

The Year Ahead

Message from the President & CEO

David Phillips, President and Chief Executive Officer, CUCC

A look at the year ahead, as we start 2009, suggests that this year will be one of new challenges and opportunities in the Canadian credit union system.

We know that credit unions will face a slowing economy at the start of this year. We also know that the system has the strength to weather adversity and that credit unions will continue to serve as important sources of support to their members and communities throughout Canada.

Over the next year, the consolidation of credit unions will likely proceed at much the same pace as in the past few years - a reduction of 30 to 40 credit unions during the year - but overall system growth will continue. Significantly there is also consolidation underway at the second-tier level as provincial Centrals consider mergers in the Atlantic provinces and on the Prairies. We may be headed toward a system in which provincial Centrals will be replaced by a smaller number of regional Centrals.

An important new product for financial institutions is being introduced in 2009. The offering of tax-free savings accounts (TFSA's) is expected to be one of the biggest developments within the system this year. We have been working with our partners across the system to help credit unions prepare for this new savings vehicle.

At Canadian Central, a particular emphasis in 2009 will be placed on government relations in Ottawa. There has been considerable turnover at the political and official levels in Ottawa during the past few months. Consequently, CUCC intends to have a series of meetings with newly elected Members of Parliament and with the public officials who have recently moved into new positions. Many of them are unfamiliar with credit unions, or have information that is out-of-date. It

is important to the credit union system that federal government decision-makers be well informed about the circumstances and aspirations of Canadian credit unions.

There are also a number of important multi-year programs at Canadian Central that will continue in 2009. These include the International Financial Reporting Standards (IFRS) project, the Canadian Business Owners Strategy (CBOS), and the implementation of chip-enabled payment cards.

Canadian Central's role will continue to be to serve as a national forum for the system, as well as a national voice and a provider of some services to credit unions. Canadian Central's annual conference will be held in Halifax this May and, as indicated by the conference title "Future Focus", will be placing a special emphasis on the potential opportunities that lie ahead for credit unions in a more prosperous economy.

An important event in 2009 will be the 100th anniversary of the Canadian Co-operative Association (CCA). Canadian Central looks forward to participating in the CCA's celebrations and in helping to draw attention to the past and current importance of co-operatives to the Canadian economy and the Canadian way of life.

On The Policy Front

Prescriptions For Financial Reform – No. 2

Robert Martin, Director of Research, CUCC

The December 11, 2008 edition of the *Policy and Advocacy Report* began a series of articles that examine the current policy debates concerning the recent financial turmoil: its causes, consequences and potential remedies. The first article in this series (see: http://www.cucentral.ca/Policyv4_15dec08) focused on a wide ranging address by David Dodge; former Governor of the Bank of Canada.

Dodge's speech focused on the need for:

1. macro-prudential financial supervision and regulation that focuses on the total leverage and risk in the financial system as a whole;
2. financial instruments exhibiting greater transparency;
3. a review of accounting standards and Basel II to ensure they do not enhance pro-cyclicality in economic expansions and declines; and
4. greater attention to structures of liquidity management to ensure they are able to withstand significant stress

The views outlined by David Dodge were picked up in almost all the main points in a recent address by Pierre Duguay, Deputy Governor of the Bank of Canada to the Risk Management Association, Toronto Chapter (see: <http://www.bank-banque-canada.ca/en/speeches/2009/sp09-1.html>). In fact, when compared to Dodge's analysis, the only additional element in Duguay's assessment of the causes of the current crisis is his greater emphasis on inadequate risk management practices at the financial institutional level; practices that did not appropriately address what might happen during a systemic disruption of financial markets. According to Duguay, risk-management models used at financial institutions were too often based on limited data and a presumption of continuous liquidity and this did not prepare them for crisis conditions. Reliance on these models led to a focus within institutions that ignored the risk of a significant disruption to the financial system if everyone reacted to a large shock in the same way.

