CONSUMER CREDIT: AN OVERVIEW

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January 1994

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INTRODUCTION

Credit can be defined as "the advance of goods, services or funds in exchange for a promise to pay at some future date". Consumer credit differs from other forms of credit in that it is used only for consumption and not as a means of increasing the wealth of the borrower.

Advantages and Disadvantages of Consumer Credit

Consumer credit has increased standards of living and improved quality of life by allowing consumers to buy goods and services earlier than they otherwise would. This is especially valuable to those in the early years of the family life cycle when consumption needs tend to be high and incomes low, and to those facing unforeseen, short term emergencies such as illness or large repair bills. Credit cards offer convenience by reducing the amounts of cash consumers need to carry, diminishing cash loss due to carelessness or theft, and lessening the inconvenience of running out of cash.

The disadvantages of consumer credit are that it anticipates continuing income to pay for past purchases, and that consumers incur interest charges and lose interest on foregone savings. The disadvantages can be critical for consumers with poor financial management skills and for those whose lives are disrupted by, for example, extended unemployment or family breakdown. In such situations debt problems can lead eventually to bankruptcy.

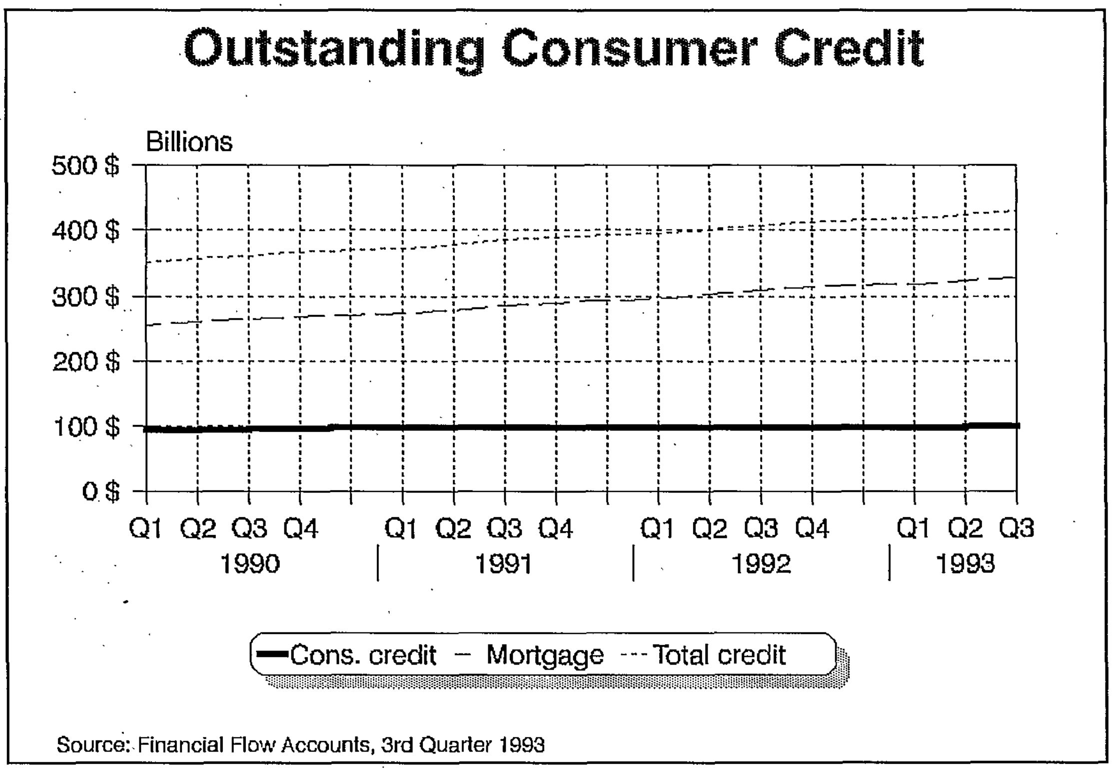
Consumer credit problems are also clearly linked to rapid economic change. Fast-rising interest rates in the late 70s and early 80s caused many consumers to lose their homes in the face of suddenly unmanageable mortgage debt, and the recent recession saw consumer bankruptcies rise to the record level of 61,000 in 1992. During the recession, media, consumer advocates and others were quick to publicize the plight of indebted consumers and to call on governments to remedy consumers' credit problems. For example, in 1992 the Standing Committee on Consumer and Corporate Affairs and Government Operations focused its attention on credit card interest rates for the third time in six years.

