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CREDIT UNION CENTRAL OF CANADA



**SUBMISSION TO THE
STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE**

ON

Consumer Issues in the Financial Services Sector

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PARLIAMENT HILL
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INTRODUCTION

Credit Union Central of Canada (Canadian Central) welcomes the opportunity to present the views of Canada's credit unions on consumer issues in the financial services sector to the Standing Senate Committee on Banking, Trade and Commerce. As community-oriented financial institutions, credit unions are eager to participate in a process that advances the interests of consumers and contributes to the social and economic well being of Canadians.

This submission outlines the general structure of the credit union system in Canada outside of Quebec. It sets out the manner in which the system is regulated with special emphasis on consumer regulation of credit unions – the key retail element of our system. After discussing the manner in which credit unions are regulated from the consumer side, this submission will address a consumer issue of general concern to our system: cost of consumer credit disclosure harmonization.

THE CREDIT UNION SYSTEM

Credit unions and *caisses populaires* are independent, community-based financial institutions, co-operatively owned and democratically controlled by their members. Credit union ownership and corporate governance are based on co-operative principles, and the primary commitment of a credit union is to serve its members' financial needs. This distinguishes credit unions from joint stock banking organizations that exist primarily to earn a profit for their shareholders.

Each customer of a credit union is required to become a member of the credit union or *caisse populaire*. Each member becomes a shareholder and each member has one vote, regardless of the size of their deposits or the share capital they hold. Members of a credit union can vote for the Board of Directors, stand for elections to the voluntary Board, attend the annual meetings and vote on motions that will guide credit union policy. As shareholders, members are also entitled to yearly dividends and profit sharing. The aim of this unique shareholder and governance structure is to more closely align the policies of the credit union with the interests of those using its services and to close the gap that sometimes exists between the interests of shareholders in a joint-stock banking organization and the customers of those organizations. Thus the service orientation and democratic nature of credit unions make them very sensitive to the needs of their members and to the needs of the communities in which they are embedded.

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The credit union system outside of Quebec is decentralized and diverse in terms of size and the communities that credit unions serve. 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 also enables credit unions to respond quickly and effectively to community needs.

CREDIT UNION SYSTEM STATISTICS

At the end of 2004, there were 558 credit unions in the Canadian Central affiliated credit union system. This number represents a drop from approximately 745 in the first quarter of 2000 as efforts to boost efficiency and maintain service quality have led to many mergers in the system. During the same period the number of credit union locations has risen from 1737 to approximately 1783. Membership has also risen over the same period from about 4.3 million to approximately 4.7 million Canadian residents. Currently, the credit union system employs over 23,300 people and an additional 4,000 Canadian residents participate as volunteers on credit union boards across Canada.

As of the fourth quarter of 2004, the Canadian Central affiliated credit union system had approximately \$78.6 billion in assets, \$63.3 billion in loans and \$70.5 billion in savings. Asset growth over the past couple of years has averaged around 8.0% annually.

The credit union system in Canada outside of Québec is a three-tiered structure of local, provincial and national organizations. Local credit unions provide full service, retail financial services to their members and form the first tier of the system. Credit unions are provincially regulated. 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. Provincial central organizations come under both federal and provincial regulation. 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 federally regulated under the federal *Cooperative Credit Associations Act*. Canadian Central currently 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.

LENDING TO SMALL AND MEDIUM SIZE ENTERPRISES (SMES)

In addition to servicing the consumer financial services market, credit unions are a rapidly growing presence in the small and medium sized enterprise lending market in both the agricultural and commercial sectors. 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 which sits at approximately \$20.7 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 8% 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.^{30 31}

³⁰ Finance Canada, *Canada's Credit Unions and Caisses Populaires*, January 2002, p. 1.

³¹ Statistics Canada. "Financing of Small and Medium-sized Enterprises", *The Daily*, January 29, 2002. Note: data gathered in 2001.