Duguay's speech is of most interest because he outlines the practical steps policy makers are now considering to prevent similar problems in the future. In this regard, Duguay's comments are four-fold:

First, Duguay states that the Bank of Canada believes that now is the time to take a macro-prudential approach to financial stability, in terms of both surveillance and regulation. Macro-prudential surveillance would assess financial system risks by looking at the broad economic and financial conditions that can generate difficulties for the financial system in the future. Macro-prudential regulation would strengthen the financial system by designing standards and codes to limit the buildup of financial and economic imbalances. He indicates that the bank of Canada will advocate the need for macro-prudential regulation and surveillance in key domestic and international organizations and notes that the bank is already placing increased emphasis on identifying risks

and vulnerabilities in the Canadian financial system. If the bank is successful in its promotion of a macro-prudential approach Canadians would likely see a higher profile for the bank and it would be far more active in managing economic and financial activity than in the recent past.

Secondly, Duguay indicates that central banks and regulators should address shortcomings in the risk management practices at financial institutions by developing macroeconomic stress-test scenarios through which they can observe the details of risk-management systems at individual institutions and identify possible feedbacks that are missing in these systems. The results of these exercises could be passed on (in aggregated form) among risk managers at other financial institutions to help them adapt their internal risk management practices to the results of the macroeconomic stress tests.

Third, Duguay notes that regulators will do more to improve transparency and disclosure, particularly for complex financial instruments. Duguay signals progress is being made in encouraging greater transparency and that the Financial Stability Forum (FSF) of the G20 has developed a template for the disclosure of financial institution exposures to these products. Duguay believes these steps must be taken further and highlights work underway at the International Organization of Securities Commissions to address gaps in transparency and disclosure.

Finally, Duguay notes that at the international level, the Bank of Canada is working with its global partners to strengthen financial stability. It is contributing to FSF work on pro-cyclicality issues related to bank capital, loan-loss provisioning, and margin requirements. Canada is engaged at the G-20 in working groups considering potential regulatory improvements in a broad range of areas. The efforts of these working groups will culminate in action plans for the next summit of G-20 leaders in April 2009.

Throughout the financial crisis the Bank of Canada has played a key role in managing the fall-out from financial market turmoil. The bank appears determined to play a significant leadership role in fashioning Canada's regulatory response aimed at preventing similar developments in the future. The alignment of the views between the Bank of Canada and David Dodge appears to signal some agreement among senior policy makers concerning the main contours of that response. That said, a great deal more will be known in April when the G20 releases their Action Plan for financial reform.

Export Development Canada, a Partner in Difficult Times

Brigitte Goulard, Vice President, Policy, CUCC

On November 18, Canadian Central's Legislative Affairs Committee approved its Work Plan for 2009. One of the elements of this plan is for Canadian Central to develop closer relationships with key federal government departments or agencies.

One such agency is Export Development Canada (EDC). The EDC is a Crown corporation wholly owned by the Government of Canada that acts as an export credit agency. More specifically, the EDC has a mandate to help Canadian exporters and investors expand their international business. To that end the EDC offers a wide range of financing, insurance and risk management solutions for Canadian companies that export or invest abroad. The EDC's services can be provided to the exporter in partnership with credit unions or directly to members. Approximately 90 per cent of the exports supported by EDC are small and medium-sized businesses which aligns very nicely with the credit unions system's focus on this same market segment.

At a time when financial capacity is becoming a challenge and credit union members are faced with increased risks, EDC can assist credit unions to mitigate these risks while still serving their members. For example, the EDC can assist credit unions by: (1) mitigating risks of a transaction or an entire facility, as it is backed by a AAA rated government entity (2) supporting the activities of exporting members to help maintain and grow these relationships (3) providing access to EDC's trade finance expertise for support with any transactions that relate to exports, be it direct exporting or members' ownership/investment activities outside of Canada.

An example of how EDC recently supported a credit union with their exporting client: A Saskatchewan based credit union provided its long time member a \$700,000 line of credit. However, due to the nature of the member's business, the \$700,000 was not sufficient for the few months of the year during which the need for working capital spiked. As a result of a guarantee from EDC, the line of credit was enhanced to \$1,200,000 in order to provide adequate working capital to purchase inputs that will be processed for export.

