

Canada's Credit and Debit Card Marketplace

Submission to the Joint Meeting of the
Standing Committee on Finance and the
Standing Committee on Industry, Science
and Technology

The Canadian Bankers Association

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Introduction

The Canadian Bankers Association (CBA) represents its 50 member banks, including domestic chartered banks, foreign bank subsidiaries and foreign bank branches operating in Canada. Of these banks, 17 issue credit cards. In terms of employment, CBA member banks employ a quarter of a million Canadians, an increase of 16 per cent over the past ten years. In fact, banks account for 1.5 per cent of total employment in Canada. When it comes to Gross Domestic Product, banks contribute 3.3 per cent to the nation's output.

The CBA is 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 sound policies for banks at the municipal, provincial and federal government levels.

The CBA appeared before the Senate Banking Committee last month as part of its hearings on the issue of payment cards and has also met with many Members of Parliament, including many around this table, as well as with both the Canadian Federation of Independent Business and the Retail Council of Canada. The CBA has been actively engaged in discussions related to credit cards and has heard the issues that have been raised – for instance, on interchange fees, the introduction of certain types of premium cards into the market, interest rates on certain cards, as well as the future of the debit card system in this country.

The CBA welcomes this opportunity to present the banking industry's perspective on the card payments system, and to provide some suggestions about what the banking industry can do better when it comes to disclosure and transparency for the consumer. The banking industry strongly supports enhanced levels of disclosure and transparency.

It is important to remember, however, that the payment card market in Canada is a very sophisticated and complex system with a range of different players, each with its own roles and responsibilities. While the CBA is pleased to offer our thoughts and suggestions on issues from the perspective of institutions which issue cards, there are a range of matters – the setting of interchange fees, the terms of merchant-acquirer contracts and the "honour all cards rule", for example – which the banking industry does not control and where we are not able to provide substantive comments.

It is also important to remember that in a competitive marketplace, where individual institutions are actively competing for customer business, information regarding bank operations, revenues, expenses, fees and business strategies is highly confidential and proprietary in nature. It is information that banks do not share among themselves or with the CBA to ensure full compliance with the Competition Act, and – like any other business in the marketplace – would not wish to have divulged to competitors.

Canada has a highly evolved, secure and efficient payment card system that is at the heart of the commerce economy in this country. The system is a critical element in ensuring that individual Canadians have access to credit and that retailers have certainty of payment. While it can be improved upon to continue to serve customers and retailers alike, we have to keep in mind that any changes to that system need to be considered carefully.

Payment card market

In the payment market in Canada, particularly credit cards, consumers and businesses benefit from the tremendous competition and choice in that marketplace.

Credit cards are not the only type of payment available to consumers and businesses. They are one form of payment that consumers can choose when deciding how to make a purchase, and that businesses can accept as a form of payment from their customers. Credit cards compete with cash, cheques, debit cards, as well as unregulated electronic payments services like PayPal. Each form of payment has its benefits and it is readily apparent that credit cards offer significant benefits to both the customer and the business. There are over 68 million credit cards in Canada, and they account for 29 per cent of consumer spending¹.

Credit cards

Consumer benefits

Much of the recent commentary about credit cards has not been balanced. While there are areas for improvement, it is fair to say that Canadians are well-served by the credit card marketplace.

For consumers, 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.
- Value-added benefits and rewards – many credit cards offer Canadians a host of cardholder benefits and rewards such as travel medical insurance, travel rewards points, cash back, and discounts or rebates on everyday essentials such as gasoline and groceries.

¹ Source: Visa Canada Research, 2008

Competition and choice – for consumers

When it comes to competition, 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, features and interest rates. And Canadians understand that they have choice and that they are in the driver's seat when it comes to selecting the card that is right for them. Recent research found that 95 per cent of Canadians believe consumers have a responsibility to shop around for the most appropriate credit card for their use if they want to ensure the lowest cost and the lowest rates².

It is important to note that there are many more institutions and organizations other than banks that issue and distribute credit cards, including retailers, credit unions, and caisses populaires.

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 per cent 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 per cent of households. We also know that it is only about 50 per cent in Australia and 56 per cent in the UK³.

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 same⁴. For those customers that don't pay off their balance in full, there are more than 60 low-rate cards on the market⁵. And Canada's banks have been leaders in developing these low-rate cards.

Competition and choice for businesses

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 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. There is no question that accepting cheques carries a greater level of risk for the retailer because of NSF cheques and fraud. The decision is up to the business owner based on the value they receive from each form of payment, including credit cards.

² Strategic Counsel research, May 2009.

³ Household spending survey, Boston Consulting Group, 2009

⁴ Statistics Canada Survey of Financial Security, 2005

⁵ FCAC Card Comparison – as of January 2009

When it comes to the value retailers receive from credit cards, the list is extensive. It includes:

- guaranteed payment
- reduced cash handling costs
- security and safety from handling less cash
- increased sales
- the ability to sell on credit
- ability to sell online to a world-wide market

These are significant benefits to retailers of all sizes. It would come as no surprise then that there are costs to providing this service to retailers.