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.³²

In terms of customer satisfaction, credit unions receive very high ratings from their SME customer members. In CFIB's 2003 Banking Survey,³³ 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 10)	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

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.³⁴

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. This local orientation contributes daily to the economic health of rural areas, as well as towns and cities across Canada.

For example, in 2003, 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 \$21.6 million in community contributions in 2003. These contributions took the form of donations and sponsorships, scholarships and bursaries, charitable fundraising and contributions to community economic development. Community

³² CFIB Research, *Small Business Primer 2002*. p. 1.

³³ CFIB, *Banking on Competition: Results of CFIB Banking Survey*, (October, 2003), p. 3. Note: in these rankings the CFIB scored the Desjardins system separately.

³⁴ CFIB, *Banking on Competition: Results of CFIB Banking Survey*, (October, 2003), p. 14.

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 initiatives. These can include community loan funds, community partnerships and special programs to assist the disadvantaged. In the case of credit unions, both decision-making and profits stay in the communities that they serve.

Our commitment to Canada's communities is also evident in our efforts to purchase bank branches in communities that commercial banks have decided to divest. Since 2000, credit unions have purchased 72 bank branches: 14 in British Columbia, 21 in Alberta, 17 in Saskatchewan, 16 in Manitoba, 2 in New Brunswick, and 2 in Nova Scotia.³⁵

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REGULATION OF THE CREDIT UNION SYSTEM

As indicated above Canadian Central is regulated by the Federal Government while provincial central organizations face dual regulation from both the federal and provincial governments.

Credit unions, on the others hand, are the primary retail financial institutions in our system and they are provincially regulated. Thus they derive their general powers from provincial credit union statutes (e.g. a provincial Credit Union Act) that set out their business and investment powers, corporate governance practices, and capital/liquidity requirements. Provincial regulators have the responsibility to ensure that credit unions comply with the legislative and regulatory requirements set out by provincial authorities.

On the consumer front, credit union member/customers are for the most part protected by legislative requirements embedded in either provincial Credit Union Acts or by provincial consumer protection laws of general application.

For example, provincial credit union statutes set out legislative requirements for credit unions as they relate to deposit insurance. Credit union member deposits are protected by provincial deposit insurance frameworks that vary somewhat across the country. However, all credit unions must participate in a deposit insurance framework and the respective provincial organizations responsible for credit union deposit protection monitor credit union financial performance closely, independent of the audits and other inspections mandated by provincial legislation. Levels of deposit protection vary somewhat from province to province but range from \$60,000 per individual to a 100% guarantee.

Credit union legislation may also set out the obligations of a credit union as they relate to cost of borrowing disclosure and protections that relate to membership and withdrawal from membership in a credit union.

A significant amount of consumer protection derives from broader provincial legislation that may have application beyond the credit union sector. In a formal sense, this legislation can take different forms in different provinces and often comes under the banner of a *Consumer Protection Act*, a *Fair Trading Act*, a *Business Practices Act* or a

³⁵ Compiled by Credit Union Central of Canada Research Department, (2003).

Collection Agencies Act. However, in a substantive sense, the aims and actual requirements of such varied approaches to consumer protection are fairly similar across provinces.

Thus such provincial legislation sets out a wide range of consumer protections that credit unions adhere to:

- Rules that govern the formation of contracts (e.g. dealing with the competence of parties) and breach of contract;
- Rules that govern the handling of information as it relates to credit reporting organizations;
- Rules that protect consumers from unfair business practices and misleading representations;
- Rules that enable consumers to seek redress when harmed by unfair business practices;
- Rules that impose obligations on lenders in realizing on security and that describes the rights of debtors;
- Rules that grant relief from usurious loan transactions;
- Rules that limit the steps that can be taken to collect on outstanding debts.

It is also noted that federally regulated financial institutions have periodically suggested that provincial consumer protection legislation does not apply to them. In order to ensure consumer protection, it is essential that any such regulation be applied uniformly not only to provincially regulated organizations but also to federally regulated organizations.

PROTECTING THE PRIVACY OF CREDIT UNION MEMBERS

Privacy protection is another area which demonstrates credit union commitment to member/customer protection.

