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Canada Deposit Insurance Corporation

Société d'assurance-dépôts du Canada

CDIC Summary of Responses to its Differential Premiums System Consultation Paper

January 16, 2023

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On July 25, 2022, CDIC announced revisions to its deposit protection fund (ex ante fund) target level and launched a public consultation paper seeking input on proposed changes to its Differential Premiums System (DPS). In the consultation paper, CDIC sought feedback on a number of proposed changes to its ratings system used to differentiate member institutions to achieve key policy objectives.1

Proposals included raising the number of premium rate categories to five from four, increasing the frequency of differential premium assessments, and enhancing metrics related to financial and regulatory criteria used by CDIC to complete assessments, including a greater emphasis on the risks members may pose to CDIC's ex ante fund if they were to fail.

CDIC received feedback from 9 respondents, including member institutions and industry organizations. CDIC thanks those who submitted comments.

Summary of Feedback to Consultation Paper

Respondents acknowledged the need for structural changes, such as improving differentiation and fairness through the introduction of a fifth premium category, increasing the weight of the CDIC component of the Regulatory Criteria, and giving resolvability considerations greater prominence. There were no concerns raised with the removal of the stress-tested net income and efficiency ratio financial metrics and there was general support for incorporating funding and liquidity considerations into the Financial Criteria.

While there was acknowledgement of the need to introduce funding and liquidity measures, respondents recommend that CDIC leverage existing regulatory measures (e.g., Liquidity Coverage Ratio (LCR), Net Stable Funding Ratio (NSFR) and Net Cumulative Cash Flow (NCCF)) rather than incorporate additional metrics.

Respondents recognized potential benefits of quarterly classification but expressed caution in relation to a potential accompanying increase in administrative burden, particularly for smaller institutions. There was also a view that quarterly DPS reporting may be administratively inefficient and potentially duplicative of current OSFI reporting requirements. Respondents suggested that finding ways to

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[1] The core objective of the DPS is to: *send an early warning signal — with financial consequences — to the management and board of directors of a member institution concerning the risk (i.e., likelihood of failure and resolvability) the member poses to CDIC.*

calculate ratios and scores automatically using data sourced directly from submitted returns to OSFI (as is currently the case) could reduce any potential additional burden.

While most respondents supported proposed changes to the new member policy2, some argued it should be more conservative. Others cautioned that making premiums too punitive for new entrants could reduce the appetite for institutions to join the federally regulated financial institution framework.

Another area of focus for respondents was the higher standards and supervisory requirements applied to federally regulated financial institutions to improve the safety and soundness of Canada's financial system in recent years (i.e., adherence to total loss absorbing capacity, capital, liquidity and resolution planning requirements). These respondents are supportive of a DPS and ex ante funding target that appropriately reflect these system enhancing measures.

Lastly, some respondents also requested premiums remain at current levels for a transition period while members adjust to the new framework, noting that increasing the risk sensitivity of the DPS criteria could create volatility and have the potential to be procyclical.

The attached Annex includes a summary of key messages provided by respondents for each of the major DPS proposals and ex ante target.

Next Steps

CDIC is currently considering feedback. It will revise proposals where appropriate and may ask for further feedback from the industry. CDIC will share with member institutions updated changes to the DPS framework in Spring 2023. Upon finalization of changes, CDIC will organize information sessions with members to ensure that changes and timelines for compliance are well understood.

Annex: Brief Summary of Respondent Feedback[3]

Ex Ante Fund Target

Some respondents expressed the view that the proposed near-term target for the ex ante fund (85 bps) should appropriately reflect recent efforts made to improve the safety and soundness of Canada's financial system (e.g., capital, liquidity, resolution planning and total loss absorbing capacity requirements). It was suggested that the risk of failure of CDIC member institutions has decreased as a result of these changes, and so should be appropriately reflected in the DPS framework, the target level for the ex ante fund, as well as the premium rate path utilized to achieve the target.

[2] CDIC proposes that new members will be placed in category 2 for the first two years of membership, unless staged by OSFI, in which case they would be downgraded commensurate to their risk profile.
[3] While CDIC has reviewed all feedback, not all comments could be included in this summary.

Some respondents also shared a perspective that CDIC is using a temporarily inflated (due to COVID-19-related support measures) level of insured deposits (i.e., as at March 31, 2022), which respondents believe will decrease with the implementation of quantitative tightening, to inform its near-term target. Finally, some respondents requested CDIC consider a transition period where premium rates would remain at current levels while members adjust to the new framework.