Extending credit is profitable to credit grantors as long as lending rates provide returns which exceed the cost of funds and administrative expenses. This may not be the case when loans are made to risky borrowers. Under these circumstances, the cost of collections and defaults tend to reduce returns, and ultimately, to increase the costs of, and decrease access to, credit for other consumers.

Computer technology has enabled credit grantors to assess would-be borrowers' credit worthiness faster, more cheaply and more reliably; and to offer new forms of credit and to make it more widely and readily available. It has also given rise to concerns about consumer privacy and security of funds.

Significance to the Canadian Economy

The dollar value of consumer credit rose from approximately $47 billion to $100 billion between 1983 and 1993. This growth persisted, though at a reduced rate, into the recession, paused in 1992 and began again at a slow rate in 1993. Mortgage debt, which presently accounts for approximately 76% of total household debt, continued to grow throughout the recession. In the third quarter of 1993, growth in consumer borrowing resulted in a debt-to-income ratio of 86.7%. [See chart below].



The ratio of household debt to GDP was 60% in the third quarter of 1993. Consumer credit increased slightly in the third quarter from $100 billion to a total of $100.8 billion, and mortgage debt grew to $327.2 billion from $323.2 billion in the previous quarter, for a total of $428 billion in household credit (consumer and mortgage debt). The shifts in debt carried by households provide economists with a measure of the changes within and health of, the economy. While the amount of household credit seems immense, the bulk of it is a debt toward a financial asset or a means of future income.

To put household debt in perspective, consumers' asset accumulation has also been strong over the last ten years, mostly due to increasing real estate values in the latter part of the 1980s. Liquidity, or assets that can be readily converted to cash, has been high since 1987.

Scope of the Paper

The major role of consumer credit in the Canadian economy suggests the importance of a clear understanding of the consumer issues involved, particularly in view of rapidly changing conditions in the financial services industry. This paper:

- provides an historical perspective on the use and regulation of credit;
- reviews the role of credit in modern society;
- analyzes contemporary influences and issues.

BACKGROUND

Historical Perspective on Credit in Europe and Canada

The concept of credit predates money economies and banking systems. In barter economies farmers procured seed from merchants with the promise of payment following harvest. Loans were made based on trust, personal relationships, and on presumed honesty and ability repay.

Credit use expanded when currency eclipsed barter because adequate quantities of coin were not always available. The practice of extending credit enabled local economies to function in the absence of a sufficient money supply, and appears to have been the foundation for the modern use of credit. Scarcity of coin, still prevalent in eighteenth century Europe, resulted in the evolution of an intricate credit network, linking regional networks to one another and to capital markets.

While credit played an important role in commerce, shortage of coin also affected consumers. When currency was too scarce to pay wages, employers would deposit payments with local tradesmen, who then extended credit to the employees. However dependence on credit in the face of currency shortages made economic conditions volatile and, in times of economic crisis, liquidity problems caused considerable hardship.

There are few accounts of the early evolution of consumer credit in Canada. In the early days of the New World, coinage shipped from England and France was scarce and transactions were primarily effected by barter. In New France, the medium of exchange for day-to-day transactions was, at different times, beaver skins, wheat and playing cards. Early in the eighteenth century, promissory notes were introduced, payable in card money or bills of exchange drawn on the French treasury. With the cession of Canada to Britain in 1763, the standard of value became equally scarce sterling and merchants issued promissory notes redeemable either in their own goods or in coinage.

Modern consumer credit, involving deferred payment for durable goods, appeared in Canada in the early 1800s, when furniture companies began to sell home furnishings on an instalment basis. The range of goods available on instalment credit expanded slowly to include sewing machines and pianos by the end of the century, and automobiles in the early 1900s. Early in the twentieth century many retailers began to offer instalment, or some other form of credit, to their customers.

Lending laws have evolved in reflection of contemporary philosophical, religious, and economic values. Ancient Greece frowned on all interest-taking and Rome restricted its use to business loans. In the Middle Ages, lending and interest-taking were prohibited by the Roman Catholic church, relegating moneylending to those outside the Christian faith. In the sixteenth century, fixed interest rates replaced the prohibition on interest-taking, and usury laws were repealed entirely in the mid-nineteenth century, only to be reintroduced by the turn of the twentieth century. Canada retained statutory interest rate ceilings for banks until the late 1960s.