For more information on how EDC can help you with an export transaction you can directly contact the Small

Business Team at 1-866-551-3607 or e-mail to sbsolutions@edc.ca. You can also check their website at www.edc.ca

Your Policy Team At Work

Industry Canada Evaluation of the Small Business Financing Program

Robert Martin, Director of Research, CUCC

The Audit and Evaluation Branch (AEB) of Industry Canada is currently undertaking a final evaluation of the Canada Small Business Financing Program in support of an upcoming comprehensive review. The evaluation is designed to assess the success of the program in achieving its objectives, and to provide program management with information for decision-making. The AEB has established a Steering Committee to provide advice and feedback to the evaluation team with membership including program managers, representatives of various stakeholder groups and a chair from within the Industry Canada management team.

Credit Union Central of Canada has agreed to participate as a member of the Steering Committee. The Committee will meet a number of times between January and April to discuss and provide feedback on the findings of the on-going evaluation. The audit and evaluation work is currently being carried out by a private sector consulting firm - KPMG.

As the work of the Steering Committee progresses Canadian Central will consult with the National Lenders Committee for feedback on the program evaluation.

Mandatory Compliance with the Canadian Code of Practice for Consumer Debit Card Services for Interac Members

Jan Hopper, Senior Policy Advisor, Consumer Affairs, CUCC

The new Interac Operating Regulation 9.9, requires that all Interac members comply with the Canadian Code of Practice for Consumer Debit Card Services ("the Code of Practice") in respect to any messages that are transmitted as part of the INTERAC Shared Services (SCD and IDP).

What this does is essentially make mandatory the Code of Practice that was previously "voluntary" for credit unions. Banks have had to comply with the Code of Practice due to oversight by the Financial Consumer Agency of Canada (FCAC). The FCAC

monitors the compliance of federally regulated financial institutions with consumer provisions. Being a federal agency, the FCAC does not have jurisdiction over provincially regulated financial institutions such as credit unions.

Recently a consultation process was implemented by the federal government to broaden the existing Code of Practice to include all forms of electronic transactions. At present this process has stalled due to other priorities within the Department of Finance. During the consultation process, consumer advocacy groups were adamant that the requirements of the Code of Practice should be legislated, thereby removing its “voluntary” status. The draw back for consumer groups is that legislated changes would have to be made at both the federal and provincial levels and therefore take time to implement.

Interac’s imposition of compliance with the existing Code of Practice may alleviate the pressure from consumer groups. Issues of non-compliance will result in a general sanction of \$1,000 unless the compliance issue is rectified within 30 days. Non-compliance with the Code of Practice will be evidenced through consumer complaints. In the past some consumers that were not reimbursed for losses resulting from skimmed debit cards, took their complaints to the media. Such publicity will now result in the levying of sanctions from Interac in addition to the negative impact on the financial institution’s reputation.

The credit union system has been an adherent to the Code of Practice since it was first developed in the early 1990s. The Board of Directors of Credit Union Central of Canada endorsed the revised Code of Practice in 2005. Through its endorsement, Canadian Central committed to building awareness of, and encouraging compliance with the Code of Practice within the credit union system. This approach to endorsement recognized the voluntary status of the Code of Practice for credit unions. Canadian Central worked with CUSOURCE to build awareness about the Code of Practice through the development of an on-line training program and the delivery of webinars for credit union staff and management. The training program will be updated upon the finalization of the new Electronic Funds Transfer Code of Practice.

Happening on the Hill

Parliament Returns January 26

Robert Martin, Director of Research, CUCC

The much awaited 40th Parliament will resume on Monday, January 26 with a Speech from the Throne. The next day Finance Minister Jim Flaherty will table in the House of Commons his much anticipated budget. There is no doubt the question on everyone’s mind is whether Stephen Harper’s minority Conservative Government will face the possibility of defeat at the hands of a coalition of the NDP, the Liberals and the Bloc as was threatened before the House of Commons prorogued in December 2008. The NDP appears to have chosen to oppose the Conservative budget before it has been tabled but, more importantly, the Liberal Party’s support for the coalition has been very muted since the appointment of Michael Ignatieff as party leader. It is likely that the stimulus package in the budget will be sufficiently broad-based to gain Liberal support and therefore eliminate the threat of coalition government for the time being.