Increased Number of Categories

Respondents generally agreed that adding a fifth risk category would enable more differentiation of member institutions on the basis of risk and improve fairness through a reduction of cross subsidization. However, some felt the proposed threshold for category 1 (i.e,: ≥ 90 vs ≥ 80 under the current framework) was too high and should be lower. Respondents were concerned that this change might be accompanied by an increase in premium rates and sought clarity on what the premium rate structure would look like under the new framework.

New Member Policy

Respondents were generally supportive of CDIC's proposed change to its new member policy (see Footnote 2). However, some respondents felt it should be more conservative, suggesting new members, particularly those joining CDIC with a large, existing book of deposits, be placed in a lower category for longer. Other respondents questioned whether the policy would reduce the appetite of institutions to join the federally regulated financial institution framework. Another suggestion was made that continuing institutions, with the requisite historical data, should bypass the new member policy and be subject to the DPS categorization applicable to the rest of the membership.

Frequency of Assessment

While some respondents indicated understanding the potential benefits of quarterly classification and the importance for capturing timely changes in the DPS' new liquidity and funding metrics, most respondents suggested that quarterly DPS reporting could add burden for relatively little benefit. Respondents also indicated that quarterly DPS reporting would present disproportionate burden to smaller institutions and that quarterly financial data can be more volatile. Respondents suggested that finding ways to calculate ratios and scores automatically using data sourced directly from submitted returns to OSFI (as is currently the case) could reduce any potential additional burden. Another suggestion was to impose quarterly classification only for those member institutions classified in a premium category other than 1.

Regulatory Criteria

Respondents did not express concerns with increasing the weighting of the CDIC component of the Regulatory Criteria and incorporating resolvability considerations. However, there was interest in seeing

increased transparency in the methodology behind CDIC's Internal Member Rating. Some respondents inquired about the use of the term "Full Compliance" with respect to the Resolution Planning By-law (RPB) and the Data and System Requirements By-law (DSRB). Respondents wondered whether this meant a new standard of compliance with these by-laws was being introduced.[4]

Financial Criteria

CDIC received minimal comments on several proposed changes to the DPS Financial Criteria. The following list only includes those proposals which received material feedback:

Capital Adequacy

- One respondent indicated that the metrics do not award added value to institutions with strong excess capital positions.
- Another expressed that the scale penalizes members that already have a high capital target.

Return on Risk-Weighted Assets

- Some respondents viewed the proposed change to the upper scoring threshold as too high.
- There were concerns raised from a non-DSIB perspective that the metric does not incorporate a component that recognizes the benefits of higher capital buffers.
- Some respondents felt that the metric is not an appropriate measure for all business models.

Real Estate Asset Concentration

- Most respondents felt that there were no concerns re-introducing the metric for DSIBs.
- Some respondents suggested changes to the formula to ensure greater consistency and comparison between members with mortgages within and outside Canada.

Asset Encumbrance Measure

- Some respondents recommended continued use of existing liquidity risk monitoring tools instead of this measure.
- Some respondents expressed that the metric doesn't consider decisions made by institutions to enhance contingent funding capacity in stress situations.
- There was concern the measure could disproportionately impact smaller members, thereby negatively impacting industry innovation and competitiveness.
- Proposed scoring thresholds were viewed as punitive by some respondents.
- Some respondents proposed using another OSFI return, such as the H4, rather than the U3 for inputs to the formula.

HQLA to Short-Term Funding

- While respondents generally supported incorporating liquidity and funding measures into the DPS, they viewed the High-Quality Liquid Assets to Short-Term Funding metric as unnecessary, preferring to use existing metrics, such as the LCR, NSFR and NCCF.

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[4] The use of the term "full compliance" in the DPS consultation paper was not meant to imply a new standard of compliance with either the RPB or DSRB. Compliance requirements for these by-laws will remain unchanged.

- Concerns were raised by some respondents that the metric does not sufficiently differentiate potential stresses to an institution.
- Some respondents also noted that the metric could deteriorate in severe financial stress, resulting in a lower score and potentially higher premiums, prolonging recovery.
- Concerns were also expressed that the operational burden of managing to a new liquidity metric would be significant.

Stable Funding Ratio

- Some respondents recommended utilizing existing metrics such as the NCCF and LCR rather than introducing this metric, while acknowledging that such measures do not apply to all member institutions.
- Some respondents expressed the view that the metric ignores liquidity held to manage risk associated with funding, does not differentiate assets and does not recognize asset/liability matching.
- Some respondents also proposed technical adjustments to the formula to enhance consistency between it and other metrics.

Brokered Deposits Ratio

- Most respondents believe this measure incents institutions to reduce reliance on brokered deposit funding. There was concern this could hurt smaller institutions and competition.
- Some respondents recommended only including demand based brokered deposits in the formula and removing term brokered deposits.