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**Tuesday, June 16, 2009**

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**Chairs**

**Mr. James Rajotte**  
**The Honourable Michael Chong**

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## Standing Committee on Industry, Science and Technology

Tuesday, June 16, 2009

•(1010)

[English]

**The Co-Chair (Mr. James Rajotte (Edmonton—Leduc, CPC)):** I call this meeting to order.

This is another joint meeting of the Standing Committee on Industry, Science and Technology and the Standing Committee on Finance. Pursuant to Standing Order 108(2), we are continuing our study of credit card interchange fees and the debit payment system in Canada.

Colleagues, we have with us today the Interac Association. We have the president and CEO, Mr. Mark O'Connell. Welcome, sir. I believe we have you for the full session today. You have time for an opening statement of up to ten minutes, and then we'll go to questions from members.

Please begin your opening statement at any time.

[Translation]

**Mr. Mark O'Connell (President and Chief Executive Officer, Interac Association):** Thank you, Mr. Chair.

Good morning, ladies and gentlemen, members of the committee.  
[English]

Good morning, and thank you for this opportunity.

Although the hearings to date have focused more on credit card issues, I am here to talk about the evolution of the debit market. This is an important topic, given that Canadians are the second highest users of debit in the world.

The debit market is changing, and how it evolves is going to have a significant impact on Canadian merchants and consumers well into the future. Let me be clear. There is a great deal of competition in the Canadian payments marketplace, and at Interac we welcome additional competition. That is not the core issue. The core issue is the need to have a level playing field.

I will address this issue as I talk about where we want to take Interac, a great Canadian gem, and what needs to happen to ensure that all stakeholders—issuers, acquirers, merchants, and consumers—continue to be well served in this debit marketplace. As I do so, I will also set the record straight about some comments made by others about our business, so that you can accurately understand who we are and why our continued viability is so important to the Canadian marketplace.

Without question, Canadians love Interac and Interac debit. It offers 24/7 convenience, reliability, and security. In short, Interac is a

successful Canadian world-class debit payment system. Interac Association, which was first formed in 1984, 25 years ago, is responsible for the operations of the network.

Our members are not just the banks. Our membership also includes credit unions, other financial institutions, and payment and technology companies. We even have a merchant represented on our board. As a payment network, we do not issue payment cards or own or operate ABMs or merchant point-of-sale terminals, and we do not charge fees to merchants or consumers.

Interac is Canada's only domestically run, coast-to-coast debit payment network. We are the only home-grown payment brand. Interac operates on an efficient world-class national payments infrastructure with leading-edge security. We have the only debit payment product that clears and settles under the rules of the Canadian Payments Association and their built-in solvency and liquidity protections. Interac is Canadians' preferred and leading payment option, and we have a long-standing track record of being merchants' low-cost payment option. We offer a suite of trusted solutions for consumers and merchants across both the physical and the online space.

I'll turn to slide 3 and address that suite of solutions. Many of you likely know the first two, which are our main products. The first is shared cash dispensing, and this is the service upon which Interac was founded. It enables Canadians to withdraw money across the country at ABMs that do not belong to their financial institution. Our largest service by volume is Interac direct payment, which is a real-time, ubiquitous, PIN-based national debit service that allows Canadians to make purchases at retailers across Canada.

We also offer cross-border debit, which allows Canadian travellers to pay with their debit card at nearly two million point-of-sale locations in the United States through our partnership with the NYCE network, which covers about 80% of the US market. There are more partnerships in the plans and in the works.

Despite the views expressed by others, Interac is indeed in the online space. The first product is Interac e-mail money transfer. It allows Canadians to send and receive money across the country, in near-real time, from one bank account to another. Transactions are done quickly and securely through web banking, without the sender needing to know any of the recipient's banking information. All that's needed is the recipient's e-mail address.

The second is Interac Online, a unique solution that allows Canadian Internet shoppers to securely make online purchases directly from their bank account without providing any personal financial information to the merchant, not even a card number. It is offered by some prominent Canadian online merchants, including VIA Rail, the telecommunications companies—Rogers, Telus, Virgin Mobile—charities such as the Canadian Red Cross, numerous universities, municipalities, and other leading retailers such as Dell, which went live two days ago.

