Summary of CDIC's Review of the Deposit Premium Structure (DPS)

Prepared by: Morgan Paulgaard
Last updated: August 2023

Introduction

The Canada Deposit Insurance Corporation (CDIC) published its system review and conclusions of the Deposit Premium Structure (DPS) on July 31, 2023. The document provides an overview of changes to the DPS, which will be implemented in 2025 for Federally Regulated Financial Institutions (FRFIs).

The review follows a 90-day consultation undertaken in the fall of 2022. CDIC published a summary of feedback from the consultation earlier this year. As a result, our analysis will provide an overview of the changes and compare outcomes with responses received by CDIC. We have included this information in detail in the Appendix. FRFIs are encouraged to assess all changes outlined in CDIC's document.

Summary

CDIC's stated intention is that this document reflects the changing operating and risk environment for member financial institutions, which has shifted significantly since the DPS was last reviewed in 2014.

The new document introduces structural changes through (i) the introduction of a new premium category and (ii) new member policy, (iii) increasing the assessment frequency from annual to twice per a year, and (iv) increasing the weight of the CDIC component of the regulatory criteria (previously called "qualitative" criteria) to giving resolvability considerations greater prominence. In addition, (v) CDIC has made a number of adjustments to the financial criteria (previously referred to as quantitative criteria) in accordance with its consultation paper. Finally, while the consultation paper consulted on a near term target fund size of 85 basis points, the paper omitted a decision.

New Risk Category

CDIC increased the number of categories from four to five in line with its proposal and feedback received. The additional category (i.e. ≥ 90) was intended to improve differentiation and reduce cross-subsidization of risk. Under the previous matrix, CDIC found that a large and increasing majority of members have been classified in the top premium category (i.e. ≥ 80). For example, in 2021 and 2022, 90% and 92% of members fell in this category respectively.

Score	Premium Category
≥ 90 [1]	1
≥ 80 but < 90	2
≥ 65 but < 80	3
≥ 50 but < 65	4
< 50	5

New Member Policy

In its consultation paper, CDIC introduced a new member policy, which would place federally continued institutions into category 2 of the scoring range (≥ 80 but < 90) for the first two years of membership, unless staged by OSFI, in which case they would be downgraded commensurate to their risk profile.

[1] New category to be introduced in 2025.

The new DPS was modified such that after the FRFI's first year of membership, the member will have the option to "opt out" of the new member policy and be assessed against individual differential premium measures, provided the requisite data is available through the Regulatory Reporting System (RRS). If the data is unavailable through RRS, they will continue to be subject to the new member policy (i.e., placed in category 2 unless staged) for the second year.

Frequency of Assessment

In its consultation paper, CDIC proposed that premiums be issued on a quarterly basis. However, most feedback suggested that quarterly DPS reporting could add burden for relatively little benefit, and that it would present disproportionate burden to smaller institutions. Quarterly financial data may also be more volatile.

As a result, the frequency with which CDIC classifies members into premium categories will be twice annually. The stated intent is to incentivize member institutions to correct issues identified by CDIC or the regulator quicker. This offers a FI the opportunity to potentially reduce their overall annual premiums.

Under the new system, members will be classified as of October 31 and April 30 and receive notice of their differential premium score and associated category shortly thereafter. The annual premium rate will be determined with a weighted average of the rates that correspond to the applicable premium category for each semi-annual period. This rate will then be multiplied by the member's total volume of insured deposits as of April 30 to determine their annual premium.

Regulatory Criteria

The "Other Information" component in the Regulatory Criteria (previously referred to as Qualitative Criteria) will be replaced by the "CDIC Risk and Resolvability Rating" (CDIC RRR) and expanded to incorporate: (i) CDIC's assessment of factors contributing to the likelihood of failure, and (ii) CDIC's assessment of resolvability challenges for a member institution.

In addition, the weight of this amended category will be increased from 5 to 15 points. Sections of the current By-law relating to premium penalties for non-compliance with the Resolution Planning By-law (RPB) and Data and System Requirements By-law (DSRB) will be repealed. Instead, non-compliance with the RPB and DSRB will be reflected in the CDIC RRR. The increase in CDIC's component will be offset by an equal reduction in the weight of the Examiner Rating component (i.e., from 35 to 25 points).

