Credit Union Movement in Canada as a Banking Solution for the Un-Banked and Underbanked: Why more Credit Union and Microfinance solutions are needed to fight poverty in Manitoba

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Issue: Credit unions in Canada encourage lending and savings to poor people while offering a middle ground between chartered banks and federal government-run banks.

The lack of financial services to low income citizens, with chartered banks moving out of these areas, have only helped to lessen chances to build financial assets and wealth capacity. Other attempts by governments to bring in state-operated banks have been economically inefficient, as cheap credit has often been given to the politically well-connected or credit rationed. The credit union (CU) system in Canada, which allows members to have a say in how the financial institution is run, is the best way to encourage lending and savings to low-income people. The CU system also provides a strong alternative to both Canadian chartered banks and state-owned banks as it can absorb shocks while encouraging members to pool resources together.

THE IMPACT OF BANKING SERVICES ON THE CANADIAN POOR

In recent years, chartered banks in Canada have affected in how poor people attain wealth. A report by Wayne Simpson and Jerry Buckland (2009) discusses at length how Canadian chartered banks neglecting inner-city areas, as well as new "fringe services" like cheque cashing and pawn shops in these areas, have made it very difficult to build self-sustaining finances. Simpson and Buckland call this "financial exclusion," in which people who do not have sufficient financial services cannot build up savings for retirement (Registered Retirement Savings Plan or RRSPs), or a rainy day fund, and cannot receive lending products to create wealth through entrepreneurship. Rather, they are forced to go to fringe services, or their own family members. Fringe banks that offer such services as cheque cashing or tax discounting often charge drastically higher-than-normal interest rates. Critics have characterized as inequitable. The authors specify two indications of financial exclusion: they are underbanked or unbanked. Definitions of "underbanked" are varied, and usually mean that the individual uses banking services less frequently than normal. Those who are underbanked will sometimes, according to the authors, have poor credit or savings services, hence relying on fringe services if no alternative is available. "Unbanked" simply means that there are no mainstream bank services available, according to the report. This means that the person will use often those fringe services available in the area.

Simpson and Buckland give solid theories as to why low-income people are financially excluded. One example is neo-classical economics, in which the mainstream and fringe banks are operating and competing against one another. For example, payday loans may have a competitive advantage over mainstream banks as they provide very short and instantaneous loans to low-income people by charging high rates. Hence, the riskier the client, the higher their interest rate it will be.

Both Simpson and Buckland point to the life cycle theory of savings, in which there is little savings (borrowing) in early life, higher in mid-life, and divesting late in life, thus creating the smoothing of consumption. They point out, however, that this is not always the case. As they mention, Stiglitz and Weiss's work in 1981 noted how imperfect information can create obstacles between the lender and the borrower; the ensuing credit constraints lead to financial exclusion for the borrower and create a reversed moral hazard. Their data in the report also reveals that as both wealth and income fell for Canadians between 1999 and 2005, based on Statistics Canada data, they found that financial exclusion increased. The authors conclude that policy-makers need to focus on the relationship of supply and demand in the context of financial exclusion. With regards to the supply side, the tightening of fringe financial service regulations, while also requesting mainstream services to served the underbanked, would be preferable. On the demand side, the authors suggest financial literacy and poverty reduction through various programs such as asset building.

Another report, *Fringe Banking in Winnipeg*, deals with the increase of fringe financial services in Winnipeg's poorest communities (Buckland, Martin, et al., 2005). The authors point to the dramatic increase of fringe banking services in the North End. While they point out that the idea of fringe financial services is not new, the types of products offered, including payday loans and rent to loan agreements in which the costs of interest are astonishingly higher than that of a mainstream bank or a credit union, while the service being provided by the fringe bank is often small. They also note that these types of services have increased elsewhere in Canada, the United States, and the United Kingdom. The authors note that the average income in Winnipeg's North End is $22,320, approximately 50% of the average income earner in all of Winnipeg, which is $44,937. Some reasons why people use these services include single parenthood, lack of mainstream financial services in the area, and lack of identification. They also found that fringe bank owners believed their clients were low-income (85% on Income Assistance). They concluded that in order for more people not to use fringe banks, better alternatives must be offered, which includes encouraging mainstream credit unions and banks to stay, raising awareness by community groups to citizens on the concerns of fringe financial services, and the government establishing a guaranteed income assistance program. All of these ideas from the report would satisfy the supply and demand concerns that were noted in the Buckland-Simpson report on low income people and banking.

