



Credit Union Central of Canada

Submission to the House of Commons
Standing Committee on Finance

On

*Bill C-37 - An Act to amend the law
governing financial institutions and to
provide for related and consequential
matters*

February 19, 2007
Parliament Hill, Ottawa Ontario

1. INTRODUCTION

Credit Union Central of Canada (Canadian Central) is pleased to provide the House of Commons Standing Committee on Finance with a credit union system perspective on Bill C-37: *An Act to amend the law governing financial institutions and to provide for related and consequential matters.*

Canadian Central is a federally regulated financial institution that operates as the national trade association and finance facility for our shareholders, the provincial credit union centrals and, through them, for 501 affiliated credit unions across Canada. Our credit unions employ more than 24,000 Canadians, serving our members, who number over 4.9 million Canadians. At the end of the third quarter of 2006 our credit unions held more than \$92 billion in assets.

Credit unions are provincially regulated and, from a constitutional standpoint, fall under exclusive provincial jurisdiction. The Federal Government regulates the system at the level of Canadian Central as well as those provincial Centrals that choose to be governed by Part XVI of the *Cooperative Credit Associations Act* (CCA Act) and any retail associations established under the Act (e.g. the Concentra Financial Services Association established in January 2005).

Bill C-37 is important to the credit union system since it proposes to amend, and add provisions to, the federal CCA Act. As indicated above, the CCA Act currently governs the activities of some aspects of our system. Of possible greater significance is the fact that some of the legislative proposals contained in Bill C-37 can assist our system in meeting current and future competitive challenges by granting credit unions and provincial Central organizations broader operating flexibility and options to restructure.

With this in mind Canadian Central would like to clearly state its broad support for Bill C-37. In our view, the proposed legislation will enhance the interests of consumers, increase legislative and regulatory efficiency, and adapt the federal legislative framework to new developments.¹

¹ Having stated general support for Bill C-37, Canadian Central is of the view that the Bill has a few shortcomings that will continue to limit the usefulness of the CCA Act as a vehicle for the credit union system. For example, sections 398 and 399 of the Act will not be amended to increase an association's permitted commercial loan limits. The Act will also not be amended to allow the members of an association to authorize the Board of Directors of the association to set minimum capital contribution requirements. Finally, the Act will not be amended to permit an association to have more than one class of membership shares. These shortcomings will continue to reduce the usefulness of the Act for our system. Canadian Central looks forward to working with the Department of Finance in order to remedy these shortcomings.

Before turning to specific aspects of Bill C-37 that are important to credit unions, this submission will provide the Committee members with some background on the credit union system and the factors that are driving it to evolve and restructure to become more competitive. This discussion will provide the Committee with some context that explains our support for specific aspects of Bill C-37 – the key point being that the credit union system needs broader operating flexibility in its legislative environment to contend with competitive challenges. Bill C-37 has an important role to play in providing the system with that operating flexibility.

2. 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 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.

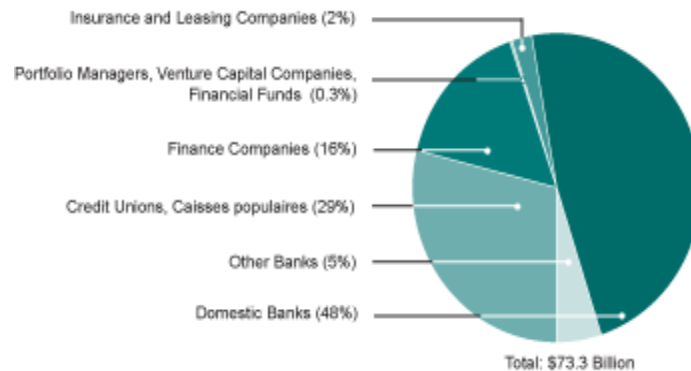
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SUPPORTING SMALL AND MEDIUM SIZE ENTERPRISES (SMEs)

Although primarily known for servicing the consumer financial services market, credit unions are, in fact, a major 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. In fact, 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 a very high market share of SME 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, in 2004, credit unions or *caisses populaires* captured nearly a third (29 percent) of the market for authorizations under \$250 000 (see Figure 1), and 23 percent of the market for all authorizations to SMEs.