Interchange fees

With respect to interchange fees, which are a focal point of this Joint Committee's deliberations, there are a few points that should be highlighted:

- Interchange rates are set by the credit card companies, not issuers or acquirers.
- Further, while Visa and MasterCard do not receive the interchange fee directly, they do receive:
 - a transaction fee from acquirers and,
 - a transaction fee from card issuers like banks, credit unions etc.

In a credit card transaction, all participants benefit from the transaction so all share in the cost.

- The consumer may pay an annual fee (depending upon his/her card) and/or interest (if he/she carries a balance) to the card issuer;
- The merchant pays a merchant discount rate to the acquirer;
- The acquirer and the card issuer pay transaction fees to the card company (Visa or MasterCard);
- The acquirer pays an interchange fee to the card issuer.

(See Appendix 1 – Flow Chart of Card Transactions)

A key issue raised in the Committee hearings is the disclosure of interchange fees by card companies and acquirers to merchants. The CBA notes from these hearings that Visa and MasterCard have heard these concerns and we understand they will be working more closely with retailers to resolve them. This is a very positive step forward in this area.

And even though banks do not set these fees, banks are always working to improve clarity and disclosure to their own customers, and CBA members agree that there are things that can be further enhanced to assist consumers in better understanding the process. Banks as card issuers are considering better explanations for their card customers about the cost of interchange fees to merchants when credit cards are used. This is in addition to the great amount of new disclosure information that will be required by banks as a result of the regulations just announced by the federal government.

Premium cards

One of the key issues that has been raised during the public policy debate about the payment card system is the introduction of so-called “premium cards” into the Canadian market, and particularly how these cards were introduced. The CBA has heard these concerns and has some suggestions to make. Before addressing these concerns, however, it is important to be very clear on what a “premium card” actually is, since there has been a great deal of confusion in discussions on this matter.

What is a “premium card”?: Some stakeholders use the term “premium card” to refer to any card that has certain level of rewards or benefits, such as a gold card. In the context of the public policy discussion before this Committee, however, a *true* “premium card” is a very specific class of credit card that has enhanced rewards and benefits and which attracts a somewhat higher interchange rate. This difference is important, because while there are many cards in circulation with enhanced benefits and rewards, the number of *true* “premium cards” in circulation is very small. CBA estimates that true premium cards account for only 9 per cent of banks’ credit card accounts.

In fact, eligibility for the true premium card is restricted both by the card companies and by the issuers. Card companies place conditions around the true premium card product offering such as income and spending thresholds or enhanced rewards requirements for the premium card products. In addition, since the premium card is meant to be targeted at a select group of clientele, issuers have set their own application criteria in addition to the restrictions imposed by the card companies. As a consequence, for retailers, premium cardholders are premium customers – they have higher incomes and they spend more money.

It is also important to understand that the incremental interchange associated with a true premium card is not as high as some would have you believe. Premium cards attract an additional 20-35 basis points (0.2-0.35 per cent) of interchange (approximate), which translates into an additional \$0.20-\$0.35 on a \$100 purchase.

Concerns about premium cards: The CBA knows that this Committee has heard a great deal about premium cards, particularly around the introduction and issuing of some of these cards to consumers. While banks have had few complaints from consumers – indeed the experience for most consumers has been positive in light of proactive efforts by banks to provide them with products featuring increased benefits and security at no cost – we also agree that there was confusion on the part of some consumers when these cards were introduced. There could have been better and clearer communications to the consumer about why these cards were being introduced. Going forward, the lesson learned is that more care needs to be taken to ensure that there is greater clarity for the consumer in any such future implementation.

Another concern that has been raised is the question of credit cards being sent to consumers without their consent. Again, the intent was to try to proactively match clients with the product that gives them the best value. When premium cards were made available by the card companies, it was apparent that some current cardholders would obtain better value from a premium card at no additional cost, so the new product offered the cardholder better value. CBA members are competing for new customers, and actively trying to provide clients with the best value from the products that are available is part of that competition. Having said that, banks have heard the concerns and are reviewing their practices around issuing these cards.

As well, there is concern that true premium cards have been sent to people who perhaps should not have received them. As has been noted above, there are clear criteria and requirements imposed by the card companies and the issuers, and so a step that could be taken by the banks is to further clarify for consumers what the applicant eligibility requirements are for true premium cards.

New credit card regulations

The federal government has introduced new regulations governing credit cards. While the full implications of these proposed regulations are still unclear, they will have a big impact on financial institutions that issue credit cards. These regulations will require significant changes to products, systems and processes. Canada's credit card systems are extensive and sophisticated and implementing these regulations will be costly.

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. As well, they come at a time when banks, like all other sectors, are feeling the effects of the recession and when banks face increasing risk associated with credit cards.

