

Passing the Buck? Examining Canadian Banks Approaches to Financial Exclusion

by

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Passing the Buck?

Examining Canadian Banks Approaches to Financial Exclusion

1) Introduction

The purpose of this report is to examine what Canadian banks say they are doing to address financial exclusion.¹ It offers a ‘high-level’ perspective on what banks understand about financial exclusion and what they do to promote financial inclusion. It is a companion report to one that focused on one particular approach to financial inclusion, the community banking project.² This report seeks to identify what banks understand about financial exclusion: its causes, consequences, and solutions. It does this by reviewing relevant bank reports and reporting on a series of banker interviews.

For discussion purposes, financial exclusion is defined as a process whereby some people have no access or inadequate access to mainstream bank services (financial services from a mainstream bank, trust company, credit union or *caisse populaire*). As a consequence of this, unbanked or underbanked people must rely on fringe financial services (e.g., payday lenders, cheque-cashers, pawn brokers) or informal financial services (credit from a friend or corner store). It is often stated that approximately 3% of Canadian adults are unbanked, having no bank account, but that this share rises for people with low-income.³ This places the level of financial exclusion in Canada on par with France and Germany, below that of the US and the UK, and above that of northern European nations such as Sweden and Denmark. Being underbanked, having insufficient bank services is a tougher concept to measure. One indicator of underbanked is not having a credit card. Using data from the 2005 Survey of Financial Security it was found that 18% of Canadians were without a credit card (Buckland and Simpson 2008). This was a decrease from 1999 when the share stood at 21.1%.

There is much debate about the causes of financial exclusion. Some argue the cause of financial exclusion lies in individual behaviour. There are two important versions of this approach. The rational choice approach, rooted in neoclassical economic theory finds that individuals operate within a relatively institution-less environment dominated by frictionless markets. Financial exclusion is the result of a rational choice by some individuals using benefit-cost calculus to opt out of formal banking (Elliehausen and Lawrence 2001). A second individualist approach, from behavioural economics, finds that people behave in complex ways that are inconsistent with simple rational choice models (Mullainathan and Thaler 2001). Here financial exclusion may result from people making a number of small but cumulative errors that undermine their self-interest.

Others find that financial exclusion is rooted in structural barriers associated with policy and practice affecting poor people, most notably associated with government and banks. It has

¹ This report is one of several from a research project entitled ‘Financial Exclusion & Poverty in Canada.’ This report is one of several from a research project entitled ‘Financial Exclusion & Poverty in Canada.’ Information on the overall project and links to more reports can be found at: <http://financial-exclusion.uwinnipeg.ca>.

² The companion report examined a set of special community banking projects including Pigeon Park Savings, Desjardins Federation microloan program, Cash and Save, and Community Financial Service Project (see: Buckland, Jerry 2008. “Community Banking Projects for Low-income Canadians: A Report Examining Four Projects to Promote Financial Inclusion,” available: <http://financial-exclusion.uwinnipeg.ca>).

³ The 3% unbanked share is from a survey undertaken for the MacKay Task Force. The survey was designed to more adequately sample low-income people. This is in part because of the strong evidence about the negative correlation between income and bank account holding. However, adequately sampling low-income people is difficult when the survey is implemented through land-line telephones as low-income people are less likely to have land-lines.

been argued that mainstream banks operate in such a way as to prevent certain people from using mainstream bank services (Dymski 2003). Barriers are created through branch location, product development and pricing, and staff training (Buckland, Brennan and Fikkert 2010). The result is that rational or bounded rational consumers face barriers that prevent them from inclusion in mainstream banking.

A final theoretical framework sees banking obstacles on the personal and structural sides (Caskey 1994; Buckland and Martin 2005a). For instance, the institutional theory of savings accepts that bounded rationality of consumers and structural barriers of banks can encourage financial exclusion (Sherradan and Barr 2005). This study is rooted in an institutional theory that sees barriers to banking rooted in both personal and structural factors. However, this study is concerned to understand structural barriers associated with the banking market. This theory posits that banks are indifferent to the problem of financial exclusion because they are pre-occupied with meeting their shareholder profits demands. Any other goals –such as promoting financial inclusion– that divert bank management’s attention from that prime goal are considered unacceptable. For this study the first hypothesis is that banks are disinterested in addressing financial exclusion. This will be tested by reviewing bank annual reports to determine their activities in this area. The second hypothesis is that bankers do not understand the complex nature of financial exclusion but, rather, understand it as being largely driven by personal choice. In other words, most bankers believe that unbanked people freely choose to be unbanked and that structural barriers are not present.

There are two principal sections to this report. The first part examines bank reporting on issues relating to financial inclusion. This section relies primarily on bank accountability reports. The second part reports on a series of primary interviews that were conducted with bank officials about the causes, consequences, and solutions to financial exclusion.

a) Bank Reporting on Financial Inclusion Issues

Widening access to basic banking services became a policy ambition of the Canadian government in 2001. This was the product of an extensive public consultation process that resulted in significant legislative reform of Canada’s financial services sector. The new policy framework includes measures to promote the efficiency and growth of the sector, foster domestic competition, empower and protect consumers, and improve the regulatory environment (Department of Finance, Canada 2008). A stronger role for credit unions was also contemplated within the policy framework, allowing for the creation of a single national services entity that would help credit unions overcome regional fragmentation and help them to compete better with large institutions.

The changes established new legislated consumer provisions and a new consumer regulatory body – the Financial Consumer Agency of Canada, FCAC – to enforce the provisions, monitor the industry’s self-regulatory initiatives, promote consumer awareness of their rights under the legislation, and investigate consumer complaints about financial matters. The legislated consumer provisions in the Bank Act provide for an array of protective measures (Canadian Bankers Association 2005a),⁴ but there are four that relate specifically to addressing the needs of lower-income consumers for access to basic banking services:

⁴ FCAC’s January 2002 compilation of the consumer provisions as they apply to each type of financial institution is attached as Appendix 6.

1. Ensuring Access – Under the Access to Basic Banking Regulations, banks are legally required to open accounts for any individual without requirements such as employment, and minimum deposits. Non-customers may cash federal government cheques up to \$1500. Eligible clients must have adequate personal identification, specified in the regulations, to take advantage of these services.

2. Low-Cost Accounts – The government and eight banks entered into Memoranda of Understanding whereby those banks offer a standard set of services, including in-branch transactions, for a minimal cost (Canadian Bankers Association 2005a).⁵

3. Branch Closures – The Notice of Branch Closure Regulations require banks to provide four months' notice of branch closures. In rural areas where there is no other financial institution located within a 10-kilometre radius of the closing branch, six months' notice is required. The intention is to ensure that community stakeholders have an opportunity to consult with the bank prior to closure.

4. Publication of Annual Public Accountability Statements – Banks and federally incorporated or registered trust and insurance firms with more than \$1 billion in equity are required to publish information in the form of an annual Public Accountability Statement, describing the institution's contributions to the Canadian economy and society.

It is this fourth measure – the publication of annual public accountability statements – that is a primary source of information of banks' financial inclusion efforts. However, as we will see, it is also the source of controversy. According to the Financial Consumer Agency of Canada website, each institution must make its Public Accountability Statement available no later than 135 days after the end of its financial year. Statement requirements are as follows:

- Detailed examples of the financial institution's involvement in community development projects
- Examples and the total dollar value of the institution's charitable donations and other philanthropic activities
- A report setting out the total amount of money authorized for firms in Canada concerning debt financing. The dollar amounts are to be broken down by the prescribed loan authorization size, and by province or territory. The report must note the number of firms authorized for debt financing.
- An overview of initiatives to improve access to banking services for low-income individuals, seniors and disabled persons
- The address of deposit-taking institution branches opened and closed over the year reported by province.
- The total number of individuals employed full-time and part-time by the institution in each province
- The total amount of taxes paid to the federal and provincial governments
- Information on new initiatives or assistance programs undertaken for financing small businesses and for investments or partnerships in micro-credit programs
- A list of affiliates included in the Public Accountability Statements

⁵ Appendix 1 outlines low-fee account MOU information. Appendix 2 details low-fee account information contained in promotional materials for all accounts.

