# CREDIT CARDS IN CANADA

## REPORT OF THE STANDING COMMITTEE ON FINANCE AND ECONOMIC AFFAIRS

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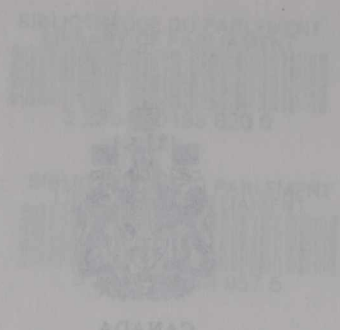

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HOUSE OF COMMONS

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**Chairman: Don Blenkarn**

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# Finance and Economic Affairs

RESPECTING:

Order of Reference pursuant to S.O. 96(2), in relation to interest rates charged by the issuers of credit and charge cards

INCLUDING:

The Fifth Report to the House

Second Session of the
Thirty-third Parliament, 1986-87

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# Finances et des affaires économiques

CONCERNANT:

Ordre de renvoi en vertu de l'article 96(2) du Règlement, ayant trait au niveau actuel des ta
d'intérêt exigés par les émetteurs de cartes de crédit

Y COMPRIS:

Le Cinquième Rapport à la Chambre

Deuxième session de la
trente-troisième législature, 1986-1987

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The Standing Committee on Finance and Economic Affairs has the honour to present its

# FIFTH REPORT

In accordance with its mandate under Standing Order 96(2), your Committee examined interest rates on credit cards in Canada and has agreed to present its findings.

## SUMMARY OF RECOMMENDATIONS

1. **That all written material relating to credit or charge cards (promotional flyers and pamphlets, application forms, contracts and monthly statements) display prominently the effective annual compound interest rate charged on outstanding balances, the amount of any fees associated with the card and the length of any grace period associated with the card.**

2. **That on monthly statements, the effective annual compound interest rate charged on outstanding balances should be displayed prominently on the front of the statement.**

3. **That all card issuers be required to submit quarterly to the Minister of Consumer and Corporate Affairs the interest rates, fees and other aspects of the pricing of their cards. The Minister should then issue a press release and use other appropriate means to provide a convenient comparison of credit card pricing in Canada.**

4. **That the Minister of Finance work with the relevant provincial ministers to put into force legislation requiring all credit card issuers to calculate interest-bearing balances by a common method. The method should be uniform, allow a grace period for new purchases (to ensure that payments are credited first to any interest-bearing balance), recognize the timing of payments (so being late a day on a payment does not lead to interest charges for an entire month) and allow that any partial payment lower the interest-bearing balance.**

5. **That the Minister of Finance and the Minister of Consumer and Corporate Affairs work with the relevant provincial ministers to standardize the requirements for notification of increases in interest rates to a common period which the Committee recommends should be 30 days.**

6. **That although the Committee recommends that ceilings on interest rates not be imposed at this time, present money market rates indicate that there should be a substantial downward movement in credit card interest rates and other related charges. In the event the major Schedule A banks do not take action, at least to the extent taken by the Toronto Dominion Bank, the Minister of Consumer and Corporate Affairs should investigate whether there is anti-competitive behaviour and take appropriate action.**

7. **That retailers should provide that the credit card interest rates applied to outstanding balances over a certain level (say $400) follow the interest rates on Visa and MasterCard.**

## INTRODUCTION

On 26 May 1986, the House of Commons issued an Order of Reference to the Finance Committee:

> **That the Standing Committee on Finance and Economic Affairs be empowered to study the present interest rates charged by the issuers of credit cards and charge cards.**

Mr. Reginald Stackhouse, M.P., who had introduced the matter in the House, appeared before the Finance Committee on 17 June 1986 to discuss the issue. Mr. Stackhouse was concerned that the interest rates charged on credit cards seemed high and that these rates had not moved down with other interest rates in Canada since 1983. He wondered whether these rates could be justified.

As the discussion during the Committee hearing made clear, the issue is far from straightforward. Interest rates on credit card balances, for example, are but one dimension of the cost of a credit card. Accordingly, the Committee directed its researchers to prepare a background paper on credit cards in Canada. Laurent Desbois and Terrence J. Thomas, economists with the Research Branch of the Library of Parliament and assigned to the Finance Committee, prepared the paper "Interest Rates and Credit Cards" over the summer.

Before the paper was completed, however, Parliament prorogued and the Order of Reference to the Finance Committee was no longer in effect. When Parliament resumed and the Committee was reconstituted, the Committee Members decided to continue pursuing the issue, this time under Standing Order 96(2).

Between the end of November and the middle of December, the Committee heard six sets of witnesses - three card issuers (Air Canada's *en Route* Card Inc., Canada Trust and Petro-Canada), two organizations representing card issuers (Canadian Bankers' Association and Retail Council of Canada) and a consumers' group (Consumers' Association of Canada). After these hearings, the Committee met several times *in camera* to discuss the issue.

Credit card interest rates have also been a concern in the United States. Thirty-five states have restrictions on credit card interest rates, although not all these restrictions are binding. New York, for example, has a ceiling on instalment credit rates of 25 per cent, while the market rates on credit cards are well below this. Before 1979, 48 states imposed ceilings on credit card interest rates. By 1985, 19 of those states raised their ceilings and another 15 repealed them. The pendulum may have started swinging the other way, however, with several states examining ceilings (or tighter ceilings) on credit card rates. Connecticut in June 1986 lowered the ceiling on credit card rates to 15 per cent; this ceiling holds when cards have been used for the purchase of goods and services, but not for direct cash advances. Other states where relatively low ceilings apply include Texas, Washington and Arkansas.

## BACKGROUND ON CREDIT CARD OPERATIONS IN CANADA

Most Canadians take credit cards for granted. According to one estimate, two-thirds of all adult Canadians now carry at least one credit card. The growth of credit card use in recent years has been substantial. Hundreds of millions of transactions using credit cards take place each year. Credit cards, especially MasterCard and Visa, are becoming more versatile each year. A card holder can use a credit card 24 hours a day and around the globe; cards can be a source of instant cash or revolving credit that is tapped and paid off, subject to some minimum payment requirements, when the card holder wishes. Having a credit card becomes an indication of credit worthiness: it is easier to cash a cheque if one has a credit card. Carrying a credit card

is safer than carrying cash, and if a card is lost, the holder bears a limited liability for any fraudulent use of the lost card.

Table 1, from the brief submitted by the Canadian Bankers' Association, shows selected statistics from 10 issuers of MasterCard and Visa cards. Among these issuers of the so-called bank cards are two trust companies, a caisse populaire and a credit union. At the end of the 1985 fiscal year, outstanding balances on the cards of these 10 issuers equalled $5.02 billion. The six major retailers that provided data through the Retail Council of Canada had total average receivables in 1985 of $2.24 billion. Not all these outstanding balances bear interest, but it is accurate to say that credit card borrowing represents a multi-billion dollar component of consumer borrowing.

Interest charges are thus substantial and amount to hundreds of millions and probably over a billion dollars each year. To provide some perspective, total interest income for the chartered banks in 1985 was over $41 billion. Still, interest paid by Canadians on outstanding credit card balances is high enough to cause concern about the level of interest rates associated with credit cards. These interest rates provided the focus for the Finance Committee.

## THE PRICING OF CREDIT CARD SERVICES

There are many dimensions to the total price of credit card services. The interest rate, which was picked to be the focus of the Finance Committee study, is but one. The other dimensions of pricing are fees (annual, transaction or a combination), the length of the grace period (the time during which card users can pay off their credit card balances without being charged interest) and the method used to calculate the interest-bearing card balance. For those who pay their credit card balances before the end of the grace period the level of interest rates is irrelevant.

The revenue of credit card operations comes from four sources - merchant fees, transaction fees, monthly or annual fees and interest charges. In addition to credit, the services a consumer receives from a credit card include portability, safety, acceptability of credit cards as a means of payment and monthly record-keeping. Hence those consumers who pay their credit card bills on time and are not charged a fee receive a significant service for free and are, in essence, subsidized by those consumers who do pay credit charges and by the fees received from merchants.

For those who pay interest some months of each year and for those who always pay interest on outstanding card balances, of course, the rate of interest is important - though not necessarily as important as the other costs of credit cards. Interest rates on credit cards are not now the same for all credit cards. Of 34 cards examined by Desbois and Thomas, rates varied from prime plus 1.5% (at the middle of March 1987 equal to 10.25%) to 28.8%. One card, which is marketed as a charge card and not a credit card, had a penalty rate for late payment equivalent to 30% per annum. Fees also varied among credit cards, generally being higher for those cards with lower interest rates.

The wide spread of available interest rates on credit cards suggests that there is some degree of competition among card issuers on the basis of interest rate. In other words, consumers can now shop around to find a card with a low rate. Witnesses before the Committee from the Consumers' Association of Canada, however, suggested that many consumers are not aware of the options available to them. Some consumers, in fact, are not aware of the interest rate charged on the cards they currently use. The Committee believes that consumers benefit from competition among card issuers and that competition becomes more intense when information on the pricing of credit cards is readily available.

**TABLE 1**
**SELECTED MASTERCARD AND VISA STATISTICS**

| Date Year end: | Number of Cards in Circulation (Millions) | Dollar Sales (Billions) | Outstanding Dollars (Billions [1]) | Gross Dollar Volume (Billions) | Sales Slips Processed (Millions) | Average Sale [4] | Delinquency 90 days & over [3] | # Cards Reported Lost or Stolen | # Cards Fraudulently used [2] | $ Amount of fraudulent Accounts Written off/Qtr. (Millions) | Merchants Accounts [4] | Number of Card Issuing Insts. [5] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 77/09/31 | 8.18 | 3.61 | 1.38 | 4.04 | 118.82 | 30.46 | 1.3 | — | — | — | 271,150 | — |
| 78/09/31 | 8.99 | 4.90 | 1.84 | 5.44 | 150.76 | 32.50 | 1.3 | — | — | — | 290,692 | — |
| 79/09/31 | 9.85 | 6.64 | 2.35 | 7.32 | 185.83 | 35.72 | 1.2 | — | — | — | 322,115 | — |
| 80/09/31 | 10.76 | 8.82 | 2.87 | 9.44 | 218.42 | 39.47 | 1.3 | — | — | — | 347,845 | — |
| 81/09/31 | 11.98 | 10.59 | 3.40 | 11.51 | 249.64 | 42.43 | 1.0 | — | — | — | 371,831 | — |
| 82/10/31 | 11.58 | 13.83 | 3.72 | 13.38 | 274.90 | 50.30 | 1.7 | 69,152 | — | 15.88 | 382,206 | — |
| 83/10/31 | 12.13 | 14.84 | 3.73 | 14.85 | 297.55 | 49.88 | 0.9 | 79,482 | 19,200 | 17.39 | 419,610 | 10 |
| 84/10/31 | 13.05 | 16.92 | 4.42 | 17.10 | 325.16 | 52.05 | 0.7 | 80,542 | 21,332 | 16.79 | 442,928 | 10 |
| 85/10/31 | 13.97 | 19.35 | 5.06 | 20.42 | 372.91 | 51.90 | 0.7 | 91,957 | 21,026 | 17.54 | 527,042 | 10 |

SOURCE: CANADIAN BANKERS' ASSOCIATION

(1) As at last day of year end. Not necessarily interest bearing.

(2) Reported to year end.

(3) Percentage of outstandings.

(4) Merchants accepting Visa and/or MarsterCard.
Duplication may occur as merchants offering both cards have been reported by each plan.

(5) Includes: Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, National Bank of Canada, The Royal Bank of Canada, The Toronto-Dominion Bank, The Canada Trust Company, Guaranty Trust Company of Canada, Caisses Populaires Desjardins, Credit Union Electronic Services Inc. (CUETS).

Therefore, your Committee recommends:

1. **That all written material relating to credit or charge cards (promotional flyers and pamphlets, application forms, contracts and monthly statements) display prominently the effective annual compound interest rate charged on outstanding balances, the amount of any fees associated with the card and the length of any grace period associated with the card.**

2. **That on monthly statements, the effective annual compound interest rate charged on outstanding balances should be displayed prominently on the front of the statement.**

3. **That all card issuers be required to submit quarterly to the Minister of Consumer and Corporate Affairs the interest rates, fees and other aspects of the pricing of their cards. The Minister should then issue a press release and use other appropriate means to provide a convenient comparison of credit card pricing in Canada.**

## CALCULATION OF INTEREST CHARGES

Even if all card users knew the interest rate applied to outstanding balances on their credit card accounts, there would still be confusion over the calculation of interest charges. Confusion arises especially in those cases where a partial payment is made. The background paper prepared over the summer for the Finance Committee took almost four pages to explain the calculation of interest-bearing balances after a partial payment; the President of the Consumers' Association of Canada told the Finance Committee about her frustrations in trying to understand the calculation of interest charges as explained on the back of a monthly credit card statement.

In part, the confusion surrounding the calculation of the interest-bearing reflects the sophistication of a credit card as a means of borrowing. Confusion also arises because some card users who pay their balances before the end of the grace period receive interest-free loans. If a card user does not pay the account balance in full, interest may be charged on the average daily balance retroactive to the posting date (which can be the same as, but is usually somewhat after, the purchase or transaction date).

Only some card issuers, however, use this method, and this highlights another source of confusion in the calculation of interest-bearing balances, namely that different card issuers use different methods for calculating the balance. Some, as in the example above, charge interest on the average daily balance retroactive to posting dates; some charge interest from the statement date; some, after a partial payment is made, charge interest on the total previous outstanding balance to either the posting dates or the statement date; and some charge interest on the previous balance less the partial payment, if the partial payment is greater than 50% of the previous balance.

Choice is usually of benefit to the consumer. But if the variety of methods of calculating interest-bearing balances merely confuses the card user, there is little benefit from wide choice. This is the case with respect to the calculation of interest charges by credit card issuers; the wide choice appears to be the result of historical accident or the dictates of different computer programs rather than the forces of competition and the attempts of card issuers to create a new dimension for credit cards aimed at a particular market niche.

Therefore, your Committee recommends:

**4. That the Minister of Finance work with the relevant provincial ministers to put into force legislation requiring all credit card issuers to calculate interest-bearing balances by a common method. The method should be uniform, allow a grace period for new purchases (to ensure that payments are credited first to any interest-bearing balances), recognize the timing of payments (so being late a day on a payment does not lead to interest charges for an entire month) and allow that any partial payment lower the interest-bearing balance.**

## NOTIFICATION REQUIREMENTS

Critics of the relatively high interest rates on credit cards have pointed to the stickiness of these rates as an indication of supposed monopoly pricing. Card issuers have raised the counter argument that the stickiness is a result of provincial requirements for the notification of interest rate increases. According to testimony from the Retail Council of Canada before the Committee, a large retailer with around two million accounts could spend $1 million notifying its customers of a change in interest rates. This obviously makes card issuers avoid frequent rate changes.

