

CREDIT UNION CENTRAL OF CANADA



**SUBMISSION TO THE
HOUSE OF COMMONS STANDING COMMITTEE ON FINANCE**

2005 PRE-BUDGET CONSULTATIONS

OTTAWA, ONTARIO

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INTRODUCTION

Credit Union Central of Canada (Canadian Central) welcomes the opportunity to present our views on the upcoming federal budget to the House of Commons Standing Committee on Finance. As community-oriented financial institutions, credit unions are eager to participate in a process that contributes to the social and economic well being of Canadians.

THE CREDIT UNION SYSTEM

Credit unions are independent, community-based financial institutions that operate on co-operative and democratic principles. As such, the credit union system is decentralized and diverse in terms of size and the communities that they serve. The credit union system does not operate like a bank and credit unions are not "branches" subject to centralized direction but rather they are locally autonomous institutions that are accountable to their members. This local focus enables credit unions to respond quickly and effectively to community needs.

The credit union system in Canada outside of Québec is a three-tiered structure of local, provincial and national organizations. Local credit unions provide retail financial services to their members and form the first tier of the system. Credit unions are the primary shareholder members of the nine provincial Centrals, the system's second tier. Provincial Centrals provide credit unions with corporate financial services and development support. The provincial Centrals are, in turn, the primary shareholder members of Credit Union Central of Canada.

Canadian Central is the national trade association and central finance facility for the credit union system in Canada. It was incorporated in 1953 and is regulated under the federal Cooperative Credit Associations Act. Canadian Central provides system representation for its owner associations in national organizations such as the Canadian Payments Association and Interac. It also provides the system with national representation to the Federal Government. Furthermore, Canadian Central provides its provincial central owners with a forum in which to work together on collective national challenges and acts as an instrument to help build and implement national capabilities and services.

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Currently there are 534 credit unions in the Canadian Central affiliated credit union system. This number represents a drop from approximately 732 in the first quarter of 2000 as efforts to boost efficiency and service quality have led to many mergers in the system. During the same period the number of credit union locations has risen from 1712 to approximately 1807, reflecting a commitment to ensuring high levels of service to our members. Membership has also risen over the same period from about 4.2 million to approximately 4.8 million Canadians. Currently, the credit union system employs over 21,000 people and an additional 6,000 Canadians participate as volunteers on credit union boards across Canada.

As of the second quarter 2005, the Canadian Central affiliated credit union system has approximately \$82 billion in assets, \$67 billion in loans and \$73 billion in savings. Between the

second quarter 2004 and the second quarter 2005 the Canadian Central affiliated credit union system experienced asset growth of approximately 9.8%¹.

LENDING TO SMALL AND MEDIUM SIZE ENTERPRISES (SMEs)

Although primarily known for servicing the consumer financial services market, credit unions are, in fact, a rapidly growing presence in the small and medium sized enterprise lending market. Credit unions in several provinces have had significant market share for a number of years. Recently, research carried out by Canadian Central determined that, on a consolidated basis, credit union participation in the SME market in Canada equals approximately \$18 billion, a figure that is near equivalent to that of the Royal Bank at approximately \$20 billion.

In terms of business authorizations under \$250,000 the credit union system represents an even higher market share of lending in Canada. To illustrate, assets in credit unions and caisses populaires in Canada equal approximately 10% of the total domestic assets of Canada’s deposit taking institutions. However, credit unions and caisses populaires account for approximately 38% of the market for authorizations of less than \$50,000 and 26% of the market for authorizations between \$50,000 and \$250,000.^{2 3} For authorizations below one million dollars, credit unions and caisses populaires account for 18% of the market while the domestic banks – despite their size – only account for 48%.

