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FINANCIAL SERVICES
CLIENT UPDATE

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PAYMENT CARD NETWORKS MUST ADOPT CODE OF CONDUCT OR FACE REGULATION

The federal government is poised to regulate the commercial practices of credit and debit card networks if they do not adopt the "Code of Conduct for the Credit and Debit Card Industry in Canada" (the "Code") voluntarily by May 17, 2010. The final form of the Code was announced by Canada's Minister of Finance, Jim Flaherty on April 16, 2010 together with a warning that regulation would follow if necessary.¹

The Effect of the Code's Policy Elements

With the May 17, 2010 deadline now upon us, and given that Visa, MasterCard, American Express and Interac have announced they will adopt the Code, industry participants will be interested to know how the Code will affect their businesses. One of the biggest shifts between the draft form of the Code released in November 2009 and the final form of the Code is that co-badged debit cards with competing applications from different networks will not be permitted on the same card, eliminating the ability to have Interac point-of-sale debit and Visa or MasterCard point-of-sale debit on the same card. A related change is the removal from the final form of the Code of a merchant's right to choose the lowest cost debit option on co-badged debit cards. This change addresses the systems and routing issues that would be faced by acquirers and processors if merchants were permitted to choose between competing debit applications on the same card. However, it poses challenges for issuers that may have already issued such co-badged debit cards. Fortunately, the Code allows issuers up to one year to reissue cards that breach this "Policy Element".

The federal government has also made it clear that all of the "Policy Elements" (which are no longer recommended but are better described as mandated) must be adopted and the Code must be incorporated, in its entirety, into a payment network's contracts, governing rules and regulations. We anticipate that all payment card networks will prefer adopting the Code, by incorporating the

¹ For a discussion of the measures the federal government has taken in this regard, please see our article entitled "[Between the Lines: Feds begin to implement greater regulatory oversight of payment networks in Canada](#)". See also our article on the draft form of the Code entitled "[Proposed Voluntary Code of Conduct will Materially Affect Canada's Payments Systems if Adopted](#)".

PAYMENT CARD NETWORKS MUST ADOPT CODE OF CONDUCT OR FACE REGULATION

"Policy Elements" in a manner that is most convenient to their business and respective rules of operation, rather than being subject to direct and express regulation by the federal government.

The final form of the Code affects participants of Canada's Payment System in a number of ways. The following summarizes each participant's new obligations.

Payment Card Networks:

Payment card networks will bear the burden of ensuring that the issuers and acquirers in their payment network abide by the Code. The "Policy Elements" that payment card networks must include in their rules that relate solely to an issuer or an acquirer are described in more detail below. However, payment card networks will also have compliance obligations that relate to their own activities, not just those of acquirers or issuers, and the Code will have implications for their business models:

- they will have new disclosure requirements, including providing "any requested information regarding actions taken by themselves or participants to the Financial Consumer Agency of Canada" (the "FCAC"), the body that will be empowered by the federal government to monitor compliance with the Code;
- by adopting the Code, payment card networks will agree to pay fees assessed by the FCAC in connection with such monitoring;
- they will be required to post their interchange rates on their websites and post any upcoming changes to these fees once they are provided to acquirers;
- they must work with acquirers and merchants, possibly through merchant associations, to ensure that a "sufficient" level of detail is provided in the merchant-acquirer's contracts and monthly statements and that the contracts and statements are easy to understand; and
- they must provide acquirers with at least 90 days notice of any rate and/or fee increases (that are not made in accordance with pre-determined fee schedules) and at least 180 days notice of any structural changes (i.e. significant changes to the fee structure of a payment card network, including new interchange fees or changes to interchange rate structure).

Acquirers:

Acquirers, while clearly affected by the Code, will have most of the changes dictated to them by the payment card networks. The Code requires acquirers to:

- ensure that a "sufficient" level of detail is provided in the merchant-acquirer's contracts and monthly statements and that the contracts and statements are easy to understand;

PAYMENT CARD NETWORKS MUST ADOPT CODE OF CONDUCT OR FACE REGULATION

- in connection with this "sufficient" level of detail, include the following information in merchant statements in a manner that is clear, simple and not misleading:
 - the effective merchant discount rate for each type of payment card from a payment card network;
 - interchange rates and any other rates charged to the merchants by the acquirer;
 - the number and volume of transactions for each type of payment transaction; and
 - total amount of fees applicable to each rate;
- provide merchants with at least 90 days notice of any fee increases (that are not made in accordance with pre-determined fee schedules) or introduction of new fees related to credit or debit card transactions;
- include in the merchant contract the right of a merchant to cancel its contract without penalty within 90 days of receiving notice of a fee increase (other than fee increases made in accordance with pre-determined fee schedules) or the introduction of a new fee;
- not require merchants to "honour all cards" or accept both credit and debit payments from a particular payment card network;
- permit merchants to offer discounts for different methods of payment and among different payment card networks; and
- ensure that "negative option acceptance" is not allowed (i.e. merchants shall not be obligated to accept new products or services and must agree in writing to accept such products or services).

