

March 27, 2009 – Volume 4

New Ottawa Offices

I am pleased to report that Canadian Central's Ottawa staff have now relocated to new premises at 350 Sparks Street in the office building attached to the Delta Hotel. Joan Ellis of CUSOURCE Credit Union Knowledge Network has joined the Ottawa team. As you may recall, our previous offices situated at 275 Bank Street, suffered extensive fire damage on the night of September 14, 2008. The arsonist was eventually caught (after setting a second fire in the same building two weeks later) and sentenced to 15 years in prison.

Although it took more than six months to find and renovate the premises, the Ottawa policy team is very proud of its new digs and welcomes members of the credit unions system to come and visit us. We even have an office available for your use.

We hope to see you soon!

Brigitte Goulard, Vice President, Policy



CUCC Ottawa Staff (standing)
Left to Right:

Brigitte Goulard

Robert Martin

Anna Morena

Seated:
Joan Ellis,
CUSOURCE

Analysis of Bill C-10

Brigitte Goulard, Vice President, Policy, CUCC,
Gary Rogers, Vice President, Financial Policy, CUCC
Robert Giesbrecht, Corporate Counsel, Credit Union Central of Manitoba

Bill C-10, an Act to implement certain provisions of the 2009 budget received Royal Assent on March 12th. This omnibus bill which amends over 40 pieces of legislation not only seeks to implement the proposals described in *Canada's Economic Action Plan* but also "cleans house" in that it proceeds with a much wider range of amendments than had first been anticipated.

The January 27th edition of the Policy and Advocacy Report highlighted those sections of *Canada's Economic Action Plan* that may impact credit unions. The following analysis examines how the Budget proposals that impact credit unions were in fact translated into Bill C-10.

The government announced in its budget that it would seek to address the current financial market crises by improving access to financing and by strengthening Canada's financial system.

Bill C-10 contains provisions to achieve both objectives. Let us first look at how the Bill proposes to improve access to financing.

Improvement to Financing

Canadian Secured Credit Facility (CSCF)

The 2009 federal budget announced the creation of a \$12 billion CSCF to purchase term asset-backed securities backed by loans and leases on vehicles and equipment. It is to be priced "on commercial terms".

Federally regulated FIs (e.g. banks, some credit union Centrals, Concentra Financial) are eligible to sell into the CSCF. The Business Development Bank of Canada (BDC) will purchase the securities and hold them to maturity, but may sell them if a secondary market becomes available.

The Department of Finance has already begun consultations about the structure of the CSCF and Canadian Central has provided the following comments about the proposals:

- The minimum size of the pools of assets must be as low as \$25 – 50 million to enable credit unions to participate.
- Instead of limiting eligibility to loans and leases originated no more than six to nine months before, the vintage should be extended to two years.
- A facility to fund commercial mortgages also would be welcomed by credit unions.

New flexibility and resources for Crown Corporations

With the objective of improving access to financing for Canadian businesses, the federal government has put forth amendments to the legislative frameworks governing Crown corporations such as the Business Development Bank and Export Development Canada. It will be important ensure that the new powers granted to such institutions will not result in them directly competing with financial institutions as has been the case with the Farm Credit Corporation.

Export Development Bank (EDC)

The Export Development Corporation Act previously stated that EDC was established for the purposes of supporting and developing, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities. Bill C-10 amended the Act by

adding that EDC can now also support and develop, directly or indirectly, "domestic trade and Canadian capacity to engage in that trade and to respond to domestic business opportunities."

Although some concerns might be raised that this new purpose could result in EDC directly competing with financial institutions, some comfort can be taken by the fact that the Bill also provides that with respect to its activities to engage in domestic trade and domestic business, EDC must do so in a manner that "complements the products and services available from commercial financial institutions and commercial insurance providers."

It is interesting to note that the provision granting EDC the power to assist the domestic market is to be repealed two years from the date on which it came into force.

In the months to come Canadian Central will examine how EDC proposes to engage in this new purpose.

The Bill also increased EDC's contingent liability limit to \$45 billion to enable EDC to grow and enhance its guarantee and insurance program. EDC's authorized capital limits have also been increased to \$1.5 billion.

Business Development Bank

The only amendment made to the *Business Development Bank of Canada Act* has been to increase its authorized capital limit from \$1.5 billion to \$3 billion.

