



Credit cards:
New Solutions for Better Consumer Protection
(Executive summary)

Report produced by Option consommateurs
and presented to
Industry Canada's Office of Consumer Affairs

2009

In consumer contracts, highly sophisticated corporations will often exploit consumers' behavioral biases. Competition cannot cure such exploitation. On the contrary, competitive forces compel sellers to take advantage of consumers' weaknesses.

Oren Bar-Gill,
Faculty of Law, New York University

OPTION CONSOMMATEURS

MISSION

Option consommateurs is a not-for-profit association whose mission is to defend the rights and interests of consumers and to ensure that they are respected.

HISTORY

Option consommateurs has been in existence since 1983, when it arose from the *Associations coopératives d'économie familiale* movement, more specifically, the Montreal ACEF. In 1999 it joined forces with the *Association des consommateurs du Québec* (ACQ), which had already pursued a similar mission for over 50 years

PRINCIPAL ACTIVITIES

Options consommateurs has a team of some 30 employees working in five departments: Budgeting, Energy Efficiency, Legal Affairs, Press Room, and Research and Representation. Over the years, *Option consommateurs* has developed special expertise in the areas of financial services, health, agrifood, energy, travel, access to justice, trade practices, indebtedness, and the protection of privacy. Every year, we reach 7,000–10,000 consumers directly, conduct numerous interviews in the media, participate in working groups, sit on boards of directors, carry out large-scale projects with key partners, and produce research reports, policy papers and buyers' guides, including the annual *Toy Guide* in *Protégez-vous* magazine.

MEMBERSHIP

In its quest to bring about change, *Option consommateurs* is active on many fronts: conducting research, organizing class action suits, and applying pressure on companies and government authorities. You can help us do more for you by becoming a member of *Option consommateurs* at www.option-consommateurs.org.

ACKNOWLEDGMENTS

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EXECUTIVE SUMMARY

Context

Since the appearance of the first Diner's Club credit card in Manhattan in 1950, there has been an explosion worldwide in the number of cards and the quantity of purchases they have been used to finance.

In 1977, there were 8.2 million credit cards in circulation in Canada. In 2003, there were 50.4 million and in October 2008, 68.2 million. From 1996 to 2008, the annual volume of credit card transactions grew from 903.5 million to over 2.4 billion¹.

Considering the size of the credit card market, particularly in North America, we considered it a priority to include the business or marketing practices aimed at convincing consumers to obtain one or more cards as well as the traps that such practices may conceal.

A growing number of authors claim that credit cards, unlike cash or other modes of payment, encourage not only spending but also borrowing². We therefore decided to target practices that seem designed to incite Canadian consumers to spend and borrow. We wanted to determine the impact of these practices on consumers' finances and budgets. We chose five current practices that in our view satisfy these criteria and whose budgetary impact can be measured in a relatively reliable manner:

1. Preferential introductory rates and balance transfers
2. Cash advance cheques
3. Reduced minimum required payments

¹ Jacinthe Tremblay, "Le diktat du plastique," *La Presse*, Sunday, March 7, 2004, p.5 quoted from *l'Association des Banquiers Canadiens, système automatisé de compensation et de règlement et rapport 2000 du comité sur les systèmes de paiements et de règlement du groupe des 10* and Canadian Bankers Association, *Les cartes de crédit*, <http://www.cba.ca/fr/content/stats/fastfacts/090130b%20-%20Credit%20Cards%20FR%20Updated.pdf>, URL consulted on 20-02-09

² Oren Bar-Gill, *Seduction by Plastic*, American Law & Economics Association Annual Meeting from American Law & Economics Association, 14th Annual Meeting, April 2004, 66 pages, On line: <http://law.bepress.com/cgi/viewcontent.cgi?article=1013&context=alea>, 12-12-08, pp. 12 and 13

4. Payment holidays
5. Cash back programs

Methodology

Out of all the practices used by credit card issuing companies to attract consumers, we identified five whose financial and budgetary impact can be measured relatively accurately.

For each practice identified, we gave a short history together with as a description of how it works. We then attempted to identify the principal advantages and disadvantages for consumers.

In order to ensure that the documents we quote as examples are truly representative, they were selected according to the following criteria:

- They were produced by the financial institutions with the largest share of the Canadian credit card market.
- They were produced by institutions that, to our knowledge, do the most advertising.
- They incorporated atypical or original practices.

We then called on the expertise of chartered accountant and financial planner Mr. Éric Brassard to determine the potential impact of these practices on consumers' finances.

For each of these practices, we also took into account, whenever relevant, the "psychology of the consumer" in order to determine how the practice in question might influence consumers' choices and behaviour.

We then studied the legality of these five practices in Canada, particularly in Quebec, Ontario and British Columbia.

Finally, we held discussions with two Canadian and three American informants with expertise in credit card regulation. We collected their opinions on each of the five practices targeted by this report. We also asked them for their opinions regarding solutions to the problems we raise in this study.