A detailed interpretation of the regulation is found in the amendment to the Bank Act (Canada Gazette 2002).

b) Historical Significance

The introduction of Basic Banking Regulations was the culmination of a process that began in 1996 with the establishment of the (MacKay) Task Force on the Future of the Canadian Financial Services Sector (MacKay Task Force 1998). The Task Force was established in preparation for the decadal review of the Bank Act. The government responded to the Task Force with a policy paper outlining reforms to the federal Bank Act (Department of Finance, Canada 1999). Subsequently the government introduced Access to Basic Banking Regulations, Public Accountability Statement requirements, and participated with banks in establishing Voluntary Codes of Conduct. Access to Basic Banking Regulations require federally regulated banks to open an account or cash certain federal government cheques for anyone with adequate personal identification. Through Public Accountability Statements, banks are required to annually disclose how they contribute to the Canadian economy and society. Voluntary Codes of Conduct have to do with establishing such things as low-fee, simple bank accounts.

Evidence is that the federal government and banks are satisfied with the reforms that were made. The Department of Finance sees the PAS regulations as a means to foster greater competition in the banking sector (Department of Finance, Canada 2003). A leading bank, Canadian Imperial Bank of Commerce, CIBC, supports that view (CIBC 2003). The Canadian Bankers Association (CBA), in its 2005 submission to the Senate Standing Committee on Banking, Trade and Commerce, documented the changes in Canada's financial services marketplace since the late 1990s, and offers its perspective on how these developments have resulted in more choice, lower prices and better access for Canadian consumers.

However these reforms were critiqued by some as being too mild.⁶ The Canadian Community Reinvestment Coalition (CCRC), for one, lobbied for a US-style Community Reinvestment Act. The CCRC has since produced several reports and position papers arguing that the 2001 reforms to the Bank Act contained loopholes that undermine the intent of the regulations (e.g., Conacher 2007). It continues to advocate the merits of the U.S. Community Reinvestment Act, saying that the Canadian concession is a poor substitute that encourages rhetoric with no way to hold banks accountable for poor performance.

c) Current Bank Reports⁷

All major Canadian chartered banks have filed a minimum of five public accountability statements with the Financial Consumer Agency of Canada (FCAC) since the regulation has come into force. These include RBC, TD Canada Trust, Scotiabank, Bank of Montreal and CIBC. Over time, other banks and larger credit unions such as Vancity, Coast Capital to name a few have issued annual accountability statements. According to bank literature, it is an enormous undertaking that duplicates a multitude of reporting requirements in an already heavily regulated industry (CBA 2005a; Solstice Sustainability Works 2005; Vancity Credit Union 2006). Yet critics charge reporting is superficial and does not go far enough to address strategy and practice

⁶ The CCRC describes itself as “a non-partisan coalition based in Ottawa, formed in 1996 by organizations from several sectors of society which are working together on concerns about financial institutions, with a focus on the issues of access to capital for community reinvestment and access to other basic financial services.” CCRC objectives and principles can be accessed from: <http://www.cancrc.org/purposeandobjectives.html>.

⁷ See Appendix 1 for a summary of comments relating to financial inclusion from CIBC and RBC reports.

designed to tackle financial exclusion. Support for this perspective can be found in the small but growing body of academic literature devoted to the subject of corporate social reporting (Adams 2004; Bebbington 1997; Gray, Owen & Munders 1998; King & Lennox 2000; Morsing 2005; O'Dwyer 2003; Owen, Swift, Humphrey & Bowerman 2000).

The reports themselves show evidence of improvement in the quality and level of detail provided, especially in the area of environmental reporting which is more developed and more quantifiable than seems to be the case with social reporting. Contribution to society remains focused on charitable and philanthropic activities, involvement in community development projects, and employee volunteerism. Discussion of initiatives to improve access for low-income individuals is generally limited to account opening and cheque cashing procedures, availability of low-cost accounts, consumer education, and branch bank closure statistics. But little data are provided to demonstrate activities here. A small number of local projects, and a few that are more national in scope, remain at the pilot stage but offer little formal evaluation. Thus the reports provide evidence to support the first hypothesis, that banks are relatively inactive in addressing financial exclusion.

There are notable exceptions. RBC, for example, appears to be drawing on its experience in the U.S., where its affiliate has drawn criticism for questionable practices under the Community Reinvestment Act (Fair Finance Watch 2008). The spill-over effect may be contributing to more comprehensive reporting that is more in line with U.S. style criteria. Canada's credit unions are adopting the conventions of PAS reporting, albeit on a smaller scale, though often with richer detail. Vancity Credit Union is well recognized for its pioneering efforts in the area of corporate social responsibility and reporting (Vancity Credit Union 2006). Its efforts have set the standard for a stepped-up role for credit unions in Canada, serving as inspiration for those wishing to grow and compete on a much larger scale by serving markets said to be left behind by the major banks.

Still, all major banks appear to be ramping up reporting efforts that invoke internationally recognized standards such as those set by the *Global Reporting Initiative* (GRI)⁸, perhaps a function of pressure to conform to world benchmark guidelines (Strandberg 2006; Strandberg 2005; The Corporate Citizenship Company 2005; Vander Stichele 2004), the UNEP's *Finance Initiative*, and/or the lobby efforts of advocacy groups (e.g., Banktrack, Fair Finance Watch, Canadian Community Reinvestment Coalition). Even so, it is difficult to identify specific actions and an overall strategy to tackle the problem of financial inclusion from these reports. Part of the challenge is a lack of clear definitions for central concepts such as community development. In some cases banks seem to be retrofitting organizational activity to provide the appearance of compliance, rather than bringing resources to bear on the problem itself.

2) Bankers' Views about Financial Exclusion

a) Introduction

This section of the report summarizes results from eight banker interviews involving 13 bankers, (some interviews involved more than one banker) (Table 1). Respondents came from a variety of organizations including mainstream banks –both bank and credit union– and fringe banks, specifically payday lenders, and bank associations. The bankers were senior staff members based in their head office. They came from various departments including public relations, operations, and economics. In all but one case, the bank identified the respondent. In this case, the

⁸ See Global Reporting Initiative undated. 'The Global Reporting Initiative,' available: <http://www.globalreporting.org/Home> (accessed 18 August 2010).

respondent cleared participation in the interview with his supervisor. One bank, after extensive communication, declined to participate in an interview. The interviews were held between March 2008 and October 2009. Interviews followed the questionnaire found in the appendix (Appendix 2) although each interview emphasised slightly different aspects of the list of questions.

Table 1. Number of Respondents by Type of Organization

Category	Company	Association	Sub-total
Bank	6	2	8
Credit Union/ <i>Caisse populaire</i>	2		2
Fringe Bank	2	1	3
Sub-total	10	3	13

The interview data was analyzed using content analysis. Prominent themes and issues were identified and then the data was categorized by these themes and issues. Then the responses were examined by type of bank (fringe or mainstream). Finally, other key issues were identified by re-reading the materials looking for other important issues.

In some cases, bank respondents were cooperative in participating in the interviews. They responded to the invitation and scheduled a time for the interview. In other cases bankers participated in a reluctant manner, not responding to communications and only scheduling an interview after much effort on the part of the interviewer. In one case, a bank refused to participate in the survey.

Results of the analysis are presented below in five sections, following the structure of the questionnaire. The first section considers how respondents would describe financial exclusion. The next section presents bankers' views on the causes of financial exclusion, and the third section discusses banker views on the consequences of financial exclusion. The last two sections consider how financial exclusion might be addressed, and examines some other pertinent issues.

b) Defining and Understanding Financial Exclusion

i) Financial exclusion definition

We presented the respondents with a definition of financial exclusion and asked them about their thoughts on it. The definition highlighted banking challenges faced by urban low-income people: financial exclusion as a situation when a person has no, or a very limited, relationship with mainstream bank and relies on expensive and limited fringe banks services from cheque-casher, pawnshop, etc. It is correlated with low-income (and associated variables) and manifests a second tier of banking.” Responses to this question varied. Some respondents rejected the definition and some respondents accepted it.

Two mainstream bank respondents commented on this question. One felt that exclusion was a poor word as it implied a deliberate action on the part of the bank to keep certain people out:

Well, I find it...I have a little problem with the term financial exclusion because it sounds like someone is excluding as opposed to you know, not participating. So, I think the question has to be asked because it has a sort of pejorative ring about it...and a judgemental ring about it—that term exclusion. I don't think...I mean we

certainly...we are not trying to exclude people from banking with us. We want them to bank with us or one of our competitors. There may be a range of issues as to why they're not doing that that needs to be explored and better understood. We're certainly very interested in attracting from the payday lender world many of those people who use their services.

