CT-95/02

THE COMPETITION TRIBUNAL

IN THE MATTER OF an Application by the Director of Investigation and Research under Sections 79 and 105 of the *Competition Act*, R.S.C. 1985, c. C-34;

AND IN THE MATTER OF an abuse of dominant position in the supply of shared electronic network services for consumer-initiated shared electronic financial services.

BETWEEN:

The Director Investigation and Research

Applicant

- and -

Bank of Montreal
The Bank of Nova Scotia
Canada Trustco Mortgage Company
Canadian Imperial Bank of Commerce
La Confédération des caisses populaires et d'économie Desjardins du Québec
Credit Union Central of Canada
National Bank of Canada
Royal Bank of Canada
The Toronto-Dominion Bank of Canada
Interac Inc.

Respondents

- and -

TelPay, a division of CTI-Comtel Inc.
Retail Council of Canada
Canadian Life and Health Insurance Association Inc.
Midland Walwyn Capital Inc.
Richardson Greenshields of Canada Limited
Mackenzie Financial Corporation
Trimark Investment Management Inc.

Intervenors

AFFIDAVIT OF BRADLEY CRAWFORD, Q.C. SWORN
MARCH 29, 1996

AFFIDAVIT OF BRADLEY CRAWFORD

I, BRADLEY CRAWFORD, of the City of Toronto in the Province of Ontario, make oath and say as follows:

1. I am a member of the Law Society of Upper Canada, having been admitted in 1966 and practiced as a member of the firm of McCarthy & McCarthy, later McCarthy Tétrault, since 1972. I received my patent as Queen's Counsel from the Queen in right of Canada in 1990. I was a professor in the Faculty of Law at the University of Toronto from 1963 until 1972, teaching a number of business-related subjects including the law of payment.

2. I have been a specialist practitioner in the law of banking and payment systems since about 1975. Since that time I have been a legal advisor to The Canadian Bankers' Association on matters related to the law of banking and payment, and am now the senior outside legal counsel to that Association. In addition to acting for private banking clients, I have been a consultant and legal advisor on the law of domestic and international payments systems to the Department of Justice, Canada; the Bank of Canada; the United Nations Commission on International Trade Law; the International Monetary Fund; and the Canadian Payments Association.

3. I am the author of the treatise, Crawford and Falconbridge on Banking and Bills of Exchange (1986) and of numerous articles and conference papers on various aspects of the law of banking and payment systems over the past 20 years.

4. I was first retained by the Respondents in late December, 1995 to advise on the implications for them, and for the operation of their Interac payment system, of the remedies proposed by the Draft Consent Order in these proceedings and to assist the Respondents in answering the allegations and demands of the Intervenors in these proceedings.

5. I have read the Draft Consent Order and the material filed in this matter by the Intervenors, Canadian Life and Health Insurance Association, the Retail Council of Canada, Midland Dougherty et al., including the affidavits filed by Professor Neil Quigley and Mr. K.J. Morrison. The Intervenors essentially ask the Tribunal to decide certain issues without regard for the constraints imposed by the existing law.

6. In his affidavit, Professor Quigley states that there is no reason why the Intervenors could not be admitted as direct participants and card issuers of Interac Association. This opinion is expressed in various ways at the following places in Professor Quigley's affidavit: paragraph 22 at page 9; paragraph 25 at pages 10 and 11; paragraph 30 at page 13. I assume that Professor Quigley intends to be understood as addressing only economic arguments or reasons. If he intended to include **legal** arguments, I am of the opinion that he was mistaken.

7. The Intervenors have asked the Tribunal to compel the Respondents to cause Interac Association to admit the Intervenors as card issuers. If implemented in the present legal environment, this proposal would make it difficult if not impossible, for Interac to continue to operate in its present manner. There would be difficulties with the exchange of payment items, with the clearing process and with the settlement. The most difficult issues would arise with respect to the settlement of members' claims.

As now operated, Interac Association members use the Automated Clearing Settlement System (the "ACSS") that has been established and is operated under the statutory and regulatory scheme of the *Canadian Payments Association Act* ("CPA Act") for the purposes of clearing and settlement.

8. The CPA was formed pursuant to provisions enacted in the *Banks and Banking Law Amendment Act* S.C. 1980-81-82-83, c. 40. Attached to this affidavit as Exhibit A are excerpts from a description of the CPA and its role in the Canadian payments system which I published in 1986. That description remains valid in all material particulars, to this date.

9. I will address the details later in this affidavit, but in brief, the CPA has the statutory duty to establish and operate a national payments system. Its members are the deposit-taking financial institutions that provide payments services to the Canadian public. It is important that membership be restricted to financial institutions of undoubted credit and reputation, in order to maintain public confidence in the payments system.