Another factor inhibiting rate changes is the time period required by some provinces before a credit card rate may be increased. A witness for Petro-Canada summed up the problem:

> Five provinces require that we give them 30 days' notice; Alberta requires 60 days' notice to customers; Manitoba, 90 days' notice. From the mid-1970s until recently, British Columbia required six months' notice of an increase in charge. So we as a national marketer have little choice but to apply the most stringent requirement to our total operation ...

Provinces may have different notification requirements, but card issuers will use a single notification period across Canada - the longest notification period required by any province.

Therefore, your Committee recommends:

**5. That the Minister of Finance and the Minister of Consumer and Corporate Affairs work with the relevant provincial ministers to standardize the requirements for notification of increases in interest rates to a common period which the Committee recommends should be 30 days.**

One witness before the Finance Committee commended the provincial ministers for their recent search for ways to harmonize disclosure requirements. The Committee obviously hopes that the search is successful and that harmonization extends to other aspects of credit card regulation.

Both the federal government and the provincial governments exercise jurisdiction over some aspects of credit card borrowing. The federal government has responsibility over interest rates; provincial governments have responsibility over matters dealing with property and civil rights in the province, jurisdiction that has led to provincial laws covering disclosure, grace periods and the calculation of the interest-bearig balance for credit card accounts. There are, however, gray areas where federal and provincial jurisdiction seem to overlap. Changing the calculation of the interest-bearing balance, as called for in Recommendation 4, alters the effective interest paid on credit card balances. The Committee has made its recommendations to aid consumers across Canada, and hopes that possible jurisdictional conflicts can be avoided by co-operation between levels of government.

## COSTS, PROFITS AND COMPETITION

There are several ways of asking whether interest rates on credit cards are too high: Are the effective interest rates on credit card services out of line with the costs of providing these services? Are the profits on credit card services excessive? Are those who pay interest charges subsidizing those who pay their credit card bills on time?

In recent months, the striking contrast between high and stable credit card rates and falling interest rates in general has led several observers to conclude that profits on card operations are excessive. Although the Committee is concerned by the gap between credit card rates and other interest rates, a longer perspective than the last year is needed to gauge the profitability of the credit card business.

The data examined by the Finance Committee are the best available data on credit card operations in Canada. Table 2 provides a summary of yields on the credit card operations of the major banks and retailers in Canada and the large banks in the U.S.

**TABLE 2**
**CREDIT CARD OPERATIONS**
**NET YIELD BEFORE INCOME TAX**
**(% of outstanding balances)**

| | 1981 | 1985 |
|---|---|---|
| Canadian Banks | −6.06 | 3.42 |
| U.S. Banks | 1.33 | 3.99 |
| Canadian Retailers | −2.42 | 2.4 |

Sources: Canadian Banks — CBA Presentation to the Finance Committee, 27 November 1986.

U.S. Banks — Federal Reserve Bank of Boston, *Functional Cost Analysis*, 1981 and 1985.

Canadian Retailers — Retail Council of Canada presentation to the Committee, 26 November 1986 and information provided later to the Committee.

Although these data are the best available, the information must be used with caution. After the Hearings, some card issuers provided additional data on a confidential basis, and the same caution holds. Briefs by the Canadian Bankers' Association (CBA) and the Consumers' Association of Canada and the background paper prepared for the Finance Committee by Desbois and Thomas noted the difficulties in providing precise estimates of the costs of credit card operations. It is especially difficult to allocate overhead for card operations; any bias in the cost estimates, of course, automatically biases the estimate of profits.

In addition, the figures shown are averages. The CBA data, for example, are averages of figures from the five major banks in Canada. Data presented by the Retail Council of Canada give some indication of the difficulty in drawing conclusions from averages. For 1985, the weighted average for the net yield before tax on credit card operations for six large retailers was 2.4%; the yield for the six retailers ranged, however, from -5.2% to +4.4%, a spread of 9.6 percentage points! Confidential data from the major banks show slightly less variation around the average with a range of 2.8 percentage points.

What seems to emerge from the data, especially the longer time series available for U.S. banks, is that profits on credit card operations are cyclical. There was some discussion during the appearance by the CBA before the Finance Committee of the 3.42% figure for net revenue before income tax of bank credit card operations in 1985. Some Committee Members felt this indicated high profits for card operations, especially when compared to the total return on assets for banking. The comparison might not be valid, as the representatives of the CBA argued, but this is less important than the observation that the profit in 1985 was more than offset by a loss on card operations in 1981. Annual fees are more prevalent now than at the beginning of the decade, but the rate charged merchants (the merchant discount) has, according to some anecdotal evidence, gone down since then.

The Federal Reserve Board in the United States examined credit card operations there and drew similar conclusions. What seemed important to the Federal Reserve was that the average over the business cycle of reported returns from credit card operations was not out of line with the reported returns from other bank activities. The Federal Reserve examined data going back to 1972 and had information on card operations as well as other bank activities such as commercial and mortgage lending.

Some card issuers in Canada do not make profits even during boom phases of the business cycle. Petro-Canada appeared before the Finance Committee and explained that its card operations, which were probably similar to those of other gas companies, did not make a profit in 1985. The interest rate on the Petro-Canada credit card is 24%, but most of its customers do not pay interest charges. The company sees the card as an important marketing device, a means of attracting customers to Petro-Canada stations. Any losses on the credit card should be made up by increased gasoline sales.

At least one major retailer also reported losses on card operations in 1985. An obvious question emerges: If interest rates in general are falling while credit card rates are high and stable, how can a card issuer not be making large profits? The answer is that the operating costs of credit card operations are high and not linked to interest rates. Operating costs may be 10% of total costs for mortgage lending but up to 70% for credit card operations. Most card issuers who appeared before the Finance Committee suggested that the cost of funds is about half of the total costs for card operations in Canada. High operating costs result from the very high volume of small transactions for credit cards. And these costs can reflect, therefore, the convenience and flexibility of credit cards.

What should keep the prices of card services in line with costs is competition. Competition can be fierce among credit card issuers. Although there are only two major bank cards in Canada, MasterCard and Visa, each institution that issues one of these bank cards sets its own terms for the card. Canada Trust and the Bank of Montreal, for example, each issue MasterCard, but there is a difference of 4.5 percentage points between the interest rates charged on the two cards. These two financial institutions compete with other MasterCard issuers and with all Visa card issuers. The bank cards, in turn, provide stiff competition for other credit cards in Canada. Most retailers now accept bank cards, even though they issue their own credit cards.

Competition among the various card issuers takes many forms. Interest rates vary, and so do annual fees, transaction fees, length of the grace period and the method used to calculate the balance on which interest is charged. All these elements show that pricing credit card services is extremely complicated, and an issuer competes by trying to convince card users that the effective price of its card is lower than the effective price of other cards. The effective price, which takes into account all the elements of pricing, will differ among card users.

Card issuers also compete using non-price elements of credit cards. Some premium cards offer automatic travel insurance when tickets are purchased with these cards; some cards offer

tie-ins with other financial services such as lines of credit. Many card issuers stress the convenience of their cards and strive to sign up as many merchants as possible and arrange links with merchants outside Canada. At least one trust company now offers a one per cent rebate on purchases made using its card. Premium cards such as the American Express gold card carry some status and are advertised accordingly. Air Canada markets its *en Route* cards to business users and offers flexibility in billing - the accounting format and timing of the statements can be tailored to the needs of a business. Retailers may offer special notice of sales to their card holders.

In addition to having a wide choice of credit cards to use, many Canadians have alternative sources of consumer borrowing - personal lines of credit or specific consumer loans. Card issuers thus compete with each other and with any possible source of consumer borrowing. Competition becomes more intense as more consumers become aware of their alternatives. The Committee supports any action taken to improve the information about consumer credit alternatives available to consumers.

## THE SPECIAL POSITION OF THE LARGE BANKS

Witnesses for the Consumers' Association of Canada appeared before the Committee December 3, 1986 and argued that the market for credit cards was an oligopoly - that is, a market with a few sellers. The Chairman of the Committee, however, pointed out that there was a wide range of interest rates and fees available on credit cards, that there were many issuers competing for customers, so there was competition in the market. The witnesses with the Consumers' Association then responded that there was some competition but not enough to lower the high rates now charged outstanding credit card balances; they cited the large banks and the major retailers as groups that have maintained their high rates in the face of falling costs.

The six large banks in Canada dominate the market in MasterCard and Visa cards. As these so-called bank cards (trust companies, co-op's, credit unions and caisses populaires also issue MasterCard and Visa) attract more users and become accepted by more merchants, the six banks will come to dominate credit card business in general. It is worthwhile, therefore, examining the special position of these large banks.

The six large banks, in order of asset size at the end of 1986, are the Royal Bank of Canada, the Canadian Imperial Bank of Commerce, the Bank of Montreal, the Bank of Nova Scotia, the Toronto-Dominion Bank and the National Bank of Canada. These banks have total assets of over $400 billion which is over 90% of total assets for all banks of Canada. To provide some perspective - outstanding credit card balances of all issuing banks at the end of the third quarter of 1986 equalled $5.4 billion while total personal loans equalled $42.4 billion and residential mortgages equalled $47.4 billion. Credit card lending is thus about 6 per cent of the banks' personal loans plus mortgages.

Until recently, the six large banks had high, stable and, depending on the card, identical rates and similar fees for the cards they issued. The large Visa banks charged 18.6% per annum and levied fees, generally $1 per month. The large MasterCard banks charge 21% but have no fees. All the large banks give a grace period of 21 days. The wide choice of rates and fees comes from the smaller financial institutions. The City and District Savings Bank, for example, offers a Visa card with a 15.9% rate and a $9 annual fee. Canada Trust offers MasterCard with a 16.5% rate and a fee of $1 per statement; the fee, moreover, is reduced by any interest payments, so card users with a modest interest-bearing balance (more than about $70) pay no fees. The Royal Trust offers a gold MasterCard with a 14.75% rate and a $50 annual fee; users receive a credit of 1% of the purchases made with this card.

The banks, according to evidence supplied by the Canadian Banker's Association (CBA), had healthy profits in 1985, and these helped counter heavy losses experienced in 1981. Since the early eighties several banks have introduced fees, although this increase in income might have been offset somewhat by falling merchant discounts. Even if the large profits in 1985 offset the losses in 1981 - in other words, average profits over the cycle were not excessive - profits in 1986 must also have been large.

And profits in 1987 should also be healthy. In the autumn of 1986, the Conference Board of Canada surveyed a number of economic forecasters in Canada, including four of the large banks. These banks saw falling interest rates in 1987, so the cost of funds for credit card operations would also fall. Since 1985 short-term interest rates have fallen by over 2 percentage points. Most of the large banks have made no move to cut their credit card rates in line with falling costs. If there are economies of scale in card operations, moreover, the rapid growth of the banks' credit card business should lower its average operating costs. (Since the end of 1981, lending by department stores has increased with inflation, while bank credit card lending has shown real growth.) Between 1981 and 1985, according to data supplied by the CBA, total operating expenses (including loan and fraud losses but excluding the cost of funds) as a percentage of credit card outstandings fell from 9.81 % to 8.74 %.

If the banks maintain high card rates while other financial institutions provide innovative and competitive pricing on their credit cards, an obvious question emerges. *Why don't Canadians switch their Visa and MasterCard accounts from the large banks to other financial institutions*? The answer to this question provides the key to any recommendation about credit card rates. There are three possible answers.

The first is that there may be a lack of information about the credit card market. Canadians may not be aware of the substitutes available for credit card borrowing or of the wide choice of rates and fees for bank cards issued by different financial institutions. Some Canadians may not realize that they can get a bank card from a financial institution other than the one they normally use. They might also not realize that they can use the automated teller machine (ATM) at one bank while having a credit card issued by another financial institution. Even with all this information the typical consumer might not switch. As one Member of the Committee put it:

> ... the cost to the individual of shifting from one card to another is quite substantial - not necessarily the financial cost, but the transaction cost of filling in a new application, of getting used to the new card, of finding out the quirks of the new issuer, rather than the old. It is not as though you can simply, from day to day, move from one form of card to the other with ease.

There is also some uncertainty that the prospective card issuer might increase its rates and fees or the consumer's current card issuer might match any better terms in the near future.

The second reason that Canadians might not switch is that they prefer dealing with banks and are willing to pay a higher price to do so. Canadians have a tradition of using banks. Canadians consider banks safer than other financial institutions - though this should be more of a concern for depositors than card users - and they find banks more convenient. Banks have a large number of branches and readily accessible ATM's, and credit card holders will pay for the extra convenience these provide.

Here the banks enjoy some regulatory barriers to entry. Only institutions chartered under the *Bank Act* may call themselves banks or refer to their business as banking. Some trust companies have argued that they are as large and safe as the major banks and that they can offer consumers the basic services provided by banks. But Canadians do not treat these trust companies as the equal of the banks. Under the current *Trust Companies Act*, the trust

companies are limited in the size of their personal and commercial lending, so they are inhibited from some competition with the banks. The banks do face reserve requirements, adding about 3/8 per cent to their cost of funds, but some trust companies and other small financial institutions can still undercut the credit card rates of the large banks by more than 2 percentage points.

The third reason Canadians might not switch is that they are relatively insensitive to the high interest rate on credit cards. This view is consistent with testimony by some of the non-bank, card issuers who appeared before the Committee. In 1983, Air Canada lowered the rate on its *en Route* card from 24% to 19% and "when we lowered our rate the number of people revolving [maintaining an interest-bearing balance] went down as well." Later, Air Canada added:

> I think it is fair to say that if we lowered our rate to 5% we would not see an upsurge in people revolving ... Similarly, I think if we raised it to 35%, I am not sure that hard core of people would go down.

The representative from Canada Trust, which in June 1986 lowered the rate on its MasterCard from 18.43% to 16.5%, also commented on the apathy of consumers with respect to the rates on credit cards: "... it is not the rate that seems to determine people's decision to carry one card or another. It is something else: convenience, loyalty, perceived value."

There may, of course, be a good reason for the apathy toward credit card rates. Although the rates are high, the dollar amounts of interest charges are small, especially when compared to the interest charges for car loans or mortgages. The most recent survey of Consumer Finance by Statistics Canada showed that the average debt on credit cards in 1984 was $869 . Lowering interest rates by 4 percentage points would save the average credit card debtor less than $3 per month. The average car loan is now about $13,000 and the average residential mortgage loan is about $56,000. A lowering of interest rates by only 1 percentage point would save the average borrower $10.83 and $46.67 per month on these loans.

Consumers are less sensitive to price changes for an item that makes up a small portion of their expenditure. As can be seen from the above, consumers would gain more from 0.25 percentage point drop in mortgage rates than from a 10 percentage point cut in credit card rates. This helps explain why consumers will shop around for the best mortgage deal and why banks follow closely any mortgage innovations by trust companies.

Whatever the reason that Canadians stick with Visa and MasterCard issued by the large banks, the banks can exploit the relationship and maintain high interest rates on credit cards. For those customers sensitive to interest rates changes the banks do compete with their premium or gold cards. Most bank card holders, however, can be treated as a captive group, and the banks will not lose these card holders by maintaining high rates. On the other hand, if the banks lower the rates by (say) 1 per cent they would not increase the number of new card holders or the use of cards by current holders by more than 1 per cent. Lowering rates would lead to lower revenue, not more business.

