Task Force for the Payments System Review

Policy Paper A: Users and their Discontent

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Contents

Executive summary

Users of the Canadian payments system are discontented. Whether they are consumers, merchants, small and medium enterprises, not-for-profits or large corporate or government organizations, they rely on the payments system every day but are not getting what they need or expect from it.

The depth and extent of this discontent came as a shock to the Task Force. We saw that addressing it needed to be one of the basic drivers of our work, alongside our concern for the impact of the payments system on the future development of the Canadian economy. That is why we begin our analysis of the payments system from the point of view of users and why we have made sure that their concerns are vividly portrayed.

Accordingly, this paper starts by examining the failures and limitations of the current payments system from the point of view of users. The analysis is based on input from a wide range of stakeholders in meetings and round tables and through written submissions and reports. The Task Force was assisted in this work by the Consumer Advisory Group and by the Electronic Invoicing and Payments Working Group.

Users

Consumers account for more than three quarters of all payment transactions in Canada. They are highly diverse in their circumstances and needs with respect to payment services, and too many are poorly served by payments providers.

Many consumers face barriers to their use of financial and payments services. A significant percentage possess limited literacy skills and may have trouble with complex systems. Financial services, Internet connectivity and cell phone coverage vary greatly across Canada, with about one quarter of all Canadians lacking adequate telecommunications services. Many consumers are financially limited and need low-cost solutions. In short, the “digital divide” already prevents many Canadians from fully participating in the digital economy.

While cases of payment fraud or serious error are fairly rare, the current regulatory framework does little to ensure that Canadians can understand their risks and liability should things go wrong. If these problems are not addressed, further legal uncertainty and confusion will result any time new payment methods are introduced. Despite the collective power of consumers, some individuals feel powerless and insecure in the face of market changes.

Merchants have their own problems as users of the payments system. To remain competitive, they must provide a wide range of payment options and invest in the necessary infrastructure and staff training, yet they have little say about how solutions and policies are designed or implemented. Retailers also report that they do not understand the full costs and implications of new payment technologies and often have to make investments on short notice. Merchants also have little opportunity for providing input on interchange and service fees. They need the means to communicate with providers about their concerns.

Small and medium enterprises (SMEs) include many firms that, in the absence of compelling digital alternatives, still make most of their payments with paper cheques. Likewise, many small businesses outside the retail and hospitality sector still do not accept debit or credit cards. By contrast, the medium-sized businesses in this category are much more likely to use electronic payment transfers for payroll and other purposes.

One reason for this reluctance to adopt new payment methods is the perceived cost and trouble of conversion. To overcome their resistance to change, SMEs must see real benefit in changing. Products and services that they find valuable and cost-effective are needed. Given the benefits to the Canadian economy of transitioning to digital payments discussed in *Going Digital*, governments should promote awareness and offer incentives to adopt new payment mechanisms.

Large corporate and government organizations differ from other users in that they are generally eager for a change to digital payments. They see new payment methods as an opportunity for major savings, as well as for improvements in the efficiency and effectiveness of their transactions with individual clients and with other organizations. They look forward to achieving integration through automated accounting and billing systems. They have major concerns about current and possible future systems in areas such as fees, security, functionality, and interoperability between providers, and they see few signs of improvement or innovation in the foreseeable future.

Challenges of responding to user needs

Users need a payments system that is faster, richer in information, more secure in managing online transactions, clearer about rules, more accessible to everyone everywhere, and less expensive.

Existing suppliers face a wide range of challenges in providing new services, while new entrants, who could bring competition and innovation to the system, are often unable to gain access to the core infrastructure. What is needed is a technically advanced system that is accessible to users throughout Canada and that allows easier entry for new providers. It should have a place in its governance for all types of users as stakeholders, provide services at a fair and reasonable cost, and be fully interoperable domestically and internationally.

Principles and objectives

The Consumer Advisory Group recommended three simple principles that the Task Force believes are fundamental to any successful payments system: **trust**, **access** and **good value**. The Task Force proposes that these core principles be at the heart of a new governance model for the Canadian payments system. The payments system must achieve the following objectives:

- Generate and maintain a high level of **trust** among participants,
- Be easily **accessible** to all users and supportive of a reasonable expectation that they can choose among adequate payment mechanisms, and
- Provide **good value** for its users.

None of these principles stands alone. None is absolute; they must be balanced against each other. The system is not expected to be compliant in every detail and at all times but to use these principles as guidance for its overall direction.

Introduction

Users of the Canadian payments system are discontented. Whether they are consumers, merchants, small and medium enterprises (SMEs), or large corporate or government organizations, they rely on the transmission and receipt of payments every day but are not getting what they need or expect from the payments system.

The depth and extent of this discontent came as a shock to the Task Force. As we absorbed its implications, we saw that addressing it needed to be one of the basic drivers of our work, alongside our concern for the impact of the payments system on the future development of the Canadian economy. That is why we begin our analysis of the payments system from the point of view of users and why we have made sure that their concerns are vividly portrayed.

How we came to understand the issue

The Task Force can say all this with some confidence, having been immersed for 18 months in the real world of payments issues through its engagement with a wide range of stakeholders. We held national and regional round tables with more than 100 businesses and other organizations and had hundreds of one-on-one meetings across the country with people involved with convenience stores, gas stations, small businesses, big businesses and governments (federal, provincial and municipal). We also talked to consumers through our social media network.

Another important source of information for us was a survey conducted by the Canadian Federation of Independent Business of 8,200 SMEs. In addition to the responses to specific questions, this survey produced over 400 pages of comments on the (mostly negative) experience of businesses with the Canadian payments system. All of this information helped us understand the issues from a business point of view.

The Task Force gained an understanding of a wide range of payments issues through the efforts of its various working groups and their subcommittees. For example, the Electronic Invoices and Payments Working Group was supported by numerous individual experts and by subcommittees representing the views of SMEs, large corporate and government users, and individual users.

Our insight into the payments system as seen by individual users was further enhanced by the advice of the Consumer Advisory Group, a thoughtful and knowledgeable body representing both citizens groups and businesses that serve consumers. We also benefited from a 100-page research paper (posted on our website) prepared by a university lecturer who is close to consumer groups.[1] Through such input, we learned that, until 2008, when the Retail Council of Canada created the Stop Sticking It To Us Coalition to oppose certain credit card practices, the voice of the user was seldom heard on payments matters in Canada.

When we talked to the providers, they told us that the payments system is safe, reliable and efficient. Our own research bore out much of what they said about the basic system. Users too tend to trust the system but in other respects are dissatisfied. No matter whom we talked to in any part of the user community, we heard a steady stream of complaints reflecting widely felt, serious and long-standing deficiencies that need to be addressed now. Perhaps even more important for the longer-term, users told us that they have no way of ensuring that their concerns and expectations are heard by the providers and no way of influencing the future direction of the payments system.

As will become apparent in this series of policy papers, the realization that users of all kinds must have a strong and direct voice within a payments industry that is flexible, responsive and, as far as possible, self-governing was fundamental to shaping the thinking of the Task Force. Accordingly, that is where we start our explanation.

Structure of this paper

The first part of this paper examines the failures and limitations of the current payments system from the point of view of the various categories of users. This analysis is based on what the Task Force heard from users over many months of meetings and round tables, through many written submissions and through our research on payments in other countries.

The second part explores the challenges of responding to these needs, including the issues facing both established providers and potential new entrants to the payments system. The overall goal of a modern and effective electronic payments system is set out.

The third part of the paper presents principles developed by the Consumer Advisory Group and adopted by Task Force members as they sought to create the conceptual foundation for a substantially revamped Canadian payments system. These principles are based on three requirements for a payments system that meets the needs and expectations of users: **trust**, **access** and **good value**.

