MANAGING LEGAL RISK IN THE CANADIAN RETAIL ELECTRONIC PAYMENT SYSTEM:

THE CONSUMER'S PERSPECTIVE

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Executive Summary

Payments are essential to a modern economy, as they facilitate the exchange of value between market participants. Left on their own, they are inherently risky. It is necessary to mitigate those risks, and legal mechanisms are frequently used in order to do so. However, these legal mechanisms may be to some extent inadequate or inefficient. This report posits that such is currently the case in the Canadian retail payment ecosystem: legal mechanisms do not mitigate risk associated with payments as well as they could, which in itself generates legal risk. In short, in this area, the law falls short of expectations, with adverse consequences for all participants, and in particular for consumers.

According to a 2015 national Environics survey, only 48% of Canadian consumers profess to have "a great deal of trust" in electronic payment systems and 87% believe they should be comprehensively and consistently regulated. This lack of trust impacts negatively on the development of electronic payment systems in Canada and their acceptance by consumers.

Legal risk can result from the absence of a legal norm, from its ambiguity, from its inadequacy or from its unenforceability. There is no exhaustive compilation of consumer problems associated with payments in Canada. There are, however, some clues which indicate that consumers are experiencing challenges. Trying to identify the rules governing payments in Canada, and to assess which rule applies to a specific situation, is a remarkably complicated process.

Parts of the regulatory framework target payment mechanisms, such as currency and cheques, but eschew for the most part more recently developed types of instruments. Other parts are framed in institutional terms: the transaction is regulated insofar as a specific type of entity is the provider, but not otherwise. Parliament and the provinces have both legislated, and there may be apparent overlap in some cases and potential inconsistencies in how specific mechanisms are regulated. Nor can consumers necessarily rely on the contractual terms and policies of their banks and financial institutions to protect them, as these terms often bolster asymmetries between banks and customers and disrupt the market to the banks' very significant advantage. Customers' terms and conditions also make the market less efficient, and they allow banks to take operational and other risks without caring for the potential legal consequences, by purporting to shift legal risk squarely onto consumers' shoulders.

Canada requires a universal regulatory framework that is based on certain principles and consumer safeguards, including: universality and consistency (as comprehensive as possible), functional regulation (regulating a function rather than the nature of the provider), accountability (*e.g.* the "least cost avoider" principle), and objectives which go

further than promoting market efficiency and examine, for instance, social and financial inclusion.

This report sets out the following recommendations in order to lay a foundation for a strong regulatory framework for retail payments which will protect Canadian consumers.

Recommendation 1: Use the *United Nations Guidelines for Consumer Protection* as the basis for developing the principles governing a regulatory framework for retail payment mechanisms, including requirements for financial institutions to implement clear, concise and easy to understand contract terms that are not unfair, and to make clear the responsibility of the provider to provide services which are reliable.

Recommendation 2: Adopt the "least cost avoider" principle in all regulatory and policy development to ensure the market participant who is most able to mitigate a risk (or other problem), and at the lowest cost, should be required or incentivized to do so.

Recommendation 3: Reform all external regulatory complaint bodies, including the Ombudsman for Banking Services and Investments and ADRBO, to ensure it is well-resourced, has effective authority and enforcement powers, and includes mandatory participation of financial institutions.

Recommendation 4: Establish a universal, enforceable and mandatory federal financial consumer protection framework (including rules relevant to retail payments) which will apply to all transactions in Canada. This framework should harmonize existing rules and establish new obligations where appropriate, and should involve multi-stakeholder consultations, particularly with public interest and consumer groups.

Managing Legal Risk In The Canadian Retail Electronic Payment System: The Consumer's Perspective

1.0 Framing the Topic

1.1 Formulating hypotheses

Payments are essential to a modern economy, as they facilitate the exchange of value between market participants. Left on their own, they are inherently risky. It is necessary to mitigate those risks, and legal mechanisms are frequently used in order to do so. However, these legal mechanisms may be to some extent inadequate or inefficient. We posit that such is currently the case in the Canadian retail payment ecosystem: legal mechanisms do not mitigate risk associated with payments as well as they could, which in itself generates legal risk. In short, in this area, the law falls short of expectations, with adverse consequences for all participants.

Canadian consumers experience this shortfall and express at least amorphous discomfort about it. For instance, an October 2015 pan-Canadian survey by Environics shows that 17% of online bill payment mechanism users, and 12% of preauthorized debit users, have experienced a problem with those processes over the past two years, and in both cases 17% of those felt that the problem had not been settled to their satisfaction, with some opting to cease using the electronic payment mechanism as a result.[1] Anecdotal information obtained by Canadian consumer groups shows that there are frequent problems with other types of electronic payments, with consumers lacking any understanding of their rights and obligations. It is therefore perhaps unsurprising that, according to the same survey, only 48% of Canadian consumers profess to have "a great deal of trust" in electronic payment systems and 87% believe they should be comprehensively and consistently regulated.[2] The value of what is used in order to pay may change, or what is exchanged may be counterfeit (or might even not belong to the "payor"). The exchange may be compromised or delayed. If intermediaries are involved, which is usually the case, they may be incompetent or dishonest, or cease to operate. And, of course, all those participants may simply make occasional mistakes. Actually, what may seem remarkable is that most payments work well. This efficiency results from decades of experience understanding the risks and striving to mitigate them. Lack of trust

1 Centre d'intervention budgétaire et sociale de la Mauricie, *Accélérer le paiement électronique des factures : La perspectives des consommateurs* (Trois-Rivières : Centre d'intervention budgétaire et sociale de la Mauricie, 2016), online : Cibes-Mauricie.ca <https://cibes-mauricie.ca/wp-content/uploads/recherches/recherche-paiement.pdf> at pp 53 and 61.

2 *Ibid* at p 63.

impacts negatively on the development of electronic payment systems in Canada and their acceptance by consumers even though, as the Task Force for the Payments System Review documented in 2011-2012, migration to electronic payments would make the Canadian economy more efficient and competitive.[3]

This research seeks (1) to establish the nature and components of legal risk in retail payment systems, (2) to identify and describe concepts developed in legal theory that can underlie a coherent regulatory framework designed to mitigate these risks and (3) to identify, as a benchmark, current best regulatory practices in this area in the United States, European Union and Australia. From a methodological standpoint, the research was largely focused on documentary research and analysis, with interactions with key stakeholders complementing our work.

At this point, we formulate the hypothesis that legal risk in the Canadian retail payment system stems from three types of causes: first, the absence of norms and their ambiguity or inadequacy when they exist; second, that it takes on two aspects, i.e., substantive risk (a "bad" norm) and procedural risk (the absence of an appropriate forum to enforce a norm); and third, that it has impacts on market entry, market behaviour and reputation. We further posit that the current regulatory framework is unable to mitigate adequately such risk, and formulate the hypothesis that this inability stems from its lack of consistency in how it treats risk and the significant gaps in its coverage. We further hypothesize that there are regulatory principles which have been identified in the academic literature, and implemented in other jurisdictions, which could guide a review of our regulatory framework in order to make it more consistent, more complete and more effective.

1.2 Setting boundaries

1.2.1 Focusing on "electronic fund transfers"

Payments are omnipresent in markets. They involve practically everyone and they take different forms. In addition, the term "payment" is at the same time very broad and somewhat narrow: it may include transactions in kind, with which we are not concerned, and it might not be perceived as including, for instance, a consumer's request to transfer value from one account she holds in a financial institution to another account within the same institution, even though this operation may raise the same types of operational, financial or legal risk as a "payment" *per se*.

For our purposes, we therefore focus on a subset of payments (or analogous transactions) involving at least one physical person acting in Canada. More specifically,

3 Task Force for the Payments System Review, *Moving Canada into the Digital Age* (2011), online: <https://www.finextra.com/finextra-downloads/newsdocs/canadapaymentstaskforce.pdf>. See, for instance pp 4 and 6.

we define the term "payment" as the transfer of funds for personal or domestic purposes. And we acknowledge this requires some explanation.

First, we intend to discuss operations that involve a "transfer of funds". We adopt this terminology to avoid being hampered by the growing controversies over the notion of "money", while also excluding forms of performance in kind. We mean by "funds" a form of fungible property (material or immaterial) that is accepted by parties as having the power to extinguish an obligation, that can be transferred to another party under similar conditions and that has no intrinsic value apart from its uses as a financial instrument[4]. The notion as we define it, therefore, includes money *stricto sensu*, but also instruments whose status is less well-defined, such as cryptocurrencies and loyalty points.

In addition, there should be a "transfer". In other words, the relationship between the funds and their owner or possessor should change materially. In many cases, it will involve another entity to whom funds are transferred to satisfy an obligation, or who holds the funds on behalf of the transferor or another party. However, the notion includes an operation where an individual moves funds from her bank account to a prepaid card issued by that bank, for instance, or from her current bank account to a savings account.[5]

Finally, we consider operations that involve physical persons acting for personal or domestic purposes. This includes what would usually be deemed to be "consumer" transactions, but also operations where the physical person is the recipient of funds (such as government benefits or wages) and operations between physical persons. In other words, we intend to cover C2B, B2C and P2P operations, but exclude B2B[6]. We are therefore dealing exclusively with "retail" transactions involving at least one physical person.

In addition, we will focus primarily on electronic fund transfers, mostly because transactions involving cash or paper-based items, such as cheques, are already well regulated and therefore raise different types of legal risk.

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4 This last element excludes payments in kind; we acknowledge that it also excludes bullion, but specific risks associated with either type of payment mechanism exceed the remit of this analysis.

5 That is, we are trying to include transactions that do not necessarily fundamentally change the legal relationships between the parties, that is, there has not necessarily been a "payment" or assignment but the processes used to "move money" have been used. We do this as the potential for mistakes, errors and losses are virtually identical, from the consumer point of view, to other payments which do involve changing legal relationships between the parties.

6 Or, if the reader prefers, Consumer to Business, Business to Consumer, Person to Person and Business to Business.

1.2.2 The vexed question of payment "systems"

Many papers examining questions pertaining to payments and legal risk focus on the notion of payment "systems" [7]. This is to some extent understandable, since systems process large volumes of transactions, hence making up a significant proportion of the market. It is our belief that this insistence on addressing "systems", however, is misguided.

There is no clear definition of what a "system" might be. From an institutional perspective, the notion arguably includes networks such as Interac, MasterCard or Visa. But does it include the Canadian Payments Association [8], one of whose "systems" processes "retail" payments even though it has been designated by the Bank of Canada as a "prominent" system? Does it include PayPal, or issuers of prepaid cards?

What does it take to be a "system"? Infrastructure? Rules and procedures? Size? Any, or all of those factors? What would be the criteria associated with such factors?

