

Payment Cards in Canada: Choice and Competition for Consumers and Businesses

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for

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CHECK AGAINST DELIVERY

Good afternoon.

It is my pleasure to be here today to participate in the Committee's discussions of the payment card systems in Canada.

I am joined by my colleagues from the Canadian Bankers Association – Terry Campbell, Vice President of Policy and Darren Hannah, Director, Banking Operations. We also have for you an information package on the issues that we will be discussing this morning.

The CBA represents our 50 member banks, including domestic chartered banks, foreign bank subsidiaries and foreign bank branches operating in Canada. We are a source of public information and research on banks in Canada, we provide a forum for discussion on issues of common interest to our members and we advocate for banks at the municipal, provincial and federal government levels.

Banks in Canada – stable and secure

When we were here a few weeks ago, I shared with you some information about our banks and about their role in this time of economic turmoil. If I may, I would like to very briefly highlight a couple of those points again today because they are important to our discussion on payment cards.

Banks in Canada make a significant contribution to the Canadian economy. They employ a quarter of a million Canadians and contribute 3.3 per cent to the Gross Domestic Product – the nation's output.

As well, most Canadians are shareholders in Canadian banks either directly or through the Canada Pension Plan (CPP), other pension and mutual funds. Pension funds and RRSPs are the main beneficiaries of the billions of dollars that the banks pay in dividends each year.

We have a very stable and secure banking system in Canada. Our banks have largely avoided the difficulties that banks around the world are now facing because Canada's banks are diversified, well-capitalized and well-managed, with prudent lending practices. We have a strong regulatory system for the financial sector and a solid mortgage market.

What does this mean for Canada and Canadians?

It means that unlike so many other countries, Canadian taxpayers have not had to bail out financial institutions, not had to inject capital into our institutions, and not had to set up public entities to buy toxic assets.

In contrast, in order to inject liquidity into a market affected by the global credit freeze, the federal government chose to purchase sound, insured mortgages at commercial rates through the Canada Mortgage and Housing Corporation (CMHC) – an investment by the government that will turn a profit for the Canadian taxpayer.

Our banks are doing their part. They are continuing to lend to both consumers and businesses. In fact, the most recent Bank of Canada lending figures show that bank lending to businesses in February of this year is up over 9 per cent from the year before.

Impact of global turmoil on our banks

Nonetheless, the turmoil in the global financial markets has had an impact on our banks. In particular, when we look at the cost of credit there are some challenges facing banks.

The fact is there is a new reality in the credit marketplace here and internationally. Certain types of credit – like commercial paper, the securitization market, the bond market – are no longer functioning properly around

the world, resulting in relatively higher cost than in the past. This affects the banks' overall cost of borrowing and therefore, has an impact on the consumer, particularly for medium and longer-term borrowing.

Another factor that affects the rates that banks set for their loans is risk. We are in a recession, and that has an impact on the creditworthiness of customers – both retail and business. As prudent lenders, banks need to adjust their pricing to reflect this new risk reality.

These are the factors that determine the cost of credit. I know that many people think that the Bank of Canada determines the cost of credit. This is not the case. Banks borrow less than 1% of their funds from the Bank of Canada.

The impact of the global financial turmoil has also meant that our banks have increased their provisioning for credit losses. In the first quarter reports of Canada's big six banks which were reported recently, loan loss provisioning was close to two and half billion dollars – an increase of 124% from the same time the year before.

The bottom line is that Canada's banking system, like Canada itself, is not immune to what is going on in the global financial market.

Payment card market

I would like to take a few minutes to describe the payment market in Canada, particularly credit cards, and how Canadian consumers and businesses benefit from the tremendous competition and choice in that marketplace.

While we are focussed on credit cards today, we should remember that they are not the only type of payment available to consumers. They are one form of payment that consumers can choose when deciding on how to make a purchase. They compete with cash, cheques, debit cards, as well as unregulated electronic payments services like PayPal.

The decision about which one to use is up to the consumer, and the decision about which one to accept is up to the business owner.

Credit cards

Consumer benefits

Credit cards are primarily a convenient and secure payment tool. And as a payment tool, there are many benefits to the consumer:

- An interest-free period of up to 51 days from purchase to payment, depending on the card, as long as the balance is paid in full when owing.
- Choice – there are hundreds of institutions including retailers, credit unions and banks offering major credit cards in Canada – most offering multiple card products; some with rewards, loyalty and insurance products attached and some with low-rate plain vanilla options.
- Extensive global use – credit cards are accepted at over 661,000 outlets in Canada and 30 million locations around the world.

Effective credit card interest for most Canadians = zero

When it comes to interest rates on credit cards there is a great deal of misinformation and confusion about what Canadians actually pay. In fact, the vast majority of Canadians pay no interest. Zero interest.

A recent Boston Consulting Group study found that 70% of Canadian households regularly pay off their credit card balances in full every month, so for them the interest rate is zero. The same survey found that in the United States this is true for only 50% of households. We also know that it is only about 50% in Australia and 56% in the UK.

It is interesting to note that income is not a factor on who pays off their credit cards. Statistics Canada found that the percentage of low, middle and high income families paying off their credit cards every month is roughly the same.

Low-rate cards / loan products

For those customers that don't pay off their balance in full, there are more than 60 low-rate cards on the market. And banks have been leaders in developing these low-rate cards.

Banks also offer some prime-plus cards with an interest rate directly linked to the prime rate, so that option is available to consumers. And with the prime rate at historic lows, these cards are very affordable.

