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BACKGROUNDER

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Change is in the Cards:

Competition in the Canadian Debit Card Market

Philippe Bergevin

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In this issue...

As new players enter the debit card market, new rules are required to ensure a fair and efficient outcome.

The Study in Brief

Using debit cards to make point-of-sale purchases is extremely popular among Canadians. Established nationwide over 15 years ago, in 1994, the Interac direct payment system is so popular today that only Swedes, on a per-capita basis, make more such transactions.

However, the landscape is about to change, dramatically. VISA and MasterCard are entering the Canadian debit market. Their presence raises for policymakers issues involving the efficiency and fairness of the various elements that comprise a national debit card system, from the financial institution issuing the card through the payment networks, payment processors and merchants to the card-holding consumer. In short, the playing field is not even. VISA and MasterCard are largely unregulated when it comes to debit transactions, while the non-profit Interac association operates under the restrictions of a dated Competition Tribunal order.

This *Backgrounder* considers the implications of the rapidly changing debit payment landscape and makes three recommendations for government action to ensure that consumers and merchants are protected and that the system can evolve to serve them even better.

The recommendations are to:

- remove current restrictions on Interac so that the association can evolve on a for-profit basis;
- minimize differences in rules and standards applied to payment systems; and
- implement a voluntary code of conduct that (i) enhances the level of transparency and disclosure to merchants, (ii) allows merchants to decline debit services for any transaction types, and (iii) allows merchants to provide discounts or surcharges related to type of payment.

Adopting these recommendations would help ensure that Canadians have a debit market that is both fair and efficient.

The Author of This Issue

Philippe Bergevin
is a Policy Analyst at the
C.D. Howe Institute.

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INDEPENDENT • REASONED • RELEVANT

Canada has embraced debit cards like few other countries. Almost 30 percent of all retail transactions in Canada are settled by debit card, making Canadians the second heaviest per capita debit card users in the world, behind Sweden (BIS 2009).

Until recently, effectively all debit card transactions in Canada were facilitated by Interac, which operates the networks that make such transactions possible. The competitive landscape is, however, changing rapidly and Interac's dominant position faces serious challenges.

Two large payment networks, VISA and MasterCard, are entering the Canadian debit market. Canadian financial institutions have started – or are expected in the near future – to issue debit cards that can access VISA and MasterCard networks for debit transactions. This change should lead to more innovation and ultimately more attractive debit products for cardholders and merchants.

At present, Interac operates at a marketplace disadvantage in relation to VISA and MasterCard. Since 1996, the Interac association has operated under a Competition Tribunal order that effectively limits its ability to respond to the fast-changing competitive environment. On the other hand, VISA and MasterCard are largely unregulated.

Furthermore, some market participants have expressed concerns about the impact of these new entrants. Merchants in particular are concerned they will face higher transaction fees.[1] Merchants have also complained about the degree of disclosure and transparency in the new debit services being proposed to them. Some business practices, such as "priority-routing" that give preference to a particular network over another, have also been the subject of criticism.

This *Backgrounder* provides an overview of the changes that are taking place in the Canadian debit market and provides recommendations for an efficient and fair debit payment system. I begin with an overview of how payment systems work and discuss the principles that should guide public policies for these markets. A short history of the debit market in Canada is followed by a review of recent changes in the competitive landscape. The subsequent section considers the potential impacts of VISA's and MasterCard's entry into the Canadian debit market. The last section provides recommendations for a more efficient and fair debit market in Canada.

The Economics of Payment Systems

Debit card payment systems are not ordinary markets. Misconceptions in this regard will lead to false conclusions and suboptimal policy outcomes. This section provides a brief overview of how such systems work and presents some basic economic principles that are helpful in guiding relevant public policies. First, cardholders and merchants tend to place a higher value on payment systems that are more widely used than those that are not. An important implication of this characteristic, known as a network effect, is that there are few payment systems, they tend to be large and, once established, usually enjoy a competitive advantage.

