

{ Canada: An Update on Banking Systems

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duncan consulting
{ innovative banking strategies }

{ Presentation Outline

- Introduction
- Opportunities in Canada
- Overview of Canadian banking
- Highlights of differences between Canadian and US banking
- Market share and trends in the Canadian market
- Emerging trends and new initiatives



{ Opportunity in Canada

- Canada traditionally follows the US economic climate
- In 2003, the following occurred in the Canadian market:

Exports = 400 billion

Imports = 342 billion

Of this, the US accounted for:

Exports = 83 %

Imports = 70 %

- Cross-border trade between US and Canada is driven by Manufacturing with the highest percentage attributed to the automotive industry.

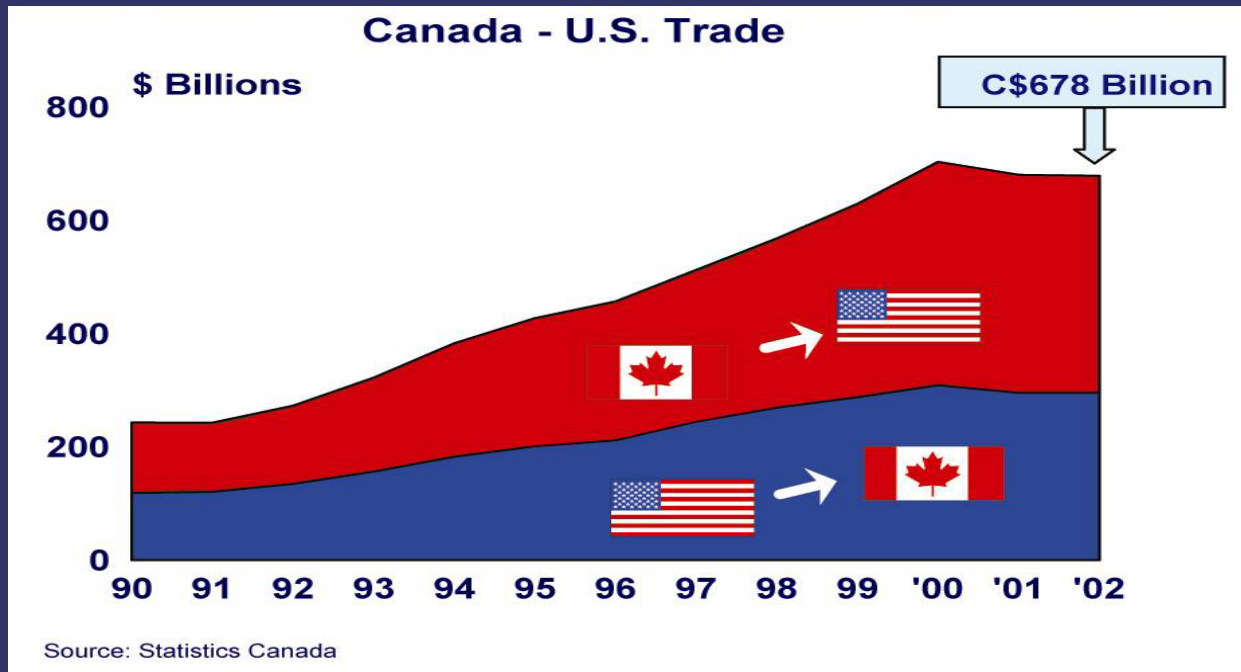


{ Opportunity in Canada

- 📄 Geography and NAFTA grant access to the world's most prosperous market
 - 400 million people
 - GDP of \$11.4 trillion USD
- 📄 Canada is the largest US trading partner
 - Canadian/US two-way trade equaled CAD \$678 billion in 2002
- 📄 US trades more with Canada than with all EU countries combined
- 📄 Canada is open to direct foreign investment
- 📄 Ontario's Imports from Midwest footprint in 2002 = \$52 billion
- 📄 Ontario's Exports into the Midwest footprint in 2002 = \$63 billion



Opportunity in Canada



- Year over year, Exports increased by 17% and Imports increased at 9% according to Statistics Canada reference June 2003 versus June 2004.



{ Success in Canada

- Understanding the differences in payment systems between the US and Canada
- Utilize the most cost effective and efficient means of remitting and receiving payments
- Establishing your company in Canada
 - Brick and mortar and/or
 - Account establishment
- Development of an effective cash management and foreign exchange strategy...
- Offer dual currency receivables....improve marketability



{ Success in Canada

- *Example:* Canadian Cash Management Collection benefit:
Company ABC Establishes Canadian account with lockbox in Toronto
- Total annual collection = 7.15 million
Lockbox benefit = 8+ days on receivables
- Savings result on early collection at prime (4.25) = \$6,660 PLUS.....
 - Internal Processing Reduction and potentially staff
 - Improved client service
 - Establishment in market
 - Increased Business



{ Success in Canada

- *Example Foreign Exchange Hedging:*
Company ABC Hedges 7.15 Million USD 12-04 to 12-05 in conjunction with Cash Management Solution
- Present fx gain = 213,000 as of 09-09-04

Cash Management Solution plus Foreign Exchange Hedging =

Gain of nearly \$220,000.00 Annually



{ Success in Canada

- Consider the following when choosing a Financial Institution:
 - Customer Service, Single Provider and Platform plus overall relationship are key
 - Utilize FI Experts
 - Consider a Third Party Provider
 - Rely on FI to offer the latest in technology
 - Allow Market differences to work for your company