In setting up the objectives for a new payments system, the paper paves the way for the three other interrelated papers in this collection. *Policy Paper B: Governance—Stakeholders and their Disconnect* proposes a governance model for the payments system. *Policy Paper C: Legislation—Establishing the Payments Industry* outlines the legislation needed to support that model. *Policy Paper D: Infrastructure—A Reinvented CPA* looks at necessary changes to the payments infrastructure.

What do users need and expect?

Almost every individual, institution and organization in our society is a user of the payments system. As discussed later, some may not be full participants since they are marginalized by social or economic issues or by disability. Even those who provide payment services are themselves users of the system.

Starting with the users is the logical way to approach a review of the payments system. Understanding user needs and expectations provides a way to define the principles and objectives that should drive reform of the payments system (recognizing that needs are fluid and are shaped, in part, by available services).

For the purposes of the review, we have identified four main categories of users:

1. Consumers
2. Merchants (and others at the retail level)
3. Small and medium enterprises
4. Large corporate and government organizations

Consumers

How consumers choose to receive or transfer funds matters a great deal to the future of the payments system. While the value of consumer payments accounts for less than 5% of that of all payments in Canada,[2] these transactions represent more than 75% of the total volume. Since 34% of all payments are still made with cash and 4% with cheques, mostly by consumers, in order for Canada to embrace the digital age, a significant number of consumer payments will have to migrate to existing or new forms of electronic transactions.

Changing the ways consumers pay and get paid is important but sensitive. It will involve all participants in the payments system. It is not merely an issue of changing consumer habits: new products and services must be offered by providers; used by those who have payment relationships with consumers, be they employers, insurance companies, governments, utilities or retailers; and accepted by consumers. Of those three challenges, the last one may well be the most daunting, as consumers will switch to new payment methods only if they trust them, can access them and find that the change actually provides a benefit.

Because they account for such a large portion of all payments, consumers have a special role to play in the success of any changes in the payments system.

Consumers and change

Over the past 50 years, new technology has engulfed consumers' lives. Innovators have sought to understand why we adopt some technologies and shun others. Research in fields such as psychology and marketing has tried to design models to explain user behaviours as they relate to the adoption of new technologies.[3]

A clear message emerges from most of these studies: consumers will adopt new technology that they find easy to use and truly useful. Overly complicated gadgets,[4] and innovations that don't provide a clear advantage over existing solutions, tend to fail.

But other factors also come into play. Security is a must. Unresolved privacy and authentication concerns are significant obstacles to the development of digital payments and make some consumers uncomfortable about the payment mechanisms that are currently available.

Brand preferences and social status associated with a brand or technology clearly impact the choices and loyalties of consumers. Consumers' willingness to move from one provider to another may also be significantly altered by the costs and trouble of switching, which often unduly discourage migration even when consumers are ready to adopt new services and suppliers. The hassle surrounding the transfer of preauthorized debits and other arrangements when one moves from one financial institution to another is a good example.[5]

"Innovative" fees imposed on consumers for a number of electronic transactions do not help. As convenient as a service might be, it will not be adopted widely if consumers feel that its price greatly exceeds its comparative advantages, especially if they suspect that they are not getting good value in the process. Current debates in the United States around debit interchange fees, as well as consumers' reactions to spiking bank fees, provide a vivid illustration.

These and other factors already influence nearly all consumers, and they will only become more disruptive in the future if they are not addressed. Change is hard to bring about, even when consumers are not entirely satisfied with the current service.

Who are "consumers"?

Many stakeholders proclaim that caring for "the consumer" is their absolute priority. But there is no typical consumer. Consumers range from well-off early adopters of new technology to unemployed single parents with low literacy. It is tempting to focus on the former, if only because they tend to be the highest-margin customers for diverse providers. Families with low incomes and low net worth, however, are more numerous than affluent Blackberry users.[6]

One million households have $400 or less on deposit at a financial institution.[7] It is estimated that one million adult Canadians do not have an account with a deposit-taking financial institution,[8] most often because there is none in their area or because they cannot meet the account-opening requirements imposed by many institutions.[9] Of salaried Canadians, 57% would find things "difficult" if the payment of their wages was delayed, even by only a week.[10] A significant number of Canadians are therefore financially vulnerable, which impacts the types of payment methods they can use.

There are other types of vulnerabilities. Many Canadians have limited literacy skills; they can read words but are overwhelmed by complex messages. They are not comfortable with complicated interfaces and will surely not read a provider's terms and conditions.

Geography is also a challenge. Financial institutions and other mainstream providers are not present throughout Canada, and merchants who take on the necessary task of providing payment services in Nunavut or the Northwest Territories, for instance, cannot provide a full range of options. There are technological, regulatory and financial reasons for this: there are no cell networks, the merchants are not financial institutions, and getting the service there is expensive. Even in the south there are significant gaps in high-speed Internet connectivity and cell phone coverage between the larger urban communities.

Connectivity is an ongoing issue, yet it is fundamental to the future of the payments system. In 2010, close to half the rural population had no access to connections that had a download speed exceeding 5 megabits per second, which the Canadian Radio-television and Telecommunications Commission (CRTC) defines as the minimum threshold for acceptable broadband service. By contrast, more than 80% of those living in urban areas had access to connections faster than 20 megabits per second.[11] Large areas of the country (admittedly, with a low population density) have no wireless coverage whatsoever.[12]

Cost is also a barrier. Both wireless and broadband services are fairly expensive in Canada, compared with many other jurisdictions.[13] It is perhaps no coincidence that in 2010 over 90% of Canadian households in the highest income quintile used cell phones, but the proportion was only 50% for households in the lowest income quintile.[14] If mobile access is the key to payments tomorrow (particularly via smart phones), this cost issue potentially poses challenges for access to payments.

We could go on and describe the challenges faced by recent immigrants or, on a wholly different level, those confronting disabled persons. We agree with this assessment made by the CRTC earlier in 2011:

> Other consumers are less plugged into the digital environment. Canadians with low digital literacy skills will be challenged to fully participate in the digital economy and will face impediments to engagement in an increasingly digital society. Canadians with disabilities, older Canadians, new Canadians, and those living in poverty or in rural and remote areas may also face barriers. For a wide range of reasons, consumers may lack the knowledge they need to obtain the services they need. As a group, these consumers bear a disproportionate share of risk if the market fails to meet public policy goals, or when public policies do not succeed or have unintended consequences.[15]

These comments apply both to digital payments and to connectivity issues, and these issues will need to be resolved if Canada is to transition successfully to digital payments.

Most payment services cannot target only the early adopters: innovations must be quickly usable by nearly everyone in order to have a critical mass. Users' needs and concerns must therefore be taken into account at the design stage, which does not always happen. For instance, adapting services to consumers with low literacy skills, impaired vision or limited mobility is often envisioned only "downstream," after an offering has been deployed in the market, when it is much more expensive to modify.[16] This results in needless social exclusion and hinders migration toward digital payments.

This digital divide impairs the full growth potential of mobile commerce and mobile payments, yet technology and developments should help us close—not widen—the gap in terms of ultimately making payment offerings more secure, reliable and accessible for a wide range of users. We therefore invite telecommunications providers, other stakeholders, the CRTC and government to address more effectively the obstacles that prevent too many Canadians from fully participating in the digital economy.

Current consumer market

There are problems with the current Canadian consumer payments market.

A consumer who pays her utility bill on the due date via her financial institution's website will likely be charged a late fee because the payment will not be credited to her account with the utility for a day or two. Large financial institutions like to put the blame on ineffective internal processes on the billers' side, while the billers complain that their bankers will not offer them the data-enriched networks they need. In the meantime, aggrieved consumers launch class actions against billers.[17]

In 2006, a survey[18] showed that 12% of households using preauthorized debits had experienced a significant problem with such a transaction within the previous two years. Mistakes ranged from the wrong transaction date, to double-dipping, to debits extending well past the end of the contract; 22% of those who had a problem did not feel that it had been resolved to their satisfaction, either by the biller or by their financial institution. Recent reports indicate that those issues continue to plague consumers.[19]

And the cost of making payments—paying to pay—may become problematic. Payments appeared to be free for consumers when they were chiefly made by way of cash and cheques. But new charges for online convenience are constantly being added, and the trend is not likely to abate.[20] The situation is complicated by loyalty points and other incentives that tilt consumer demand toward certain payment mechanisms.