As members of the Senate Banking Trade and Commerce Committee are aware, the Federal Government granted the *Personal Information Protection and Electronic Documents Act* (PIPEDA) Royal Assent on April 13, 2000.

PIPEDA establishes rules for the management of personal information by organizations involved in commercial activities. The Act sets out ground rules for how private sector organizations may collect, use or disclose personal information in the course of commercial activities. The law gives individuals the right to access and request correction of the personal information these organizations may have collected about them.

Credit unions have always been committed to the protection of member privacy. In fact, Canadian Central participated in the process to develop the Canadian Standards Association Privacy Code that eventually formed the backbone of PIPEDA.

As member-oriented institutions, credit unions understand that the personal information of their members needs to be protected to the highest standards. Credit unions are committed to complying with applicable privacy laws, including PIPEDA or “substantially similar” provincial legislation. .

COST OF CONSUMER CREDIT DISCLOSURE HARMONIZATION

An area of consumer protection that is of great concern to credit unions relates to cost of consumer credit disclosure harmonization in Canada.

This is an area where the federal government and provincial governments have undertaken a formal process – through the offices of the Industry Canada’s Consumer Measures Committee (CMC) – that aims to harmonize cost of borrowing disclosure regulations and practices across all of Canada’s jurisdictions.

This process was formally undertaken when Ministers responsible for Consumer Affairs agreed to a package of cost of consumer credit disclosure harmonization proposals presented to them in September 1996. These Ministers then tasked the Consumer Measures Committee with developing a technical template expressing the harmonization proposals in sufficient detail to guide legal drafting and with conducting technical consultations with stakeholders. This *Agreement for Harmonization of Cost of Credit Disclosure Laws in Canada - Drafting Template* (the “Template”) was finalized in 1998.

Harmonized laws are meant to ensure that:

- consumers receive fair, accurate, timely and **comparable information** about the cost of credit in order to obtain the most economical credit for their needs;
- disclosure and disclosure requirements be as clear and simple as possible, given the inherent complexity of the subject matter;
- consumers be entitled to pay off loans (other than mortgages) at any time, and if they do so, incur only those finance charges earned up to the time at which the loan is paid off.

While harmonized cost of consumer credit disclosure legislation in this area is clearly of value, the Canadian credit union system questions whether the steps taken to date towards the implementation of the Template have met with a desirable level of harmonization. We must stress that the consumer can only benefit from disclosure if the disclosure provisions applicable to differently regulated institutions is **identical**, regardless of the regulatory jurisdiction.

While similar provincial regulation is a commendable goal, in this area, there must be **identical** provisions applying to provincially and federally regulated institutions as a consumer can justifiably be expected to compare disclosures provided by institutions in their home jurisdiction. It is highly unlikely that a consumer will be comparing disclosure statements provided by credit unions from two different provinces and more likely that the consumer will compare the disclosure provided by their local credit union with that provided by a chartered bank. If the disclosure is not identical, the consumer might be misled by a seemingly lower rate when, in fact, the relevant loan may not be in the consumer’s best interests. This could also lead to a competitive disadvantage to an institution required to disclose information calculated in a manner that results in a rate seemingly less attractive to a consumer (regardless of the facts related to that calculation).

Although substantive examples have been provided in the past, we must stress that not only must the effect be the same, but the language used must also be the same to ensure that the same result is achieved in all instances. For example, the concepts of “value given” and “value received” in the Template lead to greater interpretation difficulty than

the structure of “including the following charges” and not including certain charges as seen in the Cost of Borrowing (Banks) Regulation.

In addition to the foregoing overarching issue, two areas currently under consideration in this regard are the application of regulations relating to calculation of the Annual Percentage Rate on Lines of Credit and the conditions for the waiver of the two-day notice period before entering into a mortgage loan contract.

