



TRANSPARENCY, BALANCE AND CHOICE: CANADA'S CREDIT CARD AND DEBIT CARD SYSTEMS

**Report of
The Standing Senate Committee on
Banking, Trade and Commerce**

The Honourable Michael A. Meighen
Chair
The Honourable Céline Hervieux-Payette, P.C.
Deputy Chair

June 2009

Ce document est disponible en français.

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banking_banques@sen.parl.gc.ca.

MEMBERSHIP

The Honourable Senator Michael A. Meighen, Q.C., Chair

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and

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Paul J. Massicotte

Wilfred P. Moore, Q.C.

Donald H. Oliver, Q.C.

Pierrette Ringuette

* *Ex Officio Members of the Committee*

Other Senators who have participated on this study:

The Honourable Senators Catherine Callbeck,
Dennis Dawson and Nancy Greene Raine
and

The Honourable Yoine Goldstein as Deputy Chair until May 11, 2009, date of his retirement.

Parliamentary Information and Research Service, Library of Parliament:

Marc-André Pigeon, Analyst

John Bulmer, Analyst

Hugues Létourneau, Intern

Senate Committees Directorate:

Louise Pronovost, Administrative Assistant

Clerk of the Committee:

Dr. Line Gravel

FOREWORD

I am pleased to present this report on credit and debit card systems in Canada.

All witnesses who appeared before the Committee and every group or individual who submitted written briefs must be recognized for their informative and thoughtful contributions.

The work of staff from the Parliamentary Information and Research Branch needs to be acknowledged. In particular, Marc-André Pigeon, John Bulmer and June Dewetering delivered exceptional service to our Committee on a timely basis.

I am deeply grateful to the Clerk of the Committee, Line Gravel, for her tremendous efforts in organizing our meetings and planning the work of the Committee.

Thanks must also be extended to Senate support staff and translators.

Finally, I am very proud to be associated with all of the Senators who participated in our hearings. The rigour and intelligence they demonstrated, as reflected in the pages of this report, is a credit to the institution of Parliament.

MICHAEL A. MEIGHEN

Chair,
Standing Senate Committee on
Banking, Trade and Commerce

ORDER OF REFERENCE

Extract from the *Journals of the Senate* of Tuesday, March 3, 2009:

The Honourable Senator Ringuette moved, seconded by the Honourable Senator Rompkey, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report on the credit and debit card systems in Canada and their relative rates and fees, in particular for businesses and consumers; and

That the Committee report to the Senate no later than June 30, 2009, and that the Committee retain all powers necessary to publicize its findings until 90 days after the tabling of the final report.

The question being put on the motion, it was adopted.

Paul C. Bélisle

Clerk of the Senate

MOTION

Extract from the *Journals of the Senate*, of Monday, June 22, 2009:

The Honourable Senator Meighen moved, seconded by the Honourable Senator Keon:

That notwithstanding the Order of the Senate adopted on March 3, 2009, that the Standing Senate Committee on Banking, Trade and Commerce which was authorized to examine and report on the credit and debit card systems in Canada and their relative rates and fees, in particular for businesses and consumers, be empowered to deposit a report with the Clerk of the Senate between June 18, 2009 and June 30, 2009 inclusive, if the Senate is not sitting; and that the report be deemed to have been tabled in the Senate.

The question being put on the motion, it was adopted.

Paul C. Bélisle

Clerk of the Senate

RECOMMENDATIONS

RECOMMENDATION 1: The federal government appoint an “oversight board”, within an existing federal organization, that would consult with participants from Canada’s credit card and debit card payment systems as well as relevant federal stakeholders.

The proposed oversight board’s mandate should be to:

- **make recommendations, by 31 December 2009, on any regulatory or legislative measures that it considers to be required to ensure fairness for participants in the credit card and debit card payment systems;**
- **monitor and publish annually information on trends in interchange, switch, merchant and other associated payment systems fees; and**
- **establish a code of conduct for payment systems participants and practices for setting fees and rates, in respect of which it should ensure compliance.**

Finally, merchants should be permitted to bargain collectively regarding payment card conditions and fees, and this form of cooperation should be exempt from the provisions of the *Competition Act.*) (page 20)

RECOMMENDATION 2: The federal government take appropriate action to:

- **permit surcharging and/or discounting by merchants;**
- **require merchants to display, at the point of purchase, the amount of any applicable surcharge or discount;**
- **permit merchants to inform customers about relatively lower-cost payment methods; and**
- **prohibit any “honour-all-cards” rules, including those that require merchants to accept a network operator’s higher-cost premium cards and those that link credit card and debit card merchant acceptance. (page 23)**

RECOMMENDATION 3: The federal government take appropriate action to:

- **require the calculation of switch and interchange fees on the basis of a flat fee for debit card transactions;**
- **set the interchange fee at zero for a period of three years for all debit card transactions; and**
- **prohibit priority routing in order that cardholders are able to select, at the point of sale, their preferred payment method when using a co-badged card.** (page 32)

RECOMMENDATION 4: The federal government require card issuers to disclose, in a clear, simple and conspicuous fashion, the following information on each monthly statement:

- **the number of months it would take to pay off the balance owing and the cost that would ensue if no further advances and/or purchases were made and if the consumer were to make only the minimum monthly payment;**
- **the monthly payment required to pay off the outstanding balance within 36 months if no further purchases and/or advances were made; and**
- **the year-to-date total of all interest costs and other fees that have been paid and/or accrued from use of the credit card.**

Moreover, the government should require card issuers to provide cardholders with information about the range of their credit card products, including all associated fees and interest rates, and with information that would direct the cardholder to the Financial Consumer Agency of Canada's online credit-card selection tool.

Finally, the government should direct the Financial Consumer Agency of Canada, and provide it with the resources necessary, to take a more vigorous approach to enforcing existing and future disclosure requirements. The Agency should also be required to monitor and report on card issuer practices, including compliance with new and existing federal regulations in respect of disclosure requirements. (page 39)

RECOMMENDATION 5: The federal government act expeditiously on selected 21 May 2009 proposals to regulate certain credit card terms and conditions under which card issuers would be required to:

- **provide a minimum 21-day, interest-free grace period on all new credit card purchases to cardholders when they pay the outstanding balance in full;**
- **obtain explicit consent from cardholders before increasing credit card limits;**
- **direct debt collectors to refrain from calling cardholders on statutory holidays, before 7:00 a.m. or after 9:00 p.m. Monday through Saturday, and/or before 1:00 p.m. or after 5:00 p.m. on Sundays; and**
- **eliminate over-the-limit fees that result from merchant holds.**

In addition to these proposed measures, the government should expeditiously introduce the necessary legislative and/or regulatory measures to ensure that card issuers are required to:

- **allocate all cardholder payments in excess of the required minimum to higher-interest-rate balances;**
- **charge interest costs on the net balance owing only;**
- **protect cardholders from unexpected interest charges, including increases in the rate during the first year after account opening and increases in the rate charged on pre-existing credit card balances;**
- **give cardholders a notice period of at least 45 days prior to any significant changes to the terms of their credit card agreement (such as fees, interest rates and finance charges), including at the time of renewal;**
- **offer promotional rates for a minimum period of six months;**
- **refrain from issuing a new credit card to, or increasing credit limits for, existing cardholders unless it considers the ability of the cardholder to make required payments under the terms of his or her credit card agreement;**
- **post, on their website, copies of all of their cardholder agreements; and**
- **end the practice of offering “tangible items,” such as t-shirts, to induce students to apply for a credit card while promoting the credit card on or near the campus of a higher-education institution. (page 48)**

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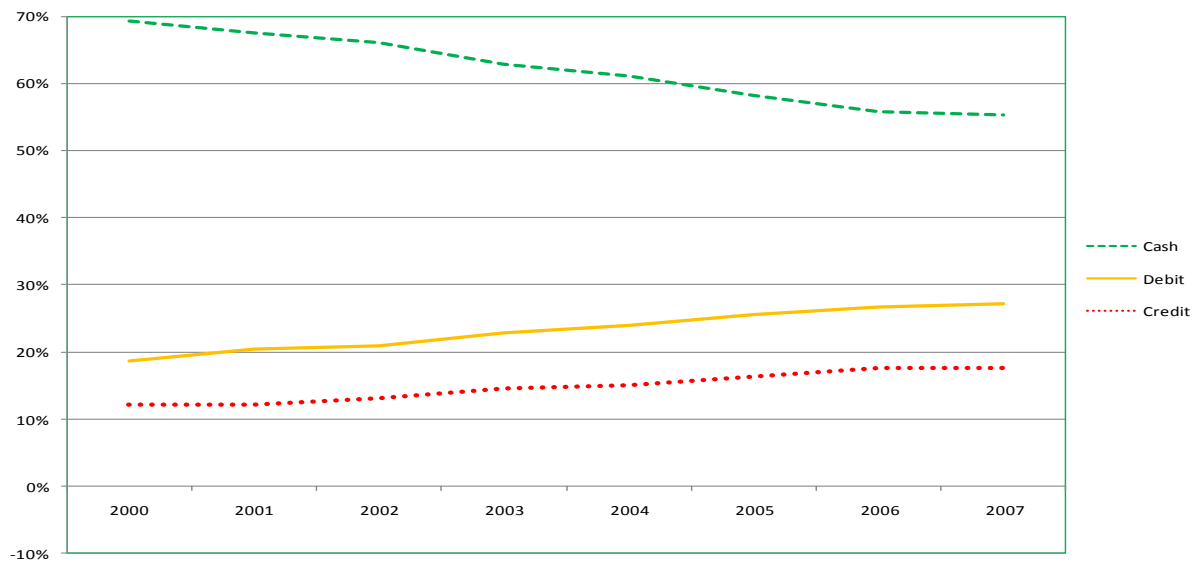
Transparency, Balance and Choice:

Canada's Credit Card and Debit Card Systems

CHAPTER 1: INTRODUCTION

Credit card and debit card payment systems are occupying an increasingly important place in the retail purchasing habits of Canadians. Figure 1 shows that the share of retail transactions settled with credit cards and debit cards increased at a steady rate from 2000 to 2007; by that time, they accounted for almost one-half of all transactions in Canada.

Figure 1: Estimated Percentage of Transactions, by Payment Method at the Point of Sale, 2000-2007



Source: Library of Parliament, based on credit and debit card data from the Bank of International Settlements (BIS), *Statistics on Payment and Settlement Systems in Selected Countries*, March 2006 and March 2009, http://www.bis.org/statistics/payment_stats.htm. The percentage share of cash transactions was calculated by the Library of Parliament using the methodology discussed by Varya Taylor in “Trends in Retail Payments and Insights from Public Survey Results,” *Bank of Canada Review*, Spring 2006, p. 27.

The growing use of credit cards and debit cards relative to cash for making retail purchases has taken place against the backdrop of a competitive environment that, until recently, had not changed much over the last 30 years. Visa Canada Inc. (hereafter, Visa) and MasterCard Canada Inc. (hereafter, MasterCard), for example, have long dominated Canada's credit card market and currently account for 94% of the value of all credit card

transactions. Competitors, such as American Express, have operated largely at the margins, targeting such niche markets as upper-income cardholders and government accounts. Regarding debit card transactions, the Interac Association (hereafter, Interac) has been essentially the sole provider of debit card transactions at automated banking machines (ABMs) and at the point of sale since these services were first introduced on a nationwide basis in 1986 and 1994 respectively.

In the last two years, however, there have been changes to the competitive landscape in Canada's credit card and debit card markets as well as in payment systems more generally. In September 2007, Interac began discussions with the Competition Bureau about altering its organizational form to a for-profit company from its current not-for-profit status. In spring 2008, Visa made the first significant changes to the way it calculates the "interchange fee" in more than 30 years.¹ It also introduced a new premium credit card – Visa Infinite – with a higher interchange fee than its standard, gold and platinum cards.

Similarly, in fall 2008, MasterCard made the first significant changes to its fees in seven years. MasterCard also introduced enhanced features on its existing gold and platinum cards. Then, in December 2008, MasterCard processed its first-ever debit card transaction in Canada as part of a pilot project with its Maestro-branded debit card, while Visa published fees scheduled to take effect 28 May 2009 for debit cards issued under its brand name. Finally, eBay.ca announced that, beginning in mid-June 2009, it will no longer allow paper payment methods for transactions that occur through its website.²

These events took place against the backdrop of three other developments:

- (1) innovations in chip technology that credit card companies say will reduce fraud and make credit cards and debit cards easier to use for consumers and more convenient and cost effective for merchants;
- (2) changes in credit card terms and conditions as they apply to consumers, such as shortened grace periods and lower minimum payment requirements; and
- (3) regulatory and legal scrutiny of the pricing and terms governing credit card and debit card use in a number of developed and developing countries.³

¹ The interchange fee is usually calculated as a percentage of the value of each transaction and is paid by payment processors to card issuers. See Chapter 2 and Appendix A for a more detailed discussion.

² eBay.ca noted that consumers who pay with cheques or money orders are "61% more likely to file an 'item not received' dispute than buyers who pay with PayPal or with a credit card. Buyers who pay with cheques or money orders are also 38% more likely to leave negative feedback" about an eBay seller.

³ In initial public offering (IPO) documents filed with the US Securities and Exchange Commission, Visa and MasterCard noted that their credit card pricing schedules and terms have been the subject of "significant legal and regulatory scrutiny worldwide" and identified 20 jurisdictions where this scrutiny has taken place, including Australia, New Zealand, Norway, Sweden, the United Kingdom and the United States.

It is in this context that, on 3 March 2009, the Standing Senate Committee on Banking, Trade and Commerce was authorized to conduct a “study on the credit and debit card systems in Canada and their relative rates and fees, in particular for businesses and consumers.” Before turning to what the witnesses told us, it is useful to identify key participants and review some terms related to credit card and debit card payment systems.

CHAPTER 2: PAYMENT SYSTEM PARTICIPANTS AND TERMINOLOGY

The ability to use credit cards and debit cards to purchase goods and services rests largely on a behind-the-scenes architecture of procedures, rules and technology that governs how funds and information are transferred between people and institutions in the process of settling accounts, i.e., of ensuring that merchants that sell goods and services get paid by the people who purchase them. This architecture is called a *payment system*.⁴ Any payment system transaction involves some or all of the following participants:

- (1) **the consumer** who purchases a good or service;
- (2) **the merchant** that sells a good or service;
- (3) **the issuer** (chartered banks, credit unions and some major retailers) that issues the means of payment, such as cheques, credit cards or debit cards;
- (4) **the payment processor** (Moneris Solutions, TD Merchant Services, Desjardins Group and others) that sells or rents credit card and debit card terminals to merchants and that moves information and funds between the merchant and the issuer; and
- (5) **the network operator** (Visa, MasterCard, Interac and others) that operates and oversees the payment system that structures transactions between consumers, merchants and their respective financial institutions.

