

## Puzzling Out the Payment System

Brigitte Goulard, Vice President, Policy, CUCC

The Payment System. On its own, the term has the power to send shivers down peoples' spines or, in some cases, put them to sleep. Most people, including policy wonks, are baffled by the complexities of the system, particularly as it is now becoming more and more electronically based.

Credit union members take it for granted that their ATM will dispense cash, that their credit cards will not be unduly refused, that their debit cards will work in Paris, France and even more important, that their credit unions are taking the necessary precautions to protect them from fraud.

However, behind each of the above statements is a complex set of rules and protocols that regulates and oversees the system. As previously noted in the Policy and Advocacy Report, the payment system is in the midst of significant changes: a proposed Code of Conduct for debit and credit cards, the possible entry of Visa and Mastercard in the debit card market, and potential changes to the manner in which the Canadian payment system functions. It has therefore become imperative that credit unions executives better appreciate the intricacies of the system and its impact on their organization.

However, understanding this complex system can be overwhelming. To help our readers along the path to knowledge, the Policy and Advocacy Report will include, when relevant, an article on a dedicated topic. For example, I invite you this month to read Doug Whalen's article on the Proposed Code of Conduct for the Credit and Debit Card Industry in Canada. Our Research Bits section also highlights a report from the

CD Howe Institute, Change is in the Cards: Competition in the Canadian Debit Card Market.

In addition, we undertake to answer in each edition of the Policy and Advocacy Report, a specific question relating to the Payment System. We hope this week's question: "What is the purpose of the *Payment Clearing and Settlement Act*" will help you discover new, fascinating topics.

PS: Keep an eye out for our Special Federal Budget Edition, which will be released on March 4<sup>th</sup>.

## Credit Union Collaboration

Brigitte Goulard, Vice President, Policy, CUCC

Project 1: Frameworks for Credit Union Growth through the 6<sup>th</sup> principle: Co-operation among co-operatives

Credit unions in 2010 face many challenges: a still fragile economy, the renewed interest of the banks in more traditional lending, the continuing trend toward credit union consolidation, the mergers of provincial Centrals, the rising cost of keeping up with technology,  
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changing demographics and a shrinking workforce – to name a few.

This list is not meant to discourage but rather to encourage credit unions to consider alternative ways to seek growth, one of which could be collaboration with other credit unions.

One of Canadian Central's priority projects for 2010 is to research and catalogue the type of collaborative arrangements that currently exist domestically and internationally. This research will eventually be made available to credit unions in a reference document. Although we are still at the preliminary stages of our research, already our data supports the claim that "collaboration" can be a very useful tool to deal with today's challenges and provide for tomorrow's growth.

For example, in 2009, Sunshine Coast Credit Union CEO, Shelley McDade conducted a survey of 74 credit union executives from across Canada on the topic of credit union alliances. The results of the survey revealed that 92% of credit union executives believe that alliances and collaboration can play a role in dealing with the challenges currently facing the industry. Also surprising, almost 60% of responding credit unions were engaged in some form of collaborative effort at the time of the survey. Some of the most cited areas of collaboration include: human resources benefits, wealth management, volume aggregation, intellectual capital sharing and storing, purchasing groups, advertising, and credit union inter-connectivity.

The survey results demonstrate that credit unions want – and are – collaborating, but are they doing enough? And what about the other 40% that currently do not collaborate? Perhaps they need resources, tools or information to understand what is necessary to achieve a successful collaboration. Mr. Michael Taylor, author of "*A Road Map for Credit Union Back-Office Collaboration*", a Filene Research Institute study, lays out in his report a road map for credit unions wishing to start or continue on the collaboration journey.

Mr. Taylor's research identifies the top three reasons to collaborate as being:

1. To benefit from others' expertise and reduce expenses.
2. To focus more effectively on growth.
3. To enhance focus on the frontline.