Furthermore, payment systems share some characteristics with so-called natural monopolies, like some utilities, because they require large up-front investments and benefit from economies of scale. For these and other reasons, payment systems are sometimes accused of enjoying a monopoly-like position, leading to allegations of "abuse of dominant position" and calls for

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1 See for example, Canadian Federation for Independent Business, "Member Alert: Read the fine print when signing your debit card agreements," available at http://www.cfib-fcei.ca.

government regulation.[2] However, while a payment system may share similarities with a monopoly, this does not necessarily imply it is one and can abuse its dominant position by, for example, charging higher prices. A payment system that is dominant today may not be tomorrow, and the threat of new entrants puts important limits on what payment systems can and cannot do.[3] In addition, customers and merchants can always fall back on a government-controlled payment system; i.e., cash.

Another characteristic of debit card payment systems is that they are two-sided markets, meaning that they compete for two types of customers; in this instance cardholders and merchants.[4] In a two-sided market, the price imposed on customers on one side of the market does not necessarily reflect the costs associated with providing the service to them. Payment networks (e.g., Interac or VISA) can shift costs from one side of the market to the other. For example, payment networks can take advantage of the fact that one side may respond differently to prices (implying that they have different price elasticities of demand) and could therefore potentially assume a larger proportion of the cost. Since payment networks are typically paid on a per transaction basis, a profit maximizing payment network would generally set a price structure that maximizes the level of transactions on its network.

Higher merchant fees in a card payment system therefore do not necessarily imply that a particular system is more costly. Instead, they may imply simply that it has a different cost structure and that a greater proportion of the direct cost is borne by one side of the market.

In some two-sided markets, all of the cost is born by one side. Take a shopping mall where customers have free access to all the facilities while store owners pay all the direct costs. Merchants can, however, ultimately pass these costs on to consumers through higher retail prices.

Two fundamental economic principles should guide public policy in the debit market: efficiency and equity. Economic efficiency refers to using resources in a way that maximizes the production of goods and services. In more concrete terms, an efficient payment system is one that – at the lowest cost possible – maximizes the attributes that one expects of a payment system such as speed, reliability, safety and high levels of acceptance and convenience.[5] According to standard economic theory, free markets are believed – under certain conditions – to allocate resources in such a way as to ensure an efficient outcome. For this assertion to hold true, markets must be competitive.

An efficient outcome does not necessarily imply, however, that the gains are distributed evenly in the economy. An outcome can be efficient even if all the gains are available only to one person. In contrast, the concept of equity or fairness is concerned with how the gains from economic activity are allocated among individuals. While the primary objective of public policies related to the debit card market should be to ensure an efficient payment system, perceptions of fairness will influence the acceptability of potential solutions.

2 For example, the merchant associations in Canada – particularly the Canadian Retail Council and the Canadian Federation of Independent Business – have recently led a public campaign against alleged abuses on the part of some payment networks, especially in the credit card market. Their campaign led to parliamentary committee hearings and culminated in a Standing Senate Committee on Banking, Trade and Commerce report entitled "Transparency, Balance and Choice: Canada's Credit Card and Debit Card Systems," which was tabled in June 2009. The report makes a number of recommendations for the credit and debit card market. A copy of the report is available at: http://www.parl.gc.ca/40/2/parlbus/commbus/senate/com-e/bank-e/rep-e/rep04Jun09-e.htm.

3 For example, the Internet is supporting the emergence of new payment technologies – PayPal is an example – that could one day threaten the dominant position of current payment networks.

4 There are numerous other examples of two-sided markets such as shopping malls that compete for both stores and customers and newspapers that compete for readership and advertising.