Credit in Modern Canadian Society

Changing Consumer Behaviour

The twentieth century has seen a gradual replacement of the sixteenth century value system which encouraged people to "work hard, save and accumulate, forego present goods, and plough resources into new investment". Credit has become a convenient way to buy now and pay later, initially for consumer durables, and more recently for nondurable goods and a variety of services.

Consumer credit use expanded markedly following the Second World War as a result of changing consumer attitudes, an increase in personal disposable income, an increase in demand for household goods linked to the post-war baby boom, and an increase in the number of credit grantors and credit instruments. The establishment of social security safety nets, which lessened the risks and hardship involved in accumulating debt witnessed during the depression, may also have contributed to consumers' willingness to use credit.

North Americans subsequently adopted an increasingly consumption-oriented ethic facilitated by innovations in the automobile industry, the mass production of various goods, and two decades of stability and prosperity which followed the end of the Korean War. During these years, consumers typically used instalment credit to purchase durable goods, though some department stores also provided charge accounts to their best customers. During the 1970s high inflation rates acted as an inducement for increased use of credit, with low real interest rates allowing borrowers to pay devaluing debts with relative ease.

Developments in Credit Grantor Behaviour

Paralleling changing consumer attitudes, lenders substantially changed their approaches to credit during the course of the twentieth century. In the early part of the century, sales finance companies were established to meet consumers' need for automobile credit. Small loan companies, caisses populaires, and credit unions also began to supply consumer credit at that time. Oil company credit cards began to appear after 1946.

While a few banks supplied small loans during the postwar period, chartered banks did not enter the consumer credit market aggressively until 1958. Banks overtook sales finance companies as a source of consumer credit in 1969 as consumers moved away from point-of-sale to cash borrowing. By 1991, financial institutions supplied approximately 85% of credit to consumers.

All credit grantors promoted consumer credit heavily in the

1960s and 1970s. Credit terms were eased and new credit instruments introduced. The first credit card, Chargex (later known as Visa), was introduced in Canada in 1968 by the Toronto Dominion Bank. Master Charge (later to become MasterCard) arrived in Canada in 1973. The appearance of the credit cards coincided with the most notable increase in the use of consumer credit, particularly from the late-1970s to mid-1980s.

Credit cards have provided easier access to credit and more flexible payment terms, allowing consumers to buy many items from different sources without the need to request a loan for each purchase. Their potential disadvantages include: a tendency to increase both the number of purchases consumers make and the amounts spent on each purchase; and interest rates which have tended to be considerably higher than those for other types of loan.

Recent Developments in the Canadian Credit Card Marketplace--From Sticky Interest Rates to Card "Wars"

Historically there has been a marked spread between credit and charge card interest rates and the bank rate. For example, between 1987 and 1992, Visa and Mastercard rates varied between 6% and 10% or more above bank rate, while retail credit card rates have remained fixed at 28.8% for many years.

A number of factors have acted to slow growth in the number of credit card accounts and have induced considerable change in the credit card industry. Two recessions in ten years, slow wage growth, and high unemployment have exacerbated Canadians' debt problems. In the face of slow recovery from the most recent recession and persistent high unemployment as Canada struggles to compete in the global marketplace, consumers have been cutting down on some forms of spending and attempting to pay down debt. A spring 1993 Goldfarb survey indicated that the average Canadian holds no more credit cards now than was the case ten years ago.

Faced with apparent market saturation, public criticism of high interest rates and critical attention from parliamentary committees on three occasions since 1987, financial institutions have adopted new strategies to increase the attractiveness of their credit cards.

Some financial institutions have lowered interest rates, or have introduced low rate cards for customers who normally do not pay off their balances each month. Such cards have interest rates as low as 3% to 4% above prime but higher service charges. Others have opted for "bells and whistles" such as credits toward automobile purchases, mortgage downpayments on first homes, or the accumulation of air miles. In August 1993, the Toronto Dominion and the CIBC announced they had attracted close to 400,000 customers in the first few months for their G.M. and Ford credit cards.

Some retailers have also changed tactics in order to hold on to and increase market share in the face of a harsh recession, and fierce competition from U.S. retailers who have entered the Canadian market. In an effort to remain competitive in a rapidly changing marketplace, some retailers are aggressively seeking new credit card accounts.

Technological Developments: The Future of Credit

Access to money and the types of credit instruments available to consumers are becoming increasingly sophisticated and varied. Consumers can take out personal loans, obtain lines of credit, and have innumerable credit card products from which to choose. Card issuers will provide personal identification numbers (PINs) with credit cards so that they may be used at automatic teller machines to obtain cash credit advances. Some financial institutions offer combined credit and debit cards for use at point of sale.