Another mainstream bank respondent felt that the definition was too broad to be helpful. She argued that people without a bank account face a very different situation as compared with people without access to mainstream bank credit. Moreover, the definition was further complicated with reference to fringe banks. The two credit union respondents and a mainstream bank respondent felt the definition was useful.

ii) Financial exclusion size

Mainstream bank respondents (not fringe bank respondents) were presented with the figure that 3 to 5% of adults and 8% to 16% of low-income adults do not have a bank account in Canada. They were asked if they accepted these figures or not, and why. For those willing to volunteer an answer, there was general consensus that this figure is likely close to the actual rate but some argued it was likely a little lower and some argued it was a little higher. One respondent could not confirm or refute the figure. Two respondents, associated with mainstream banks, argued that the figure was too high and that they had seen evidence the actual unbanked rate was closer to 1%. Moreover, they added, the Canadian unbanked rate at around 1% is substantially lower than the rate in the US which is closer to 8 to 9%.

You know you look at a lot of –I even hate to say it– but even some in our generation that, you know, the husband does all of the banking and the wife doesn't have an account. You know – that was typically my parent's age when that sort of thing happened. It still does happen.

One credit union respondent and a mainstream bank respondent felt the quoted rate was accurate and a second argued it was likely higher due to survey under-representing low-income people who are more likely to be unbanked.

iii) Is financial exclusion a social problem?

Respondents were asked if they felt that financial exclusion represented a social problem. Just one of the mainstream bank respondents who commented felt that being unbanked did not present a social problem. This respondent felt "I think a number between 96 and 99 [percent banked] is a pretty good indication that we do not have a problem in Canada." One mainstream bank respondent had a mixed feeling about whether financial exclusion was an indication of a social problem. Regarding having no bank account, the respondent felt that individuals choose to not have a bank account because they did not have that experience in their family's past, and/or because they did not realize the benefits to mainstream banking.

You know, people don't know about this [access to basic banking] stuff...I'm not sure what the FCAC has done but I don't know how well people know this. We [the bank] certainly don't go broadly advertising it because our advertising campaigns are focused on other things.

While not having a bank account may not indicate a social problem, this same mainstream bank respondent did identify high rates of household debt—exemplified in the rapid growth of payday loans—as an indicator of a social problem. So to the extent that household debt accumulation is due to reliance on fringe and sub-prime credit, financial exclusion was a social problem for this respondent. Both credit union respondents felt that financial exclusion reflects a social problem in Canada. A final mainstream bank respondent felt that since banks and government were doing all they could to provide basic banking, if there was a problem it lied elsewhere: “with all of the provisions that are in place—the banks and the government and everyone is trying to make it as easy as possible to have access to a basic bank account.”

Conversely, lack of access to banking hurts individuals and, since many individuals are affected, financial exclusion is associated with a social problem, noted a mainstream bank respondent. Moreover this respondent argued that any type of financial exclusion is problematic for a person to operate within the economy. Without a bank account one is limited in terms of employment, savings and credit access. Savings and credit are important resources for individuals and households to overcome adverse shocks. Moreover, he noted the positive relationship between economic and social capital: a lack of the one acts as a brake for the other. The mainstream bank respondent opined,

And I think therein there is a link to long-term ability to perform within labour markets. Take the simple example of being able to maintain consistent employment without consistent lodging or communication through telephone. All of these inhibit the matching and the sustainability of employment. So therein I see a link between social inclusion, economic inclusion and access to financial transactions services. For the longer term, savings is an important means of self-ensuring for adverse shocks over life events through one’s working life and into retirement at some stage providing a base of assets that can be used. And also, taking to some degree the family as a unit, parents’ ability to make investments in their children relies on some asset base and the ability to fund beneficial activities for the family unit. So in all these different ways I believe there is an individual level importance of financial services to overall economic participation.

c) Explaining financial exclusion

Respondents were asked if they had any general thoughts on the cause of financial exclusion. To facilitate the conversation, respondents were asked about two sets of explanations:

- One question focused on the demand-side: ‘We think that one cause, on the demand side of the financial service market, is that low-income households’ income has stagnated in the last few years. Do you think this is a factor causing financial exclusion?’
- A second question focused on the supply-side: ‘We think that bank branch closures in inner-city neighbourhoods has raised the costs to poor people in using banks and led to greater financial exclusion. Do you think this is a factor causing financial exclusion?’

Several respondents addressed this question by concentrating on payday lending. For this reason the next section summarizes comments on payday lending. That section is followed by a

section considering responses about supply-side factors and then a section examining respondents' thoughts on demand-side factors.

i) Payday lending

Several respondents spent considerable time sharing their views about what has caused payday loans to be so popular, particularly in light of their relatively steep fees. One point that everyone seemed to agree on –including the fringe bank respondents– was that payday loans were a relatively expensive source of credit. Responses below are categorized as those from mainstream bankers and those from fringe bankers.

(1) Mainstream bank respondents' views about payday lending

Mainstream bank respondents did not claim they completely understood the popularity of payday loans. One mainstream bank respondent was 'puzzled' at the payday loan phenomenon. This respondent's bank had lengthened its operating hours in order to be more convenient but this had not dampened the payday loan phenomenon.

A credit union respondent noted that there is a lack of alternative products from mainstream banks for the payday loan, driving the consumer to rely on the payday lender. A mainstream bank respondent commented that the use of payday lending was an issue of individual choice but also stated some puzzlement:

But one of the common misperceptions out there is that if you need a small loan for a short period of time then you need a payday loan. But the banks do offer short-term, small sum loans. You can have overdraft protection, get a line of credit, a credit card with varying interest rates but certainly much lower than what you would get at a payday lender. These are all readily available, convenient.

Another mainstream bank respondent argued that payday lenders, themselves, contribute to financial exclusion: "I don't think that it's the under-banking that drives the decision to go to payday loans, I think the payday loan drives the under-banking." Loan repayment leads one to cash one's cheque at the payday lender, moving the person to becoming more financially excluded.

One credit union respondent felt that payday lending was partly driven by excessive consumption and borrowing: "I think it's a generation that has overextended themselves; pretty foolhardy." One mainstream bank respondent claimed that these borrowers were behaving irrationally and lacked adequate financial education. In some cases other factors were identified:

And in talking about some of the causes, as we have done...some of it was problems like bipolar, mental disabilities that led to more, like, impulse behaviour. So some of it may be medically or addictions-related.

One mainstream bank respondent reported uncertainty about why payday loans are so popular:

I guess, you know, some of the research that is around and I think the business around the payday lender issue is that, you know, that when we shake our heads here, you know— what is possessing someone to go to a payday lender which is a block down the street from a branch of ours or frankly a competitor's [branch], and to pay more for a service they could get at a bank? I think that has been

something that puzzles some of us on occasion and I think if you look now at certainly ourselves, we have been opening branches in for example, parts of Toronto in places that people wouldn't be expecting us to be opening bank branches.

A final bank respondent had a more nuanced explanation for payday lending's popularity. She argued that, for many people, income has not kept pace with prices so that some people have had to borrow in order to hold their spending constant. Moreover, this respondent reflected on the nature of information shared by bankers to consumers and the role of government regulation in regards to credit products:

But there are organizations out there that are thriving on that, pushing credit products regardless of type of customer. I got a call from a mono-line credit card company yesterday asking for my daughter, saying it was so-and-so credit card company and they said so-and-so has been approved for a credit card. She's 4 years old. You know, at the end of the day my daughter, in ten years, would love the shopping money but I don't think it's entirely the fault of the businesses either. If I'm that business and I can gouge people, I will. There is a regulatory obligation, similar to what they're executing on the big banks to apply to some of these things. A lot of little companies, whether its payday loans or credit cards are able to do things that are other big financial institutions cannot and they're taking advantage of the situation and – you know what? A lot of people would take a \$10,000 credit card. Its there, right? So I think there is responsibility from an industry standpoint, but I think there's a responsibility from a government standpoint and a society standpoint to make sure these things don't happen.

(2) Fringe bank respondents' views

Whereas some mainstream bank respondents appeared perplexed about the popularity of payday loans, fringe bank respondents claimed to have a clear understanding about its popularity. Fringe bank respondents argued that their clients are making rational decisions about their credit choice which is based on the superior design features of the payday loan. For instance one fringe bank respondent argued that it was the high level of service provision in fringe banks, as compared to mainstream banks, that brought clients into the payday lender: "Well, yes...because people want to go where they get service." This respondent elaborated:

An argument has been made...is frequently made...that the reason that this industry is booming is because of financial exclusion. I disagree so fundamentally because I think one of the reasons that the industry is booming is not because of exclusion. It's because of accessibility of financial services. Basically, through this past economic cycle which is now coming to an end, we're starting a new one; the whole cycle has been driven by easily accessible consumer credit products that are driven by the financial services industry. And so, people just want to have access to money to buy things, they don't want to wait, they're knowledgeable about their financial situation but don't manage it very well, they get stretched. And they have multiple payments for their various different types of credit products and they get stretched.