5 For a discussion on economic efficiency in the context of payment networks, see for example Bolth and David (2005).

Box 1: Primer on the Canadian Debit Card Payment System

The Canadian debit card payment system is comprised of five main types of participants, namely cardholders, merchants, payment processors, payment networks and card issuers (Bulmer 2009). *Payment processors,* such as Moneris Solutions Corp., are responsible for providing point-of-sale terminals to merchants and acting as the middleman between merchants and the rest of the payment system. *Payment networks,* such as Interac, are mainly responsible for the development and operations of the networks that allow payment processors and card issuers to communicate with each other to authorize payments.[a] *Card issuers*, as the name implies, are financial institutions such as banks or credit unions that issue the cards.[b]

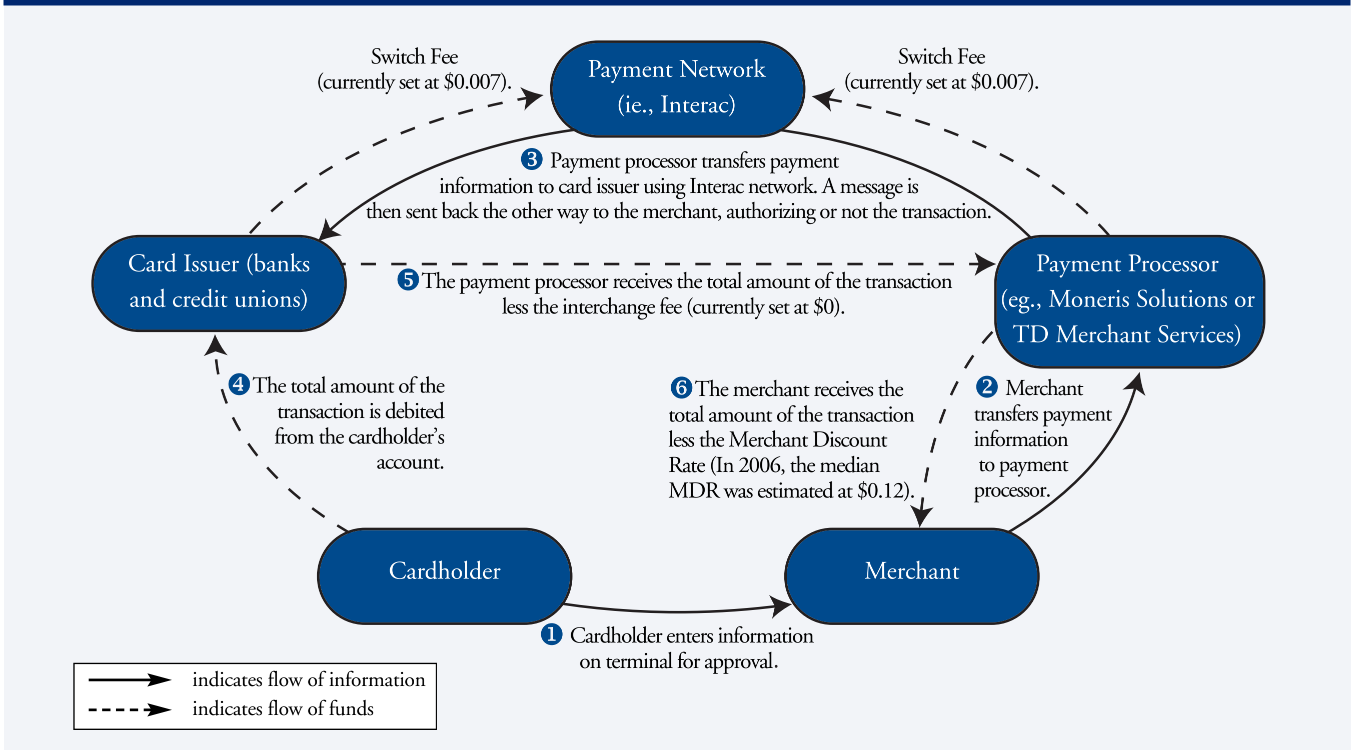
A typical transaction (Figure 1) begins with a cardholder making a purchase. Once the cardholder has confirmed the purchase amount and entered his/her personal identification information (PIN) on the terminal, a message is sent to the payment processor. From there, the message is forwarded to the card issuer, through a payment network, to confirm that the information entered by the cardholder is correct and that sufficient funds are available. A return message to the merchant authorizes the transaction, or not. If the transaction is approved, the funds are typically debited from the customer's account right away and transferred to the merchant on the same, or within one, business day.