Financial Criteria

At a high-level, the DPS scorecard's Financial Criteria (previously referred to as Quantitative Criteria) will be updated through the removal of certain metrics, adjustments to formulae and thresholds, and the introduction of liquidity and funding-related metrics. Affected metrics include Capital Adequacy, Return on Risk-weighted Assets, HQLA to Short-term Funding, Stable Funding Ratio, Brokered Deposits Ratio, a new Liquidity Coverage Ratio for D-SIBs, and the introduction of a Real Estate Asset Concentration metric and Asset Encumbrance Measure. In relation to the Aggregate Commercial Loan Concentration Ratio, no changes were proposed or made to either the formula itself or the current thresholds. We have provided an overview of the changes in the appendix below.

Conclusion

We understand that CDIC is targeting premium year 2025 for the new DPS to come into effect. The process will include the drafting of amendments, Board approvals, publication in the Canada Gazette, and approval of the Minister of Finance. Please see the Appendix below for more information. FRFIs are also encouraged to review all changes outlined in CDIC's document.

Appendix: Summary of Feedback & Changes

Proposed Change	Response from FRFI	CDIC Conclusions
***Ex Ante* Fund Target**		
CDIC proposed a near-term target for the *ex ante* fund of 85 bps.	Some respondents felt the fund 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. In addition, some respondents shared the view that CDIC is using a temporarily inflated (due to COVID-19- related support measures) level of insured deposits (i.e., as of March 31, 2022), which may decrease with the implementation of quantitative tightening, to inform its near-term target. Lastly, some respondents requested CDIC consider a transition period where premium rates would remain at current levels while members adjust to the new framework.	Decision not included.
New Risk Category		
CDIC proposed to add an additional category (i.e. ≥ 90) was intended to improve differentiation.	Feedback generally agreed that adding a fifth risk category would enable more differentiation of member institutions on the basis of risk. Some felt the proposed threshold for category 1 (i.e,: ≥ 90 vs ≥ 80 under the previous framework) was too high and should be lower. However, CDIC maintained its proposed threshold category 1 (i.e,: ≥ 90) in the finalized document. Respondents were also 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.	CDIC will proceed with this proposal.
New Member Policy		
CDIC proposed a new member policy, which would place federally continued institutions into category 2 of the scoring range (≥ 80 but < 90) for the first two years of membership, unless staged by OSFI, in which case they would be downgraded commensurate to their risk profile.	Respondents were generally supportive of CDIC's proposed change to its new member policy. However, some felt CDIC 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. Others questioned whether the policy would reduce the appetite of institutions to join the FRFI 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.	The new DPS was modified. After the FRFI's first year of membership, the FRFI will have the option to "opt out" of the new member policy and be assessed against individual differential premium measures, provided the requisite data is available through the Regulatory Reporting System (RRS). If the data is unavailable through RRS, they will continue to be subject to the new member policy (i.e., placed in category 2 unless staged) for the second year.