When payment mistakes or fraud occur, Canadians find out the hard way that the regulatory framework consists in large part of "voluntary codes" that are unenforceable by users and of clearing rules that most know nothing about. Part of the problem is that some, such as Interac rules, are not public, and that others, such as Visa and MasterCard rules, use opaque language and tiny print. While they pose a potential risk for all consumers, these issues particularly affect those least able to deal with them. As St. Christopher House argued in its 2010 submission to the Task Force, "Low-income Canadians suffer the most when there is a payment processing mistake."[21] Community organizations involved with disabled Canadians also underline the "lack of proactive and consistent effort by the industry to engage the disability community."[22]

A number of stakeholders emphasized to the Task Force the importance of a fair, consistent and clearly explained set of rules for digital payments.

Consumers Council of Canada submission (September 13, 2010)

"Electronic payments can make the economy more efficient. But consumer confidence is vital to their success, and to the economy in general. There is a risk that an inadequate legal framework for the most common electronic payment mechanisms will come to erode confidence in such systems. It is therefore important for Canada to act now, in order to ensure the implementation of a fair set of rules governing electronic payments."

Canadian Payments Association submission (August 15, 2011)

"There is currently an imbalance of oversight. The lack of oversight for many new retail payment mechanisms means that similar payments are not subject to similar rules, which may affect the consumer and merchant experiences. . . . There is lack of clarity around requirements. Similar payments instruments do not necessarily share the same requirements or attributes with respect to consumer protection, participant liabilities, security or authentication, etc."

As new payment methods emerge, this legal uncertainty and confusion will only increase, hindering adoption and augmenting risk. The rules that are in place are often dictated by providers through non-negotiable standard form agreements that generally advantage providers over users. The Union des consommateurs and others have therefore urged the Task Force to ensure that all payment forms are covered under clear, coherent legislation. As the Consumers Council of Canada noted in its 2010 submission to the Task Force, "A lack of consumer confidence in the reliability, security and choice of payments systems is consistently cited by all stakeholders as a barrier to growth for the so-called digital economy in Canada." The next section, "Trying to Understand Liability: A Case Study," explores this issue further.

When it comes to making a purchase on the Web, a Canadian consumer can typically use only a credit card or possibly a PayPal account. There are limited payment options in this space. For person-to-person transactions, cash and cheques remain the most practical options. The less well known e-transfer services offered by Interac/Acxsys are beginning to gain traction but remain a costly alternative to cash and cheques. Even personal cheques are less than convenient, because banks often put the funds on hold for up to a week.[23]

What about innovation? A Canadian consumer can walk to a Western Union counter and hand over money that, when arriving at its destination in Kenya, will be processed speedily through the M-Pesa mobile payment network. That Canadian consumer could be forgiven for thinking that our domestic providers are lagging behind those in the rest of the world.

Trying to understand liability: A case study

To understand more concretely one of the problems faced by users in dealing with the current Canadian payments system, let's look at the case of an imaginary "average Canadian" who strives to stay on top of her financial affairs.

Sonia has an account at a financial institution, a debit card, a credit card from another institution, and a few preauthorized debits, some on her deposit account and some on her credit card account. She pays some of her bills on her institution's website, but she still writes the occasional cheque. She has recently created a PayPal account that is linked to her credit card.

To understand her potential liability if a problem arose, Sonia would have to consult, at the very least, the following:

1. The legislation under which the financial institution was created;
2. Her agreement(s) with the financial institution holding the account;
3. The *Canadian Code of Practice for Consumer Debit Card Services*;
4. Canadian Payments Association (CPA) rules A4, A6, E1, E2, and E4;
5. Interac rules;
6. The applicable provincial consumer protection legislation;
7. The legislation under which her credit card issuer was created;
8. The agreement(s) governing the use of that credit card;
9. The credit card network rules;
10. The *Bills of Exchange Act*; and
11. The PayPal agreements.

But the result of all this research would be misleading. The courts have determined that customers of financial institutions cannot base a legally enforceable claim on CPA rules, and that conclusion would likely extend to Interac and credit card network rules. Interac rules are, for the most part, not publicly available. Provisions in rules and agreements may be invalid because of superseding legislative requirements.

The result of Sonia's research would also be misleading in that many of the documents have significant gaps, regulate only a limited range of cases, or provide solutions that would hardly satisfy most reasonable consumers. One could be forgiven for feeling overwhelmed.

What does it mean, practically speaking? Let's imagine Sonia again, doing some shopping at the mall and wondering whether to use her debit or credit card at the point of sale, or to instead get cash at the bank machine. Here are the choices before her, along with the liability she might have to face should a fraudulent transaction happen, through no fault of her own:

1. Debit card with personal identification number (PIN) at point-of-sale or banking machine: No liability, under the *Canadian Code of Practice for Consumer Debit Card Services.*
2. Debit card without PIN at point-of-sale: Liability depends on agreement with issuing financial institution; the burden of proof is on the consumer.
3. Credit card at point-of-sale: Liability limited to $50 at most, under provincial legislation and under paragraph 12(1)(*c*) of the *Cost of Borrowing (Banks) Regulations.*
4. Non–bank-issued credit card at banking machine: Liability unclear, but presumably capped at $50 under provincial legislation.
5. Bank-issued credit card at banking machine: Liability up to credit available through card, under paragraph 12(1)(*d*) of the *Cost of Borrowing (Banks) Regulations*.

Card networks may wish to point out that, in case of a fraudulent transaction, they provide consumers with their own safety net, in the form of "zero-liability" guarantees. The protection offered under one large card network's rules is explained in the following note:[24]

> **Visa cardholders must establish that the transaction is not their responsibility as per all applicable agreements of the issuing financial institution. Does not apply to ABM transactions or PIN transactions not processed by Visa. Individual provisional credit amounts may be withheld, delayed, limited, or rescinded by an issuer based on factors such as gross negligence or fraud, delay in reporting unauthorized use, investigation and verification of claim, and account standing and history

The text on the website is apparently set in 6-point Arial, in a pearly grey hue. It may be more legible in the following format:

> **Visa cardholders must establish that the transaction is not their responsibility as per all applicable agreements of the issuing financial institution. Does not apply to ABM transactions or PIN transactions not processed by Visa. Individual provisional credit amounts may be withheld, delayed, limited, or rescinded by an issuer based on factors such as gross negligence or fraud, delay in reporting unauthorized use, investigation and verification of claim, and account standing and history.

Basically, cardholders must establish that they are not responsible for the allegedly fraudulent transaction. The onus is on them if they are to benefit from the guarantee. Absence of responsibility must be demonstrated according to criteria imposed by card issuers in standard form agreements. The guarantee does not apply to various transactions routed (without the consumer's choice or knowledge) on other networks. Reimbursements may be rescinded on the basis of the consumer's "account standing and history," presumably, at the card issuer's discretion. In fairness to this card network, others fare little better when the small print is read closely.

But perhaps Sonia would rather make an online purchase instead of going to the mall. Should the goods not be delivered as promised, she may have chargeback protection in certain jurisdictions if she has paid with her credit card but not if she has used other means of payment or if she lives in another province or territory.

In short, despite the requirement under various statutes for some payments service providers to have complaint-handling procedures and to be members of third-party ombudservices, little is done to help consumers like Sonia better understand their rights and obligations.