Assuming for the sake of illustration that, for instance, so-called "card networks" are "systems", what entities and activities would actually come within the oversight perimeter: the network "operator" only, or also the card issuers, or the third-party processors? Do agreements between, say, an issuer and a consumer, or a merchant and an acquirer, come within the ambit of the "system" that is to be regulated? Or is the notion

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7 See *e.g.* Department of Finance Canada. *Balancing Oversight and Innovation in the Ways We Pay: a Consultation Paper*. Ottawa, April 2015. Available at http://fin.gc.ca/activty/consult/onps-ssnp-eng.asp.

8 We are mindful that CPA purported in June 2016 to change its branding to "Payments Canada". However, section 3 of the *Canadian Payments Act*, R.S.C., c. C-21, is quite explicit in stating that "A corporation is hereby established to be called the Canadian Payments Association" and we can find no provision in the Act that would, directly or indirectly, provide for CPA's capacity to change its name. In particular, section 34 of the *Canadian Payments Act* establishes that specific provisions (down to subsection numbers) of the *Canada Business Corporations Act* ("CBCA") apply to the corporation, but the listing excludes both subsections 10 (6) and 173 (1) (a) of CBCA, which respectively provide for a corporation's right to use an alternate name and for the process to change a name. Given well-known rules of statutory construction, including the maxim *expressio unius est exclusio alterius* (see in particular Côté, P.-A.; Beaulac, S.; Devinat, M. *Interprétation des lois*. 4e éd. Montréal, Thémis, 2009. 865 p. Pp. 386-387, §§ 1249, 1251 and caselaw cited therein, as well as Sullivan, R., *Sullivan on the Construction of Statutes*. 6th ed. Markham, LexisNexis, 2014. 881 p. Pp. 248-249, and especially §8.92), we respectfully incline to the view that Parliament has therefore explicitly chosen not to grant CPA the ability to change its name, and so we shall continue to follow the direction provided by s. 3 and to call it the Canadian Payments Association, or CPA in short form, at least until applicable legislation is modified.

of “system” actually aimed at infrastructure, rather than at the legal web of relationships between system participants, whoever they may be?

Conversely, reliance on a notion of “system” would preclude application in cases where a fund transfer is purely a bilateral transaction, unless the notion is extended all the way to its conceptual limit. Yet such bilateral transactions may well raise significant risk for users, in particular, and should be regulated appropriately.

The notion of “system” is, therefore, not very helpful, and is in fact quite ambiguous, when one seeks to oversee retail fund transfers. A significant proportion of these activities (including some which may raise the greatest risks for consumers) are not provided by “systems” (except in the very broadest meaning one could give to the word). And if only “systems” in a narrower sense, such as networks, are to be regulated, there will be no level playing field in the Canadian payments market.

We therefore suggest that the notion of “system” should be for all practical purposes removed from any analysis or attempt at designing regulatory measures governing retail fund transfers.

1.3 The landscape

The way Canadians pay or, more generally, transfer funds, is evolving at a quickening pace. Data from the Canadian Payments Association that includes “retail” transactions, which are sufficiently close to the type of operations we are interested in to provide an acceptable proxy, illustrates the trends:

Table 1[9]
Evolution of the use of various instruments in order to perform retail payments in Canada by volume of transactions (2011, 2015) (%)

Type of instrument	2011	2015
Cash	41.8	32.4
Debit	20.4	24.8
Credit card	16.9	21.8
EFT[10]	10.5	12.4
Cheque and paper	5.8	4.2
ABM[11]	3.7	2.8
Prepaid card	0.7	1.1
Online transfers[12]	0.1	0.6

9 Tompkins, Michael; Galociova, Viktoria. *Canadian Payment Methods and Trends 2016 – Discussion Paper No 7*. Ottawa, Canadian Payments Association, November 2016. 24 p. P. 9, figure 3. Consulted at https://www.payments.ca/sites/default/files/cpmt_report_english.pdf. Additional data is found in the document's Appendix I. The definition of "on-us" transactions provided in section B of Appendix II estimates their volume at approximately 20% of the total, with variations according to the type of instrument.

10 In this context, "EFT", or "Electronic fund transfers", include transactions such as preauthorized debits drawn from deposit accounts held by CPA members, the automated payment of wages or government benefits or online bill payment. See the document's Appendix II, section B for definitions.

11 In this context, "ABM", or "Automated banking machines", refers to transactions performed through such machines.

12 This refers to transactions performed through the Interac network's E-transfer service (see http://interac.ca/en/interac-e-transfer-consumer.html) or through networks such as PayPal.

Table 2
Evolution of the use of various instruments
in order to perform retail payments in Canada
by total value of transactions (2011, 2015) (%)

Type of instrument	2011	2015
Cheque and paper	50.1	44.7
EFT	39.4	44.5
Credit card	4.4	5.5
Debit	2.5	2.5
Cash	2.0	1.3
ABM	1.2	0.8
Prepaid card	0.1	0.2
Online transfers	0.1	0.5

Some trends are obvious. Canadians still make a large number of cash transactions, although they are increasingly turning to alternatives. On the whole, cash transactions tend to be of quite low value. Debit and credit card transactions are competing head-to-head in the retail market, with transaction values tending to be higher for credit card operations. ABM transactions are increasingly marginal, which is consistent with the reduced use of cash. And while they are growing at a brisk pace, prepaid cards and online transfers still represent very low proportions of the volume of payments, and of the value being exchanged.

The significant proportion of value still being exchanged by cheques and other paper instruments may seem more surprising, but it is largely explained by the fact that business undertakings still use cheques as a common way to make "remote" payments – that is, payments not made face-to-face. Especially in smaller businesses, accounting systems are still largely set up to process cheques, which provide practical advantages to payor and payee (such as the ability to attach remittance information to the stub of the payment instrument), even though processing is costly and slow[13].

Globally, however, the direction is clear: payments are increasingly becoming electronic, with cash and cheques being slowly set aside. This phenomenon should accelerate as the Canadian Payments Association implements its Modernization initiative and other providers market innovative electronically based payment mechanisms.

13 For a discussion of some of these issues, see Tompkins *et al*, *op. cit.*, pp. 16-18.

1.4 Assessing risk

Payments are inherently risky. The value of what is used in order to pay may change, or what is exchanged may be counterfeit (or might even not belong to the "payor"). The exchange may be compromised or delayed. If intermediaries are involved, which is usually the case, they may be incompetent or dishonest, or cease to operate. And, of course, all those participants may simply make occasional mistakes. Actually, what may seem remarkable is that most payments work well. This efficiency results from decades of experience understanding the risks and striving to mitigate them.

Categories of risks pertaining to retail payments previously have been identified, so that they could be understood and managed. While categories differ both in range and terminology, they generally tend to overlap[14]. For our specific purposes, we are primarily concerned with:

- credit risk: the risk that a participant "will not settle an obligation for full value, either when due or at any time thereafter" [15], because it has become insolvent, for instance;
- liquidity risk: the risk that a participant will not settle an obligation at the time it is due[16], generally for lack of available funds at that moment;

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14 See for instance Committee on Payments and Market Infrastructures; Bank for International Settlements. *Non-banks in retail payments*. Berne, September 2014. 44 p. Available at http://www.bis.org/cpmi/publ/d118.pdf; Federal Financial Institution Examination Council (FFIEC). *Retail PaymentSystems Risk Management*. In IT Examination HandBook InfoBase. Available at http://ithandbook.ffiec.gov/it-booklets/retail-payment-systems/retail-payment-systems-risk-management.aspx; Weyman, Julius. *Risks in Faster Payments*. Federal Reserve Bank of Atlanta – Retail Payments Risk Forum. Atlanta, Federal Reserve Bank of Atlanta, May 2016. 38 p. Available through https://www.frbatlanta.org/rprf/publications/2016/05/risks-in-faster-payments.aspx. While, to our knowledge, it has not been made public at this point, we have also consulted FinPay Working Group on National Retail Payment Systems Oversight. *Assessment of Risk in National Retail Payment Systems*. Ottawa, November 2015. We express reservations as to the typology and exhaustiveness of that paper, regarding in particular legal and social risk. The Royal Bank of Canada provides a useful categorization of risks faced by a large financial services provider, as well as of its implementation in business management: see for instance Royal Bank of Canada. *Annual Report 2016*. Montréal, Royal Bank of Canada, December 2016. 212 p. Pp. 54-89. Consulted at http://www.rbc.com/investorrelations/pdf/ar_2016_e.pdf.

15 We borrow this definition from Bank of International Settlements. *A glossary of terms used in payments and settlement systems*. Bern, Bank for International Settlements, March 2013. 51 p. Available at http://www.bis.org/cpmi/glossary_030301.pdf).

16 Our definition is inspired by the Bank of International Settlements, glossary, *ibid*.

- operational risk: the risk of hardship to participants due to system disruptions, processing errors or other problems associated with the proper functioning of systems;
- market conduct risk: the risk of confusion in the market or harm to participants due to inappropriate or inadequate behaviour by participants regarding issues such as terms of agreement governing transactions, data protection or dispute resolution;
- social risk: the risk that a vulnerability will lead to social exclusion, including economic and financial exclusion.

There are obviously other types of risks that need to be addressed when formulating a framework for retail payments, including:

- efficiency risk: the risk that anti-competitive behaviours will impact innovation or result in higher costs or other disadvantages incurred by participants;
- reputational risk: the risk that a behaviour will adversely impact a participant's reputation, whether it is its own behaviour or that of any participant[17]; and
- strategic risk: the risk that a participant will make inappropriate choices regarding its development or will be unable to implement its choices[18].

Our purpose here is not to provide an exhaustive analysis of risks associated with payments; rather, we are concerned with the identification of those risks which are of greatest significance for consumers, are fairly specific to payments and are most amenable to mitigation through legal processes. Since the scope of efficiency risk issues is much broader, while reputational risk and strategic risk are primarily of interest to providers, they are therefore less relevant in this specific context – which obviously does not make them less important to the effective functioning of payment systems more generally.

But a consumer wishing to make a payment expects he or she will have access to a payment mechanism, that it will work properly, that its counterparties will act fairly and that funds will arrive when and where they are expected. All of these properties of a functioning payment mechanism can potentially be enhanced by legal rules, as we will develop *infra*.

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17 There can be risk "contagion", with a whole industry tarred by the misbehavior of one participant, for instance: see in particular Barnett, Michael L.; Hoffman, Andrew J. *Beyond Corporate Reputation: Managing Reputational Interdependence*. Corp. Reputation Rev. (2008) 11:1. Consulted at https://link.springer.com/article/10.1057/crr.2008.2.

18 This definition borrows from the Royal Bank of Canada, *op. cit.*, p. 85.

1.5 Mitigating risk through law

1.5.1 A long tradition

It is commonplace to say that the law can be used to mitigate risk: it provides rules, thus reducing uncertainty as to expected behaviour, and it usually provides enforcement mechanisms which are intended to support compliance with those rules. If A knows how he should behave and how his counterparty should behave, and if A has a recourse should the counterparty misbehave, the risk that A will incur an unexpected or undesirable loss is lessened, and so is his counterparty's.

