Credit Unions and Caisses Populaires

Background, Market Characteristics, and Future Development

J. Terence Zinger

Occasional Paper Series

Centre for the Study of Co-operatives
University of Saskatchewan

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CREDIT UNIONS AND CAISSES POPULAIRES

BACKGROUND, MARKET CHARACTERISTICS AND FUTURE DEVELOPMENT*

J. Terence Zinger

I. INTRODUCTION

Since its inception at the turn of the century, the Canadian credit union movement has experienced steady growth, particularly during the 1950s and 1960s when credit union/caisse populaire growth rates outpaced those of Canadian chartered banks and trust companies.

Credit unions and caisses populaires can be differentiated from other financial institutions by their non-profit orientation. They are deposit taking intermediaries governed by the co-operative principles of the European people's banks and savings banks of the nineteenth century —the primary focus is on the mobilization of the membership's pooled savings for the enhancement of the economic and social well-being of the group. These organizations are characterized by democratic control, open membership (generally), and the return of operating surpluses to members.

The founder of the first co-operative in Canada was Alphonse Desjardins, who established the Levis (Quebec) caisse populaire in 1901. Desjardins was responding to what he saw as the exploitation of lower and middle class working people by the main financial institutions of the time.[1]

He wanted lending decisions to be based to a large extent on one's character and to be in the hands of one's peers. In the words of one historian, the intent was that "... once the savings of the parish were safely pooled in the vaults of the caisse, credit was to be made available to as many members as possible by giving preference to small loans over large ones, and to loans for productive purposes over the demands for the acquisition of luxuries."[2]

The raison d'être of the Canadian credit union movement was later articulated as follows:

> The whole idea of the Credit Union Movement is to get people to work together locally, to handle their own finances, to work out economic problems which beset them as a particular group and to determine their own financial matters as much as possible within the structure that has been created.[3]

Through their elected Board of Directors, members participate in the decision-making process, voting on everything from lending policy and the breadth of the product line, to service fees. Members generally have some common bond of association. Caisses populaires (heavily concentrated within the province of Quebec), which were really the only organized financial co-operatives for the first quarter of this century, were initially linked to the Roman Catholic Church; hence all caisse members also attended the same church.

* For example, occupational credit unions which use their company's premises, or parish credit unions which operate from the church hall. Such credit unions represent a very small segment of the current industry.

Credit unions, on the other hand, while sometimes affiliated with a specific parish, typically originated as industrial or community based organizations. Indeed, the notion of community credit unions evolved out of a co-operative education program which was launched at St. Francis Xavier University in Antigonish, Nova Scotia in 1928—'The Antigonish Movement.' While caisses populaires promoted the virtues of thrift, credit unions placed a greater emphasis on providing a convenient and inexpensive source of credit for personal borrowing needs. As a result, the percentage of members who were also borrowers would tend to be much lower at a typical caisse populaire. Historically, caisses populaires encouraged members to accumulate their savings via deposit accounts, whereas credit unions tended to favour the purchase of credit union 'shares' (these will be discussed in the next section).

Table 1 provides an historical breakdown of membership. It is interesting to note that the credit union movement has achieved a relatively low level of penetration in the province of Ontario, whereas in Quebec, the local caisse populaire has become interwoven into the fabric of Quebec society; indeed there are more caisse populaire offices than bank branches in the province. While credit unions and caisses populaires have always been relatively successful in attracting deposits, controlling 15 percent of the deposit market nationwide as of 1991, by comparison, the share of the market held by the caisses populaires in Quebec, was close to 40 percent.

Table 1 Comparative Membership Data, Credit Unions & Caisses Populaires (Bracketed Figures Denote Percentage of Province's Population)

	1970	1980	1991
Newfoundland	5,195 (1%)	13,331 (2.4%)	43,858 (7.5%)
New Brunswick	103,709 (17%)	213,512 (30.7%)	252,000 (35%)
Nova Scotia	101,220 (13.4%)	163,502 (19.3%)	164,000 (18%)
P.E.I.	11,322 (10.4%)	25,551 (21%)	41,500 (32%)
Quebec	2,947,406 (51%)	4,980,877 (78%)	4,900,000 (72.5%)
Ontario	1,025,325 (14.7%)	1,869,128 (21.8%)	1,879,000 (19%)
Manitoba	187,225 (19.4%)	334,600 (32.6%)	363,000 (33%)
Saskatchewan	319,656 (33.5%)	561,009 (58.5%)	585,000 (58.5%)
Alberta	158,413 (10.8%)	526,658 (24.6%)	417,000 (17%)
British Columbia	344,021 (18.4%)	964,123 (36%)	1,111,876 (35%)
Totals	5,203,402	9,652,291	9,757,234

Sources: Statistics Canada, Credit Unions, Catalogue No. 61-209;
Credit Union Central of Canada;
Conseil Canadien de la co-operation;
Statistics Canada, *Canada Yearbook,* Catalogue No. 11-402E