FEES: In this process, the payment processor, the payment network and the issuing bank all charge a fee for their services. The payment processor collects from the merchant what is referred to as a merchant discount rate or *merchant fee*. This fee covers, among other things, the costs for the payment processor to process the payment and the fees that the payment processor transfers to other participants in the network. The payment processor pays both an *interchange fee* to the card issuer and a *switch fee* to the payment network. The interchange fee – a fee that is usually set by the payment network – can be used as a way to compensate financial institutions for the cost of issuing debit cards. They in turn lower, can costs or offer more benefits to cardholders. The switch fee is paid to the payment network to compensate them for the use of their networks. Payment networks typically collect a switch fee from the issuing bank as well.

The Interac network currently sets its switch fee at $0.007299 per transaction.[c] Currently, Interac does not charge an interchange fee. The switch fee for VISA debit transactions in Canada is not publicly available. VISA sets the interchange fee at a rate that varies from 0.15 percent of the value of the transaction plus $0.05 per transaction to 1.15 percent of the value of the transaction (VISA 2009). According to public statements, MasterCard's switch fee for debit transactions is set at $0.005. Like Interac, it does not currently levy an interchange fee (House of Commons 2009a).

Notes:
a The proprietary networks of payment networks can also be used in some instances to clear and settle payments.
b Some financial institutions such as TD Bank Financial Group are both card issuers and payment processors.
c Interac Association, http://www.interac.ca/members/fees.php.

Figure 1: An Illustration of a Debit Payment Transaction on the Interac Network



Source: Adapted from Bulmer 2009.

A Short History of the Debit Card Market in Canada

In the 1970s, Canadian financial institutions began putting in place proprietary networks of Automated Banking Machines (ABMs), allowing customers to access their money outside normal banking hours and at locations other than their local branch. Financial institutions quickly recognized the benefits of connecting together their proprietary networks, both in terms of reduced costs and enhanced access for their customers (Competition Bureau 1996).

In 1984, five major VISA-issuing financial institutions[6] formed a cooperative venture to link together their ABM networks, marking the beginning of the Interac Association.[7] By the end of 1985, the four largest MasterCard-issuing financial institutions had also joined the association.[8] In the early 1990s, Interac launched the Interac Direct Payment as a pilot project, allowing customers to use their debit card for point-of-sale purchases. By 1994, Interac Direct Payment was available nationwide.

While Canadians quickly adopted Interac's ABM and Interac Direct Payment products, the association drew criticism concerning the way it

6 The institutions are Royal Bank, CIBC, Scotiabank, TD Bank and Desjardins.

7 Interac actually consists of two entities, Interac Inc. and the Interac Association. Interac Inc. is a corporation that owns the computer software and the Interac trademark while the Interac Association is responsible for the management of the network's operations. Furthermore, Acxsys Corporation, which was founded in 1996 by a group of Canadian financial institutions, provides management services to the Interac Association and specializes in the development and operation of new payment services, such as Interac Online. Unless otherwise noted, the term Interac refers to the Interac Association for the purpose of this paper.

