions: The Role of Insuring Bodies - An Overview from a CDIC Perspective”, June 1995.

Merton, R. C. & Z. Bodie, 1993 “Deposit Insurance Reform: A Functional Approach”, Carnegie, Rochester Conference Series on Public Policy, 38:1-34.

McKinsey & Company Inc., “Building Better Banks: The Case for Performance Based Regulation”, 1996.

Parrin, Thorau & Associates Limited, “Comparison of Canadian Depositor Protection Arrangements: Final Report, October 16, 1996.

Pattison, John C., Senior Vice President, CIBC, “Financial Regulation in the Twenty-First Century: Competition, Technology, and Trade in Financial Services”. Presented at Queen’s University Annual Business Law Symposium, November 22-23, 1996.

Peters, D., “The White Paper: A Turning Point in Regulatory Philosophy”, Policy Options, June 1995, Published by the Institute for Research on Public Policy.

Pesando, James E., “The Wyman Report: An Economist’s Perspective, 1996”.

Roth, Michael, “Too Big to Fail” and “The Stability of the Banking System: Some Insights from Foreign Countries - Business Economics, October 1994.

Sutton, B. & Andrews, M., 1993 “Compensation Plans in the Canadian Financial Sector: A Comparison”. Report prepared for the Department of Finance, Deposit Insurance View by the Conference Board of Canada. Ottawa.

Schwartz, Lawrence T., “Improving Federal Deposit Insurance - Discussion Paper No. 93-01.

Senate “Regulation and Consumer Protection in the Federally Regulated Financial Services Industry: Striking a Balance”. Report of the Standing Senate Committee on Banking Trade and Commerce, November 1994.

Sutton, Andrews M. & Conner, B.C., “Roles and Responsibilities in the Nova Scotia Credit Union System”. Report prepared for Nova Scotia Credit Union Stabilization Fund Board, and Credit Union Central of Nova Scotia, by the Conference Board of Canada. United States General Accounting Office, Report to Congressional requesters “Securities Investor Protection: The Regulatory Framework has minimized SIPC’s Losses”, September 1992.

Wilson, Greg, “Building Better Banks: The Case for Performance Based Regulation”, Bank Management, July/August 1996.

Wyman, W. R., Final Report of the Working Committee on the Canadian Deposit Insurance Corporation (CDIC), April 24, 1985.

APPENDIX VI

APPENDIX VII

Commercial Banking, Structure, Regulation and Performance;
An International Comparison,
By James R. Barth, Daniel E. Nolle, Tara N. Rice.

Economics Working Paper 97-6, March 1997, Comptroller of the Currency.
Administrator of National Banks.

Table 10
Deposit Insurance Schemes for Commercial Banks in the EU and G-10 Countries 1995