The credit union movement is also strongly entrenched in Saskatchewan, where some 58 percent of the province's one million residents are credit union members, and in British Columbia, Manitoba, P.E.I. and New Brunswick, where the ratio exceeds 30 percent. The co-operative movement has a strong presence in a variety of industries, a number of which are based in Western Canada. During the 1920s, Aaron Sapiro was the driving force behind the development of the prairie wheat pools. He argued that by banding together, farm operators could control enough volume to command better prices from buyers. These organizations have flourished and farmer-owned co-ops now handle approximately 70 percent of Canada's grain crop. (Seven of the country's 10 largest agri-food enterprises are co-operatives, e.g. United Grain Growers and Saskatchewan Wheat Pool, which processes over 50 percent of the province's grain production.). [4]

Through the period 1970 - 1991, assets grew steadily with membership, averaging 10 percent per annum in the four years leading up to 1991. The long term growth record is highlighted in Table 2. However, to put these numbers in perspective, the system's total assets were well below those of any of the largest chartered banks and represented but a small fraction of the total combined assets of the banks and trust companies (11.9% as of 1990).

Table 2 Total Assets (1951-1991)
($ million)

	1951	1970	1975	1980	1987	1990	1991
Credit Unions & Caisses Populaires	359	3,048	12,331	29,763	55,060	72,366	79,800
CharteredBanks	9,610	47,307	108,378	281,244	486,384	609,682	635,912

Sources: Statistics Canada, Credit Unions, Catalogue No.61—209;
Statistics Canada, National Balance Sheet Accounts, Catalogue No. 13-214;
Bank of Canada Review, Tables C-3, D-3

II. INDUSTRY STRUCTURE

A system of 'locals,' operating as autonomous units, forms the backbone of the Canadian credit union system.These locals consist of one or more branch offices and typically serve a small regional market area. The range of services available to the retail customer is generally comparable to that offered by the chartered banks; in addition, a number of the larger credit unions/caisses populaires have made inroads into the commercial lending field.

The mandatory purchase of a membership 'share' by each member represents a key distinguishing feature of these financial institutions. However, unlike the shareholders of incorporated companies, all members are equal owners. These shares carry a fixed value and in fact are quite similar in nature to non-chequing savings deposits, although the customer's return is in the form of dividends which vary with the performance of the local, and thus is not guaranteed. Minimum share purchases are often as low as $5.00, although this will vary, with some locals charging as much as $50.00 for a share. One feature which makes credit union shares quite similar in nature to deposits is the fact that in many provinces they are covered by deposit insurance. It should be noted that, quite apart from these share accounts, credit unions and caisses populaires offer a range of savings and chequing accounts.

A. Credit Unions

Local credit unions fall under provincial legislation, which governs reserve requirements, types of investments, permissable sources of funds, and individual loan limits. Most belong to one of eight (one in each province, except Quebec and Newfoundland) regional or provincial Centrals. The basic purpose of the Centrals is to provide member locals with services not readily available elsewhere. The Central will help organize a local's accounting system, provide cheque cashing support or even printing and stationery services. As a group, the locals can benefit from having access to the economic forecasts or market research data supplied by their Central. In effect, the Centrals function as umbrella organizations, supervising the financial welfare of their locals, establishing guidelines to ensure that the network runs smoothly, and providing links to other co-operative organizations.

The locals are the main shareholders and depositors in their respective Centrals and one of their most important functions is to provide for a proper level of liquidity at the provincial level. Other services include:

- access to deposit insurance;[5]
- development of marketing programs;
- electronic data processing and software development;
- educational services;
- public relations; and
- legal services.

The provincial centrals are all regulated provincially and six (excluding the Credit Union Centrals of New Brunswick and P.E.I.) are also subject to federal legislation through the Co-operative Credit Associations Act.

Each provincial Central is a member of the Credit Union Central of Canada (formerly known as the Canadian Co-operative Credit Society), which is the trade association and national financial intermediary for the credit union system. The Credit Union Central of Canada (C.U.C.C.) is federally regulated and is one of four national financial co-operatives; the others—the Co-operative Trust Company of Canada, CUMIS and the Co-operators Group—provide an array of insurance, trust, investment counselling, and other financial services.

The C.U.C.C. is required to hold at least eight percent of the system's total assets in the form of liquid assets, thus providing the system with a second tier of liquidity protection. Besides providing liquidity support, this so-called "super-central" extends credit to the respective centrals, undertakes electronic network planning, maintains access to the Canadian Payments System, provides market research services, and acts as a liaison with the federal government and affiliated organizations such as the Desjardins Group in Quebec and the World Council of Credit Unions. Its main shareholders are the provincial centrals, which hold 16 of the 18 directorships. The C.U.C.C.'s membership encompasses a broad range of producer, consumer and supplier-owned co-ops as well as a number of international co-operative organizations.

The Credit Union Central of Canada, along with such organizations as the Co-operative Housing Federation, is part of a network of national co-operative associations. All of these organizations fall under the umbrella of the Canadian Co-operative Association, whose membership also includes regional as well as provincial co-operatives, which, in turn, are owned by local co-ops engaging in such diverse fields as housing, dairy production, fisheries, retailing, and agricultural marketing. The C.C.A. is headquartered in Ottawa and coordinates the system's international development efforts in cooperation with the Canadian International Development Agency. As a member of the World Council of Credit Unions, the C.U.C.C. provides a link to approximately 40,000 credit unions in some 80 countries.