Another point raised by fringe bank respondents was the unique ‘convenience’ character of the payday loan. Outlets are open long hours, they are available in many parts of any city, and applying for the loan can be done quickly. One fringe bank respondent compared this with the inconvenience of credit from a mainstream bank:

Pick up the phone and call any credit union and say that I need \$200, can you lend it to me...and you’ll get sure but...but you have to leave money in the account, but you have to be with us for 18 months, but...And the person sitting there is saying, look, all I want to do is borrow \$200 and I’ll pay you for that opportunity. All of the rules that are in place for the credit unions and banks have more rules. There isn’t the opportunity for someone who needs a small loan quickly and conveniently to obtain it through conventional means.

Fringe bank respondents claimed that payday loans are better designed than other fringe bank products such as pawnshop loans that can offer a small loan but at the expense of depositing an asset with the pawnbroker. These respondents noted that payday loans fill a need for young people who are net borrowers within the credit-savings life cycle. Finally, they noted, payday loans are actually a less ‘tempting’ form of credit as compared to a credit card or line. This is because the loan is negotiated for an absolute amount that must be repaid on a particular date, as opposed to carrying a credit balance.

ii) Demand-side factors

Regarding the demand-side, respondents were asked if they thought that declining or stagnating incomes among some Canadian groups was a factor in explaining financial exclusion. Without elaborating on the point, both credit union respondents felt that this was a factor. This was also supported by one mainstream bank respondent. One fringe bank respondent felt that it might be a factor while another dismissed it as a factor.

One mainstream bank respondent noted that individual choice to use fringe banks is irrational and the solution is financial education:

I mean why would someone who is a savvy money manager—why would they pay \$5 or \$10 to cash a cheque? When for \$4 you can have a bank account and do all of your banking over the course of a month. So, you know, there has to be information and financial literacy amongst the people who are having problems managing their money.

Another issue raised was the marketing of basic banking products. One mainstream bank respondent pointed out that government is not doing enough to make citizens aware of low-fee accounts available in mainstream banks:

I think a lot of people would be surprised to know that there is an access to basic banking regulation and that banks offer a lot of banking service for 4 bucks a month. I think people would be shocked to know that. What is the government doing about that?

iii) Supply-side factors

In terms of explaining financial exclusion, respondents had more to say about bank location, an important supply-side factor, as compared with demand-side factors such as income trends. Fringe bank respondents were strongly critical of the view that payday loan outlets are mainly located in low-income neighbourhoods. While one respondent argued that pawnshops do locate in low-income areas, all fringe bank respondents argued that payday lenders locate their outlets where their clients live and work. This, they claimed, is primarily in malls with other retailers such as restaurants and mainstream banks.

In Ontario and in Alberta they have these places called ‘commons.’ It’s basically an outdoor mall: you’ve got a Keg; you’ve got a Starbucks; and you’ve got a Safeway. Safeway and Starbucks co-locate; all that kind of stuff. That’s what we do. We basically locate where we know people are going to go for services. Very often we will locate close to banks.

In fact one fringe bank respondent argued that banks deliberately allow fringe banks to locate nearby:

So, of course, whenever you go out to the suburbs and to the shopping malls, you’ll always see a payday loan store. And they’re in there because the banks and credit unions as the anchor tenant will have consented to that store going in there. So that’s an implicit acknowledgement by banks and by credit unions that there are services being provided [by payday lenders] that they can’t provide, and there are customers in those socio-economic areas that the banks are moving into.

Respondent comments about mainstream bank location strategies were quite consistent. First, the general view among mainstream bankers is that with branches, ATMs, POS terminals, internet and telephone banking, that mainstream bank services are quite available: “If we’re talking about just access to basic banking services... There’s a lot of supply.” One mainstream bank respondent noted that some rural areas are particularly bereft of mainstream banks.

One fringe bank, one credit union and one mainstream bank respondent supported the view that mainstream bank closures were particularly hurtful on low-income neighbourhoods. One credit union respondent claimed that mainstream banks had been closing marginal inner-city branches but that the trend had reversed and now these same mainstream banks were opening new branches in the these locations. A fringe bank respondent put it this way:

Now, two banks in particular... I know [Bank X] is doing this, although I don’t know if they’ve made it public, but certainly [Bank Y] has, they’re saying we made a mistake from [its] retreat from all of these neighbourhoods: “We’re going back in there.”

One mainstream banker provided a useful example of this phenomenon:

What was very interesting to us was that lower income markets –branches in lower income markets– were actually more profitable than in high income area markets. I always use the example of Rosedale in Toronto which is one of the most premium neighbourhoods in our city. Those branches were nowhere near as profitable as our branches, say in Scarborough, or a pocket of Scarborough where

an average income person lives. We saw on more than one occasion that lower income, high population density areas – those branches are actually more profitable.

What is causing some mainstream banks to open branches in lower-income neighbourhoods? A credit union respondent claimed this was the result of gentrification, i.e., the process of rising average neighbourhood income through in-migration of middle-income households. Another mainstream bank respondent provided another explanation. He argued that his bank had examined the relative profitability of branches in neighbourhoods with different average income levels. They had come to a surprising result: branches in high-end neighbourhoods were not as profitable (or not so much more profitable) than branches in more modest neighbourhoods. Why? He noted two main factors: volume of transactions and the profit margin on services.

You know, it's the volume/spread trade-off. One of the things we found [through our research] was that a lot more transactions were done by branches in these areas. More transactions generate more revenue. You know, you have a branch in a high-income area, the houses are bigger, the people are less, the people are financially savvy, and they know how to optimize their banking and how to get the best deal within and among packages. So they benefit from that. The average person is doing business the normal way.

As compared with affluent neighbourhoods, lower-income neighbourhoods can generate more transactions for the mainstream bank leading to greater fee revenue. And, lower-income customers are less able than affluent customers to negotiate good rates for loans and investments.

However, some neighbourhoods simply don't have the wealth to support a mainstream bank. The lack of initial wealth has long-term implications for the neighbourhood. The mainstream bank respondent pointed out:

...banks are going to locate where there is demand for those services. There may be a chicken and egg situation –or maybe not as there might have been a branch there that was closed—there has been a bit of that in Winnipeg's North End. The branch may not have been realizing a profitable level of services. There is the question of whether these sorts of entities have filled a demand gap but have done so in a way which has contributed to financial exclusion and incurred some other deleterious affects. I could see that as a consequence of having fewer branches in the neighbourhood. What the solution is, is more difficult.

d) Consequences of financial exclusion

i) Of payday lending

Respondents spoke about the consequences of relying on payday lenders. In this connection, the term 'vicious cycle' was used by several times by one mainstream bank respondent and one credit union respondent. These respondents argued that payday lenders are responsible for people accumulating an unsustainable amount of debt. Payday lenders allow people to become over-extended in debt obligations, as one mainstream banker noted:

I think one of the reasons people go to payday loans is because they've gotten to the point where they can't get ahead on their budget and their spending more than they can afford to. Not just a lender of last resort issue, people get into a situation where their expenses get the better of their income and before you know it they're missing payments and their credit history gets spoiled. They're no longer eligible for the same type of credit from the large financial institutions so they go get that payday loan and enter that vicious cycle. They get caught in it.

Interestingly, one payday lender argued quite a different point. He argued that heavy debt was accumulated through mainstream banks, not payday lenders. Payday lenders offer small loans that don't add much to a person's debt load. Moreover, he argued that the payday loan was designed as a time-limited, one time loan, such that it was less conducive to debt accumulation than credit lines and cards. It is the mainstream bank and the design of its products that is responsible for high levels of consumer debt.