The majority of changes in the areas of banking and credit have been driven by advances in data processing and telecommunications technology, and many have been put in place in an effort to secure credit cards from fraud. These changes have facilitated quick, easy access to credit across Canada and internationally, in part because they have led to improvements in credit screening and rating systems.

Credit bureaux maintain data bases containing information on the credit record of the millions of North Americans who apply for credit each year. Through credit bureaux, credit grantors are able to obtain on-line access, on a fee per enquiry basis, to the credit files of these individuals. Computerisation and on-line access to credit files has reduced the time taken to process a credit application, increased the amount of information on file, and substantially reduced the cost per enquiry. Current software also enables credit bureaux to perform more sophisticated analyses of the information on file, including individual risk assessment. These capabilities reduce the risk of credit delinquency and fraud, making credit more easily accessible and less costly for the majority of consumers. However they also raise concerns about privacy, particularly as the majority of consumers are ill-informed about credit screening systems.

More and more financial institutions are offering customers telephone access to their personal bank accounts. Services available through an ATM, other than deposits and cash withdrawals, could be transacted over the telephone. As an extension to home banking, Visa International and a computer company are developing a software package that would enable credit card holders to access their personal credit accounts using a personal computer and telephone link. The software enables consumers to access information on the state of their credit card accounts as well as provide information on their shopping and budgeting habits.

Future credit cards may be "smart" cards, containing a computer chip memory and providing consumers with increased security and versatility. Added security would derive from identifying information in the microchip which would make a stolen card difficult to copy or use. Versatility could be enhanced by "charging up" the card with a deposit from a bank branch, or ATM, and "emptying" it as subsequent payments reduce the balance in its memory.

While smart card technology is becoming widely used in Europe and Japan, adoption of smart cards in North America has been considerably slower. The North American credit card industry has invested heavily in equipment designed to work with current magnetic stripe technology and adoption of smart credit cards is therefore likely to be slow while current technology continues to serve both industry and consumers relatively well.

CREDIT AND THE LAW IN CANADA

Present federal and provincial statutes governing credit granting have essentially codified and modified prior common law principles to deal with changing business practices and marketplace conditions.

Interest Rate Laws in Canada

It is worth noting that comparatively low interest rate ceilings on credit existed in Canada from the late eighteenth century and were only abolished for banks in 1967. Because of constitutional division of powers, laws applying to banks and other lenders have developed separately.

Quebec enacted legislation in 1777 fixing the interest rate at 6 percent. Similarly, an 1811 act of Upper Canada and the bank charters that started to appear in 1821 included a 6 percent ceiling on interest rates. Subsequently, attempts were made to have the legislation revised as the system was easily evaded, difficult to enforce, and stifled free demand and supply. By 1858, the 6 percent interest rate ceiling was removed for all lending institutions except financial institutions, whose rate ceiling was increased to 7 percent.

In 1906, the *Money Lenders Act* was instituted, setting a 12 percent interest rate ceiling on loans under $500. This law proved to be ineffective because the term "interest" was not adequately defined and no government department was given responsibility for enforcing the Act. This Act was repealed in 1956. The deficiencies of the *Money Lenders Act* led to the enactment of the 1939 *Small Loans Act*, which regulated the total cost of borrowing, was administered by the Department of Insurance and required that all money lenders, excluding chartered banks and registered pawnbrokers, be licensed. This Act was found to have many shortcomings, including the exclusion of chartered banks from the provisions of the Act, leading to the repeal of the Act on a section-by-section basis. To this date, however, the Act has not been completely repealed.

Following division of federal and provincial powers at Confederation, the chartered banks were regulated by the federal government through the *Bank Act*, and in 1871, the 7 percent interest rate ceiling was incorporated into the Bank Act. However, the Act contained no effective provisions to exact penalties against banks that did not comply with the interest rate ceiling. This omission was corrected in the 1934 amendment to the Act. The interest rate ceiling was reduced to 6 percent in 1944. However, by the end of 1967, the rate ceiling was removed, and in its place banks were required to disclose the borrowing costs in percent per annum terms to borrowers. Since then, the remaining restrictions on interest rate levels are the 60 percent usury limit set by the *Criminal Code*, and the five percent default rate set by the *Interest Act* in the event that a lender fails to disclose an annual (or semi-annual in the case of mortgages) interest rate. By the late 1970s, it was determined that full disclosure of credit cost features would be more beneficial to consumers than further restricting the lending industry. Thus in 1981, the *Bank Act* was amended to include clauses related to truth in lending.