Furthermore, the CBA believes that imposing US-style solutions on a well-functioning Canadian credit card market is neither necessary nor effective. The Canadian market is very different from that of the US:

- Canadians use credit cards primarily as a payment card whereas Americans tend to use them as a credit vehicle. Over 70 per cent of Canadians pay off their credit card every month; while fewer than half of Americans do.
- Canadian credit card pricing structures are different and tend to have far fewer, and far lower, fees than cards in the US.
- Aspects of the credit market that are common in the US and in much of the rest of the world – late payment fees, for example – are not applied by issuers in Canada.

The banking industry agrees that it is important that consumers understand the terms and conditions of a credit card or any financial product. In fact, banks in Canada already adhere to federal regulation that requires them to fully disclose information about terms, fees and interest rates to credit card customers. Banks are always willing to look at ways to make their written materials easier to understand, and will work with the government to this end.

The CBA and its members will review the proposed regulations and provide feedback to the federal government as part of its consultation process. The goal is to make sure customers continue to have the kind of convenience, choice and services they have come to expect.

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.

Canadians are among the heaviest users of debit cards in the world. The success of debit cards in Canada can be attributed in large measure to the fact that Canadians are attracted to the convenience of debit.

Interac can rightfully take some credit for that. Interac is a very strong brand in Canada. It is widely recognized by Canadian consumers and accepted at over 400,000 locations coast-to-coast.

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. For example, Canadians' ability to use their debit cards for point-of-sale purchases outside of Canada is very limited, so Canadians are often denied this choice of payment when travelling abroad.

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. Canadians are engaging in e-commerce in record numbers. For example, in 2007, 45 per cent of home internet users ordered personal goods and services online. However, nearly all on-line retail sales in Canada are done with credit cards even though debit card transactions outnumber credit card transactions by a factor of 1.4:1. Clearly there is unfulfilled consumer demand – competition and innovation could fill that demand. In addition, mobile payments are growing rapidly worldwide but are in their infancy in Canada. Competition among debit networks could accelerate the development of new mobile technologies in Canada.

For competition to be an effective driver of innovation, we need to ensure that all competitors have the freedom to compete fully in an open marketplace, including Interac. All competitors must be given the latitude they need to develop new products, introduce new services and structure their businesses in ways that are best suited to the needs of a competitive marketplace. That principle underlies all competitive markets and ensures that markets deliver the best and most innovative products to Canadians.

We recognize that there are questions and concerns about the introduction of new debit card systems into Canada; however, the reality is that competition in retail payments services already exists. Conventional debit card systems, and the institutions that provide them, are facing increasing competition from unregulated payments services providers such as PayPal. Since 2002, the value of PayPal transactions has grown from US\$1.5 billion to US\$14 billion (2007) – a growth rate of 45 per cent per year.⁶ PayPal's Total Payment Volume in 2008 represented nearly 9 per cent of global e-commerce and 15 per cent of US e-commerce⁷. According to eBay, PayPal will handle as much as 14 per cent of online payments globally by 2011.⁸ To remain competitive, service providers and card issuers need flexibility to offer their customers more and better payments services. Competition is key to generating those innovations and making them available to customers.

⁶ Calculated from statistics in Nikil Chande, *A Survey and Risk Analysis of Selected Non-bank Retail Payments Systems*. Bank of Canada Discussion Paper 2008-17. p. 11 (Chart 2).

⁷ Source: <https://www.paypal-media.com/documentdisplay.cfm?DocumentID=2260>

⁸ Source: Bloomberg, March 2009.

Banks helping during recession

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.

In the meantime, banks continue to lend to credit-worthy customers. Even as non-bank providers have reduced their lending or withdrawn from the marketplace entirely, Canada's banks have continued to make credit available to Canadian businesses and individual customers. Month after month since the financial crisis erupted, Bank of Canada data shows that Canada's banks have increased their lending to businesses over the same period a year before. As of the end of April 2009, for instance, bank lending to businesses was up 6.3 per cent compared to April 2008, still higher than the increase in financing from all sources (at 3.7 per cent). In terms of lending to individuals, total personal credit from banks in April 2009 was up 14 per cent over the same month last year⁹.

Financial Literacy

The CBA has been involved in financial literacy at the high school level for over a decade. Last year the CBA redeveloped its program, now called *YourMoney*, in close collaboration with the Financial Consumer Agency of Canada, and offers a seminar-based classroom presentation on the fundamentals of financial literacy. Through the *YourMoney* program the CBA is working with 1,000 banker volunteers in communities across Canada and have reached more than 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

The payment system in Canada and around the world, particularly the credit card market, has evolved to the point where most Canadians take for granted the level of sophistication, efficiency and the breadth of the credit card system that exists. The system in Canada works well for individuals and businesses, and is a critical element in ensuring that access to credit and the flow of payments continue to work efficiently for the benefit of the economy as a whole. While improvements can be made to the system – and the CBA has made some suggestions in this submission – it is important that policy-makers and legislators carefully consider the potential impacts on all aspects of the system, and on consumers and businesses, before new measures are considered.

⁹ Bank of Canada, Weekly Financial Statistics, May 22, 2009

Appendix 1 – Flow Chart of Card Transactions

Card Transactions: Who Pays Whom?