They come to us to get a loan. The bank still has a relationship with them. They haven't used them up, they've [mainstream banks] got them [the payday loan client] in an extended cycle of debt repayment. One of the things...levelled against the [payday loan] industry is that [it] traps people into a cycle of debt. Well, our product is very different from a typical line of credit or a credit card. Those products [credit lines and cards] are specifically designed as a cyclical product. Look at any detailed financial reporting on the revenue potential for a credit card. A credit card company will report on the average rolling balance on a credit card. Like MBNA will say our average rolling balance on a credit card is \$2,700. So basically, we have 4 million customers with an average rolling balance. So basically for the next 10 years they have a revenue stream on that chunk of receivables. And then the whole business model is built on extracting value from those receivables. They sell them to people, they market them to people, and they do all kinds of advertising...

ii) Of not having a mainstream bank account

Only one respondent, a mainstream bank respondent, spoke about the personal consequences of being unbanked. He presented a clear, comprehensive picture of the weaknesses of financial exclusion:

Being limited to that second tier of banking [fringe banks], but its not really banking, or that 2nd tier of financial services is problematic in that it provides no link to the kind of financial services that we would hope individuals would participate in throughout their lives with both choice and the understanding to best make choice, literacy about financial products and knowledge about how expenditure and savings and which vehicles to house savings would relate to conditions tomorrow. That lack of access does diminish future prospects and therein the definition does fit.

e) Addressing Financial Exclusion

i) Organizational mission & its relationship to financial inclusion

To begin the next section of the interview, respondents were asked to say a little about their organization's mission or mandate. One mainstream bank respondent noted his organization's goal to provide banking services to all Canadians. A second representative referred to providing banking services in a convenient way. One credit union representative reported having a mission that had explicit economic and social goals while a second credit union respondent noted the goal of financial inclusion and the challenge to convince members of the importance to include unbanked people. Association respondents spoke to policy level work as their mandates.

Respondents were then asked whether addressing financial inclusion was a component of their organization's mission. One mainstream bank respondent noted that her organization's financial literacy work was how they addressed financial exclusion. Another mainstream bank respondent noted that by maintaining longer retail hours of operation, and by keeping some, more marginally-profitable branches open, it was engaged in financial inclusion work. A third mainstream bank respondent had a more nuanced comment about financial inclusion. He recognized that financial exclusion did affect particular groups, and that these groups were low-income and younger. He commented that his bank had identified these differences in uptake of banking services and that his bank seeks to provide services to address those who are particularly marginalized. The two credit union respondents noted an explicit understanding within their organizations about financial exclusion and that through micro-loan programs they seek to address one aspect of it. One fringe bank respondent argued that they were not responsible for financial inclusion:

Well, I don't think that's a mandate for us. When you look at credit unions and banks, they receive powers in charter from the federal and provincial government that confers on them special status and benefits. In return for that special status and benefits, they have to provide or there is a responsibility for them to provide accessible services to low-income Canadians. Because of the special statuses, they have become very profitable...Here, with the payday loan industry; we're talking about private benefits.

ii) Who are your clients?

This was a relatively simple question and it provided interesting insights about how banks think about their clientele. The purpose of the question was to understand how banks related to people who were most likely to be financially excluded, i.e., low-income clients? Respondents voiced at least two different types of views. One perspective was that low-income clients have unique financial service needs and these needs must be understood by the bank. One mainstream bank respondent and two credit union respondents accepted low-income as an identifiably distinct and important group that they serve.

The second view, held by mainstream bankers, excluding credit union respondents, was that their bank serves *all* Canadians, whether rich or poor. One mainstream bank respondent rejected low-income as a meaningful way to understand some of its customers. These respondents argued that their services are not shaped for a particular segment of the market. In the two interviews with mainstream bank respondents (not the association), the reference to the expression 'all Canadians' was used four times.

iii) Solutions to financial inclusion

Most respondents identified financial education as either the key, or one of a few, steps that need to be taken to address financial exclusion. The consensus solution to financial exclusion (and

over indebtedness crept in as an issue in light of the current economic crisis) was improved consumer education. This is reflected in the number of times words relating to financial literacy occur in the interviews: ‘literacy’ was said 32 times, ‘education’ occurred 48 times, ‘management’ occurred 16 times, ‘skills’ occurred 4 times, and ‘counselling’ occurred 6 times. In total these terms occurred 106 times.

Most respondents were thus seeing financial exclusion as the responsibility of the consumer. This point was most forcefully argued for people who were carrying heavy debt and relying on sources—such as payday lenders—for credit. But it was applied to unbanked people as well. One mainstream bank respondent noted that financial education, in the form of debt counselling, has a good record of achievement:

A person who has been through their [credit counselling] program...has learned how to manage their money. Recidivism rate is about 1 to 2 percent. Education has been proven to show that people who learn how to manage their credit wisely go on to be much better at it [money management].

Once again, however, the credit union and a mainstream bank respondent respondents took a broader perspective than the mainstream bank respondents. One credit union respondent noted that financial education is important, but that banking in our finance-driven economy must be understood as a right for all people. As a right, banking services must be available in a fair and accessible way for all people. A second credit union respondent noted that strengthening the financial literacy of consumers is important as is providing more financial services for under-banked people. This respondent noted the need for government loan guarantees to enable mainstream banks to engage in loan programs that can compete with payday loans. A loan guarantee program would reduce the risk faced by the bank in offering expensive small-sized loans. A mainstream bank respondent noted the weaknesses in the current public entitlement system:

I can’t speak to operations here. It seems like this is an issue of advocacy. Assurance of identity is important. Security of the individual and the overall integrity of the transaction process is important. As an ideal I would see making a lot of these transactions electronic as we move to a system of social assistance that is less case-worker oriented and more tied to some guaranteed income and delivered through the tax system. That is often what we speak to in re-jigging income security moving towards a less sort of welfare wall system and more where the taxation system is used as the method of delivery that ensures a guaranteed income without the need to check all the boxes. The best way to achieve this is through a direct transfer through which individuals could then easily access funds...ideally you want people to use low-cost transactions, if it is those transactions that they seek.

iv) Who is responsible to address financial exclusion?

Respondents reflected a variety of positions about where the responsibility lies in addressing financial exclusion. One credit union respondent noted financial exclusion is a deeply rooted problem that can only be addressed when society works together on it. Another credit union person commented that banks needed to partner with communities to address financial exclusion. One mainstream bank and one credit union respondent argued that mainstream banks have a role

in financial inclusion: “I’d like to see the industry take more of a leadership role in reaching out to communities and doing education courses about financial planning.” One fringe bank respondent argued that many actors can assist in strengthening financial education:

Education is the way to go. In terms of community support, banks, credit unions, payday lenders all getting behind those sorts of things. Because [Bank X] is not going to be putting brand new banks into the inner-city or poor neighbourhoods and if they do people aren’t going to feel comfortable going to them. But as part of a community outreach, that’s a good way to begin tackling the problem.

One fringe bank respondent identified excessive household debt as a problem for households and the country. Another fringe bank respondent commented that since there is no problem, there is no need to identify responsible agents to solve it:

The average household in Canada spends at least 2% more per year than it earns; it hits every single demographic category. Are Canadians financially literate? In my opinion, they are. They just choose to behave in a particular way.

v) Addressing financial inclusion

Respondents’ views varied considerably about how to solve financial exclusion. Suggestions went from stating that there is no problem to calling for changes to government entitlement schemes. Suggestions that were made included new products, government regulation, and by addressing root causes of poverty. The suggestions included placing more branches in marginal neighbourhoods, offering special loans and mortgages products (with relaxed criteria) for new Canadians, simplifying product design, advertising products for low-income people, and working with ‘communities’ to develop products. Government regulation was raised as a step that is needed with respect to payday lenders. One respondent argued that the causes of being unbanked partly lie in the welfare system that uses social workers to enforce policy and cheques to make payments.

One mainstream bank respondent noted their low-fee account, budget counselling service, online budget tools, and special mortgage products for newcomer Canadians. Another mainstream bank respondent said they had no specific products for low-income people: “I mean, you’re making it sound like low-income Canadians don’t have...they have, in most cases, similar financial product needs as other Canadians, right?” However, this same respondent noted that they do offer a low-fee account, ‘low-cost’ credit cards, among other activities. One credit union respondent referred to their producer micro-loan program, research they engaged in on payday loan alternative, a no-fee account, and debt counselling. A second credit union respondent noted offering low-fee account, insurance, and financial education.

One mainstream bank respondent and one credit union respondent noted their effort to simplify their products. The credit union respondent noted a major refurbishment of their financial service products as a process of focusing on more basic financial services:

Respondent: Yes. We’re re-evaluating our entire product line, so that’s a big project we have underway right now. We’re aiming for simplification of our product line. It’ll probably take 2 years...to get it where we want it to be. So what we have now may not resemble what we will have in the future but...

Interviewer: This is all part of going back to the core competencies?

Respondent: Yes.