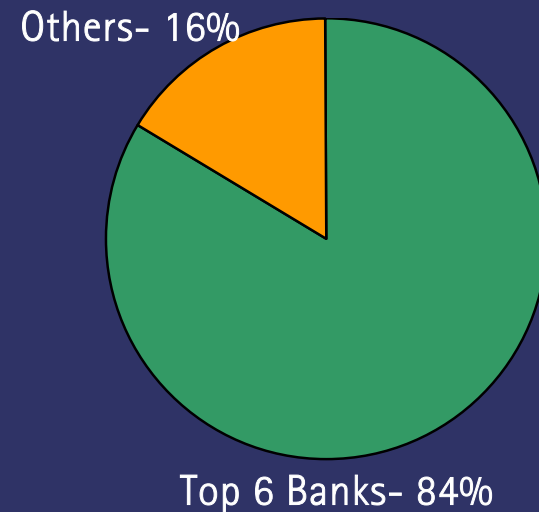
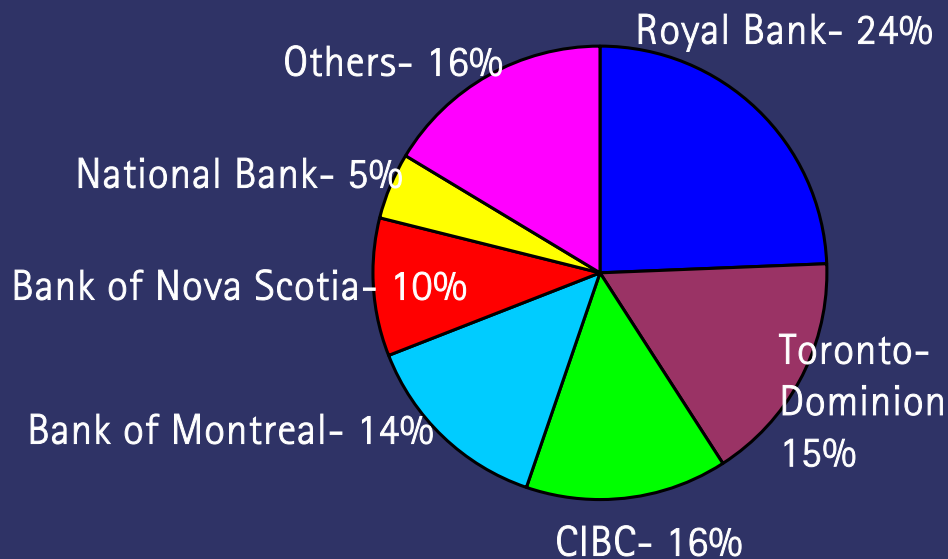


{ Overview of Canadian Banking

- National banking, across 6 time zones
- Market is dominated by six large banks
- Cheques declining since 1991
 - same day value; overnight clearing
 - Post dates allowed
 - \$25 million maximum cheque value since 2003
 - Also clear cheques in \$US
- Electronic items gaining in popularity
 - ACH debits & credits
 - EDI
 - Large value wires
 - Electronic bill payments
 - POS debits (consumer debit card)
 - ATM withdrawals



{ Overview of Canadian Banking- Players*



The Canadian payments market is dominated by 6 large banks.

* As determined by total combined payment transaction volumes published by CPA for 2002; see www.cdnpay.ca



{ Overview of Canadian Payments Systems

- Comprised of 2 main clearing and settlement systems:
 - LVTS- Large Value Transfer System (similar to RTGS)
 - an electronic wire system introduced in 1999 to facilitate irrevocable payments in Canadian dollars in real time
 - **High value, low volume!**
 - ACSS- Automated Clearing & Settlement System
 - the system through which the vast majority of payment items in Canada are cleared
 - **High volume, low value!**
 - Others- Other payment systems include \$US cheque clearing and settlement (USBE)



{ Overview of Payment Systems– Automated Clearing & Settlement System

- Settles for following payment mechanisms:
 - EDI
 - Cheques
 - Money orders
 - Paper bill payments
 - EFT credits & debits
 - POS debits & ATM withdrawals
 - Automated bill payments
 - Travelers cheques, gift certificates
- Participants include:
 - 11 direct clearers, plus the Bank of Canada
 - Over 100 indirect clearers
- Key features:
 - Clears 99% of total transaction volume; equals 15% of \$\$ value
 - Transaction files transmitted between banks, several times daily
 - Final settlement done via net entries at accounts held at the Bank of Canada



{ Overview of Payment Systems– Large Value Transfer System

- Settles for following payment mechanisms:
 - wire payments
 - Visa & MasterCard
 - E-mail money transfers
- Participants include:
 - 13 CPA members, plus Bank of Canada
- Key features:
 - Collateralized interbank settlement mechanism provides final and irrevocable settlement
 - Reduces interbank settlement risk in Canada
 - 89% of all inter-bank \$\$ value in Canada is settled via LVTS
 - Approximately 90% of \$\$ value cleared through LVTS is for bank-initiated payments (i.e. securities settlements, foreign exchange settlements, etc)



{ Canadian vs. US banking systems

Banking in Canada

- Consolidated - 5 major financial institutions
- Cross-country branch network
- Post-dated cheques allowed
- Same-day value for cheques
- Single mail delivery per day
- Post-dating of clearing transactions
- Credit interest is allowed
- Service charges

Banking in the U.S.