Mr. Taylor also examined why there is not more collaboration occurring in the industry and found the following three reasons:

1. Studies of successful collaboration are not very well known.
2. Lack of understanding of benefits.
3. Overcapitalization does not encourage efficiencies.

As you can see from the above information, this priority project promises to be very interesting – and hopefully – useful to credit unions. We will provide more information on our research in future editions of the Policy and Advocacy Report.

I am pleased to report that both Mr. Taylor and Ms. McDade will present the results of their research at the 2010 CUCC Canadian Conference for Credit Union Leaders which will be held in Winnipeg from May 1 – 5. See <http://www.cucentral.ca/eventsconf> for more information on the Conference.

Please contact Anna Morena at [morenaa@cucentral.com](mailto:morenaa@cucentral.com) if you are interested in obtaining a copy of Mr. Taylor's report, "*A Road Map for Credit Union Back-Office Collaboration*".

## Consultations

### Canada Small Business Internship Program

Jan Hopper, Senior Policy Advisor, CUCC

Most credit unions are eligible to receive financial subsidies from an Industry Canada program that encourages e-commerce development and employment of post-secondary students. The Small Business Internship Program (SBIP) will reimburse 75% of eligible wages, to a total of \$10,000, paid to

post-secondary students working on e-business projects at Small to Medium sized enterprises (SMEs). SBIP funding is available for a period of twelve weeks. A credit union will qualify as a SME if it employs fewer than 500 people. This program can benefit credit unions that are hiring students for the summer, or part-time, while improving their e-business practices and technologies.

Canadian Central has worked with Industry Canada to overcome initial resistance to making credit unions eligible for the SBIP as SMEs. However, written confirmation has been received that credit unions will be able to participate in this program.

Information about the program is available on the SBIP website at <http://www.ic.gc.ca/eic/site/sbip-pspe.nsf/eng/home>. The site will be updated in March or April, adding a list of regional delivery agents. Regional delivery agents will adjudicate the applications received. To aid in application acceptance, credit unions should have an e-business project planned that would benefit from the assistance of an intern under the SBIP. Details of the project including objectives, deliverables, timelines, budget and expected benefits are required to complete the application.

A copy of the Industry Canada document supporting credit union eligibility is available for inclusion with applications being submitted to a regional delivery agent. Please contact Jan Hopper at 416-232-3414 or [hopperj@cucentral.com](mailto:hopperj@cucentral.com) for a copy of this document, or if you have any questions about the program.

## Code of Conduct for the Credit and Debit Card Industry in Canada

Doug Whalen, Director, Payments, CUCC

*On November 19<sup>th</sup>, the Government of Canada released a Draft Voluntary Code of Conduct for the Credit and Debit Card Industry in Canada. The Government invited stakeholders to pass on their comments and concerns by January 19<sup>th</sup>. Canadian Central's four-page response was submitted to the Minister of Finance in early January, 2010. A summary of our response follows.*

Canada's credit unions appreciate that the overall intent of the Draft Code, as stated in its Purpose, is to protect and expand the interests of merchants. However, we believe the draft Code places consumers at a disadvantage. It does not acknowledge the consumer as an equal participant and party to debit and credit card transactions, and several of the Code's provisions either do not adequately protect consumer interests, or protect the interests of merchants at the expense of the consumer.

As written, the Draft Code sets aside the interests of the other parties involved in a debit transaction in order to provide merchants with the ability to determine priority routing for debit services. In so doing, it does not consider the interests of consumers or the card issuer, and ignores fundamental principles of consumer rights and choice. As there is no requirement for the merchant to choose the payment card network that is most beneficial or least costly for the consumer, merchants will most likely choose the network that is least costly or most beneficial for the merchant.

The most significant concern of Canadian credit unions regarding the Draft Code is its potential to negatively impact the future of Interac debit services and the viability of Interac itself. We believe that providing merchants with the ability to set Priority Routing for debit services will increase the vulnerability of Interac Association to predatory pricing practices by the much larger international payment card networks.