10. The ACSS is a restricted access, highly secure computerized service to which the Direct Clearer members of the Canadian Payments Association (the "CPA") have access for the purpose of advising each other and Bank of Canada of the claims that they will have against each other at the end of the day as a result of the exchange of payment items of various kinds. Since it is accessible only to members of the CPA on a "need to use" basis, there are no formal rules governing access of which I am aware. The only conditions of access are that the financial institution be a Direct Clearer member, and comply with the technical specifications to communicate with other users of the system. These technical specifications are set out in the CPA Rules and the ACSS Users Manual, and are not material to these proceedings in my opinion. The Direct Clearer members are the largest members, each having more than 0.5% of the total payments items traffic in Canada each year.

CPA By-Law Number 1, section 10.01; volume 117 The Canada Gazette Part I (15 January 1983), Exhibit B hereto

11. Since the ACSS is a part of the national clearing and settlement system, members may have access to it only for payment items that acceptable for clearing, in accordance with the clearing by-law of the CPA and the Rules established under it. If Interac Association were to admit as card issuers, persons that are ineligible for membership in the CPA, they could obviously not clear and settle by means of the ACSS. Some other means of clearing and settlement would have to be devised for them. If that were to occur, it would introduce an undesirable over-night credit risk for some members and not others, and create an unfair competitive advantage for those Interac Association members

who were unable to use the ACSS. That is, because their payments to other members would always be settled the next banking day, they would benefit from a float and credit risk advantage over members whose payments to them were always settled the same banking day. Due to the practical effect of established cut-off times in all streams of the CPA clearing process, there is no practical way for a person that is not a Direct Clearer or an Indirect Clearer member of the CPA to make a payment after about 4:00 pm for settlement that day. Participants in Interac Association's Shared Services do not know their net payment or receipt obligations until hours after that each day.

12. Furthermore, the difficulties raised by the admission of the Intervenors as card issuers would extend right back to the exchange of messages that makes the operation of the network possible.

13. Messages addressed directly to card issuers that were not members would not qualify as payment items acceptable for clearing. Interac Association would cease to qualify to use CPA facilities, under CPA Rules E1 and E2. Excerpts of the CPA Rules are appended to my affidavit as Exhibit C.

14. Under the rules of the CPA for the operation of shared cash dispensing ("ABM") and point of sale or service ("EFT/POS") electronic funds transfer systems, issuers must be members of the CPA and be able to make direct or indirect use of the clearing and settlement facilities of the CPA in order to discharge their financial obligations arising from each day's exchange of payment messages such as Interac's Shared Cash Dispensing

("SCD") service, or the Interac Direct Payment ("IDP") service (collectively, the "Shared Services").

15. In my opinion, no Intervenor is capable of conforming to those requirements, for a number of reasons, all derived from the closely inter-related laws that limit and control participation in the Canadian payments system:

(a) no Intervenor is authorized to receive deposits from the public; and therefore,

(b) no Intervenor is qualified to be admitted as a member of Canada Deposit Insurance Corporation ("CDIC"), or any other recognized deposit insurance provider or program; and therefore,

(c) no Intervenor is qualified to be a member of the CPA; and therefore,

(d) no Intervenor is qualified to use the ACSS or other facilities of the CPA clear and its payment obligations with the members of that Association; and

(e) no Intervenor is qualified to hold settlement accounts with the Bank of Canada; and therefore,

(f) no Intervenor is capable of settling its net obligations to other members of Interac in relation to the Shared Services on the accounts of Bank of Canada, through the use of the ACSS or otherwise (except by making use of the payments services of some Direct Clearer member of the CPA); and therefore,

(g) no Intervenor is capable of performing the functions of an Issuer in the Shared Services operated by Interac Association in accordance with the applicable rules of the CPA; and therefore

(h) no amendment to the operating procedures or rules of Interac Association would be effective to give the Intervenors the right to access the ACSS or to hold settlement accounts at Bank of Canada in order to enable them to perform as card issuers in the Shared Services of Interac Association.

16. I will address each of those points in turn and attempt to show the legal basis for each of the opinions expressed.

No Intervenor is Authorized to Receive Deposits

17. Although a deposit is a debt of a deposit-taking financial institution, not all debts incurred by financial institutions are properly described as deposits. The distinction is important, because deposit-taking is a privileged and highly regulated activity in Canada.

(a) Canadian banks may receive money on deposit from the public, and may also receive funds and become indebted to the public in non-depositary relationships.

Atkinson v. *Bradford Third Equitable Benefit Building Society* (1890), 25 Q.B.D. 377 at 381 (C.A) Lindley L.J.; Exhibit D hereto

Re Shields Estate, [1901] 1 I.R. 172 at 198; Exhibit E hereto

Re Bergethaler Waisenamt, [1948] 1 D.L.R 761 at 767 (M.K.B.), Exhibit F hereto

(b) Even Canadian banks, trust companies and loan companies are not allowed to receive deposits from the public in Canada unless they are members of CDIC.