Law has been used to mitigate risk associated with payments for a very long time. For example, as early as c. 1754 B.C.E., the Babylonian Code of Hammurabi included provisions regarding payments, such as its section 108:

> 108. If a tavern-keeper (feminine) does not accept corn according to gross weight in payment of drink, but takes money, and the price of the drink is less than that of the corn, she shall be convicted and thrown into the water.[19]

This ancient rule identifies what is acceptable as a form of payment for a specific type of good, and to what extent. It also provides a radical penalty in case of non-compliance[20].

Over the past three thousand years, innumerable enactments have been promulgated in order to define and regulate types of payment instruments, their value and the rights and liabilities related to their use. Given the social and economic importance of payments, it comes as no surprise that courts were also regularly required to interpret these enactments.

Payments generate risk, and law can mitigate risk associated with payments. But in doing so, it is possible to generate additional risk if legal measures are not entirely adequate to the needs. One must therefore also manage legal risk.

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19 *The Code of Hammurabi*. Transl. by King, L.W. Consulted at http://www.general-intelligence.com/library/hr.pdf. The Code itself is physically preserved in particular on a stone stele which can be admired at the Louvre museum. The provision would appear to prohibit offering a preferential, lower price to those paying in money, rather than in corn: a specific form of rebate is thus forbidden. The misogynistic element is horrifically shocking.

20 Surviving being thrown in a fast-flowing river was not a given. Section 2 of the Code envisions both the scenario where the accused emerges and where she drowns, thus making the penalty a form of ordeal familiar to western readers from witchcraft trials.

1.5.2 The blurred features of legal risk

There is no consensus on the notion of legal risk. To some providers, it is mostly – and simply – related to the detrimental consequences resulting from non-compliance with legal rules, or the possibility that changes to the regulatory framework could impact their operations[21]. For our purposes, we consider legal risk from a broader perspective.

In its broadest sense, legal risk is associated with the outcome of the encounter between a factual situation and a legal norm. Payment activities are rife with such encounters. Yet economic or banking literature on payment risk seldom focuses on legal risk, the emphasis usually being rather on systemic, credit, liquidity or operational risk[22]. In that strand of research, legal risk issues associated with payments are often confined to short, synthetic papers or a mere definition in a glossary[23].

It is, therefore, necessary to start our analysis at a fairly high level, in order to mark out the boundaries of our topic. It is axiomatic that there are legal norms applying to payments; when the application (or non-application, as the case may be) of these norms produces results that are universally satisfactory, no issue arises – as a practical matter,

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21 See *e.g.* Royal Bank of Canada, *op. cit.*, pp. 84-85. With respect, we incline to see mere non-compliance as akin to a subset of operational risk, and changes to the regulatory framework as a subset of strategic risk.

22 There is, especially in the United States, a significant amount of legal literature addressing risk management in payments, as will become obvious *infra*. This therefore seems to be an area of interest for the legal community more than to the payments community as a whole; it may be that the "banking" community had been used to assuming that the existing legal framework was adequate, without need for further study. However, that legal literature is generally more concerned with the design of solutions than with the definition of "legal risk" *per se*.

23 An interesting analysis is offered by Collard, Christophe; Roquilly, Christophe. *Proposals for a Definition and Map of Legal Risk*. Nice: EDHEC Business School, June 2011. 17 p. Available at https://www.edhec.edu/sites/www.edhec-portail.pprod.net/files/edhec-position-paper-proposals-for-a-definition.pdf. The Bank of International Settlements' *A glossary of terms used in payments and settlement systems* (March 2013, available at http://www.bis.org/cpmi/glossary_030301.pdf) defines legal risk as either "the risk of loss because of the unexpected application of a law or regulation or because a contract cannot be enforced" or "the risk that a party will suffer a loss because laws or regulations do not support the rules […], the performance of […] arrangements, or the property rights and other interests held […]. Legal risk also arises if the application of laws and regulations is unclear".

anyway[24]. But sometimes the result is less happy; it behooves us, therefore, to identify the categories of situations where legal risk will emerge, then to understand the impact it may have. In short, what causes legal risk, and what are its consequences?

1.5.3 Some causes of legal risk

Legal risk can result from the absence of a legal norm, from its ambiguity, from its inadequacy, or from its unenforceability.

1.5.3.1 *The absence of a norm*

Where there is no legal norm applicable to a situation, stakeholders do not know how to behave. The absence of a specific norm does not mean that they have no rights or obligations; simply, that they cannot establish with any certainty what those rights or obligations might be when they make a decision. This results from the fact that courts will proceed to decide a matter even in the absence of a specific norm, on the basis of general legal principles – and with often unpredictable results for the parties[25].

When identified as such, the uncertainty associated with the absence of a norm may have negative impacts, varying from the reluctance to enter into agreements that may be invalid or that may generate unexpected results, to the stifling of innovation. When not identified *a priori*, that uncertainty can generate significant costs and damage industries, as courts fumble through complex factual situations and inadequate guidance from legislators in order to provide an *ad hoc* solution that may not be fully consonant with the best public policy. Simply put, courts are in such cases put in a position where they have to do their best without having the tools required to ensure they can get it right.

Issues such as the validity of a payment in bitcoins in Canada[26], the legal status of funds held by a provider such as PayPal in the case of its bankruptcy[27], or the specific

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24 Conceptually, there may well be risk associated with these situations but, as it does not crystallize, it remains of academic interest. Such risk, should it materialize, would fall within the categories examined below.

25 In Quebec, for instance, s. 10 of the *Code of Civil Procedure*, R.S.Q., c. C-25.01, specifically states that courts "cannot refuse to adjudicate under the pretext that the law is silent, obscure or insufficient". The principle that courts have "an obligation to hear and determine" issues was recently reiterated by the Supreme Court of Canada: *Douez* v. *Facebook, Inc.*, 2017 CSC 33, §25 (albeit admittedly in a somewhat broader context).

26 Let us postulate that, at time t_1, A promises to pay B one bitcoin for a service to be provided at time t_2, when payment should also be made. In the interval, the market value of a bitcoin doubles, with A therefore claiming that she owes only a half-bitcoin for the service. Under the hallowed principle of nominalism, known to English law since at the least the *Case of Mixt Moneys, Gilbert* v. *Brett* (1604), Davies 18; 2 State Trials 114 (and also codified under

liability of a an electronic "wallet" provider (as opposed to the issuer's or the network's), are but illustrations of situations where Canadian law is currently at best tenuous, and most likely non-existent. Courts would, therefore, need to develop solutions based on generic legal concepts such as legal tender, equitable set-off, or agency as applied to the (sometimes insufficient) evidence adduced before them, with results that are unpredictable for the parties and that may not be consonant with the best public policy.

1.5.3.2 *The ambiguity of a norm*

Where there is a legal norm which may be applicable to a situation but is unclear, again stakeholders do not know how to behave, and may find out after the fact that their behaviour was judged to be inappropriate. Ambiguity may pertain to the scope of a rule, to its meaning, to its complexity, or to its stability.

Prior to the *Marcotte* trilogy of decisions from the Supreme Court in Canada in September 2014, there was uncertainty regarding the scope of provincial jurisdiction over banks' disclosure of fees, with banks forcefully arguing for their immunity. The issue was resolved in favour of provincial jurisdiction, and has likely cost the banking industry two hundred million dollars or more. There are most likely other areas where scoping issues can be identified. Some will be related to the application of provincial legislation to "federal undertakings", as that notion is understood in Canadian constitutional law[28];

Quebec law in the *Civil Code of Quebec*, s. 1564), A is clearly wrong if the Bitcoin is money: she owes the number of units of value that she promised, rather than the market value of those units. But is Bitcoin money? For a discussion of nominalism, see Mann, F.A.. *The legal aspect of money – with special reference to comparative private and public international law*. 4th ed. Oxford, Clarendon Press, 1982. 602 p. See in particular pp. 86-96. The issue is complicated by the *Currency Act*, R.S.C., c. C-52, whose section 13 confirms the validity of contractual clauses requiring payment in Canadian currency or the currency of one or more countries, but whose section 12 requires that any reference to money in legal proceedings be expressed in the currency of Canada. For a discussion of these provisions, see David, Guy. *Money in Canadian Law*. [1986] 65 Can. B. Rev. 192, at 214-222.

27 When a payor resorts to a provider such as PayPal to send funds to a payee, there is a period where the provider is in possession of the funds, but has not yet transferred them to the payee; should that provider become insolvent at that point, are the funds to be legally considered as belonging to the payor, to the payee, or the provider, in which case they would be commingled with other assets in order to reimburse the provider's creditors in accordance with bankruptcy law? We note, in particular, that there is currently no clear requirement for such providers to put funds that are in transit in trust accounts, or to otherwise protect them. Contrast with safeguarding requirements established by section 10 of PSD2.

28 Federal undertakings include entities primarily engaged in federally-regulated activities, such as telecommunications, banking or air transport, those deemed to be for the general advantage of Canada (such as components of the nuclear industry or grain elevators and, to a

others may have to do with issues such as the definition of the types of payment instruments to which they apply[29].

Even when the scope of a rule is clear, its meaning may be ambiguous. For instance, in Section 5 of the *Canadian Code of Practice for Consumer Debit Card Services*, what does the notion of "reasonable time" provided for a consumer to advise the issuer of the loss or theft of a debit card mean, given that the Interpretation Guide to the Code requires the consumer to advise "as soon as" he becomes aware of the theft or loss, notwithstanding the fact that he may at that moment be materially unable to provide such notification?

In addition, many clear rules, taken together, may create a normative landscape so complex that it becomes an almost impenetrable thicket where even the wisest are likely to get lost. We currently have in Canada different rules for preauthorized debits drawn from deposit accounts (and potential differences whether the debit clears through the Canadian Payments Association's Automated Clearing and Settlement System or not[30]), preauthorized debits on credit card accounts, and those on online bill payments, even though all three types of operations may serve to pay the very same monthly utility bill.

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lesser extent, federally-incorporated companies. For a discussion, see Hogg, Peter. *Constitutional Law of Canada – 2011 Student Edition*. Toronto, Carswell, 2011. §§ 15.8 (c).

29 The *Canadian Code of Practice for Consumer Debit Card Services* (available at https://www.canada.ca/content/dam/canada/financial-consumer-agency/migration/eng/documents/debitcardcode-eng.pdf) applies to debit transactions performed with a card and personal identification number ("PIN"); therefore and on a literal interpretation, it would seem to exclude PIN-less transactions, which are increasingly common (CPA estimates that "contactless", or PIN-less debit and credit card transactions have grown by 70% in 2015 and now make up 12% of all such transactions: Tompkins *et al.*, *op. cit.*, p. 13); would courts consider a "living tree" interpretation of the Code and conclude that it should be read as including this new type of transaction? In addition and since the Code was ratified by the Canadian Bankers Association and the (currently named) Fédération des caisses Desjardins du Québec, it is legally unclear to what extent these organisations acted as agents or mandataries for individual card issuers and account holders (such as the banks), hence to what extent the scope of the Code actually extends to these institutions.