These are great products, but I will acknowledge that growing them has been hindered by the challenges that underscore our governance problems, which I will address shortly.

Having addressed the myth that we lack an online payment solution, let me turn to the security claims of our competitors.

Interac is and has been throughout its history a leader in the prevention, detection, and management of debit card fraud. We see investments in security as investments in the payment franchise itself. Our multi-layered strategy includes significant investments in consumer and merchant education, and of course, in our ongoing migration to chip technology, and we are delivering unique and powerful fraud management tools to our members. This investment has been ongoing, but it must be sustained and increased in the future.

In fact, this investment has played a part in the industry's enabling of its first overall declines in debit card fraud levels in many years. In 2008, debit card fraud declined by 3%, to \$104 million, after years of steady growth. By contrast, according to the CBA's testimony before this very committee, our counterparts in the credit card industry saw fraud losses increase by 34%, to \$500 million.

In the all-important web arena, the unique design of the Interac Online product I just described to you makes it one of the most secure electronic payment methods available anywhere, boasting a fraud loss ratio of one basis point, compared with 78 basis points for online credit card transactions and "card not present" transactions in the U.K., for example. I believe it is superior in this respect to the online debit options offered by the credit card companies.

I will turn to the matter of fees and of how Interac covers the cost of operating the Interac direct payment service.

As I noted earlier, Interac debit has always been a low-cost payment option for merchants. On a debit transaction, Interac receives a switch fee from acquirers and issuers to process the transaction. The association operates on a consent-order-mandated cost recovery basis, with these switch fees set solely to recover the operating expenditures of the association on an annual basis. The flat rate switch fee is currently 0.8¢ per transaction; historically our fees have varied from year to year, from about 0.4¢ to 0.8¢.

As you have heard in their testimony, MasterCard's switch fee is currently 0.5¢ per transaction on their Maestro debit product in Canada. Let me reiterate that Interac operates today solely on a cost recovery basis, with very modest marketing budgets and almost no research and development. I'm not privy to the strategic approach that they are employing as they enter the Canadian market, and although it is tempting, I am not going to speculate. I can say, however, that this rate is dramatically lower than MasterCard and

Maestro debit pricing in any other market in the world that I know of.

• (1015)

Interac's position in the Canadian marketplace is clear and rooted. Interac has a long-standing track record of being a low-cost provider. It has been our strategy and it will continue to be our strategy.

As you have heard from the merchant community—

**The Co-Chair (Mr. James Rajotte):** You have about one minute, Mr. O'Connell.

**Mr. Mark O'Connell:** —and the payment processors and financial institutions, there is a broad consensus that against the backdrop of a rapidly changing marketplace, Interac must also change. Our current association and cost recovery structures are outdated and are not sustainable. Since 1996, we've operated under a consent order that is tremendously constraining across all facets of our business. Throughout the world, it has been recognized that associations tend to be slow and ponderous, moving at the pace of the slowest. We are clearly at a competitive disadvantage.

The debit products that Visa and MasterCard are putting into the market today are similar to the Interac product, whereby your bank account is debited when you make a purchase using your debit card. These companies have tremendous experience in gaining market share rapidly at the expense of domestic providers. Through the debit wars in the United States this is evidenced, and we are seeing the same type of strategies being employed here, as they aggressively work to sign up issuers, acquirers, and merchants.

You heard directly from the acquirers that this was happening. They are receiving financial incentives to develop and market these products and applications and are now facing penalties if they do not. Time is of the essence. Change needs to happen, and it needs to happen quickly.

Arriving at this point, we are in discussions with the Competition Bureau regarding the consent order and changes to our internal structure. Our governance structure needs to change, and we need to generate organic capital for reinvestment in the business and to be governed independently from our participants.

Third, preserving Interac requires greater investment in infrastructure and innovation, and this means some changes to the pricing system for Interac products in a manner that meets the needs of the business but also respects our legacy and ongoing strategy of being a low-cost provider.