Federal/Provincial Jurisdiction Over Consumer Credit

Under section 91 of the Constitution Act, banking (s. 91(15)), bills of exchange and promissory notes (s.91(18)), interest (s. 91(19)), and bankruptcy and insolvency (s.91(21)) fall under federal jurisdiction, while property and civil rights (contractual obligations) (s. 92(13)), and matters of a local or private nature, fall under provincial jurisdiction. Thus, while chartered banks and some trust and loan companies are federally-regulated, credit unions, caisses populaires, provincially-incorporated trust and loan companies, retailers and any other moneylending institutions are regulated by provincial statutes.

Current federal laws that deal with consumer credit protection include the *Bank Act*, the *Bills of Exchange Act*, the *Criminal Code*, the *Interest Act* and more recently include the *Trust and Loan Companies Act* and the *Insurance Companies Act*.

The provinces have enacted consumer credit legislation that deals primarily with the disclosure of credit costs, false or misleading advertising, sale of goods and creditor's remedies. While provincial statutes are generally similar in scope and intent, their detailed provisions are not harmonized.

Conflicts between federal and provincial jurisdictions have focused on the costs of borrowing, especially where regulation of interest charges was concerned. Exclusive federal jurisdiction in the regulation of interest charges has been subject to challenge, because provinces are able to legislate in certain areas of consumer credit financing. For example, in 1963 the Supreme Court of Canada was required to rule in the *Barfried* case, whether the province of Ontario had the constitutional authority to regulate the cost of a loan under its *Unconscionable Relief Act*, because the cost of a loan included interest. The Act was upheld on the grounds that "the regulation of contract was the predominant aspect of the act" and that the interest made up a part of the entire cost of the loan.

The question of harmonizing federal and provincial requirements in this area has been discussed intermittently for many years. The latest initiative, currently under review by federal and provincial consumer deputy ministers, is led by the Uniform Law Conference of Canada and involves harmonization of disclosure requirements for credit costs. The topic is also under discussion in the negotiations relating to removal of internal trade barriers, which are scheduled for completion in June 1994.

An unsuccessful attempt to overcome jurisdictional conflicts in the area of credit was made in 1976, with the introduction of the *Borrowers and Depositors Protection Act* (BDPA). The BDPA responded to the absence of federal legislation in the credit field, which hampered provinces' efforts to regulate credit grantors falling under their jurisdiction. The problem was that provincially-regulated credit grantors might suffer a competitive disadvantage if bound by rules not affecting their federally-regulated counterparts. The BDPA would have superseded the *Small Loans Act* and the *Interest Act*, and have addressed uniform truth in lending. However, the Act was criticized mainly for its encroachment on provincial jurisdiction and died on the Order Paper.

CURRENT CONSUMER ISSUES

Current consumer credit issues include questions of:

- access and debt problems;
- credit screening and monitoring practices;
- privacy;
- interest rates;
- costs, including disclosure of credit costs and harmonization of related regulations; and
- refinement of consumer information and education techniques.

These are discussed in order below:

Access to Credit and Consumer Debt Problems

The large number of personal bankruptcies and other consumer debt problems during the recent recession have given rise to suggestions that consumer credit (especially credit cards) is too easily available. Media attention has focused on cases of bankrupt consumers possessing a large number of cards, while credit grantors suggest such cases occur only when cards are obtained fraudulently.

There is evidence that some people who declare personal bankruptcy hold more than the average number of credit cards. However the links between credit card use and bankruptcy are complex and difficult to define. In some cases, the ready availability of credit may tempt consumers to live beyond their means. In others, credit cards may act to postpone bankruptcy. Severely indebted consumers will be tempted to use their credit cards to the limit in the hope that they can avoid bankruptcy by borrowing until other circumstances improve.

Published figures on the numbers of credit cards in circulation and on levels of consumer indebtedness must also be interpreted carefully. Data on credit card use suggest that, while the total number of credit cards in circulation and the variety of cards available has increased in the last decade, there has been no significant increase in the number of cards held by the average Canadian. Rising credit card numbers have apparently been roughly in step with increases in the adult population. Moreover, while the total amount of consumer credit has increased markedly in the last ten years, the growth has been balanced by increases in personal assets. In fact in 1992, the ratio of net wealth to disposable income posted a twenty-year high.