The banks have almost no incentive to lower their credit card rates. In fact, in May 1986 one bank increased its rate from 17.4% to 18.6%. Only if consumers begin switching from the large banks to other Visa and MasterCard issuers who offer lower interest rates will the banks be under any market pressure to lower their rates.

The Finance Committee grappled with the question: What would be an appropriate interest rate on the credit cards issued by the large banks? Using data supplied by the CBA and the six large banks, the Committee tried several approaches to answer this question. None of the approaches was ideal and the data, as mentioned above, are far from perfect. Nevertheless, the

results seem to indicate that a drop of about 3 percentage points - or a combined change in fees, rates and other terms equivalent to such a drop - would now be in order for the Bank of Montreal, the Bank of Nova Scotia, the Canadian Imperial Bank of Commerce and the Royal Bank. In other words, the Committee finds that interest rates on the majority of outstanding bank credit cards in Canada are too high and should be reduced.

This estimate received some support from the recent actions of the Toronto Dominion Bank. On February 20, 1987 that bank announced that, effective the beginning of March, the interest rate on its Visa card would be 15.9 %, down from 18.6 %. Beginning in April the bank will charge all credit card users an annual fee of $6 in place of the current annual fee of $12 or the option of a $6 fee and a $0.10 fee per transaction. With the lowering of fees the change in terms by the Toronto Dominion Bank is equivalent to an interest rate cut of over 3 percentage points. The pricing of credit card services by this bank is now in line with the pricing by Canada Trust, the Royal Trust and some smaller financial institutions.

Therefore, your Committee recommends:

6. **That although the Committee recommends that the ceilings on interest rates not be imposed at this time, present money market rates indicate that there should be a substantial downward movement in credit card interest rates and other related charges. In the event the major Schedule A banks do not take action, at least to the extent taken by the Toronto Dominion Bank, the Minister of Consumer and Corporate Affairs should investigate whether there is anti-competitive behaviour and take appropriate action.**

There was unanimous agreement that these banks should soon lower the terms on their credit cards. The New Democratic Party Members on the Committee feel that of there is no downward movement in credit card terms within a short period from this report, the Minister of Finance should bring legislation to Parliament that will impose a floating ceiling on the interest rates that banks can charge on their credit cards.

## POSSIBLE EFFECTS OF INTEREST RATES CEILINGS ON CREDIT CARDS

The Committee examined three types of restrictions on interest rates that could be imposed on the issuers of credit cards:

(1) an absolute limit on the rate that may be charged (for example, an 18% ceiling);

(2) a floating limit that moves with some reference interest rate (for example, a limit equal to the prime rate plus 5%); and

(3) a tiered system of limits (for example, outstanding balances below $500 would face one limit — an absolute or floating limit — while balances above $500 would face a different limit).

There are problems with each type of restriction, although each may appear attractive during periods of relatively high interest rates on credit cards.

The central flaw with an absolute limit on rates is that interest rates have wide fluctuations, so a limit that appears reasonable in one year may be too low in some other years and too high in still others. In the last 15 years, for example, the prime rate on business loans in Canada has fluctuated between 6% and 22.75%; in the last 15 months, it has fluctuated between 8.75% and 13%.

Some states in the U.S. had an 18% limit on consumer lending rates and, until the early 1980s, this limit appeared to protect consumers from interest rate gouging while allowing institutions a reasonable return on their lending. When interest rates went above 20% in the U.S., of course, no one wanted to lend at 18%. Credit card issuers introduced or increased fees, stopped issuing cards, revoked some cards, lowered credit limits or combined some of these actions. The result was that those card users who paid their balances before the end of the grace period now paid fees for using a charge card, while some consumers lost access to revolving credit.

The suggestion for a floating limit seems more sophisticated and more practical. If the credit card rate were tied to an interest rate that followed the general cycle of interest rates, the limit would appear to be reasonable throughout the interest rate cycle. However, the proposal also has problems.

The most significant problem is in choosing the margin that should be fixed between the reference interest rate and the credit card rate. Choosing the reference rate is also a problem. A witness with the Consumers' Association of Canada suggested that credit card rates be linked to the prime rate, but would not be pinned down to specifying the margin over prime for card rates. This witness did say that the appropriate level for the credit card rate in early December 1986 would be about equal to the consumer loan rate.

It is far easier to say that credit card rates should float with short-term interest rates than it is to specify the margin that would link the credit card rate to the chosen reference rate. The argument for legislating a floating ceiling on credit card rates presumes that credit card operations produce excess profits - that current interest rates on credit cards are too high. The floating ceiling, according to this view, merely eliminates the excess profits. Again, this seems simple, but the problem comes in trying to determine the precise amount of the excess profits so that the precise margin for the floating ceiling can be set.

Because of the variance in interest rates on credit cards, a floating ceiling would not affect all card issuers equally. A truly equitable policy would control not only interest rates but also any fees and the length of the grace period. Although superficially equitable, such policy could destroy much of the choice consumers now enjoy with respect to differently priced credit cards.

Another reason for not restricting the rate on credit cards to some margin above a reference short-term interest rate is that profits on credit card operations are cyclical. If the configuration of rate, fees and grace period were chosen to eliminate excess profits in one year, the card issuers might still suffer losses in other years. As seen above, the relatively high returns on card operations in 1985 offset to some extent the losses in 1981. In other words, one needs to know how interest rates, other operating costs and credit card use vary over the cycle to choose the correct margin.

The third type of restriction on credit card rates is a tiered system of rates with those with larger outstanding balances paying a lower rate of interest than those with lower outstanding balances. The rationale for this system is the nature of the fixed costs per account. Interest charges (and fees, if any) cover these fixed costs and the cost of funds. Those with large outstanding balances pay high interest charges that should easily cover the fixed costs for the account and probably cover the fixed costs for those with low (or zero) outstanding balances. It might seem fair, therefore, to have those with high balances pay lower interest charges, so they are not subsidizing other card users.

One of the witnesses before the Committee said that it had experimented with a tiered system of rates, but its customers objected to the system, claiming that the issuer was trying to tempt its card holders into running up larger bills. The experiment was discontinued because of the bad public relations involved. On the other hand, Canada Trust offers tiered rates on one of

its premium cards - 16.5% on balances below $2,500 and 13.5% on balances above $2,500. Several card issuers in the U.S. also offer tiered rates. There are, however, problems with tiering interest rates for different categories of card user. The main problem is the same as for the other restrictions on rates, namely that the information needed to set the tiers is difficult to determine. One would need to know the fixed costs per account and this is difficult to calculate as it involves allocating overhead to credit card operations and then to separate accounts. Different card issuers will have different accounting procedures; a tiered system that seems fair for the holders of one card may seem unfair to the holders of other cards.

How Canadians would be affected by rate ceilings would depend on how card issuers react to the ceilings and on the characteristics of card users. Those who do not now have a credit card and those who will never have a credit card could also be affected by interest rate ceilings.

All card issuers would probably react to ceilings with measures aimed at maintaining profits. Such measures would include:

(1) introducing or increasing annual or transaction fees;

(2) shortening or eliminating the grace period;

(3) using a new method for calculating the interest- bearing balance;

(4) improving the quality of credit card loans by
  (a) ending the issue of new cards,
  (b) taking back some cards (for example, those with delinquent accounts),
  (c) lowering credit limits;

(5) linking credit card use to other services and increasing the price of these services

(6) increasing merchant discounts; and

(7) (for those issuers selling goods and services) raising other prices.

This list is based on the background paper by Desbois and Thomas and a recent study by the Board of Governors of the Federal Reserve System in the U.S. (G.B. Canner and J.T. Fergus, "The Economic Effects of Proposed Ceilings on Credit Card Interest Rates", *Federal Reserve Bulletin*, January 1987).

The Federal Reserve paper examined relevant studies on consumer credit restrictions in the U.S. and consumer surveys carried out during the past two decades by researchers at the University of Michigan. The Federal Reserve study concluded that reactions to ceilings would erode the benefits of ceilings to credit card borrowers and impose costs on other consumers. Among the other consumers, those with lower incomes would be most affected.

Which Canadians would be affected by ceilings (and how they would be affected) depends on:

(1) the split between those with credit cards and those without cards;

(2) how card holders use their cards:
  (a) always as charge cards (that is, never paying interest for card use),
  (b) always as credit cards (that is, always paying interest),
  (c) sometimes as charge cards, sometimes as credit cards;

(3) the average outstanding interest-bearing balance; and

(4) the distribution of outstanding balances by income group.

A mixture of evidence from the U.S. and Canada suggests that ceilings on credit card rates in Canada would, in the main, benefit well-educated, upper income, card users between 35 and 44 years old with above-average card balances who, for unknown reasons, do not now take advantage of lower-cost alternatives to regular credit card borrowing.

Statistics Canada provided the Committee with information on the distribution of instalment debt by income group. Table 3 presents the data. Instalment debt consists of debt on bank cards; universal credit cards; cards issued by department and retail stores, gasoline companies and others; and purchases made on a continuous account basis.

The data are for spring 1984 and show, as mentioned above, an average debt of $869. What is significant in the table is that average debt rises with income and that a large proportion of those with low incomes have no instalment debt. Over half of those with 1983 incomes below $25,000 had no instalment debt; some in this group had paid off their instalment borrowing, while others in the group held no credit cards. This latter group would be affected by ceilings on credit card rates if the reaction to ceilings led to higher prices.

Although obviously important when examining possible policy, averages can mask the difficulties of those who are not average. There are, for example, numerous low-income families with large credit card balances, and these families accumulate large interest charges, charges that could be a heavy financial burden. But this does not mean that interest rate ceilings are the best policy to help low-income families.

## RETAILERS' CREDIT CARDS

The large retailers also occupy a special position in a study of credit cards in Canada because they have the highest nominal rates on credit cards - 28.8% per annum. The effective rate paid by card users differs from the nominal rate and is generally below it because retailers charge interest from the statement date and not from the date of purchase and because retailers lower the interest-bearing balance by any partial payment greater than 50% of the previous balance. Nevertheless, the retail card rates are high and a concern to the Committee.

The retailers, represented before the Committee by the Retail Council of Canada, have argued that their costs of card operations are higher than those of the banks. Retailers pay more for funds and have lower average balances than the banks. Moreover, the retailers do not receive any income from merchant discounts or fees from card holders. To the extent that customers increase their use of bank cards instead of the retailers' own cards, the average costs of card accounts will rise for retailers.

At least one retailer reported a loss on its card operations in 1985, and the average profit for the six major retailers in that year was below the average profit for banks, although profits between the two types of card issuers are not strictly comparable. It may be that the credit card operations of the retailers would show a profit if their internal accounting recorded the equivalent of the merchant fee that they would pay for an outside credit card. Retailers compete with other retailers on the price of their products and the quality of their service; the cost of credit is not a focal point of competition. With banks and other financial institutions, on the other hand, the cost of credit should be the focus of competition.

This is not to say, however, that there is no scope for the large retailers to lower their rates. Retail card rates are generally higher than bank card rates, but the differential now is much higher than it has been. In the mid-seventies, for example, the differential was about 3

**TABLE 3**
**Percentage Distribution of Families and Unattached Individuals by Instalment Debt, Spring 1984, and Income Groups**
**1983 INCOME GROUPS**

| | Under 5,000 | 5,000 9,999 | 10,000 14,999 | 15,000 24,999 | 25,000 34,999 | 35,000 44,499 | 45,000 59,999 | 60,000 and Over | Total | Average Income |
|---|---|---|---|---|---|---|---|---|---|---|
| No Instalment Debt | 83.3 | 82.9 | 68.6 | 56.7 | 46.0 | 43.1 | 40.3 | 41.0 | 56.3 | 24,492 |
| Under $500 | 10.1 | 10.9 | 18.1 | 23.1 | 25.5 | 24.8 | 25.4 | 22.6 | 21.1 | 32,257 |
| $ 500—$ 999 | 3.6 | 2.8 | 5.9 | 9.9 | 13.0 | 13.7 | 13.1 | 14.0 | 9.9 | 35,710 |
| 1,000— 1,499 | 1.2 | 1.5 | 3.3 | 4.3 | 6.3 | 5.7 | 8.4 | 8.1 | 4.9 | 37,573 |
| 1,500— 1,999 | .2 | .9 | 2.0 | 2.8 | 3.4 | 3.6 | 4.3 | 3.7 | 2.8 | 36,038 |
| 2,000— 2,999 | .9 | .5 | 1.2 | 1.8 | 3.7 | 5.6 | 4.4 | 5.3 | 2.9 | 41,879 |
| 3,000— 4,999 | .8 | .4 | .7 | 1.1 | 1.5 | 2.6 | 3.2 | 4.1 | 1.7 | 43,423 |
| 5,000 and over | .0 | .2 | .2 | .3 | .6 | .9 | .9 | 1.2 | .5 | 42,189 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 29,113 |
| Average Debt | 109 | 103 | 211 | 306 | 447 | 581 | 616 | 658 | 380 | |
| Median Debt | — | — | — | — | 79 | 141 | 191 | 200 | — | |
| Average Debt, Debtors Only | 654 | 600 | 671 | 707 | 829 | 1,019 | 1,032 | 1,116 | 869 | |
| Sample Size | 678 | 1,893 | 1,740 | 2,847 | 2,497 | 1,820 | 1,506 | 1,048 | 14,029 | |

Source: Statistics Canada

percentage points. It is now almost 8 percentage points above the no-fee MasterCard rate, and the Committee feels that this bank card rate has room to fall.

As was the case with banks, the rates on retail credit cards may be high but the average dollar charges for accrued interest on outstanding balances are relatively low. The average outstanding balance on retail accounts is about $400. If the rates on credit cards were cut in half, the savings for someone with an average outstanding retail account balance would be about $4.80 per month.

Throughout last summer Canada Trust paid people $25 to switch to a Canada Trust MasterCard from their other credit cards. "We expected to have a lot of department store customers switching over because of the difference in rate of 28.8% versus 16.5%, but less than 20% of our new business came from that avenue." The witness concluded, as quoted above, that convenience, loyalty and perceived value outweighed high interest rates.

In a sense the retailers may be exploiting the loyalty of those card users with large interest-bearing balances. Because there are no fees on retail credit cards, interest charges must cover the fixed costs of all card users, even those who always pay their full balance before the end of the grace period. About half of retail credit card accounts by value are paid before the end of the grace period, so interest rates are high to ensure that the half paying interest charges pay enough to cover all costs. This seems unfair, blatantly unfair during periods of falling interest rates.

Therefore, your Committee recommends:

7. **That retailers should provide that the credit card interest rates applied to outstanding balances over a certain level (say, $400) follow the interest rates on Visa and MasterCard.**

The New Democratic Party Members feel that if interest rates on retail credit cards are not reduced in line with Recommendation 7, that legislation should also be introduced to impose interest rate ceilings on retail credit cards.

