



**Consumers' Association of Canada  
Association des consommateurs du Canada**

Presentation to

Senate of Canada  
Standing Committee on Banking, Trade and Commerce

Re: Consumers and Financial Services

May 10, 2005

The Consumers Association of Canada (CAC) is pleased to have this opportunity to present its views to the Senate Committee on Banking, Trade and Commerce.

The Consumers' Association of Canada (CAC) is a 58 year old independent, not-for-profit, volunteer based organization with a National office in Ottawa and provincial/territorial representatives. Our mandate is to inform and educate consumers on marketplace issues, to advocate for consumers with government and industry, and work with government and industry to solve marketplace problems in beneficial ways.

There are four issues which concern us regarding consumers and financial services. The first is the continuing lack of competition in the provision of banking services, even leaving aside the very real possibility of renewed merger proposals among the largest banks. The second is our concern over the continuing drop in the number of bank branches in small communities, and the impact that this has on consumers. The third is the degree to which consumers remain at risk as the provision of financial services becomes more electronic and less personal. The fourth is regarding the apparent failure of voluntary codes of practice to accomplish their goals.

Markets, to be efficient, must be competitive; otherwise, less than optimal quantities of goods and services will be produced at higher than optimal prices. Canada has one of the least competitive banking sectors in the world, and our concern is that unless the federal government is prepared to ban mergers among the five largest banks the threat of even less competition hangs over consumers. Like the banks, the Consumers Association of Canada awaits with interest the long delayed merger guidelines. In particular, our view is that the impact on competition should be assessed at the local market level, as is laid down in the Competition Bureau's Merger Guidelines as Applied to Bank Mergers. Local markets are at least as important as national markets when assessing the impact on competition of any proposed merger. The Competition Bureau defines such markets using a variety of economic criteria rather than using the simpler but less relevant political boundaries. In our view, a merger should have to pass a competition test at the local level, and applicants should be required to demonstrate how competition will be maintained if the merger is allowed to proceed. This, we believe, will be a difficult task.

Merger proponents have still been unable to make a convincing case for why mergers between the large banks are in the national interest. Much of their argument revolves around two factors: first, there will be better access to funds by large Canadian firms, presumably because of the relationships that Canadian firms have established with Canadian banks. Second, jobs for Canadians will be enhanced, both in quality and quantity. Regarding the first argument, large firms, whether Canadian or otherwise, have many opportunities available to them for financing, whether from bank or non-bank sources, and they choose their financing based on many factors, the least of which is the nationality of the provider. Even assuming that fewer but larger Canadian banks makes

them more competitive abroad and so may bring more international financing opportunities to Canadian banks, it is unlikely that Canadian businesses operating in this market would be unable to secure funding in the absence of larger Canadian banks. Thus the benefits of an even more oligopolistic structure for banking services in Canada would accrue primarily to the banks and their shareholders. Worse, economic theory suggests that firms operating in two distinct markets, one competitive and one oligopolistic, will have incentives to cross-subsidize the competitive market by raising prices in the oligopolistic market. Merger proponents have so far been unable to provide a convincing explanation of how this is in the public interest. While there might be some tax benefit to Canada through taxing the perhaps higher profits of Canadian banks earned in this market, it is perverse public policy to suggest that we deliberately create oligopolists in order that we can tax away a portion of the oligopoly profits. The same argument applies to the sometimes heard proposition that because banks are widely held we should allow them to merge.

Much the same argument applies to jobs. The jobs likely to be created would be head office jobs, not jobs in the local communities. Consumers are not likely to be impressed that they will face less choice and higher costs in order for higher paying jobs to be created somewhere else. The corollary to the jobs argument that has been made on occasion in the past is that Canadian jobs will be lost in the absence of mergers, because Canada will fall backward as a financial centre and jobs will relocate elsewhere. It is difficult to take such an argument seriously. Global finance is highly competitive, and jobs go where they are needed. The nationality of the FSP doesn't matter; if regional financial centers become less important, then Canadian banks, no matter how large, will almost certainly transfer some of their operations to the major financial centres. Mergers have little to do with where the jobs are physically located.

We are less opposed to mergers with insurance companies. These offer the same benefits to the banks as do mergers with each other, but allow the merged institutions to exploit economies of scale and scope without the negative public interest effects that result from mergers with each other. Insurance companies are as successful internationally as Canadian banks, with over 50% of revenue being earned abroad. A merger of a large bank with a large insurer would not remove any competitors domestically. There are clear scope economies in consumer finance, which might well result in lower costs to consumers in purchasing insurance and mutual funds; banks have a more efficient distribution network using salaried staff rather than commissioned brokers. Moreover, the European experience with bank/life insurance mergers has been generally positive.