Merchants

Canadian retailers are required to manage a bewildering range of payment mechanisms at the point-of-sale. They must increasingly invest in infrastructure and staff training in order to offer those mechanisms to their customers. The Retail Council of Canada estimates that the rollout of Chip & PIN cost merchants approximately $1 billion. And they have been vocal about the rising prices they have to pay for payments services.

The competition between networks is a case in point. The larger credit card networks compete for participating issuers by, among other means, increasing the interchange fees paid by merchants. As noted in our paper *Credit and Debit Card Markets*, it is an open question as to whether competition will yield efficient interchange fees. Certainly, the number of jurisdictions that have attempted to address the issue of interchange fees suggests that there are challenges to the market's achieving an efficient outcome in the absence of government or antitrust intervention. In Canada, stakeholders such as the Retail Council of Canada, the Canadian Federation of Independent Business (CFIB) and the Canadian Convenience Stores Association all commented in their 2010 submissions to the Task Force that merchants would see no benefit from opening the debit payment market to competition.

Fees paid by merchants appear unrelated to costs and are opaque, according to the Retail Council of Canada and the Canadian Restaurant and Foodservices Association. The Canadian Convenience Stores Association and the Coalition québécoise contre l'augmentation des frais de cartes de crédit et de débit have explicitly called for the regulation of merchant or interchange fees. According to the Retail Council of Canada, something must be done to ensure the fairness of debit and credit card networks.

The CFIB, the Canadian Restaurant and Foodservices Association and the Canadian Convenience Stores Association argue that credit card networks provide incentives for consumers to use payment methods that are more expensive for retailers. According to a recent survey,[25] SMEs in the retail and hospitality industry prefer to be paid by debit card (44%) or by cash (37%) rather than by credit card (5%). But transaction volume favours credit cards (35%) over debit cards (27%) and cash (19%). In other words, consumers prefer to use the mechanism that is often the most expensive for retailers to process. They do this because they believe that in doing so they are minimizing their own costs and legal risk, while maximizing rewards such as points, convenience and easy record keeping.[26] As a result, merchants' freedom to choose which payment mechanisms to offer is severely limited if they are to retain their customer base. Whether this results in the most efficient allocation of resources in the market is unclear.

Retailers, who indicate that they must offer a broad range of payment mechanisms in order to remain competitive in the market, even if those mechanisms are expensive, also face ongoing requirements from some providers to invest in new technology (such as point-of-sale terminals) and processes (such as security compliance).[27] They claim, however, to have little say in how those requirements are designed and implemented. In the words of the Canadian Restaurant and Foodservices Association, "change is unilaterally imposed on the industry, and merchants must absorb the cost." The CFIB claims that "merchants bear the entire cost of new security measures," even though there is scant evidence that the nature and level of actual risk really require all those expensive measures. Retailers have indicated repeatedly that they do not understand the full costs and implications of new payment technologies. They often cannot plan ahead, because requirements for new investments are, in their view, sprung on them on too short notice.

There are also service issues associated with the implementation of new services:

Retail Council of Canada submission (September 17, 2010)

"… from September 2009 through June 2010, as chip-enabled terminals were being deployed throughout thousands of stores across Canada, by hundreds of large, mid-size, and small chains, almost a dozen merchants experienced serious terminal pad failures, with very high failure rates . . . . While a number of processors reacted quickly, a number of large companies in Canada had no recourse when it took days, if not weeks, to resolve this issue within their stores, because the individual providers in the payments system (issuers, card companies and processors) each pointed their finger at the other, leaving the merchant with no recourse or explanation . . . . In Canada, there was no opportunity to raise this issue in any forum. From a merchant perspective, mobile payments could bring with it the same issues, exposing them to the same risks with little reward in increased sales or traffic."

This is not the mark of a healthy, competitive market. In fact, retailers face limited choice between card networks, since just three (Interac, MasterCard and Visa) control by far the largest proportion of debit and credit card transactions in the country. Market entry by newcomers is difficult, owing to challenges in establishing new payment networks.[28]

Retail Council of Canada submission (September 17, 2010)

"In the credit card business, the competition is only for one set of 'customers,' the financial institutions that are issuers of the brands' cards and effectively their business partners. The card companies compete by seeking to offer ever-higher returns to the issuers. The costs of this 'competition' are borne not by the networks but by merchants and the broad base of consumers who purchase their goods and services."

Canadian Life and Health Insurance Association submission (September 15, 2010)

"It is worth recalling that the [Canadian Payments Association] was initially created in the 1970s to redress the competitive imbalances that arose out of the big banks' dominance of the paper-based payments system. Unfortunately, even today it continues to be the case that a very small number of firms can heavily influence the pace of introduction of new payment solutions. This fact has extended beyond paper cheques to include a wide range of payment types, including lockbox processing, imaging solutions, debit card transactions, merchant card acquiring business and SWIFT wire payments."

Card networks and other providers point out the advantages related to card payments:

MasterCard submission (September 2, 2011)

"Canadians annually spend more than $267 billion using credit card services, enjoying significant benefits many of which are unavailable with other forms of payment such as:

- Convenience and security
- A globally recognized form of payment
- Zero liability and chargeback protections
- Rewards – goods and services incentives that further stimulate the economy
- Online purchasing capability
- Innovations such as contactless MasterCard® *PayPass™*. . ."

But these are two different conversations, which makes it difficult to find common ground. Consumers may benefit to some extent from using credit cards and may indeed prefer retailers who offer those payment mechanisms. The market for merchant credit card services has different dynamics. Retailers exhibit fairly inelastic demand for payment card products and receive services from a limited group of service providers.

And when retailers hear that mobile payments are about to enter the market, they worry that even though issues with existing card-related services and security have not yet been solved, a whole new layer of services and associated costs[29] might be imposed on them. If there were a permanent mobile payments working group, it could bridge the divide between merchants and service providers and address issues before new products come to market.

This is just one example. The information gathered by the Task Force clearly suggests that more communication between providers and users would significantly help address some concerns. There is a need for a process that would allow stakeholders to work together to make projects such as the implementation of Chip & PIN more effective. These issues are addressed in *Policy Paper B*.

In a nutshell, retailers feel that they have limited options but unlimited costs. In this, they share a number of payment issues with SMEs, with large corporations and with governments.

Small and medium enterprises

According to the recent CFIB survey mentioned above, SMEs outside the retail and hospitality industry still make and receive most of their payments through cheques.[30] They do not complain much about this, perhaps because their accounting processes are set up to support cheques and because they cannot measure the potential efficiency gains associated with switching to digital payments, while the costs and aggravation of migrating may feel painfully obvious to businesses whose field of expertise is not payments.

Even though the volume of cheques used in Canada is declining, this form of payment is apparently still quite useful and is valued by most SMEs, which is why the CFIB has urged the Task Force to take into account the unique needs and concerns of SMEs when proposing a transition from cheques to digital payments. There are, however, variations. In particular, the size of a business has a significant impact on the types of payments it prefers. For instance, larger SMEs are five times more likely to pay employees through electronic transfers than are the smallest firms, which still use cheques for the most part. Industrial sector is also an important variable: 96% of retail SMEs can accept credit cards, but only 37% of businesses in the natural resources sector can do so.

Why are traditional payment mechanisms still so popular with SMEs? The simple answer is that they do not see any viable electronic alternatives to paper cheques and invoices. The CFIB survey showed that SMEs would be very interested in pursuing such options if they were available at a reasonable price. Indeed, cost is perceived as the biggest obstacle to transition.

Network effects are another major hurdle. No widely accepted new electronic payment mechanisms have emerged to give customers, suppliers and other business partners a digital option. Firms are therefore reluctant to take the investment initiative on their own, as success depends on interoperability, which requires standards that remain elusive. Everyone is waiting for everyone else. This unwillingness to commit is compounded by concerns over security and privacy.