Administration of and Membership in the System						
Country	**Name of Guarantee/Insurance System**	**Year First Established**	**Date Current System Took Effect**	**Administration of System: Government or Industry**	**Agency Responsible for Administering System**	**Membership: Voluntary or Compulsory**
Austria	Deposit Guarantee System	1979	July 1, 1995	Industry	Sectoral Associations	Compulsory
Belgium	Guarantee Scheme for Deposits with Credit Institutions	1974	January 1, 1995	Government/Industry – joint	Herdiscontering-en Waarborginstituut-Institut de Reescompte et de Garantie	Compulsory
Canada	Canada Deposit Insurance System	1967	1967	Government (Crown Corporation)	Canada Deposit Insurance Corporation	Compulsory
Denmark	Deposit Insurance Fund	1987	July 1, 1995	Government	Deposit Insurance Fund	Compulsory
Finland[1]	Quarantee Fund of Commercial Banks and Postipankki Ltd.	1966	July 1, 1995	Industry	Quarantee Fund of Commercial Banks and Postipankki Ltd.	Compulsory
France	Deposit Guarantee Fund	1980	No information	Industry	French Bankers' Association	Compulsory
Germany	Deposit Protection Fund of the Federal Association of German Banks	1966	1976	Industry	Federal Association of German Banks	Voluntary
Greece	Deposit Guarantee Fund	1995[2]	July 17, 1995	Government/Industry – joint	Deposit Guarantee Fund	Compulsory
Ireland	Deposit Protection Account (Central Bank)	1989	July 1, 1995	Government	Central Bank of Ireland	Compulsory
Italy	Fonds Inerbancario Di Tutela Dei Depositi	1987	1987	Industry	Independently Administered	Voluntary
Japan	Deposit Insurance Corporation	1971	No information	Government/Industry – joint	Deposit Insurance Corporation	Compulsory
Luxembourg	Association pour la Garantie des Dépôts, Luxembourg (AGDL)	1989	October 1995	Industry	AGDL	Compulsory
Netherlands	Collective Guarantee System	1979	July 1, 1995	Government/Industry – joint	De Netherlandsche Bank N.V.	Compulsory
Portugal	Deposit Guarantee Fund	1992	1994	Government	Deposit Guarantee Fund	Compulsory
Spain	Deposit Guarantee Fund	1977	End of 1995	Government/Industry – joint	Fondo de Garantia de Depositos	Compulsory
Sweden	Swedish Deposit-Guarantee Scheme	1974	January 1, 1996	Government	The Bank Support Authority	Compulsory
Switzerland	Deposit Guarantee Scheme	1982	July 1, 1993	Industry	Swiss Banker's Association	Voluntary
United Kingdom	Deposit Protection Fund	1982	July 1, 1995	Government	Deposit Protection Board	Compulsory
United States	Bank Insurance Fund	1933	January 1, 1996	Government	Federal Deposit Insurance Corporation	Compulsory
European Union (EC Directive on Deposit-Guarantee Schemes)	Determined within each member state	Adopted on May 30, 1994	July 1, 1995	Only directs that each member state shall ensure within its territory one or more deposit guarantee schemes are introduced and officially recognized	Determined within each member state.	Compulsory

Table 10 (continued)

Coverage or Protection								
Country	**Extent or Amount of Coverage**	**Interbank Deposits Covered**	**Deposits of Foreign Branches of Domestic Banks Covered**		**Deposits of Domestic Branches of Foreign Banks Covered**		**Foreign-Currency Denominated Deposits Covered**	**Non-resident Depositors Covered**
			Branches located in EU Country	**Branches located in Non-EU Country**	**Branches of EU Banks**	**Branches of Non-EU Banks**		
Austria	ATS 260,000 (per physical person-depositor)	No	Yes	Yes	Yes, amount depends on home country.	Yes	Yes	Yes
Belgium	15,000 ECU units DEC 1999. 20,000 ECU thereafter	No	Yes	No	Yes[4]	Yes	Yes, but only deposits expressed in ECU or another EU currency.	Yes
Canada	Can $60,000 (per depositor)	Yes	No	No	Yes[3]	Yes[3]	No	Yes
Denmark	300,000DKK or 42,000 ECU (per depositor)	No	Yes	Yes	Yes[4]	Yes	Yes	Yes
Finland	100 percent (per depositor)	No	Yes	Yes	Yes[4]	Yes	Yes	Yes
France	FF 400,000 (per depositor)	No	Yes	No, except for EEA countries	Yes	Yes	Yes, but only deposits expressed in ECU or another EU currency	No information
Germany	100% up to a limit of 30% of the bank capital (per depositor)	No	Yes	Yes	Yes	Yes	Yes	Yes
Greece	20,000 ECU (per depositor)	No	Yes[3]	Yes[5]	Yes[4]	Yes[6]	Yes	Yes
Ireland	90% of deposit – Max. Compensation in 15,000 ECU	No	Yes	Yes	No	Yes	Yes	Yes
Italy	100% of first 200 million Lit and 75% of the next 800 million Lit (per depositor)	No	Yes	Yes[7]	Yes	Yes	Yes	Yes
Japan	10 million Yen (per depositor)	No	No	No	No	No	No	Yes
Luxembourg	Lux F 500,000 per depositor), only natural persons	No	No	No	Yes	Yes	Yes	Yes
Netherlands	20,000 ECU (per depositor), compensation paid in Guilders	No	Yes	No	Yes[4]	Yes[8]	Yes	Yes
Portugal	100% up to 15,000 ECU 75% - 15,000 – 30,000 ECU 50% - 30,000 – 45,000 ECU (per depositor)	No	Yes	No	Yes[4]	Yes	Yes	Yes
Spain	Ptas 1.5 million (per depositor); to be increased to 20,000 ECU	No	Yes	Yes	Yes	Yes	Yes	Yes
Sweden	SEK 250,000 (per depositor)	No	Yes[9]	No[10]	Yes[4]	Yes	Yes	Yes
Switzerland	SF 30,000 (per depositor)	No	No	No	Yes	Yes	Yes	Yes