Bank Act, S.C. 1991, c. 46, s. 413; Exhibit G hereto

Trust and Loan Companies Act, S.C. 1991, c. 45, s. 413, Exhibit H hereto

(c) Foreign banks (a term that includes many foreign insurance companies) are not permitted to receive deposits in Canada under any conditions.

Bank Act, S.C. 1991, c. 46, s. 508(1)(a) and s. 561; Exhibit G hereto

Regina v. *Milelli* (1989), 51 C.C.C. (3d) 165 (O.C.A.) lv to app ref 38 O.A.C. 160n (S.C.C.), Exhibit I hereto

(d) Federally incorporated insurance companies are prohibited from accepting deposits from the public generally, but may retain or receive back for segregated

investment, funds payable by them to policyholders as dividends, bonuses or proceeds of policies they have issued.

Insurance Companies Act, S.C. 1991, c. 47, ss 467, 450 and 451, Exhibit J hereto

(e) A corporation incorporated federally, for the purpose of carrying on business as a stockbroker, mutual fund dealer or manager, investment portfolio manager or advisor, or investment dealer may not carry on business as a bank. Therefore, they may not receive deposits from the public, even though they may become indebted to their customers for funds received for the purpose of investment. They may receive and retain, on behalf of their customers, securities entitlements and proceeds of disposition awaiting reinvestment or disbursement.

Canada Business Corporations Act, R.S.C. 1985, c. C-44, s. 3(4)(a); Exhibit K hereto

Bank Act, S.C. 1991, c. 46, ss 13 and 564(2), Exhibit G hereto

(f) A corporation incorporated federally for the purpose of carrying on business as a retail shop or chain of shops may not carry on business as a bank, and therefore, may not receive deposits from the public, even though they may advance credit to their customers for purchase of goods and services in their own shops, and they may occasionally receive from their customers, and retain until later use, small sums by way or overpayment of accounts due, or prepayment in anticipation of future purchases.

Canada Business Corporations Act, R.S.C. 1985, c. C-44, s. 3(4)(a), Exhibit K hereto

Bank Act, S.C. 1991, c. 46, ss 13 and 564(2), Exhibit G hereto

(g) Every province has statutes which prohibit locally or other provincially incorporated companies from accepting deposits from the public unless they are registered and in good standing under special regulatory legislation.

Eg. *Loan and Trust Corporations Act*, R.S.O. 1990, c. L.25, s. 213 and definitions of "loan corporation" and "trust corporation" in s. 1; Exhibit L hereto

Ontario Deposit Insurance Corporation Act, R.S.O. 1990, c. O.9, s. 23(1); Exhibit M hereto

Deposit Insurance Act, R.S.Q. 1977, c. A-26, s. 24, Exhibit N hereto

(h) In Ontario, any person that accepts deposits from the public, other than a person qualifying for exemption under a list of exceptions that comprise the regulated financial institutions, and certain others, must segregate and hold in an account at a bank or in short term securities, 60% of all funds received on deposit from the public.

Deposits Regulation Act, R.S.O. 1990, c. D.8, s. 5(1), Exhibit O hereto

18. Funds held by enterprises that are not deposit-taking financial institutions do not become the equivalent of deposits merely because they may be transferable by order to

third parties. The provisions of the federal law governing negotiable instruments make it possible for any person to draw a bill of exchange upon any debtor for the whole, or any part, of the debt owing and transfer the right to collect it and to enforce payment to any other person.

Bills of Exchange Act, R.S.C. 1985, c. B-4, ss 16, 127 and 59(1), Exhibit P hereto .

19. My reason for making the foregoing assertions with respect to the Intervenors' lack of deposit-taking powers is that in each case, the debt of the unqualified financial institution, or ordinary business enterprise, does not have the functional capacity of a deposit. Except for a few statutory definitions which apply for specific purposes, the true definition of a deposit is not legal, but factual. A deposit is a debt of a particular kind of financial institution: one that is a member of the payments system in the currency area in which the deposit is located.

20. An ordinary debt may be transferable by a payment instrument, but a deposit is transferable by the payments system. The distinction is fundamental. Only deposits are transferable through a nation's payment system. Payment items payable by the deposit-taking financial institutions are an established and generally acceptable medium for private payments. They are protected by a variety of laws and customs designed to maintain public confidence in them and in the payments system. For example, it is an offence under the *Criminal Code* of Canada to write a cheque on a non-existent account, or one in which you do not have a reasonable expectation of having sufficient funds or

credit to pay it upon presentment. No such law, apart from the general laws regarding fraud, discourages fraudulent or negligent issue of bills of exchange drawn on commercial enterprises, or non-deposit-taking financial institutions.