30 Transactions involving different financial institutions on behalf of payor and payee will clear through CPA, and will, therefore, be governed by CPA rules. However, "on-us" transactions do not clear through CPA, so that its rules do not apply and, as noted *supra*, they account for approximately 20% of payments in Canada. In many cases, it is practically impossible for a consumer to determine whether a transaction will be "on-us" or not, since it requires that person know who his counterparty banks with, and therefore impossible to make an enlightened decision regarding the normative framework associated with the intended transaction.

We have different rules regarding consumer liability for fraudulent withdrawal from an automated teller machine using a debit card, using a credit card issued by a bank, or using a credit card issued by a deposit-taking financial institution which is not a bank[31]. Not only is it doubtful that Canadian consumers understand these subtle nuances governing legal risk associated with apparently similar transactions; it is also unclear that financial institutions understand and apply them consistently either[32].

We have lengthy customer agreements, the (impenetrable) contents of which may be partly illegal under provincial jurisdiction or at common law[33], and we are therefore faced with the complex interaction of contractual clauses, legislation and common law: while all the rules may (hypothetically) be clear, their interaction is anything but.

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31 "Debit" transactions are (in principle) governed by the *Code of practice*. Withdrawals at an automated teller machine using a credit card issued by a bank are governed by subs. 12 (1) (d) of the *Cost of Borrowing (Banks) Regulations*, which allows the bank to determine in its terms and conditions the maximum liability potentially incurred by the hapless consumer. Similar withdrawals using a credit card issued by a provincially-regulated financial institution would likely be governed by provincial law (such as section 69 of Ontario's *Consumer Protection Act*, S.O. 2002, c. 30, sched. A and section 58 of *Regulation 17/05* or s. 124 of Québec's *Consumer Protection Act*). Assuming a fraudulent withdrawal to which the consumer has not contributed in any way, she would bear no liability in the first case but she could be wholly liable for the amount fraudulently withdrawn in the second case, while in the third scenario her liability could be capped at fifty dollars ($50) if a court came to the conclusion that it was a credit card transaction governed by provincial law (a result that is uncertain, as those provisions were for the most part drafted at a time when credit cards were used to make purchases at the point of sale and have not been updated to clarify that they also apply to automated cash withdrawals).

32 This apparent lack of understanding recently became apparent, when a bank purported to hold its customer wholly liable for fraudulent credit card transactions which had happened in stores, rather than through a banking machine, thus conflating subsections 12 (1) (c) and (d) of the aforementioned *Cost of Borrowing Regulations* (not to mention the confusion about the potential application of provincial law, or the statement attributed to a representative of the Financial Consumer Agency of Canada regarding the legal impact of statements and warranties provided by a bank): see McLaughlin, Ross; Hermiston, Sandra. *New credit card technology may not protect you like you think*. CTV News, April 24 2017. Consulted at http://bc.ctvnews.ca/new-credit-card-technology-may-not-protect-you-like-you-think-1.3376140.

33 Many current provisions in consumer agreements with payment service providers are arguably void under Québec law; lawyers drafting those agreements on behalf of providers may also wish to peruse *Bhasin* v. *Hrynew*, 2014 SCC 71, [2014] 3 S.C.R. 494, where the Supreme Court of Canada explicitly acknowledged the existence of an "organizing principle of good faith" that "exemplifies the notion that, in carrying out his or her own performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner".

To complicate matters further, a legal norm may be found to be constitutionally vague. In contexts where technologies or market practices evolve quickly, the legislator might prefer to implement generic requirements, in order to avoid having to adapt the rule as practices evolve. While that may well be sound public policy and make for good law, Parliament must still be careful to provide sufficient guidance to future legal debates[34].

In addition, assuming a rule is clear and simple in its scope and contents, its continuity may be uncertain. Government may express the wish to modify the rule in an unspecified future date, or a significant decision may be expected from an appellate court within a year or two, for instance. In short, the future of a rule (or of the absence thereof) may be uncertain and ambiguous.

Legal rules cannot always be perfectly clear, and they are not eternal: reality is too complex and unpredictable. Hence legal risk cannot be entirely avoided. But the murkier the regulatory framework, the more uncertainty and risk there is for all market participants.

1.5.3.3 *The adequacy of a norm*

Even where a norm obviously exists and is clear, it may be inadequate – or, at least, be perceived to be so. While its application will be predictable, it will result in an undesirable outcome.

It is now well-established that an end-user cannot base a court claim on a CPA rule, however much that rule may potentially serve his case[35]. The rule is clear, but precludes the application of requirements designed to protect consumers, such as rule H1's provisions regarding the unwinding of preauthorized debits not complying with consumer's authorization, or rule H6's provisions (usually) deeming a payment to have been made on the day the consumer transferred the funds, rather than on the day they were received by the payee[36].

As noted above, under subsection 12 (1) (c) of the federal *Cost of Borrowing (Banks) Regulations*, an end-user's liability for fraudulent credit card transactions is explicitly

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34 *R. v. Nova Scotia Pharmaceutical Society*, [1992] 2 S.C.R. 606, 643; *Wakeling* v. *United States of America*, 2014 SCC 72, [2014] 3 SCR 549, § 62 .

35 *B.M.P Global Distribution inc.* v. *Bank of Nova Scotia*, 2009 SCC 15, [2009] 1 S.C.R. 504.

36 Canadian Payments Association. *Rule H1 –Pre-Authorized Debits*, sections 20 and 23, consulted at https://www.payments.ca/sites/default/files/h1eng.updated.pdf; *Rule H6 – Rules Pertaining to the Inter-financial Institution Exchange of Bill Payment Remittances for the Purpose of Clearing and Settlement*, subsection 5 (e), which refers to subsection 3 (m), consulted at https://www.payments.ca/sites/default/files/h6eng.pdf.

capped at $50 if the card is lost or stolen, but subsection 12 (1) (d) provides no such liability cap where the card is used to make a withdrawal through a banking machine; there is no obvious rationale for this distinction, since both the card and PIN number would usually be required in both cases. In addition, there is no provision establishing a liability cap if the card number is used in a card-not-present situation while the card has never been lost or stolen, yet these situations are increasingly frequent: it is well-known that millions of credit card numbers have been intercepted and stolen, and are used to perpetrate fraud online (or with counterfeit cards), while the original card itself has remained safely nestled in the cardholder's wallet.

Arguably, these legal norms are inadequate, given in particular the evolution of technology. They do not provide principled, coherent or fair solutions to issues experienced by consumers and other users.

1.5.3.4 *The enforceability of a norm*

Let us assume that a problematic situation has occurred, which is governed by an existing, clear and fair rule. But is that rule effectively applicable?

From the perspective of the party required to comply with a rule, there must be processes in place to ensure that the rule is carried out by staff or other representatives. Non-compliance may expose that party to penalties, in cases where the rule so determines and where an authority charged with implementing that rule is willing and able to launch a process eventually leading to a non-compliant provider being chastised.

From the perspective of the party benefitting from the rule, there must be processes to ensure that the rule is enforced. All such processes must function without requiring excessive costs and efforts. Otherwise, the protection purportedly granted to that party will be ineffective.

From the rule maker's perspective, the rule must foster the attainment of its objectives and do so effectively, *i.e.*, without requiring excessive cost or effort. Otherwise, not only will the regulatory objective not be fulfilled, but the rule maker's credibility and reputation may be tarnished.

Unfortunately, compliance, access to justice and resource-related issues too often prevent existing norms in the Canadian payments ecosystem from being enforceable: what rules we have are too often mere ink on paper without significant practical effect.

Provider compliance issues have been documented, anecdotally and otherwise, by consumer organizations for years. One cannot help being mystified by the fact that the incidence of pre-authorized debits which are not consistent with the payor's authorization has essentially remained unchanged from 2006 to 2015, with 12% of consumers using pre-authorized debits reporting that they had experienced such a situation in the

preceding two years[37]; and consumers are not always correctly informed by tellers regarding their right to be reimbursed. There is evidence that billers who process transactions under CPA's rule H6 do not always postconsumer payments on the day the consumer issued the transfer order[38]. There are arguably significant issues with regard to the compliance of the contents of financial institutions' terms and conditions with existing rules, a problem that is of great concern given the prominence of these institutions in Canada's payment ecosystem.

Such ineffective compliance likely results in large part from the absence of effective enforcers. Some rules are voluntary; others are lost in a maze of regulations, the application of which is entrusted to regulators without effective power, lacking sufficient resources, or simply not prioritizing payment issues.

Challenges experienced by consumers when they personally try to obtain redress create a further problem. The state of access to justice in Canada is "abysmal": we take this characterization from a finding of the Access to Justice Committee of the Canadian Bar Association[39]. There is no reason to believe the situation has evolved significantly since that Committee's report was published. Consumer-related issues are especially problematic, since the amounts involved are often fairly low, providing limited impetus to consumers to face the costs and complexity of legal proceedings. Non-judicial redress mechanisms, such as arbitration, are often less than perfectly appropriate in a consumer law setting, while the ombudsmen systems currently in place in Canada are unevenly effective. Assessing their level of expertise regarding the retail payment regulatory framework might also be an eye-opening exercise, which unfortunately is beyond the remit of this analysis.

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37 Centre d'intervention budgétaire et sociale de la Mauricie (CIBES). *Accélérer le paiement électronique des factures: la perspective des consommateurs*. Shawinigan, CIBES, 2016. 144 p. Available at http://www.cibes-mauricie.ca/wptools/wp-content/uploads/Acc%C3%A9l%C3%A9rer-le-paiement-2016-rapport-final-CIBES.pdf. Data based on two pan-canadian Environics surveys, one in 2006 and the other in 2015.

38 CIBES, *op. cit.* Consumer groups occasionally receive complaints from individuals who have been charged late fees or suffered other inconveniences, even though their payment had been made on time. Where such issues have found their way to courts, class action settlements too often have merely required billers to advise their customers that they should allow for processing delays, even though the purpose of CPA Rule H6's aforementioned provisions is to eliminate that processing delay risk for payors.

39 Canadian Bar Association – Access to Justice Committee. *Reaching equal justice: An invitation to envision and act*. (Ottawa: Canadian Bar Association, November 2013). 175 p. P. 8. We note that the first word of the title is not capitalized in the report itself. Consulted at http://www.cba.org/CBAMediaLibrary/cba_na/images/Equal%20Justice%20-%20Microsite/PDFs/EqualJusticeFinalReport-eng.pdf.

1.5.3.5 *An exhaustive framework*

Law mitigates risk by providing rules that, to some extent at least, are enforceable. From a logical perspective, law will fail to achieve that result when there is no rule, when the rule is inadequate or when it cannot be enforced.

2.0 Framing the Problem

2.1 Market practices

There is no exhaustive compilation of consumer problems associated with payments in Canada. There is, however, some evidence that indicates consumers are experiencing challenges.