Table 10 (continued)

Coverage or Protection								
Country	**Extent or Amount of Coverage**	**Interbank Deposits Covered**	**Deposits of Foreign Branches of Domestic Banks Covered**		**Deposits of Domestic Branches of Foreign Banks Covered**		**Foreign-Currency Denominated Deposits Covered**	**Non-resident Depositors Covered**
			Branches located in EU Country	**Branches located in Non-EU Country**	**Branches of EU Banks**	**Branches of Non-EU Banks**		
United Kingdom	90% of protected deposits, with the maximum amount of deposits protected for each depositor being L20,000 (unless the sterling equivalent of ECU 22,222 is greater). Thus the most an individual can collect in a bank failure is L18,000 (per depositor) or ECU 20,000 if greater	No	Yes, throughout EEA	No	Yes[12]	Yes[13]	Yes, but only deposits in other EEA currencies and the ECU, as well as sterling	Yes
United States	100,000 USD (per depositor)	No	No	No	No, unless engaged in retail deposit-taking activities	No, unless engaged in retail deposit-taking activities	Yes	Yes
European Union	The aggregate deposits of each depositor must be covered up to ECU 20,000. Until December 31, 1999, member states in which deposits are not covered up to ECU 20,000 may retain the maximum amount laid down on their guarantee schemes, provided that this amount is not less than ECU 15,000 (per depositor)	No	If located within the EU, but until December 31, 1999 not to exceed the maximum amount laid down in their guarantee scheme within the territory of the host member state. If the host member state has greater coverage a branch may voluntarily supplement its coverage.	This issue is determined by each member state	Yes, either by having coverage equivalent to the Directive or by joining the host-country deposit-guarantee scheme if it is more favorable for the extra coverage.	NA	Yes, if denominated in ECU or currencies of member states of EU.	Yes, determined within each member state.

Table 10 (continued)

Funding					
Country	**Ex Ante or Ex post Funding**	**Fund Minimum Reserve Level**	**Base for Premium**	**Premium Rate**	**Risk-Based Premiums**
Austria	Ex post, system organized as an incident-related guarantee facility	NA	The deposit guarantee system shall obligate its member institutions, in case of paying-out of guaranteed deposits, to pay without delay pro rata amounts which shall be computer according to the share of the remaining member institution at the preceding balance sheet date as compared to the sum of such guaranteed deposits of the deposit guarantee system.	See adjacent column at left	NA
Belgium	Ex ante, but in case of insufficient reserves, banks may be asked to pay, each year if necessary, an exceptional additional contribution up to 0.04 percent.	No	Total amount of customers' deposits which qualify for reimbursement and which are expressed either in BEF, ECU or another EU currency.	0.02 percent	No
Canada	Ex ante	No	Insured Deposits	One-sixth of one percent	No
Denmark	Ex ante	Yes, 3 billion DKK	Deposits	Max 0.2 percent	No
Finland	Ex ante	No	Total Assets	Between 0.01 and 0.05	No
France	Ex post	NA	The contribution consists of two parts: a.1 A fixed part, irrespective of the size of the bank, equal to 0.1% of any claim settled and with a FFR 200,000 ceiling; 2. A proportional part, varying according to a regressive scale relative to the size of the bank contributing, based on deposits and one-third credits.	See adjacent column to left	NA
Germany	Ex ante; however, additional assessments may be made if necessary to discharge the fund's responsibilities. These contributions are limited to twice the annual contribution.	No	Balance sheet item "Liabilities to Customers."	0.03 percent	No
Greece	Ex ante	No	Total Deposits	0 – 200 billion GRD 2% 200 – 500 billion GRD 1% 500 – 1,000 billion GRD 0.4% Above 1,000 billion GRD 0.1%	No
Ireland	Ex ante	No, but see information under Premium Rate column	Total Deposits excluding Interbank Deposits and Deposits represented by Negotiable Certificates of Deposit.	0.2 percent, with a minimum of L 20,000	No
Italy	Ex post; banks commit ex ante, however contributions are ex post.	NA	Max. limit for funding for the whole system: 4,000 Billion Lire. Contributions are distributed among participants on the bases of: (Deposits + Loans – Own Funds) with a correction mechanism linked to deposit growth.	See adjacent column to left	NA
Japan	Ex ante	No	Insured Deposits	0.012 percent	No
Luxembourg	Ex post	NA	Banks' premiums based on percentage of loss to be met.	See adjacent column to left	NA
Netherlands	Ex post	NA	Amount repaid in Compensation to insured is apportioned among participating institutions. However, the contribution is any one year shall not exceed 5% per an institution's own funds and per all institutions' own funds	See adjacent column to left	NA
Portugal	Ex ante. However, the payment of the annual contributions may be partly replaced, with a legal maximums of 75%, by the commitment to deliver the amount due to the Fund, at any moment it proves necessary.	No	Guaranteed Deposits	0.08 to 0.12 percent	Yes
Spain	Ex ante	No	Deposits	Max. 2 per thousand. Premiums will be interrupted when the fund reaches 2%.	No
Sweden	Ex ante	No	Covered Deposits	0.25 percent[11]	Yes