For a payment system to function properly, participants must have confidence that it will safely, efficiently and reliably settle claims and liabilities at a reasonable cost for a given means of payment. In the case of cash, for example, a consumer's liability, incurred when goods and services are purchased, is settled immediately by presenting the merchant with the appropriate amount of money. The process works differently for credit card and debit card transactions. In a credit card transaction, a consumer purchases goods and services on credit from a merchant using a card that is branded with the logo of the credit card company (the network operator). According to TD Merchant Services and Moneris Solutions, merchants in Canada usually wait no more than one or two days to be paid; in the tourism sector, however, merchants may have to wait up to six months for payment.⁵ Consumers, in turn, receive a statement sometime later which itemizes their transactions for the statement period and the amount owing. In a debit card transaction, merchants are normally credited for the transaction by the end of the day;⁶ consumers' bank accounts are normally debited within a similar time frame.

⁴ Formally, the Bank of Canada defines a payment system as "a set of instruments, procedures and rules used to transfer funds" among financial institutions "either on their own behalf or that of their consumers." See: Bank of Canada, *What is a Payment System*, http://www.bank-banque-canada.ca/en/financial/financial_gen.html#what (accessed 1 May 2009).

⁵ The longer waiting period applies because purchases in this sector are often made well in advance of actual delivery. There is, therefore, a relatively greater risk that the merchant may go out of business before delivering the service.

⁶ Email correspondence between TD Merchant Services and Library of Parliament staff.

The number of participants involved in a payment card transaction varies depending on whether the consumer is using a card supported by a “three-party” or a “four-party”⁷ payment system. In a three-party payment system, the credit card company is at once network operator, card issuer and payment processor. It therefore deals directly with consumers and merchants, and sets all relevant terms and fees. American Express is an example of a company that operates a three-party payment system. In a four-party payment system, the card issuer is a federally regulated bank or provincially regulated credit union which markets cards and sets and/or negotiates terms with consumers, while the payment processor sets and/or negotiates fees and terms with merchants. For credit card payment systems, the network operator is the credit card company; for debit card payment systems, the network operator is Interac. Visa and MasterCard operate four-party payment systems. Interac’s debit card network also uses the four-party approach.

In both the three- and the four-party payment system, the network operator tries to ensure the widest possible acceptance among consumers and merchants, since the operator’s revenue depends on the number and/or value of transactions that flow through its network. To increase acceptance, network operators use marketing techniques to gain brand recognition; system participants may also set fees and rules, and create products that encourage consumer and merchant acceptance, including:

- **interchange fees**,⁸ which can be calculated either as a flat fee per transaction, as a percentage of the transaction value or both. These fees are normally paid by payment processors to card issuers and are usually, in whole or in part, reflected in the merchant fee;
- **switch fees**,⁹ which can be calculated either as a flat fee per transaction, as a percentage of the transaction value or both. These fees are charged to payment processors and/or card issuers, and are set and collected by the network operator;
- **merchant fees**, which can be calculated either as a flat fee per transaction, as a percentage of the transaction value or both. Merchant fees are equal to the sum of interchange fees, switch fees, payment processor costs plus profit margin and any other applicable fees;
- **“no-surcharge” rules**, which prevent merchants from charging consumers a fee for the use of a payment card rather than some other method of payment;

⁷ The term “four-party” payment system is somewhat misleading because it focuses strictly on the participants directly involved in the transaction and omits the role of the network operator, which may also be a participant.

⁸ As noted in Chapter 1, merchants pay more in interchange fees to process a transaction using premium credit cards with enhanced “rewards programs,” such as Visa Infinite. Merchants also pay relatively higher interchange fees, regardless of the type of credit card (standard, gold, platinum and/or infinite), whenever the merchant processes a purchase where the card is not physically present.

⁹ The switch fee is a network access fee. In its testimony to the Standing Senate Committee on Banking, Trade and Commerce on 22 April 2009, Visa referred to the switch fee in a credit card transaction as a “service fee.”

- **“honour-all-cards” rules**, which require merchants that accept any of a credit card company’s cards to accept all of that company’s cards (regular, gold and platinum, for example), regardless of the applicable interchange fee. Another form of the rule may apply to a company’s debit cards, requiring merchants that accept a brand’s credit cards to also accept its debit cards;
- **“co-badging,”** which – for the purposes of this report – refers to the practice of offering competing payment system brands and/or credit and debit card functions on the same card;¹⁰ and
- **“priority routing,”** which refers to the practice of automatically routing a debit transaction to a particular network operator in the case of a co-badged card.

It is important to understand clearly the difference between flat *fees* and *rates*. Interchange *fees* and switch *fees* can be calculated as either a percentage of the transaction value – a *rate* – or as a flat *fee* per transaction. Merchants, for example, pay merchant *fees* to payment processors on credit card and debit card transactions. For credit cards, these fees are usually calculated as a percentage of the value of each transaction, which is referred to as the merchant discount rate (MDR); on debit card transactions in Canada, merchant fees are usually calculated on the basis of a flat fee per transaction.

Similarly, payment processors pay interchange *fees* to card issuers based on interchange *rates* set by the network operators. In other words, the *fees* are calculated as a *rate*, i.e., as a percentage of the value of each transaction. Finally, payment processors and card issuers pay switch *fees* to the network operator that are calculated either as a flat fee per transaction, a percentage of the transaction value or some combination of these two methods.

Finally, it is also important to note that credit card payment systems operate outside the scope of the by-laws and rules of the Canadian Payments Association, the organization that oversees Canada’s large-value transfer system and its automated clearing settlement system. As the Association noted in its submission to the Committee, “when a purchase is made using a credit card, the cardholder’s account is credited via the credit card company’s clearing and settlement process, not the (Association’s).”¹¹ The *Canadian Payments Act*, however, gives the federal minister of finance the power to

¹⁰ In its 22 April 2009 testimony to the Standing Senate Committee on Banking, Trade and Commerce, Visa used the term “co-badging” in a narrower sense to mean competing payment system brands, such as Visa debit and Interac debit, on a single debit card. It is also important to avoid confusion between “co-badging” and “co-branding.” The latter term is often used to refer to the practice whereby a card issuer jointly issues a Visa-, MasterCard- or American Express-branded credit card with another institution, such as a university or a retailer.

¹¹ That said, and as the Canadian Payments Association noted in its 12 May 2009 submission to the Standing Senate Committee on Banking, Trade and Commerce, settlement from the perspective of credit card issuers “may” take place through the large-value transfer system, while final settlement from the perspective of consumers (when paying their credit card bill) will “generally” take place through the automated clearing settlement system.

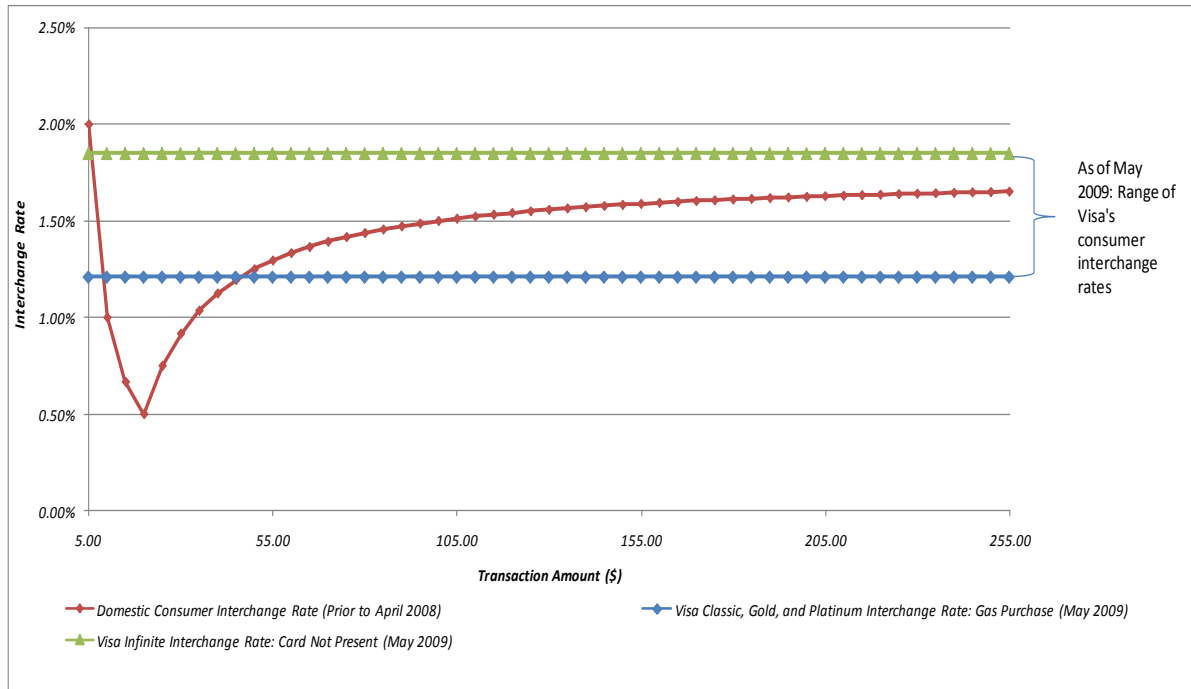
designate a payment system as subject to the Act if the minister believes this designation is in the public interest.

CHAPTER 3: CREDIT CARD MERCHANT FEES

In April 2008, Visa changed the way its credit card interchange fees are calculated. It moved from two formulae for calculating interchange fees to 21 formulae that vary based on sector of activity (gasoline retailers, grocery retailers and other), the nature of the transaction (online versus in-person), the type of card used to make the purchase (standard, gold, platinum or infinite) and the target audience (consumers or businesses).

Under Visa's interchange formulae prior to April 2008, the consumer interchange fee formula was 1.75% of the transaction value minus \$0.25, with a minimum fee of \$0.10, and the commercial interchange fee formula was 2.00% of the transaction value minus \$0.15, with a minimum fee of \$0.10. Under Visa's new fee structure, the 21 formulae are based on a percentage – the interchange *rate* – of the transaction value, with no minimum fee. Additionally, MasterCard has moved from three formulae for calculating interchange fees to 19 formulae ranging from 1.21% to 2.13% of the transaction value. Figure 2 shows Visa's consumer interchange rates for the period prior to April 2008 as well as the upper and lower ranges of Visa's current consumer interchange rates.

Figure 2: Visa's Consumer Interchange Rates Prior To and Since April 2008 (% of the transaction value)



Note: Visa's commercial interchange rates are not cited in this figure; these rates are higher than the consumer interchange rates in effect prior to and after April 2008.

Source: Testimony by Visa to the Standing Senate Committee on Banking, Trade and Commerce on 22 April 2009 and email correspondence between TD Merchant Services and Library of Parliament staff, 14 April 2009. Visa, *Visa Canada Interchange Reimbursement Fees*, p. 3, http://www.visa.ca/en/aboutcan/mediacentre/interchange/pdf/interchange_brochure.pdf.

Table 1 presents Canada's credit card interchange rates as well as the rates in Australia, the United Kingdom and the United States.

Table 1: Credit Card Interchange Rates in Australia, Canada, the United Kingdom and the United States

Country	Interchange Rate
Australia ¹²	The weighted average interchange rate cannot exceed 0.50% of the transaction value. (2008)
Canada	Visa has stated that its weighted average interchange rate is about 1.6% of the transaction value. (2009) MasterCard's average interchange rate is unknown.
United Kingdom ¹³	The average interchange rate was just over 1.1% of the transaction value. (2000)
United States ¹⁴	Visa USA's system-wide effective interchange rate was expected to be 1.77% of the transaction value. (2007) MasterCard's average interchange rate is unknown.

WHAT THE WITNESSES SAID

The changes in the Visa and MasterCard interchange formulae that took place in 2008 elicited concern from a number of the Committee's witnesses, especially those representing small and medium-sized retail operations. For example, the Stop Sticking It To Us Coalition (hereafter, the Coalition),¹⁵ which was formed because of concern about changes to interchange fees, told the Committee that one of its members, Giant Tiger Stores Ltd., experienced a 30% increase in its merchant fees because of changes to Visa's and MasterCard's interchange formulae and increased use of premium cards, which have relatively higher interchange fees.

In its submission, the Newfoundland and Labrador Liquor Corporation informed the Committee that "(r)ecent changes to the Visa and MasterCard fee structure have meant an increase in excess of 20% from what the (Corporation) would have otherwise paid under our original contract for Visa and MasterCard services. ... The increased fees ... have had no incremental benefit for the (Corporation), are completely inconsistent with the 'spirit' of what was contracted for and have done nothing other than add to the profits of Visa and MasterCard while adding unjustified costs to the (Corporation)." Other witnesses, such as the Canadian Restaurant and Foodservices Association, expressed

¹² Reserve Bank of Australia, *Reform of Australia's Payments System: Conclusions of the 2007/08 Review*, September 2008, p. 3, http://www.rba.gov.au/PaymentsSystem/Reforms/RevCardPaySys/Pdf/conclusions_2007_2008_review.pdf.

¹³ Don Cruickshank, *Competition in UK Banking: A Report to the Chancellor of the Exchequer*, March 2000, p. 256, <http://www.hm-treasury.gov.uk/d/BankReviewAnnexD3.pdf>.

¹⁴ Visa Inc., *Visa USA Updates Interchange Rates*, 12 April 2007, <http://corporate.visa.com/md/nr/press695.jsp> (accessed 29 May 2009).

¹⁵ Members of the Coalition appearing at the Standing Senate Committee on Banking, Trade and Commerce's hearings included the Canadian Council of Grocery Distributors, Giant Tiger Stores Ltd., the Retail Council of Canada and Sobeys Inc. Other members of the Coalition submitted briefs to the Committee, including the Canadian Convenience Stores Association and Kudell Enterprises Ltd.

similar concerns, citing a 24% increase in merchant fees for foodservice operators between 2007 and 2008.

The Coalition indicated that it would like the federal government to regulate interchange fees based on costs, and suggested that it look to Australia for ideas that could be adapted to the Canadian context. In October 2003, the Reserve Bank of Australia limited the interchange rate to an average of 0.55% of the transaction value for four-party credit card payment systems such as Visa and MasterCard, down from 0.95% previously; in 2006, it said that the weighted average interchange rate on Visa and MasterCard credit cards cannot exceed 0.50%. The Reserve Bank of Australia based its fee regulations on what it described as acceptable credit card issuer costs, namely the interest-free period, fraud and fraud prevention, and authorizing, receiving, verifying and reconciling transactions.¹⁶

In its submission, Renaissance Jewellers Inc. urged the Committee to help independent retailers “fight to gain some control on these fees as ultimately they have to be charged back to the consumer.” Target Discount, another independent retailer, said in its submission that the federal government should “seriously consider taking over this ‘industry.’ There could be one service provider (the Canadian Government) for all electronic transactions that happen in this country.”