• (1020)

**The Co-Chair (Mr. James Rajotte):** I'm sorry, but we are way over our opening statement time. Unless members want him to finish.... It's 10 minutes maximum.

Do members want him to finish his statement?

**Some hon. members:** Yes.

**Mr. Mark O'Connell:** Thank you.

**The Co-Chair (Mr. James Rajotte):** The Minister of Finance did it in less than 10 minutes, I will say, however. But go ahead.

**Hon. John McCallum (Markham—Unionville, Lib.):** Yes, but he has more to say.

**Some hon. members:** Oh, oh!

**The Co-Chair (Mr. James Rajotte):** Order.

Mr. O'Connell, please continue.

**Mr. Mark O'Connell:** Thank you.

As I was saying, preserving Interac requires greater investment in infrastructure and innovation. This does mean changes to the pricing system for Interac products in a manner that meets the needs of the business but also respects our strategy of being a low-cost provider. This is important.

Without firm numbers, I know that this is a “trust me” statement, and I have faced questions about our intent in pursuing a for-profit status. I've heard clearly the concerns expressed about the potential for excessive profit-taking. I can tell you that we are committed to staying a low-cost provider. In this regard, I offer to make available our financial statements on an annual basis for scrutiny by the Department of Finance, and we are willing to enshrine this commitment. We will stand up and we will be accountable.

Interac needs to change, as you will see on slide 8. I hope this has been well established, but my point here today is that internal changes to our organization are not enough to ensure a healthy debit marketplace in Canada. The Canadian payments system is a national infrastructure and it should be viewed through that lens.

A level playing field is an essential foundation of any competitive market. This committee has heard testimony from all stakeholders about the need for transparency in cardholder choice, in merchant choice, and in having the same basic rules for all players in the game. I echo these sentiments, but unfortunately, this level playing field is not a reality today.

Clear information on service offerings and their associated costs and being able to act on this information with choice should be hallmarks of the Canadian debit market and of competition in this market. They are at the heart of our business model and our strategy. We are going to continue to be upfront with our customers about our service offerings and our fees, and we hope the marketplace can follow this example and provide consumers and merchants with clear and understandable choices.

When given the right foundations, and if this level playing field is in effect, competition can indeed be effective in delivering the best outcomes to all participants. When these foundations are not in place, however, the result will not benefit the users of the system, and Interac will not be successful.

In conclusion, let me restate that we welcome new competition, but we firmly believe that participants should operate on a level playing field and that transparency should be a hallmark of our debit system, where choice is given to its users. Interac competing against the Visas and MasterCard of the world does not mean that we will adopt their strategies. In fact, from consulting with and watching our

counterparts from around the world, that is a no win approach. Interac will instead continue to operate true to its Canadian roots, capitalizing on and leveraging our differences, not seeking to eliminate them.

One of the strategic advantages for Interac comes from being a low-cost payment option with per transaction flat-fee pricing. Any changes to the pricing structure will be mindful of those principles, and we are committed to proving that by opening our books to the federal government.

Given the forces at play, however, the change that I have identified must happen. If it doesn't, if we are not allowed to compete on a level playing field with these U.S. competitors, Canada's only payment brand and network will be hobbled, and we will not be able to provide Canadians with the services they demand and deserve.

Thank you very much.

• (1025)

**The Co-Chair (Mr. James Rajotte):** Thank you.

We'll go to questions from members.

We'll start with Mr. McTeague. You have seven minutes.

**Hon. Dan McTeague (Pickering—Scarborough East, Lib.):** Thank you, Mr. Chair.

Mr. O'Connell, thank you for being here. You have certainly addressed a number of issues that this committee has been looking forward to tackling.

I will go very quickly to the underlying concern that I have and that I think many of us around this table share. You already have the power, under the mandate given to you, to set interchange rates as well as to set fees high enough to generate revenue for the kind of innovation you are referring to, which you tend to believe is hobbling you.

My question to you is, why do you need the ability now to make profit? Do you not see that as an opening for your competitors to come in and offer in the credit system exactly what they may have proposed to do in the debit system, which might ultimately lead to your no longer being in business?