Results

After studying each of the five identified practices, we concluded that they could all have a negative impact on the financial health of card holders. Such practices are symptomatic of an industry which, in its search for profits, has ended up totally disconnected from the needs of its clients.

Indeed, the consumers most likely to be attracted by such bait are often those in the greatest financial difficulty. Since the credit card products studied are aimed primarily at clients who already have difficulty paying or who pay monthly interest on their credit cards, it appears obvious to us that the stringent rules accompanying these offers (numerous restrictions, multiple charges, shortening – even eliminating – grace periods, rising interest rates, etc.) penalize the consumer.

Our research also revealed that advertising material, solicitation and credit card contracts are most often presented in such a way as to exploit the errors and weaknesses of consumers. It is our opinion that credit card issuers use these strategies to abuse their dominant position to the detriment of consumers.

Finally, we were better able to measure the size of the credit card system. The five practices that we studied form part of a gigantic, complex whole of changing contractual clauses, additional charges, fluctuating interest rates, etc.

Attempting to correct the power relationship between consumers and these companies by targeting only five commercial practices can be compared to putting a bandaid on a malignant tumour. It may be motivated by goodwill, but it is like trying to stop the wind.

The credit card industry is an extremely powerful industry that carries out very effective lobbying in both Canada and in the United States.

We do not believe that any legislative intervention aimed at one commercial practice or another is likely to convince the credit card industry to join the ranks of responsible merchants. It will probably require intervention by the courts – and that could take a very long time. Option consommateurs therefore believes that, in the short term, the Canadian provinces need to submit all the rules relating to the credit industry to an in-depth study.

Given all the practices we observed during this research, we fear that the American experience could be repeated here: lobbying in order to modify, even invalidate, the rules governing consumer protection and tightening those related to bankruptcy, the growing debt recovery market, adding new charges, attempting to circumvent existing regulations by employing unregulated forms of advertising or by dissimulating information in tiny print³, etc.

This business model produced the disastrous consequences that we have come to know. Moreover, given the near absence of laws and regulations, it is very difficult for American consumers to obtain redress when they suffer injustice. In fact, it is impossible to claim that the law has been violated when the law no longer exists.

Finally, in the context of the current financial crisis, we do not believe that the situation of Canadians could be improved merely by sprinkling it with a few of the recommendations in this report. The recommendations we present form a unit and, in our opinion, they must all be adopted in order to be effective.

³ Iain Ramsay, [From Truth in Lending to Responsible Lending](http://www.iaclaw.org/Research_papers/Truthinlendingtoresponsiblelending.pdf), Osgoode Hall Law School, York University, Toronto, Canada, 19 pages. On line: http://www.iaclaw.org/Research_papers/Truthinlendingtoresponsiblelending.pdf, 07-11-08, p. 3

Recommendations

- We recommend that the Department of Finance undertake a thorough study of electronic payments. The roles, responsibilities and obligations of the various parties involved must be identified, and the groundwork laid for the establishment of a complete regulatory framework governing electronic payments;
- We recommend that the government regulate and monitor commercial practices related to the cost of credit and information disclosure such as the calculation and the impact of minimum payments, late charges and other penalties, interest rate changes, appropriation of payments, retroactive interest, advances, unilateral contract modifications, advertising, soliciting clients in stores, etc;
- We recommend that the federal authorities, in particular the Department of Finance and the Bank of Canada, in partnership with representatives of consumers and industry, bring in legislation to control credit cards. This exercise should include the adoption of clear, uniform rules governing consumer credit, particularly with regard to calculating the credit rate and compulsory charges. Such rules would ensure the existence of a uniform Canada-wide legislative base, which would then be supplemented by provincial consumer protection legislation.
- We recommend that legislation be adopted to establish a floating ceiling on the interest rates that credit card issuer are allowed to impose;
- We recommend legislation aimed at making the use of simple language compulsory in all credit card contracts, forms and advertising. We also recommend that the information be presented in a user-friendly way. A presentation using tables, combined with the use of average-sized characters could influence consumers in deciding whether or not to read the information provided to them. It is of the utmost importance that financial education measures

- be undertaken in collaboration with provincial education departments to ensure that this recommendation is implemented effectively;
- We recommend that the regulations governing commercial practices related to credit charges be accompanied by measures aimed at ensuring responsible lending. In particular, we recommend that personal meetings between the financial institutions and credit card applicants be made compulsory in order to evaluate the latter's real ability to repay before a card is issued. These meetings should require the card issuer not only to provide simple, compulsory information, but also advice. If this were done, financial institutions would help consumers choose the form of credit most appropriate to their needs based on their financial standing, the advantages and disadvantages associated with the product and the consumer's reasons for seeking to obtain credit⁴.

⁴ Iain Ramsay, *From Truth in Lending to Responsible Lending*, Osgoode Hall Law School, York University, Toronto, Canada, 19 pages. On line: http://www.iaclaw.org/Research_papers/Truthinlendingtoresponsiblelending.pdf, 07-11-08, p. 11