Criminal Code, R.S.C. 1985, c. C-46, s.362(4) Exhibit Q hereto

21. Another example is that in some forms, payment items payable by deposit-taking financial institutions enjoy a super-priority in the insolvency of the institution liable to pay them. No such priority is given to private drafts or other forms of bills or notes.

Canadian Payments Association Act, R.S.C. 1985, c. C-21, s. 31, Exhibit R hereto

22. In my opinion, it is very important to a nation that its citizens and others maintain a high level of confidence in the safety and reliability of its payments system. Ultimately, that depends upon the financial strength and reliability of the participants in the payments system. I am not aware of any country in the world to-day in which non-deposit-taking entities are admitted as full members of the payments system, and I think that reflects a generally accepted policy to that effect.

No Intervenor is Qualified to Join CDIC

23. Membership in CDIC is restricted, by provisions of the governing federal statute, to banks and to trust and loan companies that are: (i) authorized to accept deposits from the public; and (ii) carry on an active business of accepting deposits from the public. For

those corporations, membership is mandatory if they accept deposits, but not possible if they restrict their powers and do not accept deposits.

Canada Deposit Insurance Corporation Act, R.S.C. 1985, c. C-3, ss 8, 9 and 15, and definitions of "federal institution" and "provincial institution" in s. 2, Exhibit S hereto

24. The significance of that restriction is that for a corporation to be a member of the CPA, its deposits must be insured in one of the ways recognized by the CPA Act. For a business corporation, those ways are effectively limited to membership in CDIC or in a provincial deposit insurance program that both insures deposits and provides for prudential and solvency inspections.

Canadian Payments Association Act R.S.C. 1985, c. C-21, s. 30, Exhibit R hereto

25. Federally incorporated corporations are effectively limited to participating in CDIC if they require deposit insurance, both as a practical matter, and as a result of the mandatory provisions of the CDIC Act.

Canada Deposit Insurance Corporation Act, R.S.C. 1985, c. C-3, s. 15, Exhibit S hereto

26. No federally incorporated insurance company is authorized to accept deposits from the public, and therefore, no federally incorporated insurance company is eligible for membership in CDIC.

Insurance Companies Act, S.C. 1991, c. 47, s. 467, Exhibit J hereto

Canada Deposit Insurance Corporation Act R.S.C. 1985, c. C-3, s. 8, Exhibit S hereto

27. I am not aware of any law in force in any province that authorizes provincially incorporated insurance companies to accept deposits from the public, although I understand that most provinces allow their life insurance companies to retain policy dividends for investment, and to receive funds in various kinds of annuity contracts.

See e.g. *Insurance Act*, R.S.O. 1990, c. I.8, ss 109 and 110, Exhibit T hereto

28. Ordinary business corporations such as those Intervenors which are not represented by Canadian Life and Health Insurance Association are not eligible for membership in CDIC.

Canada Deposit Insurance Corporation Act, R.S.C. 1985, c. C-3, Exhibit S hereto

29. Even where corporations of the nature of the Intervenors are indebted to their customers for funds temporarily left on account with them, the balances are not insured to the same extent as deposits in regulated deposit-taking financial institutions.

(a) The insurance industry's policyholder compensation plan, administered by Canadian Life and Health Insurance Compensation Corporation ("CompCorp") does not insure sums held by its members in segregated funds, where there is no guarantee by the company of the performance of the fund.

Canadian Life and Health Insurance Association, Memorandum of Operations, (as amended and restated 27 June, 1995) Schedule A, paragraph (a); Exhibit U hereto

Sutton and Andrews, **Compensation Plans in the Canadian Financial Sector: A Comparison**, Conference Board of Canada, March 1993, Appendix I, p. 3 ("Coverage exclusions")

(b) Brokerage corporations, investment dealers and managers may be members of the Canadian Investor Protection Fund, and their customers may be entitled to the protection of that industry-funded compensation program, but the obligations of the Canadian Investor Protection Fund (i) are not guaranteed by any government, and (ii) do not meet the requirement of providing inspection, asset quality rules and the like, sufficient to enable the corporations to be recognized and regulated as deposit-taking financial institutions in any jurisdiction in Canada.

(c) There is no industry or governmental guaranty or compensation fund with respect to the sums left on account with retail corporations by customers.

No Intervenor is Qualified to Join CPA

30. To be eligible for membership in the CPA, a corporation (other than the Bank of Canada and credit unions that are members of a federation or central that is a member,) must be a bank, trust or loan company, or a provincial government agency, such as Alberta Treasury Branches or the Province of Ontario Savings Offices.