A further reason for businesses to continue mailing paper cheques is that doing so allows them to include inserts that provide branding and marketing opportunities. Current electronic payment options do not offer any equivalent. The lack of appropriate remittance information attached to electronic payments is seen as yet another obstacle to migration.

In such a context, why go from the known, easy-to-use, affordable and well-functioning to the unknown—especially if the unknown might turn out to be more expensive? In the survey, as in other discussions, the perceived efficiency gains from migration to electronic payments do not yet appear to be capable of turning the tide. The current systems work, and switching is seen as onerous and risky. In other words, the few alternatives that are available are not perceived as better or cheaper than the status quo. They are sometimes even seen as less effective, so user adoption is limited. While it has begun, especially with larger firms and in specific business areas, SME migration to electronic payments is therefore likely to be very gradual.

To overcome this resistance to change, SMEs must see the prospect of real benefits in electronic invoicing and payments. As discussed in *Going Digital*, products and services that they find valuable and cost-effective need to be developed. Possibilities include cash flow forecasting, automated profit and loss statements, and receivables and payables factoring. The Task Force suggests that government do its part by offering incentives such as faster payment of government invoices and investment tax credits to support the necessary investment in technology. As well, marketing and education are needed to make users more aware of the benefits and less fearful of the costs of going digital.

Large corporate and government organizations

In contrast to the reticence of SMEs is the impatience of large corporate and government organizations. These users are eager for new offerings that would serve their growing needs and are critical of suppliers for not providing what they require.

Canada lags behind world leaders in some areas

"Innovations in mobile payments, integrated supply chain solutions and enhancements to ACH payment types (IAT, CTX payments) in the US, as well as the introduction of Single Euro Payments Area (SEPA) payments in Europe and 'Faster Payments' in the UK are just a selective list of the innovative, customer focused, enhancements that have been brought to market abroad in the last several years. We do not feel that there is a commensurate level of innovation occurring in Canada." (Source: CLHIA Submission, September 15, 2010)

"Though Canada has made advancements in electronic payments from consumers to businesses, progress has been much slower in penetrating two essential markets—business to business and business to government."

CFIB Report, *Changing the Way We Pay: Getting the Transition Right for SMEs* (October 2011)

They dream of transaction-related data flowing seamlessly with payments and facilitating management, especially with regard to automated accounts-receivable and accounts-payable processing. They are seeking swift finality and irrevocability of payments. They expect similar transactions to follow similar rules, whoever the provider may be and whether or not payments transit through clearing processes. They need international transactions to be facilitated. They have doubts about the trustworthiness of incumbents' legacy systems, are looking for open systems and are unhappy with the fees they currently have to pay.

Comments to the Task Force in these large users' submissions included ideas such as the following:

- The bulk of the payments market is controlled by the "Big 5," with the largest financial institutions in a position to exert massive influence on the major payment networks.
- Innovation and evolution tend to take place at the pace of the slowest.
- The Canadian payments system should be augmented with enriched online transaction data to provide detailed information to users.
- Canadians require an online system that is time-sensitive and final.
- There are no consistent standards in the system.

In short, these users do not see an innovative market at work in Canada, a market that would provide them with the opportunities they see their counterparts in other countries enjoying. Both the infrastructure and the services being offered in Canada lag behind what is available, or soon will be, in other jurisdictions, and large users currently see no sign that the situation might improve in the foreseeable future.

The challenges do not rest solely with providers, however. For instance, some of the larger users would happily do away with cheques, but they are faced with the obstacles mentioned earlier: many of the SMEs they deal with currently see little point in migrating to other payment mechanisms, while a significant proportion of consumers remain uncomfortable with digital payments.[31] Network effects, costs and uncertainty thus also conspire to sustain the status quo.

Challenge of responding to user needs

What is it that users in Canada are missing when it comes to their payments system? Why are users' needs going unmet? Why are incumbent firms and new entrants not scrambling to roll out new products to fill the gaps?

We know from experience in other countries that innovative payment options are possible. But, with some notable exceptions, they are not happening in Canada.

What do users want?

As explained earlier, the Task Force quickly learned how the current Canadian payments system needs to be improved to meet user needs. While different users have different priorities, nearly all would agree that the payments system needs, to the greatest extent possible, to become:

- **Faster**, with the ultimate goal of instant funds transfer;
- **Richer** in terms of the information that accompanies payments;
- **More secure** in protecting information and money;
- **Clearer and more consistent** about rules and liabilities;
- **More accessible** throughout Canada, to people and businesses in all circumstances; and
- **Less expensive**, at least with respect to the basic payments services.

The fundamental needs of users are clear, and they are not being met quickly enough.

Why don't existing providers respond?

Financial institutions and other existing providers of payments services face a number of significant challenges and disincentives when they consider adding to their payment offerings.

The first challenge is that the initial return on investment in new services is likely to be low. The payments industry tends to be a high-volume, low-margin business, where economies of scale are crucial, whereas implementing a new service entails starting with a comparatively small volume. Moreover, the new service typically displaces an existing one, even though the expenditures associated with the existing service may not have been fully recovered.

Over the last few decades, financial institutions have been able to move a significant proportion of face-to-face, storefront retail transactions from cash and cheque payments to credit and debit cards. Despite a gradual technical evolution (most recently from a magnetic stripe to a chip on cards), payment cards and point-of-sale terminals have seen the deployment of a fairly standardized technology across a wide consumer and merchant base.

Bringing in the next generation, however, will be more difficult. The incremental benefit to financial institutions of introducing new payment mechanisms is likely to be much less than that of the earlier conversion from cash and paper to cards, although in some cases the investment can be made more attractive by providing value-added services that generate new revenue streams. There is also the threat of new competitors, who may be able to offer similar services, especially if they have access to the core infrastructure.

The situation is more difficult still in many of the underserved market segments, such as remote areas of Canada, because potential volumes are smaller and because the payment experience may vary substantially, requiring more expensive, customizable solutions, often involving costly expansion or upgrading of the infrastructure to accommodate new customers.

A second challenge is that the payments industry is an inherently network-based business. This means that to achieve the volumes critical to making any payments systems efficient and profitable, providers must work together to ensure interoperability. The deposit account from which the funds are drawn and the credit account to which the payments are directed are typically with different providers. It is rare that a single provider can attract enough customers to maintain a profitable proprietary system. This requirement that providers cooperate with competitors to ensure interoperability and minimum standards for the payment offering complicates the process of introducing new products.

Financial institutions face another challenge: the often decades-old legacy systems on which existing financial services, such as bank accounts, depend. To quote McKinsey,

> Banks are struggling to cope with transaction platforms that no longer serve their needs. A legacy of silo IT architecture combined with the need for data integration is leading these institutions to investigate payment hubs as a solution. There seems to be little consensus, however, as to what a payment hub is (even among those who are building them) and where it sits in the overall payments system.[32]

Given the investment by providers in existing technology, there is a bias toward new offerings that can run on existing systems or on technology workarounds, such as payment hubs, and this imposes significant limitations.

Another kind of legacy issue arises because, while system architecture must change to accommodate new payment mechanisms, it must still support the old mechanisms. Thus, as their business gradually migrates to the new means of payment, the institutions must continue to support a steadily less profitable older system. The evolution of the cheque processing market provides a good example.

Change is therefore demanding and often costly for established providers, yet returns, at least in the short run and viewed narrowly, are limited. The incentive to innovate is not strong.

Moreover, while users may be discontented with the existing payments system, as the Task Force heard repeatedly, there is little focused demand for change directed at providers or at government. The result is that change comes slowly to the Canadian payments scene.

Why don't other providers offer solutions?

The classic response of a market system when current suppliers fail to keep up with the demand for new products or services is that new suppliers emerge to fill the gap. Why, then, the Task Force asked, is competition not leading to users' needs for new and better payments options being met by providers outside the mainstream of the current payments system?