With an increase in the number of interchange formulae for both Visa and MasterCard, credit card pricing has become increasingly complex, according to witnesses. The Canadian Federation of Independent Business stated that, prior to the change in the way interchange fees were calculated, merchants could expect payment processors to charge a merchant fee equal to 1.7% of the transaction value; with the introduction of premium cards, which entail higher interchange fees, as well as the different interchange fees associated with different payment methods (for example, a higher interchange fee is charged if the card is not present when the merchant concludes the transaction), merchants are having difficulty controlling and predicting the level of merchant fees that will be paid from credit card transactions at the end of the month.

The Canadian Federation of Independent Business recommended that the federal government undertake a comprehensive study of the credit card and debit card payment systems in Canada and abroad that would serve as a future reference point for policymakers and that would help to strengthen the bargaining position of retailers. Further, the Federation recommended that the federal government appoint a regulatory body to oversee and monitor the credit card and debit card payment systems in Canada.

¹⁶ Reserve Bank of Australia, *Reform of Credit Card Schemes in Australia IV: Final Reforms and Regulation Impact Statement*, August 2002, p. 43, <http://www.rba.gov.au/PaymentsSystem/Reforms/CCSchemes/FinalReforms/index.html>.

For their part, Visa and MasterCard told the Committee that, while they probably could do a better job of educating merchants about the benefits of credit card acceptance and their new structure for calculating interchange fees, they opposed any effort to regulate interchange fees. For Visa and MasterCard, credit card markets operate as classic “two-sided markets” similar to the newspaper business, where the newspapers’ objective is to secure as many readers as possible in order to increase the audience available to advertisers. To broaden their audience and make the advertising proposition relatively more attractive for advertisers, newspapers charge their readers only a small portion of the total cost of producing the news product, while advertisers finance a relatively higher proportion of the cost because of their desire to reach the newspapers’ audience. Visa and MasterCard said that the same is true in credit card markets: interchange fees allow card issuers to increase the “audience” – the number of cardholders – by offering an attractive product (with reward points and an interest-free period), which in turn should increase the value of credit card acceptance to merchants.

Visa and MasterCard also cautioned against using Australia as a model for policy action in Canada, arguing that while Australian regulatory changes led to lower merchant fees, they also resulted in increased credit card annual fees and reduced credit card rewards. Visa and MasterCard also stated that there is no evidence that the decline in Australian merchant fees led to lower retail prices for consumers. The Coalition, for its part, pointed out that there was no evidence that prices did *not* go down in Australia subsequent to regulatory action in that country.

Merchant Power

Another theme in the Committee’s hearings dealt with the merchants’ relative lack of power to negotiate. Merchants told us they feel constrained in their ability to not accept Visa and MasterCard credit cards given their widespread use by consumers. In their view, this constraint, in turn, limits their ability to influence fees set by the credit card companies.¹⁷

Citing the Office of Fair Trading in the United Kingdom, the Coalition stated, for example, that “there is an element of ‘must-take’” in regard to credit card acceptance by merchants. Target Discount said that it “would be out of business if (it) did not accept credit and debit cards. That is a FACT! The only reason (it accepts) credit and debit cards is because (it does not) have a choice. Unless going out of business is one of (its) choices.” The Coalition also told the Committee that it was easier to negotiate lower merchant fees when all payment processors were directly owned by card issuers because those fees were “part of a bundled package of financial services.”

¹⁷ Strictly speaking, merchants can only negotiate merchant fees (of which interchange fees are a component) with their payment processor. Merchant associations, such as the Canadian Federation of Independent Business and the Stop Sticking It To Us Coalition, told the Standing Senate Committee on Banking, Trade and Commerce that they have either tried to arrange a meeting or have met with Visa and MasterCard about interchange fees.

In its submission, Chase Paymentech Solutions noted that it is “working with the Retail Council of Canada and the Canadian Federation of Independent Business to provide members of these two organizations with payment processing service packages with competitive fees.”

Like the Coalition, the Canadian Federation of Independent Grocers also expressed concern about the merchant’s relative bargaining position in credit card payment systems, and noted that it is “fair to characterize these methods of financial transactions as almost public utilities which are as necessary to the welfare of the business as electrical power or even the publicly travelled roads to the store.” The Canadian Restaurant and Foodservices Association, for its part, noted that, despite the fact that it represents 33,000 members, “it was not able to satisfactorily address the cost and unfair business practices imposed by Visa and MasterCard.”

Finally, the Competition Bureau told the Committee that, with respect to credit card interchange fees, it is currently studying “whether there may have been a contravention of section 79 or other sections of the (*Competition Act*). Section 79, Abuse of Dominant Position, prohibits dominant firms from engaging in practices that have had, are having or are likely to have the effect of preventing or lessening competition in a market. If during this investigation we find evidence of a breach of the provisions of the Competition Act, we will act.”

MasterCard, for its part, said that merchants are not obliged to accept credit cards as payment; while 600,000 merchants currently accept MasterCard credit cards as payment, one million do not. Additionally, according to MasterCard, Canadian consumers have a high level of tolerance for merchants that refuse to accept credit cards as payment. Lastly, MasterCard argued that merchant associations like the Canadian Federation of Independent Business and the Retail Council of Canada do have bargaining power and have negotiated on behalf of their members with payment processors for lower merchant discount fees. Visa reinforced the argument of MasterCard when it suggested that a number of major merchants do not accept Visa credit cards as payment, including Costco, No Frills and Tim Horton’s.

Competition and Regulation

Visa and MasterCard opposed fee regulation for payment cards, and favoured competition among competing payment methods. MasterCard noted that Canadian credit card payment systems are highly competitive and are driven by market forces. According to MasterCard, competing payment systems include “cash, cheque, Interac, Visa, American Express, retail store cards, preauthorized debit and, most recently, unregulated web-based payments like PayPal.” Visa also said that Canadian payment systems are highly competitive, and cited a similar list of competing payment methods. Similarly,

American Express opposed fee regulation and supported fees set in a vigorously competitive marketplace. Roots Canada was also opposed to the regulation of electronic payment methods, and believed that competition “leads to increased choice and better prices.”

To compete with other payment methods, MasterCard has lowered the interchange rate in sectors where merchant acceptance is low. At the same time, MasterCard determined that it was at a competitive disadvantage in relation to Visa and American Express among “affluent rewards-driven cardholders” and, therefore, “adjusted premium card interchange to ensure MasterCard issuers were positioned to attract and retain these valuable cardholders while still being priced lower than American Express.” This view was confirmed by Moneris Solutions, which told the Committee that, in Canada, MasterCard’s interchange rates were “unusually low” and MasterCard was “having a hard time attracting Visa issuers.” Moneris Solutions added that MasterCard subsequently increased its interchange rates and made them more tiered.

For its part, Visa told the Committee that Visa Infinite, its premium credit card, has an interchange fee that is 20 basis points higher than Visa’s standard, gold and platinum credit cards. Visa created this credit card “to compete with alternative premium card offers to encourage use and to attract more cardholders.”

The Coalition was critical of the claim that competition among credit card payment systems is beneficial and told the Committee that while competition normally leads to price reductions, “this is not the case in the credit card market.” The Coalition said that, currently in Canada, competition provides incentives for Visa and MasterCard to raise interchange fees in order to attract card issuers, which in turn means higher costs for merchants and higher prices for consumers. This higher retail price effect may be especially pronounced in sectors with narrow profit margins, such as grocery stores and pharmacies.

In response to claims by retail groups that rising credit card interchange fees lead to higher retail prices, which affect credit card users and non-users alike, MasterCard told the Committee that there are many instances where some consumers indirectly subsidize other consumers. For example, to the extent that the cost of providing free parking is reflected in the price of goods and services, car owners who benefit from free parking when they go shopping are indirectly subsidized by those who do not use cars. Additionally, Visa informed us that there is a cost associated with accepting any method of payment, including cash and cheques as well as Visa cards.

Premium Cards

The Coalition also expressed concern about the proliferation of premium credit cards, which incur higher fees for merchants. It said that its members were unable to avoid paying these higher fees because Visa's and MasterCard's "honour-all-cards" rule requires merchants that accept any of its credit cards to accept all of its credit cards, regardless of the merchant cost that they incur. According to a member of the Coalition, Giant Tiger Store Ltd., the proportion of credit card purchases made at its stores with premium credit cards increased from 0.7% one year ago to more than 35% today, despite the fact that its client base is made up mostly of low- and middle-income families. It added that the increased share of purchases made at its stores with premium credit cards has not led to increased sales.

The Association des hôteliers du Québec, a member of the Coalition québécoise contre la hausse des frais de transaction par carte de crédit et de débit, for example, argued that the use of premium cards such as Visa Infinite has not generated the promised increase in hotel bookings, but only an unavoidable and significant increase in costs: "Everyone, therefore, will end up paying and they will not stay one more night just to earn more points. As someone said in their presentation, you do not buy one more bag of apples simply to have more points."

The Canadian Restaurant and Foodservices Association also expressed concern about premium cards, noting that these cardholders "will not necessarily spend more in their restaurant as opposed to their competitor's and therefore they receive no additional value."

MasterCard, for its part, said that only 5% of its cardholders had premium credit cards and that, on average, those cardholders spent \$24,000 per year on their credit card. Additionally, it noted survey evidence which indicates that 80% of Canadians value the rewards associated with credit card purchases. Visa told the Committee that premium cards provide value to merchants because those cards increase cardholder spending. Moreover, MasterCard noted that merchants that accept credit cards benefit from "payment guarantee, increased sales, improved efficiency, increased safety, billions of dollars of infrastructure investment, innovation, speedier checkout and easy access to international customers."

In a submission to the Committee following its appearance, the Canadian Bankers Association said that its estimates indicate that what it called "true" premium cards – those entailing higher interchange fees – represent about 9% of all bank credit card accounts. In response to concerns that these premium cards were issued to cardholders without their consent or adequate explanation, the Association said that its members are "reviewing their practices around issuing these cards." It also indicated that its members "could" take steps to "further clarify for consumers what the applicant eligibility requirements are for true premium cards."

Sector-Specific Issues

Several of the Committee's witnesses argued that the introduction of new premium cards and changes in interchange and merchant fees affect various sectors differently or, at least, that some sectors should be treated differently because of their unique features.

For its part, the Canadian Federation of Independent Grocers said that it was simply "nonsensical" to claim, as some academics do, that higher interchange and merchant fees are borne equally by all sectors: "No disrespect is intended to the chains, and they do wonderful things, but the fact is that when those rates go up, there are many avenues and creative ways that they can find to help mitigate the impact of some of those costs. The independents do not have that leverage in the market. They will go under."

In speaking about the tourism sector, Nick Mulder informed the Committee that travel providers and payment processors are required to finance "chargeback guarantees," which has been problematic for both Air Canada and Conquest Vacations, especially in the current economic turmoil. He also claimed that Moneris Solutions lost \$45 million when Jetsgo ceased operations. Consequently, payment processors were looking to shift the default liability risk onto travel providers in order to assure their own financial security.

Moneris Solutions, for its part, told the Committee that it underwrites the purchase of airline tickets on credit cards. Underwriting means that it pays the airline immediately and assumes the risk that the airline will fail before it can deliver its service. Consequently, it assesses whether the airline is solvent and holds reserves in the case of default, all of which is costly and burdensome from the payment processor perspective.

In its submission, Blue Plume International Marketing described to the Committee how its payment processor had withheld a "security reserve" against a chargeback that Blue Plume said was made in error by one of its clients. Blue Plume said, however, that it had little negotiating power relative to payment processors because "like many other small and mid-sized businesses, (it needs) the service of credit card processing to survive."

The role of interchange rates in charitable donations was also discussed by witnesses. CanadaHelps stated that its merchant fees increased from 1.6% of each transaction in 2003 to 2.1% in 2009. Furthermore, it noted that, since being founded in 2000, it has paid \$2 million in merchant fees; it believes that only \$1.6 million would have been paid under the old, relatively lower credit card fee schedule.

Conversely, Big Brothers Big Sisters of Canada indicated that credit cards facilitate giving and allow donations from around the globe. It also noted that its "average gift per participant has climbed to almost \$25, up from \$15 from traditional (payments)

vehicles.” Credit cards have also allowed Big Brothers Big Sisters of Canada to receive online donations.

In their testimony, Visa and MasterCard noted that they were aware that a number of universities did not accept their credit cards as payment. In MasterCard’s view, it needs to adjust its pricing system to capture those institutions. It also told the Committee that “(t)he good news about universities is that they do not need to leverage their collective bargaining strength because if one university in Canada falls off the MasterCard radar screen, it is a bad problem.”

WHAT THE COMMITTEE BELIEVES

The Committee believes that the Canadian credit card market needs improvement and clarity. Moreover, the relative power of the participants in the credit card payment system is unequal. We accept, to a great extent, the argument that most merchants lack the individual bargaining power needed to negotiate on an equal basis with other participants in the payment system. With a few exceptions, merchants told us that they have no choice but to continue accepting credit cards, despite rising fees, in order to avoid losing customers and sales. In our view, something is wrong when so many merchants, big and small and from across a variety of sectors, feel that other participants in the payment system are not adequately responding to their concerns. Despite the efforts of organizations representing hundreds of thousands of merchants, such as the Canadian Federation of Independent Business, the Retail Council of Canada and the Stop Sticking It To Us Coalition, merchants still claim to have inadequate bargaining power in their dealings with the credit card companies.

The Committee is concerned that competition among credit card networks may lead to rising interchange and merchant fees. A cycle can result from this inter-network competition, with credit card companies competing for card issuers by setting higher interchange rates that allow card issuers to benefit from higher revenue and/or to provide cardholders with more generous credit card features. The end result of higher interchange rates is higher costs for merchants and higher retail prices for consumers. The cycle can also lead to a more inequitable distribution of income in the sense that some consumers do not benefit from rewards programs, either because they do not have a credit card or because they qualify for a low- or no-reward card.

The Committee is cognizant that fee regulation can have both intended and – importantly – unintended consequences on behaviour, market participants and other prices. Furthermore, given the complexity and number of participants in the credit card market, we cannot recommend fee regulation as a first course of action. We are also not convinced that it is a simple matter to adapt the Australian regulatory approach – or the approach of any other country – to the Canadian context, as some witnesses recommended. Just as the environment in which the credit card system is operating in Canada has changed over time, it is also the case that each country has a unique

environment in which its credit card system must operate. As the current financial crisis clearly demonstrates, each country has unique institutional and cultural features that must be considered when designing policy.