Frequency of Assessment		
CDIC proposed that premiums be issued quarterly.	Most feedback suggested that quarterly DPS reporting could add burden for relatively little benefit, and that it would present disproportionate burden to smaller institutions. Quarterly financial data may also be more volatile.	The frequency with which CDIC classifies members into premium categories will be twice annually. The stated intent is to incentivize member institutions to correct issues identified by CDIC or the regulator quicker, offering the opportunity for FRFIs to make adjustments and potentially reduce their overall annual premiums.
Regulatory Criteria		
CDIC proposes to reduce the Regulatory Criteria's Examiner Rating component from 35 to 25 points, introduce a CDIC Risk and Resolvability Rating to replace the current "Other Information" component, and increase the weight of this component from 5 to 15 points. The CDIC Risk and Resolvability Rating would incorporate both CDIC's assessment of factors contributing to the likelihood of failure of a member institution (i.e., Internal Member Rating (IMR)) and the assessment of resolvability challenges for the member.	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.	CDIC will proceed with this proposal. CDIC confirmed that no new compliance standard will be introduced for the RPB nor DSRB. Furthermore, existing penalties for non-compliance will be repealed, and instead incorporated in the form of DPS points.
Capital Adequacy		
CDIC proposed to reduce the weight of the capital adequacy section from 20 to 10 points. The criterion and scoring would also differ based on whether the member is a D-SIB, Category I/II SMSB, or Category III SMSB. • D-SIB Metrics: TLAC Leverage Ratio (5 points) and Combined CET-1/Risk-Based TLAC Ratio metric (5 points) • Cat I and II Non-D-SIBs: Leverage Ratio (5 points) and Combined CET-1/Total Capital Ratio metric (5 points) • Cat III Non-D-SIBs: Combined CET-1/Total Capital Ratio metric (10 points)	• 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.	CDIC will proceed with this proposal. However, **some changes will be made to the metric's terminology to ensure consistency with OSFI nomenclature.**

Return on Risk-Weighted Assets		
CDIC proposed two changes to the Return on Risk-Weighted Assets criterion: (i) alter the upper scoring threshold (from < 1.15% to < 1.75%); and *(ii)* for Category III SMSBs, replace "Adjusted Risk-Weighted Assets" in the denominator with "Adjusted Total Assets + Operational RWA"	• 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.	CDIC received feedback that the increase in the upper threshold to 1.75% may be overly punitive. Following analysis, CDIC decided to lower the upper threshold **from < 1.75% to < 1.6%**.
Mean Adjusted Net Income Volatility		
CDIC proposed amending the upper and lower scoring thresholds of the Mean Adjusted Net Income Volatility ratio metric (from < 0.5 to < 0.75 and from < 1.25 to < 1.5 respectively).	N/A	CDIC will proceed with this proposal.
Stress-Tested Net Income		
CDIC proposed to remove the Stress-Tested Net Income Criterion from the DPS.	N/A	CDIC will proceed with this proposal.
Efficiency Ratio		
CDIC proposed to remove the Efficiency Ratio from the DPS.	N/A	CDIC will proceed with this proposal.
Net Impaired Assets to Total Capital		
CDIC proposed to alter the scoring thresholds of the Net Impaired Assets to Total Capital metric from < 40%, and ≥ 40% to < 30% and ≥ 30% respectively.	N/A	CDIC will proceed with this proposal.
Three-Year Moving Average Asset Growth		
No changes are proposed to either the formula itself or the current thresholds.	N/A	N/A

Real Estate Asset Concentration		
CDIC proposed that a Real Estate Concentration Ratio metric be introduced for D-SIBs and that it continue to apply to non-D-SIBs.	• 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.	Based on feedback that elements of the numerator and denominator for the first step of the metric are not sourced from the same time period, and may be inconsistent in their expected credit losses (ECL) application**, CDIC will change the approach to use a consistent time period for all variables**. Furthermore, in light of a comment that the metric may be inconsistent in geographic scope, CDIC has stated that it **will change the formula to treat mortgages consistently, regardless of geography.**
Asset Encumbrance Measure		
CDIC proposed that the Asset Encumbrance metric be applied to non-D-SIBs, in addition to D-SIBs. Furthermore, Derivative Liabilities would be subtracted from the numerator and Impairment would no longer be subtracted from the denominator of the formula used to calculate the Unencumbered Asset Concentration ratio.	• 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.	"CDIC will apply this metric to non-D-SIBs (in addition to D-SIBs), as well as make the above changes to the numerator and denominator of the formula. However, further threshold analysis for this metric indicated the original threshold for Unencumbered Asset Concentration of 100% is sufficient to provide appropriate differentiation. Therefore, that **threshold will remain at 100%**."
Aggregate Commercial Loan Concentration Ratio		
No changes are proposed to either the formula itself or the current thresholds.	N/A	N/A
Liquidity & Funding		
CDIC proposes allocating 15 DPS points to a criterion that measures liquidity risk, from both the liquidity profile and funding profile dimensions. Given differing regulatory requirements and funding structures for larger, more complex banks, CDIC proposes separate criteria for D-SIBs and non-D-SIBs.	N/A	CDIC will proceed with this proposal.
HQLA to Short-Term Funding		
CDIC proposed an HQLA to Short-Term Funding criterion to measure an institution's high quality liquid assets as	• 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	"CDIC also received feedback that the proposed criterion would not appropriately capture nuances of liquidity profiles for members with large, complex balance