1) CALCULATION OF THE ANNUAL PERCENTAGE RATE (APR) ON LINES OF CREDIT

Lines of credit are characterized by variability both in terms of interest rate and principal amount of the loan outstanding. The *Bank Act's Cost of Borrowing Regulations* recognize that an accurate APR disclosure for these types of credit agreement is not possible. Consequently, the *Cost of Borrowing (Banks) Regulations* state that the cost of borrowing for these types of loans is not to be disclosed as an APR. Rather, if the loan has a fixed annual interest rate, then that interest rate is the disclosed amount. If the loan has a variable interest rate, the rate to be disclosed is the annual interest rate that applies on the date of disclosure.³⁶ The Bank Act regulations also require that the borrower be provided with an "initial disclosure statement" for these loans which contains information appropriate to lines of credit and credit card loans.³⁷

The provincial cost of credit disclosure legislation developed based on the Template is problematic in this area. The basis for the difficulty would appear to be the Template itself. The Template does not discuss and otherwise pays little attention to the assumption underlying the APR calculation that the total cost of borrowing on lines of credit is a known amount. Yet, if the total cost of borrowing is not known, it is not possible for the APR to be calculated. The APR calculation, therefore, is well suited to fixed term loans at fixed rates. It is much less effective when variability of rate or term is factored into the loan arrangement.

The Federal Government has not given any indication that it will move to harmonize its own *Cost of Borrowing (Banks) Regulations* with the Template in this area. In fact, Ontario has now drafted legislation that purports to align with the federal approach on this matter. Newfoundland and Labrador's proposed regulations are also similar to the current federal approach. These developments should not be surprising, given that the federal regulations appear to be more realistic and simpler to understand and comply with than the Template.

Despite these obvious problems, a recent consultation carried out by the CMC to address concerns in this area would not even consider adopting the federal approach because it does "...not meet the APR requirement as set out in the Harmonized Agreement, and...[cannot] be given consideration, without varying from the Harmonization Agreement."³⁸ This approach simply ignores the underlying flaws of the Template.

³⁶ Department of Justice Canada, *Cost of Borrowing (Banks) Regulations*, (2001) s. 3(3).

³⁷ Department of Justice Canada, *Cost of Borrowing (Banks) Regulations*, (2001) s. 10 11.

³⁸ Consumer Measures Committee, *Consultation on Cost of Credit Disclosure*, (2005), p. 3.

2) WAIVER OF TWO-DAY NOTICE PERIOD

The conditions for waiving the two-day cooling off period in mortgage contracts found in the Template also do not align with the options available under the *Bank Act – Cost of Borrowing (Banks) Regulations*.

Specifically, the federal regulation allows the consumer to exercise an unconditional waiver of the two-day cooling off period. On the other hand, the Template provides for a two-day notification period -- the period between disclosure and entering the contract. The Agreement allows for a waiver of this period following initial disclosure, only if the consumer receives legal advice as to the effect of the waiver.

This provision in the Template ignores the realities of the market and the kinds of difficulties that might arise for lenders and borrowers if this two day period is strictly adhered to. Experience in the market suggests that borrowers demand quick responses when seeking approval or rejection of an application for mortgage funding. A lender that, for legal reasons, requires a borrower to seek legal advice for a waiver or to wait two days before entering into a contract is not in the same competitive position as a lender that can enter into an immediate commitment.

Once again, the recent consultation carried out by the CMC sought to address some concerns about the waiver period, yet, the consultation would not contemplate options available under the *Bank Act – Cost of Borrowing (Banks) Regulations*.

Whatever the outcome of the CMC's consultation, it will not produce harmonized cost of consumer credit disclosure regulations and practices across Canada unless the federal approach to these issues is adopted or the federal government revises its regulation to bring it into line with the Template. The later option, in our opinion, would be ill-advised, given the inherent flaws in the Template.

CONCLUSION

To conclude, Canadian Central thanks the Standing Senate Committee on Banking Trade and Commerce for this opportunity to comment on consumer issues in the financial services sector. We hope that Canadian Central's comments are of interest to the Committee and assist in the formulation of the Committee's study and possible recommendations.