B. Caisses Populaires

As already noted, Quebec is a stronghold for the movement, with caisses populaires in that province representing approximately one-half of all the locals in Canada (See Exhibit 1) and typically generating over 50 percent of the credit union system's annual revenues. La Confederation des caisses populaires et d'economie Desjardins du Quebec, represents the 1,327 caisses populaires in Quebec and is regarded as one of the most progressive financial groups in the country.

The organization of the caisses populaire system differs somewhat from the three tiered organizational pyramid which is sometimes used to describe the structure of the country's anglophone credit unions. For instance, the Quebec system's liquidity fund (including money market operations), is managed by the Caisse Centrale Desjardins du Quebec, which also handles larger loans directly, holds membership in the Canadian Payments Association, and makes lines of credit available to the 11 regional federations in the province.[6]

Also, the Confederation has direct supervisory powers over its caisse populaire locals, which is not the case for the Credit Union Central of Canada and its credit union locals.

The Desjardins Group has always been at the leading edge of Electronic Funds Transfer (E.F.T.) technology and has also become a prominent player in the financial market. By 1990, it controlled 36% of the province's residential mortgage market, 31% of consumer loans, and 22% of industrial and commercial loans[7] (compared to a seven percent share of the market 15 years earlier). Total assets grew from the $2 billion level in 1972 and $8.8 billion in 1978 to over $40 billion in 1990, and with 34,000 employees, the Desjardins Group had surpassed B.C.E. Inc. as the province's largest employer.

La Confederation des caisses populaires et d'economie Desjardins du Québec has steadily been broadening its scope to encompass a wide range of activities, as evidenced by the following partial list of its holdings:

- business financing (Credit Industrielle Desjardins);
- life insurance (L'Assurance-vie Desjardins);
- stock brokerage (Investissements Disnat Inc);
- leasing (Desjardins Leasing);
- general insurance (Groupe Desjardins Assurances generale);
- trust services (Fiducie Desjardins);[8] and
- electronic funds transfer systems (Centre Desjardins de traitement de cartes Inc).

Through its investment division—La societe d'investissement Desjardins—the group has diversified its interests to include such sectors as:

- transportation (Provost Corp.);
- chemicals (Sico Inc.);
- steel (Canam Manac Ltd.); and
- pastries (Culinar Inc.).

In addition, by 1991 there were nearly 170 caisses populaires situated outside of Quebec, representing over 450,000 members; each of these locals belong to one of the following federations:

- La Federation des caisses populaires Acadiennes, Ltee;
- La Federation des caisses populaires du Manitoba Inc.;
- L'Alliance des caisses populaires de l'Ontario, Ltee; and
- La Federation des caisses populaires de l'Ontario Inc.

The latter two organizations serve Ontario's 60 caisses populaires, which have over 200,000 members in total.

III. Innovation and Competition

During the 1970s as the credit union movement was flourishing, it became clear that this ongoing success was attributable to more than just the unique concept of a financial institution being run "for the members, by the members." Due to such traditional, distinctive advantages as subsidized or semi-subsidized premises,* a complement of volunteer staff, and no income tax until 1972, credit unions/caisses populaires had been able to offer very attractive lending rates. Moreover, many customers seemed to be drawn away from conventional institutions by the informal atmosphere, the convenient "after-bank" hours of business, the innovations in financial services, and the sense of involvement and loyalty that the organization engendered—given the customer's identification with a geographic, occupational, ethnic or religious community.

The market share comparisons outlined in Exhibit 2 provide an indication of the progress made by these intermediaries during the 1970s.

The credit unions/caisses populaires earned a reputation as innovators, having pioneered such financial products as daily interest savings accounts, variable rate mortgages, debit cards, and weekly payment mortgages. Indeed Canada's largest credit union, Vancouver City Savings Credit Union, was the first Canadian financial institution to offer customers access to their accounts when out of the country. In the early 1980s, through an agreement with California based City National Bank, VanCity was able to link its shared network of automatic teller machines to 5,000 units throughout the U.S. Furthermore, in 1985, the Civil Service Co-op had embarked on a plan to implement a special identification number that would facilitate such home banking services as telephone accessed balance inquiry and account transfers. On a different front, in 1990 the Cataract Savings & Credit Union in Niagara Falls, Ont. developed the country's first reverse mortgage package.[9]

However, the growth and development of the credit unions and caisses populaires was not without its problems. By the early 1980s, they were drawing a strong response from competing financial intermediaries, particularly in the consumer lending and residential mortgage areas.

With the impetus provided by the *Bank Act* revisions of 1967 (perhaps the most noteworthy being the removal of ceilings on loan rates), the chartered banks took aim at the consumer credit and residential mortgage markets. On the strength of their extensive branch networks, aggressive marketing programs, and the ability to offer most financial services under one roof, the banks were very successful in building their collective market share in these two areas (See Exhibits 3 and 4). The trust companies, seeing their dominance in residential mortgage lending threatened, responded with a program of new branch openings, extended hours of business, liberal advertising expenditures and a broadening of their product lines.