**Mr. Mark O'Connell:** So you are correct in your first assertion that even under the association model, interchange is currently set at zero. Under the consent order, a majority vote of the board could change that rate, but I think that underscores that we're going through this restructuring, because it isn't about interchange. It's about an organization that has been frozen in time for 15 years, in a model that has proven around the world to be slow and ponderous.

That gets to your second point, and I would challenge the assertion that under our governance structure we actually have the ability to respond in a timely fashion to a very quickly changing marketplace—and you have heard through testimony how fast this marketplace is changing—with respect to the required investment that the organization needs and in raising those funds. I think that's what we are trying to do here. We are trying to get an independently governed organization that has the ability to raise organic capital pools to invest in the business as it sees fit and in a manner that is not taking five board meetings to decide whether we are going to respond to a certain market event, and that allows outcomes to be dictated by competition and not any other factors.

**Hon. Dan McTeague:** On that point, Mr. O'Connell, I appreciate that. You are in many respects governed by and have worked with credit unions and the banks. They're also being competed with on the credit side by the MasterCard and Visas of this world. They of course have an advantage on the credit side, which you simply do not have on the credit side, and that's the issue of priority routing. In that kind of scenario, given that you are currently governed by banks that may be enticed, induced, interested, or entreated by higher rewards or higher incentives, how do you find you're going to be able to compete when priority routing leaves you literally out of the loop?

• (1030)

**Mr. Mark O'Connell:** With respect to priority routing—does everyone understand priority routing?

Priority routing starts with the financial institution that issues the debit card. If a financial institution chooses to offer two competing networks on the same debit card, the financial institution can either predetermine which network is processed first at the point of sale or they can allow the cardholder to choose the option they prefer. So when a financial institution predetermines that option, that's priority routing. If a merchant, for example, accepts all of the networks that are on that card, the terminal will automatically preselect the predetermined option and process the transaction in that way.

**Hon. Dan McTeague:** Mr. O'Connell, I think we understand that. I want to know how Interac is going to respond, how they're going to handle that in the onslaught of competition should it come forward, as you suggest, through non-profit.

**Mr. Mark O'Connell:** I just wanted to make sure that everyone understood it first.

I do have significant concerns with priority routing. It is contrary to my stated strategies and beliefs of consumer choice and of merchant choice. So we are working through those things with the board, but I do have issues with it from a competition standpoint.

**Hon. Dan McTeague:** So let me ask, if you're looking at certain plans, what will happen to Interac if priority routing becomes commonplace, as some of us here feel perhaps it will?

**Mr. Mark O'Connell:** I think we're certainly going to have to look at our strategies. It would have some detrimental effects on those. We are putting our strategies and our pricing in the hands of merchants and consumer choice. If that choice is not available to them, then we would have to revert back and look at our strategies.

I think it would be very detrimental to Interac's future. I'm the CEO of Interac and the custodian of the brand, and priority routing

also causes confusion with respect to the brand. A consumer may think they are doing an Interac transaction when in fact they are using a competing brand, with all of its different terms and services, and so forth. I think the Interac brand is very strong in the Canadian marketplace. I know it is very strong with respect to the merchants. We have a history of partnership and clear and transparent dealings with the merchants. Our strategy is based on merchants being able to choose and or influence the choice of consumers.

**Hon. Dan McTeague:** I appreciate that, Mr. O'Connell.

This is my last question to you, and my colleagues will follow up. Do you envision having your own policy or practice of establishing your own priority routing to meet that competition?

**Mr. Mark O'Connell:** We believe in fair competition. We are working through this issue. It's a very complex issue when you're talking about multiple debit networks on the same card. It is an important competitive imperative for us going forward.

**The Co-Chair (Mr. James Rajotte):** You've got 30 seconds.

**Hon. Dan McTeague:** We've heard from a number of retail groups in particular who have approached the committee members asking that debit fees be mandated as flat. We know that one of the competitors has already proposed to go into the debit system on an *ad valorem* basis. What's Interac's position on mandating a fee that would be structured in a way where there is no suggestion of *ad valorem*?