By unintentionally facilitating a significant threat to the future viability of Interac, the Code may ultimately hasten a reduction in competition and choice of debit services available to Canadian merchants, consumers and card issuers. We believe that the Draft Code should be amended, to provide consumers with transparency, flexibility and the opportunity to make an informed choice when using debit and credit services; and to preserve a competitively balanced market that includes a strong, Canadian-focused payments delivery channel as provided by Interac.

The Draft Code is available at <http://www.fin.gc.ca/n08/09-109-eng.asp>. Please direct questions to [whalend@cucentral.com](mailto:whalend@cucentral.com).

## Your Fraud Report

### March is “Fraud Prevention Month” Fraud: Recognize it. Report it. Stop it.

Jan Hopper, Senior Policy Advisor, CUCC

Once again the credit union system will be participating in “Fraud Prevention Month” held in March each year. Canadian Central represents the system on the Competition Bureau’s Fraud Prevention Forum, the coordinating body for Fraud Prevention Month. Membership in the Forum has grown considerably from 22 members in 2004 to the present total of over 100. Participating organizations include financial institutions, federal, provincial and municipal government agencies, and corporations from a wide array of industry sectors.

The Forum was established through shared concern that consumers needed to be better informed about different types of fraud to help prevent them from becoming victims. Common messaging – “Fraud: Recognize it. Report it. and Stop it.” is used by members of the Forum throughout Fraud Prevention Month to instruct consumers on what fraud is and what to do about it. This slogan has served to build consumer awareness about fraud as it has been repeatedly broadcast through government public service announcements as well as radio and television advertising.

The theme for Fraud Prevention Month 2010 is “On-line Fraud”. According to PhoneBusters (the Canadian Anti-fraud Call Centre), incidents of on-line fraud are increasing significantly. The greatest number of fraud victims in 2009 were solicited either via e-mail, the internet or through text messaging. The resulting losses accounted for almost 25% of the reported \$59.3 million lost through fraud in 2009. Access a detailed statistical report with a breakdown of losses by province:

[http://www.phonebusters.com/english/documents/AnnualStatisticalReport2009\\_001.pdf](http://www.phonebusters.com/english/documents/AnnualStatisticalReport2009_001.pdf).

A common type of on-line fraud affecting the financial services industry is “phishing”. This is when fraudsters send e-mails purporting to be from financial institutions

that try to get consumers to provide personal banking information. In most cases, the e-mails indicate that consumers’ accounts have been compromised and that they need to provide personal information to remedy the situation. Of course, the e-mails are not legitimate and some consumers end up revealing their account details to the fraudsters. There were 1,205 complaints about phishing reported to Phonebusters in 2009.

Credit unions and Centrals wishing to promote Fraud Prevention Month can access marketing materials through the Competition Bureau's website. Also, a calendar of events has been posted that lists the various activities of the members of the Forum through the month of March. The intent of the list is to provide other organizations with information about potential opportunities to partner with other local organizations. In the past some credit unions/Centrals have partnered with their local Better Business Bureau in coordinating local “Scam Jams”. Credit unions or Centrals that wish to have their events added to the 2010 Events Calendar, should e-mail [hopperj@cucentral.com](mailto:hopperj@cucentral.com) prior to February 26<sup>th</sup>, 2010.

Additionally, credit unions can purchase Canadian Central’s booklet “Defend Yourself from Fraud” throughout the year. This booklet has been designed to provide information that will increase credit union member awareness about common fraudulent schemes. To learn more about this booklet contact Magda Stec at [stecm@cucentral.com](mailto:stecm@cucentral.com).

For further information about the Fraud Prevention Forum, Fraud Prevention Month and on-line fraud, please go to <http://competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03110.html>.

## IFRS Readiness for Credit Unions – Phase II

Gary Rogers, Vice President, Financial Policy, CUCC

As critical implementation dates approach, all deliverables under the national IFRS Readiness for Credit Unions project are complete and the project is now proceeding to Phase II.