IV. The Changing Marketplace

A. Economic Pressures

The 1960s and early 1970s brought a period of burgeoning demand for consumer durables, most notably automobiles and household appliances; moreover, the coming of age of the baby boom generation spurred new construction activity and hence the need for residential mortgage funding. These developments contributed directly to the aforementioned growth trends experienced by the credit unions/caisses populaires during this era. However, the strength of the credit union movement during the 1970s and early 1980s was severely tested by a number of external factors, including deregulation and globalization of the financial marketplace, periods of runaway inflation, volatile interest rate behaviour, recessionary pressures (1981-82, 1990-92), and unprecedented innovation in financial services. The problems of rising operating costs encountered by the credit unions and caisses populaires and inadequate collateral to cover outstanding loan balances, were exacerbated by the traditional practice of charging low service fees. Credit unions and caisses populaires have come to recognize the financial costs associated with providing financial services to their members at below market rates—during the 1980s there was a trend towards fewer interest rate rebates and member bonuses; as a result of user fees being levied on credit cards, foreign currency deposits, personal lines of credit and electronic banking services, fee income doubled from 0.2 percent of assets in 1981 to 0.4 percent in 1987.[10]

Another serious problem that has continued to plague financial co-operatives stems from their difficulty in maintaining a stable capital base, due in large part to the absence of outside investors. In determining their taxable income, credit unions and caisses populaires are permitted to deduct bonus interest payments, interest rebates on outstanding loans, and dividend payments on member shares. The latter are more properly called patronage allocations (section 135 of the *Income Tax Act*) and are in effect a form of volume discount; hence while patronage allocations can offer significant tax savings to the local, they are not unique to co-operatives. In any case, the traditional policy of paying out a high proportion of earnings has worked against efforts to strengthen capital bases, which of course, are essential as a foundation for future asset growth.

The strategy of reinvesting more earnings implies a higher tax liability for another reason: while all small businesses are taxed at the low, small business tax rate on their first $200,000 of taxable income in a given year, credit unions and caisses populaires qualify for this favourable tax treatment regardless of the earnings level, as long as the earned surplus of the local does not exceed five percent of "amounts owing to members," i.e., deposits and shares. Consequently, there is quite a strong incentive to distribute earnings to the members.

Despite these tax consequences it seems that a policy of retaining a greater portion of earnings within the co-operative merits serious consideration as one means of addressing the capital shortage problem.

Given the challenges of this operating environment, it became necessary for many of the locals to merge in order to survive. Accordingly, the number of credit unions/caisses populaires in operation declined from a peak of 5,000 in 1965 to 4,117 in 1975, with a further decrease to 2,664 by 1991. As shown in Exhibit 1, all regions of the country felt the effects of this industry shakeout. The locals were particularly vulnerable due to the fact that a large proportion of their assets have typically been in the form of intermediate and long term instruments, such as mortgages and consumer loans (See Exhibit 5). For many of the locals, the lower profits generated during much of the 1980s translated into a weakening of already thin capital bases and continued merger activity. Some had no choice but to close their doors.

In Ontario, for instance, 100 of the 950 locals in operation in 1982 had incurred losses large enough to exhaust their accumulated retained earnings. Similarly, in 1984, the province of Alberta was forced to come to the rescue of the credit union system in the wake of a spate of mortgage defaults and commercial loan losses. Some locals had been providing mortgage financing for as much as 90 percent of property values and suffered widespread defaults as the energy sector sputtered, real estate values plummeted, and bankruptcies soared. In fact, the average annual growth rates in assets in the Prairies and British Columbia fell from 22 percent and 26 percent respectively, for the 1971-81 period, to seven percent and six percent for 1981-87.

Certainly, the financial strength of the credit union system at any given time differs from region to region and lending policies can vary widely. For example, as of 1990, the ratio of mortgages to total assets ranged from 14% in Nova Scotia to 75% in British Columbia. Overall profitability levels are also subject to wide variability, as illustrated by the Earnings totals and Return on Equity ratios in Exhibit 6.

B. The Development of Electronic Funds Transfer Systems

By the late 1970s, credit unions, as well as trust companies, were relying to varying degrees on new automated services to gain a competitive edge over the banks. By definition, the credit unions have a distinct advantage here: unlike their competitors, they are not obligated to design their financial products to meet the needs of a diverse audience that is national in scope. Market tests can be conducted on a small scale.

The Desjardins Group, in co-operation with IBM Canada Ltd., developed an inter-caisse computer based accounting and information system in 1970—before the appearance of the Bank of Montreal's much heralded multi-branch banking system. Subsequently, in late 1984, the Desjardins Group, along with four major Canadian banks, founded the Interac shared automatic teller machine (ATM) network. Within 12 months, the Bank of Montreal, Canada Trust, the Canadian Co-operative Credit Society and the National Bank of Canada had also become participants in this system—operational in June of 1986—allowing customers to make withdrawals at any one of 2,000 member institution terminals. By 1988, the network had expanded to encompass 17 institutions and ATMs were being used for upwards of 60 percent of deposits, withdrawals and transfers. ATMs continued to grow in popularity, and by 1990 were commonplace in convenience stores and gas stations.

The development of shared ATM networks and the proliferation in the number of machines helped stimulate interest in the next step in the technological sequence: electronic funds transfer at the point of sale (EFT/POS). Perhaps the most controversial application of this technology is the *debit card,* through which purchases at various retail outlets can be immediately deducted from the consumer's bank account, thus reducing paper processing costs and providing the merchant with immediate cash. This concept was first implemented in 1983 by the Credit Union Centrals of Alberta and Saskatchewan, through the introduction of Mastercard II. This card not only serves as a debit card in participating restaurants, gas stations and supermarkets, but also enables the holder to access the credit union's ATMs.

