

July 24, 2018

To
Financial Systems Division
Financial Sector Policy Branch
Department of Finance Canada
90 Elgin Street
Ottawa ON K1A 0G5
Email: fin.payments-paiements.fin@canada.ca

Dear Sirs/ Madams

Subject: **Consultation on the Review of the Canadian Payments Act**

Reference your subject consultation invite, I have pleasure in submitting mine herebelow. I consent to the disclosure of the attached submission (without my contact details).

My comments are organized under the two main topics being consulted on

1. *Have the 2015 changes to Payments Canada's governance been successful in better enabling the organization to achieve its public policy mandate to promote the efficiency, safety, and soundness of its systems while taking into account the interests of users? (emphasis added by me)*
2. *Are there aspects of Payments Canada's governance structure that could be improved to better allow Payments Canada to carry out its mandate and serve its public policy objectives?*

The impact of the 2015 governance changes in achieving intended public policy mandate to promote efficiency... :

The changes did improve the Governance aspect. However, apparently much more needs to be done.

- Efficiency Objective has totally NOT been achieved. What is happening in the payments space could be seen as a flagrant violation of public policy so far as pricing/cost efficiency is concerned. It needs to be recognized that payments are an essential service, and its pricing should be reasonable, not cartel-like. It should be regulated on the basis of cost plus a reasonable profit margin, much like regulated utilities. Whereas at present:
 - Members, whether directly or through payment processor companies (which are mostly privately held companies, mostly in turn owned by banks) charge fees for processing credit card payments averaging as high as effectively 2% to 3% of sales (of each payment amount, flat charge i.e. not per annum), especially for small businesses. The fees are rather non-transparent, and generally appear too high
e.g.

<https://www.forbes.com/sites/forbesfinancecouncil/2018/01/26/dirty-little-secret-the-merchant-services-industry/>, and
<https://www.theglobeandmail.com/report-on-business/small-business/sb-money/will-the-new-payment-processing-rules-satisfy-merchants/article13021792/>, and
<http://instoredoes.com/making-cents-of-credit-card-processing-fees/>, and
https://en.wikipedia.org/wiki/Merchant_account#Rates_and_fees, etc. (There is also some mis-information out there in various articles apparently written by journalists in a hurry who. Some articles are by (unregulated) 'brokers'/resellers who work with payment processors, and start out with headlines that sound critical of payment processors but promise to lead a businessman through the confusion to nirvana, which may not always happen.

- Some merchants associations are out there too some of whom may claim from time to time to have negotiated a great deal for members. Upon closer inspection, the deal may involve "average fees" charged by the bank/processor, which a small merchant has no way of knowing or verifying. Since larger companies like Walmart have been reported to have negotiated special payment processing/ merchant discount rates (details normally remain undisclosed), the small business has to pay high rates for the "average" to hold.
- Many small business owners make a thin and varying profit margin, often about 5% or so on sales, after risking pretty much all their resources and spending nearly every ounce of their energy. It may be difficult to see the justification for banks/card processors to take away such a significant of their profits (2%+ of sales), and leave them with all the business risk and efforts.
- EU, UK had legislated to cap credit card interchange fees at 0.3% of the payment amount since 2015 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/466783/Interchange_fee_regulation_response.pdf). Australia capped these fees @ 0.5%. Since Interchange fees are the lions share of the total fees merchants have to pay, why should Canadian small businesses be fleeced much more, for essentially same banking service? Apparently it is time for us to catch up!
- What is the cost: Non-Profit Interac has successfully delivered Debit payments @ 6 cents per payment, regardless of the amount. The safety standards are similar as is the delivery of service (no risk of buyer default, sure and fast payment to merchant/seller/payee, comparable to credit card payments). Hence the cost for credit card payments should likely be in the 6 cents neighbourhood!
 - the main difference in credit card payments (vs Interac Debit) is that buyers/ payers are given an interest-free grace period of approx 36 days for each payment (a 'statement accumulation period' of 'average' ½ of a month, say 15 days, and a '21 days post-statement grace period', totalling 36 days) during which the credit card issuers are out-of-funds, for which they need to be compensated and the Interchange Fees/Merchant Discount Fees were apparently designed to compensate banks for same.

Ask banks to provide copies of their old/original credit card product program approvals (dating back to late sixties) and you will likely see it mentioned there. Banks probably do not provide free credit to card holders for the goodness of bankers hearts, but because they get compensated for it in the form of Interchange fees. But there are a number of problems:

- First, banks only provide 'grace period' interest free credit to approx [58% of the credit card customers who pay in full by the due date](#) (the so called "Transactors" or the "Convenience Users", but charge the grace period interest to merchants on 100% of payments! (The other approx 42% - the so called "revolvers" who use the revolving credit line included with credit cards - are normally not given ANY interest free grace period, as banks clawback the grace period from them. This is a dual interest charge for same credit period - a possible felony which could put a used-car salesman to shame (even they dont sell the same used car twice to two different buyers!) Specifically, Banks should only be allowed to charge once for this credit period, either to merchant, or to card-holder/borrowers, but not to both. Once they have charged the merchants through what is apparently a discounting of the merchant's receivables, arguably they no longer have title to that financing period. Banks should not clawback grace-period and charge interest on it again to the card holders. Having paid the 'discount rate' on this apparent discounting of receivables, ('Discount Rate' is indeed mentioned on certain payment processors' statements of account to merchants) arguably the merchants/small businesses have acquired title to this finance period from the banks/card issuers. Yet the banks/card issuers charge interest also to the credit card debtors "revolvers" again. Payments Canada should consider to put its foot down and stop this double-dipping 'robbery' in broad daylight!
- Second, the charge itself is too high. The cost of these payments should also be capped at Interac-type 6 cents per payment, and any added interest should be reasonable, not highly inflated rates dating back to the rates prevailing decades ago, or even higher: The high interchange fees probably made sense when interest rates were 15% or 16% as back in mid-eighties so the 'discount rate needed to be high to cover banks' cost of providing grace period. It does not make sense now that rates are much lower. It should be noted that the grace period financing is in the nature of short-term bridge finance, and considered low risk. The other end of the bridge is the bank who has extended a credit line to the cardholder. The Public Policy objective of providing EFFICIENT