Canadian Payments Association Act, R.S.C. 1985, c. C-21 s. 4, Exhibit R hereto

31. In addition, as previously noted, each member of the CPA must be a member of CDIC, or have its deposits insured or guaranteed under a provincial enactment that provides for protection of depositors and for inspection of depositaries to ensure that they apply sound business and financial practices.

Canadian Payments Association Act, R.S.C. 1985, c. C-21, s. 30(1), Exhibit R hereto

32. No Intervenor qualifies (directly or through an industry association) for membership in the CPA under the foregoing criteria.

No Intervenor is Qualified to Hold Accounts with Bank of Canada

33. Bank of Canada is a statutory corporation, created by Act of Parliament in 1935 and continued by federal legislation to date. It has only the powers set out in its

governing legislation. It has the power to receive deposits from a limited group of persons that includes the banks and any other member of the CPA, but which does not include any Intervenor.

Bank of Canada Act, R.S.C. 1985, c. B-2, s. 18(l), Exhibit V hereto

34. Bank of Canada has some ancillary powers to "do any other banking business incidental to or consequential on the provisions of this Act and not prohibited by this Act", but in my opinion, that power does not authorize Bank of Canada to accept settlement deposits for persons such as the Intervenors.

Bank of Canada Act, R.S.C. 1985, c. B-2, s. 18(p); Exhibit V hereto

Communities Economic Development Fund v. *Canadian Pickles Corp.* (1991), 85 D.L.R. 4th 88 (SCC), Exhibit W hereto

Interac Issuers Must Be Able to Settle in Bank of Canada Funds

35. The rules under which the Shared Services have been operated require issuers of cards to be financial institutions that are qualified to settle their net obligations resulting from each day's operations of the Shared Services in Bank of Canada funds. That is the way that the Shared Services were designed to operate. It is a highly secure and efficient settlement procedure which would be impossible to duplicate, and which is far superior to any available alternative.

36. Settlement on the books of Bank of Canada is accomplished by means of the ACSS, a service of CPA, available only to members of the CPA that have settlement accounts with Bank of Canada, as I have already discussed. Since no Intervenor is qualified for membership in the CPA or may have settlement accounts with Bank of Canada, no Intervenor is able to settle the net obligations incurred as a result of its participation as an issuer in the Shared Services in the same way, and with the same counterparty risk as the existing settling members.

37. For all the foregoing reasons, I am of the opinion that it is not possible for Interac Association to admit any Intervenor to perform the functions of a card issuer without making extensive and fundamental changes to the way that members exchange payment items, and clear and settle their mutual claims.

No Amendment to the Interac Rules Can Assist the Intervenors

38. The By-Laws of Interac Association must, as a practical matter, comply with the requirements of the CPA governing the operations of ABM and EFT/POS payment systems. Otherwise, members of Interac Association would not be able to clear and settle through the ACSS with respect to their exchanges of payment items. Any order of the Competition Tribunal that required the Respondents to cause Interac Association to amend its rules in a way that violated the rules of the CPA would jeopardize the continued ability of the Respondents and other members of Interac Association to use these facilities to clear and settle. If that occurred the Respondents would be obliged to

develop a new clearing and settlement procedure for the Shared Services, or to cease their participation in the Shared Services.

39. As a matter of law, changes to the statutory scheme created by the CPA Act can be made only by Parliament.

(a) The *CPA Act*, which was first enacted in 1980 as part of the *Bank Act Amendment Act* of that year (S.C. 1980-81-82-83, c. 40), and the subordinate legislation made by the CPA under its statutory powers, are laws of general application which can only be amended by Parliament (in the case of the statute) and by either Parliament or the CPA (in the case of the subordinate legislation).

(b) Section 5 of the CPA Act states that the objects for which the CPA was created to achieve are

> "...to establish and operate a national clearings and settlements system, and to plan the evolution of the national payments system."

(c) Section 6 of the CPA Act provides that for the attainment of its objects, the CPA has the power to

> "...arrange the exchange of payment its at such places in Canada as the Association considers appropriate...."

(d) Section 18 of the CPA Act goes on to provide that the Association's board of directors may make by-laws in the ordinary way, but that the by-laws are not binding upon the members of the CPA until they have been approved by the Governor in Council. The section also requires that when a by-law is approved, it must be published in the Canada Gazette.

(e) Section 19 of the CPA Act gives the board the authority to

> "...make such rules respecting clearing arrangements and the settlement of payment items as it considers necessary." A payment item is defined by the Act as including any class of items approved by by-law of the Association.