While chartered banks have become less a part of the fabric of many low-income areas of urban centres as mentioned above, some policy-makers have argued for the idea of state-owned banks as a way to provide microfinance services. However, many cases worldwide have pointed to many concerns to state-run banking or financing as an alternative to privately owned chartered banks. *The Economics of Microfinance: Second edition* mentions that state-owned banks are heavily subsidized, which creates a lower interest rate (Armendariz, Morduch, 2010, 9-11). While the authors mention that the idea was to encourage productivity and wages, one example from the Philippines showed that heavily subsidized interest rates created a negative interest rate. This created larger demand, and pressure to lend to those well connected politically. Credit rationing occurred, while low interest rates offered in rural areas for savings, were depleted from inflation. The authors also mention that it was not the poorest of the poor that got these loans, but people who had higher incomes. Armendariz and Morduch suggested that these loans were not going the most productive ideas, but those by people who had the best political connections. This suggests that government-operated banks may not necessarily be the best way to go for offering financial services to poor people.

However, another method of financial services in Canada has been around since the mid-1800’s, providing financial services to middle- and low-income people, while creating a positive impact on Canadian society.

THE HISTORY AND STRUCTURE OF THE CREDIT UNION SYSTEM IN CANADA

The CU system is actually rooted in Europe. The movement was shaped by social upheaval in the mid-1800's, at which time industrialization grew, causing many people to relocate from the farm lands in search of jobs. This increased poverty, along with the lack of financial services which lead according the book *Hands Around the Globe: A History of the International Credit Union Movement* (MacPherson, 1999). Friedrich Wilhelm Raiffeisen and Hermann Schulze Delitzch created the idea of co-operative lending and savings institutions that would allow members to borrow and save among one another. Other parts of the continent began to learn how successful this was as an alternative to large money lenders who took advantage of poor artisans, labourers, and small shopkeepers.

However, the credit union movement did not get a foothold in North America until the late 1800’s, in Quebec. According to MacPherson, Alphonse Desjardins, a House of Commons translator who was well-versed in social activism within the Catholic community, had great concern with many Canadians having limited access to financial resources. It was then that he took inspiration from readings of such experienced co-operative people like Luigi Luzzatti and Henry W. Wolff. On December 6, 1900, he, his wife, and a few neighbours formed the Levis Caisse Populaire, raising a total of $26.40 at their first meeting. That meeting helped form the basis of the Canadian credit union movement, while helping microfinance take shape in Canada, to help give the disadvantaged a chance at accessing fair financial services.

Credit Unions eventually started to branch outside of Quebec, including into the Prairie Provinces. As the Great Depression went on, financing was extremely hard to secure as banks were not willing to lend. More people became attached to credit unions as a way of obtaining loans; members pooled their finances together in the interests of both savings and lending.

Credit unions work differently from both chartered banks and government-owned financial institutions. Unlike their counterparts, credit unions are owned by their members, not shareholders. Members pay a membership share that allows them not only to open up an account within the credit union, but to also have voting privileges on major policy issues concerning the union, as well as for the board of directors at Annual General Meetings. Compare this to chartered banks, which are owned by shareholders, and state-owned banks, which are owned either directly by the government or a Crown corporation and are responsible to the taxpayers.