payments services means the pricing has to be reasonable, say cost plus a reasonable profit-margin. It is anything but, and this is not acceptable.

- Whereas Banks charge a fixed fee for most other (non-credit card) payments (e.g. demand drafts/ telex transfers/electronic swift etc payments/online transfers) as should be the case, certain non-members whose services are typically used by lower-income workers, immigrants or overseas students etc, and who effect payments without requiring bank accounts, charge a fee based on remitted amounts tiers, which is excessive, unconscionable, and against the public policy objective of providing efficient payment services. These remittance charges and fees should also be capped. Leaks into exchange-rate gouging should also be plugged. A fixed cost-plus exchange rate margin should be prescribed/capped, including a reasonable profit margin. This can be published each day. A mechanism to deal with exceptions may be hammered out for exceptionally large intra-day foreign exchange moves. It would not be difficult to deal with real exceptions, e.g. as through a pre-set formula for intra-day exceptional adjustment, to be approved post-facto by the regulator if justified by facts, or not approved, leading to disgorgement/penalty etc if the intraday adjustment were deemed not justified.
 - The extra regulation would probably not be needed if *prima-facie* unconscionable, unreasonable behaviour were not rampant. Price fixing is difficult to prove. However, it is not difficult to see that, for example, a new public sector institution could be viable while offering much lower, reasonable fees and interest rates (<https://www.linkedin.com/pulse/not-so-great-credit-card-interest-rates-robbery-abdullah-albeidh/>)
- There are other aspects including competition and transparency. As regards competition, payment processing is mostly handled by a relatively small number of mostly privately held companies, (in turn mostly owned by the banks). There have been a number of anti-trust class-action lawsuits. While some were not successful, at least so far reportedly due to practical difficulty around processing individual claims (rather than any defect in proof of wrongdoing), others resulted in multi-billion fines/settlements:
 - "Regulators in several countries have questioned the collective determination of interchange rates and fees as potential examples of price-fixing. Merchant groups in particular, including the U.S.-based Merchants Payments Coalition and Merchant Bill of Rights, also claim that interchange fees are much higher than necessary,[16] pointing to the fact that even though technology and efficiency have improved, interchange fees have more than doubled in the last 10 years. Issuing banks argue that reduced interchange fees would result in increased costs for cardholders, and reduce their ability to satisfy rewards on cards already issued." (https://en.wikipedia.org/wiki/Interchange_fee#Price-fixing)

- "...In December 2013, U.S. District Court Judge John Gleeson approved a settlement for \$7.25 billion.[19] The settlement reduces interchange fees for merchants and also protects credit card companies from lawsuits over the issue in the future again.[20]" (ibid)

Aspects of Payments Canada's governance structure that could be improved to better allow Payments Canada to carry out its mandate and serve its public policy objectives

The Payments System's most important stakeholder is understandably the **consumer**, whether individuals, businesses, non-profits or Govt, etc, who receive and pay for items and services bought and sold every day, and other payments (salaries, investments, taxes, charities etc). Then there are other stakeholders - the institutions executing and facilitating payments, who are also important but in the nature of **service providers/ suppliers**, so to speak. Currently the Act seems to recognize more or less the need to safeguard the interests of consumers. As such it is provided in 8.1 (d) that a majority (seven of the thirteen) directors must be independent of the Association and its members. It is further provided that the Association's Chairperson And a Deputy Chairperson must be elected by the directors from among these (seven) independent directors. However this may need to be strengthened further in a couple of places as follows:

- Duty of Care: The directors duty of care should be not just to the association but also to the consumers. A useful analogy may be governance structure of Investment Funds. The Investment Fund directors' duty of care normally is not to the Fund vehicle company, nor to service providers like the custodian, the investment manager, the legal advisor etc, but to the main stakeholders/consumers, i.e. the investors.
- Representation on the Board: The invite quite rightly recognized that "...End-user interests are not homogenous and are reflective of a wide range of needs of both businesses and consumers. The *Canadian Payments Act* should ensure that the governance and operation of Canada's core payment systems is carried out in the public interest, taking into account the interests of users."(Motivation for Review - last part of point 3). The Service Providers (members and eligible non-members) representation on the Board may be shifted from the Board to the Advisory committees. But the 'service providers'/ vendors do not need to be on the Board. They can fully participate being on Advisory committees. Otherwise the service providers commercial interests and lobbying power could render it very difficult for the Board to meet its public policy objectives. Observed experience seems to confirm this is not just a theoretical apprehension.

Regards