Canada Small Business Financing Act

To improve Canadian businesses' access to credit, Bill C-10 increased the maximum loan amount available under the Canada Small Business Financing Program from \$250,000 to \$350,000 and to \$500,000 for loans to acquire real property.

The Bill also increased from 10% to 12% the guarantee provided to lenders for aggregate principle amounts of loans that exceed \$500,000.

Strengthening Canada's Financial System

In alignment with the government's objective to strengthen Canada's financial system, Part 5 of the Bill entitled "Stability and Efficiency of the Financial System" amends 14 different Acts, including the Cooperative Credit Association Act.

It is interesting to note that the government's idea of "strengthening" Canada's financial system revolve around granting federal authorities such as the Minister of Finance and in particular, the Canada Deposit Insurance Corporation (CDIC) greater power to intervene in the affairs of a financial institution. The new powers granted to CDIC over its member institutions are broad and far reaching and include the following:

- CDIC will have the right to establish a bridge institution as a further resolution tool to preserve critical function and help maintain financial stability in the event a CDIC member is no longer viable.
- Prior to Bill C-10 CDIC was required to resolve a failure in a manner that resulted in a lowest-cost solution. In view of the potential risk associated with systemic failure, CDIC will now be allowed to resolve failures in ways that may not result in a lowest-cost solution to CDIC.
- CDIC will, when necessary to promote the stability of the financial system, be allowed to hold or own shares in its member institutions.

The Minister of Finance has also been granted additional powers to ensure the stability of financial institutions. For example, amendments to the *Financial*

Administration Act authorize the Minister of Finance to promote the stability or maintain the efficiency of the financial system by:

- Purchasing, acquiring, holding, lending or selling or otherwise disposing of securities in an entity;
- Creating a charge on the securities of an entity held by the Minister;
- Making a loan to an entity;
- Providing a line of credit to an entity;
- Guaranteeing any debt, obligations or financial asset of an entity; and
- Providing loan insurance or credit insurance for the benefit of an entity.

Since the term "entity" is defined as "an entity operating in Canada" credit unions as well as provincial centrals not governed by the CCAA could, should the need arise, have access to federal government support such as outlined above.

With respect to provincial Centrals governed by Part XVI of the CCAA, it is uncertain because of drafting particularities whether the government's right to hold shares in a provincial central (governed by the CCAA) is the result of amendments to the *Financial Administration Act* or amendments to the CCAA. Notwithstanding this interpretation difficulty it is clear that the Minister of Finance does have the power to inject capital in a provincial central governed by the CCAA by purchasing shares in such institutions.

The CCAA has also been amended to grant the Governor in Council the right to "make regulations respecting any matters involving a retail association's dealings, or its employee' or representatives' dealings, with customers or the public."

It is interesting to note that the Bill specifically refers to the right of the Governor to make regulations regarding the activities of the retail association as it pertains to its activities with persons or entities that fall outside the

standard group to which it usually provides services (members, other cooperative organizations) as well as to any activities that pertain to services such as acting as a financial agent, providing investment counseling services or issuing payment, credit or charge cards. Regulations could also be made regarding the time, place and manner in which activities could be carried out.

Another amendment worth noting is the amendment to the CCAA which provides that a retail association that has obtained insurance or a guarantee against default on the loan on the security of residential property shall not charge a borrower an amount for the insurance or guarantee that exceeds the actual cost to the retail association of the insurance or guarantee. The Act also provides for the making of regulations relating to this insurance or guarantee including the disclosure that will be required by retail associations.

Although there has been speculation that this provision applies to creditor insurance products such as life creditor insurance, it has been confirmed that these amendments only apply to mortgage insurance such as that provided by entities such as CMHC or other private corporations such as Genworth. Additional amendments provide that the FCAC will oversee compliance with such disclosure requirements.

Competition Act

There has been a fundamental overhaul of a number of important provisions of the *Competition Act*. The changes can be described under four broad categories, only the last of which is likely to have any significant effect on the credit union system:

Advertising and Marketing Rules – the rules governing marketing and advertising have been tightened up and strengthened. Under the new rules, it will be easier for the Competition Tribunal to prove that

an offence has occurred. As well the penalties and consequences of engaging in misleading advertising or deceptive marketing have been substantially increased and the Tribunal now has the power to freeze assets and order restitution.