a percentage of short-term funding. This criterion would apply to both D-SIBs and non-D-SIBs and would be worth a maximum of 5 points.	unnecessary, preferring to use existing metrics, such as the LCR, NSFR and NCCF. • 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.	sheets spanning multiple jurisdictions. As a result, CDIC will not proceed with the HQLA to Short-Term Funding criterion for D-SIBs at this time. Instead, D-SIBs will be subject to the LCR." "CDIC's analysis confirmed that the proposed criterion, with some adjustments, continues to work well and appropriately differentiate medium and smaller-sized institutions. Therefore, CDIC will proceed with the inclusion of HQLA to Short-Term Funding in the DPS for non-D-SIBs. In order to better capture a more complete liquidity and funding profile, the formula will be adjusted, such that the NCCF return(s) will be used as the primary data source (i.e., input for HQLA and <1 year liabilities by remaining maturity)." "The I3 return was used as a data source for <1-year liabilities in CDIC's original proposal. Instead members will use the NCCF return commensurate with their SMSB proportionality category (i.e. Comprehensive NCCF, Streamlined NCCF, or Operating Cashflow) in calculating the metric." **Original:** < 5% = 0 points; ≥ 5% and < 10% = 3 points; ≥ 10% = 5 points; weight of 5 points **Final:** < 10% = 0 points; ≥ 10% and < 15% = 3 points; ≥ 15% = 5 points ; weight of 5 points
Net Stable Funding Ratio		
CDIC proposed that the Net Stable Funding Ratio (NSFR) be applied to D-SIBs to measure their funding stability for DPS purposes, for a maximum of 10 points.	N/A	CDIC will proceed with this proposal. However, given the addition of the LCR (below) and removal of HQLA to Short-Term Funding for D-SIBs, the NSFR will now be worth a maximum of 7.5 points rather than 10. Thresholds for the NSFR will still be linked to requirements set out in Liquidity Adequacy Requirements (LAR) guidelines. A member that is below minimum requirements (100%) will still earn 0 points, while a member must have a ratio of 110% or greater to earn maximum points.
Stable Funding Ratio		
CDIC proposed a simplified funding stability criterion for non-D-SIBs: the Stable Funding Ratio. This criterion would be worth a maximum of 5 points.	• 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.	CDIC will proceed with this proposal.

	• Some respondents also proposed technical adjustments to the formula to enhance consistency between it and other metrics	
Brokered Deposits Ratio		
CDIC proposed a criterion that will apply to non-D-SIBs and measure an institution's reliance on brokered deposits as a proportion of total assets, as well as the tenor of those deposits. This criterion would be worth a maximum of 5 points.	• 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.	"CDIC received feedback identifying an inconsistency between the Brokered Deposits Measure and Stable Funding Ratio in their respective treatment of whether long-term (>1 year) brokered deposits are "stable" or not. CDIC will address this by ensuring these deposits are considered "stable" in both metrics. Accordingly, for alignment, CDIC has adjusted the Brokered Deposits Measure by combining the two formulas into one ratio that divides." Brokered Deposit Ratio = <1 Year Brokered Deposits / Total Assets
NEW for D-SIBS: Liquidity Coverage Ratio		
N/A	Feedback indicated that the LCR may help provide a more complete picture of member funding and liquidity profiles, particularly for those with more complex balance sheets. See also comments in Stable Funding Ratio and HQLA to Short-term Funding.	In response to consultation feedback, CDIC will implement the additional metric of the Liquidity Coverage Ratio (LCR) for D-SIBs to help measure their liquidity profile for DPS purposes, for a maximum of 5 points.