Since most of "Policy Elements" that affect acquirers will be required through the payment card network's rules, it appears that it will be the payment card networks that set out how the acquirers must meet their obligations under the Code. We note that acquirers will now benefit from an added disclosure that was not included in the draft form of the Code, since payment card networks must now provide acquirers with 90 days notice of rate and/or fee changes and 180 days notice of structural changes.

Issuers:

Issuers too will bear the burden of the Code. The obligations of issuers include:

- competing applications from different payment networks may not be offered on the same debit card, but complementary applications from different networks may exist on the same debit card;

PAYMENT CARD NETWORKS MUST ADOPT CODE OF CONDUCT OR FACE REGULATION

- co-badged debit cards must be equally branded (brand logos must be the same size, on the same side of the card, and must all be either black and white or in colour);
- payment cards must not be issued with credit payment functions and debit payment functions on the card; and
- premium credit and debit cards must only be issued to a "specific clientele who meet specific spending and income thresholds" who apply for or consent to such cards.

Within one year of a payment card network adopting the Code, issuers must re-issue any debit cards currently in circulation that either contain competing debit applications from different networks or are not "equally branded". Some industry insiders fear that the "Policy Element" which only allows complementary debit applications to exist on the same card will reduce competition in the marketplace and surmise that Visa and MasterCard are likely rethinking their business plans in the Canadian debit market in light of these developments. Any plans to develop payment options further by enabling credit and debit functions to be placed on the same card will need to be shelved.

One of the biggest questions that still remains is who will determine the specific qualifiers with respect to the issue of premium cards. The charges associated with premium cards were initially raised through merchants' complaints regarding increased interchange fees that are associated with these cards. It seems likely that either the payment card networks (through specific rules) or the issuers (through their policies) will decide who the "specific clientele" are and what the applicable "spending and income thresholds" will be.

Merchants:

Merchants, being the principal beneficiaries of this Code, will be provided more disclosure than is currently available and will be afforded certain rights and protections that are designed to "level the playing field". These include:

- the right to terminate contracts with acquirers without penalty within 90 days following notice of a fee increase (other than in accordance with pre-determined fee schedules) or the introduction of a new fee;
- the right to provide differential discounts for various payment methods and payment card networks;
- not being required to "honour all cards" from a payment card network and having the ability to choose to accept only debit or credit payments from a network without having to accept both; and

PAYMENT CARD NETWORKS MUST ADOPT CODE OF CONDUCT OR FACE REGULATION

- not being obligated to accept new products or services and must agree in writing to accept such products or services.

Under the draft form of the Code, merchants were able to choose which debit payment option they would accept when presented with co-badged debit cards. Since the final form of the Code expressly prohibits competing debit applications on the same payment card, this right has been removed from the Code.

Feds poised to regulate elements of the Code

The federal government has repeatedly indicated that if the participants of Canada's payment systems do not agree to adopt the Code, then it will regulate the industry. The introduction of Bill C-9 to the House of Commons, which has been studied by the House of Commons Standing Committee on Finance and reported by the Committee back to the House without amendment, will provide the federal government with express regulatory powers to dictate the elements of the Code. As a result, the major payment card networks have agreed to adopt the Code and we anticipate that they will work quickly to make any necessary modifications to their applicable rules and regulations to ensure all "Policy Elements" are addressed within 90 days of adopting the Code.

BLG will be there to alert our clients to new developments in this area that is changing rapidly and to assist our clients in determining how the Code will affect their businesses.

PAYMENT CARD NETWORKS MUST ADOPT CODE OF CONDUCT OR FACE REGULATION

Contact Us

If you would like to know more about this specific topic or have any questions regarding this topic and how it affects your business, please do not hesitate to call or write any member of the **BLG Financial Services Regulatory Group**.

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