In order to realize the potential efficiencies, banks would need to be able to sell insurance through branches. This may have a negative impact on the insurance brokerage industry but a positive impact on consumers generally. The downsides are manageable: the need is to put in place firewalls to ensure, first, that consumer information is protected and, second, that sharing of customer information between the banking and insurance arms is

limited and under the control of the consumer. Finally, there would need to be assurance that the merged entity would put procedures in place to ensure that cross-selling of financial products is not misperceived as tied selling.

CAC now believes that even in the absence of cross-pillar mergers, the time has come to allow banks to sell insurance and to offer automobile leases through their branches. The present method of selling insurance through brokers no longer serves consumers well, and the recent controversies over commissions paid to brokers for placing business with specific companies illustrates the problem. Although we have not researched the issue in detail, the experience of Quebec consumers with buying insurance through Caisses Desjardins has, we believe, been generally favourable. The wealth management products offered by insurance companies and by banks are similar, and there seems to be no economic reason to continue to disallow sales of insurance products by the banks.

There are two objections generally raised against allowing banks to sell insurance in their branches: first, it would mean many small business people, insurance brokers, would lose all or a substantial part of their businesses and, second, if the number of bank branches continue to fall consumers in smaller centers may be deprived of easy access to insurance advice. The first is a difficult problem with social as well as economic ramifications; it can perhaps be addressed by having the bank buy the business, thus allowing older brokers to retire, and providing assistance with retraining for younger brokers, perhaps adding to the ranks of financial planners.

The second objection, the declining number of bank branches in smaller communities, brings us to our concern generally with the continuing erosion of the branch network. The safety net incorporated into the regulatory landscape that was intended to limit this has not worked, and CAC recommends that a more proactive policy be incorporated in the revision to the Act. At present the only constraints that banks face are time; the need to give notice, the need to discuss the pending closure with the community, etc. But at the end of the day, the branch closes. While there has been some success in getting another financial service provider to take over the branch, we have not been successful in getting numbers and we have the impression that the percentage of cases in which closure has been averted in this way is not substantial. The provision of electronic branches is not a satisfactory substitute. To many consumers, even those who are internet literate, personal contact is much more satisfactory whenever anything beyond the most routine banking transaction are involved. We are not suggesting that banks should be required to subsidize branches in smaller communities, although given the privileged position that banks enjoy in Canada a case might be made for that. Rather, we object to the closing of profitable branches merely because it might be cheaper to provide the same service electronically. We believe regulation in this area needs to go beyond what is in the present legislation.

Turning now to our third issue, consumers are being encouraged to use electronic methods of making payment, to use the internet for even complex banking transactions, and to use new payment methods that exist or are about to be introduced. However, there appears to have been little thought given to risk and how it is divided between the financial institution and its customer. The risks that exist are likely to greatly exceed the monetary value of the transaction by also including information that would make identity theft both feasible and likely. Our concern is not that financial institutions do not move quickly in the case of either monetary or information loss; they do. Rather, it has to do with how the risk is allocated between the financial institution and the consumer; in practice, the consumer bears most of the risk, and is certainly the most inconvenienced. At the theoretical level, a case can be made that risk should be allocated in accordance with the capacity to bear that risk, and in our view consideration should be given to moving some way in that direction. It might be argued that any division of risk other than the present creates moral hazard, but it could be equally argued that the absence of a more reasonable allocation of risk creates moral hazard in the other direction. An example is the continued use of the PIN as the primary identifier in using an access card, despite the fact that it is technology from the nineteen seventies. There is no incentive for financial institutions to implement a more secure technology as long as most of the risk of misuse falls on the consumer, even though it might be cost effective for them to do so.

Our fourth issue concerns the regulatory environment, or lack of it, on the consumer side. As one of the original participants in the multistakeholder group developing the EFT code of practice and its several revisions, CAC has been a strong proponent of voluntary codes of practice as a way of providing consumer protection in a rapidly changing electronic banking environment. Sadly, the evidence is mounting that such codes simply no longer work. Financial institutions pay lip service to them, but in fact do little to train their staff or inform consumers. While it would take time, we now believe that regulators should develop legislation which would build on what has been accomplished in the codes and would provide the legal framework for comprehensive consumer protection in managing electronically their financial affairs.

We would be happy to respond in writing to any questions that you may have.