Another thing that separates credit unions from chartered banks is that every member, despite how many shares they own, they have only one vote. In chartered banks, on the other hand, votes are cast by proxy; under this system, the number of shares you have determines how many votes you get, which decreases opportunities for banking for lower income people or social initiatives.

Credit union deposits are also 100% guaranteed by the Credit Union Deposit Guarantee Insurance Corporation of Manitoba, or CUDGE (CUDGEM, 2010). Credit unions have greater ability to absorb shocks because of this. At the same time, the credit union/caisse populaire system is governed provincially by the Credit Union and Caisse Populaire Act, compared to chartered banks, which are overseen by the Federal Government.

THE FINANCIAL AND SOCIAL IMPACT OF CREDIT UNIONS IN CANADA

Credit Union Central of Canada reports that all of the credit unions in Canada recorded assets totalling $124.4 billion in the first six months of 2010, an increase of 6.2% or $7.3 billion, compared to the end of last year (Credit Union Central of Canada, 2010). The report discusses how strongly Canadians support the idea of credit unions and caisse populaires, through the strength of its member base; statistics show that there are approximately 11 million members within the credit union/caisse populaire system, making up almost one-third of the Canadian population.

While the credit union system plays a major financial role in the lives of Canadians, the very concept of a financial institution owned by its members can impact the national economic and social fabric because of its structure. The democratic method by which a credit union sets policies and selects directors means that despite how many shares that a person may have in a credit union, everyone has an equal say in how the credit union is run. This democratic form of choosing policies and governance has had deep roots in why many credit unions often have an impact separate from their financial performance. In his working paper for the Canadian Co-Operative Association, Brent Matthews notes that credit union movements strong in democratic values include everyone of every economic stripe. The strength of these movements helps to lower poverty and increase economic opportunity within the community (Matthews, 2006, 40).

While some credit unions may only look for financial profit for their members, many would fall in line with Matthews's idea in looking to tap the assets of those underserved by other financial institutions. He specifically discusses credit unions that are geared to community economic development, such as Vancity in Vancouver and Assiniboine Credit Union in Winnipeg.

With over 414,000 members and assets reaching over $14 billion, according to the *Vancity 2009 Annual Report*, Vancity is Canada's largest credit union (Vancity, 2010, 22). This institution is set apart by its microfinance services, which are geared towards low-income people. Vancity offers a circle lending program in which members must participate in monthly meetings, train in financial literacy, and take monthly meetings with a co-ordinator (Van City, Circle Lending, 2010). Members of the Level 1 group start off with a $1,000 loan; those who complete the Self Employment Training program can start at $2,000. The maximum loan for a group is $5,000. Loan terms can range from three to 24 months, and the interest rate on the loans is prime plus 4%. Eligibility is flexible, yet geared to those who have poor credit ratings, new immigrants who do not have a credit history, and those who lack sufficient traditional collateral. Most of the Circle Lending's clients are female; according to a *Vancouver Sun* article, 9 out of 10 participants are female, and their repayment rate hovers around 95% (Bramham, Daphne, 2009). Since its inception in 1997, the program has lent over $1 million in loans to over 257 borrowers and over $11 million in self-reliance loans to 800 people (Dauncey, 2010)

While the program may be small, the Circle Lending program has many of the same characteristics that are hallmark of other microfinance programs. For starters, the program requires that people get into groups to apply for a microbusiness loan. This mitigates the general risk of lending. Should anyone not pay their portion of the loan, the entire group is cut off from any further lending until that person has paid up. The Circle Lending program also has progressive lending. Initial loans, pending on training and experience, can begin at anywhere from $1,000 to $2,000, depending on training, and can reach to $5,000.

In Winnipeg, Assiniboine Credit Union operates similarly to Vancity due to its commitment to community economic development. With assets totalling $2.62 billion (Assiniboine Credit Union, 2009, 11), it ranks as one of Manitoba's largest credit unions. Assiniboine also has a microlending program; however, unlike Vancity's Circle Lending program, this one works in collaboration with

SEED Winnipeg and other non-profit organizations that specialize in reducing poverty through lending and savings programs. Assiniboine's matched savings program works in conjunction with those organizations to encourage savings among the poorest of the poor. The program's participants' needs can vary, ranging from purchasing a new computer to acquire job skills or education, to buying new furniture.

