

**Pre-authorized Payment or Blank Cheque?
EXECUTIVE SUMMARY**



April 2005

PRE-AUTHORIZED PAYMENT

The number of pre-authorized debit payments drawn on consumer accounts has grown exponentially over recent years. Rising from 76.7 million to 370.3 million yearly transactions per year from 1990 to 2000, the annual volume of pre-authorized debit payments in Canada stood at 467.2 million transactions in 2003.¹ It is the Canadian Payments Association (CPA)² which sets the rules and standards for the exchange of payments between member institutions. One of these rules concerns procedures for compensating and processing pre-authorized debits. This rule (Rule H1) came into effect in 2002: It also imposes numerous formalities on creditors, such as those connected with settling disputes with consumers who contest the debit made.

Despite this rule, many creditors still regard the pre-authorized debit as a blank cheque which, once authorized by the consumer, will require no further formality in order to modify the dates or even the amounts of withdrawals from the consumer's personal account. This trend is coupled with another more disturbing one: the growing number of cases of irregular or even fraudulent transactions reported to us by consumers. When there is a problem with a pre-authorized payment (even if the supplier, by his own admission, is at fault), it is the consumer who suffers the sometimes considerable disadvantages. It is always the consumers who must claim reimbursement of the amount withdrawn without authorization; invest the time and energy needed to make sure the over-billing does not cause an overdraft on their account; and, in the event, pay the fees which may ensue.

Unfortunately, it appears that the content of Rule H1 is not known to most consumers, merchants, nor, quite surprisingly, to the branches of financial institutions. When the consumer consents to a pre-authorized payment he is told nothing about a procedure to follow in case of problems or disputes. The system of pre-authorized debits seems to rely on the good will of corporations which does, admittedly, work well for most transactions. But irregularities in the use of this mode of payment can have serious impacts on consumers' budgets. And, though the consumer does have recourse in case of disputes or litigation, it is essential that he and the other parties involved be correctly informed of this fact if he is to exercise his rights. This research thus examines the information consumers receive concerning potential disputes over automatic debits from their personal accounts and looks at the way these direct debits from credit cards are handled.

To this end, the Union des consommateurs conducted several surveys: (1) with 27 organizations specializing in budget consultation in 3 different provinces; (2) with 43 branches of 8 large Canadian financial institutions in the Maritimes, in Ontario, and in Quebec; (3) with head offices; (4) with Visa and MasterCard; and (5) by means of 8 control operations in branches.

¹ Canadian Payments Association. *Revue annuelle 2003: Bâtir sur du solide*. On line. http://www.cdnpay.ca/publications/pdfs_publications/annual_review_2003_fr.pdf. Consulted on 1 February 2005, p. 20.

² On average, some 18.8 million payment items, representing operations of close to \$142 billion, were compensated and processed daily by CPA systems in 2003—whether cheques, electronic deposits, direct deposits, pre-authorized debits, bill payments or point-of-sale debits. The Canadian Payments Association/*Association canadienne de paiement* Home. On line. Consulted on 1 February 2005.

Synthesis of Rule-H1 procedures

1. Beneficiary corporation signs a letter of agreement with its financial institution.
2. Beneficiary's financial institution examines the skeleton pre-authorized - debit contract before it is used.
3. Beneficiary and client sign a mandatory contract stipulating the amount, the date as well as the procedures for reimbursement and cancellation of the pre-authorized debit. The beneficiary must archive the agreement for at least 12 months.
4. Debit
5. Withdrawal is made.
6. Reimbursement and recourse: As stipulated in the agreement, the consumer is not obliged to contact the beneficiary; he can make his claim directly at his branch.

Procedures for setting up pre-authorized debits:

- All the procedures for setting up pre-authorized debits require a contract with a signature or some other validation from a payer (electronic signature). On the contract, there must appear:
 - The payer's contact information, his financial institution, the number of his personal account, and the identification number on the specimen cheque confirming its validity;
 - Procedures for reimbursement;
 - Explanation of the procedures for cancellation.
- A copy of the contract must be given to the consumer.

The amount and the date of pre-authorized debits must be clearly indicated on the contract.

If the amounts and/or the dates vary;

The merchant must send the payer a written notice at least 10 civil days before the date of withdrawal, indicating the amount to be debited, unless the payer has explicitly waived this provision.