By the late 1980s, POS terminals were quite common in Quebec, primarily as a result of the leadership of the Desjardins Group in forging electronic links with local merchants through its Centre Desjardins de Traitement de Cartes unit, and conducting test markets at the provincial level. Furthermore, both the C.U.C.C. and the Desjardins Group were primary players in Interac's multi-card, multi-institution pilot program in the Ottawa-Hull area in the fall of 1990. This was the most ambitious test ever, involving 1,250 retailers and some 1,700 terminals. This test proved to be quite successful and prompted the sponsors to expand nationally. These efforts spawned the "Member Card Program" in 1992, which provided credit union members across the country with ATM access cards designed according to uniform standards to facilitate nationwide service and give all members access to the growing Direct Payment services that were expected to become available to debit card holders. While some industry commentators were projecting that debit cards would emerge, by the end of the decade, as the most popular of all payment methods, widespread public acceptance will not be achieved without a well-developed infrastructure of participating merchants.

C. Opportunities in Commercial Lending and the Capital Shortage Problem

In light of the more intensified competition for consumer lending and residential mortgage business through the past decade, a number of credit unions saw business financing as an attractive alternative, particularly as more and more members were starting up or taking over small enterprises. As evidence of this interest, commercial lending divisions were established by the Centrals in a number of provinces, including Ontario and Saskatchewan. Moreover, in 1980 the Caisse Centrale Desjardins du Quebec began to raise money in the wholesale money market to fund large—i.e. circa $10 million—term loans.

By the end of the 1980s, the movement's share of the commercial loan market outside of Quebec stood at only 2 percent. Many within the industry considered this to be the next major growth area, with small businesses and nonfinancial co-operatives as the prime targets. Certainly there seemed to be a an opportunity to carve out a larger niche within the small business sector (See Table 3), and many credit unions and caisses populaires planned to devote greater resources to servicing the needs of small enterprises. However, since credit union legislation differs from province to province, regulations dictate the extent to which a particular operation is able to pursue any new sources of revenue. For example, the total commercial loans held by any credit union in Ontario cannot exceed seven percent of capital and surplus.

Table 3 1992 Report Card on Banking
(Canadian Federation of Independent Business)

	Interest Rates	Required Collateral	Availability of Financing	Service Charges
Credit Unions/ Caisses Populaires	A-	D+	B+	D+
Other Institutions	B	D-	B	C-
Trust Companies	B	D	C	D+
National Bank of Canada	B+	D+	B	F
Bank of Montreal	B	F	C+	F

Legend: Percentage of Respondents who rate their services as "good":

80-100%	A
70-79%	B
55-69%	C
40-54%	D
0 -39%	F

Source: Canadian Federation of Independent Business, *F.Y.I., Report Card on Banking,* May, 1992.

Moreover, it is evident from Exhibit 5 that a stronger capital base is needed. According to Claude Beland, president of La Confederation des caisses populaires et d'economie Desjardins du Quebec, "If credit unions are to expand their lending activities, and participate in the large commercial loans ... they are going to have to find new ways of increasing their capital base."[11] The difficulty in attracting permanent sources of capital applies to all co-operative organizations and not surprisingly, this was one of the themes of the Canadian Co-operative Association's 1991 Triennial Congress: "... operational stability requires co-operatives to have reserves that can ensure their existence through periods of economic stress."[12] Among the specific recommendations were the need to increase compulsory member equity and create non-voting share and debt instruments carrying competitive rates of return. Similarly, the practice of placing restrictions on member shares has attracted more attention as another way of stabilizing the capital base.

It was also suggested at the Congress that credit unions and caisses populaires adopt risk-weighted capital adequacy rules, similar to those followed by the chartered banks. Under this scheme, deposits with Centrals, for instance, might be assigned a particular weight, different from that assigned to restricted member shares or conventional common shares, if any. In this way, the local could meet its minimum capital requirements in a variety of ways.

D. Deregulation and the Financial Supermarket Concept

British Columbia's credit union legislation is more sophisticated than that of most other provinces. For instance, since the 1970s credit unions in B.C. have been allowed to sell insurance by offering the services of insurance brokers in their branches. It is interesting to note, however, that in 1989, Vancouver City Savings Credit Union (VanCity) decided to sell Van-City Insurance Services Ltd. to its employees. This transaction was explained by Peter Cook, VanCity's Chief Financial Officer as follows: "While we felt that it was a very valuable service to our members, we also discovered it was a very specialized service requiring the specific expertise of insurance specialists."[13] As the second largest credit union in the world,[14] VanCity is clearly at the forefront of change within the industry. It operates a network of some 20 branches serving over 175,000 members. VanCity has been an aggressive innovator, launching new products with regularity, ranging from a treasury bill deposit account (for balances above $10,000) to the Ethical Growth Fund. The latter, an equity-based mutual fund, was set up in 1986 for B.C. credit union members as one of Canada's first ethical investment funds. Since 1987, this fund has been available through brokers across Canada and has been one of the top mutual fund performers, generating a 7.3 percent average annual compound return—compared to an average of 1.7 percent for Canadian equity mutual funds—for the five year period ending July 31, 1992. By late 1992, the entire family of Ethical Funds (Growth, Money Market, Income, Balanced and North American Equity Funds) were available at credit unions across Canada, except Quebec.