In some cases it is. In recent years, new services such as PayPal and Zoompass have been created outside the core payments system. It is difficult, however, for proprietary systems to gain the necessary access to the core payments infrastructure, and it can often only be done using awkward and inefficient workarounds. Even then, the new entrants require the cooperation of existing providers to offer their services. Moreover, they may find making inroads into payments markets difficult, given that incumbents can create cost or more subtle barriers that protect existing offerings.[33]

It is also difficult for new entrants to have direct access to the clearing system. As we discuss in *Policy Paper D*, the eligibility requirements to become a direct clearer, which include having at least 0.5% of the total payments business in Canada, may present an insuperable barrier, at least in the initial stages of a new service.

Finally, new entrants are discouraged by an uncertain regulatory situation. Given the complex patterns of legislation and oversight that exist today, they cannot be sure that their product offerings will be supported by the existing infrastructure or subject to new legislation.

Goal

To address this unsatisfactory situation, the Task Force sought ways to bring about change. We believe that Canada needs the following:

- A technically advanced payments system comparable to the best in the world, providing for instant funding transactions, the accompanying transmission of rich information, and fully mobile services;
- A guarantee of access throughout Canada to services for users and to infrastructure for providers (subject to reasonable limits on what is technically and economically feasible);
- Easier access to infrastructure for new entrants to encourage competition and innovation, subject to appropriate and transparent conditions to protect the safety and soundness of the system;
- A place for all categories of users (consumers, businesses and governments) as stakeholders in the governance of the payments system;
- An effective and flexible form of public oversight to assert the public interest;
- More user-friendly, consistent and open rules and explanations of costs and liabilities;
- Low-cost basic services and overall costs that represent good value for users; and
- A system that is fully interoperable, both domestically and internationally.

Achieving this is what the rest of this paper and the other three policy papers are about.

Principles and policy objectives

Importance of principles and objectives

In *The Way We Pay*, the Task Force articulated the need for the adoption of a principles-based approach to address the need. The advantages of such an approach had been brought to our attention by many stakeholders, in particular, by consumer groups. The complexity and rapid evolution of the payments ecosystem are not conducive to the implementation of a detailed, rigid, exacting regulatory framework, which would likely be obsolete before it was even submitted to consultation. But unbridled freedom is not an acceptable alternative in an area that is as sensitive and crucial, from a public policy standpoint, as payments.

Principles and objectives stand in the middle: they provide a clear direction to all stakeholders and a set of benchmarks against which to measure progress, yet they allow for evolution and flexibility in the face of changing circumstances. We believe that this approach is the most appropriate in the rapidly changing environment we face.

As noted in *Policy Paper B*, the Task Force favours a governance model that is responsive to challenges arising in the payments industry. While the regime will require regulation-making authority to deal with, if necessary, any undesirable practices that the self-governing structure fails to address, the Task Force believes that the regime would likely not be successful if subjected to a host of prescriptive regulations.

In *The Way We Pay*, we proposed 12 principles and asked for stakeholder comments. We also asked people experienced with these principles to assess their effectiveness in tackling policy issues. Based on the comments we received, the Consumer Advisory Group refocused and simplified these concepts into three high-level public policy principles, which the Task Force has adopted as part of its recommendations.

In so doing, we fulfilled the first task that was given us in our mandate, which was to "identify public policy objectives to be pursued in the operation and regulation of the payments system." We also provide the basis for the principles-based governance model that is a key part of our recommendations for the future of the payments industry.

When faced with complex and difficult issues, decision-makers should strive to take into account all relevant aspects and balance diverse interests. Ultimately, there must be trade-offs (or the decisions would be easy), but a sound and transparent policy framework allows both decision-makers and other stakeholders to engage each other and to better understand, and ultimately accept, the choices that need to be made. In proposing principles and objectives for the payments system, we are seeking to provide guidance to help ensure that the public interest is well served.

Principles and objectives for a new payments system

The Consumer Advisory Group recommended three simple principles that the Task Force believes are fundamental to any successful payments system:

a) Participants must **trust** it.

b) Participants must be able to use it, in other words, **access** it.

c) The system must provide **good value**.

The Task Force believes that these core principles, and the objectives they lead to, should be at the heart of the governance model and therefore of the entire payments system. They are the starting point for more detailed objectives that will need to be developed.

a) Trust

Objective: The payments system must generate and maintain a high level of trust among participants.

A payments system and its various components must be stable and safe. It is a prime concern for all users that their money be protected, and this is also something that providers actively care about, because they share financial and reputational risk with each other. However, prudential requirements should not be so stringent that they stifle competition and innovation: they must be proportionate to risk. Similar concerns apply to issues related to operational robustness, reliability, security and privacy.

People find it easier to trust in something that they understand, that allocates the risk of loss fairly and that they believe is reasonably priced. As we have seen, the current regulatory framework of payments in Canada is *not* something that most people can easily understand, nor is it deemed fair by all. It needs to be strengthened, broadened, simplified and made more flexible and more transparent. It needs to provide more certainty and fairness to users, new entrants and incumbents alike. And the costs need to be reasonable. Drafting this new framework goes beyond the Task Force's remit and resources; however, the basic structure proposed in *Policy Paper B* and developed in *Policy Paper C* will provide a good starting point.[34]

A modernized regulatory framework will need to be effective and truly enforceable. If it is not, it will erode trust rather than foster it. Should someone engage in a practice that goes against the framework, aggrieved parties must have easy access to meaningful redress; in order to prevent such behaviours, there must be appropriate oversight.

Trust is associated with a perception of legitimacy, which in turn is often related to the ability of all stakeholders to be heard; hence, the relationship between trust and the governance model that we propose. Implementing a new approach that enables all stakeholders to work together to improve the payments system will require openness and frank dialogue. It will mean focusing on the common good more than on immediate self-interest. Success will depend on stakeholders' willingness to treat each other as equals in the discussion and sometimes, in the bargaining. For that to happen, means will have to be implemented to allow all to participate fully.

b) Access

Objective: The payments system must be easily accessible to all users and supportive of a reasonable expectation that they can choose among adequate payment mechanisms.

It is easy to forget that, even today, millions of Canadians do not have proper access to an adequate range of payment mechanisms. As we go digital, we need to ensure that no one is left behind. Consumer organizations have exceptional expertise with such accessibility issues and can make an important contribution to addressing them throughout the reform process.

Affordability will increasingly be an issue, as there is a price to pay for using many electronic payment mechanisms, whereas cash is free to users. This is problematic for low-income individuals but, in a somewhat different way, affordability is also a concern not only for small and medium enterprises but also, sometimes, for larger ones.

Many services are not available everywhere in Canada. As payments increasingly go mobile or online, the obstacle to digital payments created by gaps in high-speed, high-quality network coverage will matter more and more. The price of our telecommunications services is also an impediment to the development of digital payments that is of great concern to the Task Force.

Canadians' skills and abilities are uneven. Many adult Canadians lack the literacy skills to deal with complex documents. In the age of digital payments, they will continue to be vulnerable. We are also mindful of the disabilities that affect millions of Canadians, who often find it difficult to use payment mechanisms that do not provide effective accommodation.

One requirement for access to new digital payments services is that users be aware of them and understand their value and how to use them. As we recommended in *Going Digital*, governments and providers need to become more vocal about the benefits of digital solutions for all user groups.

Governments must deliver an education campaign, providing information, raising awareness and dispelling myths, about the benefits of electronic invoicing and payments for consumers, SMEs, large corporations and even other levels of government. Marketing and communications experts would work with stakeholders to identify the concerns of Canadian users, emphasizing the reliability, security, convenience and cost savings for everyone, including consumers.