A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 10, 11, 13 and 42 which includes this report*) is tabled.

Respectfully submitted,

DON BLENKARN

*Chairman*

# APPENDIX

## INTEREST RATES AND CREDITS CARDS

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DOCUMENT PREPARED FOR THE STANDING COMMITTEE
ON FINANCE AND ECONOMIC AFFAIRS

NOTE: The opinions expressed in this paper are those of the authors and not necessarily those of the Library of Parliament or the Standing Committee on Finance and Economic Affairs. This paper was prepared over the summer of 1986 to be used as a background paper by the Finance Committee. A few typographical and other obvious errors have been corrected, but this version of the paper does not take into account the hearings held or research undertaken after October 15, 1986.

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# INTEREST RATES AND CREDIT CARDS

## INTRODUCTION

This paper provides some background information for the investigation by the Finance Committee of interest rates and credit cards in Canada. Three major sections follow. The first shows that interest rates are not the only dimension of the pricing of credit card services. Annual fees, transaction fees, the length of the grace period before interest becomes payable and the method of calculating the balance on which interest is charged influence the effective price paid by consumers for credit card services. The effective price received by card issuers depends on these elements, the proportion of card users who pay interest on card balances and any income from merchants. The first section also compares a representative credit card rate with other interest rates (the prime rate and the consumer loan rate) over time.

The second major section discusses the costs and profits of card operations. This section is based in large part on evidence from the United States; information on Canadian card operations is consistent with the U.S. evidence, but the Canadian information is still incomplete. (The Canadian Bankers' Association and the Retail Council of Canada should be providing more complete information.) The preliminary finding is that the relatively high rates on credit cards are in line with the high costs of providing credit card services. Accordingly, profits on these operations are not excessive, although there may be cyclical highs in these profits that can be misleading if used as representative of profits over time. The ratio of the cost of funds to total cost appears to be lower for credit card operations than for other bank activities. This helps explain the relative stability of credit card rates, while other interest rates have fallen.

The third major section examines the extent of competition among card issuers. Unlike some recent claims that the credit card market is an oligopoly (that is, a market with few sellers), this section suggests that competition is fierce among card issuers. With intense competition, prices are in line with costs and profits are not excessive — the results of the previous section are the results one would expect from a competitive market. There are, however, still two elements that suggest that competition might not be as fierce as most participants claim. The first is that Sears in the U.S. has just introduced a financial services credit card to compete with bank cards — a possible indication of high profits for bank cards. The second element is the high and sticky rates charged by retailers in Canada. If competition were fierce and consumers paid any attention to the rates on credit cards, one would have expected some retailers to alter their rates to increase market share. This has not happened and rates have stayed at 28.8 per cent.

Credit card operations are complicated. The issuers of cards are usually multi-product businesses, and the choice of the pricing and marketing of credit card services is one of many interrelated pricing and marketing decisions of the business. Different banks run their card operations differently, so it is often difficult to talk of representative practices. When it is possible to talk of a representative practice for banks, moreover, this practice might differ from the representative practice of retailers or the issuers of travel and entertainment cards. The length of this paper reflects in large part the inescapable complexity of credit card operations in Canada.

An appendix on government jurisdiction over credit cards is attached to this paper. The appendix was prepared by Imants Abols of the Law and Government Division of the Research Branch of the Library of Parliament.

## INTEREST RATES AND THE PRICING OF CREDIT CARD SERVICES

### A. The Pricing of Credit Card Services

The House of Commons gave the Finance Committee the mandate to study interest rates on charge cards and credit cards. The order seemed straightforward and implied that the interest rate charged on credit card balances was the effective price the consumer pays for credit card services and the price that card issuers receive for the product they provide. In fact, the pricing of credit card services is more complicated than merely choosing an interest rate. There are many dimensions to the total price of credit card services.

The following table shows the variations of these price dimensions for many card issuers in Canada. The rates do vary, from 13.5 per cent to 28.8 per cent, but the effective price of the card with the lowest rate could be higher than the total price of the card with the highest rate. The other dimensions of pricing are fees (annual, transaction or a combination), the length of the grace period (the time during which card users can pay off their credit card balances without being charged interest) and the method used to calculate the interest-bearing card balance. As a general rule, those institutions charging higher interest have a lower fee structure and offer a longer grace period.

Not all card users pay interest. Most cards provide a grace period — typically 20 to 30 days past the statement date — during which time card users can pay off their account balances without being charged interest. When card holders receive their monthly statement, they have three options:

1. Pay the total amount before the end of the grace period from their income or savings,

2. Pay less than the total amount — but at least some specified minimum (often $10.00 or 5 per cent of the balance due) — and accrue interest charges at the posted credit card rate,

3. Pay the total amount before the end of the grace period by using a line of credit or taking out a loan at a rate of interest lower than the posted credit card rate.

Only with option 2 does the credit card user pay direct interest on the card balance. Estimates of the proportion of card users who pay no interest vary from 20 to 50 per cent. The Canadian Bankers' Association estimates that about 50 per cent of card users pay the balance on their accounts before the end of the grace period. Among retailers, about 20 per cent of the *number* of card users pay no interest but about 50 per cent of the *dollar volume* of card transactions bears no interest.

The proportion of non-interest paying card users is extremely important to the institution that issues a card. Because some users pay no interest, the effective yield on credit cards is lower than the posted rate. If the posted rate were 18.6 per cent, for example, and one-third of card balances led to no interest charges, the effective yield would be 12.4 per cent which is in line with the current rate on consumer loans.

**Interest Rates and Other Characteristics of Credit Cards as of June 1986**

**Visa issuers**

| Institution | Interest Rate | Fee Structure | Grace Period | Interest Payment Policy |
|---|---|---|---|---|
| Bank of Nova Scotia | | | | |
| Classic | 18.6% | 15¢/transaction up to $1/month | 21 days | ADBR[1] |
| Premier | 15% | $75 per annum | 21 days | ADBR |
| La Confédération des caisses populaires et d'économie Desjardins du Québec | | | | |
| Classic | 18% | $12 per annum | 21 days | ADBR |
| Premier | 18% | $60 per annum | 21 days | ADBR |
| Canadian Imperial Bank of Commerce | 18.6% | Choice between $12 per annum and 15¢ per transaction. 50¢ minimum if card used | 21 days | ADB[2] |
| City and District Savings Bank | 15.9% | $9 per annum | 21 days | ADBR |
| Guaranty Trust | 21% | 0 | 25 days | ADBR |
| Royal Bank | 18.6% | Choice between $12 per annum and 15¢ per transaction | 21 days | ADBR |

(1) Average daily balance retroactive to posting date. ADB is average daily balance.

(2) Changed to ADBR on November 1, 1986.

**Visa Issuers**

| Institution | Interest Rate | Fee Structure | Grace Period | Interest Payment Policy |
|---|---|---|---|---|
| Standard Chartered Bank of Canada | 18.6% | minimum of 15¢ /transaction up to $1/month | 21 days | ADBR |
| Sterling Trust | 18.6% | $12 per annum or 15¢ per transaction | 21 days | ADBR |
| Toronto Dominion Bank | 18.6% | $12 per annum or $6 + 10¢/ transaction | 21 days | ADB from statement date |
| Vancouver City Savings Credit Union | 18.6% | $12 per annum or 50¢/transaction | 21 days | ADBR |

**Interest Rates and Other Characteristics of Credit Cards as of June 1986**

**MasterCard Issuers**

| Institution | Interest Rate | Fee Structure | Grace Period | Interest Payment Policy |
|---|---|---|---|---|
| Bank of Montreal | | | | |
| • Standard | 21 | 0 | 21 days | ADBR |
| • Gold | Prime + 1.5% | $90 per annum | 21 days | ABDR; past due balances transferred to personal line of credit |
| Canada Trust | | | | |
| • Standard | 16.5% | $1 per month minus interest paid | 15 days | ADB from statement date[1] |
| • Gold | 16.5% if balance less than $2500; 13.5% otherwise | $60 per annum | 15 days | ADBR |
| C.U. Electronic Services[2] | Prime + 4.5% | 0 | 0 | Transaction debited from client's account |

[1] Becomes ADBR from posting date this fall.

[2] Administers card for small credit unions.

**MasterCard Issuers**

| Institution | Interest Rate | Fee Structure | Grace Period | Interest Payment Policy |
|---|---|---|---|---|
| National Bank | 21 | 0 | 21 days | ADB from statement date |
| National Trust | 21 | 0 | 21 days | ADBR |
| Royal Trust | 14.75% | $36 per annum. $50 starting September 1, 1986 | 17-21 days | ADBR |

**Interest Rates and Other Characteristics of Credit Cards as of June 1986**

**Issuers of Other Cards**

| Institution | Interest Rate | Fee Structure | Grace Period | Interest Payment Policy |
|---|---|---|---|---|
| American Express • Standard | 2.5% per month or $10 fee | $45 per annum | 1 month | Outstanding balance must be paid in full. Interest penalty accrues from statement date |
| • Gold | idem. | $60 per annum | 1 month | idem. |
| Air Canada/ *en Route* | 19% | $20 per annum | 25 days | ADB from statement date |
| Carte Blanche | 24% | $40 per annum | 30 days | ADB from statement date |
| Diner's Club | 24% | $35 per annum | 30 days | ADB from statement date |

**Issuers of Other Cards**

| Institution | Interest Rate | Fee Structure | Grace Period | Interest Payment Policy |
|---|---|---|---|---|
| Simpsons, Bay, Zellers | 28.8% | 0 | 25-30 days | ADB from statement date if payment exceeds 50% of balance. Interest on full balance if payment is less than 50% of balance |
| Sears | idem. | idem. | idem. | idem. |
| Canadian Tire | 28.8% | 0 | 25 days | Interest on full balance from statement date |
| Eatons | 28.8% | 0 | 30 days | ADB subject to 50% rule |
| Petro Canada | 24% | 0 | 25-30 days | ABD from statement date |
| Shell | idem. | idem. | idem. | idem. |
| Sunoco | idem. | idem. | idem. | idem. |
| Texaco | idem. | idem. | idem. | idem. |
| Imperial | 24% | 0 | 21 days | ABD from statement date |

*Note*: This list is meant to be representative and does not include all card issuers in Canada.

*Source*: The information was obtained by a telephone survey.

If all credit card users paid off their card balances before the end of the grace period, however, the banks and other card issuers would have to adjust the pricing of their credit card services: shortening or eliminating the grace period, instituting or increasing annual and transaction fees or some combination of these changes to increase income from card users. Card issuers might also tighten the requirements for obtaining a card and thus lower any losses on card operations. Legislation to limit interest rates on credit cards would lead to the same results.

Some people have pointed out that card users who pay interest are providing a cross-subsidy for those who do not pay interest. At first glance this might seem unjust. But the two groups are not rigidly separated; a card user may pay interest four months of the year and no interest for the other months in the year. Most card users can also exercise option 3 and find a substitute loan to replace credit card borrowing. Personal loans do have minimum limits, however, so this form of borrowing may not be a simple substitute for a credit card loan. The Finance Committee may wish to pursue the issue of alternative sources of finance with the banks, trust companies and other financial institutions.

### B. A Comparison of Interest Rates

Are current rates on credit cards abnormally high? One way to answer this is to compare a representative rate on credit cards with other interest rates. The following three charts compare a credit card rate with the prime rate and the consumer loan rate over the period from early 1973 to mid-1986. The first chart shows the levels for the three rates and the remaining two charts show the differentials between the credit card rate and the other rates.

The representative rate is the rate on the Visa bank card. Based on the of number of card holders and the volume of transactions, bank cards are the most important type of credit cards in Canada. On the same basis, Visa is the more important of the two bank cards, so the Visa rate is a good choice for a representative rate. Other interest rates, especially those for the cards of retail stores, are higher. If one of these rates were used in the comparisons, the magnitude of the differentials would of course be greater, but the general pattern of the differentials would be similar.

The general pattern of the differentials shows that credit card interest rates *relative* to other interest rates are no higher now than through most of the seventies. In other words, interest rates on credit cards are not now abnormally high. Credit card rates are high in *absolute* terms, as they have usually been, but the posted level of rates can be misleading. As explained already, the effective interest rate from the viewpoint of card issuers is lower than the posted rate. The difference between the posted and effective rate depends on the proportion of card balances that bear no interest charges. If this proportion were one-third, the effective rate on credit card balances would be close to the rate on consumer loans. Those card users who do pay interest, however, pay the posted rate not the effective rate.

### C. The Calculation of Interest-Bearing Balances after Partial Payment

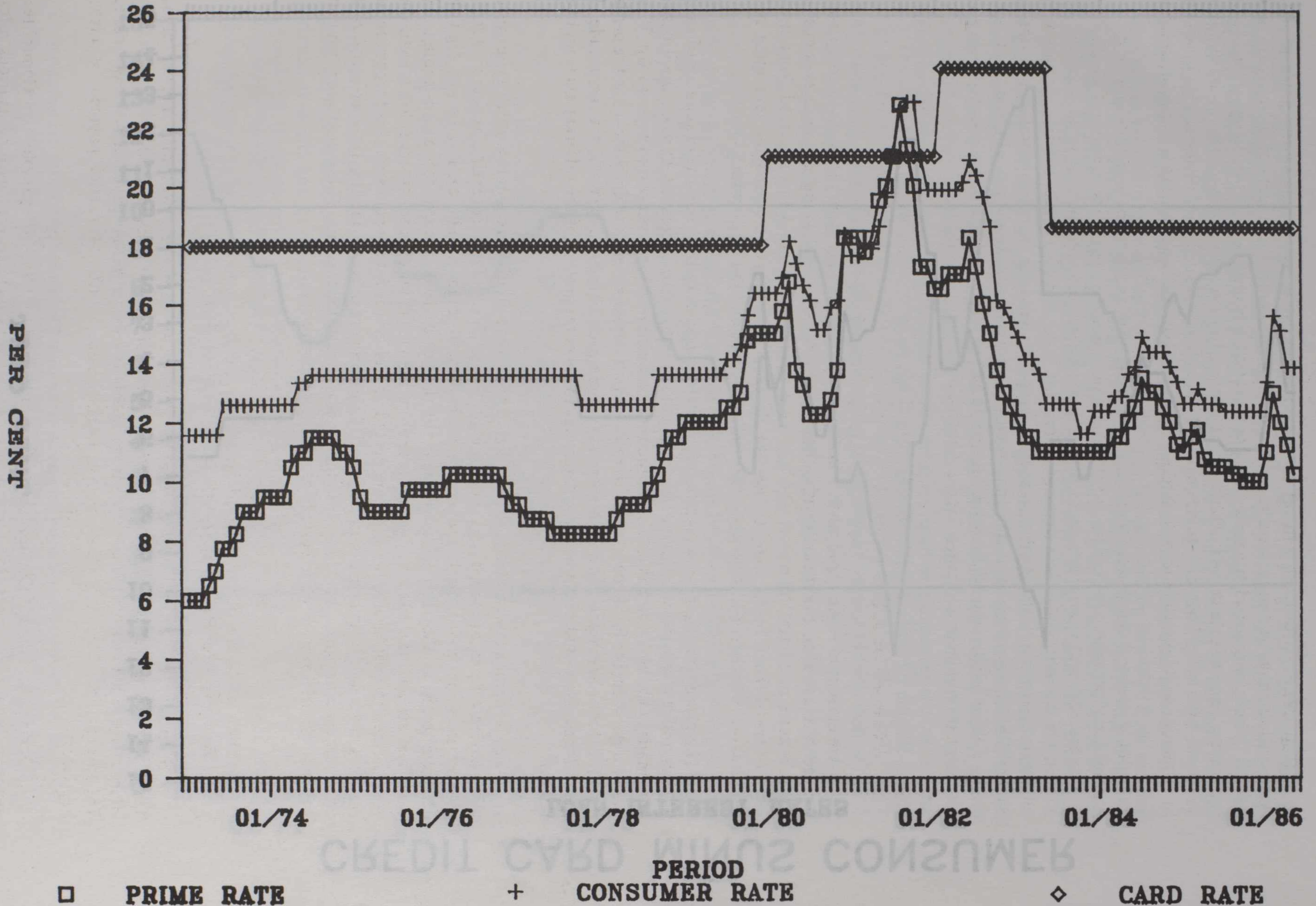
Surprisingly, relatively few complaints from credit card users deal with interest rates. Those that do, moreover, often deal not with the level of interest rates but with the way interest charges are calculated on unpaid balances, especially after a partial payment has been made. The process of calculating the interest-bearing balance after a partial payment is often misunderstood.