Canadian credit unions will be required to use the new accounting standards for fiscal years that begin January 1, 2011 or later. As previous year comparative numbers also will have to be reported using IFRS, many credit unions are already collecting the 2010 data that will be required by auditors and regulators.

Outputs from the national project are posted on the national IFRS website at [www.cucentral.com/ifrs](http://www.cucentral.com/ifrs). These include webinars, toolkits, slide decks and Communiqués on key topics.

To maintain momentum and leverage the extensive work already done, a series of IFRS webinars and Communiqués will continue throughout 2010. The emphasis will be on practical examples and solutions. Loraine McIntosh of Deloitte & Touche will continue as the external resource on the project. The first two webinars will be held on March 3 and 30. The March 3 webinar will be on “Hot Topics”, for which credit unions have already been asked for suggestions. The focus on March 30 will be practical and technical steps in migrating to the opening balance sheet.

The new requirements for loan loss provisioning as well as accounting for shares of Centrals and other cooperatives are two common issues that are frequently mentioned by credit unions as requiring additional attention. Additional support in these areas will be addressed.

An important aspect of the national project will continue to include liaison with a working group of provincial deposit insurers and regulators as they finalize their regulatory response to IFRS requirements. Each provincial regulator has issued draft guidance to credit unions in their province and has requested comments. The principles on which the draft guidance is based are threefold: (1) Maintain consistency with other Canadian regulatory bodies, primarily OSFI; (2) Minimize additional regulatory requirements; and (3) Financial statements of different credit unions should be materially comparable.

The national project will not provide all the answers to the IFRS challenges that credit unions face. Individual circumstances will require each credit union to work closely with its own auditors. However, the tools and

resources provide a wealth of support that will continue to be responsive to issues identified by credit unions throughout 2010.

## Ottawa Happenings

### Update on the Hog Industry Loan Loss Reserve Program

Robert Martin, Senior Policy Advisor, CUCC

On October 5, 2009 the Government of Canada rolled out its \$400 million Hog Industry Loan Loss Reserve Program (HILLRP) to support private sector loans to “viable” hog producers. Through the fund the government shares loan loss risk with participating private sector financial institutions – including participating credit unions.

To date, 11 credit unions are participating in the HILLRP along with 7 banks, Desjardins and Alberta Treasury Branches. As of January 29<sup>th</sup>, there have been 113 HILLRP loans registered accounting for total outstanding HILLRP loans of \$298 million. Approximately \$173 million of the potential \$400 million HILLRP Reserve fund has been dedicated to backstop these new loans. The dollar amount of HILLRP loans registered rose 13.7% in January while the number of loans rose by 59%, signaling that loans likely are being made for smaller amounts than in the early months of the Program.

As the application deadline for producers seeking to use the Program is March 1, 2010, it appears that a significant portion of the total potential reserve (\$400 million) may go unused.

## Hill Happenings

Anne Dance, Policy Analyst, CUCC

Gary Rogers, Vice President, Financial Policy, CUCC

Leading up to two long-anticipated events—the Olympics and the resumption of Canadian Parliament—the Hill is surprisingly busy as every party strives to demonstrate it is not on vacation.

The government is currently undertaking a few final consultations with business leaders and other stakeholders as it readies for the release of the March 4<sup>th</sup> budget. Prime Minister Stephen Harper recently hosted G7 finance ministers and central bankers in Iqaluit, Nunavut.

Harper shuffled his cabinet several weeks ago. Ministers in new roles with influence over government financial policy include Stockwell Day, moved from International Trade to the Treasury Board, and Rob Moore, new to the cabinet as Minister of State (Small Business and Tourism). Jean-Pierre Blackburn continues his responsibilities for the Rural and Co-operatives Secretariat as Minister of State (Agriculture and Agri-Food) while shifting from Minister of National Revenue to Minister of Veterans Affairs.

In Ottawa, Liberal leader Michael Ignatieff launched more than a dozen policy panels touching on health care and rural development. The Liberals will also launch “Canada at 150”, a three day “thinkers and doers” conference in Montreal in March.