In fact, if a customer is having difficulty with their credit card payments, they are encouraged to talk to their bank because there are options such as lines of credit and other products for longer-term borrowing.

The goal is to help them better manage their finances, maintain a good credit rating and continue to have access to credit.

Most Canadians know they have choices when it comes to borrowing and managing credit. They are making smart credit decisions such as increasingly using lower cost credit products in situations where it is appropriate. While a large proportion of Canadian households have credit cards, credit card balances account for only 3 percent of household debt. And personal lines of credit, for example, account for 9% of total household debt.

Competition and choice – for consumers and businesses

There are as many reasons for possessing a credit card as there are types and varieties of cards. With so much choice from the many cards on the market, Canadians have a great resource available to help choose the card that is right for them. The Financial Consumer Agency of Canada (FCAC) has on its web site an extensive list of cards and features and interest rates. This is a great tool and we promote it through the CBA web site as well.

It is important to note that there are many more institutions and organizations other than banks that issue and distribute credit cards. The list includes retailers, credit unions, caisses populaires, charities and universities. Non-banks represent a significant proportion of all credit card issuers in Canada. I encourage the Committee to consider the full credit card marketplace.

Just as consumers can, and do, choose the form of payment they want to offer, businesses can choose the form of payment they are willing to accept. Businesses can accept cash, cheques, credit cards, or debit cards. They can accept some brands of credit cards but not others. They can offer discounts for cash payments. And business owners exercise this freedom.

For example, nearly one in three retailers do not accept cheques even though virtually every adult Canadian has a chequing account. The decision is up to the business owner based on the value they receive from each form of payment, including credit cards.

Credit card pricing

Turning to pricing, there are a number of factors that go into the fees and rates.

As I just mentioned, customers enjoy an interest-free period from purchase to payment, depending on the card, as long as the balance is paid in full when owing.

Customers have access to unsecured credit where no collateral is needed, which makes it a higher risk for the credit card issuer.

There are significant costs to operating the credit card system. These include:

- processing a large volume of transactions;
- technology that is constantly updated to support transactions;
- preparing and mailing statements and collecting payments;
- and the costs for providing value-added rewards programs;

Fraud and Reimbursement

A significant cost is related to fraud and reimbursement. For banks, and for all credit card issuers, maintaining a reliable and secure system is of the highest priority. This requires investing millions of dollars each and every year to prevent credit card fraud and indemnify customers that suffered a loss as a result of criminal activities performed on their account.

Banks must continually focus on and significantly invest in financial crime prevention, detection and investigation to protect its customers from organized crime attacking the credit card system. When criminals succeed in stealing from our customers, we reimburse our customers and seek to learn from the experience to prevent it from reoccurring.

In 2008, in addition to the significant investment that the industry made on crime prevention and investigations, financial institutions reimbursed to their Canadian credit and debit card customers more than a half a billion dollars representing the losses these customers suffered as a result of criminal activities.

Presently, our industry is making a significant financial commitment in rolling out Chip and Pin technology to offer an even safer and more secure payment card environment for our customers and for the businesses that accept cards. Maintaining consumer confidence in the security of the payments system in Canada is in everyone's interest, and we are making every effort to do just that.

Debit Cards

Let me turn briefly to debit cards. We are pleased that you are taking a holistic look at the payments system, including debit cards.

Customers are best served by an open, competitive marketplace. That principle holds true in every sector of the economy including the retail and small business sectors as well as the debit card market.

While the current debit card system in Canada has served Canadians well, it needs to grow and evolve to meet the needs of a more integrated global economy.

Debit innovation could offer benefits for both merchants and consumers by driving innovations in debit payment technologies such as contactless payments, mobile payments and e-commerce. Debit market choice and competition is also an international trend. Canada should not be left behind.

Banks helping during recession

Before concluding I would like to take a minute and talk about what banks are doing to help their customers through this difficult economic time.

Canadians who have suffered a job loss or reduction in income and who are concerned about getting through these tough times should contact their bank, and the earlier the better. They can work with their banker to explore options to help them manage and repay their mortgage, credit card, or personal or business loan.

Banks continue to treat every situation on a case-by-case basis. There are a number of tools in the toolkit that banks can use, depending on the circumstances of the individual.

Credit Counselling

In addition to the steps that banks are taking with individual customers, we support the good work that not-for-profit credit counselling agencies do to help people manage their personal finances.

For more than 40 years banks have been supporting not-for-profit credit counselling agencies that are helping borrowers to learn better money and credit management skills and to repay their loans. This is part of a broader and on-going industry commitment to financial literacy for all Canadians.

Financial Literacy

This leads me to my last point and that is about our financial literacy program for high school students. The CBA has been involved in financial literacy at the high school level for over a decade. Last year we redeveloped our program, now called *YourMoney*, in close collaboration with the Financial Consumer Agency of Canada. Through the *YourMoney* program we are working with 1,000 banker volunteers in communities across Canada and have reached almost 175,000 high school students. The goal is to help students with practical information about budgeting, saving, borrowing, investing and keeping their money safe.

Conclusion

In closing, I want to go back to where I started – Canada's banks are strong, secure and Canadians remain confident in their banking system. This is an advantage for Canada that other countries do not have. Keeping that advantage will be crucial to the recovery of Canada's economy and to the long-term prosperity of Canadians.

Part of that strong and stable banking system is our vibrant credit card marketplace with tremendous choice and competition benefitting customers and businesses.

All Canadians can rely on a credit card network that is secure, reliable and affordable.

Thank you to the Committee for inviting us here today.

I will be pleased to respond to your questions.