As noted above in subsection 1.5.3.4, recent surveys show that measurable, significant proportions of pre-authorized debits and online bill payments are not processed properly, and those issues are not always resolved adequately. In 2014, focus groups and a survey developed by Shawinigan-based *Service de Protection et d'Information du Consommateur* indicated that some consumers have experienced problems with the automated deposit of funds in their accounts (be they wages or government benefits) to such an extent that they no longer authorized such transactions. Further, court cases in Quebec and Ontario confirm that online bill payment mechanisms are not always working properly. A recent case documented in the media illustrates that credit card transactions can also become problematic.[40] And, certainly the ongoing tumult of the federal Phoenix pay system, which has improperly paid, or not paid at all, over a hundred thousand government employees since 2016, illustrates the complexity and unpredictability of payments systems.[41]

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40 A bank recently purported to hold its customer wholly liable for fraudulent credit card transactions which had happened in stores, rather than through a banking machine, thus conflating subsections 12 (1) (c) and (d) of the *Cost of Borrowing Regulations* (not to mention, in that report the confusion about the potential application of provincial law or the statement attributed to a representative of the Financial Consumer Agency of Canada regarding the legal impact of statements and warranties provided by a bank): see McLaughlin, Ross; Hermiston, Sandra. *New credit card technology may not protect you like you think*. CTV News, April 24 2017. Consulted at http://bc.ctvnews.ca/new-credit-card-technology-may-not-protect-you-like-you-think-1.3376140.

41 CBC News, "Nearly Half of Public Servants Paid by Phoenix Have Reported Problems" (24 August 2017), online: CBC <http://www.cbc.ca/news/canada/ottawa/phoenix-data-released-radio-canada-1.4259636>;
For more information, see: Goss Gilroy Inc., *Lessons Learned from the Transformation of Pay Administration Initiative* (Ottawa: Government of Canada, 2017), online: Government of Canada <https://www.canada.ca/en/treasury-board-secretariat/corporate/reports/lessons-learned-transformation-pay-administration-initiative.html>.

Of course, the emergence of new types of providers, such as PayPal, which are not regulated *per se*, and new types of services, such as "electronic wallets" operated through smartphones, are likely to raise new types of risks.

2.2 The regulatory maze

Trying to identify the rules governing payments in Canada, and to assess which rules apply to a specific situation, is a remarkably complicated process.

Various aspects of retail payments are governed, *inter alia*, by[42]

- the *Currency Act*;
- the *Bank of Canada Act*;
- the *Canadian Payments Act*;
- the *Bills of Exchange Act*;
- the *Cost of Borrowing (Banks) Regulations*;
- the *Prepaid Payment Product Regulations*;
- Québec's *Civil Code;* and
- Provincial consumer protection legislation pertaining to credit cards, prepaid cards, or other types of payment mechanisms.

As for the courts, the perusal of any textbook on cheques and bills of exchange will immediately show how often they have been required to clarify the law in that area. More broadly, even the Supreme Court has been required to tackle various payment issues, including constitutional jurisdiction over payments, the concept of "cash", the legal status of notes issued by the Bank of Canada, or the application of CPA rules to entities which are not members of that Association[43].

Parts of the regulatory framework target payment mechanisms, such as currency and cheques, but eschew for the most part more recently developed types of instruments. Other parts are framed in institutional terms: the transaction is regulated insofar as a specific type of entity (say, a bank), is the provider, but not otherwise. Parliament and the provinces have both legislated, and there may be apparent overlap in some cases (such as with regard to prepaid cards or credit cards where, for example, different rules may apply to a specific transaction depending on the type of institution, a bank or a credit union, that

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42 This listing is by no means meant to be exhaustive.

43 See *e.g. Reference re Alberta Statutes*, [1938] S.C.R. 100; *Shockey* v. *Molnar,* [1949] 1 D.L.R. 328 (Alta. App. Div.), affmd *Molnar* v. *Shockey*, [1949] 4 D.L.R. 302 (S.C.C.); *Bank of Canada* v. *Bank of Montrea*l, [1978] 1 S.C.R. 1148; *B.M.P. Global Distribution Inc.* v. *Bank of Nova Scotia*, 2009 SCC 15, [2009] 1 S.C.R. 504. This listing is by no means meant to be exhaustive.

issued the card), raising constitutional law issues. In most cases, those rules provide for exceptions and exclusions based on the amount involved or the specific type of mechanism being used, for instance. Further complicating the situation is the fact that while legislation and regulation are expected to be enforceable before courts, other types of norms that apply to payment mechanisms, such as CPA rules or codes of practice, may not be.

The hapless consumer does not stand a chance of knowing which rule applies to what, and we suspect even the legal and banking communities are sometimes stumped.

To make matters worse, there are gaps. Numerous issues are simply not addressed by the existing framework, or are regulated by nineteenth century rules that are hopelessly antiquated.

In short, there are problems related to the absence, ambiguity, inadequacy or unenforceability of the rules. They are too often non-existent, they are usually inconsistent when they exist, they are not always fair and they are regularly breached.

2.3 Contractual solutions

It might be claimed, that many of the difficulties mentioned above are addressed by the terms and conditions that apply to contractual relationships between providers and consumers. As we will see in subsection 3.1.2, there are basic principles, grounded in consumer law, that should apply to such terms and conditions. Even if we consider only the terms proposed by the largest and most established providers in Canada, which one would expect would comply with basic legal principles, the inescapable conclusion is that the rules proposed therein are hopelessly inadequate.

A summary review of some of those agreements, in their current form, may actually be enlightening in that regard[44]. Terms and conditions from Canada's five largest banks currently include provisions that:

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44 For the purposes of this quick review, we have examined summarily Bank of Montreal's *Agreements, Bank Plans and Fees for Everyday Banking – Effective date December 1, 2016* (42 p.) at https://www.bmo.com/pdf/Agreements_Bank_Plans_and_Fees_for_Everyday_Banking.pdf ("BMO"); CIBC's *Personal Account Agreement* at https://www.cibc.com/ca/apply/disclosures/pers-acct-agreement.html ("CIBC"); Royal Bank's *RBC Royal Bank Disclosures and Agreements related to Personal Deposit Accounts – effective November 1, 2016* (88 p.) at https://www.rbcroyalbank.com/onlinebanking/servicech/pdf/PDA_Account_Disclosure_Booklet.pdf ("RBC"); Scotia's *Day-to-Day Companion Booklet – July 2016* (74 p.) at http://www.scotiabank.com/ca/common/pdf/day_to_day/day-to-day_banking_companion_booklet.pdf ("Scotia"), and Toronto-Dominion Bank's *Financial*

- allow the Bank to unilaterally terminate the relationship without notice[45]: BMO, p. 3; CIBC, s. 16, RBC[46], s. 22; Scotia[47], p. 71; TD, s. G 14;
- allow the Bank to unilaterally change the terms: (with changes coming immediately in force): BMO, pp. 4, 8, CIBC, s. 28; Scotia, p. 71; TD, p. 1[48];
- exclude Bank liability: BMO, pp. 4, 28; CIBC, ss. 9, 19; RBC, s. 23; even in cases where the Bank was negligent (CIBC, s. 20; Scotia, p. 74; TD, s. G 6) [49];
- provide short delays to verify and dispute transactions[50]: BMO, p. 6; CIBC, ss. 3-4; RBC, s. 14; Scotia, p. 72; TD, s. B 11-12;
- provide that other – often unidentified – documents also apply to the relationship: BMO, p. 8; CIBC, s. 1; RBC, ss. 1, 5; TD, section A, B 2, G 1;
- allow the Bank to charge undisclosed fees and costs[51]: BMO, p. 8; RBC, s. 3; Scotia, p. 70; TD, s. G 8.

Services Terms (10 p.) at https://www.tdcanadatrust.com/document/PDF/accounts/tdct-accounts-fst.pdf ("TD). We acknowledge that the lengthier documents include not only terms and conditions *per se*, but also other information, and that other agreements also govern parts of the relationships between banks and their customers. This is therefore not meant as an exhaustive compilation and analysis, but merely as an illustration of some of the issues raised by the current terms and conditions of Canada's largest banks and the impact Bill C-29 might have had on consumer protection. All quoted documents could be found, on December 11, 2016, on the respective banks' websites, where they were consulted.

45 This is despite the fact that the Supreme Court of Canada found that unilateral termination without notice by a bank could amount to an abuse of rights under Quebec law, as the Bank had not acted in good faith: *Houle* v. *Canadian National Bank*, [1990] 3 S.C.R. 122. Given the Supreme Court's rulings in *Bhasin* v. *Hrynew*, 2014 SC C71, [2014] 3 S.C.R. 494, and *Bank of Nova Scotia* v. *Angelica-Whitewear Ltd.*, [1987] 1 S.C.R. 59, we query whether courts in other provinces might well come to the same conclusion under common law.

46 RBC's *Deposit Account Agreement per se* starts at p. 67 of the booklet referred in note 95.

47 Scotia's *Personal Deposit Account Client Agreement per se* starts at p. 60 of the booklet referred in note 95.

48 We note that Toronto-Dominion Bank's provisions allowing it to modify unilaterally the agreement under certain conditions are the only ones that appear to comply with Québec legislation – which goes to show that banks can so comply.

49 It used to be the rule that "the Queen can do no wrong" and enjoyed sovereign immunity against lawsuits; this is of course no longer the case and Her Majesty in right of Canada can be sued in most cases, under the *Crown Liability and Proceedings Act*, R.S.C., c. C-50; apparently, banks are still striving to carve out for themselves a type of legal immunity that even the Sovereign has renounced.

50 Such delays are arguably invalid in Québec under sections 2883, 2884 and 2925 QCC.

51 This, of course, was the issue raised in *Marcotte*. We are interested here only in fees and charges that are not covered by disclosure requirements as set in the *Bank Act*'s sections 445,

Additionally, when banks mention maximum cheque hold periods, they often make no mention of their regulatory obligation to make the first $100 immediately available in most circumstances[52] (see for instance BMO, p. 5; RBC, s. 8).

We respectfully contend that most, and probably all of the above are invalid under Quebec law and, most likely, under other provincial legislation, which we believe on the basis of *Marcotte* and other cases, apply to these terms: consumers therefore currently are formally protected against terms imposed by banks in order to modify or escape their contractual obligations or their liability, even in cases where the bank has not acted in good faith. However, such terms (and many others) currently found in banks' terms and conditions gainsay these consumer protections and are simply unfair and cannot be reconciled with basic principles of contract law or economics. They bolster asymmetries in the commercial relationship between banks and customers and disrupt the market to the banks' very significant advantage, they make the market less efficient, and they allow banks to take operational and other risks by purporting to shift legal risk squarely onto consumers' shoulders, even in situations where they may lack the legislated authority to do so.