Interviewer: Back to the roots. Back to basics as it were...

Respondent: Yes, absolutely. I kind of liken banking to what it's like when you try and buy a cell phone. Its way too complicated. Going back to financial literacy as one of our pillars; having so many packages just doesn't make sense to us.

Some respondents pointed to the need for deeper rooted change than what a bank can provide. One mainstream bank respondent stated:

There's a whole variety of other ways I think we are trying to contribute to public policy discussions. Root causes, other than simply, you know, the banking sector is somehow excluding people from participating in it. There are broader issues...[like] the absurd rules that exist in Ontario that don't allow [poor people] to have any assets.

A mainstream bank respondent argued that different actors have different responsibilities. The state is responsible for consumer protection including protection from troublesome business practices of some cheque-cashers. The state must also ensure that there is adequate, but not excessive competition in the banking sector. He noted that banking has a public good character to it and so the provision of it does not always allow the provider to glean all the rewards. This presents a case for state involvement in financial service markets in some form, but he did not identify what form that might take.

The presence of a variety of banks in the neighbourhood then is beneficial but banks and credit unions/*caisse populaires* are going to have some pressure to locate branches in a profitable way. I don't know what regulation would be appropriate to inducing banks to provide full financial services in an area where certain of those services were to be demanded. You may not locate a financial planner in a neighbourhood where there isn't demand for that service. Though there is a case –a profit case– to be made for having a tailored degree of banking services. Again, I don't speak for operations so I don't know to what degree the whole suite of branch banking would be set but given the nature of the bank branch system there should be –and I think is– a longer term view that banking relationships are important for individuals and for the bank. Providing a branch as an entry point is quite essential to develop those relationships. The broader mind too would look at the health of the Canadian or local economy as the bank's ultimate profitability is bound up with the overall economic performance of the country or local region consequently there should be a mind to making near term investment for longer term profitability.

f) Other issues

Other interesting issues arose through the conversations. These issues were not related to one specific question but arose through the analysis of key issues raised in the interviews. These include the tone of the interview, bankers' views about low-income people, and bankers' views about other types of banks.

i) Interview tone

One issue had to do with the tone of the interviews. Generally the tone of the interviews was positive. Most participants felt that the questions and the assumptions behind the questions and concepts were a reasonable starting place. Many respondents agreed that banking is important and that people who are not banking face particular economic obstacles. However, some participants were less comfortable with the premises of the interview. Two mainstream bank respondents' tone suggested a discomfort with the basic premise of financial exclusion. This was reflected in challenging the name financial *exclusion*, arguing this name implies a deliberate strategy of exclusion. It was also reflected in the tone of two interviews.

Another mainstream bank respondent spent considerable time in the interview questioning the financial exclusion definition and measure. While the points raised were useful to highlight the complexity and controversy related to these issues it did set a more critical tone in the interview.

One of the interviews with a fringe bank respondent had a curious tone. He argued that financial exclusion of all kinds –not having an account, relying on payday lenders– was not a problem.

ii) Views about low-income/heavily indebted people

Without specifically asking, several respondents offered comments about the rationality of low-income or heavily-indebted people. Two mainstream and two fringe bank respondents made comments in this vein. Mainstream bank respondents made comments about the rationality of low-income or heavily-indebted people. One mainstream bank respondent simply stated that he was puzzled about the use of payday loans. He did not elaborate on the puzzlement but it suggests a level of uncertainty about payday loan consumers' behaviour. A second mainstream bank respondent was clearer about the rationality of certain people with respect to financial service choice. For instance, the respondent wondered about the rationality of a person using a cheque-casher when she could have relied on a mainstream bank account.

Financial literacy is seen as the solution to payday lending, for this mainstream bank respondent. She felt that the use of payday loans was caused by a lack of understanding that can be met through education:

A big concern is that they do it [use payday loans] willingly. They know the costs involved and they're making that choice. You can get the same services or a small, short-term loan at a financial institution for a lot less money. Even a credit card which is at the high end of the services that banks offer in the 19% range or in the low-cost card range is 10-14% and you look at what they're paying for a payday loan. The concern is that they're paying more than they need to and that they understand the choices that are available to them. So it comes down to financial literacy.

While both fringe bank respondents primarily argued that their clients were making rational decisions to use payday loans, due to service quality or convenience, they did reflect on consumer rationality. One fringe bank respondent opined:

And so, people just want to have access to money to buy things, they don't want to wait, they're knowledgeable about their financial situation but don't manage it very well, they get stretched. And they have multiple payments for their various different types of credit products and they get stretched.

Another fringe bank respondent reflected on the use of payday lenders as a small portion of the person's overall financial position.

The service personnel see that maybe you're making your third trip and yes, it is the responsibility of that lender to provide them with the education they need to assist them with their financial troubles. If they're coming to a payday lender for two or three hundred dollars then there's a good chance that customer has much larger financial issues than borrowing two hundred dollars between a paycheque. Those should be addressed in a proper forum, in a very constructive way. So education is a tremendous asset to the big picture.

iii) Views about banks by bankers

It was interesting to note the views expressed by respondents from each type of bank about the other type of bank: i.e., what did mainstream bankers think about fringe bankers and vice versa. The views expressed by each group were not entirely consistent. In some cases comments were supportive and in other cases they were not.

(1) Fringe banker views about mainstream banks

Fringe bank respondents noted that mainstream banks earned high profits due to their distinct and protected status. This special status conferred on them certain responsibilities to provide basic banking. Fringe bank respondent also noted that mainstream banks implicitly support payday loans through lease arrangements they make with malls, noted above.

Interviewer: How would you characterize the institutional relationship between the banks and the payday lending industry? Is there an open acknowledgement of each other? Any literature you come across or articles in the press-- one doesn't respond to the other. Is there an open dialogue between the industries, or is it a live-and-let-live type of relationship?

Respondent: Well, I mean I guess the nature of those relationships exist on different levels. Level 1 would be basically on a transactional basis with the banks that we operate with.

Interviewer: Right.

Respondent: At that level, we deal with [a bank]. I think that [Payday lender X] deals with [Mainstream bank X] or maybe it's [Bank Y]. Everybody's got their bank. There are certainly no issues in that respect. Then there is the relationship based on a public policy dialogue.

Interviewer: That's what I'm looking for.

Respondent: Yes. On a public policy level there is some dialogue, and we do face similar issues on a regulatory basis, but basically the banks keep a distance from us because they don't want to get roped into our problems.

Fringe bank respondents noted that mainstream banks are unable to provide the services such as payday lending and cheque-cashing that some people desire:

Canadians are probably the highest banked of any country. But it raises the question why aren't banks then providing bank accounts and you've seen lots of

research where a lot of people say they aren't comfortable in banks, the way they're treated and stuff like that.

A fringe bank respondent argued that it was mainstream bank products that have caused high levels of household debt:

The simplest example; say a person has a line of credit. And they've utilized that line of credit up to their max and are paying their monthly payment. So the bank says to them...There are two instances. Either they decide that they don't want to extend that line of credit further to finance their behaviour or they say they cannot extend the use of this facility any further. They come to us to get a loan. The bank still has a relationship with them. They haven't used them up, they've got them in an extended cycle of debt repayment. One of the things about the industry that has been levelled against the industry is that the industry traps people into a cycle of debt. Well, our product is very different from a typical line of credit or a credit card.

Finally, one fringe bank respondent commented that the impact of the recession on mainstream banks will push more people to rely on payday lenders:

People, who have traditionally been able to go to the bank when their line of credit reaches their max and want to increase their limit by a thousand bucks over the phone. The bank would say no problem. I think that these people are going to reach their limit...the bank's not going to extend that to them...and they're going to enter into our segment.

(2) Mainstream banker views about fringe banks

Two mainstream bank respondents spoke critically about payday lenders, in some cases saying that their products are harmful to the consumer. One respondent argued that fringe banks act in ways that hurt consumers, as mentioned above, through unfair disclosure of salient loan information. Moreover, "they're [the consumer relying on a payday lender] being lured into these payday loans who say, bank with us and then it turns into the vicious cycle."

One mainstream respondent, when asked about the definition of financial exclusion pointed to the CPLA and its research:

Respondent: ...Probably with the idea that you are unbanked if you don't have a bank account. So if you have a bank account. But I'm not even sure if I would put the reliance on fringe banking services as part of that. Because again that could be a separate issue. Have you seen any Canadian Payday Loan Association research?

Interviewer: Yes. I'm very familiar with their work.