During the Finance Committee meeting on June 17, 1986, for example, two Committee members brought up cases that seemed to show that card issuers were charging usurious rates

Chart 1

# PRIME, CONSUMER AND CREDIT CARD

## LOAN INTEREST RATES

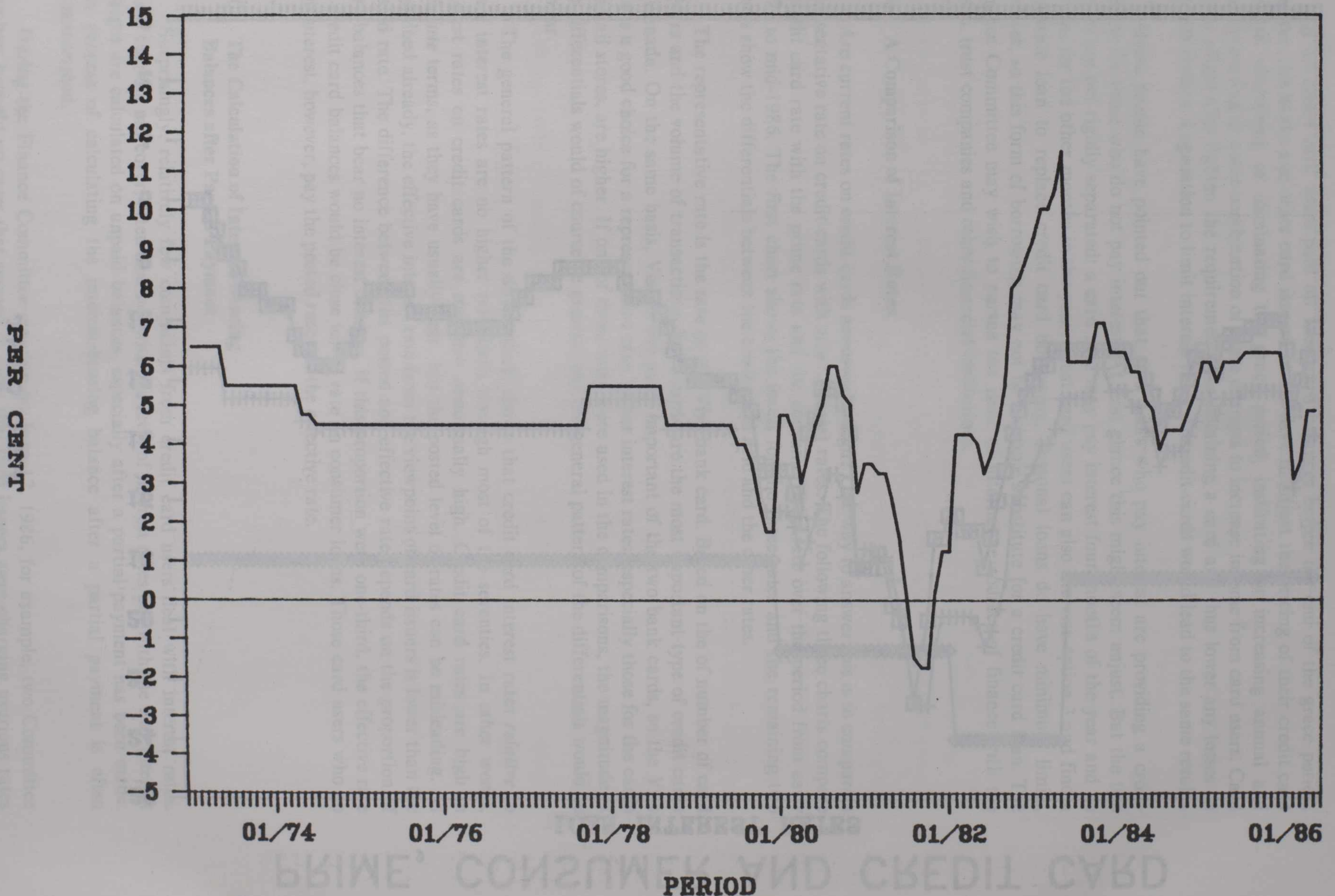



Source: Bank of Canada

Chart 2

# CREDIT CARD MINUS CONSUMER

## LOAN INTEREST RATES

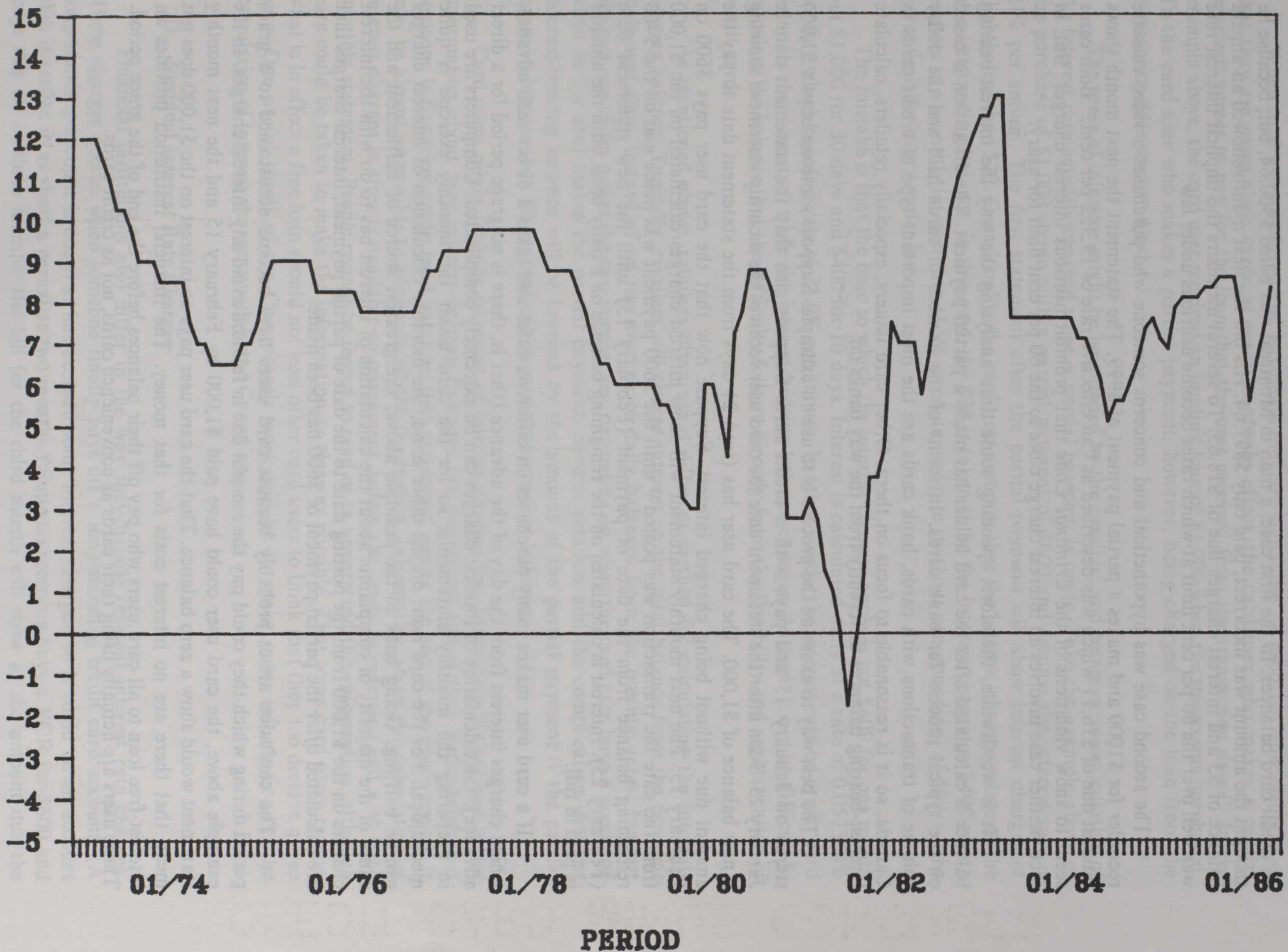



Source: Bank of Canada

Chart 3

# CREDIT CARD MINUS BANKING PRIME

## LOAN INTEREST RATES




Source: Bank of Canada

on credit card balances. In the first case, a man in Montreal was billed $900.64, but, because he thought the amount was incorrect, paid only $897.64. His bill the next month showed an unpaid balance of $3 and interest charges due of $18.65. To several members the implicit interest rate was well over the 60 per cent limit at which rates become usurious under law.

The second case was hypothetical and concerns someone who purchases a video cassette recorder for $1000 and makes a partial payment of $999. The statement the next month shows interest due of $16.11 which was described as "an effective rate of 19,332 per cent." Both cases seem to show violations of the *Criminal Code* that prohibit usurious interest charges. But, in fact, neither case involves an interest charge close to the 60 per cent limit for usury.

It is worthwhile, therefore, spending some time analysing the way the interest-bearing balance is calculated after the card holder has made a partial payment. The discussion is based on the typical process for bank cards. In terms of the number of cards held and the dollar volume of transactions with cards, bank cards are the most important type of credit cards in Canada, so it is reasonable to focus on them. Other card issuers, especially retailers, calculate interest-bearing balances differently from the way banks do.

The best way to examine the process is to use an example. Suppose someone buys a $1,000 stereo on January 15 and pays with a credit card. Suppose also that the statement date is January 25. Soon after the statement date the card user receives the monthly statement showing a new balance of $1,000. The card user has (say) 21 days from the statement date to pay the amount due without being charged interest. Suppose now that the card user pays $600 on February 15. The next monthly statement will show interest charges calculated on the $1,000 from the date the transaction was posted[1] until the $600 payment was made and on the $400 remaining balance from the date of payment (February 15) until the new statement date (February 25). Interest is calculated on the remaining balance on a daily basis until the amount is paid in full.

If a card user makes many purchases on different dates and takes a direct cash advance, which charges interest from the day of the advance (that is, there is no grace period for a direct advance), the calculation of interest charges can be extremely complicated. Computers are used in preparing the monthly statements, so for the card issuer the monthly exercise is quite mechanical. For the card user, on the other hand, the monthly calculation of interest charges can be baffling. Going back to the example above, the greatest source of bafflement and the cause of the majority of complaints about the calculation of interest has to do with the interest charges on the $1,000 from the posting date to the date of partial payment, interest charges that are calculated *after* the partial payment of $600 has been made.

The confusion arises probably because card users have become accustomed to a grace period during which they could pay the amount due in full and avoid any interest charges. In the example above, the card user could have paid $1,000 by February 15 and the next monthly statement would show a zero balance. That the card user pays no interest on the $1,000 does not mean that there are no interest costs for that money. The financial institution provides an interest-free loan to all card users who pay off their balances before the end of the grace period. These users are actually using their cards as convenience cards, not as credit cards.

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[1] The transaction date and posting date are not necessarily the same. The merchant delivers the transaction slip to a financial institution that posts a credit to the account of the merchant; the lag between transaction date and posting date depends on the speed with which the merchant delivers the transaction slips and the practices of the financial institution. In the example above the distinction between the two dates is ignored.

When card users make partial payments they are signalling — probably unknowingly — that they are using their cards as credit cards. In effect, the card user who makes a partial payment agrees to pay for the loan that the user received from the transaction date.(1) In the example above, the card user received an implicit loan of $1,000 when the stereo was purchased. To the card user who makes a partial payment, however, being charged on the loan from the transaction date seems unjust.

The sense of injustice might be heightened by the possible, and common, miscalculation of the interest rate actually charged when a partial payment is made. Take the example above of the purchase of $1,000 stereo with a partial payment of $600 and assume the interest rate is 21% per annum. The first statement after the partial payment will show interest charges of slightly less than $20. Occasionally, the card user assumes that the interest charges relate to the new outstanding balance; in this case, the $20 is taken to be the interest charge on $400 which equates to a monthly interest rate of 5% or an annual rate (without compounding) of 60% — the lower limit for usury under law.

The mistake is that the base to which the interest charges apply is not $400 for one month but $1,000 for 30 days and $400 for 10 days. Interest is calculated daily at a rate of 0.057534% per day which equals a rate of 21.0% per annum. In other words, the interest rate on credit card balances stays constant while the interest-bearing balance changes. As seen, it can be difficult to calculate the balance, but the difficulty follows directly from the flexibility and sophistication of credit cards.

As mentioned above, retailers often use a different method for calculating the interest-bearing balance. Typically, retailers will charge interest on the total balance from the previous statement date, instead of on the average of daily balances from the posting dates. Interest charges can differ under the two approaches, depending on when the card user buys a good and when he (or she) makes the partial payment. Several retailers add the complication that the interest-bearing balance will be lowered by the amount of the partial payment if the partial payment is more than 50 per cent of the previous statement balance.

Card users might find the payment of interest charges less frustrating if they had better information about how interest-bearing balances are calculated and if they understood that someone is financing credit card balances that are repaid before the end of the grace period. It may be almost impossible to eliminate all the frustration. Information about the calculation of interest charges is already available to consumers, before the credit is extended and with each monthly statement. People cannot be forced to read or to understand this information, although care could be taken to make the information as clear as possible. That some card users receive what is in effect a free loan should not lead other card users to think that they too deserve a free loan. One useful result of the Committee's work will be to make more information on the calculation of interest charges available to Canadians.