2.4 Systemic problems with consumer redress

There are also few independent institutions where consumers can bring payments complaints outside of the costly court system. For instance, there is no "payments tribunal" within the current Canadian Payments System framework – consumer complaints must often be dealt with directly with through their financial institutions with no open, independent, standard procedure. Likewise, PayPal and Visa/Mastercard/American Express have their own rules of payment dispute and their own processes which are, to varying degrees, open or opaque.

Consumer-facing agencies and institutions are severely constrained in their ability to provide redress for consumer complaints about retail payments. The Financial Consumer Agency of Canada (FCAC) is responsible for monitoring compliance with voluntary codes such as the *Code of Conduct for the Credit and Debt Card Industry in Canada* and the *Principles of Consumer Protection for Electronic Commerce*.[53] However, the former

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446 and 450; we query whether some of the terms mentioned here are actually compliant with s. 440.

52 As required by the *Access to Funds Regulations*, SOR/2012-24, s. 4.

53 Working Group on Electronic Commerce and Consumers, *Principles of Consumer Protection for Electronic Commerce: A Canadian Framework* (Ottawa: Industry Canada, 1999), online: CBA <https://www.cba.ca/Assets/CBA/Files/Article%20Category/PDF/vol_20090000_consumerprotectionelectroniccommerce_en.pdf>. See also Innovation, Science and Economic Development Canada: < http://www.ic.gc.ca/app/oca/crd/dcmnt.do?id=46&lang=eng>.

only applies to interactions between payment card network operators and merchants, not consumers.

The OECD recently updated its *Principles of Consumer Protection for Electronic Commerce* (1999), in the *Recommendation of the Council on Consumer Protection in E-commerce*, 24 March 2016 - C(2016)13. These principles now cover consumer protection in e-commerce (liability for losses, fraud and chargeback mechanisms) and dispute resolution and redress systems (quoting paras. 40-47 of the Recommendation):

> E. Payment
>
> 40. Businesses should provide consumers with easy-to-use payment mechanisms and implement security measures that are commensurate with payment-related risks, including those resulting from unauthorised access or use of personal data, fraud and identity theft.
>
> 41. Governments and stakeholders should work together to develop minimum levels of consumer protection for e-commerce payments, regardless of the payment mechanism used. Such protection should include regulatory or industry-led limitations on consumer liability for unauthorised or fraudulent charges, as well as chargeback mechanisms, when appropriate. The development of other payment arrangements that may enhance consumer confidence in e-commerce, such as escrow services, should also be encouraged.
>
> 42. Governments and stakeholders should explore other areas where greater harmonisation of payment protection rules among jurisdictions would be beneficial and seek to clarify how issues involving cross-border transactions could be best addressed when payment protection levels differ.
>
> F. Dispute Resolution and Redress
>
> 43. Consumers should be provided with meaningful access to fair, easy-to-use, transparent and effective mechanisms to resolve domestic and cross-border e-commerce disputes in a timely manner and obtain redress, as appropriate, without incurring unnecessary cost or burden. These should include out-of-court mechanisms, such as internal complaints handling and alternative dispute resolution (hereafter, "ADR"). Subject to applicable law, the use of such out-of-court mechanisms should not prevent consumers from pursuing other forms of dispute resolution and redress.
>
> Internal complaints handling
>
> 44. The development by businesses of internal complaints handling mechanisms, which enable consumers to informally resolve their complaints

directly with businesses, at the earliest possible stage, without charge, should be encouraged.

Alternative dispute resolution

45. Consumers should have access to ADR mechanisms, including online dispute resolution systems, to facilitate the resolution of claims over e-commerce transactions, with special attention to low value or cross-border transactions. Although such mechanisms may be financially supported in a variety of ways, they should be designed to provide dispute resolution on an objective, impartial, and consistent basis, with individual outcomes independent of influence by those providing financial or other support.

Redress

46. Businesses should provide redress to consumers for the harm that they suffer as a consequence of goods or services which, for example, are defective, damage their devices, do not meet advertised quality criteria or where there have been delivery problems. Governments and stakeholders should consider how to provide redress to consumers in appropriate circumstances involving non-monetary transactions.

47. Governments and stakeholders should work towards ensuring that consumer protection enforcement authorities and other relevant bodies, such as consumer organisations, and self-regulatory organisations that handle consumer complaints, have the ability to take action and obtain or facilitate redress for consumers, including monetary redress.

The trouble remains that these Principles remain voluntary and only apply to electronic commerce situations, not pure value transfers. Nonetheless, the implication is clear that Canada has not yet, with its payments framework(s), attained the level of consumer protection desired in these Recommendations, nor set up redress mechanisms that satisfy the Recommendations.

Further, the FCAC makes it clear that it only monitors, investigates and enforces compliance with obligations, and "cannot offer—or require the institution to offer—redress or compensation."[54] As the FCAC further explains to consumers, "To seek redress or compensation, you will have to go through your federally regulated financial

54 Financial Consumer Agency of Canada, "How FCAC Handles Your Complaint," online: FCAC <https://www.canada.ca/en/financial-consumer-agency/services/complaints/handle-complaint.html> (accessed 12 October 2017).

entity's complaint-handling process, which may include an internal ombudsman or an external complaints body."[55]

The Ombudsman for Banking Services and Investments (OBSI) is authorized to resolve disputes between consumers and banks or investment firms, and to recommend compensation of up to $350,000.[56] OBSI also does appear to accept complaints related to electronic retail payments. For instance, the OBSI investigated a complaint in 2016 in which the complainant transferred $8,000 several times via Interac and PayPal to a private seller on Kijiji who was later reported as fraudulent.[57] However, although the complainant was provided a guarantee through PayPal (which does not participate in OBSI), OBSI found that the bank had correctly applied its agreement, as well as Interac's "Zero Liability Policy" which only covered unauthorized or fraudulent transactions, and therefore was unable to recommend compensation for the complainant.

This case study highlights several systemic issues which significantly constrain OBSI's ability to effectively resolve consumer complaints and provide redress particularly in relation to retail payment disputes. First, participation in OBSI's dispute resolution service is not universal or mandatory. OBSI's mandate only includes financial institutions and other entities which "directly or indirectly provide financial products or services to customers in Canada."[58] Thus far, this definition does not extend to other types of payments service providers including Visa, Interac and PayPal. Participation in OBSI is also not mandatory – in fact, major Canadian banks such as TD and RBC have withdrawn from OBSI and their customers must now file their complaints with the private ADR Chambers Banking Ombuds Office.[59]

Second, OBSI can only recommend compensation of up to $350,000 per complaint, and its recommendation is not binding on the financial institution or participating firm.[60]

Finally, consumers may not be aware that OBSI may investigate and resolve complaints related to retail payments, particularly as this is not necessarily publicized either by OBSI or by financial institutions. Even where consumers are aware of the OBSI

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55 *Ibid.*

56 *Ombudsman for Banking Services and Investments Terms of Reference*, online: OBSI <https://www.obsi.ca/en/download/fm/318> s. 14 (accessed 12 October 2017).

57 Ombudsman for Banking Services and Investments, "Case Studies: Shopping Online" (2016), online: OBSI <https://www.obsi.ca/en/case-studies/banking-services/view/shopping-online>.

58 *Ombudsman for Banking Services and Investments Terms of Reference*, s. 2(a).

59 We note here that according to ADRBO's 2016 Annual Report, while ADRBO took in 225 complaints in 2016, it only resolved 6 complaints and completed 81 investigations. It appears that other complaints or cases were merely closed. See: ADR Chambers Banking Ombuds Office, *Annual Report 2016*, online: <https://bankingombuds.ca/wp-content/uploads/2016/05/ADRBO-Annual-Report-2016.pdf> at p. 9.

60 *Ombudsman for Banking Services and Investments Terms of Reference*, ss. 24(d)-(e).

process, they are unlikely to win compensation due to the complexity of retail payment cases and involvement of third parties. The OBSI's case study described above illustrates the various parties involved and the number of agreements – including those of the bank, Interac and Kijiji – which could apply to one transaction. Due to the complexity of these cases and OBSI's limited authority, consumers may have a low success rate of obtaining redress for retail payments complaints through OBSI.

2.5 An impact on efficiency

While it is not the focus of our analysis, it is worth noting that recent work undertaken by the Competition Bureau indicates that the current regulatory uncertainty surrounding the payments ecosystem also has impacts on market entry by competitors and innovation in the provision of new financial services and payment mechanisms:

> While perhaps individually sensible, we heard that this cumulative regulatory burden and the lack of clarity around regulations' application create an impediment for companies, consumers and investors. Furthermore, some FinTechs operate outside of the regulated space (whether they should be or not), making it difficult for regulators to monitor and identify risks.[61]

More broadly, inconsistent rules result in market participants who offer very similar services being regulated differently, for no rational policy reason. The regulatory burden is therefore unfairly and inefficiently distributed, with potentially some types of transactions being stifled by excessive regulation while others, which may actually be significantly riskier, are entirely unregulated.

2.6 The unavoidable conclusion

Our retail payments ecosystem is rife with risk, which our regulatory framework is currently unable to eliminate. That framework, therefore, needs to be improved. The challenge is to design principles that will enable the development of a better legal and regulatory framework to address retail payment mechanisms.

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[61] Competition Bureau, *Highlights from the Competition Bureau's FinTech Workshop: Driving Competition and Innovation in the Financial Services Sector* (2017), online: Competition Bureau <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/FinTech-Report-Workshop-Eng.pdf/$file/FinTech-Report-Workshop-Eng.pdf> at p. 7.

3.0 Designing a Response

3.1 Preliminary considerations

3.1.1 The constitutional issue

The conception of a regulatory framework in Canada must often start by examining an abstruse issue: whose responsibility is it to regulate, and to what extent?

Canada is a federation, with powers distributed between provinces and the federal government. Provinces are responsible, in particular, for issues surrounding "property and civil rights", including contracts and, to a large extent, in consequence, consumer protection. Parliament has been entrusted with specific responsibility for banking, currency, legal tender and cheques, as well as with a broader (but by no means unlimited) jurisdiction over trade and commerce. It is well-established that a given issue in matters related to consumer protection may simultaneously fall under the jurisdictions of both the provinces and the federal government, thus giving rise to a "double aspect" analysis. In such cases, both provincial and federal legislation should be applicable, except where the provincial enactment would impair the core of federal jurisdiction, would frustrate its purpose, or would be absolutely inconsistent with it. In that case, the provincial enactment will be inoperative.

