



## **The Financial Services Regulatory Report**

### **Canadian Payments Association Introduces New Requirements for Pre-Authorized Debits**

New requirements for pre-authorized debits (“PADs”) have been published in the form of a revised version of the Canadian Payments Association’s Rule H1.

In particular, the new provisions:

- i. establish mandatory requirements for two types of agreements:
  - a. a payee letter of undertaking (“LOU”). A LOU is an agreement that a financial institution, known as the sponsoring bank, must obtain from its customers (a “Payee”) who wish to be paid their receivables or other debts due by their debtors (the “Payors”) by means of a PAD. The sponsoring bank clears and settles such PADs through the Canadian clearing and settlement system; and
  - b. an agreement authorising payment of a debt owed by a Payor to a Payee by way of a PAD (a “PAD Agreement”). The Payor’s account with its bank will be debited to pay the amount of the PAD to the Payee. Sponsoring financial institutions are required to ensure that Payees use appropriate forms of PAD Agreement.

In addition, the new requirements provide a more flexible framework to create PAD Agreements through an electronic channel, such as the Internet or by telephone. Under the revised Rule H1, Payees must use a “commercially reasonable”<sup>1</sup> process to confirm the identity of the Payor when using electronic PAD Agreements. Some guidance on what is “commercially reasonable” is provided in Rule H1. In addition, the elements of a Payor’s PAD Agreement that are mandatory under the Rule must be reflected in the electronic forms or process used. The Payee must send its proposed process for confirming the identity of Payors as well as the content of its electronic Payor’s PAD Agreements to its sponsoring financial institution prior to using them.

Payees must, under the revisions, also send a written confirmation (the “Confirmation”) to each Payor when Payor’s PAD Agreement is made electronically. The Confirmation is intended to confirm the terms and conditions of the PAD Agreement and must include all of the mandatory elements set out in Appendix IV to Rule H1. The standard period for sending the Confirmation is at least 15 days prior to implementing the first PAD. This period can be shortened by mutual agreement, but not waived. Not providing confirmation of an electronic Payor’s PAD Agreement prior to the first PAD in accordance with the

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<sup>1</sup> “Commercially Reasonable” is a term used to describe certain security procedures, specifically, the verification of a person’s identity; the reasonableness of which, ultimately can be determined by a court of law in light of the purposes of the procedure and the commercial circumstances at the time the procedure was used, including, but not limited to: i) the nature of the particular business; ii) the amount of the particular transaction; iii) the Payee’s volume of payments; iv) the sophistication of the parties; v) the availability of alternatives offered to but rejected by either of the parties; vi) the cost of alternative procedures; vii) the procedures in general use for similar types of business and payment applications; and, viii) whether there is an existing business relationship between the parties.

required time period specified in the PAD Agreement has been added as a reason for which the Payor can dispute the PAD and claim a reimbursement.

A transition period is in effect until February 28, 2010 to allow Payees and financial institutions time to make the necessary changes to their forms of LOU and PAD Agreement. PAD Agreements signed before that date are grandfathered and thus remain valid to avoid inconvenience to Payors and Payees. *However, sponsoring financial institutions entering into a new LOU with their Payee customers before such date must ensure the LOU contains the provisions deemed mandatory by the revised Rule H1.*

The revisions to the CPA's rules also include the following:

- The standard period for pre-notification of the first fixed amount PAD or variable PAD or any change in amount or date remains at 10 days. A reduction/waiver clause in the Payor's PAD Agreement which reduces or waives the normal 10 day pre-notification period must be prominent (e.g., bold print, highlighted or underlined).
- The category of the PAD must be correctly identified in the Agreement either as a business or personal PAD. If a PAD includes personal and business components or if a personal PAD is incorrectly coded as a business PAD, the 90 days' recourse of Payor (normally applicable to business PADs) applies.
- Payees may not assign a LOU to another party unless the Payee obtains the sponsoring bank's prior written consent.
- The Payee may not assign a PAD Agreement to another party unless advance written notice including the name and contact information of the new Payee has been provided to the Payor at least 10 days in advance of any PAD being issued in the new Payee's name.
- the Payor's PAD Agreement must now include information on how a Payor may cancel a PAD at any time, and indicates the minimum lead time required to do so for the next PAD. Payees must cancel the PAD on a best efforts basis before the next billing or processing cycle. All cancellation requests must be acted upon within 30 days. A model cancellation form is provided in Appendix VI to CPA Rule H1 and will be available on the CPA's web site, but Payors are not required to use it to cancel their agreements.
- Payees are required to update the account number or transit number for PADs when they receive notices of change from the sponsoring bank.
- No pre-notification to Payors is required if the amount of a PAD decreases due to a change in federal, provincial or municipal taxes. However, pre-notification is required in the event of an amount change due to a tax increase unless the Payor has waived its right.
- From September 2, 2008, a new policy will be implemented which will require that all PADs initiated by non-CPA members must be in electronic format.