In 1984, a separate department for independent business loans was established at VanCity, which by the end of the decade had a portfolio of some 4,000 commercial accounts, some with outstanding loans for as much as $5 million.

By offering trust services, insurance coverage, personal financial planning and tax services, VanCity has made great strides in the direction of providing its members with "one-stop financial shopping." In fact, in 1985 VanCity opened a new multi-purpose branch in North Vancouver, which also housed an insurance agency, a law office, a travel agency, and an accounting office. This continual broadening of scope exemplifies the full-service concept that some feel represents the most appropriate strategic response to the deregulated financial system of the 1990s.

The regulatory process of dismantling the traditional institutional barriers within the financial services industry began with the release of the federal government's "Green Paper"—*The Regulation of Financial Institutions*—in 1985. The basic theme was to broaden competition for financial services. A series of legislative proposals ensued which culminated with parliament's 1992 approval of revisions to all Acts which govern the various participants in the financial services industry: the *Trust and Loan Companies Act,* the *Bank Act, The Co-operative Credit Associations Act* and the *Insurance Companies Act.* As a result of these revisions, banks, for example, were allowed to control their own trust company or insurance company, while the limitations on the commercial and consumer lending activities of trust companies were removed.

With more open competition, it will be more important than ever for credit unions/caisses populaires to counteract the general perception that they offer only a limited range of services, tend to be less efficient than other financial institutions and deal with select groups of people.[15] Misconceptions of this kind are applied to all types of co-operative organizations and there seems to be "a far lower level of knowledge by Canadians about co-operative values, operating principles and economic contributions to Canada than current membership statistics would imply."[16]

The key to replicating the VanCity or Desjardins experience lies in the ability of the locals to draw on their combined financial as well as human resources, and provide common access to their combined customer base. However, it seems unrealistic to expect the system as a whole to move in this direction; not only would there be a major expertise gap to be bridged, in terms of staff development, but in many cases, the democratic, decision-making process of the co-operative would prove to be ill-suited to the structure necessary to compete as a multi-dimensional, sophisticated financial institution.

V. THE ROAD AHEAD

The question of strategic direction has inspired a great deal of debate among co-op members, staff and outside analysts. There are those who have been less than comfortable with the notion of diversification as practiced by VanCity: Will we jeopardize our uniqueness? What is the risk that we will lose our distinctive competence with respect to those select services that we have always performed well? Will we end up engaging in head to head competition in sectors of the market where others have a competitive advantage? Is the ability to offer a wide array of financial services under one roof really in the best interests of our particular constituency?[17] Much of the debate revolves around the issue of whether autonomy is to be seen as a strength or alternatively as an impediment to the development of a coordinated strategy and the achievement of market synergy.

Autonomy is a key consideration for the small locals, many of which operate on only a part-time basis, and/or offer only basic types of deposit and loan products. This "back to basics" approach stems in part from a desire to stay close to the customer: "...redeveloping our ability to serve workers in the plants and businesses, reaching out to develop family member potential, pooling our resources along affinity lines and in regional groups are all areas where we can build on our past strengths."[18] Certainly, one could interpret the shift in societal values towards the importance of community and the benefits of collective action as an opportunity for the co-operative movement.

However, the concept of local autonomy has been responsible for a lack of cohesiveness, particularly outside of Quebec. In terms of new product development, there has been fragmentation and too much duplication of effort. Even within provinces there are a broad range of different data processing systems in use. In 1991, Ed Grad, C.E.O. of the Credit Union Central of Ontario expressed the opinion that an "integrated national plan" will be essential to the ultimate survival of the credit union movement. The national debit card program cited earlier is a good example of the locals joining together and developing alliances to open up opportunities for member service. "We must be able to provide a wide range of products and services in standardized form. We need to consolidate and rationalize."[19]

By virtue of being owned by their members, credit unions/caisses populaires have historically been quite adept at adjusting to changing customer needs, yet the marketplace has been changing so dramatically that there is an almost compelling need to be proactive. At the 1991 Triennial Congress, it was emphasized that in order to retain members, co-operatives of all types "will have to have a clear picture of how well they are actually satisfying member needs." Among the recommendations was the development of "generic service audit materials...to determine member satisfaction."[20]

There is little doubt that the competitive environment will continue to pose some serious threats, insofar as chartered banks can be expected to continue their dominance of the financial services market. Also, smaller trust companies, as part of large conglomerates, or insurance companies will attempt to position themselves in "credit union-dominated communities."[21] In response, many of the larger credit unions and caisses populaires have become more like banks in terms of their policies, procedures, and product offerings. In light of the passage of the new financial services industry legislation outlined in the previous section, many industry insiders considered it imperative that the movement continue to proceed in this direction. "Combined with the *Free Trade Agreement* between Canada and the United States, escalating technological change, and a lingering economic recession, re-regulation has created a competitive environment where the emphasis is on survival."[22] Accordingly, credit unions/caisses populaires seemed to be obliged to continue to adapt and develop their retail delivery network, their marketing strategy, their technology, and their approach to capital adequacy and formation.