Given Parliament's jurisdiction over trade and commerce, as well as its more specific jurisdiction over specific payment instruments, which in 1867 covered virtually all types of existing instruments and should be read in a "living tree" perspective, we contend that Parliament is authorized to legislate in order to provide a proper regulatory framework for retail payments. We would suggest that this framework act as a "floor", but that the floor be set high so that provinces could complement that framework, but would be unlikely to find cause to do so.[62]

3.1.2 Protecting consumers

In regard to payments, consumers are clearly vulnerable. They know less than their provider, they usually have fewer resources than their provider and they may well be captive, to some extent, especially in oligopolistic markets. There are significant

62 For more information, see PIAC's testimony to the Standing Committee of Finance (22 November 2016), online: <http://www.ourcommons.ca/DocumentViewer/en/42-1/FINA/meeting-59/evidence>, and to the Standing Senate Committee on Banking, Trade and Commerce (1 December 2016), online: <https://sencanada.ca/en/Content/SEN/Committee/421/banc/10ev-52963-e> regarding Bill C-29, *A second Act to implement certain provisions of the budget tabled in Parliament on March 22, 2016 and other measures*.

asymmetries between the two parties. The Supreme Court of Canada has acknowledged that vulnerability[63].

There may also be significant negative externalities, which individual consumers cannot address. Pollution provides the classic example: a firm saves money by polluting instead of investing in cleaner processes, but it is downstream residents who suffer the harm, even though they are powerless to change the polluter's decision and may find it daunting to bring the issue to court. In such cases, social and economic welfare are unduly diminished and there is no incentive for the party which can most easily remedy the problem (and at the lowest cost) to do so.

As a result, a sound regulatory framework designed *inter alia* to protect consumers, grounded in legal and economic considerations, should ensure full and true disclosure, in terms that are understandable, before an agreement is struck. It should prohibit, or at least restrict, unfair contractual provisions, such as the ability of a party to modify or terminate the contract unilaterally (unless the other party suffers no material prejudice from termination), or to contract out of any liability, especially when that party is the least cost avoider.

It is, therefore, unsurprising that these basic rules are enshrined in the *United Nations Guidelines for Consumer Protection*[64]. Grounded in the recognition of "imbalances" between providers and consumers, the Guidelines recommend that businesses deal fairly and honestly with consumers, especially with those who are vulnerable or disadvantaged (Section IV, par. 11 a); that national policies should encourage "good business practices" and, in particular, the implementation of "[c]lear, concise and easy to understand contract terms that are not unfair" (Section V, par. 14). Businesses should also "make clear" the responsibility of the provider to provide services which are reliable (Section V, par. 23). In addition, the Guidelines provide that:

> 26. Consumers should be protected from such contractual abuses as one-sided standard contracts, exclusion of essential rights in contracts and unconscionable conditions of credit by sellers.

Specific principles also apply to financial services, including the requirement for oversight bodies with the necessary authority and resources, fair treatment, avoidance of

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63 *Richard* v. *Time Inc.*, [2012] 1 S.C.R. 265: *Douez* v. *Facebook, Inc.*, 2017 CSC 33.

64 The Guidelines were first adopted by the General Assembly of the United Nations in 1985, expanded in 1999 and revised and adopted by the General Assembly in December 2015. A consolidated, updated version can be found at http://unctad.org/en/PublicationsLibrary/ditccplpmisc2016d1_en.pdf.

conflicts of interest, responsible lending, and the offer of "products that are suitable to the consumers' needs and means" (par. 66).

These fundamental notions also underlie the G20's *High-level principles on financial consumer protection* of October 2011 [65] and *Effective approaches to support the implementation of the remaining G20/OECD high-level principles on financial consumer protection* of September 2014[66].

These principles should guide the design of a proper framework for mitigating legal and other risks.

3.1.3 Responding to market failures

Over the past four decades or so, abundant literature, often associated with the "law and economics" school, has questioned the rationale for regulatory intervention in markets. Assumptions underlying that current of thought are, however, increasingly disputed. Economists find systemic asymmetries between providers and users, identify issues associated with rationality and take into consideration problems such as market structure[67].

Even Professor Ronald Coase, who practically founded the "law and economics" strand of research, acknowledged in his seminal 1960 paper that regulation was in some cases the least inefficient tool available to manage "social costs", *i.e.*, costs that acted as externalities. This has led to the development of the concept of the "least cost avoider": the market participant who can mitigate a risk (or other problem) at the lowest cost should be incentivized to do so.

Moreover, risk management or amelioration needs to be apportioned according to a participant's ability to manage and understand the risk. It is unreasonable to have a consumer assume, or share, the risks regarding the technical shortcomings of a payment system that are managed by a provider, yet this is exactly what many service agreements between customers and banks require when dealing with risk when consumers access online banking services from their home desktop or mobile device.

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65 Available at https://www.oecd.org/g20/topics/financial-sector-reform/48892010.pdf.

66 Available at https://www.oecd.org/daf/fin/financial-education/G20-OECD-Financial-Consumer-Protection-Principles-Implementation-2014.pdf.

67 See *e.g.* the discussion in Driesen, David M. *The Economic Dynamics of Law*. Cambridge, Cambridge University Press, 2012. 242 p. See also Stiglitz, Joseph. *Regulation and failure*. In Moss, David; Cisternino, John, eds. *New Perspectives on Regulation*. Cambridge, MA, The Tobin Project, 2009. Pp. 1-23.

From an economic perspective, therefore, not only is there a justification for regulating, but there are indications regarding the direction such regulation should take in order to prevent or mitigate market failure and the risks flowing from it.

3.1.4 Looking beyond market efficiency

While economic considerations currently loom large in the public discourse, they are by no means the only reasons why government should regulate. Greek philosophers distinguished clearly between economics related to management issues, and the much broader questions associated with government of the *polis*, the public sphere, twenty-three centuries ago [68]. Making good policy extends beyond assessing whether the economy is reasonably well managed. In fact, there are now authors opining that the "set of understandings about how markets [work] that were based in neo-classical economics and which inspired the financial sector's regulatory sector after 1990 "[…] were largely erroneous, with disastrous consequences." [69]

Academic research currently identifies numerous theories of regulation, which can be brought within a few broad categories. Theories in one of those categories emphasize efficiency, and tend to reflect economic concerns such as those noted above; although they have dominated the past quarter century, they are now disputed. Another category gives precedence to procedural concerns: regulation should ensure that proper procedure is followed to establish rules, be it for instance through "multi-interest representation" or "collaborative governance" [70].

Yet other scholars articulate a view that "overall well-being is morally relevant to regulatory choice" and should be taken into account together with distributive,

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68 The distinction is already made clearly in the *Οἰκονομικά* (*Economics*), traditionally ascribed to Aristotle but likely written by one of his students, as well as in Aristotle's *Politics*. Aristotle lived from 384 to 322 BC.

69 Black, Julia. *Seeing, Knowing and Regulating Financial Markets: Moving the Cognitive Framework from the Economic to the Social*. LSE Law, Society and Economy Working Papers 24/2013. London, 2013. 47 p. P. 2 Available at http://www.lse.ac.uk/collections/law/wps/WPS2013-24_Black.pdf. Hereinafter "Seeing". The author argues for the development of "a far more enriched, and realistic, conception of markets than the relatively sparse economic model assumes" (p. 3) and provides a number of leads to follow, which unfortunately exceed the ambit of this paper.

70 This typology summarizes and simplifies the one developed by Adler, Matthew. *Beyond efficiency and procedure: a welfarist theory of regulation*. [2000] 28 Florida State U. L. Rev. 241-338. In particular, part II of Adler's paper provides a strong refutation of theories strictly based on efficiency concerns, which is too complex to summarize herein (see especially pp. 244-249).

deontological and perfectionist criteria[71]. That is, issues such as ensuring equality (and giving priority to the well-being of those who are worse off), ensuring respect of basic rights and seeking "good" outcomes (*e.g.* caring about non-sentient species, reduced climate impact or cultural improvement) are not only valid reasons for regulating, but must actually be taken into consideration. Justice goes beyond efficiency, and so does the policy maker's remit.

When considering, for instance, accessibility to payment instruments, concerns such as systemic discrimination resulting from business or technological choices, or the consequences of geographic remoteness on social and financial inclusion, should be addressed. Efficiency-focused processes, such as cost-benefit analyses, simply cannot take into account such factors, which by their nature are largely qualitative, rather than quantitative – yet such factors should be considered in any regulatory process. As one legal scholar puts it, "We do not want society to efficiently drive itself off a cliff": assessing efficiency is not the same as setting goals, and the latter should be the primary concern for those who establish public policy[72]. Nor can cost-benefit analyses easily appraise *ex ante* processes which are highly dynamic, such as the impact of the introduction of new technologies[73], or help determine how to attain economic development through innovation[74].

This is not to say that efficiency, or the design of processes ensuring proper stakeholder participation, should not be of concern to policymakers and regulators; there are, however, other dimensions which they should take into consideration. The issue therefore is "smart regulation", to borrow from the terminology in use at the Organisation for Economic Cooperation and Development.

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71 *Ibid.*, 288-317. See also, for instance, White, Barbara Ann. *Economic efficiency and the parameters of fairness: a marriage of marketplace morals and the ethics of care*. [2005]15:1 Cornell Jnl of Law and Public Policy 1-72 Zamir, Eyal; Medina, Barak. *Law, Morality, and Economics: Integrating Moral Constraints with Economic Analysis of Law*, [2008] 96:2 California Law Rev. 325-391.

72 Driesen, *op. cit*.

73 *Ibid.*, p. 3. An added challenge for cost-benefit analysis is to properly assess *all* costs and benefits: too often, the costs of government intervention are put forward, without giving due consideration to the significant private transaction costs such intervention makes avoidable (*ibid.*, p. 33).

74 Innovation is inherently messy and may, in the short run, be highly ineffective. It is claimed – likely apocryphally – that Thomas A. Edison experimented with 10,000 prototypes before successfully testing a carbon filament and developing the light bulb as we came to know it. If Edison had had to answer to a twenty-first century MBA or accountant, we suspect he would have been told that his costs far exceeded quantifiable benefits and that he should move on long before he succeeded…

A sound regulatory policy is a very effective tool for the State to wield. When underpinned by solid research and analysis and championed by a leader with clear long-term objectives, it can serve to support reform and sustain general welfare[75]. It may actually be necessary in order to accomplish needed reforms: there can also be State failure to do its part in fostering the changes that must happen in order to facilitate developments such as innovation and increased accessibility to essential services, or to foster trust in institutions such as the payments system, which may be eroded in a period of fast-paced change.

3.2 Areas to be addressed

As noted in subsection 1.4, there are various types of risks to be addressed. Providers may become insolvent or be short on liquidity, raising credit or liquidity risk; they may be incompetent, make mistakes or behave unfairly, raising market conduct and operational risk; or they may offer services that are not accessible, raising social risk.

In order to address those risks, we suggest that at least five categories of rules are required:[76]

- eligibility rules, in order to determine who can offer services and set requirements, such as capitalization, integrity and competence;
- acceptability rules, in order to determine to what extent and under what conditions payment instruments can be used and must be accepted;
- accessibility rules, to ensure that Canadians have access to the payment mechanisms they require;
- integrity rules, to ensure that providers act fairly and competently, and

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75 For an overview of these issues, see *e.g.* Organisation for Economic Co-operation and Development. *Regulatory Policy and the Road to Sustainable Growth*. Draft Report. Paris, 2010. 104 p. Pp. 11-13, 15-16. Available at http://www.oecd.org/regreform/policyconference/46270065.pdf. See also Driesen, *op. cit.*, pp. 27, 29.