**Mr. Mark O'Connell:** While I can't comment specifically on the ongoing pricing deliberations within the restructuring project, I can say that our history is based on a simple transparent flat fee, switch fee, and we will respect that legacy. I think it's important to note, with respect to previous testimony, that there are switch fees and often around the world—even with my U.S. card counterparts—those are flat fees. But there are other fees. I believe there are eight in the United States, other fees and assessments, that can have different characteristics. Then there's interchange, which is almost uniformly *ad valorem*.

We have one simple fee and it's a flat fee.

**The Co-Chair (Mr. James Rajotte):** Okay, thank you.

*Monsieur Laforest, s'il vous plaît.*

[Translation]

**Mr. Jean-Yves Laforest (Saint-Maurice—Champlain, BQ):** Thank you, Mr. Chair.

Good morning, Mr. O'Connell. Thank you for being here. You gave an excellent and clear presentation that I greatly appreciated.

Under the current structure, fixed fees are charged to the “processors”, the ones providing the technology to merchants, who in turn transfer the costs to the retailers, with additional fees. Is that how things currently work?

• (1035)

[English]

**Mr. Mark O'Connell:** You're correct. From what I heard at the end, we charge a flat fee to the acquirer of 0.8¢, and then together with the other services they provide to the merchant, they would bundle that into their contract with the merchant.

[Translation]

**Mr. Jean-Yves Laforest:** I would like to fully understand. Is 0.8% or 8¢ charged per transaction? There are fixed fees per transaction, correct? Yes.

Do the financial institutions that issue debit cards currently receive royalties for transactions made at points of sale? Do the debit card issuing banks receive a royalty when these client debit cards are used for a transaction?

[English]

**Mr. Mark O'Connell:** In answer to your first question, our fee to the acquirers is less than a cent; it's 0.8¢. That's charged to the acquirers. And no, the issuers don't receive royalties from the point of sale transaction.

[Translation]

**Mr. Jean-Yves Laforest:** That means that 0.8¢ is charged for each transaction, of which 0.1¢ goes to the "processor". Is this correct? Therefore, Visa earns 0.7¢ per transaction.

[English]

**Mr. Mark O'Connell:** In the Interac model, Interac charges the acquirer less than a cent to process that transaction from the merchants into the system. We also charge the issuer the same flat fee amount to process the transaction on the other side into the account to ensure that the money is available, etc. Those are the only fees that are charged within the Interac debit model. I can't comment on the Visa model.

[Translation]

**Mr. Jean-Yves Laforest:** How are the fees charged to the merchant broken down? If an individual makes a \$100-purchase using a debit card, 0.8¢ is charged to the merchant for this transaction. Is that correct? How is the 0.8¢ broken down?

[English]

**Mr. Mark O'Connell:** We charge the acquirer 0.8¢ to process the transaction. Of course, the acquirer has a contract with that merchant and provides other services in processing and the terminal that sits on the point of sale at the merchant location. We're part of their operating costs. They would have a contract with the merchants that would bundle their other services and pass on those fees in a competitive environment. Typically, the end merchant cost in the Interac environment is anywhere from 3¢ to 15¢ at an average of 7¢ or 8¢ per transaction.

You're right. On the \$100 it doesn't matter whether it's a \$10 purchase, a \$100 purchase, or a \$1,000 TV; it's still the same flat-fee amount.

[Translation]

**Mr. Jean-Yves Laforest:** If possible, I would like you to provide us with a breakdown of the fees charged to merchants, in writing. Who is billed for these fees?

MasterCard told us that Interac had increased its fees by 60% in February. Is this correct? Why did you increase your fees by 60%?

• (1040)

[English]

**Mr. Mark O'Connell:** We're mandated under a cost recovery basis. Our flat-rate switch fee increases or decreases on an annual basis based on the operating costs and needs of the network in any given year. For example, historically, our fee has vacillated only from 0.4¢ to 0.8¢, and it depends on the operating expenditures in that given year. This year, we had some investments to make and we are undergoing a restructuring. Last year the 0.5¢ is where MasterCard has put its pricing, which is Interac's last year's rate. So it has increased just with the cost recovery model.