Respondent: They've done research on some of the people actually using these services and some are doing it by choice. A lot of it is by choice. You know they have access to other services. But one of the common misperceptions out there is that if you need a small loan for a short period of time then you need a payday loan. But the banks do offer short-term, small sum loans. You can have overdraft protection, get a line of credit, a credit card with varying interest rates but certainly much lower than what you would get at a payday lender. These are all

readily available, convenient. People say they use payday loans because they're convenient. But to me it's convenient to access your overdraft, for example.....

This same respondent argued against the view that payday loans are used disproportionately by lower-income Canadians: "That PIAC 2002 study on alternative banking services...on p. 38...says that 'our key hypothesis going into the household income survey was that alternative financial service providers were preying on the poor.' Then they conclude that one must reject the hypothesis that it targets primarily those in society that are disadvantaged."

One mainstream bank respondent commented that banks are criticized but payday lenders are not:

I mean payday lenders don't get criticized for *opening* offices yet banks get criticized for closing branches. Now, I certainly see there is a business case to be made for us expanding our network and we continue to do so.

g) Discussion

The banker interviews revealed interesting insights with respect to their views on financial exclusion. At a general level the interviews demonstrated a range of views about financial exclusion. Some respondents accepted the concept and engaged in constructive dialogue about its causes and solutions. Other respondents rejected the concept and were therefore less willing to dialogue about causes and solutions. In some cases mainstream bankers rejected the concept itself because they interpreted the concept –even though the definition provided did not state this– implied as a deliberate mainstream banks strategy to exclude certain customers. Indeed, two bank respondents expressed concern about the concept both in what they said and in the tone in which they said it. Other respondents were willing to engage in a fuller conversation about the concept, cause, and solutions to financial exclusion. Generally speaking, credit union representatives, and non-operations mainstream bank representatives were more willing to engage in a full ranging dialogue about financial exclusion. The remaining mainstream (closer to operations) and fringe bank representatives tended to support the personal responsibility theory. Thus the second hypothesis, that bankers were largely misinformed and disinterested in financial exclusion was rejected. Even though most bankers embraced a personal responsibility theory, several others offered comments fitting this view but other respondents offered insightful and fulsome understanding.

The question 'is financial exclusion a social problem?' elicited some interesting comments, which demonstrated a range of views and often brought the discussion onto causation. Some mainstream bankers argued that financial exclusion is not a social problem but a personal problem. That is, it is psychological forces, not social ones, leading some people to use fringe banks. Other respondents argued that there are social forces involved in financial exclusion so that it is, in part, a social problem. This question led neatly into a conversation about causation. This discussion helped to draw the lines more clearly among different views about financial exclusion. Those respondents that rejected the concept generally argued that it was not a social problem, and pointed to poor financial literacy as the cause. For these respondents, personal responsibility is the driving force of financial exclusion. Average income trends, branch closures, and the skyrocketing growth of payday loan outlets do not come into the frame, except as consequences of personal choice. Other respondents were more interested to engage in, and in some cases, embrace factors referred to by the interviewer on the demand- and supply-side.

When respondents were asked to discuss the cause of financial exclusion, several respondents pointed to payday lending. Several mainstream bankers argued that the use of payday loans is a clear-cut case of consumer irrationality. Other mainstream bank representatives accepted this point but added that the lack of similar products from mainstream banks was another factor. Fringe bank respondents argued payday loan consumers are rational and willing to pay a premium for a payday loan, for convenience-sake. With respect the financial exclusion in general, once again, the views ranged from lack of financial literacy to various factors mutually affecting bank access. Most respondents agreed that the consequences of financial exclusion were problematic. One payday lender argued that relying on payday loans was less problematic than relying on mainstream bank loans, because they are so much smaller.

Some respondents once again reacted strongly when the conversation turned to the issue of solutions to financial exclusion. For those respondents, who also felt uncomfortable with the financial exclusion concept, the solution was simple: consumer financial literacy. Other respondents included improved financial literacy as one among several factors that is needed to be addressed. These respondents also argued that mainstream bank services currently provided are sufficient for everyone's needs, including low-income Canadians. Other respondents accepted that low-income Canadians might have particular financial service needs, and that these needs might be different from those needs of middle-income people. These respondents pointed to the need for improved financial literacy among other factors including more accessible bank accounts, availability of small loans, and government loan guarantees.

3) Conclusion

Bank social reporting, more so than reporting on environmental issues, is limited with very little comment about how banks address financial exclusion. The reports reviewed for this study focused primarily on charitable activities of the banks with some exceptional references to community development. That most banks report little if anything about community development and financial inclusion is at odds with their reporting requirements. The US CRA requirements may have affected RBC's more thorough reporting, through its American affiliate's operations. Some credit unions, for instance Vancity Credit Union, offer more detail on social aspects of reporting. Based on these reports, it appears that most banks are doing little with respect to financial inclusion. The first hypothesis, that banks are not actively addressing financial exclusion, is accepted.

However, in dialoguing with bankers, a more complex story unfolded. The majority of mainstream and fringe bank respondents embraced the view that financial exclusion was driven by the personal choice of banking consumers. They argued that the rise of payday lending is a reflection of this personal choice. Those respondents argued that the solution to financial exclusion and reliance on payday lenders is financial literacy. But a minority of respondents, associated with the credit union and a few mainstream bank respondents presented a fulsome understanding of personal and structural obstacles to financial exclusion. Thus, we rejected the second hypothesis because of this minority view. While most bankers tended to point to personal responsibility as the key, some saw it as just one part of the financial exclusion puzzle.

In conclusion, banks and by-and-large bankers are 'passing the buck' with regards to financial exclusion. Bank activities to address financial exclusion, based on their reports, are limited. The majority of bankers, particularly those close to operations, tend to attribute financial exclusion to a personal choice. The cause of financial exclusion, if it is a problem, has to do with a lack of consumer financial literacy. The solution, goes the argument, is financial education.

Thus, the majority of bankers voiced a theory of financial exclusion consistent with the relative inactivity of banks regarding financial exclusion. However, an important minority of bankers, primarily credit union and non-operations bank respondents took a more fulsome view of financial exclusion. They noted that structural obstacles are acting on the lives of the financially excluded.

4) Recommendations

1. Financial Institution (FI) Responsibility

1.1. Financial Institutions in Canada need to raise awareness among their staff and shareholders about the nature, causes and solutions to financial exclusion. This could be facilitated through working groups lodged within FI associations such as the Canadian Bankers Associations, Credit Union Central Canada, the Desjardins Federation, and the provincial Credit Union Centrals. This could involve literature review and undertaking research studies to better understand roles and responsibilities.

1.2. FIs in Canada should include financial inclusion within their Corporate Social Responsibility work. Financial inclusion is already a part of the Desjardins Federation and the Credit Union Central Canada is starting to work in this area. However, financial inclusion should not rely solely on the credit union/*caisse populaire* system. Mainstream banks are much larger and therefore have more responsibility to address this problem. The credit union/*caisse populaire* system might be seen as an important source of innovation that could be replicated among the mainstream banks.

2. Government Responsibility

The federal government establishes the framework, including the Bank Act and the Access to Basic Banking Regulations, in which FIs operate. Evidence from this study is that FIs are not very active in addressing financial exclusion and the majority view is that the solution is financial literacy. While this may be one factor in the problem, research has documented many other structural factors.

2.1. Bank regulators including the FCAC, Office of the Superintendent of Financial Institutions, Department of Finance, and appropriate provincial regulators (of credit unions and fringe banks) need to place financial inclusion as a key goal of government policy.

2.2. Once financial inclusion is identified as a goal of government policy policies and programs must be put in place to foster it. Some options include a US styled Community Reinvestment Act or a UK styled financial inclusion fund.