- Fragmented – hundreds of financial institutions
- No interstate banking
- No post-dating of checks
- Processing float
- Multiple mail deliveries per day
- Controlled disbursement accounts
- Sweep accounts
- Earnings credit



{ Canadian vs. US banking systems (continued)

Banking in Canada

- EFT (CPA 005)
- EDI
- Decreasing cheque volumes since 1991
- Consumer debit transactions exceed credit card transactions
- Consumer pre-authorized debits (PADs) accepted and utilized extensively
- Wires – large value payments

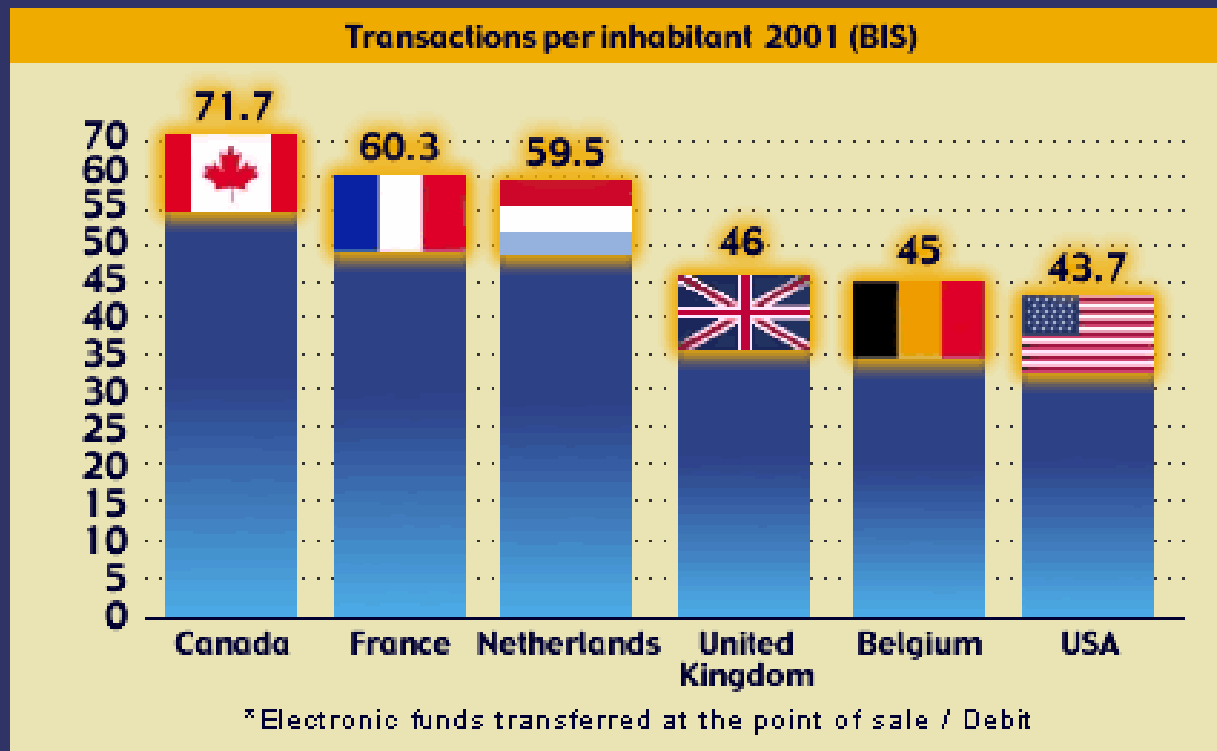
Banking in the U.S.

- ACH
- EDI+
- Check volumes stable or increasing slightly
- Check is preferred consumer payment method
- ACH *WEB* and *TEL* transactions newly introduced
- Wires – common payment method



{ Canadian vs. US banking- Consumer debits

- Canadians are world-leaders in use of EFT POS, with 72 transactions per inhabitant in 2001*

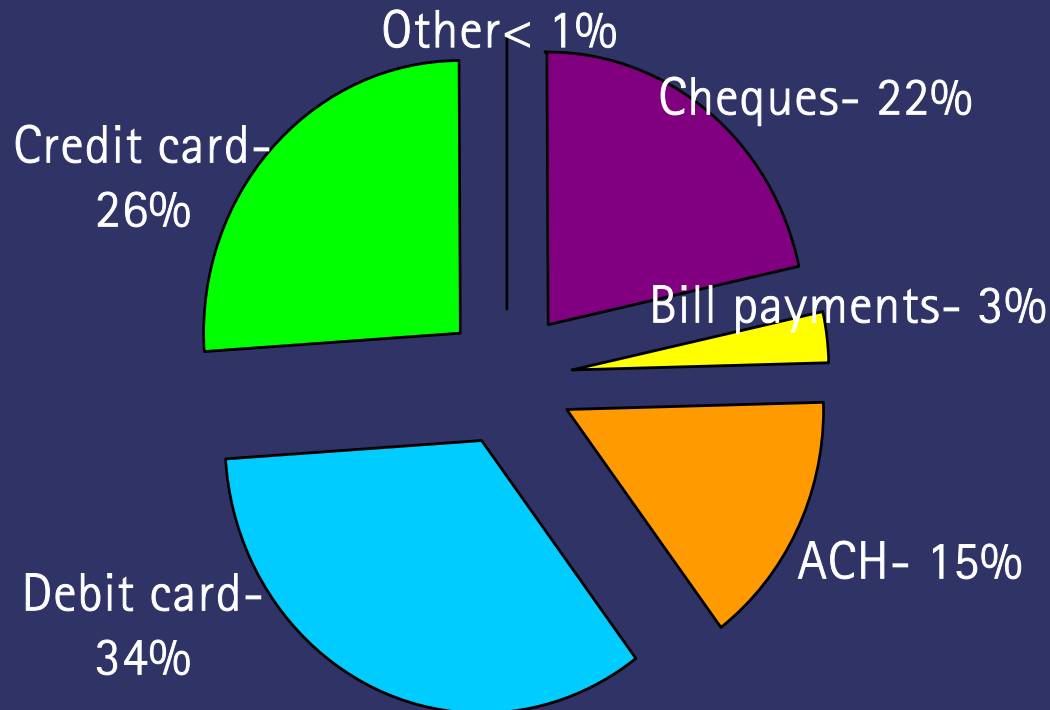


* Data is sourced from Bank for International Settlements; graph is taken from Interac web-site.