The then Minister of Consumer and Corporate Affairs, Pierre Vincent wrote to provincial consumer ministers and credit grantors in April 1993, expressing concern about current personal bankruptcy levels and ease of access to credit. Responses from both groups suggested consumer information and education as the appropriate mechanisms for dealing with the debt problems.

Credit grantors note that they are not in business to lose money by making bad loans and that credit screening procedures have been tightened considerably in recent years. Networked computer data bases have made more comprehensive and current data on consumers' credit worthiness available to credit grantors faster, and more cheaply than ever before. Acceptance rates for credit applicants vary among institutions between a low of 40% for banks and a high of 79% for others. However there are no comparative data on acceptance and default rates. Acceptance rates are apparently highest among credit unions, one of whose purposes is to make credit available at reasonable cost to people with limited means.

The evidence suggests that intervention to limit general access to consumer credit would not be justified, and that the private sector has established reasonably effective procedures to identify honest individuals who are at risk. Effective measures to reduce the number and dollar value of consumer debt problems should instead be carefully targeted and based on rigorous analysis of the situations, attitudes and behaviour patterns to which they are linked. Research studies on this subject have been funded through the grants and contributions programme administered by the Consumer Bureau, and are due for completion in mid 1994 (see Appendix I).

Screening and Monitoring of Credit Applicants

In Canada, there is one major credit bureau system, Equifax, and two smaller companies, TRW Information Ltd. and Trans Union Credit Information Ltd. For a fee, lenders access credit bureaux files to determine the creditworthiness of a would-be borrowers. An individual's credit file provides information on employment status, marital status, income level and financial status, and any recent credit problems. Outstanding loans, mortgages, or credit card ownership could be detailed in the file.

The system has three potential weaknesses: first the accuracy of the information is to some extent dependent upon the honesty of the credit applicant; secondly the system relies on credit grantors' diligence in supplying and updating information regularly to credit bureaux; and thirdly the three companies do not share their information with one another.

However, the operation of screening and monitoring procedures has been much improved in recent years. Computers have made it possible for credit bureaux to reduce fees, and thus any disincentive to use the system, substantially. New technology has given members almost instantaneous, on-line access to credit files, which contain more refined information. For example, credit bureaux now show how often an individual has applied for credit, to which credit grantors and whether or not the application was accepted in each case. Banks now provide information to credit bureaux on a daily basis and rely heavily on that information when assessing an individual's creditworthiness. In addition, financial institutions have adopted the practice of cross-checking with each other if an applicant reports the possession of other credit cards.

The bulk of consumer complaints about credit screening focus on lack of access to credit rather than the reverse. Regulation of credit bureaux is a provincial matter and provincial ministries report complaints about erroneous and incomplete information in credit files which result in an unjustified denial of credit. Consumers may also fall prey to companies offering to repair their credit ratings or to obtain information on their credit files, often for exorbitant fees. Consumers are easily able to do this themselves without charge.

It seems clear that the private sector will continue to refine its systems of credit data collection and thereby to improve the reliability of its credit screening and monitoring procedures.

However, as the amount of personal information held by credit bureaux increases and becomes more quickly and cheaply accessible, the security of this information has become a matter of concern. Some consumers are alarmed that the personal information contained in their credit files is widely available and may be accessed for illicit purposes. Their concern appears well founded, in that the US Federal Trade Commission recently began proceedings against a Cincinnati credit reporting agency for selling the contents of credit files to an information broker. This raises the question of whether criteria for access to credit files should be reassessed and new limits established in keeping with the data handling and distribution capacity of current data-processing and telecommunications technologies. While credit bureaux are provincially regulated there may be potential for a federal role under the Trade and Commerce power of the *Constitution Act*, given what now amounts to an international trade in credit information.

In addition, there is considerable scope for action to make consumers generally aware of the operation of the credit record system in Canada and of the steps they can take to ensure the accuracy of their own records.

Privacy

Consumers are increasingly concerned with the collection, use/disclosure and manipulation of their personal data. As greater amounts of personal information become available, the risks increase that the information will be used for purposes other than those for which it was originally collected.

A November 1992 survey on privacy commissioned by Consumer and Corporate Affairs Canada, the Canadian Bankers Association and the Privacy Commissioner of Canada, found that privacy concerns are reduced when individuals feel a greater sense of control over and knowledge about the information that is being accumulated. The study also found that levels of concern depend on a combination of the type of information sought and the source of the request. For example, individuals were less reluctant to divulge financial information to a bank than to a research firm.