This presence is important to note since this lending is perceived to carry a somewhat higher risk of loan loss and smaller margins. Nevertheless, this lending market has a very significant effect on job creation. According to the Canadian Federation of Independent Business (CFIB), 75% of Canada’s one million businesses employ fewer than five people – precisely the market that is served by authorizations of this size.⁴

In terms of customer satisfaction, credit unions receive very high ratings from their SME customer members. In CFIB’s 2003 Banking Survey,⁵ 10 financial institutions were ranked according to nine measures of satisfaction. In the survey, credit unions were ranked number one in seven categories and ranked number two in the remaining two. The satisfaction results were as follows:

SATISFACTION CATEGORY	CREDIT UNION RANKING (OUT OF 10)
• Information requirements for financing	#1 - tied with HSBC
• Service charges	#1
• Understanding my business	#1
• Treatment by account manager	#1 tied with HSBC/ATB
• Travel distance to full service branch	#1 tied with ATB Financial
• Branch hours of operation	#1
• Online banking	#1 tied with TD-CT & Scotiabank
• Willingness to lend	#2
• Lending terms	#2
• Overall Ranking	#1

¹ Credit Union Central of Canada Research. *Second Quarter 2005 Credit Union System Results*.

² Finance Canada, *Canada’s Credit Unions and Caisses Populaires*, January 2002, p. 1.

³ Statistics Canada. “Financing of Small and Medium-sized Enterprises”, *The Daily*, January 29, 2002. Note: data gathered in 2001.

⁴ CFIB Research, *Small Business Primer 2002*, p. 1.

⁵ CFIB, *Banking on Competition: Results of CFIB Banking Survey*, (October, 2003), p. 3. Note: in these rankings the CFIB scored the Desjardins system separately.

Furthermore, the SME loan application rejection rate by credit unions – at approximately 12.2% between 2000 and 2003 - is lower than the rate found at any of Canada’s major chartered banks.⁶

COMMITMENT TO COMMUNITIES

Canada’s credit unions work to enhance the social and economic health of their communities in a number of ways. Besides providing a full-service suite of financial products to members, credit unions also pay patronage refunds and dividends to those same members thereby putting earnings directly back into their communities. Credit unions also focus their business lending on local, small and medium sized enterprises thus ensuring that member’s savings are put to work in their own community. In the case of credit unions, both decision-making and profits stay in the communities that they serve. This local orientation contributes daily to the economic health of rural areas, as well as towns and cities across Canada.

Credit unions also demonstrate “concern for community”⁷ through both their direct contributions to community organizations and in their in community economic development.

To illustrate, in 2004, a *Credit Union Community Involvement Survey* was conducted for Credit Union Central of Canada by Ipsos Reid. The Survey revealed that credit unions distributed over \$24.6 million in community contributions in 2004. These contributions took the form of donations and sponsorships, scholarships and bursaries, charitable fundraising and contributions to community economic development. Community associations, local sports-teams, health-care organizations and arts and culture groups benefited from these contributions.

“Since 2000 the credit union system has purchased 74 bank branches: 14 in British Columbia, 21 in Alberta, 17 in Saskatchewan, 16 in Manitoba, 2 in Ontario, 2 in New Brunswick, and 2 in Nova Scotia.”

Credit unions also contribute to their communities through numerous community economic development and social economy initiatives. These include the development of community loan funds, funding micro lending programs, financing affordable housing, broadening access to financial services in underserved areas and funding non-profit organizations.

Our commitment to Canada’s communities is also evident in our efforts to purchase bank branches in communities that commercial banks have decided are not profitable enough. Since 2000, credit unions have purchased 74 bank branches: 14 in British Columbia, 21 in Alberta, 17 in Saskatchewan, 16 in Manitoba, 2 in Ontario, 2 in New Brunswick, and 2 in Nova Scotia.⁸

Finally, our commitment to Canada’s communities is evident in our continued interest in the development of effective public policy. The credit union system appreciates the Federal Government’s consultative, budget-making process because it grants Canadians from all walks of life the opportunity to contribute to policy development. To that end, we respectfully make this submission and hope it is of assistance to the Federal Government. Our submission focuses on a number of issues and concerns that our members have indicated are important for the Federal Government to consider when it is drafting the next budget.

⁶ CFIB, *Banking on Competition: Results of CFIB Banking Survey*, (October, 2003), p. 14.