The Committee thinks that the best way forward lies somewhere between doing nothing and regulating fees directly. Consequently, we believe that the federal government should take steps to empower merchants by improving the quality and range of available information. To that end, we propose that the government should create an oversight board, within an existing federal organization, that would consult with payment systems participants and relevant federal stakeholders. Once appointed, the proposed board should make recommendations on any regulatory or legislative measures that it considers to be necessary for ensuring fairness for participants in the credit card and debit card payment systems.¹⁸ We believe that these recommendations should be provided to the government by 31 December 2009. The proposed board should also monitor and report annually on payment-systems-associated fees, and should establish a code of conduct for payment systems participants and practices for setting fees and rates, in respect of which it should ensure compliance.

The Committee is conscious of the recently enacted legislation in the United States¹⁹ which requires the Comptroller General of the United States to conduct a study, due within 180 days of enactment, of credit card interchange fees that will examine: (a) the ways in which interchange fees affect the ability of merchants to negotiate pricing with network operators and card issuers; (b) the costs and factors incorporated into interchange fees; (c) the consequences of interchange fees for the prices of goods and services; (d) the manner in which merchant fees compare to the credit losses and other costs incurred by merchants to operate their own credit networks or store cards; (e) the complexity of credit card payment system rules; (f) the impact of interchange fee regulations in other jurisdictions; (g) the extent to which merchants are permitted to offer cash discounts; and (h) the extent to which interchange fees make it easier for smaller financial institutions to compete with larger financial institutions. The Comptroller General is also required to make appropriate recommendations for legislative or administrative actions.

A Canadian oversight board would, in the Committee's view, be a clear signal that the federal government is concerned about the recent events in Canada's credit card payment systems. The Committee, therefore, recommends that:

¹⁸ The Committee discusses debit card payment systems in detail in Chapter 5.

¹⁹ On 22 May 2009, US President Barack Obama signed into law H.R. 627 (the "Credit CARD Act of 2009") that, in addition to mandating the interchange fee study, also imposes new disclosure requirements on credit card issuers and new rules relating to a number of credit card practices. These disclosure requirements and rules are discussed in more detail in Chapters 6 and 7 respectively.

RECOMMENDATION 1: The federal government appoint an “oversight board,” within an existing federal organization, that would consult with participants from Canada’s credit card and debit card payment systems as well as relevant federal stakeholders.

The proposed oversight board’s mandate should be to:

- **make recommendations, by 31 December 2009, on any regulatory or legislative measures that it considers to be required to ensure fairness for participants in the credit card and debit card payment systems;**
- **monitor and publish annually information on trends in interchange, switch, merchant and other associated payment systems fees; and**
- **establish a code of conduct for payment systems participants and practices for setting fees and rates, in respect of which it should ensure compliance.**

Finally, merchants should be permitted to bargain collectively regarding payment card conditions and fees, and this form of cooperation should be exempt from the provisions of the *Competition Act*.

CHAPTER 4: MERCHANT ACCEPTANCE RULES

According to the testimony presented to the Committee by a number of retailers, merchant acceptance rules limit their ability to control their payment costs and to direct consumers to relatively lower-cost payment methods. The two principal rules that merchants discussed with us were the “no-surcharge” rule and the “honour-all-cards” rule outlined in Chapter 2.

WHAT THE WITNESSES SAID

“No-Surcharge” Rules

Contrary to the testimony that the Committee heard from the credit card companies, the Canadian Federation of Independent Business informed us that a number of its members are not permitted to offer a discount for cash purchases and/or to advertise such discounts. The Stop Sticking It To Us Coalition, for its part, said that offering a discount to customers who make purchases with cash is difficult to administer in practice because the merchant might feel obliged to vary its discount rates depending on the type of credit card. The Canadian Restaurant and Foodservices Association recommended that merchants be allowed to “pass-on the cost of accepting credit cards to customers through surcharges.”

On the other hand, MasterCard told the Committee that it allows merchants to offer discounts to customers who make purchases with cash and it allows those discounts to be advertised. Similarly, TD Merchant Services and Moneris Solutions said that they allow merchants for which they process payments to advertise and give discounts for customers who make purchases with cash. Moreover, Visa told us that while it prevents merchants from applying a surcharge for credit card purchases, it allows merchants to offer a discount for purchases made with cash. Visa has adopted this position because while there is no upper limit on a surcharge, a discount has a natural floor, as the merchant would not want to reduce the price below the cost-recovery level.

Lastly, American Express told the Committee that “(s)urcharging discriminates against card and other electronic payment instruments in favour of other less efficient forms of payment such as cash and cheques.”

“Honour-All-Cards” Rules

American Express informed the Committee that the “honour-all-cards” rule is crucial for its brand and reputation. Furthermore, it stated that if a merchant indicates that it accepts American Express cards, cardholders may be confused if some, but not all, American Express cards are accepted. Moreover, MasterCard and American Express argued that when Canadians travel abroad, they expect their credit cards to be accepted;

similarly, when tourists visit Canada, they should have confidence that their credit cards will be accepted as a method of payment.

The Coalition shared with the Committee its concern that merchants could not refuse to accept relatively high-cost credit cards because of the “honour-all-cards” rule. Furthermore, in its view, even if merchants could refuse to accept relatively high-cost credit cards as payment, it is often difficult for the merchant to assess the relative merchant cost of various cards, given the complex array of credit card options. Finally, according to the Coalition, it is difficult for a merchant to explain to a customer the reasons why a certain credit card is not accepted. Additionally, in its view, as credit card companies enter the Canadian debit card market, it could be difficult to explain why a particular credit card company’s debit card would not be accepted as payment. For its part, the Canadian Federation of Independent Business told us that merchants should be permitted to refuse certain credit cards.

WHAT THE COMMITTEE BELIEVES

The Committee believes that, although they can be mathematically identical, discounts for low-cost payment methods and surcharges for high-cost payment methods can lead to different outcomes. A surcharge allows a merchant to add a fee that can vary for each payment method. We also feel that the application of surcharges may lead customers to acquire and use payment methods that are relatively less costly for merchants, which could limit the extent to which the cost of payment methods is reflected in higher retail prices.

With respect to “honour-all-cards” rules, the Committee is encouraged by Visa’s statement that it would not require merchants that accept its credit cards as payment to accept its debit cards. We note, however, that this undertaking is voluntary, and could be rescinded at any time. Moreover, MasterCard has not, to our knowledge, commented on the issue of using “honour-all-cards” rules to link its credit cards with its debit cards. We strongly believe that network operators should not be permitted to impose “honour-all-cards” rules that link credit cards and debit cards: each network operator should compete on a level playing field based on the service and cost of the payment network that it provides. The federal government should give legislative effect to what, for some, is already a voluntary practice. Moreover, a network operator should not be permitted to require merchants that accept its credit cards to accept its premium cards, which entail relatively higher interchange rates. Given these considerations, the Committee recommends that:

RECOMMENDATION 2: The federal government take appropriate action to:

- **permit surcharging and/or discounting by merchants;**
- **require merchants to display, at the point of purchase, the amount of any applicable surcharge or discount;**
- **permit merchants to inform customers about relatively lower-cost payment methods; and**
- **prohibit any “honour-all-cards” rules, including those that require merchants to accept a network operator’s higher-cost premium cards and those that link credit card and debit card merchant acceptance.**

CHAPTER 5: DEBIT CARD COMPETITION

The payment system that enables debit card use by Canadians is operated by Interac, which was founded in 1984. Since 1996, Interac has operated under the terms of a Consent Order, now formally called a Consent Agreement, imposed by the Competition Tribunal. Among other things, the Consent Order:

- expanded the list of eligible Interac members with the effect that, over time, Interac's membership has grown from 27 members in 1996 to 62 currently;
- implemented a governance model where decisions on new services and interchange fees are made on the basis of a majority vote of the 14-member board while, for all other matters, no decision can require more than a two-thirds majority;
- gave Interac the right to set an interchange fee on debit card transactions;²⁰
- required Interac to price its payment services – that is, to set its switch fees – on a cost-recovery basis, which includes operating and development costs;²¹ and
- allowed merchants to apply a surcharge, i.e., merchants can charge consumers for costs in addition to the listed price for debit card transactions.

In 2007, Interac began discussions with the Competition Bureau in an attempt to change its Consent Order/Agreement and, as a consequence, its governance structure to a for-profit company as it faces an increasingly competitive and innovative payments market. Visa and MasterCard are already offering debit card payment system services in Canada or have indicated an intention to do so in the near future.

Table 2 presents Canada's debit card interchange fees as well as the fees in Australia, the United Kingdom and the United States.

²⁰ Interac has always set the debit card interchange fee at zero.

²¹ The switch fee is currently set at eight-tenths of one cent per transaction and is charged to both the debit card issuer and the payment processor, for a total fee per transaction of 1.6 cents.

Table 2: Debit Card Interchange Fees in Australia, Canada, the United Kingdom and the United States

Country	Interchange Fee
Australia ²²	The weighted-average interchange fee on Visa debit transactions is limited to about AU\$0.12 (\$0.103 CAD ²³) per transaction. Additionally, the interchange fee (paid by the card issuer to the payment processor) must be between AU\$0.04 (\$0.034 CAD) and AU\$0.05 (\$0.043 CAD) per transaction for EFTPOS debit transactions. (2008)
Canada ²⁴	Interac's point-of-sale interchange fee is set at zero. The interchange fee for ABM withdrawals through the Interac network is \$0.75 per withdrawal and is paid by the card issuer to the ABM operator. (2009)
United Kingdom ²⁵	The average debit interchange fee was 6.4 pence (\$0.144 CAD ²⁶) per transaction. (2000)
United States ²⁷	The average signature (Visa and MasterCard) debit interchange fee was US\$0.38 (\$0.494 CAD ²⁸) per transaction and the average PIN debit interchange fee was US\$0.19 (\$0.247 CAD) per transaction. (2004)

WHAT THE WITNESSES SAID

In its presentation to the Committee, Interac indicated that it is a proponent of competition in a free market, but only if it is “allowed to compete on a level playing field” by changing to a for-profit company. Interac described its current governance structure as “dysfunctional” and said that the structure “shackles” the organization’s ability to make the kind of investments and pricing decisions that are needed to compete effectively with well-financed and experienced competitors such as Visa and MasterCard.

²² Reserve Bank of Australia, *Reform of Australia's Payments System: Conclusions of the 2007/08 Review*, September 2008, pp. 3, 6, http://www.rba.gov.au/PaymentsSystem/Reforms/RevCardPaySys/Pdf/conclusions_2007_2008_review.pdf.

²³ The exchange rate used to convert Australian dollars into Canadian dollars was 0.8575 from 2 January 2009. See: Bank of Canada, *Rates and Statistics: Exchange Rates*, 2009, <http://www.bankofcanada.ca/en/rates/exchform.html>.

²⁴ Interac Association, *About Us*, <http://www.interac.ca/about.php> (accessed 29 May 2009).

²⁵ Don Cruickshank, *Competition in UK Banking: A Report to the Chancellor of the Exchequer*, March 2000, p. 256, <http://www.hm-treasury.gov.uk/d/BankReviewAnnexD3.pdf>.

²⁶ The exchange rate used to convert British pounds into Canadian dollars was 2.25, the average rate for 2000. See: Bank of Canada, *Rates and Statistics: Exchange Rates*, 2009, <http://www.bankofcanada.ca/en/rates/exchform.html>.

²⁷ Dove Consulting, *Debit in Canada: An Overview of the Canadian Debit System and Comparison with the U.S. Model*, February 2004, p. 1. This white paper was commissioned by PULSE EFT Association, a payment network in the United States.

²⁸ The exchange rate used to convert US dollars into Canadian dollars was 1.30, the average rate for 2004. See: Bank of Canada, *Rates and Statistics: Exchange Rates*, 2009, <http://www.bankofcanada.ca/en/rates/exchform.html>.

Interac said that if it is successful in its effort to become a for-profit entity, it will compete with Visa and MasterCard by taking advantage of its wide merchant acceptance and by promoting itself as a low-cost provider, with flat fee-based pricing. Interac indicated that this strategy would allow it to avoid the problems encountered by debit card payment systems in other countries that have tried, with little success, to compete with Visa and MasterCard by increasing interchange fees in an effort to attract card issuers and cardholders: “If merchants begin to view and accept Interac, Visa and MasterCard as being the same, then we lose the very foothold and the very cornerstone of our success. ... We want to provide a distinct choice from Visa and MasterCard. Our sustainability is based on our difference.”

A number of the Committee’s witnesses were concerned and sceptical about the benefits of competition among debit card payment systems, with or without a change to Interac’s Consent Order/Agreement. For example, the Stop Sticking It To Us Coalition told the Committee that the experience of other countries shows that competition among debit card payment systems produces “an auction for issuers’ business by increasing payment costs for all. ... We only need to look to the U.S. to see how the two card companies suppressed efficient debit card services similar to Interac. Fees have since skyrocketed and now include both flat fees and ad valorem rates.”

The Coalition also questioned the need for an interchange fee based on a percentage of the debit card transaction value: “Why should the debit fee bear any relation to the size of the transaction at the point of sale? If the money is transferred from a customer’s account to the issuer in real time, and is clearly not a loan or credit advance, how can Visa and MasterCard justify charging a percentage fee? The answer is simple: Currently they can and they are unregulated.”

With respect to payment cards with which competing payment networks can be accessed – a practice sometimes referred to as “co-badging”²⁹ – the Coalition expressed concern that Visa and MasterCard will provide “acquirers with incentives so that their debit product receives priority routing at the point of sale. This will be matched by aggressive distribution of these cards by issuers. We only need to look to the U.S. to see how the two card companies suppressed efficient debit card services similar to Interac.”

Finally, the Coalition said that it was concerned that Interac might “eventually desire interchange fees or a substantial increase in order to compete with Visa and MasterCard.” For that reason, it recommended that rules be put in place that would limit debit card pricing in a competitive environment to a flat fee structure rather than a percentage-based interchange fee, and that there be “transparency, oversight and correlation between the flat fee charged and the service provided.”

²⁹ See definition in Chapter 2 and testimony by Visa to the Standing Senate Committee on Banking, Trade and Commerce on 22 April 2009.

These views were echoed by the Canadian Federation of Independent Business, which described percentage-based interchange fees on debit card transactions as a “big cash grab.” The Federation also noted that, in discussions with US merchant groups, it was given some “stark” advice: “(D)o not let the credit card companies into the debit market ... (and) do not allow debit and credit features on the same card because it limits the extent of choice and competition.”

The Canadian Federation of Independent Business said that it “did not know that for-profit status is necessarily the way to go with Interac.” More generally, it said that if competition among debit payment systems were to take place, “it must be on a flat-fee basis or something like that. We ... believe competition is a better outcome, therefore let these players into the market, but there will be no charging a percentage of the transaction fee.”