(f) The CPA made a by-law to deal with clearing and settlement matters (the "Clearing By-Law" or "By-Law Number 3") in late 1982, which was approved by the Governor in Council in December 1982 and published in volume 117 of the Canada Gazette on 15 January, 1983. It states that

> "...Every Member and every non-Member that is an Indirect Clearer ... shall be bound by and shall comply with, respect and apply the provisions of this by-law and the Rules."

Attached as Exhibit X is a copy of By-Law Number 3.

(g) Section 14.01 of the Clearing By-law defines the payment items that are eligible for clearing through the facilities of the CPA as follows:

> "Only those payment items specified in the Rules may be exchanged through the clearing. Payment items exchanged through the clearing shall be payable on demand or otherwise conform to the Rules as to value date, be drawn on or payable through a Member...be of a class specified in accordance with section 14.02 [of the Clearing By-Law] and otherwise conform with the requirements of the Rules."

(h) Section 14.02 approves, as one of the classes of items eligible for clearing

> "(c) payment orders transmitted in any ... electronic message medium capable of being reproduced in alphanumeric characters by both the sending and receiving institution on paper, microfilm or other permanent storage medium.."

(i) In about 1985 the CPA made two new rules, Rule E1 and E2, to govern, respectively, the clearing and settlement of ABM and EFT/POS items by its members. Those Rules define the person that holds the customers' accounts that may be accessed by ABM and EFT/POS systems, and the person that holds the account of the merchant, as (in both cases) a member of the CPA. Copies of Rules E1 and E2 are appended to this affidavit as Exhibit C.

(j) In my opinion, those Rules impose a legal restriction upon the eligibility of ABM and EFT/POS payment items for clearing and settlement through the facilities of the CPA. In other words, in my view the legal effect of Rules E1 and E2 is that members of the CPA that participate in ABM and EFT/POS payment systems, such as the SCD and IDP Shared Services operated by the Respondents, must conform to CPA Rules with respect to the clearing of ABM and EFT/POS payment items if they wish to use the ACSS to settle the resulting net payment obligations.

(k) My reasoning for that conclusion is as follows:

(i) Section 29 of the CPA Act states the basic rights and duties of members of the CPA in the following terms:

"Members may present payment items and shall accept and arrange for settlement of payment items in accordance with the by-laws and the rules [of the Association]."

(ii) Section 29 thus provides members with the option to either present an eligible item to another member through the clearing, or in some other manner. If an item is presented to a member through the clearing, section 29 imposes a duty upon the receiving member to accept it and to settle for

43. I believe that there are valid underlying policy reasons why the laws of Canada (and elsewhere in the developed economies) are this way. It is possible to deduce those policies from observing the laws themselves and considering how they operate to manage and control the risks to a financial system of operating electronic payment systems such as EFT/POS systems.

44. There are a number of risks which are generally recognized as requiring consideration by the rules of electronic payments systems if such systems are to be operated in a safe and sound manner:

i) counterparty risk;

ii) liquidity risk;

iii) finality risk;

iv) regulatory risk; and

v) operations risk.

I will attempt to explain in the following paragraphs what is comprised by each of the above risks, and (where they exist) set out the legal rules in Canada to address each in the context of the national payments system operated by the CPA. Not every risk management policy is supported by explicit provisions of the federal financial institutions legislation, or in the regulatory regime that has been constructed under it.

45. Counterparty risk may be both individual and collective. On an individual basis, counterparty risk requires each pair of participants in a payments system to monitor the extent of their mutual credit exposure during a period as a result of the payments

messages they are exchanging. Each member of each pair will have established a figure representing the maximum credit that it is prepared to extend during the day to the other participant. The sums are usually not the same for both participants: for example, National Bank of Canada would probably be willing to extend more credit to Royal Bank of Canada than vice versa. There is no "law" to this effect. It is a fundamental principle that no person may be obligated to lend money to another except by agreement.

46. On a collective basis, credit risk is the exposure created by a single participant in a payments system to all other participants in the system. It is usually of concern to the operator of the system, or to the central bank or other monetary authority that has statutory responsibility for the safety and soundness of the system. Collective credit risk is controlled by the imposition of net debit caps that measure the exposure of each member to all other members, and deny access to any member whose aggregate net indebtedness to all other members exceeds the amount that the central bank or other controlling authority has imposed for it.

47. Payments systems operating in Canada to-day use both forms of controlling or managing counterparty risk. There are no rules in the by-laws of operating procedures of Interac Association to deal with either form of counterparty risk, probably because the net sums owing by the present participants on a typical day as a consequence of the transaction in the Shared Services (as distinct from the total volume of transactions cleared and settlement through the ACSS by the members) are not significant in context, given the financial resources of even the smallest member. But if Interac Association is

required by this Tribunal to admit members that are not financial institutions, to perform the functions of Issuers and Acquirers, it will become necessary for the Interac board of directors either to adopt criteria of membership that ensure that the typical daily net exposures will remain insignificant to all members, or to give consideration to the introduction of rules that will enable other Issuer and Acquirer members to control their counterparty risks. Even if such rules are made, the control of counterparty risk may become extremely difficult for individual participants if the membership of Interac Association becomes too diverse.