{ Canadian Market Share- Transactions*

- 2002 Market share of total payment transactions:



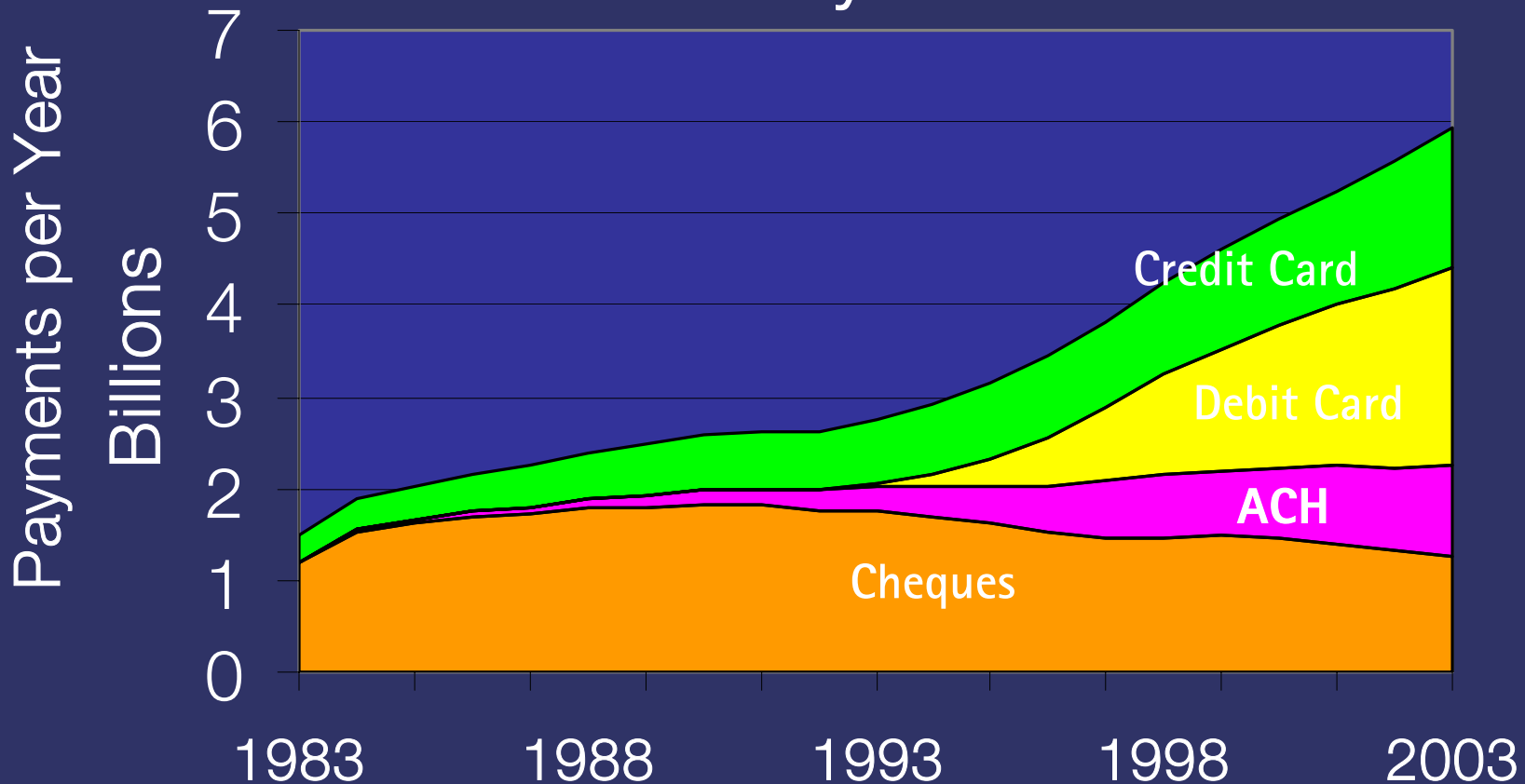
- Overall 2002 market represents 5.8 billion customer-initiated payments.

* Data sourced from Canadian Payments Association (www.cdnpay.ca), and Canadian Bankers Association (www.cba.ca).