**FIGURE 1: COMMERCIAL DEBT UNDER \$250 000 AUTHORIZED, BY FINANCIAL SUPPLIER
AS OF DECEMBER 31, 2004**



Source: SME Financing Data Initiative, Statistics Canada, *Survey of Suppliers of Business Financing*, 2004.

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), 80% of Canada's 2.4 million business establishments employ fewer than five people – precisely the market that is served by authorizations of this size.²

² CFIB Research, *Small Business Profile*, December 2005. p. 1.

In terms of customer satisfaction, credit unions receive very high ratings from their SME customer members. In CFIB's 2003 Banking Survey,³ 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.

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, SMEs 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"⁴ 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.

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.

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

⁴ "Concern for community" is 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".

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.⁵

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3. CONSOLIDATION AND DIVERSIFICATION IN THE CREDIT UNION SYSTEM

Currently, the credit union system is undergoing rapid and profound change; possibly more so than any other part of the Canadian financial services sector. The driving forces behind this rapid change include growing member expectations, intense competition from other financial institutions, evolving technology, changing demographics and globalization.

Changes in the credit union system take the form of two main trends:

1. *Rapid consolidation* in which mergers, acquisitions and amalgamations are resulting in the creation of fewer but larger credit unions;
2. *Diversification* through which elements of the credit union system seek to expand both the geographical scope of their operations and the products and services they offer.

The most apparent change in the credit union system is the consolidation of the system through the merger, acquisition/amalgamation of credit unions into larger entities. In 2001, the Canadian credit union system was comprised of approximately 670 credit unions holding \$62 billion in assets. Today, there are 501 credit unions holding \$92.4 billion in assets. Membership in the credit union system has nevertheless increased from 4.5 million members in 2001 to 4.9 million members in 2006 along with the increase in asset size⁶. Consequently, despite the reduction in the number of credit unions since 2001, the credit union system has experienced consistent growth and successfully managed to maintain a solid market position in the Canadian financial services sector.

⁵ Credit Union Central of Canada Research.

⁶ Credit Union Central of Canada, *Credit Union/Caisse Populaire System Results: Third Quarter 2006*.

This consolidation trend has implications for both provincial Centrals and local credit unions. For example, in some jurisdictions consolidation is leading to the emergence of a small number of large credit unions that possess a large portion of the assets in a province (e.g. British Columbia). These developments present a challenge to provincial Centrals as they must seek to restructure themselves to gain the economies of scale and scope to serve the needs of the large credit unions while still providing needed services to their smaller members. This may result in the pursuit of joint ventures between Centrals or a merger of provincial Central activities as is currently being pursued by Credit Union Central of Ontario and Credit Union Central of British Columbia.

At the same time, the consolidation trend has implications for the traditional geographical scope of the operations of credit unions in that consolidation objectives begin to put pressure on the jurisdiction-bound activities of credit unions. For example, large credit unions may decide at some point that their best business opportunities lie outside of their province of incorporation. Were they to do so credit unions will need a regulatory framework to help them extend business activities across provincial boundaries and readily accessible co-operative organizational vehicles under federal law that would accommodate a credit unions' cross-border strategy.

The second trend noted above involves the efforts by credit unions to *diversify* their activities for business and risk management reasons. There are two aspects to this diversification - geographic and product diversification.

A credit union that is situated in one local community and one local market is vulnerable if the local economy suffers economic hardship. The credit union is less vulnerable if it is able to expand its business over a number of communities with differing local economies and differing product needs. In so doing, it diversifies its sources of revenue and areas of potential risk. A competitive strength of the large commercial banks includes their ability to diversify their sources of revenue and potential risk over a very large geographic area and a broad range of products. Credit union mergers have helped replicate some of this diversification but it remains limited within provincial boundaries. Provincial Centrals and Canadian Central compensate for this limited diversification by operating pooling mechanisms to provide liquidity support from other credit unions on a provincial and a national basis. Once again, we can see that these market pressures highlight the need for a regulatory framework to help them extend activities

across provincial boundaries and the requirement for co-operative organizational vehicles under federal law to accommodate those needs.

