

This Bulletin is intended to clarify how CDIC views the eligibility for deposit insurance of certain financial products. The terms and conditions associated with a specific product must be reviewed to determine whether the general principles apply to it. Attached is a one page primer outlining the basics of deposit insurance coverage.

More information is available in the CDIC information brochure *Protecting Your Deposits* available in each branch of a CDIC member institution or on the CDIC web site www.cdic.ca as well as by contacting CDIC by phone at 1-800-461-2342 or by email at info@cdic.ca.

Tax Free Savings Account (TFSA)

In its February 2008 Budget, the federal government announced the introduction of a Tax-Free Savings Account (TFSA). As described in a pamphlet issued by the Department of Finance, the TFSA will allow Canadians to set money aside in eligible investment vehicles and watch those savings grow tax-free throughout their lifetimes.

Q: Is a TFSA eligible for CDIC insurance?

In order to answer this question, it must first be understood that the TFSA is a plan into which one can contribute qualified investments up to established limits. Included in the qualified investments are deposits as defined under the CDIC Act. What this means is that if a savings account or GIC is contributed to a TFSA that would otherwise be eligible for CDIC insurance, the deposit would continue to be eligible for deposit insurance within the TFSA. However, if mutual funds or bonds are contributed to the TFSA, they would not be covered by CDIC insurance as they are not eligible for deposit insurance outside of the TFSA.

Q: Are deposits held within a TFSA separately insured from other deposits at the same institution up to the \$100,000 limit, like deposits in an RRSP?

No, they are not separately insured. Deposits held in a TFSA would be added to other deposits of that depositor at the same institution to determine whether the \$100,000 coverage limit is exceeded.¹

¹ CDIC currently has six deposit insurance categories, each of which is covered to an aggregate of \$100,000 per depositor per member institution – basic coverage (savings, chequing, term deposits, GICs, etc.), trust accounts, joint accounts, deposits held in a registered retirement savings plan, deposits held in a registered retirement income fund, and realty tax accounts.

Pre-Funded Debit (and other) Cards

Is there deposit insurance coverage of positive balances on cards? In some cases there may be, but it will depend on the nature of the transaction and whether the CDIC Act definition of a deposit is met. For example, credit balances on credit cards are not considered deposits eligible for deposit insurance nor are balances on a gift card. However, funds accessible using single purpose cards may be considered deposits if they are held in a deposit account. The questions and answers below may be of assistance in determining if a card balance is eligible for deposit insurance.

Q: There is a credit balance on a credit card due to accidental overpayment or the card agreement requires a positive balance be maintained. Is it subject to deposit insurance?

No. Such positive balances have not been interpreted by CDIC as deposits under the CDIC Act. To be a deposit, the moneys must be received by the CDIC member institution in the usual course of the deposit taking business of the institution. The credit cards form part of the card business of the institution and a “deposit account” is not opened in the name of the cardholder. Further, accounting by the member institution for such balances usually takes place within the card business and are not included with the deposit liabilities of the institution.

Q: A bank required the posting of cash equal to the credit limit as security for the card. Is it covered?

Possibly. Some institutions issue cards with a limit equal to the amount you post with them on deposit. The posted amount is used to purchase a term deposit or GIC in your name that is then pledged as collateral – as security for the repayment of credit extended through the use of the credit card. If you default on the credit card, the card company can then access the deposit and use it to pay off the card balance. Provided the deposit meets the other requirements of the CDIC Act definition (i.e. less than 5 year term, not in foreign currency, payable in Canada), it would be eligible for deposit insurance should the institution fail.

Q: Certain employers use cards rather than cheques to meet their payroll obligations. Each employee signs an agreement with a bank and is issued a card and assigned a PIN to use with the card. Payroll can be accessed through ATMs using the cards. Is the pay eligible for deposit insurance?

Yes, provided that a single purpose debit card has been issued by the bank to the employee pursuant to an agreement between the bank and the employee, a PIN number has been assigned and the employer has directed the employee share of the payroll to be downloaded to the employee accounts. In a simplistic example, the employer has entered into an agreement such that it will deposit the entire payroll in a consolidated account – akin to a trust account for the benefit of the employees. It then directs the bank to credit the employee (whose deposit account is accessible by the card) with his/her portion of the payroll. Once the account has been credited with the employee’s pay, the only access to the funds is by the person with the card and corresponding PIN who can now withdraw from the account. The employer cannot reverse the flow of funds. If the bank failed, this “deposit account” would be eligible for deposit insurance provided it meets the other criteria (i.e. payable in Canada, in Canadian currency).

Principal Protected Notes (PPNs)

Q: What is a PPN?