Canadian Market- Transaction Trends

Small Dollar Payment Volumes

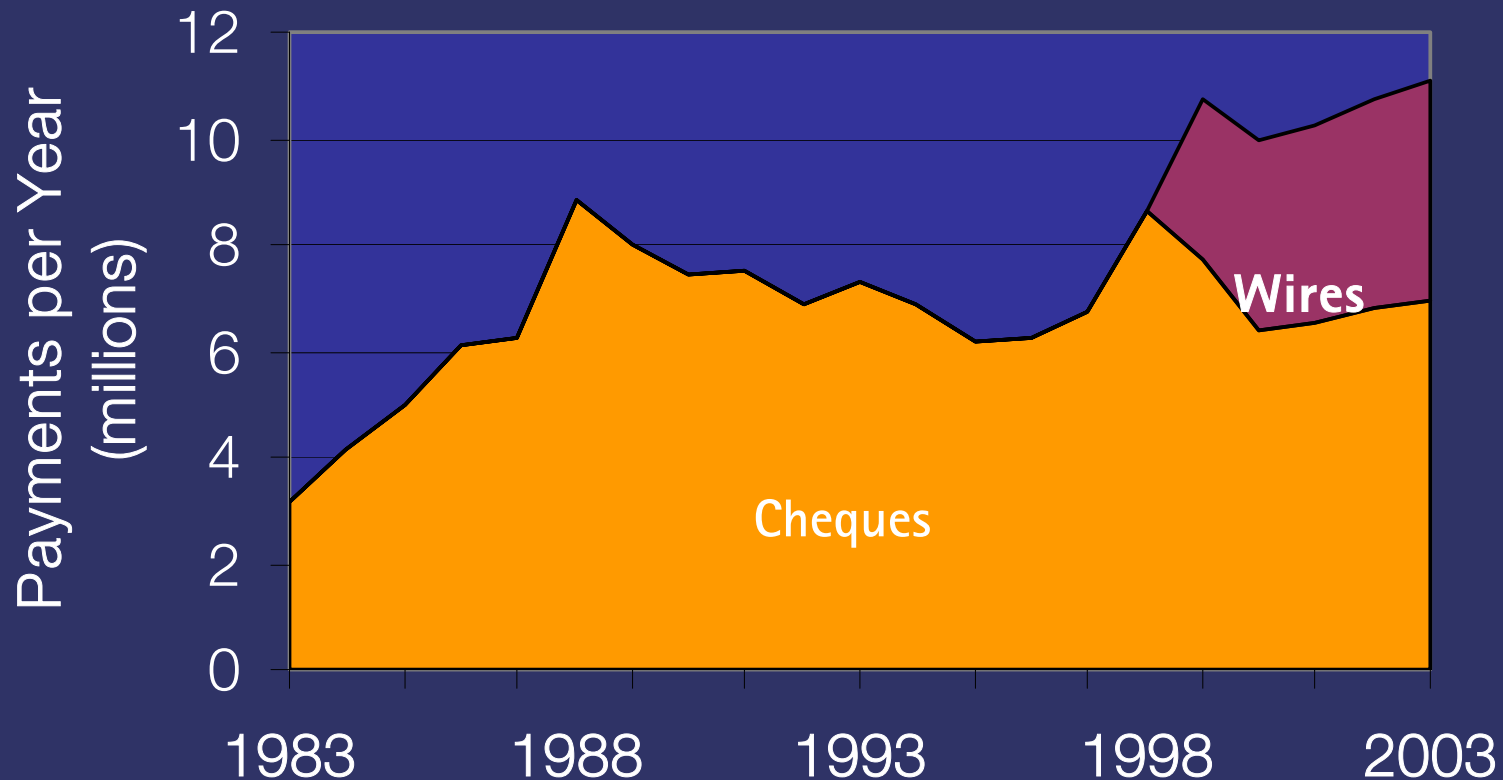


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{ Canadian Market- Transaction Trends