Reimbursement and recourse

In case of dispute, the payer can ask his financial institution, within 90 civil days of the date on which the withdrawal was made, to reverse the operation and return the funds to his account. The payer's institution then has him fill out a declaration drawn up in accordance with the model provided in Appendix III of Rule H1. However, the reimbursement will be made to the payer's financial institution only if the agreement has been violated, either:

1. The pre-authorized debit was not in conformity with the modalities of the agreement (amount or date of debit);
2. The agreement has been revoked;
3. The 10-day advance notice was not received;
4. There is no authorization to make the pre-authorized debit.

The payer contacts his financial institution which asks him to come to the branch to fill out the pro forma reimbursement form (free of charge) and then gives him the amount of the withdrawal. Any requests for the reimbursement of interest and/or transaction fees fall outside of the scope of Rule H1.

Synthesis of the findings

Survey of budget consultation organizations

Consultants perceive the theoretical procedures for contesting a withdrawal as quite simple. However, their practical application is rather complex, whether for withdrawals from a personal account or a credit card. Budget consultants have spotted a number of problem situations: the role of financial institutions, variable amounts, recurring problems within the same firms, ignorance of reimbursement procedures on the part of employees of institutions, etc.

Survey of branches and head offices

1. There is generalized ignorance of the procedures connected with Rule H1.
2. Consumers are not correctly informed about dispute procedures regarding pre-authorized debits by their financial institutions.
3. The related fees are charged to the client even if the errors are not his.
4. There is a flagrant lack of follow-up and control by financial institutions once an authorized withdrawal has been cancelled.
5. Financial institutions seemingly want to limit their role and responsibilities to those of a simple intermediary for transactions covered by the CPA's Rule H1.
6. The consumer is often left alone to bear all the negative consequences of non-compliant withdrawals.

Credit cards

Credit-card transactions are not handled by the CPA. Rule H1 does not apply to them. The credit-card industry has never adopted any specific and clear policies on automatic withdrawals.

Control operations

Financial institutions seem to shirk their obligations and to ignore the rights of consumers. The information provided to consumers is not in conformity with the procedures stated in Rule H1. To institutions, consumers' difficulties sometimes appear as excellent opportunities to sell them additional services.

RECOMMENDATIONS

The conclusions reached by the Union des consommateurs lead to several recommendations. Among these recommendations are the following:

Recommendations related to pre-authorized debits

FINANCIAL INSTITUTIONS

The Union des consommateurs recommends:

- Training on Rule H1 for all employees in financial institutions who are involved in customer service. This training should focus specifically on reimbursement and cancellation procedures.
- Handing out folders explaining the procedures to obtain the reimbursement of a pre-authorized debit, forms for cancelling payment, and information on complaint procedures.

- Disseminating an information kit on procedures for pre-authorized debits and for contesting a withdrawal; this could, notably, be done via the Internet sites of all agencies offering this type of payment.
- Providing the means required (technological amongst others) to ensure the prevention of withdrawals once an authorization has been cancelled.

RULE H1

The Union des consommateurs recommends that:

- The minister of finance impose complete compliance with the procedures spelled out in Rule H1 and introduce fines for non-compliance.
- Modifications in Rule H1 which would confirm the responsibilities of financial institutions, place a 12-month limit on authorized withdrawals, require a written confirmation of all renewals, provide for the reimbursement of charges arising from a non-compliant withdrawal.

REIMBURSEMENTS

Union des consommateurs recommends that:

- Financial institutions be forbidden to bill consumers for any costs arising, either directly or indirectly, from an erroneous or unauthorized withdrawal; to bill any charges for blocking non-authorized withdrawals; to enter in consumers' credit record any overdrafts which might arise from non-compliant withdrawals.

BENEFICIARIES

The Union des consommateurs recommends that:

- Governments bring in compensatory and penal measures aimed at firms that do not comply with the procedures spelled out in Rule H1.
- Firms be held responsible for the charges consumers must assume owing to withdrawals that go against the agreement.

CPA

The Union des consommateurs recommends that:

- The CPA conduct a survey of all its members concerning their knowledge of the rules and procedures connected with pre-authorized withdrawals which directly affect consumers and then launch a major education campaign—aimed at both members and consumers—to fill in the gaps observed.
- The CPA establish better ways of monitoring the application of this rule and then report on its observance to the minister of finance.

Recommendations related to credit cards

The Union des consommateurs recommends that:

- The minister of finance establish a mandatory framework for pre-authorized credit-card withdrawals and order complete compliance with said framework. The framework could be modelled on Rule H1, as modified by the present recommendations.

The Union des consommateurs also recommends that groups advocating consumer rights should be included in any discussions on the modification of rules governing pre-authorized payments and that the resources required for their effective participation be allotted to them.