48. In my opinion it is only because the existing charter members of Interac are all major deposit-taking financial institutions that it is possible for them to monitor and manage counterparty risk effectively now. They share the same or very similar regulatory regimes that impose key criteria of credit risk upon them in common, such as: capitalization; leverage or gearing ratios; asset quality; accounting and inspection practices; and audit, reporting and disclosure requirements. In addition, there is a good deal of informal information about each of the major financial institutions in the capital and credit markets, due to their importance and the foregoing critical factors. To the extent that other forms of institution, or ordinary business corporations might be admitted to Interac, the task of collecting and monitoring the information would become proportionally more difficult for all participants, with the result that there would inevitably be more, and more unconsidered, counterparty risk.

49. Liquidity risk is the risk that a participant in a payments system will not be able to settle (pay) its net obligations at the material time or times during or at the end of the day. Liquidity risk is controlled at the regulatory level by statutory requirements that a certain degree or ratio of quick assets or other forms of liquidity be maintained at all times. The effects of regulation are augmented by giving participants access to undoubted sources of liquidity support, such as the Bank of Canada support that is given to the Direct Clearer Members of the CPA, or secondary markets in Bank of Canada funds that may also provide liquidity to move from institutions with excess funds, to those in temporary need of additional funds. None of the Intervenors is assured of emergency liquidity by Bank of Canada or any comparable financial authority, and none has ready access to any secondary market in Bank of Canada funds, or any other form of liquidity other than Treasury Bills and money market instruments. Nor are their regulatory requirements for quick assets in the same proportion as for the deposit-taking financial institutions.

50. Finality risk is the risk that payments that are made during a day may have to be reversed if a participant in the payments system is unable to settle for its net aggregate obligation to all other participants at the end of the day or other processing cycle. Reversals of payments are very destabilizing for a payments system, since most participants - and many of their customers - require the use of their receipts in each day in order to discharge their own obligations that day. Under the rules of the CPA, if a Direct Clearer Member is unable to settle at the end of a banking day, even after taking up all the liquidity support that Bank of Canada is able to give, each other participant that

has a claim against the failing member is required to make an involuntary loan in the amount of its claim, while leaving untouched all payments made by it to the failing member that day. Members of the CPA must accordingly ensure that membership in that organization is not opened to institutions that do not have access to the same sources of liquidity that are available to the deposit-taking financial institutions, in order to control finality risk.

CPA By-Law Number 3, section 20, Exhibit X hereto

51. Regulatory risk is the risk that a business entity, or even a financial institution other than a deposit-taking financial institution, may not be subject to the same rigorous regulatory regime as that imposed upon the majority of the participants in a payments system. For example, brokers and mutual fund corporations are not subject to the same stringent rules regarding transactions with related parties as the bank and trust company members of Interac. The latter are subject to a rigorous and scrupulously administered legal regime that effectively prohibits all related-party transactions that might be solvency-threatening for the financial institutions. There is an obvious risk of extending credit to counterparties that may destroy their credit at any time by a disastrous transaction with a related party. There are similar risks in dealing with persons that are not subject to rigorous inspection and the deterring effect of the cease and desist powers of the federal financial institutions regulators. Some of the Intervenors are subject to similar regimes as the current members of Interac Association in these respect, but many others are not.

52. Operations risk describes the risks that an inexperienced participant may bring to the other participants in a payment system by reason of its lower operating standards, inexperience, or lack of vigilance in administering secure and confidential systems. Participation in a high-volume, high-speed system such as Interac Shared Services requires significant investment in equipment and personnel to ensure that the operating standards of the network and the confidentiality of customers' financial information are scrupulously maintained. That can be done profitably only if the volume of payments is sufficient to justify the cost.

53. In my opinion, there are no legal difficulties with the use of sweep or pass-through accounts by the Intervenors, as contemplated in the Draft Consent Order, as long as the payment items which are produced meet conditions which make them acceptable for clearing through the facilities of the CPA. No CPA rules are presently in place for such electronic payment items, but on the basis of a draft policy paper now being considered by the CPA, it appears that the conditions are likely to be that: (i) the financial institution makes the pay/no pay decision and guarantees payment of the item; and (ii) the account in the financial institution contains overdraft protection or its equivalent so that the account remains within the financial institution regulatory umbrella in relation to liquidity, asset quality, etc. Beyond that, the contractual relationship between the financial institution and the third party non-financial institution is a matter for negotiation between them and should not concern the CPA. Attached as Exhibit Y to this affidavit is the draft CPA policy paper entitled "Sweep Account Arrangements" dated 4 May, 1995.