Large Value Payment Volumes

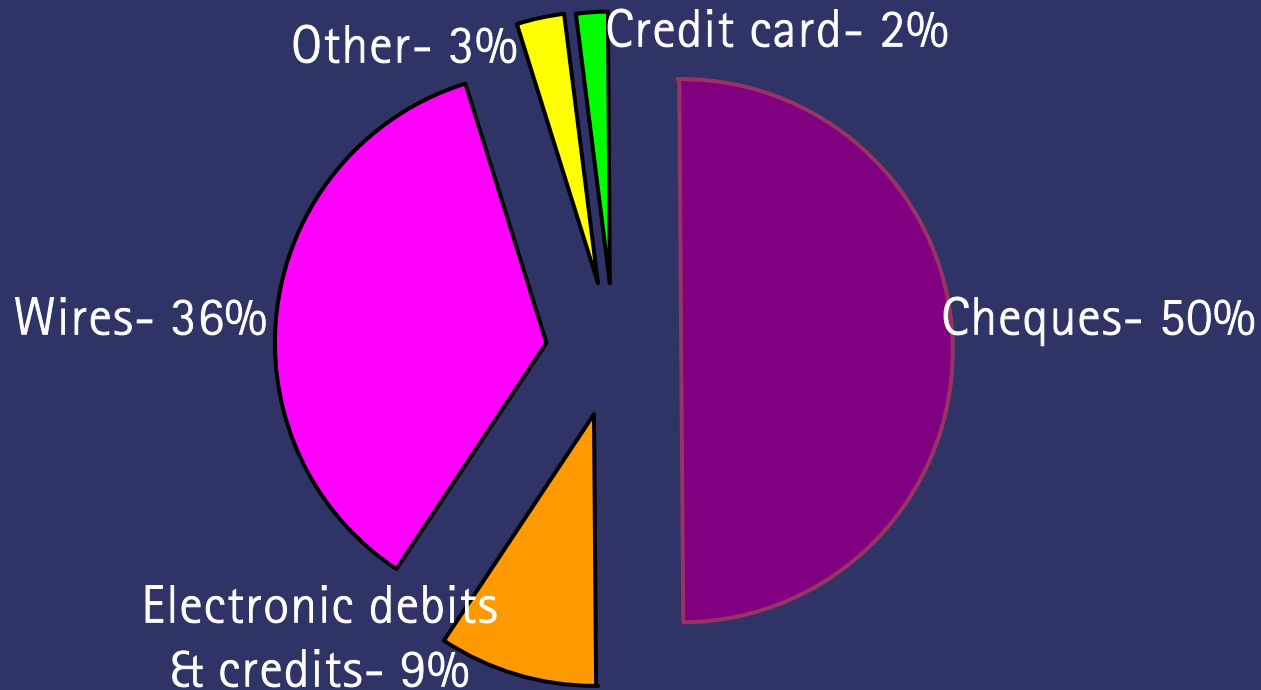


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{ Canadian Market Share- \$\$

- 2002 Market share of total market by \$\$ volume:



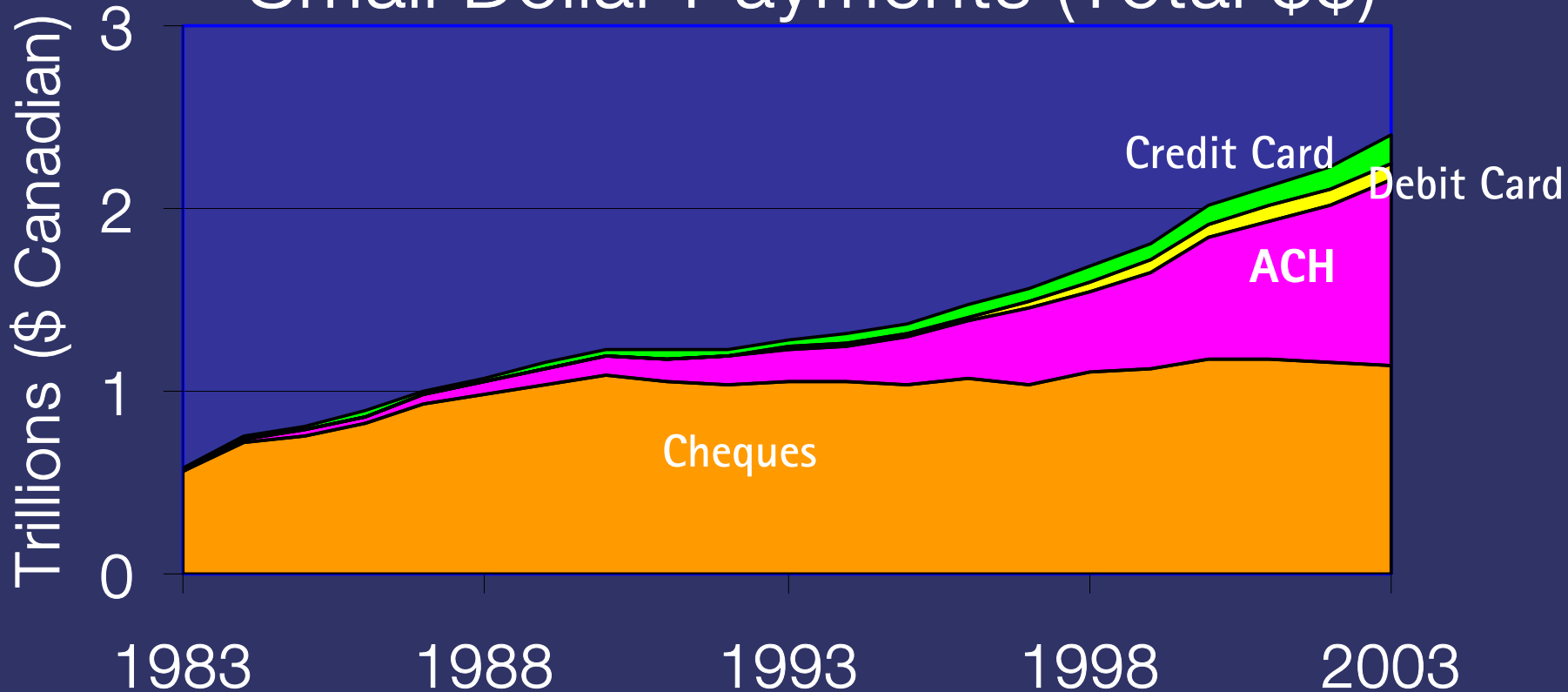
- Overall 2002 market equated to \$8 trillion in customer-initiated payments.
- Cheques & wires continue to dominate the market with 86% of \$\$ volume.

* Data sourced from Canadian Payments Association (www.cdnpay.ca), and Canadian Bankers Association (www.cba.ca).