[Translation]

**The Co-Chair (Mr. James Rajotte):** You have one minute remaining, Mr. Laforest.

**Mr. Jean-Yves Laforest:** With the possible entry of Visa and MasterCard into the debit card market, Visa told us that a client may choose to make a purchase using Visa, Visa debit or Interac. Do you think that this is possible? Will consumers be sufficiently informed to make a wise choice?

[English]

**Mr. Mark O'Connell:** As I was saying on the priority routing issue, when you have two competing networks on the same card, it does raise some issues of transparency and choice for the consumer. I would agree with you. I think it's interesting that neither MasterCard nor Visa allows each other's applications to ever co-reside on the same card, and there are some reasons for that. Today, there's no confusion in the market. When you pull out a credit card, as a consumer you know the payment vehicle you're using. It's your Visa or your MasterCard. When you pull out your Interac card, you know that as debit. It's important that transparency be instituted in the market if we're going to have the same card with two competing debit networks on it. Financial institutions would need to clearly disclose that there are two debit networks on that card.

The cards would need to be clearly branded with both networks in a way that doesn't confer advantage on either of them. Consumers would need to be educated on how the system works at the point of sale, and that terminal would need to display both networks clearly, fairly, and on the same screen, allowing the consumer to make an informed choice and the merchant to be able to influence that choice.

**The Co-Chair (Mr. James Rajotte):** Thank you, Mr. O'Connell.

We'll go now to Mr. Wallace, please.

**Mr. Mike Wallace (Burlington, CPC):** Thank you, Mr. Chair.

Thank you for coming this morning, Mr. O'Connell, and for your presentation.

I have two quick follow-ups before I get into a couple of questions. In your opening statement you say...and I'm quoting from what you have here. It's why I think there's a little bit of confusion. You say in one paragraph that you do not charge fees to merchants or consumers, and then two paragraphs later you say that you have a record of being Canadian merchants' low-cost payment option.

So there's some confusion. When I heard that, I thought, well, didn't you just tell us that you're not...? You actually do charge a fee to the acquirer, they bundle it together with all their other fees, and they do charge the merchants for it. Eventually, it gets to them. It's a flat fee, and I understand that, and I understand why. This is just a clarification.

I'm not sure if Mr. McTeague was on that route or not, but one of my initial questions was this. You're clearly not here to say we should keep competition out of the marketplace. Is it your opinion and your organization's opinion that Visa Debit and Debit MasterCard are coming to Canada regardless? Would that be your opinion?

**Mr. Mark O'Connell:** It's stronger than that. When I joined Interac two years ago, and we started the conversations with the Competition Bureau shortly thereafter, Visa and MasterCard were in the process of entering the Canadian debit market. They are here. There are over one million cards.

• (1045)

**Mr. Mike Wallace:** You're advocating for your organization that you need a legislative change, or—I don't know if it would be a legislative change—a change to the operating rules for Interac so that you're able to compete against those new players in the marketplace. That is basically what you're telling us here today, is that correct?

**Mr. Mark O'Connell:** To your first question, you're right, we're like a wholesaler, so we provide a fee to the acquirer, who then adds other services. We're an operating cost to them—and you're right, it does reach the merchants.

I am not here to prescribe legislative remedies or any prescriptive remedy; I am here to indicate that we do not have a level playing field and to indicate that Interac cannot survive if there isn't a level playing field. I'll just go to the exact attributes of that.

Number one, it's internal. We need to remove the artificial funding and governance constraints that currently are on Interac. We are different from our competitors. That's consent order imposed.

**Mr. Mike Wallace:** Consent order imposed, okay.

**Mr. Mark O'Connell:** We are, as you know, in discussions with the bureau on restructuring ourselves internally so that we have the same capabilities as our competitors.

But the second is that we need to ensure that consumers and merchants are making overt and open, informed choices in the marketplace, and this is what I think Mr. McTeague was getting to. Consumers need to know the payment vehicle they're using. They shouldn't be thinking they're using Interac when they're actually using a competitor's brand. That's going to erode my market share.

