

Reviewing our Cooperative Past to Chart a Future Course

The credit union system is evolving at a rapid pace, in response to increasing regulatory pressures, economic uncertainty and shifting member expectations. However, shifting sands and external pressures are nothing new. In fact, our system has *always* evolved and innovated, to be resilient and serve its members and communities in the face of adversity.

Like the credit union system we serve, Stabilization Central is considering the strategic path that will best serve our members. We know our system's foundation of collaboration, centralized services and shared resources is perhaps its greatest strength. We thought a reflection on that history of collaboration would be timely as we and our system chart our future course.

Learning from Past Challenges

As we look forward, there are insights to be drawn from our system's rich history of leveraging our cooperative values in challenging times. Stabilization Central and its predecessor, the Credit Union Reserve Board (CURB) have been a strength for B.C. credit unions and communities in times of crisis, for more than 60 years. Long-time credit union leader Chris Dobrzanski has authored "*Resilience Amidst Turbulence: Lessons Learned from Decades of Crisis Response to BC Credit Unions*", a series of detailed case studies about this work. The full paper can be found [here](#), and we share some highlights, below:

B.C.'s Great Recession (1981-86)

In B.C., the recession of the early 1980s constituted the most significant economic downturn since the Great Depression. Between 1981-1984, unemployment increased from 6.7% to 14.7%; goods-producing industries had a 0% growth rate in 1981 followed by a disastrous 13.1 per cent decline in 1982, and interest rates rose from 9.5% in 1978, to 15.25% in 1980, peaking at 20.0% in 1981. This created a significant stream of real estate defaults in B.C., where residential property prices fell 30%.

Credit Union Impacts & Stabilization Response / Actions:

- a) The forestry sector and the Vancouver Island communities dependent on it were among the hardest hit as mill closures and permanent layoffs worked their way through both the real economy and financial intermediaries. Credit unions in communities throughout the Cowichan region found themselves unable to meet the regulatory requirement to hold equity equalling at least 3% of assets.

CURB supported credit unions and communities through these challenges by:

- Providing grants-in-aid to ensure regulatory compliance and keep these vital community financial institutions open in a safe and sound manner.
 - Helping seek voluntary merger opportunities when a credit union was placed under supervision (rather than forced liquidation)
- b) Quickly fluctuating interest rates left many commercial real estate construction projects declaring bankruptcy, creating large loan loss provisions for the credit unions that had

funded them. This challenge was heightened by financial margins that were already squeezed from interest rate mismatches.

The Credit Union Deposit Guarantee Fund (CUDGF) established by the system helped credit unions persist through these challenges. In addition, CURB1 helped by paying out \$21 million (3 basis points of total credit union deposits in 1982) in aid, as part of its \$32million pay out over the 5-year period. Peak drawdown of the CUDGF was 33% in 1982.

The Evolution of Stabilization Central

It bears noting that in the years following the great recession, the credit union system drove an initiative to create a system-owned and -controlled stabilization organization that could intervene early where a credit union was struggling, and prevent regulatory takeovers. In 1989 CURB's deposit insurance and stabilization services were split into two new entities, the Credit Union Deposit Insurance Fund (which remained under the regulator's umbrella), and Stabilization Central Credit Union.

Implementation of the North America Free Trade Agreement (NAFTA) – 1991-1995

In 1991, Canada signed the North American Free Trade Agreement with Mexico and the United States, in a deal that eroded safeguards to many manufacturing sectors in Canada. Job loss due to NAFTA was over 500,000 over four years in Canada and Canadian job losses were four times greater than U.S. job losses per capita. Unlike eastern provinces, B.C. actually saw modest growth in employment between 1991-1995, due in large part to stable commodity prices and increased foreign investment in real estate in B.C. urban centres.

However, there was a mild economic recession in B.C. as the interest rate cycle went from a Prime Rate of 8.50% (1991) to a trough of 6.0% (1993) back to a range of 8.50-8.75% (1995-1999). B.C. experienced a gradual drop in real GDP as the post-NAFTA reality of lower employment levels and lower tax revenues began to take hold.

Credit Union Impacts and Stabilization Response / Actions

For B.C. credit unions, consolidated loan delinquency rose from 0.76% of assets in 1993 to a peak of 1.94% in 1999, as short-term interest rates rose above long-term rates and created cashflow problems for debt holders. Recessionary real estate conditions such as a buyer's market and speculative construction led to more defaults and foreclosures. However, unlike in the Great Recession (1981-1985), in this mild recession B.C. credit unions' net operating earnings were sufficient in aggregate.

