

Banking - Canada

Real Costs of Proposed New Credit Card Regulations

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With 68 million cardholders and over 27 million active cards in circulation, it is clear that Canadians love their credit cards.⁽¹⁾ On May 21 2009, on the heels of similar measures introduced in the United States, Finance Minister Jim Flaherty unveiled a number of new proposed regulations that will affect the credit card industry. Federally regulated institutions that issue these cards, including domestic and foreign banks, retail associations, domestic and foreign insurance companies and trust and loan companies, will have to comply with the proposed new regulations when they come into force.⁽²⁾ The regulations were first published in the *Canada Gazette* on May 23 2009 and the deadline for comments was June 13 2009. This update provides a general overview of the proposed changes and briefly outlines the implications for credit card issuers.

Proposed Changes - Implications for Credit Card Issuers

The proposed new Credit Business Practices Regulations⁽³⁾ will constrain and modify current business practices. Most notably, the regulations will require a minimum 21-day interest-free grace period on new credit card purchases. This grace period will apply when a customer pays the current month's balance in full, even if there is an outstanding balance from the previous month. Although no mandatory grace period currently exists, many card issuers offer 15 to 24-day grace periods, with some also accruing interest on previously outstanding balances. The regulations will also require financial institutions to select one of two options to allocate customer payments. Payments must either be allocated to the balance with the highest interest rate first or distributed based on the relative proportion of each. At present, payments are often allocated to the balance with the lowest interest rate.

The regulations will also prohibit financial institutions from increasing credit limits unless the customer gives express consent. In addition, the regulations will impose limits on the debt collection practices that financial institutions use to contact consumers. There will be a prohibition against harassment and restrictions on contacting a debtor or his or her family outside specified hours. An institution will be unable to contact a customer at his or her place of employment to collect on a debt. Further, fees will not be permitted when a credit limit is exceeded solely because a merchant has placed a hold on available credit.

Amendments to the Cost of Borrowing Regulations⁽⁴⁾ will modify the way financial institutions provide particular disclosures to customers. A summary box will be required on contracts and application forms that clearly discloses all 'salient information', such as interest rates, grace periods and fees. Customers must also be provided with information on their credit card statement each month as to the time it will take to repay an entire balance if only the minimum payment is made each month. The regulations will also require advance disclosure of interest rate increases before they take effect, even if this information has already been included in the credit contract.

These regulations will address items identified in the 2006 Financial Institutions Legislation Review. Co-borrowers must receive the required disclosures unless a designated borrower is identified by some or all co-borrowers. Borrowers under a government student loan programme are excluded from the new regulations and statements are not required as often where there is only a small balance that does not accrue interest or fees. Technical changes are also included to ensure consistency among existing regulations and to amend French terminology.

Challenges for Credit Card Issuers

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As with any new regulatory requirement, the proposed amendments to the Cost of Borrowing Regulations and the new Credit Business Practices Regulations will have a significant impact on federally regulated financial institutions. The government acknowledges that card issuers will bear the burden of the changes. Jim Flaherty conceded that the changes "will cost [financial institutions] tens of millions of dollars a year".

Canada's credit card systems are extensive and sophisticated. Depending on current practices, considerable costs and regulatory burdens will have to be incurred to make the mandated changes to systems, products and processes. The regulations and resulting costs may:

- limit the ability of financial institutions to provide some of the services expected by customers;
- restrict the number of credit card options; and
- reduce credit availability to some customers.

The current recession may intensify these pressures. During this period of economic turbulence, financial institutions face increasing risk associated with credit cards.

While the full implications of these proposals remain unclear, it is possible to anticipate a number of issues on the horizon that federally regulated financial institutions will face. The Cost of Borrowing Regulations will have similar consequences for domestic and foreign banks, retail associations, domestic and foreign insurance companies and trust and loan companies. The summary box and minimum payment calculator will require spending funds and resources to calculate a personalized monthly financial summary for each client.