Pursuant to the new Rule H1, members are responsible and liable for every PAD and every payment item purporting to be a PAD that it exchanges for the purpose of clearing and settlement and the member indemnifies the CPA and other Members for any direct loss, costs or damages incurred by them as a result of a PAD or payment item purporting to be a PAD that is has exchanged for purposes of clearing and settlement.

Members also indemnify the Association and its Members for any direct loss, costs or damages incurred as a result of the fact that the Payor's PAD Agreement or Letter of

Undertaking deviated from the requirements set out in the Rule or from the intent or effect of this Rule.

In addition, under the CPA Compliance By-law 6, there are various sanctions for failure to comply with the CPA By-laws and Rules. The process is complaints driven and rarely used. Penalties are imposed only following an investigation resulting from a complaint by another member or one initiated by the General Manager of the CPA, and formal hearings. Monetary penalties, reprimand, restitution to another member who has suffered by reason of the contravention, etc. may be imposed.

Financial institutions that make PADs available to their Payee customers should take note of the new Rule H1 and implement the requisite changes in an orderly and timely fashion. Given that new LOUs must be in place with *all Payees*, *members should take the opportunity to act now to implement the changes well prior to the 2010 date by which such changes must be incorporated.*

## **New Legislative Changes Impact Open Loop Gift Cards in Ontario**

The prepaid card market is one of the most dynamic and fastest growing segments of the financial services industry.<sup>2</sup> It includes a variety of products, ranging from traditional gift cards (closed-loop) used to make small dollar transactions with specific retailers to the more recently established branded general spending reloadable cards (open-loop) which have substantial versatility. With the advent of these new payment instruments comes new regulation of which issuers need to be aware.

Further amendments to the Ontario gift card regulations made pursuant to the Ontario *Consumer Protection Act* will come into force on September 1, 2008. An open loop gift card agreement has been defined under the revised section 23 of the general consumer protection regulations as a "gift card agreement that entitles the holder of a gift card to apply it towards purchasing goods or services from multiple unaffiliated sellers". Under the new regulations, businesses issuing gift cards under an open loop gift card agreement will only be permitted to charge the following fees:

- A fee for the customization of a gift card,
- A fee to replace a lost or stolen card,
- A dormancy fee, provided:
  - a. The fee is charged no earlier than 15 months after the end of the month during which the consumer entered into the gift card agreement, if the holder of the card does not request an extension in the 15<sup>th</sup> month, or 18 months after the end of the month that the consumer entered into the gift card agreement, in the case of a holder that does request such an extension in that 15<sup>th</sup> month.
  - b. The fee does not exceed \$2.50 per month;
  - c. The card has a notice on the front in 10 point font indicating that there is fee information on the back of the card; and
  - d. The card has a notice on the back setting out clearly and prominently, the information mentioned in a. and b. above and the supplier discloses this information to the consumer at the time the consumer enters into the agreement.

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<sup>2</sup> Cardholder Use of General Spending Prepaid Cards: A Closer Look at the Market by Sherrie L.W. Rhine, Katy Jacob, Yazmin Osaki, Jennifer Tesche (Chicago Federal Reserve).

The regulations also provide that the face value of an open-loop gift card may be up to \$1.50 less than the amount paid by the consumer to enter into the agreement. In effect this is the maximum amount that may be collected for issuing the card. We anticipate the low amount may incline card vendors from abandoning any attempt to receive a payment for issuing the card.