In general, these were the basic policy choices facing the credit unions and caisses populaires as they mapped out their strategies for the 1990s and beyond. The issues are complex and it is important that the decision-makers at all levels have a clear understanding of the implications of each particular course of action. While the following assessment of the future prospects of co-operative organizations may appear oversimplified and is not directed at financial co-operatives per se, in some ways it captures much of the essence of the foregoing discussion:

> Co-operatives will continue to succeed as long as they can function competitively in their chosen fields of business. The co-operative record shows that even within the context of growing corporate control and the perceived increasing government indifference, businesses owned and controlled by ordinary people can thrive and flourish. Co-operatives in Canada have enjoyed a very low failure rate in comparison with capital-based corporations mainly due to their people-oriented principles and values.[23]

EXHIBIT 1

Number of Credit Union/Caisse Populaire Locals

	1975	1980	1985	1988	1991
Atlantic Provinces	326	281	258 (88)	247 (87)	235 (87)
Quebec	(1,611)	(1,552)	(1,392)	(1,343)	(1,327)
Ontario	1,340	1,041	843 (53)	734 (60)	598 (60)
Prairie Provinces	653	565	468 (25)	426 (21)	396 (19)
British Columbia	187	156	134	118	108
Total	4,117	3,595	3,095	2,868	2,664

Note: Bracketed data denote caisses populaires and are included in the provincial totals; (not available for 1975 and 1980).

Sources: Statistics Canada, Credit Unions, Catalogue No.61-209;
Credit Union Central of Canada, *The Canadian Credit Union System*, 1991.

EXHIBIT 2

Domestic Financial Assets: Market Share Comparisons

	1966	1976	1981	1986	1990
Chartered Banks	48%	54.6	56.3	47.4	45
Trust Companies#	8%	9.7	10.3	13.1	14.3
Credit Unions/ Caisses Populaires	6%	8.1	7.9	7.8	8.2
Life Insurance Companies	24%	14.1	11.2	12.6	11.8
Trusteed Pension Plans	14%	13.5	14.3	19.0	20.7

Includes segregated funds

Sources: Statistics Canada, *Financial Flow Accounts,* Catalogue No. 13-014; *National Balance Sheet Accounts,* Catalogue No. 13-214.

EXHIBIT 3

Consumer Credit: Market Share Comparisons

	1970	1980	1990
Chartered Banks	40.0%	67.5	66.4
Trust Companies	--	3.4	8.2
Credit Unions & Caisses Populaires	13.0%	14.5	11.7
Finance Companies	24.4%	6.2	7.5
Life Insurance Companies	6.5%	4.4	3.0
(millions)	$11,700	$43,970	$98,241

Note: Columns do not total 100% as those intermediaries with low market shares have been omitted.

Sources: *Bank of Canada Review*, Table E-3; *Bank of Canada Statistical Supplement*

EXHIBIT 4

Residential Mortgages: Market Share Comparisons
(Private Sector Financial Institutions)

	1974	1979	1984	1990
Chartered Banks	24%	29	34	44
Trust & Mortgage Loan Companies	36%	32	31	30.5
Credit Unions & Caisses Populaires	12%	15	16	13.5
Finance Companies	2%	1	1	nom
Life Insurance Companies	15%	10	10	6.5
Pension Funds	8%	8	6	3.5
Others	3%	4	3	1.5

Source: *Bank of Canada Review*, Table E-4

EXHIBIT 5

Common Balance Sheet Proportions
Credit Unions/Caisses Populaires

		1975	1980	1987	1990
Assets					
	Cash and Deposits	21%	17%	19%	18%
	Investments	5	2	•	4
	Loans	29	25	28	26
	Mortgages	40	51	50	50
	Other Assets	5	5	3	2
		100%	100%	100%	100%
Liabilities and Equities					
	Deposits	74%	81.9%	85%	86.8%
	Other Liabilities	4	4.8	9.0	6.8
	Shares*	18	10.7	4	2.7
		96%	97.4%	98%	96.3%
	Reserves and Surplus	4	2.6	2	3.7
		100%	100.0%	100%	100.0%

Sources: *Bank of Canada Review;*
Statistics Canada, *Financial Institutions (Quarterly*, Catalogue No. 61-008.

* Since member shares are redeemable upon the withdrawal of the member from the co-operative, an argument can be made for classifying them as contingent liabilities rather than as part of the equity base. Comparative dollar amounts for both member shares and reserves and surplus are provided below:

	1980	1985 (millions)	1990	1991
Member Shares	$3,295	1,931	1,924#	2,394
Reserves and Surplus	783	959	2,694	2,844

Source: *Bank of Canada Review*, Table D-3

#This figure includes $710 million of 'non-withdrawable' shares (comparative data for other years is not available). If this amount were added on to reserves and surplus, the capital base percentage for 1990 would increase from 3.7% to 4.7%.