Pricing Practices Regime – the existing law created criminal offences of price maintenance, price discrimination, predatory pricing and promotional allowances. The criminal offences have been repealed and replaced with a new reviewable conduct regime where an abuse of dominant market position results in a prevention or lessening of competition.

Cartels – the current criminal offence of conspiring to restrain or injure competition is replaced by dual track criminal/civil to examine price-fixing schemes, agreements to allocate exclusive territories and other competitor agreements.

Merger Review – under the current regime, one option for an entity caught by the \$400 million asset size threshold when intending to merge with another entity was to file a prescribed short-form pre-notification with the Commissioner of Competition. The Commissioner then had 14 days to review the intended transaction before it could close. If a prescribed long-form pre-notification was used, the waiting period was 42 days. Under the new rules, there will be only one form of notification, which will result in a minimum 30 day no-close waiting period for all transactions. The Commissioner can then elect to require the production of additional information that is “relevant” to the assessment of the merger. This request would trigger an additional 30 day waiting period after the Commissioner’s requirements had been fully satisfied. The new provisions accordingly increase the waiting period that merging entities must hold off consummating the amalgamation.

There are several positive changes, however: Where merging entities have filed the prescribed pre-notification and the Commissioner has not taken steps to prevent the amalgamation and the transaction proceeds, the Commissioner currently has three years

in which to challenge it. Bill C-10 would shorten this to one year.

One of the thresholds to determine whether pre-notification is required is the target's Canadian asset book value and sales. These thresholds have been raised to \$70 million with annual adjustments for inflation. While this won't help with credit union mergers, it may be of assistance where subsidiaries are being acquired.

Whereas before the notification provisions would be triggered if any of the organizations subject to the merger had assets exceeding \$70 million. Under the proposed provisions, at least two organizations would be required to have assets exceeding \$70 million for the threshold to be met. It should however be noted that the overall transaction threshold remains at \$400 million.

Therefore in practical terms, the notification provisions would not be triggered if a credit union with assets of \$350 million merges with a credit union with assets of \$35 million (one of the party has assets under \$70 million). The notification provisions would however be triggered if the second credit union has assets of \$60 million (above the overall transaction threshold of \$400 million). Although minor this change should alleviate the burden associated with larger credit unions merging with smaller credit unions.

No changes have been made to address the concerns of the credit union system about the price structure on pre-notification or advance ruling certificate requests.

Tax Measures

Income tax measures proposed in the January 27, 2009 Budget are detailed in our Policy & Advocacy Report of the same date. Among the budget measures implemented by C-10 are:

- Increasing RRSP Home Buyers' Plan withdrawals from \$20,000 to \$25,000

- Increasing the small business income threshold from \$400,000 to \$500,000 to which the small business tax rate applies
- Allowing recognition of losses in RRIFs and RRSPs between date of death and final distribution of property from the accounts
- Allowing 100% write-off of computers purchased before February 1, 2011.
- Various personal tax reductions and credits

The Bill also includes other measures previously announced, including:

- 25% reduction in the minimum amount required to be withdrawn from a RRIF for 2008 and allows related re-contributions
- Minor "fix-ups" to Tax-Free Savings Account legislation previously implemented
- Extending the deadline for 2008 Registered Disability Savings Account contributions
- Amendments to take into account financial institutions accounting changes

Political Update

Brigitte Goulard, Vice President, Policy, CUCC

As predicted in a previous issue of the Policy and Advocacy Report, the 40th Parliament is proving to be extremely busy. Bill C-10, *An Act to implement certain provisions of the 2009 budget* which is reviewed in this edition of the Policy and Advocacy Report amended over 40 Acts of Parliament including the *Cooperative Credit Association Act*. Although no other Bills of interest to the system have to date been introduced in Parliament, several Parliamentary committees have indicated their desire to examine different aspects of the financial services industry.

The House of Commons Standing Committee on Finance has already commenced holding hearings on a "Study on Measures to Enhance Credit Availability and the Stability of the Canadian Financial System".

Witnesses from the Department of Finance, OSFI, Crown Corporations such as the Business Development Bank and Export Development Canada, and associations such as the Canadian Bankers Association have already appeared before the Committee. Canadian Central will be appearing on April 2.