76 We note in passing that these categories are consistent with regulatory objectives proposed in the past by the Canadian Consumer Initiative, of which PIAC was a member, as well as with the National Payments Policy proposed by the Task Force for the Payments System Review: Policy Paper A, *Users and their Discontent*, especially p. 25, and available at http://paymentsystemreview.ca/wp-content/themes/psr-esp-hub/documents/ppA_eng.pdf. The CCI regulatory objectives addressed universality (regulating all payment technologies), technological neutrality, security, accountability, transparency, liberty of choice, enforceability and legitimacy. For reference, see: Consumers Council of Canada, "The Need for Laws Governing Electronic Payments in Canada," online: Consumers Council <http://www.consumerscouncil.com/index.cfm?id=26965>.

- enforceability rules, to ensure compliance with the aforementioned rules.

3.3 Design principles

The current legal framework for retail payments has evolved piecemeal over more than a century. It is therefore inconsistent, full of gaps and obsolete. The design of a new regime should be rooted in a number of basic principles.

3.3.1 Functional regulation

As things currently stand, the rights of a consumer using a credit or a prepaid card will vary depending on whether the card was issued by a federally-regulated or a provincially-regulated institution, even if the transaction that is performed is exactly the same. This is a result of the fact that a significant proportion of the legal framework is institutionally based: rules depend on the nature of the provider one is dealing with. There are two unfortunate consequences to this approach: rules are inconsistent, and services offered by providers who do not happen to be regulated are not covered. This may also create an advantage for some providers, who are not bound by the same obligations as their competitors, and it is likely to disadvantage consumers, as it fosters confusion and creates situations where there is no adequate legal protection for users.

Reliance on a functional approach should therefore be a fundamental underlying principle for a new regulatory framework. It is the function generating risk that should be regulated, regardless of what company or institution is performing that function.

3.3.2 A principles-based approach

There has been a raging debate in regulatory policy for the past thirty years or so around the notion of "principles-based" regulation. The intent is to do away with exceedingly precise and prescriptive regulation, which often becomes quickly obsolete. We therefore support the use of a principles-based approach. We note, however, that such an approach is in fact quite demanding for regulators, enforcers and participants who must adapt to less specific requirements. A principles-based approach is not synonymous with the adoption of a few vague principles, supplemented by voluntary codes or other non-binding instruments. It requires a rigorous process, without which it will fail miserably and actually enhance market risk, rather than mitigate it[77].

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77 On these issues, see for instance Black, Julia. *The Rise, Fall and Fate of Principles Based Regulation*. Law, Society and Economy Working Papers 17/2010. London, London School of Economics and Political Science, 2010. 25 p. Available at http://www.lse.ac.uk/collections/law/wps/WPS2010-17_Black.pdf. Black, Julia. *Paradoxes and Failures: 'New Governance' Techniques and the Financial Crisis*. [2012] 75 (6) Modern Law Rev. 1037; Band, Christa; Black, Julia; Hopper, Martyn. *Making a success of*

3.3.3 Neutral and universal regulation

Inconsistency fosters uncertainty. A new framework should therefore seek to cover the broadest range of payment technologies and providers, and to cover them similarly, insofar as possible. Regulation should be inclusive and consistent.

3.3.4 Accountability

A legal framework should be designed so as to foster the application of the least cost avoider principle, from product design to liability allocation rules. The market participant who creates a risk, or who is best placed to mitigate that risk, should be incentivized in doing so. This may be achieved through design requirements, fiscal measures, or rules imposing liability on the provider, for instance[78].

3.4 Regulatory choices

Legal rules can take a multitude of forms. Legislation and regulation are obvious examples, but contracts also embed legal rules. Other instruments, such as codes of practice, may do so as well.

Each type of tool has its advantages and drawbacks. For instance, sole reliance on contracts may support flexibility, but it may also facilitate unfairness when terms are dictated by one party to the other. Researchers have also pointed out that contracts may provide more certainty, as compared to reliance on the amorphous body of implicit law underlying contracts – but, again, the underlying body of law may be more favorable to the consumer than to the provider (assuming they are aware of it, of course[79]). For this reason, consumer law often relies on legislation, which has the ability to impose constraints on market participant behaviour, even though it is less flexible.

Principles-based regulation. [2007] Law and Fin. Markets Rev. 191; Frantz, Pascal; Insterfjord, Norvald. *Rules vs Principles Based Financial Regulation* November 25, 2014. Available through http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2561370; Ford, Cristie. *Principles-Based Securities Regulation in the Wake of the Global Financial Crisis*. (2010) 55 McGill L.J. 257. Pp. 266-267; Sanders, Deen. *Reinventing regulation*. [2014] 8:2 Law & Fin. Markets Rev. 98.

78 Regarding the latter issue, see for instance Cooter, Robert; Rubin, Edward. *A Theory of Loss Allocation for Consumer Payments*. (1987-88) 66 Tex. L. Rev.63-130.

79 On this issue, see for instance Ben-Shahar, Omri. *Regulation through boilerplate: an apologia*. [2014] 112 Mich. L. Rev.883.

4.0 Experiences Abroad

The research can also benefit from benchmarking. Innovative regulatory solutions are implemented in the European Union, with the adoption of the new Payment Services Directive (*Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC,*OJ L 337/35, December 23 2015). The Directive (also known as "PSD2") expands the scope of its rules to transactions where only one payment service provider is located in the EU[80] and creates standardized rules for new "payment initiation service providers" and "account information service providers". This essentially requires financial institutions to "open up" a customer's bank account to third party services or applications. PSD2 also creates new consumer protection rules, such as banning debit and credit surcharges in most cases,[81] limiting the amount a customer is required to pay for an unauthorized transaction to €50,[82] and codifying an "unconditional refund" right for direct debits within eight weeks, even in the case of a disputed transaction.[83] PSD2 must be adopted by Member States as national law by January 2018.[84]

Australian authorities conducted significant research before implementing the *ePayments Code*[85] and other regulatory instruments. The Code *inter alia* sets out "clear and unambiguous" disclosure requirements,[86] establishes that a customer is not liable for unauthorized transactions unless a PIN number is used and the customer delays reporting it to his or her financial institution,[87] and prescribes a detailed process to recover a

80 *Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC,*OJ L 337/35 (December 23 2015), art 2.

81 *Ibid*, recital 1 and art 62.4.

82 *Ibid*, art 74.1.

83 *Ibid*, art 76-77.

84 Payments UK, *The Second Payment Services Directive (PSD2)* (July 2016), online: Payments UK <https://www.paymentsuk.org.uk/sites/default/files/PSD2%20report%20June%202016.pdf> at 7.

85 Australian Securities & Investments Commission, *ePayments Code* (29 March 2016), online: ASIC <http://download.asic.gov.au/media/3798542/epayments-code-published-29-march-2016.pdf>.

86 *Ibid*, s 4.

87 *Ibid*, s 10.

"mistaken internet payment".[88] The Code also imposes fewer requirements on "low value facilities" or providers that can hold a balance of no more than $500 at a time.[89]

In the United States, consumers engaging in electronic retail payments are protected by the *Electronic Fund Transfer Act of 1978*.[90] The Act currently applies to "access devices", including any means to access a consumer's account and initiate electronic transfers, such as ATMs, direct deposits, point-of-sale terminals, telephone transfers, remote banking programs, and remittance transfers (*i.e.* international money transfers).[91] Some of the consumer protections included in the Act are: a general prohibition on charging overdraft fees for paying an ATM or one-time debit card transaction, unless the consumer has opted in;[92] a limitation of a consumer's liability for unauthorized transfers to $50 if the consumer reports a loss or theft within two business days;[93] and procedures for resolving errors or cancellations and refunds of remittance transfers.[94] The Federal Reserve, including the Payments System Policy Advisory Committee, regularly reviews and reports on "aggregate volumes, trends, and related information on the payments system in the United States."[95] The Consumer Financial Protection Bureau is also contemplating innovative regulatory approaches and undertakes regular research into consumer issues in alternative financial services, such as a 2016 report on online payday loan payments.[96]

There is therefore a significant body of work which can undergird the development of a new, more effective regulatory framework.

5.0 Conclusion & Recommendations

Until this report, inadequate attention has been paid to the legal risks posed by online payment transactions carried out by consumers. This report identified some of the key

88 *Ibid*, chapter E.

89 Financial Ombudsman Service, "E-Payments Code" (2012), *The Financial Ombudsman Service Circular*, online: FOS <https://www.fos.org.au/the-circular-9-home/epayments-code/#6>.

90 15 U.S.C. 1693.

91 Office of the Comptroller of the Currency, *Consumer Compliance: Electronic Fund Transfer Act* (2014), v. 2.0, online: <https://www.occ.gov/publications/publications-by-type/comptrollers-handbook/electronic-fund-transfer-act/pub-ch-efta.pdf> at p. 1.

92 12 CFR 1005.17(b).

93 12 CFR 1005.6.

94 12 CFR 1005.33-34.

95 See for instance: Board of Governors of the Federal Reserve System, "Federal Reserve Payments Study," online: Federal Reserve <https://www.federalreserve.gov/paymentsystems/fr-payments-study.htm> (accessed 29 September 2017).

96 Consumer Financial Protection Bureau, *Online Payday Loan Payments* (April 2016), online: CFPB <http://files.consumerfinance.gov/f/201604_cfpb_online-payday-loan-payments.pdf>.

risks and appropriate regulatory approaches to resolving them. Notably, this report found that policy makers cannot rely on financial institutions alone to ensure that the legal rights of consumers are protected. Rather, carefully crafted mandatory policies and rules - with enforcement and redress mechanisms - are required in order to mitigate and remedy online payment legal risks.

This report sets out the following recommendations in order to lay a foundation for a strong regulatory framework for retail payments which will protect Canadian consumers.

Recommendation 1: Use the *United Nations Guidelines for Consumer Protection* as the basis for developing the principles governing a regulatory framework for retail payment mechanisms, including requirements for financial institutions to implement clear, concise and easy to understand contract terms that are not unfair, and to make clear the responsibility of the provider to provide services which are reliable.

Recommendation 2: Adopt the "least cost avoider" principle in all regulatory and policy development to ensure the market participant who is most able to mitigate a risk (or other problem), and at the lowest cost, should be required or incentivized to do so.

Recommendation 3: Reform all external regulatory complaint bodies, including the Ombudsman for Banking Services and Investments and ADRBO, to ensure it is well-resourced, has effective authority and enforcement powers, and includes mandatory participation of financial institutions.

Recommendation 4: Establish a universal, enforceable and mandatory federal financial consumer protection framework (including rules relevant to retail payments) which will apply to all transactions in Canada. This framework should harmonize existing rules and establish new obligations where appropriate, and should involve multi-stakeholder consultations, particularly with public interest and consumer groups.

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