EXHIBIT 6

Comparative Performance of Locals by Province or Region — 1990
(Millions)

	British Columbia	Prairie Provinces	Ontario	Quebec	Atlantic Provinces	**Total $ and % of Total $**
Revenues	$1,243	1,502	1,435	4,580	252	**$9,012**
Earnings	73	71	203	253	15.7	**$ 616**
Return on Equity*	17%	13.5%	46%	11.9%	17.4%	**17.1%**
Surplus-Reserves/ Total Assets	2.5%	1.4%	3.5%	4.9%	4%	**3.7%**

*Excludes unrestricted member shares

Source: *Co-operation in Canada. 1990*, Co-operatives Secretariat, pp. 34-36.

Notes

1 Desjardins' accomplishments were ultimately rewarded by the Catholic Church, with the Pope bestowing upon him the title of Commander of the Order of St. Gregory.

2 Ronald Rudin, *In Whose Interest? (Quebec's Caisses populaires: 1900-1945*), (Montreal; Kingston: McGill-Queen's University Press, 1990), p. 12.

3 Royal Commission on Banking and Finance, *Hearings*, p. 3066.

4 *Saskatchewan Co-operatives: A Record of Community Development,* Centre for the Study of Co-operatives, University of Saskatchewan, February, 1992, p. 19.

5 Each credit union contributes to a stabilization fund, which is independent of the credit union movement (e.g. Ontario Share and Deposit Insurance Corporation, Credit Union Reserve Board [B.C.], Newfoundland and Labrador Credit Union Stabilization Fund). Coverage varies from province to province, but in all cases is greater than that provided by the C.D.I.C.. For instance, in Alberta, Manitoba, and Saskatchewan, deposits are protected with no limits, while in New Brunswick and P.E.I., coverage also extends to credit union shares. Under federal legislation, the C.D.I.C. is authorized to provide lender of last resort facilities to these deposit insurers.

6 For an expanded discussion, see: Sean O'Connor, "The Structure of the Canadian Co-operative Credit System in Canada," *Bank of Canada Review,* December, 1988, pp. 3-10.

7 If one expands the definition of the market to include commercial mortgages, then this market share rises to 27.8% in 1990, compared to 60% for chartered banks and 10.7% for trust companies.

8 By 1990, this trust company encompassed a network of 14 offices (including one in Ottawa), employed 563 people and had $16.6 billion in assets under administration. To avoid direct competition with caisse populaire offices, Fiducie Desjardins has been prohibited from offering traditional deposit and chequing accounts.

9 Reverse Mortgages were developed primarily as a means of allowing retirees to gain ready access to the equity in their homes. Typically, the proceeds of the mortgage are paid out to the homeowner partly as a lump sum, with the remainder in the form of regular annuity payments. No repayment of principal or interest is due until either the death of the mortgagor or the sale of the residence.

10 Sean O'Connor and Ed Fine, "New Directions for the Co-operative Credit System in Canada,*" Bank of Canada Review,* March, 1989, pp. 3-16.

11 Jade Hemeon, "A Going Concern," *Challenges*, 4, no. 1 Winter, 1991, p.18. (For example, financial co-operatives in Quebec and Alberta have won the right to issue non-voting shares as well as preferred stock.)

12 *Taking Responsibility for the Future: Co-operatives in the Year 2004*, Report to the Triennial Congress, Calgary, Alta, June, 1991, p. 8.

13 David Schulze, "Fighting for Your Life," *Financial Post Moneywise,* November 1989, p. 53.

14 The largest is the U.S. Navy Credit Union, which has offices throughout the country as well as several foreign locations where its personnel are stationed.

[15] *Credit Union Environmental Scan* notes a lingering perception that membership is restricted and credit unions and caisses populaires "...are inconvenient and lack many key products." (The Credit Union Central of Canada, 1992, p.3).

[16] The Bundon Group Limited, *The Role of Co-operatives in the Economy: Opportunities and Constraints for the Future,* Report to the Triennial Congress, Calgary, Alta., June, 1991, p.18.

Among the organizations involved in research and education activities on behalf of the co-operative sector are the *Centre for the Study of Co-operatives* (Univ. of Saskatchewan), the *Institut de recherche et d'enseignement* (l'Universite de Sherbrooke), and the *Canadian Credit Union Institute,* an independent body based in Ottawa which operates the credit union system's accreditation program.

[17] It should be noted that some provinces have opened up credit union membership by waiving the stipulation that members have some common bond of association. As a result, these credit unions can be thought of as "consumer banks which just happen to be owned by their customers." See: Ronald A. Shearer, J.F. Chant, and D.E. Bond, *The Economics of the Canadian Financial System: Theory. Policy & Institutions,* 2nd ed. (Toronto: Prentice-Hall Canada, Inc., 1984), p.235.

[18] John Ellis, *Marketing—An Important Part of Every Credit Union's Operations*, Presentation to the Annual Meeting of the Credit Union Central of Ontario, March 21, 1985, p.9.

[19] Hemeon, "A Going Concern," pp. 18-19.

[20] *Taking Responsibility for the Future: Co-operatives in the Year 2004*, Report to the Triennial Congress, Calgary, Alta, June, 1991, p. 11.

[21] Credit Union Central of Canada, *Credit Union Environmental Scan*, 1992, p.2.

[22] Credit Union Central of Canada, *Credit Union Environmental Scan*, 1992, p.1.

[23] *Taking Responsibility for the Future: Co-operatives in the Year 2004,* Report to the Triennial Congress, Calgary, Alta, June, 1991, p. 15.