Assiniboine's matched savings accounts work as follows: The participant will put a certain amount into the savings account. Every month, the credit union matches the participant's amount threefold. As soon as the total needed amount of savings has been reached, the participant can use those funds to purchase assets (Assiniboine Credit Union, Matched Savings Accounts, 2010). The number of participants in Matched Savings Account increased in 2009 to 480 from 379 in 2008. The annual report also notes that savings by members in 2009 totalled $79,701, and total funds matched were $193,736. The total amount which participants were able to use to purchase assets was $273,437. Assiniboine's matched savings program is similar to SEED's (Supporting Enterprises for Economic Development) Savings Products account, as mentioned by Armendariz and Morduch.

Credit unions have significant financial and social clout among Canadians, which can create sizable potential for social change. Examples such as Vancity's Circle Lending and Assiniboine Credit Union's Matched Savings program show that microfinance programs offered through credit unions offer optimal banking services for the financially underserved, although there is not a lot of data to show a larger overall picture of alleviating poverty.

BANKING SOLUTIONS FOR POVERTY REDUCTION

As poverty has grown in Manitoba, the province recorded a $555 million deficit for the 2009-2010 fiscal period (Kusch, L. Owen, B., March 24, 2010). This, along with fringe financial services continuing to open up in lower income neighbourhoods, will put a strain on efforts to alleviate poverty. With the constraint of the recent deficit and lack of mainstream financial options, the province will need to find efficient and equitable ways of reducing poverty through the private sector.

Buckland's co-written papers have mentioned a number of solutions. He argues in favour of working more with community groups to provide more financial literacy in low-income areas. At the same time, the provincial government of Manitoba could also work with those same community groups to encourage alternative financial services that do not hurt lower income people. An example is the Alternative Financial Services Coalition that Assiniboine Credit Union, along with a few non-governmental organizations, work with in order to help people in these neighbourhoods get proper savings accounts and the necessary identification.

Another solution to provide lower income people with more financial services would be to encourage credit unions to set up shop in these areas. An example is the West Broadway Branch of Assiniboine Credit Union, which opened up in the early 2000s in response to members who were concerned after many chartered banks left the economically depressed neighbourhood in the mid- to late 1990s. The West Broadway branch serves in an area in which 73% of children and 65% of households live in poverty (Assiniboine Credit Union, West Broadway, 2010).

A third solution would be to amend the tax system so as not to claw back welfare from any low-income people who use savings vehicles. At the same time, the province could also encourage tax incentives for matched savings vehicles for low-income people. This would be an efficient and equitable way of reducing poverty as it minimizes risk and maximizes wealth savings for these people. Matched savings programs could also be encouraged to use an RRSP type of savings program.

CONCLUSION

As chartered banks have left low-income areas in Canadian cities, fringe financial institutions that offer cheque cashing, tax discounting, and pawning have increased their impact in these areas, charging very high rates and serving the very poor. Some have argued for state-owned banks as an alternative provider of financial services. However, as seen in examples from around the world, state-operated banks have many fundamental problems, including cheap credit which encourages credit rationing, and credit only going to the most politically well-connected users.

The credit union movement, which arose out of a lack of proper financial services among poor people in Europe, provided a solution starting in the late 1800s and moving to Canada in the early 20th century. Canada's credit unions have a deep financial and social impact (i.e. VanCity and ACU). In a fiscally constrained province like Manitoba that is running a deficit with poverty still fairly high, encouraging financial literacy and more credit unions in poorer areas, and tax changes to encourage savings among very low-income people, can appeal to both sides of the political spectrum in Manitoba.

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