Under the consumer protection rules both before and after these changes, the failure of a supplier to disclose the required information entitles the consumer to cancel the gift card and to receive a refund of the outstanding balance for up to one year after the gift card was issued. Similarly, if the consumer is charged a fee or an amount not otherwise permitted, the consumer is entitled to a refund of the fee for up to one year provided that notice is given to the supplier pursuant to the *Consumer Protection Act*.

## **Developments in Other Provinces**

### **British Columbia**

In British Columbia, the *Public Safety and Solicitor General (Gift Card Certainty) Statutes Amendment Act, 2008* amended the *Business Practices and Consumer Protection Act*. It prohibits companies from placing expiry dates on or levying service charges for their gift cards, except in limited circumstances as may be set out in regulations still to be adopted.

In the addition, the new law, which comes into force on a date to be set by regulation, will require businesses to inform consumers at the time of purchase how cards can be redeemed, used and replaced and how the consumer can in general obtain information regarding the cards including claiming any remaining balance.

Individuals or businesses that violate the new law will be subject to administrative penalties, and customers would be entitled to a refund if they are charged prohibited fees.

The provisions above will apply from the date the amendments are made effective by regulation except that for currently issued cards, any expiry dates therein are deemed without effect (i.e., the card remains redeemable at any time) unless the regulation provides otherwise.

### **Saskatchewan**

Bill 12, *An Act to amend the Consumer Protection Act*, received third reading in the Saskatchewan Legislature on April 22, 2008. Bill 12 prohibits expiry dates on most gift cards supplied by retailers and other suppliers, the law is not yet proclaimed in force. No fees may be charged to the holder of a gift card, including inactivity and dormancy fees, subject to any specific exemptions in regulations to be made pursuant to the Bill. Additionally, retailers must provide all information relating to the use of the gift card as set out in the regulations.

The law will not be retroactive, subject otherwise as may be provided in the regulations.

Bill 12 also includes inspection, investigation, enforcement, and penalty provisions. Individuals in contravention of any provision of the Bill may be fined a monetary penalty of not more than \$5,000 and/or one year in prison for the first offence, and a fine of not more than \$10,000 and/or one year in prison for subsequent offences. Corporations may be fined \$100,000 and \$500,000 for a first and subsequent offence, respectively. In addition to these penalties, the court may issue a compliance and/or restitution order.

### **Manitoba**

Manitoba's *Consumer Protection Amendment Act (Prepaid Purchase Cards)*, which amended the *Consumer Protection Act* to address gift cards, was proclaimed in force on November 1, 2007. Regulations concerning gift cards were also released and, for the most part, mirror many of the restrictions and requirements in Ontario. As in Ontario, there is a prohibition against the use of expiry dates on the card, with some exceptions.

For gift cards that can be used at multiple, unaffiliated stores, Manitoba permits a maximum monthly fee of \$2.50 if the card has not been activated within one year. Cancellation and refund provisions are contained in the Manitoba regulations, as well as minimum disclosure requirements. In addition, there is a requirement to disclose how the gift card holder may obtain information about the card, including any remaining balance. The regulations also provide for administrative penalties where a supplier of a gift card fails to meet certain requirements.

### **Nova Scotia**

Bill 35, *An Act to Amend the Consumer Protection Act*, came into force on December 13, 2007. Bill 35 permits the implementation of regulations imposing restrictions on gift cards, including the regulation or prohibition of expiry dates where the dates are within 36 months from issuance. To date, no regulations have been proposed.

### **New Brunswick**

Gift card legislation that will eliminate expiry dates was introduced by the Government of New Brunswick on May 27, 2008.

The *Gift Cards Act* will:

- eliminate expiry dates unless otherwise provided for by regulation;
- define different types of gift cards and require disclosure of the terms and conditions of their use;
- provide for fees that may be charged for gift card customization and replacement; and
- allow the purchaser of a gift card the right to demand a refund for any fees charged by the seller or supplier in contravention of the legislation, and require the seller or supplier to grant the refund within 15 days of receiving the notice.

Disclosure of terms and conditions will be required, and the legislation will only be applicable to cards purchased after the Act comes into force.

The proposed legislation was developed with the intention of being consistent with the provisions of legislation introduced in the five other provinces above-noted.



*If you require assistance on how any of the above-noted matters will affect your organization please call Libby Gillman at 416.418.7204 or contact her at [libbyg@lawgill.com](mailto:libbyg@lawgill.com)*

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