Canadian Tire Corporation and the Canadian Federation of Independent Grocers made similar arguments. For example, Canadian Tire Corporation asked that the federal government “carefully monitor and control the entry of new competition into the debit card business to ensure there is real competition so that fees remain low and appropriately transaction-based.” The Canadian Federation of Independent Grocers, for its part, said that if competition is to take place, then Visa, MasterCard and a for-profit Interac should be obliged to set fees that “relate to the cost of processing plus only a reasonable rate of return with no allowance for percentage charges.”

In a submission that echoed the views of US merchants as articulated by the Canadian Federation of Independent Business, Loreen Paterson asked the Committee to “(p)lease stop Visa and MasterCard from entering this market.”

Other witnesses took a different view about competition among debit card payment systems and possible changes to Interac’s Consent Order/Agreement. In its submission to the Committee, American Express said that it supports “free, fair and enhanced competition so that payment options such as American Express, Interac and new entrants are available to compete with entrenched payment networks such as Visa and MasterCard.”

The Credit Union Central of Canada, which is a member of Interac, said that its members “need access to the broadest possible range of products, suppliers and delivery models for debit and credit card services. This kind of flexibility is consistent with an open market environment that provides competitive choice for credit unions and for their members. It also includes support for preserving a strong, domestically focused payments delivery channel as provided by Interac.” It noted that “(a)s the card services market is transformed by the introduction of chip and other new technology, it will become even more important to preserve the capability to develop and deliver card-based services focused on the needs of Canadians and the characteristics of the Canadian marketplace.”

For its part, the Canadian Bankers Association said that it does not have a policy position on debit card competition from Visa and MasterCard, but noted that “customers are best served by an open and competitive marketplace. The current debit card system serves Canadians well. It needs to grow and evolve to meet the needs of a more integrated global economy.”

Other witnesses stressed the potential benefits from more competition among debit card payment systems. In his submission, Vishal Malik said that Canada should welcome the entry of Visa and MasterCard into the Canadian debit card market because of what he described as a number of “shortcomings” with Interac-based debit cards. In his view, these shortcomings include his inability to use debit cards in Canada to rent vehicles, book hotel rooms, make purchases overseas and transact business online. Interac, however, told the Committee that its debit payment system *can* be used to make online purchases.

UseMyBank Services, Inc. expressed an opinion similar to Mr. Malik’s, arguing that “it is in our country’s best interest to have as many suppliers of online debit services in Canada as possible to ensure good services and fair prices.”

With new debit card products either already available in Canada or expected to be available soon, Visa and MasterCard supported more competition among debit card payment systems. Visa, for example, told the Committee that “we believe in consumer choice,” while MasterCard said that, by promoting competition, “Canada’s debit system will begin to deliver enhanced value to consumers and merchants through choice, price competition, innovation and international reach.”

Visa and MasterCard said that they are adapting their pricing and marketing strategies to the unique aspects of the Canadian financial market. These aspects include a financial system dominated by a few large institutions and a debit market dominated by the not-for-profit Interac. Given what they believe to be these institutional realities, both companies said that what happened in other countries is not directly relevant to what will happen in Canada.

As discussed earlier, Visa told the Committee that, if and when it enters the Canadian debit card market, it will not enforce an “honour-all-cards” rule for debit cards on merchants that accept its credit cards. MasterCard, for its part, indicated that it has not set an interchange fee in relation to its Maestro debit card and, moreover, that its switch fees are currently set at one-half of one cent (\$0.005) per transaction, or 37.5% less than the eight-tenths of one cent (\$0.008253) currently charged by Interac. In short, it argued that competitive forces have already yielded benefits.

Visa also informed the Committee that its entry into the Canadian debit card market will include an interchange fee, calculated as a flat fee and as a percentage of each

transaction.³⁰ In its view, an interchange fee of zero “is unsustainable in the long-term” due to the costs of funding innovation and providing services such as buying goods online, through mail order or by telephone. Visa acknowledged that its proposed interchange fee may cause its debit product to be more costly than competing debit cards but the company said that merchants can choose to not accept its debit cards if the cost is too high.³¹

MasterCard told the Committee that it supports proposed changes to Interac’s organizational structure “provided that Interac loses its monopoly status and becomes subject to market-driven competition from other debit providers.”

With respect to the issue of “co-badging,” Visa told the Committee that it is “promoting consumer choice. The banks are thinking about it and we are talking about a proposition that includes both Visa and Interac on the chip, and that would present consumers with a choice at the point of sale. Consumers would be able to select either Interac or Visa for their transaction.”

Finally, the testimony of the Desjardins Group indicated that the ideal policy solution might lie somewhere between the two extremes presented by the retailers and by Visa and MasterCard. It noted that “(t)oday, retailers are arguing for keeping the status quo and Desjardins fully understands the rationale for their stand, even more so given that the Canadian debit network is often cited as a model example for foreign markets and is the envy of foreign payment organizations. Proper functioning of these payment systems means that competition between the actors who make up the payment system should be open. There must be competition, everybody agrees on that, but there also has to be a high level of collaboration because the success of current systems is due in large part to collaborative work between the institutions to deal with the on-going chaos wrought by fruitless new initiatives that have the potential to increase costs for merchants and confuse consumers who always end up on the hook for all costs associated with the payment service.”

WHAT THE COMMITTEE BELIEVES

The Committee notes the widely shared view among our witnesses that, whatever its current limitations, Interac – as shaped by the Consent Order/Agreement in place since 1996 – has been tremendously successful in making debit cards a widely used and

³⁰ These rates will range from 0.15% of the transaction value + \$0.05 for grocery and gas purchases to 1.15% of the transaction value for transactions that take place without the physical presence of the debit card (e.g., online and telephone purchases). See Visa, *Visa Canada Interchange Reimbursement Fees*, p. 4, http://www.visa.ca/en/aboutcan/mediacentre/interchange/pdf/interchange_brochure.pdf.

³¹ Visa also noted that institutions that choose to issue its debit cards will have the option of issuing a Visa-only debit card or of “co-badging” the Visa product with Interac on the same debit card, allowing consumer choice at the point of sale.

accepted means of payment in Canada. We note, for example, that Canadians are the second highest per capita debit card users in the world after the Swedes.

At the same time, the Committee recognizes that the Canadian debit card market has recently changed. Debit card transactions using the Visa and MasterCard payment networks are either already happening or will be happening soon, and Interac clearly recognizes this competitive threat, as evidenced by its discussions with the Competition Bureau about changing its Consent Order/Agreement so that it can alter its governance structure from a not-for-profit association to a for-profit company. We are mindful of Interac's argument that its current not-for-profit and governance status hinders its ability to compete, given the new realities of the marketplace. While we cannot pre-judge the outcome of these discussions, as a general rule we believe that market participants should be able to compete on a level playing field.

That said, the Committee is concerned that competition among debit card payment systems could lead to higher costs for merchants and, eventually, higher retail prices for consumers. We know that interchange fees on debit cards issued under the Visa brand will be calculated on a combined flat fee and percentage basis that Visa admits may entail higher merchant costs than those associated with cards issued under the Interac and MasterCard brands. MasterCard points to the fact that its Maestro debit card is less expensive than Interac's debit card as proof that competition yields benefits. However, we are not convinced that this situation will endure, and we are concerned that competition between Interac and two well-financed and market-savvy competitors such as Visa and MasterCard will marginalize Interac, and either drive it out of business regardless of its governance structure or lead to a merger or acquisition that would have the effect of limiting competition in the debit card market to Visa and MasterCard. At that point, debit card merchant fees would likely do what they have done elsewhere under these circumstances: they would rise.

The Committee also believes that there is little rationale for percentage-based interchange, merchant discount and switch fees on debit cards, since this payment method involves a relatively simple and nearly instantaneous transfer of funds from the account of the purchaser to the account of the seller. There is no obvious credit risk and no interest-free period to fund in these transfers as there is for credit card transactions. Moreover, the experience of Interac has shown that a flat fee pricing structure, even under a not-for-profit model and with an interchange fee of zero, can be successful both in its issuance and acceptance even in the face of fraud risks and costs, which we believe are rising. In this regard, we are mindful of the Canadian Bankers Association's testimony to us, which indicated that – in 2008 – Canadian credit card and debit card customers were reimbursed more than \$500 million as a result of losses associated with criminal activities. We feel that switch and interchange fees set on a flat fee basis can be sufficient to fund innovation costs. Interac advised us that it has been unable to fund these costs to date largely due to a governance structure that impedes board of director decisions to raise fees. Interac's Consent Order/Agreement clearly allows Interac to set

switch fees to cover the cost of development. It is also empowered to set interchange fees but has refrained from doing so.

Additionally, for the purpose of ensuring a level playing field during the early stages of Canada's newly competitive debit card market, the Committee believes that the federal government should set interchange fees on debit card transactions at zero, which is the fee currently set by Interac and in relation to MasterCard's Maestro debit card. Further, the Minister of Finance should also deem Interac, Visa and MasterCard as designated payment systems under the *Canadian Payments Act* if he or she believes that this action is necessary to promote the efficiency and competitiveness of payment systems in Canada, i.e., a level playing field.³²

Finally, the Committee recognizes that "co-badging" is already taking place. We are concerned that, through a practice known as "priority routing," the choice among the merchant-accepted payment options on a particular card would not be made by the merchant or by the cardholder. We believe that cardholders should be free to choose their desired payment method and payment system.

To summarize, the Committee believes that, because of the nature of competition among payment systems, there is a risk that debit card payment competition would lead to rising debit card costs for payment processors and merchants and, eventually, to higher retail prices for consumers. We also feel that debit card transactions are inherently less risky and costly than credit card transactions; consequently, they do not warrant a percentage-based fee structure, whether at the level of interchange fees or switch fees. Finally, we recognize the need for these fees to finance reasonable innovation costs as well as a reasonable return on investment. Given these considerations, we think that switch and interchange fees in the debit card market should be set on a flat fee per transaction basis, and that cardholders should be free to choose, at the point of sale, their desired payment method and payment system. Therefore, the Committee recommends that:

RECOMMENDATION 3: The federal government take appropriate action to:

- **require the calculation of switch and interchange fees on the basis of a flat fee for debit card transactions;**
- **set the interchange fee at zero for a period of three years for all debit card transactions; and**
- **prohibit priority routing in order that cardholders are able to select, at the point of sale, their preferred payment method when using a co-badged card.**

³² See Subsection 37(2) of the *Canadian Payments Act*.

CHAPTER 6: FINANCIAL INFORMATION DISCLOSURE

Over the course of our study, the Committee identified two main consumer-related themes with respect to credit cards: credit card interest rates, terms and conditions, which are discussed in Chapter 7, and financial information disclosure, which is discussed in this chapter. With rare exceptions, our witnesses did not discuss debit cards from a consumer perspective. Before reviewing the Committee's evidence and our recommendations, factual information from the consumer's perspective provides a useful context.

Canada's chartered banks began issuing credit cards in 1968. Since then, credit card issuance and use have increased sharply. In 1977, there were 8.2 million Visa and MasterCard credit cards in circulation in Canada.³³ By 2007, there were about 64.5 million credit cards – Visa, MasterCard, American Express and others – in circulation in Canada.³⁴ In 2007, Canadians used their credit cards for an average of 67.3 transactions per person at an average value per transaction of US\$100.70, compared with 41.4 transactions at an average value of US\$65.10 in 2000.³⁵ In total, Canadians made credit card purchases totaling about \$240.5 billion in 2007.³⁶

Survey evidence discussed by the Committee's witnesses indicates that between 60% and 70% of credit cardholders routinely pay their credit card balances in full every month. The Financial Consumer Agency of Canada, for example, told us that its survey evidence shows that 60% of credit cardholders pays the monthly balance in full while the Canadian Bankers Association, citing a study by the Boston Consulting Group, said that 70% of credit cardholders routinely pays the monthly balance in full. Those who do not pay their balance in full when due, or who use their credit cards for cash advances, incur interest costs as set out in the terms of their credit card contract.

According to recent reports, the current recession is causing an increasing number of credit card delinquencies, defined as situations where cardholders are 90 days or more behind in their credit card payments. From 31 January 2004 to 31 October 2008, the "delinquency rate" – defined as the value of delinquent credit card loans divided by the total outstanding credit card balance for a given period in time – was 0.84% on Visa and MasterCard credit cards. By 31 January 2009, however, the delinquency rate had climbed 36% to 1.14%.³⁷

³³ Canadian Bankers Association, *Credit Card Statistics – VISA and MasterCard*, http://www.cba.ca/contents/files/statistics/stat_20081031_cc_db038_en.pdf.

³⁴ Bank for International Settlements, *Statistics on payment and settlement systems in selected countries* (Red Book), various years, http://www.bis.org/list/cpss/tid_57/index.htm.

³⁵ Ibid.

³⁶ Ibid.

³⁷ Canadian Bankers Association, *Credit Card Delinquency and Loss Statistics – Visa and MasterCard*, http://www.cba.ca/contents/files/statistics/stat_creditcarddelinquency_en.pdf.

A January 2009 Deloitte Touche Tohmatsu survey of financial services executives found that increasing delinquencies were resulting in losses and that a 100-basis-point increase in the annualized loss rate – defined as net write-offs divided by total outstanding balances – would represent “annualized losses of over \$800 million to the (credit card) industry as a whole.”³⁸ This loss, in turn, would have represented about 0.33% of the total value of credit card transactions in 2007. While Canadian card issuers have “traditionally seen loss rates of less than 4% – a figure much lower than that of their American counterparts (6% and growing),” the fact that the debt-to-disposable income ratio of Canadian consumers recently exceeded that of the US³⁹ likely means that “Canadian issuers face new risks,” especially because, “since 2004, Canadian banks have seen their credit card balances increase by almost 40%.”⁴⁰ A more recent study by CIBC World Markets showed that the loss rate in Canada, as of December 2008, had reached an annualized rate of 4.53%.⁴¹

On 21 May 2009, the federal government announced several proposed regulatory changes aimed at improving credit card information and disclosure; public comments on the proposed changes are currently being examined by the Department of Finance. Appendix B describes these proposed changes as well as recently enacted changes to credit disclosure rules in the US.

WHAT THE WITNESSES SAID

A number of the Committee’s witnesses expressed concern that Canadians may not fully understand the costs and implications of acquiring and using credit cards. This situation may be due in part to “supply-side” information problems, such as the complexity of the language used to explain credit card terms and contractual features, and in part to “demand-side” problems, such as the consumer’s inability to understand financial language or to pay adequate attention to contractual terms.

The federal government’s 21 May 2009 announcement about proposed changes to the *Bank Act* regulations is consistent with the testimony presented to the Committee by the Department of Finance, which indicated that the government was “increasingly concerned about the complexity of offerings.” To address this concern, the Department said that the government would “make improvements in areas such as the provision of clear and simple information on credit card application forms and contracts and clear and timely advance notice of changes in rates and fees.”

