Intelligence MEMOS

From: Mark Zelmer

To: Financial System Watchers

Date: July 28, 2025

Re: **There's A Cost to More Generous Deposit Insurance Limits**

As Canada adjusts to a more hostile geopolitical environment, it is important that the safety net that underpins our financial system remains fit for purpose.

Deposit insurance is an important part of that net. Because of the confidence it gives deposit-holders, it helps smaller institutions compete against the Big Six banks because customers can confidently place deposits with them knowing their deposits are fully insured by the federal government within defined limits.

In light of this changing environment, we applaud the Department of Finance for launching a public consultation on a series of proposals to enhance the federal deposit insurance framework administered by the Canada Deposit Insurance Corporation (CDIC). However, we suggest some changes to the details.

The proposals include: An increase in the main deposit insurance limit to $150,000 to account for inflation since the last increase in 2005; a higher limit of $500,000 for non-retail depositors; an even higher limit of at least $1 million for temporary higher deposit balances arising from significant life events like real estate transactions or inheritances; merging the registered and tax-free deposit categories and proposing unlimited deposit insurance for those deposits; and requiring federal deposit-taking institutions insured by CDIC to give their customers tailored information on the amount of insured deposits they hold.

Such changes look attractive at first glance, but would introduce more complexity into the federal deposit insurance system that could be gamed. For example, wealthier Canadians could easily manage their financial affairs to take advantage of a higher limit for non-retail deposits by simply establishing their own companies to hold most of their non-registered deposits. Similarly, operating the life-event category in practice could be rather costly and time-consuming for all concerned. And, setting an unlimited limit for registered and tax-exempt deposits would clearly increase moral hazard – because there would be less incentive for depositors to monitor the health of their banks.

Why not keep things simple and just set a higher limit of, say, $500,000 for all deposits? The simpler the system, the easier for depositors to understand it, and hence less need for costly tailored disclosure requirements.

Left unaddressed in the consultation are some fairly important questions that should be considered before implementation. It is not enough to simply offer Canadians the prospect of better benefits; they should also be told the cost of providing them.

None of Canada's deposit insurance entities – be they at the federal or provincial level – is fully funded with a pool of assets readily available to cover all insured deposits. Far from it. So, if we increase the coverage maximums, we need to consider both the size of insurance premium required, given that they are ultimately paid one way or another by depositors, and the size of those deposit insurance funds. Higher premiums represent capital that is not in use in the economy. At the same time, relying more on industry levies to pay for a failure after the fact – because premiums are set too low – could undermine the financial condition of surviving institutions at a time of stress and cause serious damage to the economy.

Smaller institutions benefit greatly from deposit insurance. This is partly because big banks pay more into the funds, while consumers gain more confidence leaving their money at smaller institutions. This is good from a competition standpoint. However, the failure of some US banks in 2023 is a reminder that those smaller institutions can be systemically important as a group even if they are not individually.

If the government proceeds with the proposed higher deposit insurance limits, which by definition increases moral hazard, should smaller institutions face more stringent capital and liquidity requirements, closer to those currently imposed on the six major banks? Would it make sense to require them to adopt the bail-in debt requirements (debt which gets converted to equity if a bank is deemed non-viable) imposed on major banks so that more of any resolution cost is imposed on wholesale debtholders of the failing institution rather than the rest of the industry or, worse, the public purse? Careful balancing is needed to ensure system stability without unduly affecting competition.

Finally, as the federal government works to update the coverage limits for deposit insurance it is also incumbent on CDIC to complete its work on modernizing the deposit insurance payout system. It is not enough to have generous deposit insurance limits. Canadians also need to have confidence that if an institution encounters stress in this more febrile environment, they will continue to either have unimpeded access to their deposits or that CDIC will quickly return their money to them without delay.

The Department of Finance is right on the need to update the federal deposit insurance scheme to make sure it is fit for purpose. Let's get the details right too.

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