⁷ “Concern for community” is a one of 7 internationally agreed co-operative principles that credit unions ascribe to. Principle 7 states: “While focusing on member needs, co-operatives work for the sustainable development of their communities through policies accepted by their members”.

⁸ Credit Union Central of Canada Research.



THE FEDERAL GOVERNMENT'S NEXT BUDGET

1. THE FEDERAL GOVERNMENT'S FISCAL STANCE

In Prime Minister Paul Martin's September 20, 2005 speech to senior public servants, he stated that:

"Financial discipline is a guiding ethic that has led us to eight consecutive years in surplus. Our commitment to balanced budgets equips Canada to build the economic strength needed to succeed in tomorrow's world. It gives government the flexibility to lower taxes, strengthen social programs and handle the unexpected...Even with the pressures of minority government...we have never strayed from our dedication to fiscal integrity. We will stay out of deficit"

Canadian Central supports the Government of Canada's continued commitment to maintaining fiscal discipline and not running annual deficits. Furthermore, we believe that continuing to reduce Canada's debt-to-GDP ratio is an important goal, since a declining ratio will leave Canada less vulnerable to economic and fiscal shocks and expand our fiscal sovereignty. We support the Prime Minister's broad commitment to reduce our debt-to-GDP. We acknowledge the debt-to-GDP target ratio of 25 per cent has been the subject of some debate among economists; however, we believe the exact figure is less important than ensuring the ratio continues to fall from its current level of approximately 38 per cent.⁹

The credit union system encourages the Federal Government to exercise caution when contemplating either increased program spending or large tax cuts.

In keeping with these views, Canadian Central notes with concern that program spending increased 15.1 per cent in fiscal 2004-2005¹⁰. We encourage the Government to exercise caution when contemplating either increased program spending or large tax cuts.

2. ASSISTING CANADIAN AGRICULTURE

The credit union system is a significant and growing lender to agriculture and to the agri-food sectors in Canada. Our presence as lenders to the rural economy is becoming more pronounced as many chartered banks leave rural communities and focus their business activities on urban centers and internationally¹¹.

The credit union system's focus on agricultural lending makes credit unions very sensitive to developments in the rural economy and enhances our concern for the well-being of farm producers across Canada. For example, the recent BSE crisis has been an issue of great concern to credit unions and many credit unions undertook significant measures to help cattle producer members. These measures include the holding of including fundraisers, permitting interest only repayments, not realizing on security, loan extensions, assisting producer groups, and lobbying governments for assistance.

⁹ Prime Minister Paul Martin. *Address by Prime Minister Paul Martin to Senior Public Servants*. (September 20, 2005). P. 7-8.

¹⁰ Finance Canada. *Annual Financial Report of the Government of Canada: Fiscal Year 2004-2005*. p. 5.

¹¹ Between 2000 and 2004 Canadian Central affiliated credit unions increased their loans to agriculture by 8.1% whereas the banks increased loans to agriculture by only 4.1%. Source: Credit Union Central of Canada Research Department.



Credit Union Central of Canada's 2004 submission to the House of Common's Finance Committee stated that the BSE crisis and the US imposed tariff on Canadian hogs:

“...revealed the need to reconsider the approach of the Canadian government and Canadian producers to trade in agricultural products. In particular, these developments point to a need to reduce our vulnerability to trade disruption in the agricultural sector.”

We believe that this is still the case today despite the fact that the BSE crisis has eased somewhat with the opening of the US border. Thus, Canadian Central supports the Federal Government's recent initiative to establish a Beef and Cattle Trade Advisory Group (BCTAG). We hope that the creation of the BCTAG will facilitate the identification of appropriate trade priorities and work to increase access to foreign markets beyond that of the United States.

That being said, Canada's credit unions understand that the challenges facing Canada's agricultural economy go beyond trade issues. We agree with Prime Minister Martin's recent statement that:

“...economic disparity has become less a regional or provincial phenomenon, and rather a reflection of the rural-urban split. It is in Canada's smaller communities and their linkage to the rural economy, where the opportunities and downsides of globalization and demographics are most challenging.”