Canadian Market- \$\$ Trends

Small Dollar Payments (Total \$\$)

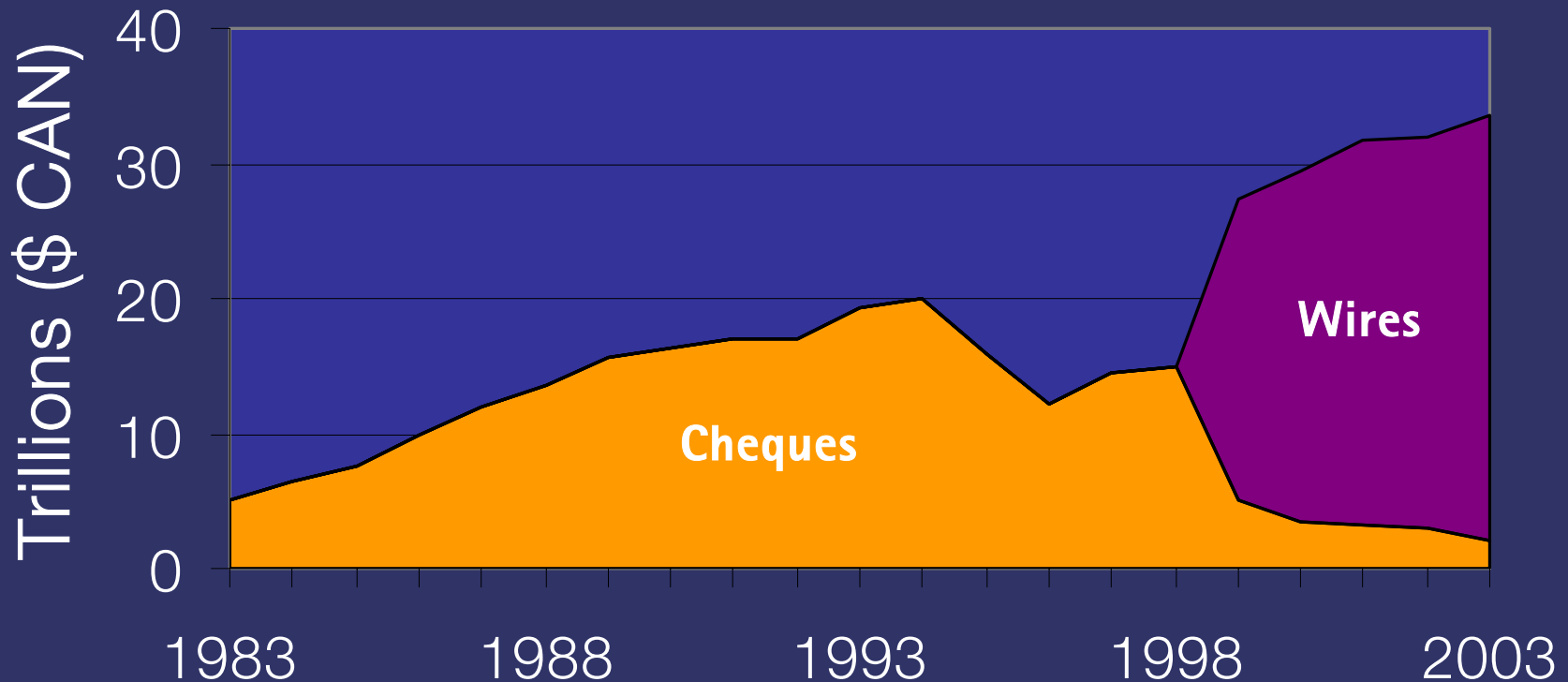


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Canadian Market- \$\$ Trends

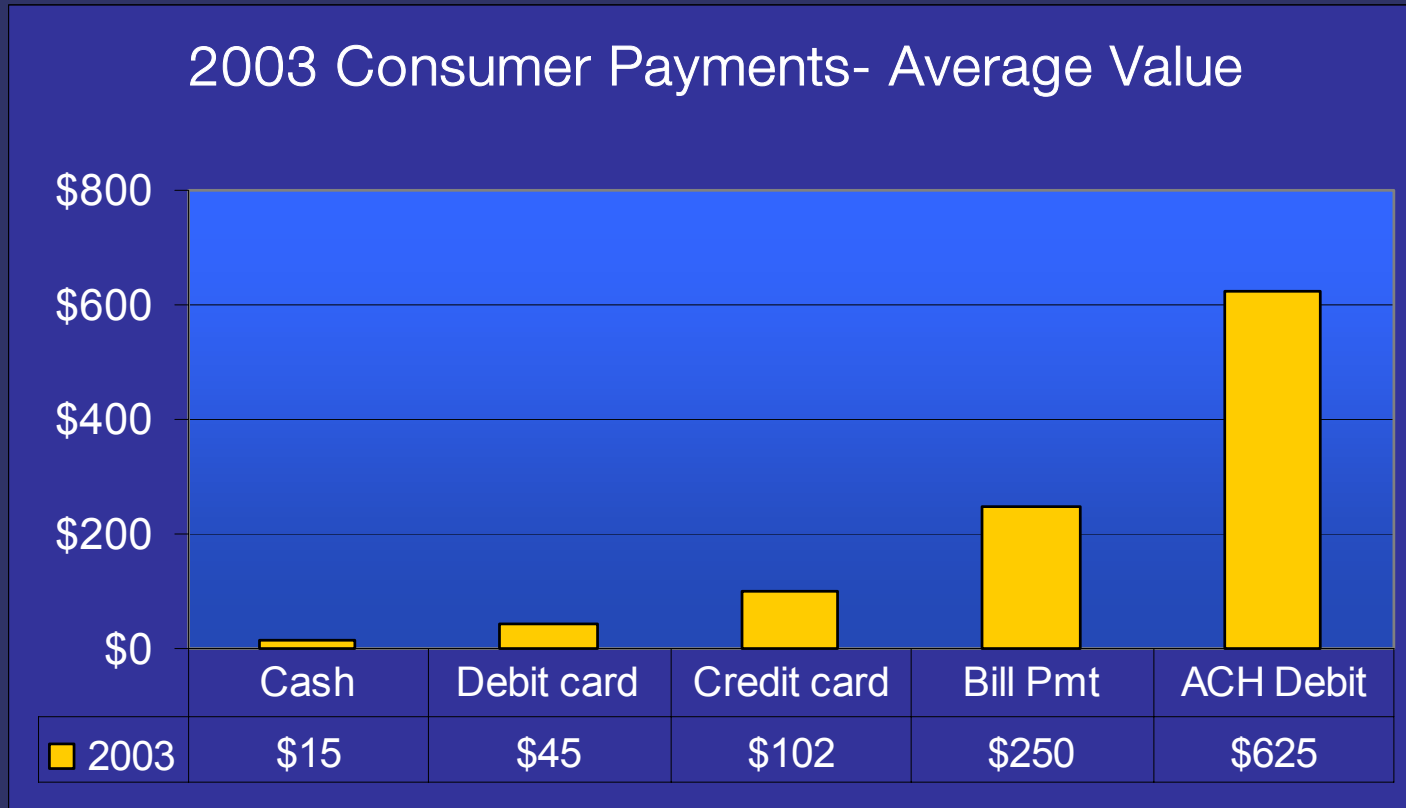
Large Dollar Payments (Total \$\$)