The NDP also remains active on the Hill and has spoken out about a number of issues, addressing consumer rights for debit and credit cards and strategies for the automotive sector.

An issue to watch is government mortgage lending policy. Some bankers have privately asked the government to cool the housing market by tightening mortgage rules—such as increasing the minimum down payment on homes from 5 per cent to up to 10 per cent and reducing the maximum amortization period from 35 to 30 years. Another idea receiving attention is the creation of new rules that would govern how financial institutions evaluate mortgage borrowers. This would seem to address concerns that borrowers buying homes at low mortgage rates will be unable to pay monthly payments when interest rates increase. Although Finance Minister Jim Flaherty has cautioned that new regulations could damage the market, a recent report in the *Globe and Mail* suggests that his department will soon begin crafting new rules governing how banks evaluate mortgage borrowers.

When Parliament resumes on March 3<sup>rd</sup>, the Upper Chamber will be home to five more Conservative senators. None of these new Parliamentarians has an extensive background in the credit union system, although Quebec Senator Pierre-Hugues Boisvenu’s grandfather helped found a *caisse populaire* in Salette, Quebec.

Recent polls show the Conservatives and Liberals virtually tied in popular support, with the NDP at traditional levels. As this is not a recipe for a spring election, we expect an intensive period of Parliamentary activity ahead.

## Research Bits

Les Czarnota, Researcher, Information Services, CUCC

Credit Union Central of Canada subscribes to various research firms on behalf of the Canadian credit union system. This allows affiliated members to access the research directly and search for relevant material to fulfill an information need. This installment of Research Bits reviews in more detail one recent report from Toronto-based C. D. Howe Institute. Reports from the C.D. Howe Institute, The Conference Board of Canada and The Council on Financial Competition are available to credit unions free of charge.

The C.D. Howe Institute is Canada's leading nonpartisan public policy think tank and celebrated its 50th Anniversary in 2008. The Institute has stayed on the forefront of public policy debates in Canada, providing clear, innovative thinking about the nation's challenges. Its publications may be of interest to our readers and are freely accessible at <http://www.cdhowe.org/index.cfm>.

**Change is in the Cards: Competition in the Canadian Debit Card Market** by Philippe Bergevin. C. D. Howe Institute Backgrounder No. 125, February 2010 [http://www.cdhowe.org/pdf/backgrounder\\_125.pdf](http://www.cdhowe.org/pdf/backgrounder_125.pdf).

VISA and MasterCard are entering the Canadian debit market. Their presence raises issues involving the efficiency and fairness of the various elements that comprise a national debit card system, from the financial institution issuing the card through the payment networks, payment processors and merchants to the card-holding consumer. In short, the playing field is not even. VISA and MasterCard are largely unregulated when it comes to debit transactions, while the non-profit Interac association operates under the restrictions of a dated Competition Tribunal order.

This Backgrounder considers the implications of the rapidly changing debit payment landscape and makes three recommendations for government action to ensure that consumers and merchants are protected and that the system can evolve to serve them even better.

The recommendations are:

- Remove current restrictions on Interac so that the association can evolve on a for-profit basis;
- Minimize differences in rules and standards applied to payment systems; and
- Implement a voluntary code of conduct that (i) enhances the level of transparency and disclosure to merchants, (ii) allows merchants to decline debit services for any transaction types, and (iii) allows merchants to provide discounts or surcharges related to type of payment.

Adopting these recommendations would help ensure that Canadians have a debit market that is both fair and efficient.

