Intelligence MEMOS

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To: Canadian Finance System Watchers

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Re: **Building Greater Resilience in Canada's Big Credit Unions**

Even as the 2007-2009 financial crisis recedes from memory, financial sector policymakers continue to roll out a policy agenda built around what is believed to be a key cause of the financial crisis, namely poor corporate governance at large internationally active banks.

The governance focus addresses the premise that, without effective oversight by the board of directors, managers may take actions that harm the interests of shareholders or other stakeholders. To carry this out, the board needs to have the appropriate skills, expertise and experience.

Less is known about how credit unions have evolved their governance practices and standards to address the growing complexity of banking and the changes taking place in the provincial credit union sector, as well as how credit unions have performed financially.

This gap is not altogether surprising. Credit unions are much smaller than the chartered banks, have no publicly traded shares and are subject to few public disclosure requirements. As a result, they typically generate far less academic, media or policy scrutiny than banks.

However, the high-profile demise of Pace Credit Union, a mid-sized southern Ontario credit union, has drawn sustained media and public attention and raised questions about the sector's governance practices, including the quality of supervision.

Concerns about co-operative governance are not new. As co-operatives, credit unions are structured as one-member, one-vote businesses. Observers have long expressed concern, going back at least to the 1960s, about the dwindling share of members who vote at annual general meetings. A 2012 **study** of Canadian and US credit unions, for example, found that turnout was often below 2 percent of the eligible membership.

The low participation rate raises questions about board management capture, incentives and efficacy. Meanwhile, anyone interested in monitoring credit unions faces challenges finding publicly available financial information beyond that available in annual reports.

If credit unions were unimportant, these observations might not matter. However, credit unions represent an important part of the Canadian banking sector and, therefore, the Canadian economy. Outside Quebec, at the end of 2021 credit unions held almost $280 billion in assets, representing about 7 percent of banking sector assets. They serve an estimated 40 percent of people residing in BC, 41 percent of those in Saskatchewan and 50 percent of Manitobans, and employ some 29,000 people, two-thirds in western Canada. By contrast, Canadian banks employ 72 percent of their staff in Ontario.

Our new C.D. Howe Institute **E-Brief** offers a snapshot of the evolution and performance of the credit union sector over the 2012-2019 period, reviews the practices and board composition at some of the country's biggest credit unions and outlines how these practices have evolved over time.

Underpinning our analysis is the idea that strong governance supports strong financial performance. We focused on the largest credit unions, in part because of the relative absence of publicly available information about the wider universe of credit unions, and in part because of their weight: the 10 largest account for more than half all credit union assets.

On performance, the available data suggest the largest credit unions have fared well over the period before the pandemic but with some important opportunities for improvement.

On governance, there have been commendable efforts to improve, with boards increasingly using deliberate strategies to recruit skilled and experienced board members. Acknowledging this, we provide specific governance-related recommendations of things credit unions can do to head off existing, emerging and future challenges, especially those associated with a shifting technological, regulatory and competitive environment as well as those inherent with democratic governance in large co-operatives.

First, credit unions need to be clear about their purpose. They need to use that purpose as a guide through an increasingly difficult operating environment including future mergers, the possibility of interprovincial "passports" and whether to take up the federal credit union option.

Second, credit unions need to be mindful of the challenges associated with more deliberate board recruitment strategies. These include a potential loss of legitimacy as democratic institutions, the absence of strong voices from non-professional walks of life and, ultimately, the risk of capture by management and a small cadre of voters.

Third, it should be easier to learn about Canada's credit unions, and for members to hold them to account. It is elsewhere. For example, in the US the National Credit Union Administration provides easy-to-access historical financial data on credit unions going back decades. OSFI similarly makes data on the large banks available on its website, and provincial regulators should do the same for credit unions.

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