³⁸ Deloitte Touche Tohmatsu, a Swiss Verein, *Uncharted waters for credit card issuers*, http://www.deloitte.com/dtt/cda/doc/content/ca_en_consulting_Unchartedwaters_Jan09v2.pdf. The study was based on interviews with senior management at card-issuing institutions.

³⁹ Ibid.

⁴⁰ Ibid.

⁴¹ Benjamin Tal, “Household Credit Analysis,” *CIBC World Markets*, 4 March 2009, http://research.cibcwm.com/economic_public/download/hca-090304.pdf.

In speaking of disclosure, the Financial Consumer Agency of Canada told the Committee that there is already a requirement in the *Bank Act* regulations “for clear and straightforward language” and that it is “pushing that a little bit harder with the institutions now.” The Agency also noted that it is working closely with MasterCard to develop a “model application form” which could be used by card issuers.

In its submission to the Committee, MBNA Canada Bank (hereafter, MBNA) indicated that “we share the government’s focus on ensuring Canadians have access to credit on terms that are fair and transparent. We support the government’s proposal to strengthen disclosures on credit cards so that consumers are better equipped to make informed decisions.”

In his submission, Del Umholtz noted his support for simplified standard contracts written in plain language “because what is being put in front of consumers is clearly over the heads of the majority of them and hidden away in fine print on these often lengthy terms and conditions are many ‘got ya’ clauses that simply allow the card issuer to jack the rates up and keep the consumer on the hook for extended periods of time.”

Similarly, Option consommateurs recommended improvements to the language used in credit card application forms and contracts, but added that the federal government must “regulate and monitor” information disclosure with respect to the “calculation and impact of minimum payments, over-limit fees and other late-payment penalties, changes in interest rates, appropriation of payments, retroactive interest, cash advances, unilateral changes to contract terms, as well as advertising and in-store credit solicitation.” Option consommateurs also said that there “must be controls” on lender behaviour in the sense that lenders, when issuing credit cards, should have an obligation to counsel cardholders on the best use of credit products and on how to evaluate properly their ability to repay debt.

The Canadian Federation of Independent Business also expressed concern about what it said was a tendency for card issuers to supply credit “willy nilly,” behaviour which the Federation said has negative consequences in that “(w)e all pay through the system with higher interest rates than we probably otherwise would have to pay.” Moreover, it said that “(b)anks should not be permitted to send out cards with new fees and features that have not been requested by the consumer. ... The consumer does not even know what this new card is. They do not realize it has a higher fee for the merchant and they do not necessarily want the benefits.”

The Canadian Community Reinvestment Coalition told the Committee that consumer interests would be best served by empowering consumer advocacy groups, such as it, so that they could lobby on behalf of consumers. It recommended that the federal government require card issuers to “enclose a one-page pamphlet once or twice

each year in their mailings to customers that describe and invite customers to join the group for a nominal annual membership fee”

While improved disclosure requirements should help consumers to make more informed choices, a number of witnesses also discussed the issue of financial literacy, a theme addressed by the federal government in Budget 2009. At that time, the government proposed the creation of a national task force to “make recommendations to the Minister of Finance on a cohesive national strategy on financial literacy.”

The Credit Union Central of Canada, for example, suggested that the federal government’s proposed financial literacy task force should survey the full extent of existing financial literacy programs in “all communities of all provinces” and identify “what tools work best and what programs work best. In that way, all people could have access to those, rather than access being limited to a small group here or a small group there.”

Edgar Dunn & Company mentioned its belief in financial literacy for both consumers and for merchants, arguing that both groups need to understand better the costs and benefits of credit card and debit card use and acceptance.

For his part, Professor Roger Ware said that, given his role as an educator, “(y)ou will not hear me arguing against literacy. The question is how and where. ... A friend in Kingston told me recently that he studied economics in high school and the only thing he learned was how to balance his cheque book. It struck me that while we teach economics currently in high school, balancing a cheque book is one thing we do not teach people.” He also noted that he was in favour of action directed at the “other side” of the issue, namely better disclosure on the part of card issuers: “I think more disclosure, transparency and financial education are good ideas.”

In its submission to the Committee, the Canadian Foundation for Economic Education also said that more work needs to be done in order to improve financial literacy or what it referred to as the “demand side” of the issue.

Few of the Committee’s witnesses argued that financial literacy, on its own, would improve the way in which consumers use their credit cards. Professor Jacob Ziegel, for example, expressed scepticism about the benefits of efforts to improve financial literacy, while Option consommateurs noted that financial literacy is a subset of a much larger problem, namely alphanumeric illiteracy. Citing Statistics Canada data, Option consommateurs pointed out that 42% of Canadians between the ages of 16 and 65 are at level 2 literacy, which means that they are considered to be unable to participate fully in the knowledge economy.⁴²

⁴² See: Statistics Canada, “International Survey of Reading Skills,” *The Daily*, 9 January 2008, <http://www.statcan.gc.ca/daily-quotidien/080109/dq080109a-eng.htm>.

In his presentation, Professor Saul Schwartz said: “It is pretty clear from the evaluation literature involving these (financial literacy) programs that if they have any impact on financial literacy, that impact is quite small.” He added that, in his opinion, the policy push by providers of financial services in favour of more financial literacy strategies are often designed to avoid direct regulation. He recommended the creation of a regulatory body that would be charged with ensuring “consumer safety” through clear and simple language and with regulating the “terms and conditions under which credit and debit cards are used.”

The Canadian Foundation for Economic Education, for its part, disputed the idea that the “incentive structure” or “supply side” of the financial literacy issue is what drives many to make bad financial decisions: “(W)e believe Canadians aim to act rationally. It is not their desire to dig themselves into financial holes, suffer the financial anxieties of over-indebtedness, have relationships suffer from financial stress, and see their hopes for the future diminished.” To address these supply-side concerns, the Foundation recommended the establishment of “an Office of Financial Communications that will help ensure plain, clear language in material and resources provided by the government – and by industry and industry associations.”

WHAT THE COMMITTEE BELIEVES

The Committee believes that financial literacy is like two sides of a coin. On the one side, consumers bear some responsibility for understanding the financial products that they use. On the other side, financial services providers also bear a responsibility to communicate in a clear, concise and useful manner – to think otherwise would be, in our view, tantamount to blaming the victim, who generally tries to act rationally.

From this perspective, while the Committee generally supports the federal government’s proposed regulatory changes that were announced on 21 May 2009 and recognizes that public comments on them are currently being examined by the Department of Finance, we also feel that – at least as announced – they do not go far enough.⁴³ In particular, we believe that card issuers should be required to disclose both the number of months it would take to pay off the balance owing and the cost that would

⁴³ The federal government plays a role on both the “supply” side and the “demand” side of the financial literacy issue. Through the Financial Consumer Agency of Canada, it tries both to improve the consumer’s ability to understand financial material and to enforce the credit card disclosure requirements outlined in the regulations to the *Bank Act*. In particular, subsection 6(4) of the *Cost of Borrowing (Banks) Regulations* already requires credit card companies to communicate in “plain language that is clear and concise” and which is “presented in a manner that is logical and likely to bring to the borrower’s attention the information required by these Regulations to be disclosed.” Among other things, the existing regulations require card issuers to disclose interest rate calculations, grace periods, borrower liability in the event of a stolen card, itemized statements, and the amount due and due-by date. Card issuers are also required to provide a 30-day notice period prior to making selected changes to the credit card agreement; exceptions include a change to the credit limit, an extension of the grace period, a decline in default and non-interest charges, and changes in the variable interest rates due to changes in an underlying public index.

result if no additional advances and/or purchases were made and if the consumer were to make only the minimum monthly payment.⁴⁴ Further, we feel that card issuers should be required to indicate the monthly payment required to pay off the outstanding balance within 36 months if no further purchases and/or advances were made. These two measures would align Canada's credit card disclosure rules with those recently introduced in the United States.

In the Committee's view, financial disclosure and informed decision making by cardholders would be strengthened further if cardholders were, with each monthly statement, given a year-to-date summary of all interest costs and other fees that have been paid and/or accrued. Moreover, in order to help consumers recognize that credit cards with relatively lower interest rates may be available, we believe that card issuers should also be required to disclose regularly, and at the time of renewal, the range of their credit card products, including all associated fees and interest rates. Finally, we feel that card issuers should be required to inform cardholders periodically about the Financial Consumer Agency of Canada's online credit-card selection tool,⁴⁵ which is intended to help consumers choose the credit card that is best suited to their needs.

The Committee also notes that we have, in the past, addressed matters related to financial literacy. In our June 2006 report, entitled *Consumer Protection In The Financial Services Sector: The Unfinished Agenda*, we recommended that the federal government develop a model financial literacy curriculum, increase funding to relevant federal departments and agencies, study ways of improving access to reasonably priced credit, direct the Department of Finance to meet with financial institutions to ensure clear, simple and concise financial services contracts, and direct the Financial Consumer Agency of Canada to undertake an ongoing public education campaign. In that report, we commented, for example, on the efforts of the Canadian Foundation for Economic Education. We continue to support the efforts of this and similar organizations that are focused on improving the economic and financial literacy of Canadians.

The Committee is pleased that the federal government is acting in the spirit of at least some of our June 2006 recommendations. As discussed earlier, Budget 2009 proposed the creation of a task force that would make recommendations to the federal government with respect to developing a "cohesive" financial literacy strategy.

The Committee is concerned, however, that the proposed task force may overlook an important consideration: what to do with and about the Financial Consumer Agency of Canada. While we know that the Agency is "pushing a little harder" to enforce better disclosure on credit card issuers, we believe that this undertaking is insufficient. Given the number of witnesses who complained about the complexity of credit card contracts,

⁴⁴ Under the federal government's 21 May 2009 proposal, card issuers would only be required to disclose the number of months it would take to pay the balance owing, and not the cost.

⁴⁵ The website address is: <http://www.fcac-acfc.gc.ca/eng/consumers/ITools/CreditCards/default.asp>.

we would have liked a firmer commitment on the part of the Agency to exercise its existing regulatory power over credit card disclosure.

In light of this concern, the Committee believes that the federal government should direct the Financial Consumer Agency of Canada, and provide it with the resources necessary, to take a more vigorous approach to enforcing existing and future disclosure requirements. Moreover, the Agency should also be required to monitor and report on card issuer practices, including a study of how credit card companies assess creditworthiness. For these reasons, the Committee recommends that:

RECOMMENDATION 4: The federal government require card issuers to disclose, in a clear, simple and conspicuous fashion, the following information on each monthly statement:

- **the number of months it would take to pay off the balance owing and the cost that would ensue if no further advances and/or purchases were made and if the consumer were to make only the minimum monthly payment;**
- **the monthly payment required to pay off the outstanding balance within 36 months if no further purchases and/or advances were made; and**
- **the year-to-date total of all interest costs and other fees that have been paid and/or accrued from use of the credit card.**

Moreover, the government should require card issuers to provide cardholders with information about the range of their credit card products, including all associated fees and interest rates, and with information that would direct the cardholder to the Financial Consumer Agency of Canada's online credit-card selection tool.

Finally, the government should direct the Financial Consumer Agency of Canada, and provide it with the resources necessary, to take a more vigorous approach to enforcing existing and future disclosure requirements. The Agency should also be required to monitor and report on card issuer practices, including compliance with any applicable codes of conduct as well as new and existing federal regulations in respect of disclosure requirements.

**CHAPTER 7:
CREDIT CARD INTEREST RATES, TERMS AND CONDITIONS**

Credit card contracts specify a number of terms and conditions, including interest costs on unpaid balances and cash advances, annual fees (where applicable), fees for spending in excess of credit limits, minimum payment requirements, currency conversion methods and the circumstances under which a cardholder who has carried an unpaid balance can re-qualify for an interest-free grace period.⁴⁶ In recent months, some credit card companies have altered several of these terms and conditions. The Financial Consumer Agency of Canada, for example, told the Committee that it has observed some fee increases and the elimination of some low-interest credit cards. Table 3 depicts various credit card interest rates, the prime lending rate offered by financial institutions and the Bank of Canada target for the overnight rate from 2003 to 2008.

⁴⁶ Credit card contracts can also specify a number of benefits, including interest-free grace periods, chargeback provisions for returned items or goods and services not delivered, extended purchase warranties, insurance such as travel, health, accident and illness, and the calculation of credit card rewards. In special promotional offers, credit card companies may also offer low introductory interest rates and other benefits such as additional reward points for travel, cash back or purchases.

Table 3: Annual Interest Rates, by Credit Card Type, 2003 - 2008 (%)

	Standard credit cards		Gold credit cards		Platinum credit cards	
Year	Low rate	Standard rate	Low rate	Standard rate	Low rate	Standard rate
2003	8.90 - 13.90	15.48 - 25.99	8.90 - 13.90	17.75 - 23.99	9.99 - 12.90	16.90 - 23.99
2004	9.75 - 14.50	17.75 - 25.99	8.40 - 14.50	8.40 - 23.99	5.99 - 14.50	7.99 - 23.99
2005	9.99 - 14.50	17.90 - 25.99	8.40 - 14.50	8.40 - 23.99	5.99 - 14.50	5.99 - 23.99
2006	9.99 - 14.50	17.99 - 25.99	9.40 - 14.50	9.40 - 25.99	9.40 - 14.50	9.40 - 25.99
2007	9.99 - 14.50	16.99 - 25.99	9.40 - 14.50	9.40 - 25.99	9.40 - 14.50	9.40 - 25.99
2008	9.99 - 14.99	18.40 - 25.99	9.90 - 14.90	9.90 - 21.49 ⁴⁷	5.80 - 14.50	9.90 - 25.99

	Student credit cards		Retail credit cards ⁴⁸	Financial Institutions	Bank of Canada
Year	Low rate	Standard rate	Standard rate	Prime rate ⁴⁹	Target for the overnight rate ⁵⁰
2003	8.90 - 12.90	15.48 - 18.90	24 - 28.80	4.69	2.94
2004	10.40 - 12.90	17.75 - 18.75	24 - 28.80	4.00	2.25
2005	10.40 - 10.90	18.40 - 19.50	28.8	4.42	2.65
2006	10.40 - 11.40	18.40 - 19.75	28.8	5.81	4.01
2007	10.40 - 11.40	18.40 - 19.75	28.8	6.10	4.35
2008	11.40 - 11.90	18.40 - 19.75	28.8	4.73	3.04

Source: Financial Consumer Agency of Canada's yearly publications on credit card statistics and Bank of Canada statistics.

As a result of concerns about the way in which some of these and other credit card terms and conditions have been applied, and as indicated earlier, on 21 May 2009 the federal government announced proposed changes to the *Bank Act* regulations aimed at

⁴⁷ The 2008 figures do not include American Express. The inclusion of American Express would result in higher figures.