Table 10 (continued)

Funding					
Country	**Ex Ante or Ex post Funding**	**Fund Minimum Reserve Level**	**Base for Premium**	**Premium Rate**	**Risk-Based Premiums**
Switzerland	Ex post	NA	Two Components: Fixed fee in relation to gross profit; Variable fee depending on share of total protected of an individual bank.	See adjacent column on left.	NA
United Kingdom	Ex ante; banks make initial contributions of L10,000 when a bank is first authorized, further contributions if the fund falls below L3 million, not exceeding L300,000 per bank based on the insured deposit base of the banks involved, and special contributions, again based on the insured deposit base of the banks involved but with no contribution limit.	Yes, the fund is required by law to maintain a level of L 5 million to L 6 million, but the DPB can decide to borrow to meet its needs.	All deposits in EEA currencies less deposits by credit institutions; financial institutions, insurance undertakings, directors, controllers and managers, secured deposits, CDS, deposits by other group companies and deposits which are part of the bank's own funds.	Initial contributions are 0.01 percent. The rate of other contributions depends on the sum required to be raised.	No
United States	Ex ante.	Yes, 1.25 percent of insured deposits	Domestic Deposits	0 to 0.27 percent, subject to a flat minimum of $2,000 for the highest rated banks	Yes
European Union	Determined within each member state.	Determined within each member state.	Determined within each member state.	Determined within each member state	Determined with each member state.

SOURCE: Supervisory authorities in the listed countries provided information used to prepare this table. However, they are not responsible for any errors or misinterpretations. For exact information one must consult the pertinent laws and regulations in the individual countries. In the case of Japan, a source was Lee (1996). In the case of France, a source was Banking Federation of the European Union (1995).

NOTES:

1. A government guarantee fund was also established in 1992.
2. There was no deposit guarantee scheme prior to 1995.
3. Foreign banks must incorporate subsidiaries to operate in Canada. Deposits of foreign bank subsidiaries are covered by CDIC Insurance.
4. Yes, if they join for supplementary coverage.
5. Unless covered by an equivalent host country scheme.
6. Unless covered by an equivalent home country scheme.
7. Only if bank does not participate in local system.
8. If the coverage by their home state is equivalent
9. Covers EEA countries.
10. Unless application for non-EEA country is approved.
11. Premium rates varies by institution based upon several factors.
12. For depositors of UK branches of EEA banks whose coverage is less generous, they have the option to pay for equivalent coverage
13. Unless the Deposit Protection Board is satisfied that the home country scheme provides equivalent coverage to UK depositors.

DESCRIPTION: The EU and the 7-member European Free Trade Association (EFTA) – except Switzerland – form the European Economic Area (EEA), a single market of 18 countries. In addition to the EU countries, it includes Iceland, Liechtenstein and Norway, EFTA includes Austria, Finland, Iceland, Norway, Sweden, Switzerland and Liechtenstein. The EEA was initially established in May of 1992 and came fully into effect in January of 1994.