### D. Residual Interest Rate Charges

Financial institutions also differ in the way they handle residual interest rate charges. These charges accrue when someone finally pays off a long-standing credit card account. (A long-standing account is one that has accrued some interest charges, so it could be an account that is settled in as short a period as two months.) Suppose someone buys a VCR for $600 and pays this off in three months; the bill for the third month will show as the amount due the

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(1) Again, there is a difference between transaction date and posting date. The card user is really agreeing to pay for the loan from the posting date; the merchant finances the loan from the transaction date to the posting date. This complication has been ignored in the example.

balance from the previous month and any accrued interest during the third month. If the card user pays off this amount in full, he will still be accruing interest on the amount he has paid from the statement date to the date his payment was received. This final accrued interest is known as the residual interest. Some financial institutions will bill the card user for this interest — in the example, the bill for the fourth month will show interest due of about $4. Other financial institutions waive residual interest charges; these institutions will receive a slightly lower effective yield on their card operations than similar financial institutions that charge residual interest.

### E. Income from Merchants

Some card issuers also receive income from the merchants who accept their cards. This income, or merchant charge, consists of a discount taken by a financial institution when paying the merchant for an item charged by a credit card. For example, if the item cost $100 and the merchant charge is 3 per cent, the financial institution will pay the merchant $97. The financial institution will eventually receive $100, and possibly some interest, from the card user. This example oversimplifies by implying that there is a single financial institution involved with the credit card transaction. There are, in fact, usually two financial institutions involved — the one that provided the credit card to the consumer and the one that signed up the merchant.

Assume the two financial institutions are the "card user's bank" and the "merchant's bank" (also called the issuer and acquirer, respectively, by some financial institutions). After receiving payment for $100 by credit card the merchant will deposit the sales slip with his bank. (Actually, of course, the merchant will collect the credit card slips for some period — a day or a week — and deposit these. Large merchants will have frequent deposits of sales slips and may even present the bank with a magnetic tape of the transactions.) The merchant's bank will then credit the merchant's account with $97 and debit — through the credit card interchange system — the card user's bank $100. Some institutions immediately credit the merchant with the full $100 but debit the $3 discount only at the end of the month. The card user's bank will then bill its client $100 and eventually receive this , possibly with interest.

The interchange system coordinates the activities of the merchant's bank and the card user's bank. It is similar to the cheque clearing system, although the costs of processing a credit card transaction are higher — 50 per cent higher according to some estimates — than the costs of clearing a cheque. The interchange system also allows the splitting of the merchant discount. This splitting is complicated and varies for the different bank cards. The complications arise because the split cannot be a constant proportion of the discount (say, a 50/50 split) or each financial institution would quickly learn the discounts that all other financial institutions charge. Discounts and charges in discounts are proprietary information. The split can take the form of a fixed percentage of the purchase price less a fixed interchange fee (say 1.75 per cent less 25¢ per transaction) going to the card user's bank; the merchant's bank receives the 25¢ per transaction and the remainder of the discount.

In the example of a $100 purchase, the card user's bank receives $1.50 (($100 x 1.75%) − 25¢) and the merchant's bank receives $1.50 (($100 x (3% − 1.75%) + 25¢). This is a 50/50 split, but the proportion could differ with a different purchase price and a different merchant discount. With this method of splitting the merchant discount, only the merchant's bank knows the discount involved.

Competition to sign up merchants is fierce. Each financial institution decides on the terms it will offer a merchant, so the merchants can play one institution off against another. A 1976 study for the Economic Council of Canada suggested that the range of discount rates for Visa

was 2 — 5 3/4 per cent and for MasterCard 2 — 5½ per cent.[1] The actual rate would depend on the volume and average size of transactions, with the rate decreasing as either or both of these increase.

Since the mid-seventies there has been downward pressure on merchant discounts. As a recent article in the Financial Times reported:

> merchants ... are exercising clout to get their charges down to as low as 1.69% for MasterCard and either 1.75% or 1.9% for Visa. Other merchants who don't have the benefits of a group rate can pay up to 3.5% for the processing and handling of credit card payments.[1]

This statement implies that the range for discount rates is now 1.69 — 3.5 per cent. Because individual institutions guard the information or the merchant discounts they offer, it is difficult to gauge how accurate this newly estimated range is. Most information, however, suggests that merchant discounts have been squeezed since the mid-seventies.

It is also difficult to provide an estimate of the average merchant discount. The Board of Governors of the Federal Reserve System sponsored a survey of retailers in 1983 and discovered that the average merchant discount was 3.1 per cent and the average fee for cheque verification was 3.0 per cent.[2]

The Federal Reserve study also pointed out that merchants bear the costs of security, storage and transportation when they accept cash. The average merchant discount for credit card sales, therefore, does not necessarily increase prices by the full amount of the discount. The study estimated that "the need to cover credit-related costs would likely boost the price of a given item by less than 1 per cent." (p. 7) This is an average price increase; the estimated range was "from less than ½ per cent to perhaps 1 1/4 per cent." (p. 61).

Several conclusions emerge from the discussion of the merchant side of credit card operations. The first is that there is fierce competition for merchant business, so merchants have bargaining power with respect to the size of discounts. The second conclusion is that the income from merchants is not directly related to income received from card users. In other words, the merchant discount cannot be added to the interest rate or credit card balances and used as a measure of the total return on credit card operations. A final conclusion — but a tentative one because it is based on research from the U.S. — is that merchant discounts do not lead to large increases in prices, increases that would be borne by all consumers and not just card users.

## COSTS AND PROFITS OF CREDIT CARD OPERATIONS

As the charts in the previous section show, the posted interest rates on credit cards are higher than the rates on other types of bank lending. Many observers have pointed out that credit card rates have not fallen during the past year although other interest rates have. Several of these critics have suggested that the banks and other credit card issuers may be gouging card users. We can examine this by asking two related questions: Are the effective interest rates on credit card services out of line with the costs of providing these services? And are the profits on

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[1] H.H. Binhammer and Jane Williams, *Deposit-Taking Institutions: Innovation and the Process of Change*, Ottawa, Supply and Services, 1976, p. 110.

[1] Andrea Gordon, "The high cost of credit card convenience," *Financial Times of Canada*, September 8, 1986, p. 22.

[2] Board of Governors of the Federal Reserve System, "Credit Cards in the U.S. Economy: Their Impact on Costs, Prices and Retail Sales," Washington, D.C., July 27, 1983, p. 56.

credit card services excessive or out of line with the profits on other aspects of the credit card issuers' business?

Unfortunately, we do not have all the data we would need to provide final answers to the two questions. The information we do have, however, is consistent with findings from the United States that indicate that profits for bank cards have not been excessive. According to analysis by the Federal Reserve, credit card interest rates have probably not fallen with other interest rates because the cost of funds for credit card operations is a relatively small proportion of the total cost of these operations.

Credit card operations involve a huge volume of relatively small transactions. In 1985, for example, there were 373 million transactions involving bank cards in Canada with an average transaction of about $50. The so-called paper trail of credit card transactions is extensive. Information, now processed in part by computer, flows among merchants, the merchants' banks, the card issuers' banks and the card users. It is small wonder that costs other than the cost of funds make up a large proportion of the total costs of credit card operations.

Risk is also an important element of credit card operations. Unlike other forms of consumer lending, such as auto loans, credit card lending is unsecured — banks cannot repossess a vacation that has been enjoyed and paid for with a credit card. Defaults on card payments and losses from the fraudulent use of cards contribute to the high costs of card operations.

Several breakdowns of the cost of credit card operations can be provided. Of special interest is the relative importance of the cost of funds compared to other operating costs.

The Retail Council of Canada (RCC) provided a possible breakdown of the costs of providing credit card services:

- wages for clerical, data processing and management staff;
- communication costs including those for postage, telephone, telex and other electronic transmissions;
- stationery supplies;
- occupancy costs for office space;
- systems adjustments associated with changes in provincial regulations governing consumer credit accounts; and
- cost of funds.

The cost of funds represents about 50 per cent of total operating costs. The RCC may be able to provide a breakdown of the contribution of each of the other cost categories to total cost; they had some information that each of the first five costs represented 1-2 percentage points of the effective yield, but the raw data would have to be used differently to provide the proportion of these costs to total costs.

Information on banks in the U.S. shows a different breakdown of costs:

| | |
|---|---|
| • officers salaries | (1.1%) |
| • employee salaries | (2.0%) |
| • fringe benefits | (0.7%) |
| • data services | (1.4%) |
| • furniture and equipment | (0.4%) |
| • occupancy | (0.6%) |
| • publicity and advertising | (0.5%) |
| • credit card activity and franchise fees | (2.0%) |

- other operating expense (2.5%)
- net credit losses (0.2%)
- net fraud losses (0.2%)
- cost of funds (8.2%)

The cost breakdown is from the annual publication *Functional Cost Analysis* put out by the Federal Reserve Bank of Boston. The numbers in parentheses show the proportion of each element of cost to credit card outstandings for a sample of large banks (deposits over $200 million) in the U.S. in 1984. In this example, the cost of funds equals about 40 per cent of total costs. There are problems in allocating overhead costs over many bank functions, so the recorded proportion of cost of funds to total costs could be biased.

The breakdown given for the U.S. is for 1984. As will be argued below, it can be misleading to cite the figures for any one year as representative. Fortunately, the Federal Reserve System has been surveying commercial banks for a number of years, so it is possible to examine average cost data over a period that includes two business cycles.

> From these average cost data, published under the title *Functional Cost Analysis*, the importance of financing costs and other costs can be compared for credit card operations and for other kinds of bank lending. During the period 1974 through 1984, financing costs averaged only about three-tenths of total expenses, before taxes, for the credit card function at participating medium- and large-sized banks that issue credit cards. By comparison, financing costs at banks in the same size classes accounted for more than three-quarters of total costs of the commercial lending function, and for nearly nine-tenths of total costs of mortgage lending. Studies of credit card operations at retailers likewise have shown that funding costs are less important than operating and collection costs.[1]

The Canadian Bankers' Association hopes to be able to provide a breakdown of costs similar to that provided by the Federal Reserve. But the CBA faces the problem that individual banks differ in the way they allocate overhead costs across their various products. Many banks treat their credit card operations as part of a more comprehensive set of bank services — say, total retail services provided a merchant or total personal banking services provided an individual — so it is difficult to calculate the portion of the overhead costs for these total services that should be allocated to the credit card operations. Banks also consider detailed cost information to be proprietary information; they feel they would lose a competitive edge if their rivals had access to this information.

Unlike most banks, La Confédération des caisses populaires et d'économie Desjardins du Québec provides a breakdown of its Visa operations. The breakdown is not as detailed as that for the U.S. banks, but it is possible to calculate the ratio of the cost of funds to the total costs of credit card operations. Total costs in 1985 were $39.950 million while financing costs were $14.681 million — the cost of funds was thus 36.7 per cent of total costs, a result in line with that for U.S. banks. Profits in 1985 were $887,000 or 0.4 per cent of net outstanding credit card balances of $210.8 million. (La Confédération des caisses populaires introduced its Visa Card in 1981-82 and the profits in the early years may not represent typical or expected profits. In the U.S. in 1984 profit equalled 3.7 per cent of total credit card outstanding balances.)

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[1] Statement by Martha R. Seger, Member, Board of Governors of the Federal Reserve System, before the Subcommittee on Consumer Affairs and Coinage of the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, October 29, 1985, reprinted in the Federal Reserve *Bulletin*, Volume 71, Number 12 (December 1985).

According to an official at one financial institution, profits on credit card operations in the U.S. exceed profits in Canada. The reason is that revenue is higher for the same level of credit card activity because card users in the U.S. generally carry higher unpaid balances than do Canadians. Evidence from one of the international bank card companies supports this view; the average outstanding balance for Americans is about 70 per cent higher than for Canadians. This evidence is preliminary, from only one bank card company and for a single year that might not be representative; nevertheless, this evidence is consistent with the hypothesis that revenue per card holder is higher in the U.S. than in Canada.

One problem with talking about the profits in a particular year of any bank line is that profits are not constant over the business cycle. It is only by accident that the profits in any year are representative of the profits from the bank line. Bankers — and businessmen in general — know this and price their product lines so that profit in good years makes up for losses in bad years. (Even this seemingly reasonable statement may be misleading. A bank, or any credit card issuer, might accept small losses on credit card operations if these operations led to increased business and higher profits in other lines. Multi-product businesses, which is what most credit card issuers operate, are complicated; the analysis of multi-product businesses is thus far from straightforward.)

The discussion here concentrates on bank cards. As mentioned before, these cards are the most important type of credit card in Canada, and they are becoming more important with the increasing, and increasingly flexible, use of money machines. At the end of 1985 credit card balances at banks were $5,180 million while total consumer credit at department stores was $2,090 million. (Trust companies, co-ops and other financial institutions also issue what are now erroneously called bank cards.)

Several critics seem to imply that the banks are keeping interest rates on credit cards at unjustifiable levels to provide a major source of revenue. In fact, credit card operations provide relatively little revenue to the banks — relative, that is, to the revenue from other bank activities. To give some idea of the orders of magnitude involved, at the end of 1985 the card balances at the banks equalled 13.7 per cent of bank lending for the purchase of consumer goods and services, 2.1 per cent of total Canadian dollar assets and 1.2 per cent of total bank assets.[1]

A study[2] of the profitability of major bank card issuers in the United States highlights the cyclical nature of credit card profits.

The figures in the table are estimates based on a model that has actual profitability of individual operations "dependent on a number of variables, including the interest rate charged on credit cards, the method of funding the receivables portfolio, the operating efficiencies of the organization and the credit quality of outstandings." The figures in parentheses represent expenses or losses.

The results of this study are in line with recent research by the Board of Governors of the Federal Reserve System:

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[1] Bank of Canada *Review*, June 1986.

[2] The study was by Denis R. Laplante, "Consumer Credit: Is Lower Profitability in the Cards?" *Keefe Bankreview*, Keefe, Bruyette & Woods, Inc., April 18, 1986, p. 4. The figures are percentages of average credit card outstandings.

Data for the period 1972 through 1984 suggest that — in contrast to the higher gross finance rate on credit card indebtedness — average before-tax earnings have been substantially lower during most of the period in the case of credit card operations than they were for commercial or mortgage lending. These figures, of course, include periods of relatively low or negative returns on credit card lending, such as in 1980, and periods such as last year [1984] when the yield for the credit card function exceeded that for commercial loans and mortgage loans. *Over the longer term, returns on credit card plans have not been out of line with other types of lending; as indicated, margins actually have been lower on average in the credit card area.*[1]

| | 1980-81 | 1985 |
|---|---|---|
| Portfolio Yield | 16.50% | 17.50% |
| Cost of Funds | (12.50%) | (10.00%) |
| Net Yield | 4.00% | 7.50% |
| Annual Fee | | 2.00% |
| Merchant Discount and Interchange Fees | 2.25% | 2.25% |
| Total Income | 6.25% | 11.75% |
| Operating Expenses | (6.00%) | (4.50%) |
| Credit Losses | (2.25%) | (3.25%) |
| Net Pretax Yield | (2.00%) | 4.00% |

The *Keefe Bankreview* study goes on to predict a narrowing of profit margins in the near term. The three principal reasons for the narrowing of margins are rising consumer debt load, increasing competition among card issuers and the movement to impose rate ceilings on credit cards. With rising consumer debt, profits on credit card operations increase, but the probability of *future* bad debts also increases. High cyclical profits must therefore compensate for past and future losses.