Access is not just a consumer issue. For businesses and government, standards are critical to reduce uncertainty, both domestically and globally, regarding the interoperability of payment and information transmission. For new entrants, the ability to participate in payment networks on reasonable terms is similarly a question of access.

c) Good value

Objective: The payments system must provide good value for its users.

Everyone wants services that are both better and cheaper. In the payments area, services must not only be cost-effective, but they must benefit all Canadians. In other words, services must offer good value to users.

A payments system that offers good value is above all safe, efficient, accessible and open to innovation. Such a system can best be achieved through reliance on the market forces of competition and open entry wherever possible. Government actions with respect to the payments industry should be taken only in response to demonstrable market failure. It became clear to the Task Force that existing barriers to the entry of new service providers are limiting competition and therefore efficiency and innovation. There is, however, a risk that steps to increase competition could have the perverse effect of distorting the situation in a way that actually reduces efficiency. Resolving this problem will require cooperation, good governance and oversight to protect the public interest. That is why the objective must be to provide good value for users, not simply to enhance competition.

Other actions that will ultimately contribute to good value include streamlining the regulatory framework (see *Policy Paper B*). Transparent and objective minimum standards for system members are needed to sustain trust, but they must allow innovators and new entrants to participate on competitive terms consistent with those standards. Interoperability, both nationally and internationally, is also essential for the system to deliver good value.

Conclusion

Fostering trust, ensuring accessibility and providing good value through improved competition and innovation will not be easy. The challenges that implementing these principles will pose for the providers and potential providers of the Canadian payments system must be underestimated.

None of the principles stands alone. None is absolute: they must be balanced with each other, assessed together in relation to the common good and tested against reality. The Task Force does not expect every detail of the immense payments ecosystem to be at all times fully compliant with all the various implications of the principles. The principles are provided as guidance for the system as a whole and for the regulators who will need to maintain a clear overview of the evolution of the system. Some possible implications of these basic principles are outlined in Annex A1, and their implementation in legislation is explored further in *Policy Paper C*.

In the other papers in this collection, we explore how the principles and objectives set out here should be embodied in the new Canadian payments system that will evolve in the years ahead.

In *Policy Paper B*, we set out a model to ensure that all stakeholders, both users and providers, have an ongoing place in the great collaborative effort of building and maintaining the new system to serve the objectives identified here. We also propose an oversight mechanism to ensure that they meet their responsibilities in this regard.

In *Policy Paper C*, we outline the legislative and regulatory measures that will be needed to implement the governance model and to pursue the objectives.

Policy Paper D focuses on the key clearing and settlement systems that need to be transformed, as well as on the more traditional cheque and credit/debit card networks. Again, the discussion comes back to the three fundamental principles set out here to reflect user needs.

These principles are critical, not only as a starting point, but as a guide at every point along the way. By articulating these principles, the Task Force hopes to provide a reference point for all further developments in the reform of the payments system.

Annex A1: Proposed National Payments Policy

The following proposed National Payments Policy, developed by the Consumer Advisory Group, illustrates how the three simple principles recommended by the Task Force as fundamental drivers of reform might be transformed into more specific objectives for the Canadian payments system.

The Task Force is of the view that establishing the principles and setting out their implications in the form of objectives is crucial to providing direction for all who are involved in governing the payments system, developing new payments mechanisms, providing payment services or making and receiving payments. The proposed National Payments Policy embodies core values that the Consumer Advisory Group believes are crucial to the ongoing evolution and success of the payments ecosystem.

A National Payments Policy such as the one proposed by the Consumer Advisory Group cannot answer all specific questions that may arise, and it is not intended to. Its aim is to provide guidance to decision-makers, who will face a great range of challenges. Therefore, the Policy establishes broad principles and proposes objectives derived from them, rather than seeking to lay out detailed rules.

A note on the Form of the Policy

In presenting the proposed National Payments Policy, the Consumer Advisory Group deliberately sought to emulate the form of national policies already established by Parliament in other fields. The Task Force hopes that this will assist policy-makers in adapting these ideas to a new governance model for the Canadian payments system.

The introductory paragraph to the Policy establishes the overarching motivation for creating a set of objectives governing the Canadian payments system. Because this system is vital to our economy and society, it should evolve in ways that are most beneficial for Canada as a whole, a result that can be achieved only if it is efficient. In effect, the paragraph sets out the overall strategic objective: **Furthering growth, wealth and welfare through an efficient payments system.**

In order to achieve that strategic objective, more specific operational objectives are needed, and these are detailed in the following paragraphs.

The National Payments Policy and its specific objectives apply to the payments system as a whole. The Policy does not imply that each and every component of the system should always be perfectly compliant with all of the overall requirements, but rather that the system as a whole be consistent with these objectives.

The National Payments Policy targets "participants." We define this term as including not only end-users—consumers, businesses and governments—but also payments services providers and intermediaries. In short, the Policy is aimed at everyone in Canada who is involved in making, receiving or processing payments.

Proposed National Payments Policy

The payments system performs an essential role in the Canadian economy and society. In order to optimize the total economic and social welfare of all its participants, ensure its efficiency and guide its evolution and development, the Canadian payments system shall be governed by the following objectives:

Trust

(a) Generate and maintain a high level of trust among participants by being demonstrably:

(i) Financially stable and safe with regard to the level of risk created or incurred by participants;

(ii) Fair, reasonable and proportionate in the assignment of costs, benefits, rights and responsibilities among all participants, taking into account all relevant factors, including the level of risk involved and the ability of participants to prevent and bear risk and costs;

(iii) Operationally robust and able to process payments in a timely and accurate manner;

(iv) Secure and able to protect the integrity and privacy of information;

(v) Supported by easily accessible and understandable rules governing its use, the prices charged to participants and the information provided thereto;

(vi) Held in compliance with appropriate regulatory oversight by public agencies and authorized self-governance organizations;

(vii) Supported by easily understandable, impartial and accessible systems of redress that are responsive and efficient and that include independent appeal processes; and

(viii) Governed in a way that provides all categories of participants with a reasonable opportunity to provide input into its governance, development and use.

Accessibility

(b) Be easily accessible to all participants who use payment mechanisms and supportive of a reasonable expectation that they can choose among adequate payment mechanisms by ensuring:

(i) The provision of effective and efficient services throughout Canada;

(ii) The delivery of adequate and affordable services that are available independently of participants' socio-economic and demographic circumstances or commercial significance; and

(iii) The provision of services that are easy to use and that accommodate participants of all skills and abilities.

Good value

(c) Provide good value by:

(i) Operating in a way that delivers the most efficient costs to participants, consistent with the objectives of the National Payments Policy;

(ii) Establishing an efficient and consistent regulatory framework that applies to all participants and is founded on functional neutrality;

(iii) Facilitating competition among a wide variety of providers and services, including through the elimination of unnecessary barriers; and

(iv) Promoting interoperability, both at the national and international levels.

These objectives apply as reasonably appropriate to the different participants in the Canadian payments system, with due regard for the diversity of their circumstances.

Notes

[1] *The Problem With Adoption: An Overview of Some Critical Factors Concerning Payment Mechanisms and User Adoption in Canada*, Paper presented to the Task Force for the Payments System Review, Jacques St. Amant, February 22, 2011.

[2] Deloitte. *Canadian Payments Landscape*. Prepared for the Task Force for the Payments System Review. September 2010, page 21.

[3] For a more detailed overview of these issues, see St. Amant, J. *The Problem With Adoption: An Overview of Some Critical Factors Concerning Payment Mechanisms and User Adoption in Canada*, February 2011. Paper presented to the Task Force for the Payments System Review.

[4] An innovation can be both highly complex and highly successful, as long as the interface is intuitive. From the user's perspective, it is usually the simplicity of the interaction that counts.