⁴⁸ Retail credit cards are credit cards that typically can be used only to purchase goods and services sold by the retailer. Sears Canada, for example, offers its clients a "Sears Club" credit card that can only be used to purchase goods in-store, through its catalogue or on its website.

⁴⁹ Annual rates were obtained by calculating a yearly average of monthly prime rate data as provided on the Bank of Canada website. Since 1996, the average prime rate has typically been 175 basis points higher than the target for the overnight rate. Since December 2008, the average prime rate has been 200 basis points higher than the target for the overnight rate. The prime rate is currently 2.25%.

⁵⁰ Annual rates were obtained by calculating a yearly average of daily overnight target rates. The target for the overnight rate is set by the Bank of Canada and is the annualized rate at which financial institutions lend and borrow overnight funds from each other. The target for the overnight rate is currently 0.25%.

“limiting business practices that are not beneficial to consumers.”⁵¹ In particular, it proposed changes with respect to:⁵²

- **grace periods:** cardholders would have a minimum 21-day, interest-free grace period on all new credit card purchases when they pay the outstanding balance in full,⁵³
- **payment allocation:** card issuers would be required to allocate all payments in excess of the required minimum (a) to higher-interest-rate balances; or (b) by distributing the payments in excess of the minimum based on the relative proportion of each high- and low-interest-rate balance;
- **credit limit increases:** card issuers would have to obtain explicit consent from cardholders before increasing credit card limits;
- **debt collection:** debt collectors would no longer be able to call cardholders on statutory holidays, before 7:00 a.m. or after 9:00 p.m. Monday through Saturday and/or before 1:00 p.m. or after 5:00 p.m. on Sundays; and
- **over-the-limit fees:** card issuers would no longer be able to charge over-the-limit fees that result from merchant holds.⁵⁴

⁵¹ Department of Finance, “Minister of Finance Releases New Credit Card Regulations to Improve Protection for Consumers,” 21 May 2009, *Press Release 2009-048 and Backgrounder*, <http://www.fin.gc.ca/n08/09-048-eng.asp>. Stakeholders had until 13 June 2009 to submit comments. The comments are currently being examined by the Department of Finance.

⁵² The federal government, through the *Bank Act*, has some scope to regulate credit card terms, conditions and information disclosure requirements for cards issued by banks listed in Schedule I, II or III of the Act or by institutions affiliated with a listed bank. For credit unions that issue their own credit cards, such as Desjardins Group, regulatory responsibility for credit card terms, conditions and information disclosure requirements rests with the province in which the credit union operates. As well, the federal government plays a regulatory role on matters related to credit cards (and other lending instruments) through the *Criminal Code*, since section 347 outlaws annual interest rates in excess of 60%.

⁵³ According to the Department of Finance, “some card issuers offer 15 to 24 days grace period on new purchases when a customer pays the outstanding balance in full. However, other issuers accrue interest in that period, i.e. there is no grace period, if there is an outstanding balance carried forward from the previous period. This proposal would provide that a grace period applies to all new purchases when consumers pay in full in the current month, regardless of an outstanding balance the month before. As an example, Tom pays his monthly balance in full as a rule. In April, he paid part of his balance during the course of the billing period, but he missed the deadline to pay the remaining balance, and carried a balance of \$300 into May. On May 5, Tom made a new purchase of \$50. He paid his outstanding balance of \$350 in full by the due date shown on his statement (June 19). Here’s how the existing two different grace-period methods would affect him. If Tom’s credit card issuer uses Method 1, he will have to pay interest only on the \$300 carried over from April. He will get an interest-free period on his new purchase of \$50, because he paid his balance in full by the due date of June 19. If Tom’s credit card issuer uses Method 2, he will have to pay interest on the \$300 carried over from April *and* on the new purchase of \$50, because he carried a balance over from April. The regulations will ensure that all credit card issuers use Method 1 for the application of grace periods. Moreover, that grace period must be at least 21 days.” Department of Finance, *Backgrounder*, 21 mai 2009, http://www.fin.gc.ca/n08/data/09-048_1-eng.asp.

⁵⁴ The Department of Finance described these fees as follows: “Certain merchants, such as gas stations or hotels, place holds on a credit card (for example, typically \$100 at a gas station) and it may take time for the transaction to be fully processed and the hold released. The hold reduces the credit available to the consumer, who then could inadvertently go over their credit limit and incur fees. This measure would prohibit financial institutions from imposing a fee when the credit

Stakeholders had until 13 June 2009 to comment on the proposed changes,⁵⁵ at which point the Department of Finance began its review of the comments prior to making any needed changes and submitting the draft regulations to the Minister of Finance for approval. The Department of Finance has indicated that the Minister intends to approve the draft regulations as quickly as possible, but no firm timeline has been provided.⁵⁶

On 22 May 2009, US President Barack Obama signed legislation⁵⁷ to implement similar, but more expansive, measures to regulate a number of credit card practices.⁵⁸ In addition to nearly identical rules on grace periods, credit limit increases, over-the-limit fees and payment allocation methods, the legislation addresses the following practices:

- **interest rate charges:** cardholders are protected from unexpected interest charges, including increases in the rate during the first year after account opening and increases in the rate charged on pre-existing credit card balances;
- **notice periods:** card issuers are required, “in a clear and conspicuous manner,” to give cardholders a notice period of at least 45 days of any significant changes to the terms of their credit card agreement (such as fees and finance charges);⁵⁹
- **promotional rates:** card issuers offering promotional interest rates are required to offer these rates for a minimum period of six months;
- **credit card issuance:** card issuers are no longer able to issue a new credit card to, or to increase credit limits for, existing cardholders unless the card issuer considers the ability of the cardholder to make required payments under the terms of his or her credit card agreement;
- **credit card agreements:** card issuers are required to post, on their website, copies of all of their cardholder agreements;
- **higher education rules:** card issuers are no longer able to offer “tangible items,” such as t-shirts, to induce students to apply for a credit card while promoting the credit card on or near the campus of a higher education institution; and

limit is exceeded solely because a hold was placed on available credit. For example, Alexis has a credit limit of \$500 with a balance outstanding of \$400. She uses her credit card at a gas station, and the gas station puts a hold of \$100 on her account. While she only spends \$20, the hold remains for 3 days, during which time she spends another \$50. Because of the hold, she is charged a fee for going over her limit, despite the fact that her outstanding balance is \$470. The proposed measure would restrict the charging of an over-the-limit fee, because in the absence of the hold, Alexis would have a balance of \$470.” Ibid.

⁵⁵ The proposed changes were published in the *Canada Gazette* on 23 May 2009.

⁵⁶ Library of Parliament communication with the Department of Finance on 11 June 2009.

⁵⁷ The legislation in question is H.R. 627, also known as the “Credit CARD Act of 2009.” For a copy of H.R. 627 and a review of the process by which it became law, see: <http://www.govtrack.us/congress/bill.xpd?bill=h111-627>.

⁵⁸ Some of the measures in H.R. 627 are identical to those announced in December 2008 and intended for implementation in 2010 by the Office of Thrift Supervision, the Federal Reserve Board and the National Credit Union Administration.

⁵⁹ In Canada, the notice period is 30 days.

- **high-fee subprime cards:** card issuers are not able to charge fees for the issuance or availability of credit cards that represent 25% or more of the available credit during the first year after account opening.

WHAT THE WITNESSES SAID

Witnesses raised a number of concerns related to credit card interest rates, terms and conditions.

In a submission to the Committee, Ron Heaps expressed concern about card issuers that use so-called “teaser rates” to encourage use of their credit card products. He indicated that, in March 2008, he took advantage of a 2.99% introductory interest rate to borrow \$6,000 on his credit card. He invested the money with his stock broker and intended to repay the full amount at the end of the six-month low-interest rate period. In the interim, he expected to accrue and pay monthly interest costs (at 2.99%) on his \$6,000 debt while paying down the full amount of his normal monthly credit card purchases. Mr. Heaps indicated that it was only later that he realized that all of his monthly payments were being applied to his low-interest balance instead of his routine purchases, which involved a much higher interest cost. He acknowledged that, when he re-examined the promotional offer, the “very fine print” did explain the company’s methodology. Mr. Heaps argued, however, that while these practices are “probably legal,” they are “certainly deceptive and should, I submit, not be allowed.”

In their submission, Don Middleton and Clayton Wilson urged the Committee to “recommend legislation that limits the interest charge to the amount of the unpaid balance.” Keith Dalglish, for his part, said that he suspected that the credit card companies applied “significantly inflated” exchange rates without reference to “any regulation or ... reality” on credit card transactions made outside of Canada.

Desjardins Group told the Committee that its credit card interest rates vary between 9.9% and 19.5%, and that “when credit card users have a balance of more than \$1,000, we recommend to them a lower interest rate to better manage their personal finances. We have strategies, and we really try to give cardholders reduced interest rates, particularly those who carry a higher balance.”

In speaking from the card issuer perspective, the Canadian Bankers Association said that people with a higher-interest-rate credit card could choose a card with a lower rate, recognizing, however, that card issuing decisions are made on a case-by-case basis.

Etienne Sepulchre’s submission to the Committee indicated that he did not believe the claim by card issuers that “Canadians had the choice to opt for lower interest cards.” To support his argument, Mr. Sepulchre explained that he recently paid off and closed his credit card account, and was subsequently informed that, if he reapplied for the

same credit card, the annual interest rate would be 19.5% instead of the 14.5% rate he previously paid as a “preferred customer.”

The Consumers’ Association of Canada suggested that it “has taken the position that, while interest rates are extremely high, there are many payment options open to consumers that do not oblige them to pay those fees.” However, the Association said: “Buying on credit and carrying balances have become a way of life for most Canadians.” It also indicated that “even those consumers who take the time to work their way through the wealth of information provided by the Financial Consumer Agency of Canada probably wind up more confused than when they started.” The Association proposed regulations which would standardize and simplify fee and interest calculations as well as make it easier for consumers to compare credit cards and therefore encourage competition. In its view, increased competition, in turn, could put downward pressure on credit card interest rates. The Association also supported a “return to traditional grace periods” and “elimination of calculations which preclude achieving a zero balance.”

Professor Roger Ware also remarked on the complexity of available credit card options and interest rates. He said: “It is understandable that people become concerned about credit card markets because they can be difficult to understand, given some of the peculiarities. For example, people wonder why interest rates on credit card balances are about three times greater than the market interest rate.”

Professor Ziegel told the Committee that while the history of attempts to regulate interest costs has “not been a happy one,” neither has reliance on market forces. He recommended further study of whether the benefits of “imposing rate ceilings for credit cards will outweigh the potential costs.” He also supported Professor Schwartz’s recommendation, noted earlier, for a regulatory body with more powers than those currently allocated to the Financial Consumer Agency of Canada.

The Canadian Community Reinvestment Coalition recommended that the federal government empower the Financial Consumer Agency of Canada or the Auditor General of Canada to conduct an audit of costs, revenues and profit margins of card issuers. It said that the resulting report would, if made public, “cause the fees and rates to come down the next day because there is ample evidence that there is rampant gouging in these areas.”

HSBC Bank Canada told the Committee that the “the current statutory and regulatory regime is quite effective, requiring the disclosure of interest rates, interest charges and non-interest charges on monthly statements.”

In response to criticism that credit card interest rates have not fallen despite steep declines in the Bank of Canada’s target for the overnight interest rate, MBNA told the Committee that, in an economic downturn, “the cost of making unsecured loans rises substantially” because of increasing credit losses: “Since movements in the Bank of

Canada rate and credit losses tend to move in opposite directions, they act as a natural hedge against one another and this helps explain why credit card interest rates do not move up and down in lock step with the Bank of Canada rate.”

For its part, American Express noted that regulations imposed on credit card interest rates or other terms and conditions will “decrease competition and choice for consumers. Regulating rates and fees can have a dramatic impact on the economic viability of card issuers and the competitive landscape.”

Finally, in a submission received after 21 May 2009, the Canadian Bankers Association noted that “while the full implications of (the federal government’s) proposed regulations are still unclear,” their implementation will “require significant changes to products, systems and processes” and “will be costly.” It also said: “These regulations may also limit the banks’ ability to provide some of the services customers have come to expect, limit the number of credit card options and may reduce credit availability to some customers.” The Association also cautioned against adopting the recently enacted US credit card rules, arguing that “the Canadian market is very different from that of the US.”

WHAT THE COMMITTEE BELIEVES

The Committee believes in the need for more financial literacy and better information disclosure practices. That being said, given the increasingly complex array of financial products available to consumers, it is perhaps too much to expect consumers to grasp fully the countless permutations that can apply to credit card interest rates, terms and conditions, or to understand the rationale for credit card interest rates.

As a matter of course, confidential proprietary information is not provided to Parliamentary committees. While we examined the spreads between the prime rate and the credit card interest rates in Table 3, we are not in a position to comment on the spreads or any reasons for them.

The Committee supports the assertion of Professor Schwartz that we should no more expect the average consumer to understand all of the nuances of complicated credit card contracts than we should expect that same consumer to understand and be responsible for the electrical safety of his or her toaster. In the latter case, we have standards and regulatory bodies which ensure that toasters do not spontaneously catch fire. These organizations bear the liability, not the consumer. We believe that this analogy is useful and that the same principle should be true of some credit card terms and conditions, especially given what we know about the potential for over-leveraged consumers to undermine the financial stability of an economy.