8 The institutions are Bank of Montreal, Canada Trustco Mortgage Company, Credit Union Central of Canada and National Bank of Canada.

operated. The Competition Bureau launched an inquiry in July 1992 into allegations that Interac engaged in three broad categories of anti-competitive acts; namely, restricting access to the network, creating barriers to product innovation, and controlling access and service pricing (Competition Bureau 2002). In 1996, the Competition Tribunal approved a consent order, after an extensive public hearing, that is in force today with only minor changes. (A consent order in this instance refers to a remedy to abuse of dominance negotiated between the Competition Bureau and all relevant parties and subsequently approved by the Competition Tribunal.)[9]

Among other things, the consent order:

- expanded the list of eligible Interac members. It was alleged by the Competition Bureau that the association's bylaws effectively restricted the number and type of institutions that could participate in its network. The consent order amended the bylaws to allow any commercial entity to become a member, provided they were capable of providing services related to Interac's debit networks (except for card-issuing activities). Effectively, Interac's membership has been expanded from 27 at the time of the consent order to 62 at present.
- implemented a new governance structure. Prior to the consent order, only the charter members – the large financial institutions that are directly connected to Interac's network – could vote on any matters of significance. The consent order imposed measures to transfer some decisionmaking power from charter members to other Interac members. It established a board with no fewer than 14 members, with a minimum of two appointed by non-financial institutions that are directly connected to Interac's network and three by members that are not directly connected. Fundamental changes[10] require a two-thirds majority. Decisions related to network enhancements, new services and interchange fees are subject to a simple majority vote.
- required Interac to set its prices on a cost-recovery basis. The consent order mandates that all Interac revenues must be derived from a "switch fee" – a fee charged on a per message basis to users of Interac's network – which is based on the cost of delivering this service and on the cost of developing the network. The consent order also requires Interac Inc. to operate on a not-for-profit basis. The order, however, did not restrict the ability of Interac to set the level of the interchange fee, which it currently sets at zero percent.
- allowed merchants to impose a surcharge on Interac debit transactions. Prior to the consent order, the collection of an additional fee or surcharge on a cardholder at the point-of-sale was prohibited. As per the consent order, merchants can now charge fees to consumers paying with an Interac debit card on top of their purchase amount.

The Changing Competitive Landscape in the Canadian Debit Card Market

By almost any measure, Interac debit has been a success. As noted, Canadians are second only to Sweden in the use of debit cards on a per capita basis. In 2008, Interac processed 3.7 billion point-of-sale debit transactions worth approximately $168 billion (Interac Association 2008). In addition, Interac is generally the cheapest payment method for merchants when compared to cash and credit card transactions (Bank of Canada 2008).

The competitive landscape is, however, changing rapidly and Interac's dominant position is being

9 The Interac consent order is available at http://www.ct-tc.gc.ca/CasesAffaires/CasesDetails-eng.asp?CaseID=160.

10 Fundamental changes are defined as "decisions of the board relating to security, minimum performance standards, use of the trademarks, Interac structure and membership criteria, board composition and voting rules, and fees (other than interchange fees as defined in the by-laws)."

seriously challenged. VISA and MasterCard, which are large for-profit businesses,[11] are currently entering the Canadian debit market. They are taking advantage of the fact that all point-of-sale terminals are being gradually replaced by terminals that can support chip technology.[12] Many of the new terminals are designed to accept VISA debit and/or MasterCard's debit card, Maestro.[13]

At the same time, at least one financial institution is issuing debit cards that can potentially access more than one debit network in Canada and others are reportedly planning to do so. The chip-enabled BMO debit cards can access both Interac and MasterCard's network for debit transactions. Other financial institutions will reportedly adopt the same model where, in addition to Interac, debit cards would also be able to access the VISA or MasterCard networks.[14]

Merchants have complained about some of the business practices associated with the deployment of these new debit products.[15] They say the information received by merchants related to new debit products sometimes lacks clarity and they are not always made aware of all the impacts associated with these products. For example, they say some of the new point-of-sale terminals appear sometimes to automatically accept new debit products without the merchant's prior consent. The merchants can decline such new services but must take action with their payment processors to remove this capability.