[5] For an analysis of issues surrounding switching costs, see, among others, Dubé, Jean-Pierre; Hitsch, Günter; Rossi, Peter. "Do Switching Costs Make Markets Less Competitive?" (2009) XLVI *Journal of Marketing Research* 435-445; Shy, Oz. *A Short Survey of Network Economics*. Working Papers No. 10-3. Boston, Federal Reserve Bank of Boston, March 2010. http://www.bostonfed.org/economic/wp/wp2010/wp1003.pdf

For an example of a regulator's non-legislative action to attenuate problems associated with switching costs, see Office of Fair Trading. *Personal Current Accounts in the UK—Progress Update*. London, Office of Fair Trading, September 2010. http://www.oft.gov.uk/shared_oft/reports/financial_products/OFT1275.pdf

[6] Public Interest Advocacy Centre. *All Along the Watchtower: Seeking the Future of Canada's Payments System*. September 2010. http://paymentsystemreview.ca/wp-content/uploads/PIAC-Sept15-various2.doc

[7] Statistics Canada. *Assets and Debts Held By Family Units, Median Amounts, By Net Worth Quintile (Lowest Net Worth Quintile)*. http://www40.statcan.gc.ca/l01/cst01/famil116b-eng.htm

[8] Études marché Créatec +. *General Survey on Consumers' Awareness, Attitudes and Behaviour—Executive Summary*. Ottawa, Financial Consumer Agency of Canada, December 2006. http://www.fcac--acfc.gc.ca/eng/resources/PDFs/FCAC_GenSurvExec_2006-eng.pdf

[9] While Parliament and the Canadian government have been proactive in this area over the last decade, by requiring banks to open accounts in most situations, other financial institutions are not bound by similar legal obligations, and there are hundreds of communities in Canada where there is no bank branch.

[10] Canadian Payroll Association. *2011 National Payroll Week Employee Survey*. July 2011. Question 10.

[11] Canadian Radio-television and Telecommunications Commission. *Communications Monitoring Report*. Ottawa, July 2011, pages 137 and 145.
http://www.crtc.gc.ca/eng/publications/reports/policymonitoring/2011/cmr2011.pdf

[12] Ibid., page 165.

[13] Ibid., pages 168 and 170.

[14] Ibid., page 117.

[15] Canadian Radio-television and Telecommunications Commission. *Navigating Convergence II: Charting Canadian Communications Change and Regulatory Implications*. Ottawa, 2011.
http://www.crtc.gc.ca/eng/publications/reports/rp1108.pdf

[16] Recent experience in the United Kingdom with the proposed abolition of the cheque-clearing system is instructive in this regard. The Payments Council announced in December 2009 its decision to close the central cheque-clearing system, provided that effective alternatives could be implemented in time. The Council's own consultations and parliamentary opposition led it to reverse its decision in July 2011. Without the 2009

announcement and following consultations, the Council and industry might well have been faced with the same opposition in 2017 or 2018 and forced to step back.

[17] This is the case in Quebec against American Express Bank, as well as against Bell Canada and Bell Mobility. In the latter case, a settlement was approved by the court in 2010 under which the two companies indicated they had spent more than $2 million to upgrade their systems and compensated aggrieved consumers for over $700,000: *Boulerice* v. *Bell Canada*, 2010 QCCS 2922.

[18] Environics Canada / Option consommateurs on behalf of the Canadian Consumer Initiative. *Preauthorized Debits*. March 2006. http://www.consommateur.qc.ca/union-des-consommateurs/docu/budget/DPAsurvey.pdf

[19] Van Wageningen, Ellen. "Prearranged transactions require some scrutiny." *The Windsor Star*, November 7, 2011. Consulted at www.windsorstar.com/story_print.html?id=5667495&sponsor=true.

[20] In addition to automated banking machine fees, consumers often pay for a capped number of transactions in their monthly banking package, with additional transactions charged to their account. A number of credit cards come with annual fees. Prepaid cards often have fees attached to their use, in addition to expiration dates (where legislation permits) and other requirements that entail a cost to consumers. Prepaid cards also raise concerns about fund protection should the card issuer fail, since they are generally not insured deposits under applicable legislation.

[21] The Retail Council of Canada made a similar comment in its 2010 submission.

[22] Submissions made to the Task Force in 2010 by Neil Squire Society and the Canadian National Institute for the Blind.

[23] The federal Minister of Finance tabled draft regulations to address this problem in March 2011. At the time this report was finalized, the regulations had not yet come into force. Moreover, it would not impact similar practices by non–federally regulated deposit-taking financial institutions.

[24] See http://www.visa.ca/en/personal/securewithvisa/liability.jsp, November 15, 2011.

[25] Canadian Federation of Independent Business. *Changing the Way We Pay: Getting the Transition Right for SMEs*. Toronto, October 2011. http://www.cfib-fcei.ca/cfib-documents/rr3239.pdf

[26] Cardholder liability is capped by consumer protection legislation in the case of an unauthorized credit card transaction but usually not in other cases, as noted above. Consumers, however, may not always be aware of the finer regulatory distinctions. Legislative chargeback protection is also mostly limited to purchases made with a credit card. In addition, loyalty programs provide what is essentially a negative price for cardholders through rewards and rebates.

[27] At issue here is not primarily whether those requirements, notably those related to data security, are legitimate: it is the inflexibility and lack of adequate notice with which they are imposed that is seen as most problematic.

[28] A new network has a hard time convincing consumers to use its products, since few retailers accept them, and just as hard a time convincing retailers to offer its products, since few consumers require them. Until critical mass is attained, a new network is therefore highly fragile—and getting critical mass in the payments market, where a high level of trust in the provider is required and where incumbents already saturate the field, is a challenging proposition.

[29] As well, potentially, are liability issues. What if a consumer pays with a mobile wallet, the default function of which is "credit" rather than "debit" (unless the consumer changes it), resulting in higher interchange fees? Will a mobile transaction be deemed equivalent to a card-present or card-not-present transaction for fee and liability allocation purposes? The list of concerns is endless.

[30] We are considering most not-for-profit organizations as being within the general category of SMEs.

[31] Direct deposit is a case in point, because the recipient needs to have, and be willing to use, an account with a financial institution in order to accept the payment. It is estimated that 4% to 5% of adult Canadians—roughly one million citizens—do not have such an account, often for reasons over which they have no control. Another

segment of consumers—perhaps as large as 5%—prefer, in some cases at least, to use the services of providers other than financial institutions to cash cheques or receive payments, even though many of them do hold an account with a financial institution.

[32]Hayden, Rob; Lal, Akash; Ledford, Steve; Nunn, Charlie. "Payments Hubs: Redefining the Industry's Infrastructure." In *McKinsey on Payments*. McKinsey & Company. June 2010, page 1. http://www.mckinsey.com/clientservice/Financial_Services/Knowledge_Highlights/Recent_Reports/~/media/Reports/Financial_Services/MoP8_Payments_hubs.ashx

[33]In Canada, as in Australia, reconfiguring payment network architectures may also have competitive aspects. In both countries, the requirement that a new participant in a network such as the Canadian Payments Association's establish bilateral links with all others imposes a significant burden on the newcomer, but also on all incumbents, especially if the number of new entrants is significant. For Australia, see in particular Payments System Board, *Annual Report (2010),* Reserve Bank of Australia. http://www.rba.gov.au/publications/annual-reports/psb/2010/pdf/2010-psb-ann-report.pdf

See also Reserve Bank of Australia, *Strategic Review of Innovation in the Payments System: Issues for Consultation*. June 2011. http://www.rba.gov.au/publications/consultations/201106-strategic-review-innovation/pdf/201106-strategic-review-innovation-issues.pdf.

[34] Where new regulation, in the traditional sense, may be needed, we suggest that federal, provincial and territorial authorities examine the possibility of implementing harmonized legislation, after consultations with the governance bodies we describe in *Policy Paper B*.