* Data sourced from Canadian Payments Association (www.cdnpay.ca).



{ Canadian Payments- Average Size



* Canadian dollar estimates are based on 2003 data obtained from CPA and CBA.; cash estimate of \$15 is based on industry literature suggesting average cash transaction is less than \$10 US.



{ Trends & Issues- Banking Products

- Cheque volumes and values are decreasing, a result of market & regulatory pressures
 - Changes business models
 - Reduces processing & reconciliation time, effort, expense
- Canadian banks introducing more web-based banking applications in 2004- both consumer and corporate
- On-line payment solutions imminent in Canadian market
- Non-banks now providing payment services to consumers:
 - Retailers- many retailers offer proprietary pre-paid cards
 - PayPal & hyperWALLET- offer an online payment facility for Internet shopping
 - Canada Post- offers e-post (EBPP), postal money orders, Amex trav. cheques
 - Pay-MINT- pay for parking via cell phone (still in pilot)



{ Trends & Issues- Technology

- New Technology as enabler:
 - Image- especially for cheque and paper processing
 - EIPP & EBPP- Electronic Invoice/Bill Presentment and Payment
 - Proximity- new products emerging with built in proximity capability
 - For example- dexit, Esso's *Speedpass*
 - Mobile- many versions
 - bill to phone bill (either monthly, or pre-paid)
 - wireless terminals- on cell phone or PDA, or at merchant site (I.e. taxi)
 - Internet- new payment solutions for use on Internet; for example:
 - CertaPay, *hyperWALLET*, PayPal & YahooDirect
 - Chip- EMV will enable multi-application cards; may include applications such as debit, cash, credit, loyalty, etc.
 - Transponders- for payment of highway tolls



{ Trends & Issues- Security & Risk Management

- Security issues still being addressed
 - “Know your customer” is much more difficult in electronic environment!!
- Risk Management
 - Cheque fraud- on the rise
 - Credit card fraud- is declining, but continues to be a concern
 - Debit card fraud- is increasing in Canada
 - Internet payments- must address fraud issues, stolen identity, Internet spoofing, perceived risks, etc.
 - Interbank settlement risk- being addressed at CPA level
 - Money laundering- new reporting requirements for large transactions (FINTRAC)



{ New Initiatives

- Truncation & Electronic Cheque Presentment (TECP)
 - CPA's project to eliminate inter-bank exchange of physical cheques
 - image capture and truncate item at negotiating bank
 - streamline process & reduce costs
 - Benefits:
 - customers receive value faster and improved enquiry response
 - can image-enable ABMs, call centres, cheque reconciliation & enquiries
 - banks reduce dependence on physical movement of items
 - Target for implementation is end of 2006
- CCMP (chip card migration project) initiative in Canada
 - Amex, Visa, MasterCard & Interac developing framework to migrate to chip-based debit and credit cards by 2008 (?)
 - Based on global EMV standards (Europay MasterCard VISA)
 - Benefits:
 - Built in fraud detection & improved user authentication
 - More secure for use on Internet
 - Will shift liability from merchants to banks
 - Point of Sale terminals will allow multiple applications



{ Canadian Payments Numbers

- **1991**- First year that cheque volumes began to decline in Canada
- **222%**- increase in volume of transactions flowing through Canadian Payments system from 1990 to 2003
- **72**- the average number of point of sale electronic debit payments per Canadian in 2001
- **90%**- the estimated \$\$ value of payments through the LVTS which are *bank to bank* payments (i.e. not customer payments)



{ Summary of Canadian Banking

- Highly efficient- same day clearing of paper and electronic payments
- Electronic- 75% of payment transactions in Canada are processed electronically; dominated by debit cards, credit cards, and ACH
- Risk Managed- LVTS is a collateralized RTGS, and processes over 85% of the inter-bank payment value
- National- operates across Canada in 6 time zones
- Building for the Future- banks take a co-operative approach to new infrastructures: image processing, chip cards, large value



{ In closing.....

- Utilize your FI experts in Global Cash Management and Foreign Exchange...they can be strong Allies
- Understand differences in banking in the United States versus Canada...allow these differences to work to your advantage
- Utilize the most cost effective and efficient means of remitting and receiving payments
- Consider a Third Party Relationship with an FI...this will promote ease of opening and using foreign account services
- Lastly, realize that all of the factors when joined together equal increased potential for SUCCESS in Canada.



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