A PPN is a financial instrument issued by a financial institution that guarantees the invested principal and offers returns linked through formulas to underlying investment products that can range from a relatively straightforward basket of equities (e.g. the performance of the TSX index) to more complex investments such as hedge funds. A PPN is a promissory note (a contractual promise to pay in return for consideration received) and the contract contains a guarantee that the amount paid will be no less than the amount of the original investment (principal protection). A promissory note does not qualify as a deposit under the definition of deposit in the CDIC Act.

Q: Are PPNs eligible for deposit insurance?

No – most PPNs are not deposits as defined under the CDIC Act. The primary distinguishing feature between a deposit as defined under the CDIC Act and a PPN is that most PPNs are recorded and traded through CDS Clearings and Depository Services Inc.² whereas deposits insurable by CDIC must be recorded on the books of the institution in the name of the depositor and are not usually traded. PPNs are more often than not issued by a financial institution in a single large issue and subsequently broken down into smaller incremental notes for sale, i.e. \$1000 increments. Another feature of many PPNs is that they are usually for a term of more than five years which would also exclude them from CDIC coverage.

Q: Are all principal protected index linked products PPNs?

No. Many financial institutions offer index-linked term deposits or GICs. The fact that a product's yield or return is tied to the performance of an index or basket of equities and the principal is fully repayable does not necessarily mean it is a PPN.

Q: Would there be anything on a PPN to tell me whether it is insured by CDIC?

Possibly. Under recently imposed federal regulations relating to PPNs, if they are not insured by CDIC, the PPN instrument must so indicate. Further, under the *CDIC Deposit Insurance Information By-law*, member institutions must provide notification to depositors when a deposit (or deposit-like) product is not eligible for insurance. For example, if a term deposit is in foreign currency, the deposit certificate or receipt must state that it is not CDIC insured.

Q: How is the principal protected if it is not CDIC insured?

The guarantee of repayment of the principal comes from the institution. It is usually related to the yield calculation and the possibility that the formula could result in a negative yield. The protection of principal refers to the full repayment of principal invested notwithstanding that the performance of the index to which the yield is attached could have resulted in the investment bearing a negative return (i.e. repayment according to the formula would have been less than the original principal invested). It is not referring to repayment in the event of failure of the institution.

² CDS acts as a custodian of securities for federally incorporated institutions, such as banks, trust and loan companies, insurance companies and pension funds.

PRIMER

Deposit Insurance Coverage Basics

A deposit is only eligible for deposit insurance if it

- *is in Canadian currency,*
- *is payable in Canada and*
- *has a term of 5 years or less*

What are some examples of financial products that qualify as deposits?

Savings accounts, Chequing accounts, Commercial accounts, Term deposits, Guaranteed investment certificates (GICs), Certificates of deposit

What are some examples of financial products that do not qualify as deposits?

Mutual funds, Treasury bills, Bonds, Shares / stocks, Bearer instruments, promissory notes

Who is a depositor?

The depositor is the individual, corporation, financial institution, association, trustee, or other legal entity that has the account or term deposit or GIC in his/her/its name.

Who is a member institution?

Most federally regulated banks and trust and loan companies are members of CDIC. Membership lists are available at your branch or by contacting CDIC.

What does the \$100,000 limit mean?

Each depositor per member institution has up to \$100,000 coverage for the aggregate of the depositor's eligible deposits per insurance category.

- **Basic coverage:** At the same member, but at all different branches, Joe has \$20,000 in a chequing account, a \$30,000 GIC, and \$60,000 in a savings account. The fact that they are at different branches does not create separate coverage. Nor the fact that the deposits are in different accounts. The three would be added together to determine whether Joe had exceeded his basic coverage limit of \$100,000. In this case, Joe has exceeded it by \$10,000. If the institution failed, Joe's insurance payment under the basic coverage would have been \$100,000.
- **Joint Accounts:** Any account Joe holds jointly would be considered separately insured from Joe's personal accounts. An account in the name of Joe and Ann is viewed as a separate depositor from an account in the name of Joe and Harold jointly, or any one of them individually. All joint accounts in the same names are aggregated and are entitled to separate coverage up to \$100,000.
- **Trust Accounts:** There is up to \$100,000 separate coverage for accounts / deposits held in trust. They are considered distinct from other deposits in the name of the trustee or the beneficiary of the trust, provided that the existence of the trust and certain information about the trustee and beneficiary is disclosed on the records of the institution.
- **RRSPs and RRIFs:** There is a further \$100,000 separate coverage for deposits held either within a registered retirement savings plan or within a registered retirement income fund. Once again, aggregation takes place within the plan.
- **Realty Tax Accounts:** There is a further \$100,000 separate coverage for deposits held on behalf of a customer for the purpose of remittance to the realty tax authority.