The Senate Banking Committee has also announced its intention to study the “credit and debit card systems in Canada and their relative rates and fees, in particular for businesses and consumers”. The hearings are wide-ranging and are expected to lead to a Committee report sometime in June. Canadian Central appeared at these hearings for one hour on Thursday, March 26 along with Caisses Desjardins. Doug Whalen and Brigitte Goulard appeared on behalf of CUCC. A further report on Canadian Central’s appearances at the Senate Banking Committee and the House of Commons Finance Committee will be provided in the next issue of the Policy and Advocacy report.

The House of Commons Standing Committee on Industry, Science and Technology has also announced its intention to study two aspects of the financial services sector. In light of the Competition Bureau’s consideration of a request by Interac Association to restructure its operations to become a “for profit” entity, the Committee had decided to undertake a study and produce a report on the matter of credit card interchange fees and the debit payment system in Canada as a means of ensuring that any changes to the debit system are in the public interest.

The Committee’s second study will focus on “how the current financial crisis is affecting small and medium-sized businesses and whether financial institutions are reforming to meet the needs of these businesses in the current economic climate”. The work plans and hearing dates for both studies have yet to be finalized. Canadian Central will also be monitoring closely the activity of this important Committee.

As you can see from above, nothing like a financial crisis and a full functioning Parliament to keep Ottawa lobbyists busy!

Your Fraud Report

Recent Data Breach

Heather Mitchell, Policy Analyst, Fraud Loss Mitigation, CUCC

Heartland Payment Systems, of New Jersey, the sixth largest payment processor in the United States, released a statement on January 21, 2009, about a major security breach of its card processing system. This attack comes on the heels of the December 2008 Royal Bank of Scotland WorldPay (RBS) data breach which involved the theft of data for 1.5 million debit and credit cards. Losses resulting from the RBS breach were approximately \$9 million through ATM withdrawals. It is noted that only 100 of the 1.5 million cards were needed to access these funds.

The Heartland incident could result in the largest number of cards affected in a data breach as over 600 financial institutions have reported exposed cards. Heartland Payment Inc. processes approximately 100 million transactions a month for 250,000 medium and small sized merchants across the U.S.. Heartland spokespersons have declined to confirm the number of cards that have been affected or the amount of losses due to resulting fraud on accounts.

The estimated size of the Heartland breach is causing it to be compared to the TJX Companies Inc. breach of 2007 which involved 45 million cards. The TJX breach method was quite different and less “sophisticated”. It occurred over years and appears to have taken advantage of poor system security.¹ The refinement of the method used in the Heartland breach is cause for concern for data security officers and privacy officers.

The first warning about a possible breach came when patterns of fraudulent transactions were reported to

¹ Avivah Litan V.P. of Gartner Inc. (market research company) speculated “the hackers broke in through unprotected wireless LANs”.

Heartland by Visa Inc. and MasterCard Inc. in the fall of 2008. Although Heartland began investigating immediately, the malware responsible for the breach was not detected until January 2009. It is likely the Heartland breach involved a key logger and a “sniffer” program² which may have been installed by a rogue employee or by a direct systems attack. It is suspected that the program could have been installed on the payment processing platform in as early as May 2008.

Ironically, Heartland's systems were found to be compliant with the Payment Card Industry (PCI) Data Security Standards in an audit conducted in April 2008. Recently, Visa announced that Heartland has been removed from its list of approved service providers. In order to be reinstated, Heartland is required to revalidate its compliance with the PCI standards. The PCI standards are international standards developed by the industry to help organizations proactively protect customer account data. The fact that Heartland passed a compliance audit shows that the standards in themselves may not be enough to provide adequate data security.

Among those affected by this breach are Canadians who used their debit or credit cards at any of the 250,000 U.S. Heartland client merchant locations (including on-line transactions), since May, 2008. The costs associated with a breach spread far beyond the company that suffered the intrusion. Canadian credit unions and other financial institutions with affected cards will have to assume the cost of communicating with their members, reissuing affected cards and absorbing any fraud losses.