Merchants need to clearly understand the payment options available to them and their associated costs, and they need to choose the options they wish to accept. So merchant contracts, which are an issue in the industry, need to be in clear language, ensuring that the payment options are separately priced. They can't be blended or bundled, because that takes away our strategy and the Interac low-cost, sustainable option.

**Mr. Mike Wallace:** How quickly do the consent order changes need to happen for you to be in the marketplace in a timely manner?

**Mr. Mark O'Connell:** Yesterday.

**Mr. Mike Wallace:** Okay. You've been in my office before, and you're active on that file now, right?

**Mr. Mark O'Connell:** We are. They take their statutory duty to protect the interests, but—

**Mr. Mike Wallace:** Maybe I misinterpreted. How are the banks not in a conflict of interest when they are customers of Visa Debit and Debit MasterCard and they're on your board? How is that not a conflict?

Do you foresee that you'll need a different governance structure if the consent order requests that you're making do come through and you're able to compete in the marketplace?

**Mr. Mark O'Connell:** I've been very open as to our governance challenges and the challenges of any association model where an organization is governed by its very users. It's tremendously difficult to gain consensus, and it moves at the pace of the slowest. I think it's important to note that the board itself has acknowledged this in their recommendation and support of the proposal to restructure the organization, which could be managed by an independent board. They've also had the foresight to set up an independent board that is now looking at many of the aspects of the future restructuring.

Now, let's remember that the Interac Association's board was instituted by the consent order itself. Under our memorandum of association, each board member has a contractual duty to operate in the best interests of the association. We regularly remind them of this obligation, and under the governance model I have, I must operate under the belief that they are adhering to this obligation and that they take it seriously.

**Mr. Mike Wallace:** I have one more question. You may not have thought that anybody would ask this question, but the concern around here has been that the credit card industry, which basically has two big, big players, is trying to get into the debit marketplace. They've done it elsewhere, but they're trying to do it here.

Is there any discussion at your end about getting into the credit side of the business and be another player in the credit marketplace as part of your future as Interac?

**The Co-Chair (Mr. James Rajotte):** Be very brief, Mr. O'Connell.

• (1050)

**Mr. Mark O'Connell:** I can't divulge our strategies fully, but I would say that if we are able to restructure and this level playing field is instituted, that is a product we would strongly have to consider.

**Mr. Mike Wallace:** Thank you very much.

**The Co-Chair (Mr. James Rajotte):** Thank you.

We'll go to Mr. Thibeault, please.

**Mr. Glenn Thibeault (Sudbury, NDP):** Thank you, Mr. Chair.

Thank you, Mr. O'Connell, for coming here today.



Just a little bit off from what Mr. Wallace was talking about, maybe you can clarify something else for me. You're looking for a level playing field. So if MasterCard and Visa were not considering introducing debit cards in Canada, would Interac still be considering restructuring or higher fees?

**Mr. Mark O'Connell:** Yes, in a word, we would still be considering restructuring. The fact of the matter is the governance is challenged in reacting to the market and to product innovations, infrastructure, and so forth. I think Interac needs to evolve, because we're also competing on a world stage.

**Mr. Glenn Thibeault:** So if we're looking then at interchange fees and an increase in the cost of payment transactions to merchants, then the merchants have to pass these increases off to the consumers. If debit services by Interac are increased, what benefits will consumers see, if any? Or will they just be seeing higher prices?

**Mr. Mark O'Connell:** You have to remember that the debit market is changing. Visa and MasterCard are here, and that market is going to change whether or not Interac changes. So if Interac is not able to restructure, this market is going to be left with a duopoly of those two competitors. So I believe we have to change for the merchants—and I believe that passionately. I started that two years ago. We are already seeing the countervailing force that Interac is with respect to pricing, if you look at MasterCard's strategy. So I think it's imperative in fact to keep prices down, that Interac is a viable player in this industry.