Appendix 1. Summary of References to Financial Inclusion

(e.g., access to banking, low-income people or neighbourhoods, community development, etc.):

CIBC 2008. *Public Accountability Statement*, 25 pages.⁹

There was no specific mentioning of low income customers in relation to financial exclusion, or financially excluded or the like. There was, however, emphasis in the document on accessibility to banking (convenience factors – branch, hours etc, also accessibility for person with disabilities), banking solutions, and programs for specific target groups (seniors, students, youth, newcomers to Canada, aboriginal customers). These points are raised in the following passages:

- CIBC makes notes of its efforts at Access to Banking (number of branches, schedule of hours – Sat & Sun, evenings-, language, ABMs, online banking etc) (p. 17).
- CIBC makes notes of its efforts at serving customers with special needs (branch accessibility survey, “Access for All ABMs, Mobile HLC Home Loans.)
- CIBC notes its efforts at providing Aboriginal Banking Solutions (branch locations on reserves, team of advisors for comprehensive financial services, Aboriginal Personal Planning, contributions to organizations that support aboriginal communities) (p. 18).
- CIBC notes efforts towards providing affordable banking solutions (products and services lower-cost – CIBC everyday chequing acc, mortgage rates, no annual fee credit cards; CIBCs enviro-saver mortgage, President’s Choice Financial, free mortgage seminar) (p. 18).
- CIBC makes notes of its efforts targeted specially to children, youth, students and Seniors (CIBC Smart Start Program; Advantage for Students; Professional Edge Program, 60 Plus; financial education for youth) (p.18-19).
- CIBC notes their way of doing business based on respect to the customers, high quality client service, fee transparency, privacy protection and confidentiality (p. 19).
- CIBC makes notes of its contributions to charitable and non-profit initiatives, and contributions to education (p.26-7).
- CIBC notes its efforts to support newcomers to Canada (CIBC YMCA Access to Opportunity; series of seminars designed to provide advice and information that newcomers need to start banking in Canada, start a business and invest; job skill development program) (p. 27).
- At the end of document a list is provided on Branch openings, closings, relocation etc. A note provides info regarding process of closing a branch in a community (p.170).

⁹ Pagination of document uses non-standard format: it begins on p.15 and continues to p.31 then jumps to p.170 and runs to p.177. In total the report has 25 pages.

RBC 2008. *Corporate Responsibility Report and Public Accountability Statement*, 73 pages.¹⁰

The Report lays down RBC's corporate responsibility priorities in these areas: Economic Impact, Workplace, Marketplace, Environment, and the Community.

- Reviewing RBC's economic impact, RBC strives to support community economic development.
 - RBC notes its support in the form of donations to initiatives that have a positive economic impact such as “helping disadvantaged people access financial services” (p. 21).
 - RBC supports several financial literacy initiatives including one in Calgary which targets low-income customers: Momentum Community Economic Development Society's Money Management program: “[this program] delivers workshops to people living in low-income situations with a goal of supporting individuals to take control of their personal finances and develop money management knowledge and skills” (p. 22). In Waterloo, It also offers a financial literacy program for youth from families with lower-income (Lutherwood's Youth\$ave).
 - RBC offers support programs for customers to achieve home ownership. Some of these offer support for first-time home ownership, such as the Equity Program for New Immigrants (p. 22).
 - RBC supports newcomers in various ways – adapted credit, banking, marketing, recruiting and training practices; created a banking package tailored to the needs of newcomers; support for various organizations; among others (p. 23).
 - RBC makes reference to its commitments under the U.S. Community Reinvestment Act, stating that under the Act, RBC is “required to provide a certain amount in loans to facilitate community development, and to ensure access to banking services for low- to moderate-income groups [. . .]”, requirements which are met by RBC (specific programs not stated). RBC notes that it helps stimulate economic activity by providing credit and specialized programs that support homeownership, financial literacy and economic development for lower-income earners and neighborhoods (p. 18).
- Reviewing RBC's impact in the marketplace, RBC strives to provide access to basic banking services and to protect, educate and listen to customers.
 - RBC notes that it respects Canadian Regulations that ensure that people are able to obtain a basic bank account and RBC goes “further by facilitating access to banking through specialized programs, products, services and locations for traditionally underserved groups” (p. 26).
 - Regarding access to banking and insurance –Compliance with federal legislation regarding opening and closing of branches in local communities (p. 29).

¹⁰ RBC Public Accountability Statement (PAS) was incorporated with its Corporate Responsibility Report since many of the PAS requirements overlap with the contents now expected in corporate responsibility reports.

- Regarding access to banking and insurance – One subsection devoted to ‘Special groups’; “RBC provides banking access to a host of traditionally underserved groups through customized products, services, channels and community-based programs” (p. 30). Special groups include low-income and traditionally underserved clients, people with disabilities, seniors, students and youth, newcomers to Canada, people who speak different languages, aboriginal communities – (at p. 30-31):
 - Low-income - RBC is committed to providing banking access to low-income and traditionally underserved clients through initiatives like: low-cost Canadian deposit account; [. . .] affordable mortgage options and first-time buyer options (U.S.); Access to basic banking for remote Aboriginal communities offered through innovative partnerships with local agents; U.S. branch offices that service low- and moderate-income communities (p. 30).
 - Newcomers – Welcome to Canada package.
 - Aboriginal communities – branches; agency banking outlets; specialized team; On-reserve Housing Loan program.
- Reviewing RBC’s community donations, and employee contributions, and sponsoring of key community initiatives.
- Reviewing RBC’s contribution to Aboriginal communities.
 - Access to banking and specialized services – (at p. 57)
 - Eight Canadian branches on reserve, six branches “North of 60”, five agency banking outlets. Specialized team to provide financial advice and solutions; On-reserve Housing Loan program (p. 57 & p. 31).

Appendix 2. Questionnaire for Interviews

Section I. Defining and Understanding Financial Exclusion

1. It is said that between 3-5% of Canadian adults don't have a bank account. For low-income Canadians the figure lies between 8-16%. This is sometimes referred to as being 'unbanked' or 'financial exclusion.'
 - a) Do you think these figures are accurate?
 - b) Do you think financial exclusion represents a social problem in Canada? Why?
2. *For the purposes of this project we define financial exclusion as a situation when a person has no, or a very limited, relationship with mainstream bank & relies on expensive and limited fringe banks services from cheque-casher, pawnshop, etc. It is correlated with low-income (& associated variables) & manifests a second tier of banking.*
 - a) Is this a helpful definition? Why?
 - b) Are there aspects of the definition that you agree with?
 - c) Are there aspects of the definition that you disagree with?
3. *As an example of the consequences of financial exclusion, some consumers find they are reliant on payday loans. A payday loan is a 1-2 week loan for \$200-500 involving an annualized interest rate of 250-1000%. The costs to the consumer are far higher than if she used a credit card and the consequences are not beneficial for her credit rating.*
 - a) Why do you think consumers use fringe bank services such as payday loans?
4. Causes of Financial Exclusion
 - a) What do you believe to be the causes of financial exclusion?
 - b) *We think that one cause, on the demand side of the financial service market, is that low-income households' income has stagnated in the last few years. Do you think this could be a factor causing financial exclusion?*
 - c) *We think that bank branch closures in inner-city neighbourhoods has raised the costs to poor people in using banks and led to greater financial exclusion. Do you think this is a factor causing financial exclusion?*
5. Consequences of Financial Exclusion
 - a) What do you think are the likely consequences of financial exclusion?
 - b) *We think that labour markets, consumer markets and financial markets are increasingly segmenting leading low-income people to rely on more expensive and poorer quality goods and services. This has the potential to aggravate income inequality in Canada. Do you agree with this?*

Section II. Addressing Financial Exclusion

6. Mission

- a) What is your organization's mission?
- b) To what extent is addressing financial exclusion an important part of your organization's mission/mandate?

7. Clients

- a) In terms of your clients, who exactly are they: does your mission refer to 'all Canadians' or 'Canadians' & if so, what is meant, i.e., men, women, rich, poor, etc.?
- b) To what extent are low-income Canadians considered an important group of clients?

8. Who Addresses Financial Exclusion

- a) In your view, what is the ideal way to address financial exclusion? (e.g., government social policy, government policy for community reinvestment, competitive markets & more foreign competition)
- b) In your view, who is responsible to addressing financial exclusion? (e.g., federal government, banks)
- c) To what extent are banks responsible to address financial exclusion?
- d) Considering that Canadian banks are somewhat protected from foreign competition, do you think that means they have more responsibility to provide banking services for all – including low-income – Canadians?

9. Efforts at Financial Exclusion

We have identified a variety of ways that financial organizations have sought to address financial exclusion, alone or in partnership, including: asset-building (e.g., Learnsave), financial management, special staff training (e.g., RBC in Spence neighborhood, Toronto-Dominion in Parkdale neighborhood), local hire (e.g., Cash & Save), maintenance of inner-city branches, special subsidiaries (e.g., Cash & Save). Has your organization been involved in any of these types, or any other types, of efforts or programs?

- a) In what ways has your organization addressed financial exclusion in the past?
- b) How does your organization address financial exclusion today?
- c) Does your organization have plans to engage in new projects or strategies to address financial exclusion?

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