With this in mind, Canadian Central has noted - with interest - the wide ranging recommendations in the July 2005 report on Canadian farmers completed by Wayne Easter, Parliamentary Secretary to the Minister of Agriculture and Agri-Food: *Empowering Canadian Farmers in the Market-Place* (the Easter Report).¹² We agree with the view found in the Easter Report that the challenges of Canadian agriculture go beyond trade issues and that these issues can only be addressed if the federal and provincial governments in Canada commit to taking a more comprehensive and coordinated approach to dealing with the agricultural sector. We support the Easter Report's position that any new policy framework for Canadian agriculture must be multifaceted and address issues ranging from managing producer costs, product development, efficient and fair environmental management regulations, international trade, marketing arrangements and the market power of agri-business.

Thus, Canadian Central recommends that in the upcoming budget, the Federal Government publicly indicate that it will carefully consider all the recommendations of the Easter Report with a view to developing a comprehensive policy framework to address the concerns of Canadian farmers¹³. Of course, we believe that such a commitment must come with an additional commitment to provide the financing to adequately deliver any new programming that may arise out of the review.

Having indicated our broad support for the approach outlined in the Easter Report, Canadian Central has a number more narrowly gauged, agriculturally related recommendations to make to the House of Common's Finance Committee:

¹² Wayne Easter. *Empowering Canadian Farmers in the Marketplace*. (July, 2005).

¹³ This does not signal Canadian Central's support for any particular recommendation in the Easter Report, but rather that the Federal Government should seriously consider all the issues raised in the report with a view to developing a comprehensive regulatory approach to the agricultural sector. The credit union system looks forward to participating in any future government consultations that may arise as a result of the recommendations in the Easter Report.



- 1. Federal and provincial governments should continue to work closely with agricultural producers to ensure the Canadian Agricultural Income Stabilization Program (CAIS Program) meets the needs of producers and is simple to administer. Currently, there is a strong sense amongst producers that the CAIS Program is difficult to understand and administratively awkward.**
- 2. The federal and provincial governments should commit to long-term funding for sustainable agricultural support programs that ensure producers receive benefits that are equitable across Canada while at the same time recognizing the differing ability of provinces to fund such programs.**
- 3. In order to increase the financing options available to grain framers, we recommend that the Federal Government adjust the capital cost allowance for grain bins. In particular we recommend that grain bins should be moved from Class 6 (10%) to a class that allows quicker deduction - at least Class 10 (30%). (See Appendix A)**

3. CROWN SUPER-PRIORITIES AND LENDING TO SMES

The credit union system recognizes that the Federal Government is concerned that the SME sector in Canada remains strong and vibrant. Evidence of the Federal Government's commitment to this sector are programs such as the special tax rates applicable to small businesses and the Government's financial commitment to the Canada Small Business Financing Program. This commitment is understandable given that small businesses are major contributors to employment in Canada and that 75% of Canada's one million businesses employ fewer than five people. Credit unions are proud of the fact that our lending to small businesses helps foster and grow thousands of small businesses across the country.

Recently, however, credit unions have expressed concern over the Federal Government's super-priorities and their impact on lending to small businesses. More specifically, credit union lenders are concerned that such provisions in federal legislation and shortcomings in Canada Revenue Agency (CRA) practices threaten to make small business lending far less attractive for credit unions and other financial institutions.

Situations regrettably do arise where lenders may occasionally be required to seize and sell assets of a small business debtor to recover on an unpaid loan. However, it is not uncommon, after the sale of such assets, for CRA to come forward and claim an interest in the equipment or the proceeds from the sale of the equipment because the small business had payments to CRA in arrears where CRA claimed a super-priority. In situations where a debtor goes bankrupt, credit unions attempting to recover outstanding balances of their loans have also discovered outstanding obligations to the Crown of which they had no knowledge.