The new debit cards that can access both MasterCard's and Interac's networks, in some instances, appear to give priority to the former, meaning that debit card transactions will be routed on MasterCard's network if the merchant accepts both networks (so-called priority-routing). In the case of debit cards that support both VISA and Interac's network, some of the terminals reportedly provide cardholders with the option of choosing which payment network he or she wants to use. These new terminals, however, are expected to present VISA as the default option, requiring cardholders to decline VISA debit first if they want to access the Interac debit option. Finally, merchants are concerned instances might arise that require them to accept types of debit card products offered by a network if they already receive credit card services from the same network.

The Potential Impact of the Changing Competitive Landscape

The entry of new players in the debit card market should be welcome, because increased competition will help bring new payment technologies to Canada and ultimately lead to debit cards that are more attractive to both cardholders and merchants. From a static point of view, the consent order allowed Canadians to enjoy a relatively efficient Interac debit payment system. From a dynamic perspective, however, more competition is required to bring new payment services that are faster, more reliable, safer and more convenient, as well as widely accepted and delivered at affordable costs. The increased competition is already helping to bring new technologies into the Canadian debit market, such as contactless technologies (which involve simply waving the card in front of a card reader), along with the ability to use debit cards for Internet and international transactions.

Merchants have raised concerns, however, that the entry of new players in the debit card market could translate into higher fees. In debit markets where VISA and MasterCard operate, the fees imposed on merchants tend to be higher than those currently imposed under the Interac network. Most notably, VISA and MasterCard debit transactions

11 MasterCard Worldwide and VISA Inc. became publicly traded companies in 2006 and 2008, respectively.

12 Members of the Canadian payment card industry – including Interac, MasterCard Canada, VISA Canada and many of the associated card issuers and payment processors – in 2006 announced a broad migration to chip technology over several years. In time, this migration will gradually replace magnetic strip credit and debit cards with computer-chip cards. Chip cards offer some clear advantages over swipe cards, notably in terms of enhanced fraud protection.

13 See for example, van Duynhoven, 2009.

14 Ibid.

15 See, for example "Debit Card Processing Commentary: Visa and MasterCard Debit: A Major Threat to Interac and Canadian Merchants," http://www.cfib-fcei.ca

Table 1: Interchange and Switch fees of Current and Proposed Debit Payment Options in Canada			
	Interac	**VISA debit**	**Maestro**
Interchange fees	Currently set at zero percent	Ranges from 0.15 percent of the value of the transaction plus $0.05 to 1.15 percent of the value of the transaction	Currently set at zero percent
Switch fees	Currently set at $0.007299	Undisclosed	Currently set at $0.005

Sources: Interac Association, VISA Canada and House of Commons, Standing Committee on Finance, Evidence, May 14, 2009.

in many other jurisdictions require the payment of an interchange fee (i.e., a fee paid by payment processors to issuing banks), which represents an important part of merchant fees.[16] Interac currently does not require any interchange fee for debit transactions at point-of-sale that transit on its network, which noticeably reduces the cost born by merchants.

While some cards may be associated with higher interchange fees, it is unclear if they are more expensive overall. An increase in the interchange fee allows for the transfer of costs from one end-user to another, in this case from cardholders to merchants. If interchange fees are higher, one would expect that competitive pressure on the issuer side would produce lower costs or higher benefits, such as the ability to accumulate rewards, for cardholders.

For example, debit card issuers in Canada typically charge cardholders a fee for every debit transaction or charge for service packages that include a number of free transactions. (Under certain circumstances, such as if the customer maintains a minimum balance, there is no service package fee). In some other jurisdictions, such as in the United States where interchange fees are higher, debit transactions typically do not incur a cost for cardholders. Nonetheless, in instances where cardholders do not pay a fee for a particular transaction in Canada, the total debit fee is relatively low compared to other countries. Furthermore, to the extent that higher interchange fees would lead to increased benefits to cardholders, the total cost of the system may increase in Canada.

VISA and MasterCard have successfully gained market share at the expense of local payment networks in other countries, which raises fears that once these new networks establish themselves in Canada, they will be able to raise their prices. In the United States, for example, VISA and MasterCard dominate the signature[17] debit market and Interlink, which is owned by VISA, has become since 2005 the largest payment network in the PIN point-of-sale (POS) debit card market.