The issue of competition will be discussed in the next major section of this paper.

The call for ceilings on credit card rates is not confined to the United States. A legislated ceiling has a certain appeal, of course, as it seems to show that the government is protecting the interests of the small consumer against those of the large banks and department stores. In fact, such legislation would probably end up harming the small, and relatively powerless, consumer. If a ceiling were effective in the sense of legislating an interest rate limit below what credit card issuers would offer in the absence of the ceiling, card issuers would institute or increase annual or transaction fees, stop offering cards to new users or take back cards from existing holders, lower credit limits, try to increase the quality of credit card lending and decrease or eliminate the grace period. Those who always pay interest on their credit card balances might gain from a legislated rate ceiling — they would not gain, of course, if they lost their cards or had their credit limits lowered to below the amount they wished to borrow — but other consumers would suffer. If rates are too high and profit is excessive, the consumer is best protected by increasing competition among credit card issuers.

Before examining the extent of competition among card issuers we should look at the profits of retailers from credit card operations. The reason is that the representative rate on credit cards of retailers is 28.8 per cent, over ten percentage points greater than the

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[1] Statement by Martha R. Seger reprinted in the Federal Reserve Bulletin, (December 1985), p. 946. Emphasis added.

representative rate on bank cards. The Retail Council of Canada (RCC) argues that, despite the difference in rates, the profits on the cards of retailers are actually comparable to the profits on bank cards. According to the RCC, banks have additional sources of income (and hence profit) with their bank cards, and the banks have lower costs of providing credit card services.

The RCC points out, as do the banks, that the service charge rate on credit cards of retailers must be adjusted for the proportion of card users who pay no interest. In a recent letter prepared for provincial ministers and senior officials of departments responsible for consumer affairs, the RCC suggested that one-third of card users pay no service charge on card accounts (Letter to the Hon. Elaine McCoy, Minister of Consumer and Corporate Affairs, Alberta, September 11, 1986). Previously, the RCC had drawn the distinction between the number of card users who pay no interest (about 20 per cent according to one estimate by the RCC) and the dollar volume of card balances that are paid off before the end of the grace period and bear no service charges (about 50 per cent). The Finance Committee will want better estimates of the proportion of card users - those with bank cards and those with cards from retailers — who pay no interest.

Assume banks and retailers have the same proportion of card users who pay no interest. In this case, relative profits depend on relative interest rates (or, to the RCC, service charge rates), costs and revenues. The RCC points out that most banks receive annual fees or transaction fees (or a combination) from all card users and discount income from merchants; retailers do not have these sources of revenue. Moreover, retailers bear the point-of-sale costs that the banks avoid. The RCC also argues that banks obtain their money at advantageous rates — one to two per cent below what retailers must pay. The net result, according to the RCC, is that the effective yield on card operations is similar for banks and retailers.

Certainly, adjustments for different sources of income and different costs should be made before comparing the profits of banks and retailers. More information is needed before exact adjustments can be made, and some of this information, such as the point-of-sale costs of credit card transactions, may be difficult to obtain. A calculation based on liberal estimates for the adjustments shows that the effective yields on card operations are similar for banks and retailers:

| | **Banks** | **Retailers** |
|---|---|---|
| Posted rate | 18.6 | 28.8 |
| Adjustment for non-payment of interest (1/3 of card users) | −6.2 | −9.6 |
| Adjusted rate | 12.4 | 19.2 |
| Adjustment for fees | | − 2.4 |
| Adjustment for merchant discounts | | − 2.5 |
| Adjustment for higher cost of funds | | − 1.5 |
| Adjustment for point-of-sale costs | | − 1.0 |
| Effective rate | 12.4 | 11.8 |

The effective rates can be used to calculate the revenue from credit card transactions; the costs mentioned above would have to be subtracted from the revenue to obtain the profits on card operations. These effective rates must be used with caution, however, as the adjustments are not based on firm estimates. The adjustment for fees is based on $1 per month fee and an assumed balance of $500 per year; the adjustment for the merchant discount is based on the average discount of 3.1 per cent estimated for the U.S. for mid 1983, adjusted for the downward pressure on discounts observed in Canada in recent years; the adjustment for higher cost of funds is the average of the estimate by the RCC; the adjustment for point-of-sale costs is a guess — probably a liberal one. Even if the point-of-sale costs approached zero, the effective rates for banks and retailers would be roughly in line.

## COMPETITION AMONG CREDIT CARD ISSUERS

The previous section of this paper argued, on the basis of partial evidence for Canada and more complete evidence from the United States, that profits on credit cards have not been excessive. The high rates on cards were seen to be in line with the high costs of providing credit card services; the stability of credit card rates in the wake of general interest rate declines was attributed to the low proportion of the cost of funds to the total cost of providing card services. Another way of making the same argument is to say that there is intense competition among credit card issuers.

It is difficult to measure competition. But one indication of a market that is competitive is the presence of numerous sellers of similar products and the absence of barriers that would prevent other firms from offering a similar product. There is no hard and fast rule as to how many sellers of a product are sufficient to be deemed "numerous" and produce competition in a market. Professor James Savory of York University and a consultant to the Consumers' Association of Canada has discussed the market for credit card services and has stated: "We are in an oligopoly situation where there are relatively few card issuers. [Oligopoly means a few sellers of the same product] ... Their responsibility is to maximize their profits and when you have that kind of situation prices are sticky, whether it's in service charges or whether it's in rates."[1]

According to some views of oligopoly, the few sellers manage to earn monopoly, or excess, profits by restricting output and increasing prices. Other views of oligopoly suggest that it is difficult to get all the firms in the industry to restrict output and charge higher-than-competitive prices, because it can profit individual firms to chisel and offer increased output at slightly lower prices. Chiselling and the retaliation it produces can lead to competitive levels for output and price. The most recent theories of oligopoly (called contestability theories) argue that potential competition could lead the few sellers now in a market to price near the competitive price. If firms now outside the industry can easily enter and leave the industry — hit-and-run entry — the few firms in the industry could not charge monopoly prices (and reap monopoly profits) or new firms would enter the industry and force prices down. What these newer theories of oligopoly argue is that fewness does not necessarily imply high prices and excess profits.

The theory of oligopoly one wishes to accept may be irrelevant as the market for credit card services is actually characterized by many, not few, sellers. The table in the first major section of this paper lists many credit card issuers, though the list is only partial. Most of the issuers on the list are in competition with all the other card issuers on the list. Even those issuers with regional cards compete in their region with the national cards. The list also gives no indication of potential competition faced by current card issuers.

Research by the Board of Governors of the Federal Reserve System supports the view that competition is intense among card issuers:

> A large number of suppliers in a market usually is taken as a sign of competitive conditions. In this respect, there is no doubt that many commercial banks, retail stores, and other firms currently offer credit cards of some kind to consumers. Moreover, what used to be known as "bank" credit cards are now issued by a growing number of credit unions, finance companies, savings and loan associations, and others. Thus, there are likely to be a number of competing bank and retail credit cards available in almost any market area. *Under these conditions, it seems doubtful that a credit card issuer could maintain a position of monopoly power.*

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[1] Quoted in Financial Times, September 8, 1986, p. 19, 22.

Indeed, the marketing practices of credit card issuers suggest a zeal for obtaining new customers that generally is associated with vigorous competition.[1]

Perhaps the best way to see the intensity of competition among card issuers is to take an example of a particular card issuer and show the competition that this issuer faces. What, for example, are the competitive pressures faced by a bank that issues a Visa card? The first source of competition is that confronted by any credit card. Consumers can short-circuit the entire credit card process by using cash or cheques as a means of payment; credit card issuers must take this into account when deciding on transaction fees for card users.

Even if a consumer decides to pay by credit card, the card used may not be the Visa issued by the bank in the example. The issuing bank faces competition first from other issuers of Visa cards. There are currently at least twenty issuers of Visa cards and there are new financial institutions — new banks, co-ops, credit unions, trust companies — that could join the fray.

All these Visa issuers also compete against those financial institutions that issue Master Card. Visa and Master Card are obviously close substitutes, competing for acceptance by merchants and use by consumers. If users or merchants thought the terms on Master Card were better than those for Visa, there would be less use of Visa cards. Competition among issuers of bank cards forces the terms on these cards to be similar.

Issuers of bank cards also compete with other card issuers. Restaurants and shops that accept, say, American Express will probably also accept one or both bank cards, other travel and entertainment cards (such as Carte Blanche) and possibly other cards (Air Canada's *en Route* card is now accepted at many restaurants and hotels). In the past two years, several of the large department stores in Canada have begun accepting bank cards in addition to their own private label cards. An exception is Sears. One reason for the exception may be that Sears in the U.S. has introduced a new financial services card (the Discover Card) that will compete with bank cards, and Sears could introduce this card in Canada.

Competition among the various card issuers takes many forms. The table in the first major section of this paper shows that the price of credit card service is more than simply the quoted interest rate charged overdue balances. Interest rates do vary, but so do annual fees, transaction fees, length of the grace period and the method used to calculate the balance on which interest is charged. All these elements show that pricing credit card services is extremely complicated, and an issuer competes by trying to convince card users that the effective price of its card is lower than the effective price of other cards. The effective price, which takes into account all the elements of pricing, will differ among card users.

Card issuers also compete using non-price elements of credit cards. Some premium cards offer automatic travel insurance when tickets are purchased with these cards; some cards offer tie-ins with other financial services such as lines of credit. Many card issuers stress the convenience of their cards and strive to sign up as many merchants as possible and arrange links with merchants outside Canada. Premium cards such as the American Express gold card carry some status and are advertised accordingly. Air Canada markets its *en Route* cards to business users and offers flexibility in billing — the accounting format and timing of the statements can be tailored to the needs of a business. Retailers may offer special notice of sales to their card holders.

This non-price competition shows that competition is intense among card issuers and that the interest rate on card balances might not be the most important aspect of a card to potential users.

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[1] Statement by Martha R. Seger reprinted in Federal Reserve *Bulletin*, December 1985, p. 945. Emphasis added.

There are, however, two aspects of credit card operations that suggest that competition among card issuers is not so intense that all excess profit in these operations has been eliminated. The first is the example of Sears in the United States. The banks there have argued that card operations are not excessively profitable and prices are in line with the higher costs of these operations. Sears has introduced the Discover Card to compete with bank cards, so Sears must think that there is enough profit in credit cards to warrant the introduction of a new card. Perhaps Sears, with its nationwide operations, thinks that it can provide more efficient card services and thus make a profit by having lower costs then its competitors. On the other hand, Sears may have analysed the market for credit cards and decided that profits were high enough to support the investment in introducing a new credit card.

The second exception to the picture of fierce competition among card issuers is the level and stability of rates on cards charged by retailers. Most retailers in Canada are charging 28.8 per cent on card balances and this rate — retailers call it a service charge rate not an interest rate — has not changed for years. If competition were fierce and card users paid any attention to the rates on cards, one would expect to see some retailers attempting to alter rates (or other terms on credit cards) and increase market share. Retailers may, of course, prefer to compete by altering the prices of the goods they sell, but the Finance Committee should examine the stickiness of rates on the credit cards of retailers.

## CONCLUSIONS

The Order of Reference from the House of Commons to the Finance Committee was:

> That the Standing Committee on Finance and Economic Affairs be empowered to study the present interest rates charged by the issuers of credit cards and charge cards.

This paper has provided background information for such a study. An important finding is that interest rates are but one dimension of the pricing of credit card services. The rates themselves are high relative to other interest rates, but the differentials between the credit card rate and other rates (the prime rate and the consumer loan rate) are now back to the magnitude they had for most of the seventies.

The costs of providing credit card services are high, and the ratio of the cost of funds to total costs is lower than this ratio for other bank activities. Based on partial evidence for Canada and more complete evidence for the U.S., profits for card operations are not excessive. That prices are in line with costs (and, accordingly, profits are not excessive) is a result consistent with the presence of intense competition among card issuers.

If these findings stand after the hearings and deliberations of the Finance Committee, there will be no basis to call for ceilings on credit card rates. The Committee can, however, provide a useful service to Canadian consumers by prodding card issuers to provide better information about all the charges on credit cards and about the methods used to calculate the interest-bearing balances (especially for those card users who have made a partial payment of their statement balances). The Committee might also provide better information about the options open to card users who have interest-bearing balances; there are several lower-cost alternatives that consumers may not now realize.

# JURISDICTION OVER CREDIT CARDS

## INTRODUCTION

Identifying legislation which is applicable to credit cards is not as simple an exercise as it may seem. There are two principal factors which make this difficult. First, credit cards are not in their own right the subject matter of specific legislation. But credit cards as a financial tool used in a special form of credit transaction involve several dimensions which may be the subject matter of specific legislation or engage legislation of general application. These dimensions include: contract, interest, consumer transactions, money-lending, debtor-creditor relationships, banks and near-banks. It would be more useful, therefore, to formulate the question in general terms: what legislation applies to commercial transactions involving the use of credit cards?

Secondly, because of the various dimensions to a commercial transaction, both levels of government may have jurisdiction over one or more of these dimensions and thereby over commercial transactions involving the use of credit cards. It is necessary, therefore, to examine briefly the different heads of power under the *Constitution Act, 1982* which may govern the various dimensions. This in turn may enable us to identify legislation which, while not obvious on its face, may affect credit cards and their use.

## CONSTITUTIONAL ISSUE

### A. Federal Jurisdiction

The actual and potential sources of federal control may be found under the following heads of power: the regulation of trade and commerce (section 91(2)), banking, incorporation of banks and the issue of paper money (section 91(15)), savings banks (section 91(16)), interest ((section 91(19((, bankruptcy and insolvency (section 91(21)), and criminal law (section 91(27)).

The relevance of section 91(2), regulation of trade and commerce, may be diminished in light of judicial interpretations which hold that it does not support federal legislation designed to regulate a single trade or industry.[1] Section 91(15), banking, is of direct and increasing relevance given an elastic judicial interpretation of the term "banking" which can accommodate modern expansions of banking services such as the provision and administration of credit cards and credit card transations.[2]

Section 91(19), interest, is subject to an important qualification. The authority to control interest does not permit the federal government to encroach on the general provincial power under section 92(13), property and civil rights, to legislate in matters of contract law, or conversely does not rule out concurrent provincial legislation which, while regulating one aspect of a contract, may incidentally affect interest.[3]

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[1] *Citizens' Insurance Co. v. Parsons* (1881) 7 App. Cas. 96.

[2] See decision of Viscount Simon in *A.-G. Alta. v. A.-G. Can.* (*Alberta Bill of Rights*) [1947] A.C. 503.