Other interesting publications available from the Council on Financial Competition include:

- **What You Need to Know About Branch Sales Productivity Top 10 Takeaways from CFC's Interview with Branch Productivity Experts.** CFC Brief, February 2010, 2 pages
- **Your Money Explained How ASB Bank is Engaging Customers Online.** CFC Company Case Study, January 2010, 8 pages
- **Fundamentals of Consumer Banking Dashboard™ - January (Updated).** CFC Research Brief, January 2010, 5 pages
- **Examining the Generation X Opportunity.** CFC Research Brief, January 2010, 13 pages

## Your Statistical Report

### Housing Stats – Canada Mortgage and Housing Corporation, February 2010

Sandra Brizland, Research Analyst, CUCC

The latest release of the Canada Mortgage and Housing Corporation (CMHC) *Preliminary Housing Start Data Report* indicates a sign of strength in Canada's housing market.

According to the February 2010 report on the nation's housing market, the seasonally adjusted and annualized figure for housing starts was 186,300, advancing 5.8% from 176,100 units the previous month. It is the highest rate of construction since October 2008, when starts were reported at 209,400. Both single and multiple sector housing starts reported gains.

All regions, with the exception of the prairies, experienced increases in the housing market in January. B.C. led the way with urban construction jumping 19.8%. Both Ontario and the Atlantic region saw modest gains of 1.5% and 2.3%, respectively. The Prairies experienced an overall decline of 4.8% in housing starts. A breakdown of data revealed Alberta was responsible for the decrease in Prairie starts, with a 16.6% decline.

Results, however, may in fact be skewed by the Olympic related housing starts in B.C. Temporary building may have slightly exaggerated the actual strength of the overall recovery in housing construction, possibly impacting starts with a minor retraction next month.

The February 2010 *Preliminary Housing Start Data Report* is based on preliminary data available up to January 2010.

To see the full report: [http://www.cmhc-schl.gc.ca/odpub/esub/64695/64695\\_2010\\_M02.pdf](http://www.cmhc-schl.gc.ca/odpub/esub/64695/64695_2010_M02.pdf)

### Canadian Central Launches National Mentorship Program

Joan Ellis, Senior Manager, CUSOURCE Credit Union Knowledge Network

In April, Canadian Central will launch its first National Mentorship Program (NMP), a unique opportunity that matches individuals in senior positions with high potential employees from credit union system organizations across the country. In 2010, our goal is to attract 60 people to this program, including 30 mentors and 30 mentees. Applications to be a mentor or mentee must be submitted to Canadian Central by March 15<sup>th</sup>.

The 2010 NMP will run from April to October. The anticipated time commitment will be between 2-4 hours per month. There are no age restrictions for either mentor or mentee; however, mentors must have held a senior position for at least two years, while mentees' potential must be identified by their credit union (or system-owned partner) from any operational area. Participants are responsible for communication costs between the mentor and mentee.

Canadian Central is offering two more webinars to provide information about the NMP. Anyone interested in this program is invited to attend. Each webinar will run from 1:00 pm to 2:00 pm (EST) on February 24 and March 1. If you are interested in attending, please consult Canadian Central's website at: <http://www.cucentral.ca/Default.aspx?DN=ac2185dd-580a-47c4-bc3e-7d93c69a37c4&l=English>

## Puzzling Out the Payment System

### What is the Purpose of the *Payment Clearing and Settlement Act*?

The *Payment Clearing and Settlement Act* reflects the Bank of Canada's concern with protecting the integrity of systemically important payment systems. The Act gives the Bank of Canada authority to supervise and regulate clearing and settlement systems that the Bank determines to be systemically important.

A "systemically important" payment system is a payment system which the Bank of Canada determines has the potential through its operations to pose systemic risk. The Act defines "systemic risk" as the risk that the inability of a particular payment system participant to meet its obligations in a payment system could lead to a "transmittal of financial problems" to other participants and other payment systems.

The Bank of Canada has designated three such "systemically important" payment systems under the Act – the Large Value Transfer System (LVTS), Canadian Depository for Securities Ltd. (CDS) and CLS Bank. LVTS will be discussed in more detail in future editions of the Policy and Advocacy Report.

Please send your questions on the payment system to Brigitte Goulard at [goulardb@cucentral.com](mailto:goulardb@cucentral.com). We'll be pleased to answer them in our future editions.

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