The Credit Business Practices Regulations will also adversely affect costs and profits. The 21-day minimum grace period, coupled with the requirement that it be interest-free for new purchases irrespective of whether the cardholder carries a balance, will lead to a loss of revenue, since institutions will be unable to add interest from new purchases to the previous month's outstanding balance. It will also increase costs for credit card issuers that currently have a grace period of less than 21 days, because they will now be required to extend interest-free credit to cardholders for a longer period. The directed allocation of payments might force financial institutions to cease issuing lower interest rates, since the loss of payment allocation flexibility will make these options less economically viable. A loss or reduction of lower interest rate options would significantly harm the consumer, contrary to one of the purposes of the regulations.

Not only will obtaining consent before increasing a credit limit carry a significant administrative cost, but the rationale for the rule is questionable. Canadian card issuers keep meticulous records of complaints and problems reported by customers. The absence of consent before credit limits are raised is not a concern that has been reported with any consistency by Canadian credit card holders. Moreover, the regulations limiting debt collection practices will involve changes to procedures, practices and employee training to adhere to new business practices. The changes to merchant hold rules will also entail additional costs associated with differentiating and monitoring a specific type of charge.

Another risk is that the Credit Business Practices Regulations appear also to apply to non-consumers. If this is not a drafting oversight, it means that business credit lines that merely happen to be accessed with a credit card will now have to have a true grace period (ie, an interest-free opportunity for new purchases). Moreover, the express consent to credit limit increases would arguably also require the consent of the cardholder, who is a mere employee with no responsibility for the debt.

The Canadian Bankers Association (CBA) has articulated its opposition to changes that unnecessarily attack a well-functioning Canadian credit card market. It contends that the regulations will be ineffective and are a waste of government and financial industry resources. The CBA submits that the drafters of the US-style regulations must recognize several important distinctions between the two markets. Canadians use credit cards primarily as a payment method, while Americans tend to use them as a credit vehicle. Over 70% of Canadians pay off their credit card balance every month and pay no interest at all; this is true for only 50% of households in the United States, 50% in Australia and 56% in the United Kingdom.⁽⁵⁾ The CBA also states that Canadian credit card pricing structures tend to have fewer and lower fees than cards in the United States. In addition, late payment fees are not applied by issuers in Canada, but are common in the United States and the rest of the world.

Opportunities for Credit Card Issuers

Although presenting a number of significant challenges, several omissions in the new regulations show some encouraging signs for financial institutions. The proposed regulations do not contemplate a reduction of existing credit card interest rates. In addition, the regulations do not target a cap or ceiling on credit card interest rates and fees. Interchange fees - the credit company charges imposed by financial institutions to

merchants to accept credit payments - are also not discussed in the regulations. According to the CBA, banks have already begun to consider better interchange fee disclosure for card customers, without being compelled to do so by legislation.

Outlook

The CBA's May 28 2009 submission states that the banking industry appreciates the importance of consumers understanding the terms and conditions of a credit card, and that banks are always willing to look at ways to make their written materials easier to understand.

However, it questions the prudence of imposing US-style solutions on an already well-functioning Canadian credit card market. Prudent or not, it appears that the federal government is determined to pass the proposed new regulations into law. These proposed changes to credit card rules are highlighted in the chapter entitled "Improving Access to Financing and Strengthening Canada's Financial System" in the federal government's recent report on Canada's Economic Action Plan.⁽⁶⁾ Whether they will achieve their stated pro-consumer goals remains to be seen.

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Endnotes

(1) Canadian Bankers Association, Credit Card Statistics - VISA and MasterCard, October 2008. See www.cba.ca/contents/files/statistics/stat_20081031_cc_db038_en.pdf.

(2) Some of these institutions (eg, retail associations and domestic and foreign insurance companies) do not currently issue credit cards in Canada.

(3) Minister of Finance, New Credit Card Regulations (Links and News Release). See www.fin.gc.ca/n08/09-048-eng.asp.

(4) *Ibid.*

(5) Canadian Bankers Association, Canada's Credit and Debit Card Marketplace, May 28 2009. See www.cba.ca/contents/files/submissions/sub_20090528_creditcards_en.pdf.

(6) See Canada's Economic Action Plan, A Second Report to Canadians, June 2009, p 19.

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