A key problem is that it is practically impossible to obtain accurate information from CRA on the status of a borrower's obligations and, therefore, practically impossible for a lender to make informed decisions on what action to take with a borrower's account. For example, a credit union may be told by the CRA that a borrower's payments are up to date, only to find out later that the information was incorrect. Nevertheless, CRA reserves the right to reassess a borrower's file. We

have had instances where a credit union has been told that a business had a small outstanding balance to the CRA and, based on that information, the credit union has taken action to collect on a borrower's debt. However, CRA has subsequently reassessed the borrower's file and, many months later, claimed the proceeds from the credit union as trust funds required to cover the borrower's obligations to the Crown.

Difficulties in getting accurate information from CRA are compounded by the fact that CRA can only disclose amounts owed if the business borrower gives CRA permission to do so and if/when the creditor begins official proceedings to recover the secured amount.

Making a lender's position even more precarious is the fact that, if a creditor proceeds to realize on its security, the creditor can, upon realization, be required to pay the amounts subject to the deemed trust to CRA, even if those amounts are equal to the equity in the property recovered. If the full amount owed to CRA is not paid, a collection officer can make a claim against the creditor for the amount. These provisions can completely undermine a credit union's efforts to recover any secured amounts.

Overall, the dynamics created by this situation significantly increase the risk profile of lending to small business and this likely restricts the availability of credit to such businesses and/or increases the cost of credit for small commercial borrowers.

We believe that the Federal Government could address these concerns in one of two ways:

- 1. Use the upcoming Federal Budget to announce a “carve out” in the Crown's super-priority for equipment that was funded for purchase by a lender. This exemption would go a long way towards remedying the current problems with the deemed trust framework.**
- 2. CRA could seek to guarantee the reliability of the information provided to creditors in relation to possible arrears to CRA. Having CRA commit to providing reliable information to creditors could prevent situations in which lenders find they owe considerable sums to CRA because they have unknowingly collected from a borrower that was deeply in arrears to CRA.**

4. COMPETITION BUREAU FEES

In the 2003 and 2004 budgets, the Federal Government introduced measures aimed at reducing the tax burden borne by both small businesses and large Canadian corporations. Credit unions appreciate the Federal Government's sensitivity to the need for tax reductions on business; however, as the Federal Government increasingly employs user fees to collect revenues, greater attention must be paid to ensure these are fair, efficient and do not work to reduce innovation and competition.

In this regard, credit unions are concerned with elements of the user fee policy of the Competition Bureau. In particular, the Bureau charges a flat fee of \$50,000 to review all notifiable merger transactions. As a result, small local credit unions involved in mergers end up paying the same fee as mergers involving much larger pan-Canadian organizations where the Bureau's analysis is far more complicated. It appears that this flat fee is unfair to relatively uncomplicated mergers such as virtually all credit union mergers. It also seems clear that the flat fees paid by credit union

merger partners have the effect of subsidizing the time and work done by the Bureau on complicated merger transactions where considerable time must be taken to analyze competition issues very carefully.

Credit unions believe that they should pay merger review fees that are commensurate with the complexity of the mergers under consideration. If the Bureau aims to recover costs from the parties it regulates, credit unions should fairly compensate the Bureau for the work that it does in reviewing those transactions. Credit unions should not subsidize the work that the Bureau undertakes in regard to complex mergers that may have a major impact on the competitive market place.

Canadian Central recommends for the Committee's consideration two alternative approaches that would result in significant changes to the way that the Bureau assesses fees:

1. **Set a lower base fee with a sliding scale fee** based on assets and/or revenue or based on a billable hours approach. This would not, in our opinion, require a regulatory amendment and would bring the Bureau's fees into line with the size and complexity of mergers being reviewed.
2. **Adjust the merger notification thresholds.** Financial institutions accumulate assets in a very different manner than those of commercial organization. Applying the \$400 million notification threshold appears to require transactions with limited competitive implications to be subject to the Bureau's review. For example, there are 48 credit unions in Canada with assets of \$300 million or more. Any merger involving these credit unions will likely meet the \$400 million notifiable transaction thresholds and require the payment of review fees to the Bureau. However, the competitive implications of any such transaction seem limited, given that a \$400 million credit union has assets of less than 1% of the assets of the Royal Bank of Canada. Also a minimum transaction threshold should be introduced once the size threshold is achieved so as not to deter small operations from being assumed by large partners, these initiatives are often pursued to retain community service.