CUETS (the credit union system MasterCard issuer), has advised Canadian Central that it is reviewing its card portfolio for purposes of identifying and replacing credit union MasterCard accounts that may be at risk. CUETS will notify credit unions with affected cards directly. Canadian Central will continue to seek further information on the impact of this breach on credit union account holders.

² A sniffer program is used to detect specific information like credit card numbers.

The costs associated with card replacement and fraud reimbursement have led to the launching of a class action lawsuit against Heartland in the U.S. District Court in New Jersey by two banks and three credit unions. There are two additional class action lawsuits filed, one on behalf of consumers and the other on behalf of investors who purchased Heartland stock over a specific time period. While these class action lawsuits have been launched in U.S., Canadians are also mindful of the importance of data security.

Jennifer Stoddart, Privacy Commissioner of Canada, commented on the Heartland breach saying "I'm amazed to see something this significant can still happen with the importance that not only privacy commissioners, but experts everywhere, are placing on security. I was concerned to see this going on and the size of it."³ In a speech in November 2008, Ms. Stoddart, emphasized the importance of proper security by reminding that, “Organizations clearly need to do a better job at safeguarding the personal information entrusted to their care. Adequately protecting personal information is the law in Canada. It is not optional.”

Robert H. B. Baldwin, Jr., Heartland's President and Chief Financial Officer, said in a statement that the attack “may be the result of a widespread global cyber-fraud operation”. The investigation team, including the U.S. Secret Service and the Department of Justice has identified a prime suspect but hasn't released any further information. Several suspects have been arrested in Florida for using “Heartland” stolen card information to commit fraud. The connection of these individuals with the prime suspect is unknown at this time.

Experts warn that the current recession and banking crisis will increase breach risks at data processors as organizations deal with unhappy, displaced workers⁴ and a shortage of staff who monitor for intrusions. The Heartland, TJX and RBS breaches each give fair

³ Quote as provided in the Regina Leader-Post, January 22nd, 2009.

⁴ Fired Fannie Mae worker
<http://business.theglobeandmail.com/servlet/story/RTGAM.20090130.wfannievirus0130/BNStory/Business/home>

warning that Canadian companies also need to be prepared to address this security issue.

The challenge for organizations is that laws need to be strengthened to better protect Canadians and their financial institutions. To develop a comprehensive cyber crime program the collaboration of government, industry, law enforcement and consumers is needed. Bill C-27, An Act to amend the Criminal Code (identity theft and related misconduct), was a step in the right direction however, it could be strengthened to include increased penalties related to malicious cyber activity. The bill received first reading November 21, 2007 however had not progressed to Committee review prior to Parliament being prorogued in late 2009.



Plan to attend the 2009 Canadian Conference for Credit Union Executives, May 2 to 6 in Halifax for 4 days of networking, dynamic workshops and keynote addresses from some of today's most visionary minds as we look at bringing the Future into Focus.

Register online today!
<http://www.cucentral.ca/eventsconf>

Fraud: Recognize It. Report It. Stop It. March is Fraud Prevention Month

Heather Mitchell, Policy Analyst, Fraud Loss Mitigation, CUCC

Established in 2004 by the Fraud Prevention Forum, Fraud Prevention Month is a month-long education campaign to raise awareness about the dangers of fraud by educating consumers and businesses on how to *recognize, report and stop fraud*. Chaired by the Competition Bureau, the Fraud Prevention Forum has more than 100 members including financial institutions, consumer and volunteer groups, government agencies, law enforcement organizations. As a member of the Fraud Prevention Forum, CUCC participates in planning for the month including development of brochures, advertisements and other materials to raise fraud awareness. CUCC provides information to the system about the availability of the Forum materials and supports the fight against fraud with its own "Defend Yourself Against Fraud" brochure which is available for purchase through CUCC's Marketing Department.

Credit unions across Canada also participate in this annual education promotion through various activities such as: posting information to their websites; distributing brochures and participating in or hosting public document shredding events.

Competition Bureau experts say that fraudulent activity increases in times of economic stress and warn consumers and businesses to be alert to possible scams. CUCC supports the system in the fight against fraud by sharing information on current trends and occurrences through communiqués and presentations. The Credit Union Office for Crime Prevention (CUOCP) is also a mechanism through which fraud related information is shared with credit unions.

For more information about Fraud Prevention Month please check: <http://competitionbureau.gc.ca/fraud>

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