US payment networks have responded to competitive pressures by increasing interchange fees in an effort to encourage card issuers to choose their networks. Interac has said publicly that, learning from experiences abroad, it intends to remain a low-cost provider of debit services (House of Commons 2009b). If Interac is successful in pursuing this strategy, it is unclear if interchange fees will raise to levels seen elsewhere as other networks operating in Canada may be compelled to lower their fees to gain merchant acceptance.

In short, competition is welcome as it should lead to innovation and better debit services over

16 For example, in the United States, the average signature debit interchange fee in 2003 was US$0.38 per transaction while the average PIN debit interchange fee was US$0.19 per transaction (Dove Consulting 2004).

17 Signature cards are debit cards that require the cardholder's signature for purchase at point-of-sale instead of requiring the cardholder to enter its PIN number on the terminal.

time. Experiences abroad do suggest, however, that interchange fees may increase as a result of increased competition. The dominant position of Interac, coupled with its stated objective of remaining a low-cost provider of debit services, may dampen the increase in interchange fees. In any event, if competition does translate into higher interchange fees, it should lead to lower costs or higher benefits for cardholders.

Efficiency and Fairness: A Common Sense Solution

The following recommendations relate to current developments in the Canadian debit market; namely, the level of competition, the current lack of disclosure and transparency provided to merchants, and other business practices in rolling out the new debit services to merchants. The recommendations are provided according to the two public policy objectives stated above – efficiency and fairness.

EFFICIENCY: The primary objective of public policies related to the debit payment market should be an efficient payment system. In concrete terms, an efficient payment system is one that maximizes attributes such as speed, reliability, safety, high levels of acceptance, convenience and low cost. Since competition is the best way to ensure that Canadians receive these benefits, the entry of VISA and MasterCard in the debit market is a welcome change.

Currently, there is little real competition among debit payment networks. Interac is at a considerable competitive disadvantage because of the operating constraints imposed under the consent order. While the association has been a success so far, the structure it is operating under is starting to show its age. Its governance structure makes for slow decision making, which in the current environment could lead to Interac being relegated to a backup system for VISA debit and Maestro.

Policymakers should allow Interac to transform itself into a corporation to become more proactive and respond in a timelier manner to the unprecedented changes in the marketplace. As a corporation, Interac would also be able to raise the capital needed for investments in new products, marketing and so on. In addition, the reasons underpinning the consent order – principally that Interac prevented or substantially lessened competition in the debit card market – are simply no longer true with the entry of additional payment networks.

Also, the rules of the game need to be the same for everyone. Interac members clear and settle their transactions through the Automated Clearing Settlement System and are therefore subject to the Canadian Payments Association (CPA)'s rules and standards. VISA and MasterCard have their own proprietary clearing and settlement systems and are not subject to any formal rules or standards in Canada. The development of new payment methods and technologies may require the development of new CPA rules and standards, which are subject to an extensive internal and external consultation process. While this process may be important to ensure that new rules and standards reflect stakeholder concerns, it may slow down the introduction of new payment methods by Interac, providing their competitors with a speed advantage.

As a general objective, all payment networks should be subject to broadly similar rules and standards while taking into account the particular circumstances under which they operate. At a minimum, the CPA should ensure that its internal and external consultation process does not impose unnecessary delay in bringing new payment products and services to market.

Furthermore, competition requires transparency and disclosure so that market participants make informed choices. This *Backgrounder* accordingly supports current efforts by the federal department of finance to restore appropriate levels of transparency and disclosure for merchants by implementing a voluntary code of conduct.[18]

18 The Department of Finance released a proposed Code of Conduct on November 19, 2009 that was circulated for a 60-day comment period. The proposed code covers the credit and debit card market and is intended to promote fair business practices and ensure merchants and consumers clearly understand the costs and benefits of credit and debit cards.