5. DISABILITY SAVINGS PLAN

Credit unions are locally oriented and democratically owned financial institutions and this unique structure makes them very sensitive to needs emerging in their communities. For many credit unions, it has become apparent that some of their members have loved ones with disabilities and that these members have special financial needs. However, it is also the case that these members have little available to them in terms of financial tools and mechanisms to assist them in securing the future of their loved ones. Yet, as people with disabilities come to outlive their parents this problem will become more significant.

With this in mind Credit Union Central of Canada has noted, with interest, recent proposals put forward by community groups aimed at establishing a Disability Savings Plan^[1]. A Disability Savings Plan would provide a tax vehicle for Canadian families to plan for the financial future of a family member with a disability.

More specifically, a Disability Savings Plan would consist of a tax deferral on contributions to the Plan during the lifetime of the individual with a disability.

Contributions could be in the form of money or other financial assets, including RRSPs and RESPs. Expenditures and disbursements would be exempt from taxation and claw-backs by provincial disability income systems. Furthermore, a broad range of authorizations and disbursements would be permitted (e.g. lump sums or regular payments, education rehabilitation, home purchase/modifications).

Canadian Central believes that such a Plan **could** assist families in planning for the future of their disabled offspring. It could also provide recognition for family contributions through a tax incentive and be an impetus to contribute further to the future well-being of their disabled family members.

It is with these advantages in mind that Canadian Central recommends the Federal Government signal in the upcoming budget that they will give serious consideration to the merits of recent proposals to establish a Disability Savings Plan. It is our view that, in so doing, the Federal Government should also undertake to consult with interested stakeholders on the costs, benefits and design of such any such Plan.

CONCLUSION

Canadian Central thanks the House of Commons Standing Committee on Finance for this opportunity to contribute to the Federal Government's budget preparations and for its continuing interest in, and support for, Canada's credit union system. We hope that Canadian Central's recommendations will be of interest to the Finance Committee and assist in the formulation of government policy in the coming months.

^[1] The organization PLAN (Planned Lifetime Advocacy Network) has been at the forefront in advocating for the establishment of a Disability Savings Plan. PLAN is a not-for-profit social enterprise, founded in 1989, that works to secure a "good life" for people with disabilities. For further information on PLAN and their proposals for a Disability Savings Plan see: <http://www.plan.ca>.

APPENDIX A:

CAPITAL COST ALLOWANCE – FARM EQUIPMENT

A grain bin is a metal or wooden structure that farmers use to store grain on their farmyards. Typically they cost less than \$20,000. They are often financed. Many farmers lease the bins over a three year period rather than purchase them. Credit unions want to offer either loans or leases to finance farmers' grain bins. Credit unions have no difficulty doing so if the service is a loan, because their interest income and interest expenses are equivalent. Yet, if credit unions or their affiliates lease a grain bin there is a great mismatch between the revenue that must be recognized for tax purposes and the tax deductions that can be claimed. For example, on a three year lease of a \$10,000 bin, all revenue is recognized over three years, say \$11,800. But the offsetting capital cost allowance deductions during that three-year period are only \$2,305. The result makes it uneconomical to lease grain bins although it may be an attractive option for farmers. We recommend that this be addressed by specifying that grain bins are part of a capital cost allowance class with a higher deduction, such as Class 10.

Where a corporation derives greater than 90% of its revenue from leasing activities, it can elect certain property to be "specified leasing property" meaning it can treat each leased asset to be in a separate class. The importance is that at the end of a lease, any unclaimed capital cost may be written off as a terminal loss. Therefore, tax deductions of the leasing company more closely match taxable leasing revenues over the life of the lease. But much farm equipment is ineligible for this treatment making it more difficult to offer leasing programs for these assets. Such assets include small tractors, tillage and seeding equipment.

We recommend a review of leasing rules for farm equipment that would result in more equipment being eligible for terminal loss treatment at the end of the lease. This would make leased farm equipment more available and economical as a financing option for farmers.