In regard to the Budget, many are predicting a very large deficit (e.g. nearly \$40 billion) as the Federal Government seeks to deliver a stimulus package that will attenuate the worst aspect of the downturn. Of course, significant measures are expected to aid the auto and forestry sectors but the financial services sector may see a number of measures in the Budget aimed at expanding the availability of credit to business and consumers. Such measures may even include an expansion of the lending activities of Crown financial organizations (e.g. the Business Development Bank, Export Development Corporation) especially in regard to sectors facing difficulties along with a possible expansion of credit guarantees available through government programs such as the Canada Small Business Financing Program.

Canadian Central will provide the credit union system with an analysis of the Budget from a credit union perspective when it is tabled by the Government.

For Your Information

Insolvencies Rise as New Bankruptcy Rules Face First Tests

Robert Martin, Director of Research, CUCC

In early January the Office of the Superintendent of Bankruptcy (OSB) released its *Insolvency Statistics in Canada* report based on data available up to November 2008. The report indicates that the number of bankruptcies and consumer proposals in Canada continues to rise as the recession takes hold. For example, total bankruptcies in November 2008 were 13.8% higher than those reported for November 2007 while comparable figures for consumer proposals were 20.8% higher. Interestingly though, the number of bankruptcies and proposals reported in November 2008 was down somewhat relative to the October 2008 figures. In regard to total bankruptcies, British Columbia, Alberta and Prince Edward Island continue to show significant increases when November 2008 numbers are compared to those of November 2007, with rises of 19%, 37.3% and 48.1% respectively.

The OSB's *Insolvency Statistics in Canada* report can be obtained at:

<http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02084.html#tbl1>

Increases in the number of bankruptcies and consumer proposals are taking place just as lenders, businesses and bankruptcy professionals adapt to new legislation governing the bankruptcy process in Canada. Both the *Bankruptcy and Insolvency Act* (BIA) and the *Companies' Creditors Arrangement Act* (CCAA) have been amended with some of the new rules coming into force in July 2008. The legislative amendments are broad ranging and significant and were intended to achieve the following main goals:

1. To encourage restructuring of viable businesses as an alternative to bankruptcy.
2. To improve the protection for workers in bankruptcy. The amendments also create the legislative framework for the Wage Earner Protection Program (WEPP), which will ensure that workers receive compensation for their claims.
3. To make the insolvency system "fairer" and to reduce the potential for abuse while respecting the fundamental objective of providing a fresh start to the honest, but unfortunate, debtor.

Background material concerning the reforms to the legislation can be obtained at:

[http://www.ic.gc.ca/eic/site/bsf-osb.nsf/vwap/Summary_of_Legislative_Amendments_en.pdf/\\$FILE/Summary_of_Legislative_Amendments_en.pdf](http://www.ic.gc.ca/eic/site/bsf-osb.nsf/vwap/Summary_of_Legislative_Amendments_en.pdf/$FILE/Summary_of_Legislative_Amendments_en.pdf)

Bankruptcy and Insolvency reform was also the subject of a special session at the October 2008 National Lenders Conference. A copy of the detailed presentation on the reforms can be obtained at: http://www.cucentral.ca/Lending08_Tam_Cramm_14oct08

Federal Tax Expenditure Report and Credit Unions

Gary Rogers, Vice President, Financial Policy, CUCC

The federal Department of Finance periodically publishes a report that quantifies the benefit to taxpayers – both individuals and corporations - of various deductions and credits in the *Income Tax Act*. For example, the report lists the decrease in federal tax collections attributable to personal tax credits, charitable donations, or the small business deduction. *Tax Expenditures and Evaluations 2008* estimates amounts from 2003 – 2006 and provides projections for 2007 – 2010.

Once again, the "low tax rate for credit unions" warrants one line in the 48-page document.

Estimate (\$ millions)	Projection (\$ millions)
2003 – 74	2007 - 66
2004 – 61	2008 - 63
2005 – 56	2009 - 61
2006 – 65	2010 - 55

This is the unique tax benefit for credit unions and caisses populaires that extends their small business tax rate to income higher than for other small businesses i.e. to taxable income exceeding \$400,000. Through a complex formula, some credit unions, but not all, continue to pay the low rate of tax on most or all of their income. It recognizes that credit unions are "the small business of the financial sector" and acts as an incentive to accumulate and retain capital in the absence of access to the capital markets.

This is the provision that is sometimes attacked by banks as leading to unfair competition from credit unions. It is interesting to note the relatively small amount of benefit quantified by the government document. Hardly the basis of unfair competition!