There is some protection of privacy in the area of credit at the provincial level, with Quebec providing the most stringent regulation. However, the laws are uneven across the country and limited in scope. The *Bank Act*, the *Trust and Loan Companies Act*, and the *Insurance Companies Act* each empower the Governor in Council to regulate the use of information supplied by consumers, but as yet no regulations have been created.

Consumer advocates offer varying prescriptions for the protection of personal information in a computer age. Suppliers point to the improvements in service and costs which use of such data affords, and to the absence of evidence on real problems resulting from its use. While the issues are complex, they might be addressed in part by assuring consumers of awareness and consent as to whether their personal information can be used for marketing, or other purposes beyond those for which it was originally provided.

Cost of Credit

In recent years consumers' attention has focused almost exclusively on credit card interest and other charges because of the large differential between credit card interest rates and the Bank of Canada rate. In fact, in the case of bank-issued cards, interest rates have until recently maintained a reasonably constant relationship to bank rates, though changes in the credit card interest rate have tended to lag behind bank rate changes by several weeks. Bank credit card interest rates have recently dropped to an all-time low level in the face of persistent low

Bank of Canada rates and fierce competition among bank card issuers. On the other hand, retail credit card interest rates have remained entirely unchanged over the last decade despite wide swings in bank rates. However, retailers' lending practices mean that interest rates on retail credit cards can vary between 6% and 28% depending on customers' payment patterns.

The cost of credit is not well understood by many people. Public discussion tends to focus on the cost of credit in terms of interest rate only, and to ignore elements such as compounding of interest, service charges, the grace period, the method of interest calculation, transaction and annual fees, and the treatment of partial payments. Consumers' purchase and payment habits also affect the cost of credit. The number of variables involved make it very difficult to compare the costs of one credit card to another.

In the past, there have been calls for the standardization of some of the cost of credit features, most notably the method of interest calculation and the treatment of partial payments. Generally speaking, card issuers are against any standard calculation method, regarding it as a constraint on their ability to compete among themselves. Moreover, it seems likely that were such standards introduced, card issuers would offset their consumer benefits by changing other credit cost features in order to protect their rates of return.

To date, three House of Commons Standing Committees have focused their attention on standardizing credit card features. The 1987 and 1992 reports of House of Commons Standing Committees concluded that it is not in the consumers' interest to impose standards on various credit card cost features since some of the benefits associated with credit cards may be lost as a result of foregone revenue for credit grantors. Both Committees focused on ensuring that consumers understand the costs of using credit cards by encouraging all credit grantors to improve their disclosure practices. The 1989 report of the Standing Committee on Consumer and Corporate Affairs and Government Operations recommended that a floating interest rate cap be imposed on credit cards, however, this recommendation was not accepted by the government for the reasons provided above.

Disclosure of Credit Costs

The issue of disclosing the cost of credit is certainly not a new one. The Province of Quebec made provisions for the disclosure of interest rates in its *Instalment Sales Act of 1947*. In the 1950s and 1960s, the other provinces passed or attempted to pass, bills that required greater disclosure of the cost of borrowing. By the end of the 1960s, however, all of the provinces had legislation requiring disclosure of the interest charged on consumer credit transactions. In addition, provisions made pursuant to the Bank Act in 1967 required similar disclosures to be made by the chartered banks.

The truth in lending debate re-opened in the 1970s, particularly in relation to small loan agreements and to the narrow range of disclosure requirements in provincial and federal statutes when compared to those of the American *Truth in Lending Act of 1969*. Demands for legislation to provide borrowers more meaningful information culminated in the attempt to pass the *Borrowers and Depositors Protection Act* (BDPA), which died on the Order Paper in 1976.

Improved disclosure of credit card cost information also appeared in the recommendations of the three parliamentary committee enquiries in 1987, 1989 and 1992. In 1987, the Standing Committee on Consumer and Corporate Affairs and Government Operations recommended that Consumer and Corporate Affairs publish a quarterly report on credit card costs to provide consumers with comparative information on credit cards. The first issue was published in December 1987. Following the 1987 Standing Committee, a federal/provincial working group also brought about voluntary improvements on the part of financial institutions in the disclosure of credit card costs.