CPA By-Law Number 3, s. 14.10; Exhibit X hereto

Canadian Payments Association Act, R.S.C. 1985, c. C-21, ss. 19, 29 and definition of "payment item" in s. 2; Exhibit R hereto

Bank Act, S.C. 1991, c. 46, s. 27; Exhibit G hereto

Trust and Loan Companies Act, S.C. 1991, c. 45, s. 26, Exhibit H hereto

54. As the Draft Consent Order requires Interac Association to remove from its by-laws and rules any prohibition against the use of such accounts, there does not appear to be any legal impediment to members offering such account services, provided that they consider that they are able to do so profitably, under such rules as may be established by the CPA for the responsibilities of members clearing items for holders of such accounts with them.

55. Nor do I see any legal or practical difficulties with the use by some of the Intervenors of subsidiary banks, trust or loan companies. Such companies, if available to individual Intervenors, would provide an effective means of controlled indirect access to the ACSS.

56. I understand that in the United States many financial enterprises that are not eligible to participate directly in the payments system do so effectively indirectly, through the intermediation of a special purpose bank subsidiary.

57. Such an approach would not be available to most of the Intervenors, however, due to the constraints on ownership of a bank or federal trust company.

Bank Act S.C. 1991, c. 46, s. 27, Exhibit G hereto

Trust and Loan Companies Act S.C. 1991, c. 45, s. 26, Exhibit H hereto

SWORN before me at the City of Toronto,)
in the Municipality of Metropolitan)
Toronto on the 29th day of March, 1996)

Commissioner for Taking Affidavits
Eileen E. Clarke

BRADLEY CRAWFORD

Exhibits to the Affidavit of Bradley Crawford

Exhibit	
A	B. Crawford, Crawford and Falconbridge Banking and Bills of Exchange, vol 2 (Toronto: Canada Law Book Inc., 1986), excerpts
B	*Canadian Payments Association*, CPA By-Law Number 1
C	*Canadian Payments Association*, Rules E1 and E2
D	*Atkinson* v. *Bradford Third Equitable Benefit Building Society* (1890), 25 Q.B.D. 377 at 381 (C.A) Lindley L.J.
E	*Re Shields Estate*, [1901] 1 I.R. 172 at 198 (AC)
F	*Re Bergethaler Waisenamt*, [1948] 1 D.L.R 761 at 767 (M.K.B.)
G	*Bank Act*, S.C. 1991, c. 46, ss 13, 27, 413, 508(1)(a), 561, 564(2)
H	*Trust and Loan Companies Act* S.C. 1991, c. 45, ss 26, 413
I	*Regina* v. *Milelli* (1989), 51 C.C.C. (3d) 165 (O.C.A.) lv to app ref 38 O.A.C. 160n (S.C.C.)
J	*Insurance Companies Act*, S.C. 1991, c. 47, ss 450, 451, 467
K	*Canada Business Corporations Act*, R.S.C. 1985, c. C-44, s. 3(4)(a)
L	*Loan and Trust Corporations Act*, R.S.O. 1990, c. L.25, s. 213 and definitions of "loan corporation" and "trust corporation" in s. 1;
M	*Ontario Deposit Insurance Corporation Act*, R.S.O. 1990, c. O.9, s. 23(1);
N	*Deposit Insurance Act*, R.S.Q. 1977, c. A-26, s.24
O	*Deposits Regulation Act*, R.S.O. 1990, c. D.8, s.5(1)
P	*Bills of Exchange Act*, R.S.C. 1985, c. B-4, ss 16, 59(1), 127
Q	*Criminal Code*, R.S.C. 1985, c. C-46, s. 362(4)
R	*Canadian Payments Association Act*, R.S.C. 1985, c. C-21, definition of "payment item" in s. 2, and ss 4, 19, 29, 30, 30(1) 31

Exhibit

S	*Canada Deposit Insurance Corporation Act*, R.S.C. 1985, c. C-3, ss 8, 9, 15, and definitions of "federal institution" and "provincial institution" in s. 2
T	*Insurance Act*, R.S.O. 1990, c. 1.8, ss 109, 110
U	Canadian Life and Health Insurance Association, Memorandum of Operations, as amended and restated 27 June, 1995, excerpts
V	*Bank of Canada Act*, ss 18(l), 18(p)
W	*Communities Economic Development Fund* v. *Canadian Pickles Corp.* (1991), 85 D.L.R. 4th 88 (SCC)
X	*Canadian Payments Association*, By-Law No. 3
Y	Canada Payments Association, Sweep Account Arrangements, Policy Issues and Possible Actions to Deal with Them, May 4, 1995