For that reason, the Committee generally supports the federal government’s proposal to regulate certain credit card terms and conditions, including the imposition of minimum interest-free grace periods and some of the other measures announced on 21

May 2009. However, we also believe that these measures do not, in all cases, go far enough and should be expanded to include some of the measures enacted on 22 May 2009 in the United States and discussed above. We note that while some of the US measures address credit card practices that are either not practised or not widespread in Canada, we believe that they should be regulated on a pre-emptive basis. Additionally, we believe that consumers should pay interest costs only on the net balance owing at the end of every month.⁶⁰ From this perspective, the Committee recommends that:

RECOMMENDATION 5: The federal government act expeditiously on selected 21 May 2009 proposals to regulate certain credit card terms and conditions under which card issuers would be required to:

- **provide a minimum 21-day, interest-free grace period on all new credit card purchases to cardholders when they pay the outstanding balance in full;**
- **obtain explicit consent from cardholders before increasing credit card limits;**
- **direct debt collectors to refrain from calling cardholders on statutory holidays, before 7:00 a.m. or after 9:00 p.m. Monday through Saturday, and/or before 1:00 p.m. or after 5:00 p.m. on Sundays; and**
- **eliminate over-the-limit fees that result from merchant holds.**

In addition to these proposed measures, the government should expeditiously introduce the necessary legislative and/or regulatory measures to ensure that card issuers are required to:

- **allocate all cardholder payments in excess of the required minimum to higher-interest-rate balances;**
- **charge interest costs on the net balance owing only;**
- **protect cardholders from unexpected interest charges, including increases in the rate during the first year after account opening and increases in the rate charged on pre-existing credit card balances;**
- **give cardholders a notice period of at least 45 days prior to any significant changes to the terms of their credit card agreement (such as fees, interest rates and finance charges), including at the time of renewal;**
- **offer promotional rates for a minimum period of six months;**
- **refrain from issuing a new credit card to, or increasing credit limits for, existing cardholders unless it considers the ability of the**

⁶⁰ If, for example, a cardholder were to spend \$1,000 during a given month and were to pay \$600 towards this balance owing, interest charges would be levied on the net amount owed (\$400) instead of the full amount (\$1,000), as is currently the case.

cardholder to make required payments under the terms of his or her credit card agreement;

- **post, on their website, copies of all of their cardholder agreements; and**
- **end the practice of offering “tangible items,” such as t-shirts, to induce students to apply for a credit card while promoting the credit card on or near the campus of a higher-education institution.**

CHAPTER 8: CONCLUSION

The Committee heard a lot of contradictory evidence over the course of our hearings and in our submissions:

- Some merchants say that, given the increasing role of credit and debit cards, they have little choice but to accept these products on the terms and conditions set by payment processors and credit card companies. For them, credit and debit cards should be considered as public goods that provide an essential service.
- Credit card companies say that merchants actually have a lot of choice, and point to the substantial number of merchants that refuse to accept credit cards as a method of payment. In their view, accepting credit cards is simply a business decision like any other, and should be assessed from a cost-benefit perspective.
- Some merchants say that the federal government should adapt the Australian regulatory approach to the Canadian context because it has successfully lowered merchant fees by regulating them on a cost basis.
- Credit card companies say that the relatively lower fees in Australia have come at a high cost in terms of fewer credit card rewards and higher credit card fees, and that there is no evidence that lower discount fees have been passed to consumers in the form of lower retail prices.
- Some merchants say that the not-for-profit structure of Interac has worked well and that debit card competition will inevitably lead to higher retail prices unless the federal government regulates flat fee pricing.
- Some credit card companies say that interchange fees, calculated as a percentage of the transaction value, are necessary to pay for product innovation.

The Committee has concluded that the credit card market needs improvement and clarity, and that the debit card market could fall into a similar state of disrepair if we, as policymakers, are not careful. Our recommendations have been made in recognition of these divergent opinions but also with a spirit of trepidation with respect to government intervention.

The Committee encourages provincial and territorial governments to amend the necessary legislation and regulations to ensure that provincially regulated credit unions conform to new federal requirements. We also believe that all regulations and legislation that address credit card and debit card rates and fees should be reviewed by Parliament every five years. We look forward to prompt federal government action to implement our recommendations.

APPENDIX A: HOW THE FOUR-PARTY CREDIT CARD PAYMENT SYSTEM WORKS

In Canada, the major credit card companies – most notably, Visa and MasterCard – are structured in accordance with what is known as the four-party model comprised of the cardholder, the merchant, the card issuer and the payment processor.

To begin the transaction, the cardholder purchases goods and/or services from the merchant with his/her credit card. The merchant sends the cardholder's credit card information to the payment processor, which forwards it to the card issuer for payment authorization. Once payment has been authorized, the merchant charges the purchase to the credit card and provides the goods and/or services to the cardholder.

The card issuer pays the payment processor for the cardholder's purchase and, in doing so, retains an amount known as the interchange fee from the cardholder's total purchase. The interchange fee is set by credit card companies, such as Visa or MasterCard, as a percentage of the value of each transaction (the interchange rate). The card issuer also collects payment from the cardholder for the entire credit card bill and any interest accumulated on credit card debt outstanding.

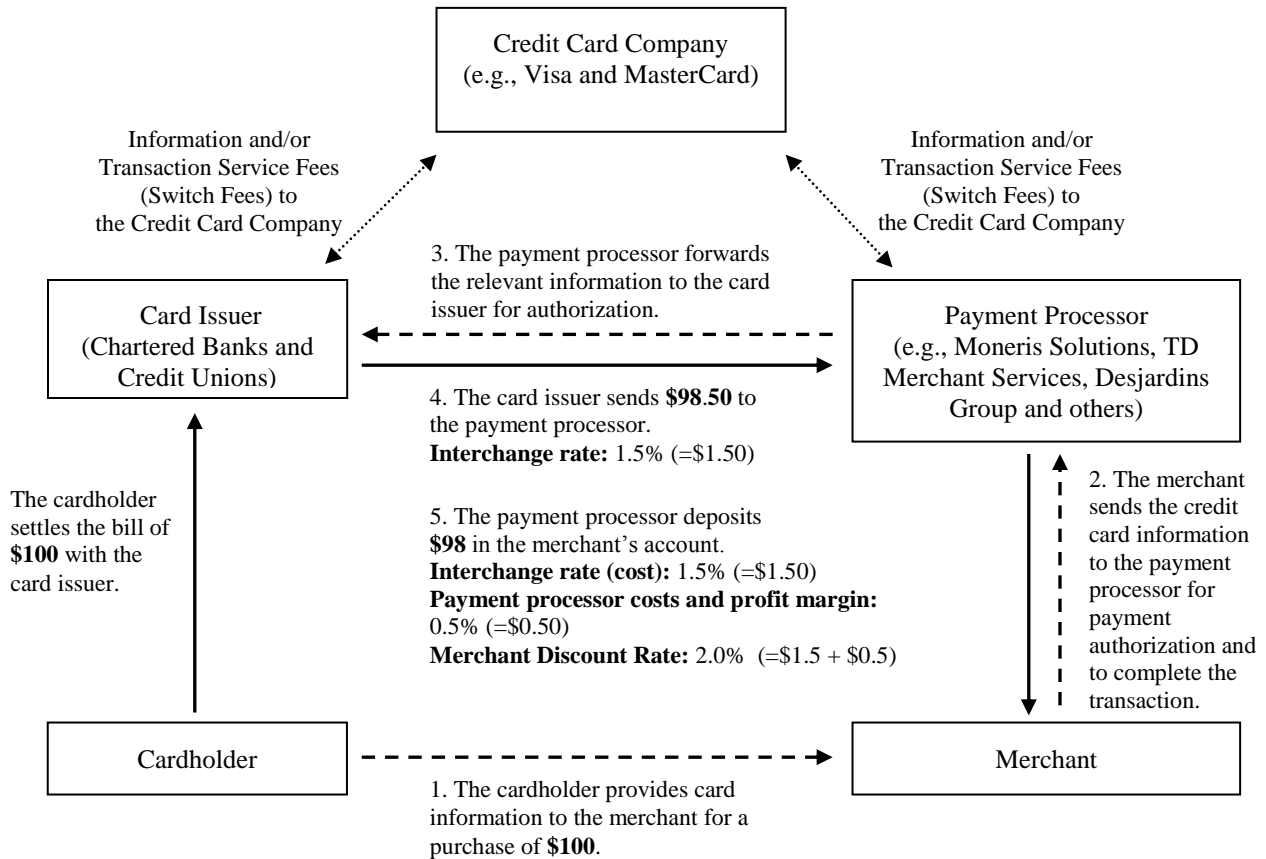
After the transaction has been completed, the payment processor receives payment (less the interchange fee) for the credit card purchase from the card issuer. The payment processor then charges the merchant an amount known as the merchant fee, in part to finance the cost of processing services it has provided, and deposits the remainder of the cardholder's bill in the merchant's account. The merchant fee is calculated as a percentage – the merchant discount rate or MDR – of the value of each transaction and “may include (the cost of the) interchange (rate); the cost of transaction processing, terminal rental and customer service; and the payment processor's or processor's margin, among other costs.”⁶¹ Additionally, the credit card company may charge transaction service fees (switch fees) to the payment processor for each credit card transaction; if that is the case, the payment processor could pass that cost to the merchant through the merchant fee. At a later date, the cardholder will be required to pay the full value of the purchase to his/her card issuer; when full payment is made within the interest-free period established by the card issuer, no interest charges are levied.

For its part, the credit card company (usually Visa or MasterCard) generates income primarily from transaction service fees (switch fees) that are linked to payment volume and/or the number of transactions processed using its branded cards. Those fees are paid by the card issuer and/or the payment processor. Figure 3 illustrates the four-party credit card model.

⁶¹ Visa, *About Visa – Interchange: Facts About Interchange*, 2009, <http://www.visa.ca/en/aboutcan/mediacentre/interchange/facts-about-interchange/>.

The four-party payment system also applies to debit card transactions. In the case of a debit transaction, the fees are different and the debit cardholder’s account is debited once the transaction takes place.

Figure 3 – Four-Party Credit Card Model (For Illustrative Purposes Only)



Note: Solid lines indicate the transfer of funds, dotted lines indicate a transfer of information, and the fuzzy lines indicate the transfer of information and possibly also payment.

Source: Adapted from Barbara Pacheco and Richard Sullivan, “Interchange Fees in Credit and Debit Card Markets: What Role for Public Authorities?” *Federal Reserve Bank of Kansas City Economic Review*, First Quarter 2006, p. 93, <http://www.kansascityfed.org/Publicat/econrev/PDF/1q06pach.pdf>.

**APPENDIX B:
SELECTED CREDIT CARD-RELATED FEDERAL
INITIATIVES IN CANADA AND THE UNITED STATES**

A. Canada

In Budget 2009, the federal government said that it would establish an independent task force, probably in spring 2009, “which will make recommendations to the Minister of Finance on a cohesive national strategy on financial literacy.” The task force will include representatives from the business and education sectors, volunteer organizations and academics, and will be supported by a federal secretariat.

Subsequently, on 21 May 2009, the federal government announced proposed amendments to the *Bank Act* regulations that would require card issuers to, among other things,⁶²

- include a summary box on credit contracts and credit card applications explaining, in clear and simple language, the applicable grace period, the calculation of minimum payments, and any fees and rates on purchases, cash advances and balance transfers;
- disclose the length of time it would take to pay off the balance owing if the cardholder makes only the minimum monthly payment and makes no further purchases and takes no additional cash advances; and
- make timely disclosure of interest rate changes.

B. United States

On 22 May 2009, US President Barack Obama signed into law new rules that require US card issuers to provide the following information in a “conspicuous and prominent location” and in a “clear and concise” way on their credit card billing statements:

- the number of months it would take to pay off the balance owing and the cost that would ensue if no further advances and/or purchases are made and if the consumer makes only the minimum monthly payment; and
- the monthly payment required to pay off the outstanding balance within 36 months if no further purchases and/or advances are made.

The new US rules also require card issuers to post copies of their credit card contract agreements on the internet. New rules regarding credit card interest rates, terms and conditions are discussed in Chapter 7.

⁶² Stakeholders had until 13 June 2009 to comment on the proposed changes, which were published in the *Canada Gazette* on 23 May 2009. At present, the comments are being reviewed by the Department of Finance. More detail about the proposed changes can be found in Chapter 7.

**APPENDIX C:
WITNESSES**

Date appeared	Name of organization	Name of presenter(s)
March 25, 2009	Department of Finance	Jeremy Rudin
March 25, 2009	Competition Bureau	Richard Taylor Martine Dagenais
March 25, 2009	Financial Consumer Agency of Canada	Ursula Menke
March 26, 2009	Desjardins Group	Patrice Dagenais Susan Murray
March 26, 2009	Credit Union Central of Canada	Brigitte Goulard Douglas Whelan
March 26, 2009	Option consommateurs	Genevieve Reed Anu Bose
April 1, 2009	Canadian Federation of Independent Business	Catherine Swift Corinne Pohlmann
April 1, 2009	Canadian Bankers Association	Nancy Hughes Anthony Terry Campbell Darren Hannah
April 2, 2009	Moneris Solutions	Jim Baumgartner Fern Glowinsky
April 2, 2009	TD Merchant Services	Jeff Van Duynhoven
April 2, 2009	Canadian Community Reinvestment Coalition	Duff Conacher
April 2, 2009	Consumers' Association of Canada	Mel Fruitman
April 22, 2009	MasterCard Canada	Kevin Stanton Diane Miquelon Andrea Cotroneo
April 22, 2009	Visa Canada	Tim Wilson
April 23, 2009	Interac Association	Mark O'Connell
April 23, 2009	Coalition: Retail Council of Canada Giant Tiger Stores Ltd. Canadian Council of Grocery Distributors Sobeys Inc.	Diane J. Brisebois Greg Farrell David Wilkes Paul Jewer
May 7, 2009	Queen's University	Roger Ware
May 7, 2009	Edgar Dunn & Company	Peter T. Dunn Robert White

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May 7, 2009	Carleton University	Saul Schwartz
May 7, 2009	Canadian Federation of Independent Grocers	John Scott Gary Sands
May 7, 2009	Conseil québécois du commerce de détail	Gaston Lafleur
May 7, 2009	Association des détaillants en alimentation du Québec	Pierre-Alexandre Blouin
May 7, 2009	Association des hôteliers du Québec	Danielle Chayer

**APPENDIX D:
BRIEFS WITHOUT THE AUTHOR'S APPEARANCE**

Name of organization	Name	Date brief was received and distributed to members
American Express	Wilf Gutzin	April 2009
Big Brothers Big Sisters of Canada	Bruce MacDonald	March 2009
Blue Plume International Marketing	Ken Kwok	April 2009
CanadaHelps	Owen Charters	April 2009
Canadian Convenience Stores Association	Dave Bryans	June 2009
Canadian Foundation for Economic Education	Gary Rabbior	May 2009
Canadian Payments Association	Guy Legault	April 2009
Canadian Restaurant and Foodservices Association	Justin Taylor	April 2009
Canadian Tire Corporation	Caroline Casselman	May 2009
Chase Paymentech Solutions	Diane G. Ferreira	May 2009
HSBC Bank Canada	Lindsay Gordon	March 2009
Individual	Del Umholtz	April 2009
Individual	Etienne Sepulchre	April 2009
Individual	Keith Dalglish	April 2009
Individual	Loreen Paterson	April 2009
Individual	Michel Lincourt	May 2009
Individual	Nick Mulder	April 2009
Individual	Ron Heaps	April 2009
Individual	Vishal Malik	April 2009
Individuals	Don Middleton Clayton Wilson	April 2009
Individual	Professor Jacob S. Ziegel	April 2009
Kudell Enterprises Ltd.	Neil Kudrinko	April 2009
MBNA Canada Bank	Debra Armstrong	May 2009
Newfoundland and Labrador Liquor Corporation	Stephen R. Winter	April 2009
Renaissance Jewellers Inc.	Lawrence Blackett	May 2009
Retail Merchants' Association of Canada (Ontario) Inc.	Ralph Moyal	May 2009

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Roots Canada	Michael Budman Don Green	March 2009
Target Discount	Patty Sawyers	May 2009
UseMyBank Services, Inc.	Brian Crozier	April 2009