The annual benefit is decreasing over time, even while credit union and caisse populaire incomes are increasing. This is because income tax rates are decreasing and the small business threshold has been increasing from \$200,000 to \$400,000 over a number of years. As a result, as the tax burden on corporations generally decreases, the benefit of this tax break for credit unions also diminishes.

RRSP – Should Re-contributions be Permitted?

Gary Rogers, Vice President, Financial Policy, CUCC

In tough economic times, many people are forced to withdraw funds from their RRSPs as an emergency measure. Yet current RRSP rules do not allow them to re-contribute these amounts when their financial position improves. A case can be made that a person's RRSP contribution room should be adjusted to permit subsequent contributions equal to occasional withdrawals. This change would put RRSPs on the same footing as tax-free savings accounts. Look for this issue to receive increasing attention, if not in the 2009 federal budget, then in subsequent discussions.

Submissions

In January 2009 the Policy Division at Canadian Central provided the Federal Government with submissions concerning the upcoming Federal Budget and the future of the Government's proposed AgriInvest business risk management program for agricultural producers.

By The Numbers

The Canadian Credit Union System has Enjoyed Strong Growth Over the Last Decade

Sandra Brizland, Research Analyst, CUCC

- In 1998 there were 809 affiliated Canadian credit unions, with total assets of almost \$50 billion. Today, 10 years later, the number of credit unions has fallen to 444, while assets have grown to over \$110 billion. The number of credit unions has dropped dramatically over the last 10 years, while system assets have more than doubled. The result is a rapid increase in the size of the average credit union.

- This trend has been accompanied by a substantial increase in the share of total credit union assets controlled by the largest credit unions.
 - Our largest credit union has \$14 billion in assets, 59 branches and more than 390,000 members.
 - The largest 100 credit unions represent almost 81 per cent of the assets in our system (outside of Quebec), compared to 68 per cent in 1998. These credit unions generally offer a full range of financial services.
 - The smallest remaining credit unions / caisses populaires have only 19 per cent of the assets and some may offer limited products and services to suit their membership.
 - The largest 10 credit unions now control close to 39% of assets compared to 29% ten years ago.
- While mergers have reduced the total number of credit unions over the years, the network of branches, combined with the range of electronic banking services available to members, remains strong.
 - The total number of locations within the system remained relatively stable over the last 10 years, declining an average of .6% each year since 1998, while the number of ATMs in the system has increased by approximately 50 per cent during the same period.
- In general terms, we have 7 per cent of the domestic financial services market in Canada. This has remained relatively constant in the last 10 years.
- Over the last 10 years, the credit union system's statutory liquidity dollar amount available to meet requirements has remained constant. In 1998, the ratio of the actual amount available to the required amount was 1.5. In 2007, it was reported at 1.4.

Canadian Credit Union System

1988 vs 2008

	1998	2008*	Annual Average Growth
Assets (\$mm)	\$49,925	\$110,635	8.5%
Deposits (\$mm)	\$45,155	\$97,636	8.3%
Loans (\$mm)	\$39,508	\$92,671	9.2%
Number of C.U.s	809	444	-6.0%
Locations	1,828	1,722	-0.6%
Membership	4,247,718	5,057,400	1.8%
Largest 100 CU/CPs			
	1998	2008**	
Assets of Top 100 (\$mm)	\$37,100	\$96,395	10.7%
Assets of Total CU/CP System (excludes QC) (\$mm)	54,900	119,235	8.6%
Top 100 Assets as a % of Total System	67.57%	80.84%	
Top 10 Assets as a % of Total System	28.75%	38.61%	
Credit Union Market Share			
	1998	2007	% Change
Assets	6.9%	6.6%	-0.3%
Deposits	7.5%	8.7%	1.2%
Residential Mortgages	8.1%	10.1%	2.0%
Personal Loans	6.1%	4.4%	-1.7%
Statutory Liquidity			
	1998	2007	% Change
Dollar Amount Required (\$mm)	\$4,341	\$8,041	
Dollar Amount Available to Meet Requirement(\$mm)	\$6,412	\$11,129	
Actual to Required Ratio	1.5	1.4	-0.1

*2008 results are as of third quarter.

** 2008 results are as of second quarter.

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