Finally, product diversification is being driven by consumer demands and expectations. These are invariably technology-based products that are expensive to launch and maintain. Provincial Centrals, through their efforts, can assist and support credit unions in various product initiatives. Nevertheless, the large amount of resources required for a credit union to keep current in its product offerings is another factor that leads credit unions to pursue consolidation as a competitive strategy through mergers of credit unions and joint ventures involving provincial Centrals.

4. BILL C-37

The preceding discussion has outlined how market pressures are driving the credit union system to diversify and seek economies of scale and scope through consolidation. These trends increasingly highlight the need for regulatory frameworks that provide the system with the operating flexibility needed to restructure to meet these challenges. Of course, ensuring that provincial credit union legislation is up to date and flexible is extremely important for our system. However, as pressures increase on our system to co-operate and, to some extent, consolidate activities across provincial boundaries, federal legislation (i.e. the CCA Act) governing the cooperative financial sector becomes increasingly important. That is one of the reasons why the credit union system, through Canadian Central, has been so actively involved in the current review of federal financial institutions legislation that has resulted in the legislative proposals contained in Bill C-37.

The credit union system believes that there is much of value in Bill C-37 and that, on the whole, the proposed legislation will enhance the interests of consumers, increase legislative and regulatory efficiency for financial institutions, and adapt the federal legislative framework to new developments. From a credit union perspective the elements in Bill C-37 that will increase efficiencies include:

- Provisions that will allow for automatic conversion of common share capital into CCA Act membership shares if a share capital corporation continues into the CCA Act.

- Amendments to the *Canada Business Corporations Act* (the “CBCA”) that will allow a CBCA corporation to continue into the CCA Act (see Section 400 of the Bill).
- Provision in the Bill that will eliminate the requirement for OSFI approvals for large dividends (i.e. section 86(5) of the CCA Act is repealed) and lengthens to 15 days from 10 days (see section 86(2) of the CCA Act) the notice of proposed dividend payments that must be given by associations to OSFI.
- Amendments to the *Bills of Exchange Act* to enable all financial institutions, including credit unions to participate in the Canadian Payments Association’s new electronic imaging system for cheque clearing. The move to cheque imaging and exchange will enhance the speed and efficiency of the cheque clearing system. It will also make the clearing system more robust by reducing its dependence on transportation networks and its vulnerability to related delays.

Although the above noted legislative proposals will be useful in helping our system gain efficiencies, Bill C-37 proposes other amendments that could be very usefully in helping the credit union system deal with the trends and pressures noted above.

1. Most importantly, Bill C-37 proposes (see section 139) to amend the CCA Act and make it easier to incorporate a retail association under the Act by reducing the number of required incorporators from the current number of 10 credit unions -from more than one provincial jurisdiction - to only 2 credit unions from more than one provincial jurisdiction.

The concept of a retail association is relatively new in federal legislation (having been introduced in 2001) and opens up the possibility for a cooperative association to provide financial services on a national basis and to provide them outside of the traditional field of membership. To date, only one retail association has been established (i.e. Concentra Financial) in part because the number of incorporators (i.e. 10 credit unions) required to establish one was so high that it made it nearly impossible to obtain the required agreement among credit unions to do so. The proposal to reduce the number of incorporators comes at the request of the credit union system and we are pleased with the continued stipulation under section 24 of the CCA Act that the two credit union incorporators could not be incorporated under the laws of only one province.

2. Bill C-37 (see section 160 of the Bill) will permit a retail association to operate on a level-playing field with wholesale banks, if a retail association limits its deposits to deposits in excess of \$150,000. Thus, if a retail association limits its deposits to deposits in excess of \$150,000, a retail association need not be a member of the Canada Deposit Insurance Corporation and avoid paying deposit insurance premiums on its deposits. Currently, banks engaged in depositing taking over \$150,000 can be exempt from CDIC membership. This proposed amendment is in response to a request of the system and we fully support this legislative proposal.

To conclude this brief submission, Credit Union Central of Canada wishes to express its appreciation for the opportunity to provide the House of Commons Standing Committee on Finance with a credit union system perspective on Bill C-37. On the whole, the credit union system supports Bill C-37 and believes that a number of the provisions in the Bill will help credit unions and provincial Centrals respond to the competitive pressures our system faces.