Despite that relatively mild impact across the system, in this period, Stabilization Central was called upon three times to offer financial assistance from the Stabilization Fund, primarily to provide loan guarantees that facilitated credit union mergers. They were also active in helping rehabilitate credit unions placed under supervision by the regulator (at least 24 such supervision assignments).

Great Financial Crisis (2008-2011)

In 2008, the near collapse of the world financial system triggered a lack of confidence among depositors in many financial institutions. Regulatory regimes required a near doubling of risk-weighted capital immediately (rising from 8% to 13-15%) and a return to retail deposits for core liquidity compliance.

Employment in B.C. dropped by 5%, primarily outside of the Vancouver metropolitan region. A common factor in these non-metro regions was a decline in forestry jobs as demand dropped due to the deep recession in housing in the U.S. at this time (following the sub-prime mortgage lending collapse).

BC Credit Union Impact and Stabilization Response / Actions

As central banks lowered interest rates to near zero (Bank Rate of 0.5% in Canada in 2009), financial assets and real estate appreciated significantly. This price appreciation enabled B.C. credit unions to offer a higher level of forbearance to those credit union members facing large debts and an inadequate cashflow to service them. B.C. credit unions had lower loan delinquency rates and lower bad loan losses in 2008-09 than in the recession in the 1990s.

After seeing how interest rate chaos wreaked havoc in the U.S. banking system and economy, B.C.'s regulator paid heightened attention to credit union risk management. Stabilization Central's was called upon to support the system in developing these risk capabilities, including governance, operational and strategic decision-making, and nurturing a strong board-led risk framework. Enterprise Risk Management focus was on taking precautionary steps and testing for unknown events in advance rather than responding and fixing losses once they occurred. The stabilization framework for BC credit unions became based more on before-the-fact loss prevention rather than after-the-fact loss mitigation.

COVID-19 Pandemic (2020 - 2022)

Fearing that pandemic lockdowns would create massive economic dislocations (job loss, loan default) that could threaten the global financial system, international banking bodies coordinated a response by central banks and governments to have central banks provide Lender of Last Resort Facilities and for government bank supervisors to provide regulatory forbearance

Rather than have a health crisis trigger another big banking crisis, some liquidity and capital rules were temporarily suspended, and implementation of Basel III was postponed. This enabled the banks - with Lender of Last Resort Facility access from their central banks - to operate with added capital capacity and more flexible liquidity without adverse accounting from any market disruption. Interestingly, these measures were the opposite of those taken in the Great Financial Crisis in 2008, where U.S. commercial banks were incented to quickly foreclose on houses, and the U.S. federal reserve rapidly increased interest rates and burst the housing bubble.

Credit Union Impact and Stabilization Response / Actions

In 2020, Stabilization Central with Central 1, and under the umbrella of CUDIC, BCFSA, Bank of Canada and CMHC, aligned to ensure adequate resources of liquidity and capital were available to B.C. credit unions during the pandemic period of two years.

Financial agencies and the federal government provided financial support to business and labour via forgiveness of debt rather than foreclosures (as was the case in 2008). Regulatory forbearance by OSFI and BCFSA during the pandemic was very significant.

As a result:

- credit union loan growth rose (supporting local economy with credit access)
- credit union loan loss provisions went up (driven by unemployment rate)
- credit union members remained confident & unconcerned by decline in capital

Charting our Future Course

Today, credit unions are facing a convergence of challenges: technological change; accelerating consumer expectations; geopolitical impacts and economic risks; cyber threats; increasing costs and margin pressures. This is leading to both consolidation and unprecedented structural changes across the credit union system.

As in the challenging times described in this article, Stabilization Central's purpose remains constant: to support the resilience of B.C. credit unions and their communities. Like our member credit unions, our strategic planning hinges on a key question: what do our members need most, and how can we best fill that need? We recognize those needs will change as the system pivots, and we are preparing to pivot as well.

To that end, we closely monitor our environment to define what that support looks like for a changed system, and ensure our strategy reflects its needs. We're considering things like which of our services will still be relevant, whether new needs are emerging, and whether partnerships or mergers with other organizations make sense. Collectively, our team has hundreds of years of credit union and financial system experience; this is intellectual capital we want to ensure remains available to members, supporting their success through both smooth and tumultuous times.

In a true cooperative spirit, this discussion will rely heavily on member input and participation, after which management will bring recommendations to your Board of Directors. Members can expect an invitation to a series of engagement sessions in the coming weeks. In the meantime, our door is always open to member input – please reach out any time to Bill Corbett to share your thoughts.