[3] See the Supreme Court of Canada's decision on the constitutionality of the *Unconscionable Transactions Relief Act*, R.S.O. 1950, c. 514, in *A.-G. Ont. v. Barfried Enterprises* [1963] S.C.R. 570.

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**B. Provincial Jurisdiction**

Provincial jurisdiction over any or all of the facets of credit card transactions would rest on section 92(13) of the *Constitution Act, 1867*, which deals with "property and civil rights in the province". Specific federal heads of power such as section 91(19), interest, and 91(21), bankruptcy and insolvency, contemplate federal incursions into this field.

## LEGISLATION

**A. Federal**

Federal statutes of direct or indirect application to credit card transactions include:

a) *Bank Act*, S.C. 1980, c. 40—insofar as most major chartered banks issue credit cards, this aspect of "banking" is sanctioned under 173(1). Section 202(6) prescribes disclosure requirements with respect to the cost of borrowing and the rights and obligations of an individual using a credit or charge card.

Many "near-banks" such as trust companies, credit unions and caisses populaires would not come under the Act, and, in fact, may be subject to provincial legislation or federal legislation such as the *Canada Business Corporation Act*, S.C. 1974-75, c. 33, as amended, or the *Trust Companies Act*, R.S.C. 1970, c. S-11, as amended, which applies to "money-lenders", or business entities other than banks carrying on the business of money-lending.

b) *Criminal Code*, R.S.C. 19780, c. C-34, as amended—several provisions are directly applicable to credit cards. Section 320(b) makes it an offence to obtain credit by false pretences or fraud. Section 301.1 deals with the offence of using a revoked or stolen credit card.

Section 305.1 deals with the charging of "criminal interest rates" or loansharking. Its applicability to loans advanced under a credit card is remote given the definition of "criminal interest rate" as: "An effective annual rate of interest calculated in accordance with generally accepted acturial practices and principles that exceeds 60% on the credit advanced under an agreement or arrangement."

c) *Interest Act*, R.S.C. 1970, c. I-18. As noted earlier, provincial legislation on other aspects of commercial or consumer transactions may also incidentally affect interest.

**B. Provincial**

Ontario is taken as an example. The following statutes may have direct or indirect application:

a) *Consumer Protection Act*, R.S.O. 1980, c. 87—Part III is devoted exclusively to credit transactions to ensure disclosure of the cost of borrowing. Credit transactions include the extension of variable credit which defines the nature of credit transactions involving credit cards.

b) *Consumer Reporting Act*, R.S.O. 1980, c. 89—the Act governs the collection and disclosure of credit information.

c) *Residential Tenancies Act*, R.S.O. 1980, c. 452—section 11(2) prohibits a landlord from accepting the payment of rent by means of a credit card.

d) *Unconscionable Transactions Relief Act*, R.S.O. 1980, c. 514, as amended—the Act may affect the cost of borrowing. An early case under the Act, however, appears to limit its application to the lending of money on the security of real estate.[1]

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[1] *Shedler* v. *Jackson* [1954] O.W.N. 245 (Master).

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# MINUTES OF PROCEEDINGS

**THURSDAY, DECEMBER 4, 1986**
**(15)**

(*TEXT*) (*Issue No. 42*)

The Standing Committee on Finance and Economic Affairs met *in camera* at 10:16 o'clock a.m. this day, in Room 112-N (Centre Block), the Chairman, Don Blenkarn, presiding.

*Members of the Committee present*: Don Blenkarn, Michael Cassidy, Murray Dorin, Paul McCrossan, George Minaker, Aideen Nicholson, André Plourde, Norman Warner and Geoff Wilson.

*In attendance*: *From the Research Branch of the Library of Parliament*: Laurent Desbois and Terrence J. Thomas, Research Officers.

By unanimous consent, the Committee resumed consideration of its Order of Reference under Standing Order 96(2), in relation to the present interest rates charged by the issuers of credit and charge cards. (*See Minutes of Proceedings and Evidence, Wednesday, November 26, 1986, Issue No. 10*).

The Committee proceeded to the consideration of certain guidelines relating to the Draft Report to the House.

At 12:01 o'clock p.m., the Committee adjourned to the call of the Chair.

**THURSDAY, JANUARY 22, 1987**
**(26)**

The Standing Committee on Finance and Economic Affairs met *in camera* at 10:06 o'clock a.m. this day, in Room 112-N (Centre Block), the Chairman, Don Blenkarn, presiding.

*Members of the Committee present*: Bill Attewell, Don Blenkarn, Michael Cassidy, Murray Dorin, Raymond Garneau, the Hon. Robert E. J. Layton, Paul McCrossan, George Minaker, Aideen Nicholson, André Plourde, Norman Warner and Geoff Wilson.

*Other Member present*: Reginald Stackhouse

*In attendance*: *From the Research Branch of the Library of Parliament*: Laurent Desbois and Terrence J. Thomas, Research Officers.

The Committee resumed consideration of its Order of Reference under Standing Order 96(2), in relation to the present interest rates charged by issuers of credit and charge cards. (*See Minutes of Proceedings and Evidence, Wednesday, November 26, 1986, Issue No. 10*).

The Committee proceeded to the consideration of the Draft Report to the House.

At 12:12 o'clock p.m., the Committee adjourned to the call of the Chair.

**MONDAY, FEBRUARY 9, 1987**
**(37)**

The Standing Committee on Finance and Economic Affairs met *in camera* at 7:38 o'clock p.m. this day, in Room 253-D (Centre Block), the Chairman, Don Blenkarn, presiding.

*Members of the Committee present*: Bill Attewell, Don Blenkarn, Michael Cassidy, the Hon. Robert E.J. Layton, Paul McCrossan, Aideen Nicholson and Geoff Wilson.

*In attendance*: *From the Research Branch of the Library of Parliament*: Laurent Desbois and Terrence J. Thomas, Research Officers.

At 8:25 o'clock p.m., the Committee resumed consideration of its Order of Reference under Standing Order 96 (2), in relation to the present interest rates charged by issuers of credit and charge cards. (*See Minutes of Proceedings and Evidence, Wednesday, November 26, 1986, Issue No. 10*).

The Committee proceeded to the consideration of its future business.

At 9:31 o'clock p.m., the Committee adjourned to the call of the Chair.

**THURSDAY, MARCH 5, 1987**
**(44)**

The Standing Committee on Finance and Economic Affairs met *in camera* at 10:06 o'clock a.m. this day, in Room 112-N (Centre Block), the Chairman, Don Blenkarn, presiding.

*Members of the Committee present*: Bill Attewell, Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Raymond Garneau, the Hon. Robert E.J. Layton, George Minaker, Aideen Nicholson, André Plourde, Norman Warner and Geoff Wilson,

*Acting Member*: Jim Jepson for Paul McCrossan.

*In attendance*: *From the Research Branch of the Library of Parliament*: Laurent Desbois and Terrence Thomas, Research Officers.

At 10:20 o'clock a.m., the Committee resumed consideration of its Order of Reference under Standing Order 96(2) in relation to the present interest rate charged by the issuers of credit and charge cards. (*See Minutes of Proceedings and Evidence, Wednesday, November 26, 1986, Issue No. 10*).

The Committee resumed consideration of the Draft Report to the House.

At 12:05 o'clock p.m., the Committee adjourned to the call of the Chair.

**TUESDAY, MARCH 10, 1987**
**(47)**

The Standing Committee on Finance and Economic Affairs met *in camera* at 8:14 o'clock p.m. this day, in Room 112-N (Centre Block), the Chairman, Don Blenkarn, presiding.

*Members of the Committee present*: Bill Attewell, Don Blenkarn, Michael Cassidy, Murray Dorin, Raymond Garneau, Paul McCrossan, Aideen Nicholson, André Plourde and Geoff Wilson.

*Other Member present*: Reginald Stackhouse.

*In attendance*: *From the Research Branch of the Library of Parliament*: Laurent Desbois and Terrence J. Thomas, Research Officers.

The Committee resumed consideration of its Order of Reference under Standing Order 96(2), in relation to the present interest rates charged by the issuers of credit and charge cards. (*See Minutes of Proceedings and Evidence, Wednesday, November 26, 1986, Issue No. 10*).

The Committee resumed consideration of the Draft Report to the House.

At 9:51 o'clock p.m., the Committee adjourned to the call of the Chair.

**WEDNESDAY, MARCH 11, 1987**
**(48)**

The Standing Committee on Finance and Economic Affairs met *in camera* at 3:44 o'clock p.m. this day, in Room 371 West Block, the Chairman, Don Blenkarn, presiding.

*Members of the Committee present*: Bill Attewell, Don Blenkarn, Michael Cassidy, Murray Dorin, Raymond Garneau, the Hon. Robert E. J. Layton, Paul McCrossan, George Minaker, André Plourde, Norman Warner and Geoff Wilson.

*Other Member present*: Reginald Stackhouse.

*In attendance*: *From the Research Branch of the Library of Parliament*: Laurent Desbois and Terrence J. Thomas, Research Officers.

By unanimous consent, at 4:05 o'clock p.m., the Committee resumed consideration of its Order of Reference under Standing Order 96(2) in relation to the present interest rates charged by the issuers of credit and charge cards. (*See Minutes of Proceedings and Evidence, Wednesday, November 26, 1986, Issue No. 10*).

The Committee resumed consideration of the Draft Report to the House.

At 5:37 o'clock p.m., the Committee adjourned to the call of the Chair.

**TUESDAY, MARCH 17, 1987**
**(52)**

The Standing Committee on Finance and Economic Affairs met *in camera* at 8:39 o'clock p.m. this day, in Room 253-D (Centre Block), the Chairman, Don Blenkarn, presiding.

*Members of the Committee present*: Bill Attewell, Don Blenkarn, Michael Cassidy, Murray Dorin, Raymond Garneau, Aideen Nicholson and Norman Warner.

*Acting Member present*: Reginald Stackhouse for Geoff Wilson.

*In attendance*: *From the Research Branch of the Library of Parliament*: Laurent Desbois and Terrence J. Thomas, Research Officers.

The Committee resumed consideration of its Order of Reference under Standing Order 96(2) in relation to present interest rates charged by issuers of credit and charge cards. (*See Minutes of Proceedings and Evidence, Wednesday, November 26, 1986, Issue No. 10*).

The Committee resumed consideration of the Draft Report to the House.

At 9:50 o'clock p.m., the Committee adjourned to the call of the Chair.

THURSDAY, MARCH 19, 1987
(54)

The Standing Committee on Finance and Economic Affairs met at *in camera* 10:24 o'clock a.m. this day, in Room 253-D (Centre Block), the Chairman, Don Blenkarn, presiding.

*Members of the Committee present*: Bill Attewell, Don Blenkarn, Michael Cassidy, Murray Dorin, Raymond Garneau, Aideen Nicholson and Norman Warner.

*Acting Members present*: Reginald Stackhouse for Geoff Wilson and Marcel Tremblay (*Québec East*) for the Honorable Robert E.J. Layton.

*In attendance*: *From the Research Branch of the Library of Parliament*: Laurent Desbois and Terrence J. Thomas, Research Officers.

The Committee resumed consideration of its Order of Reference under Standing Order 96(2) in relation to the present interest rate charged by the issuers of credit and charge cards. (*See Minutes of Proceedings and Evidence, Wednesday, November 26, 1986, Issue No. 16*).

The Committee resumed consideration of the Draft Report to the House.

It was agreed,—That the Draft Report, as amended, be concurred in.

ORDERED,—That the Chairman present to the House the Draft Report, as amended, as the Committee's Fifth Report to the House.

It was agreed,—That the background paper *Interest Rates and Credit Cards* (15 October 1986), prepared by Laurent Desbois and Terrence J. Thomas, Research Officers from the Library of Parliament, be appended to the printed version of the Committee's Fifth Report to the House.

At 11:51 o'clock a.m., the Committee adjourned to the call of the Chair.

Marie Carrière
*Clerk of the Committee*

THURSDAY, MARCH 19, 1987
(54)

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*Acting Members present*: Reginald Stackhouse for Geoff Wilson and Marcel Tremblay (*Québec East*) for the Honorable Robert E.J. Layton.

*In attendance*: *From the Research Branch of the Library of Parliament*: Laurent Desbois and Terrence J. Thomas, Research Officers.

The Committee resumed consideration of its Order of Reference under Standing Order 96(2) in relation to the present interest rate charged by the issuers of credit and charge cards. (*See Minutes of Proceedings and Evidence, Wednesday, November 26, 1986, Issue No. 16*).

The Committee resumed consideration of the Draft Report to the House.

It was agreed,—That the Draft Report, as amended, be concurred in.

ORDERED,—That the Chairman present to the House the Draft Report, as amended, as the Committee's Fifth Report to the House.

It was agreed,—That the background paper *Interest Rates and Credit Cards* (15 October 1986), prepared by Laurent Desbois and Terrence J. Thomas, Research Officers from the Library of Parliament, be appended to the printed version of the Committee's Fifth Report to the House.

At 11:51 o'clock a.m., the Committee adjourned to the call of the Chair.

Marie Carrière
*Clerk of the Committee*

**LE JEUDI 19 MARS 1987**
**(58)**

Le Comité permanent des finances et des affaires économiques se réunit, à *huis clos*, ce jour à 10 h 24, dans la pièce 253-D de l'édifice du centre, sous la présidence de Don Blenkarn (président).

*Membres du Comité présents:* Bill Attewell, Don Blenkarn, Michael Cassidy, Murray Dorin, Raymond Garneau, Aideen Nicholson et Norman Warner.

*Membres suppléants présents:* Reginald Stackhouse pour Geoff Wilson et Marcel Tremblay (*Québec-est*) pour l'honorable Robert E.J. Layton.

*Aussi présents: Du Service de recherches de la Bibliothèque du Parlement:* Laurent Desbois et Terrence J. Thomas, attachés de recherche.

En vertu du mandat que lui confère l'article 96(2) du Règlement, le Comité reprend l'étude de son ordre de renvoi relatif aux taux d'intérêt d'intérêt actuels exigés par les émetteurs de cartes de crédit (*Voir Procès-verbaux et témoignages du mercredi 26 novembre 1986, fascicule n° 10*).

Le Comité reprend l'étude d'un projet de rapport à la Chambre.

Il est convenu, - Que le projet de rapport, tel que modifié, soit adopté.

*IL EST ORDONNÉ*—Que le président présente à la Chambre le projet de rapport, tel que modifié, à titre de Cinquième Rapport du Comité à la Chambre.

Il est convenu,—Que le document de travail intitulé *Les taux d'intérêt et les cartes de crédit* (15 octobre 1986), préparé par Laurent Desbois et Terrence J. Thomas, attachés de recherche de la Bibliothèque du Parlement, figure en appendice au Cinquième Rapport du Comité à la Chambre.

À 11 h 51, le Comité s'ajourne jusqu'à nouvelle convocation du président.

*Le greffier du Comité,*
Mario Carrière