The Alberta based Borrowers Action Society recently raised controversy about declaration by credit card issuers of nominal as opposed to effective interest rates. Simply put, a nominal rate takes no account of interest compounding while an effective rate does. The Borrowers' Action Society is accusing some credit issuers of contravening the *Interest Act* by failing to disclose the true rate of interest a consumer pays when carrying over a balance on a credit or charge card. The society, has filed a class action suit in Ontario against Canadian Tire for misleading consumers. However financial institutions do not compound interest on credit card debt at all, and retailers do so only when the borrower breaches the cardholder agreement by failing to make a minimum monthly payment.

Disclosure is an increasingly important issue as new products and advancing technology make the marketplace more complicated. However there is considerable risk that the complexity of the information, and the consequent difficulty of assessing comparative costs will deter consumers from making enlightened choices.

While government intervention to standardize interest calculation methods may appear attractive under the circumstances, it would be opposed by industry representatives, and would likely limit competition and reduce consumer options. Viewed from a slightly different perspective, the intricacies of consumer credit parallel the increasing complexity of other goods and services, and complexity may be the price paid by consumers for a competitive credit marketplace offering a variety of instruments to meet different needs.

Harmonization of Disclosure Legislation

Concurrent federal and provincial legislation has led to jurisdictional problems and some confusion over the years. Generally, federal and provincial cost of borrowing laws contain disclosure requirements that pertain to all types of credit agreements. While the disclosure provisions of both federal and provincial legislation are similar, they are not identical, raising problems for those credit grantors subject to both jurisdictions.

Most recently the Uniform Law Conference of Canada (ULCC) has developed draft uniform cost of credit disclosure legislation and a draft of changes to the *Interest Act*, which are being reviewed by the provinces, and the Departments of Justice, Finance and Industry. Harmonization of cost of credit disclosure regulation has been identified as a topic for the internal barriers to trade negotiations, and the Uniform Law Conference Initiative is to be used as a basis for discussions.

Consumer Information/Education

Recent studies by the Consumers Association of Canada, Saskatchewan and the Association coopératrice d'économie familiale du Centre de Montréal (ACEF) confirm consumers' lack of knowledge about both the costs of credit and the terms and conditions of the agreements they sign in order to obtain it.

A 1993 survey conducted jointly by the polling firm CROP and ACEF found that 58% of people have great difficulty understanding bank contracts. An analysis of eight bank contracts by ACEF Centre revealed that a college-level student had difficulty comprehending them. Some financial institutions have made considerable efforts to introduce plain language into standard contracts for loans, mortgages and credit cards. Clearly others have made less progress.

The Saskatchewan study found that consumers had limited knowledge of credit and needed information, but did not know where to seek out this information. This was especially true of young consumers (high school students and adults from 20-30 years of age).

On the other hand 25% of the respondents to the ACEF survey reported rarely or never reading a credit contract before signing it, reflecting the fact that many consumers do not read information provided to them in the most timely and convenient fashion.

Moreover a good deal of clear, well-presented consumer information material is available from financial institutions, industry associations and governments on the subject of credit. However the material is often specialised, dealing with those aspects of credit which are of particular interest to the issuer. The findings of the Saskatchewan study would seem to indicate that it does not reach all the consumers who might wish to use it.

Given that a sizeable minority of consumers are unlikely to use the most readable and conveniently available material, consumer information (as opposed to formal education) efforts should concentrate on the majority who do wish to be informed, rather than expending resources to attract the attention of the uninterested.

Since most consumers only spend time seeking out information when they perceive a specific need for it (either when making a purchase, or when they encounter a problem), information strategies should focus on supplying the best possible information on such occasions.

CONCLUSION

Consumer credit issues related to interest rate levels, disclosure of cost of credit information, privacy and fair lending practices have been a focus of public concern since the mid 80s. In the intervening period, CCAC was called upon to analyze issues, to advocate improved disclosure practices and to coordinate federal and provincial action. Given continuing uncertain economic conditions, marketplace change and public interest in the area, demand for consumer resources devoted to the issue of credit is likely to be sustained for the foreseeable future.

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APPENDIX I
Studies by consumer organizations on the link between credit use, consumer debt problems and bankruptcy, for completion in 1994.

The Debt Overload of Consumers: data from budget counselling. Fédération des associations d'économie familiales du Québec.

Multiplicity of Credit Cards: cause of debt overload. Service d'aide au consommateur de Shawinigan.

Budget Counselling for Bankrupts. Association d'économie familiale de la Mauricie.