Merchants must understand clearly the implications of their choices before they adopt new debit card services, especially in terms of potentially higher interchange fees.

Finally, the guiding principle for addressing business practices in the context of a voluntary code of conduct should be the extent to which they contravene Canadian competition laws. At face value at least, requiring a merchant to accept debit cards because it accepts credit cards would resemble tied-selling, which is a practice that can be disallowed under Canadian competition laws if the practice has substantially lessened competition, or is likely to do so. To the extent that this practice could be prohibited under competition laws, it should be restricted under the voluntary code of conduct. The restriction should apply to all transactions, including online purchases, telephone order-transactions, and contactless transactions.

It is unclear, however, if other practices that have been the subject of complaints contravene competition laws. The fact that some co-badge debit cards may give priority to one network at the expense of another does not seem to resemble any act that may be reprehensible under competition laws. As long as merchants are made fully aware of the implications of their choices, we should not limit the kinds of arrangement that payment networks propose to merchants. Before addressing a business practice in the context of a voluntary code of conduct, a clear case should be made that it contravenes competition laws.[19]

FAIRNESS: While higher interchange fees may – because they can potentially increase the level of transactions on a given payment system – enhance the efficiency of payment systems, they do raise fairness concerns. To the extent that merchants pass merchant fees on to all customers in the form of higher priced goods and services, customers who use payment methods associated with fewer benefits such as cash nonetheless share the costs of payment methods associated with higher benefits. In addition, payment methods associated with fewer benefits such as cash tend to be used more heavily by poorer segments of the population (Levitin 2008).

VISA and MasterCard, however, typically impose contractual obligations on payment processors – which are ultimately imposed on merchants – that prevent merchants from imposing a surcharge on transactions using their networks. Some merchants also claim that they were prevented from providing discounts for cash purchases and/or to advertise such discounts, but VISA and MasterCard dispute this assertion (Standing Senate Committee on Banking, Trade and Commerce 2009).

To the extent that the government is more concerned with fairness than efficiency in this particular instance, it should require that merchants be allowed to provide discounts or surcharges according to what form of payment is used for a given transaction.

Conclusion

The entry of VISA and MasterCard into the Canadian debit card market represents unprecedented change to the competitive environment. New payment networks will increase competition and should lead to more innovation and ultimately better debit products for cardholders and merchants. Payment networks, however, should be allowed to compete on a level playing field and adequate transparency and disclosure should be available to all market participants. Accordingly, this *Backgrounder* makes the following three recommendations.

First, Interac must be allowed to transform itself into a for-profit organization. The current situation where our national debit network is saddled with heavy operating constraints and must compete with largely unregulated firms is untenable.

Second, differences in regulatory treatment of payment networks should be minimized. In

19 This recommendation hinges on Interac being allowed to transform itself into a for-profit organization. Otherwise, further measures to restrict business practices could be contemplated by the government to ensure a level playing field among payment networks.

particular, this paper recommends that the Canadian Payments Association ensure that its internal and external consultation process does not impose unnecessary delay in bringing new products and services to market.

Third, this *Backgrounder* supports the adoption of a voluntary code of conduct, with refinements to that currently proposed by the federal department of finance. A voluntary code of conduct should include measures to enhance transparency and disclosure for merchants to allow them to make informed decisions. In addition, the code could address possible business practices that might be cause for concern under Canadian competition laws. For example, requiring a merchant to accept debit cards because it accepts credit cards from the same network would resemble tied-selling and could therefore be addressed in the voluntary code of conduct. Lastly, to the extent that the government is more concerned with fairness than efficiency in this particular instance, the code should allow merchants to provide discounts or surcharges.

The implementation of these recommendations will help pave the way to an efficient and fair outcome to the current changes taking place in the Canadian debit market. Changes are spreading rapidly, and policy changes are required to facilitate competition among networks while ensuring transparency, disclosure and fairness in the debit market.

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