**Mr. Glenn Thibeault:** Okay. Then to what extent do you agree with the suggestion of the CFIB—the Canadian Federation of Independent Business—and the Stop Sticking It To Us Coalition that merchant fees related to debit transactions should be a fixed amount per transaction, rather than a percentage of the value of that transaction?

**Mr. Mark O'Connell:** I think that has a lot of merit. *Ad valorem*, or percentage of value, emanated from the credit business, where there is risk inherent in the transaction. That's not a good funds model transaction. Interac has a flat switch fee, because there is much less risk in that transaction as far as an unsecured loan is concerned. So whether it's for \$100 of groceries or whether you have enough in your bank account for a \$1,000 TV, we see the argument—and Interac lives it. We're here today with a flat-fee, single-fee switch fee.

**Mr. Glenn Thibeault:** So in your opinion, sir, what would it take to prevent Interac from adopting the debit fees as talked about, at *ad valorem* or a percentage of the cost of purchase, as proposed by Visa and MasterCard?

**Mr. Mark O'Connell:** Could you ask that in a different way?

**Mr. Glenn Thibeault:** What can we do to avoid the *ad valorem* or the percentage of the purchase? We're hearing loud and clear from many of the consumer groups and merchants that it's what they're concerned about—going away from the flat fee to the percentage fee. How can we prevent that? What are the steps we can take to ensure we're keeping things fair?

**Mr. Mark O'Connell:** Well, we're going to be clear and transparent with all of our fees. As I've said, we're going to open up our books to the federal government on an annual basis. As I've said, we are respecting the flat fee history of Interac in our pricing in order to preserve our relationship, which is so important in our

strategy, with the merchant community. We need the merchant community somewhat to be architects of their own cost future in debit. We are going to put a balanced value proposition out there, as we've always done. It will be clear and transparent.

We need that acceptance community, because that's a strategic bastion we have today. We have acceptance from coast to coast. Visa and MasterCard are attempting to do that. You heard from MasterCard that they are trying, on a business case by business case basis, to gain merchant acceptance. We believe we need to put a balanced value proposition out there, and we need to listen to the merchant community's concerns about *ad valorem*, because we need to appeal to that side of this two-sided market.

• (1055)

**Mr. Glenn Thibeault:** You talked a little bit about something, a 0.5% switch fee by MasterCard, I believe, in your opening statements. I think you said it's larger than any other MasterCard fee that you've seen in the world. Can you clarify for me? Did I hear that incorrectly?

**Mr. Mark O'Connell:** Yes. In fact, it's the opposite. I was commenting on MasterCard's testimony that their current rate in the Canadian market is a 0.5¢ switch fee. I believe they currently have interchange set at zero basis points. We've seen that before.

What I was saying is that while it's tempting to comment as a cost recovery organization that knows the economics of this business, that has very little marketing or R and D on the sustainability of that, I was just pointing out that in all other markets that I know of around the world that is drastically lower than the Maestro and MasterCard debit pricing.

**Mr. Glenn Thibeault:** Obviously we're not going to get into assumptions as to why they're doing that, but thank you for clarifying it for me.

If it's cost recovery and we're hearing the merchants worrying about their costs increasing and consumers will ultimately see these costs, what do we tell consumers? What are we telling them about the work we're doing right now, where we're hearing more and more people saying, or more and more organizations are going to be saying, that their costs are going to be going up?

Right now, we all know that we're in a downturn. What do we tell them when corporations like...I'm trying to do some math here. You're saying you're getting approximately 2¢ or just under 2¢ per transaction for about four billion transactions?

**Mr. Mark O'Connell:** Interac does not. Interac just receives the 0.8¢. The acquirer has various contracts and pricing agreements with their merchant base, and I think 8¢ per transaction is the average debit merchant cost, which is a payment to the acquirer.

**Mr. Glenn Thibeault:** So you get 0.8¢ from the acquirer. Do you get anything from the issuer as well, then, just for clarification?

**Mr. Mark O'Connell:** Yes, the same 0.8¢.

**Mr. Glenn Thibeault:** You add those two together and it gives you about 1.6¢, correct? So it's just under 2¢ per transaction.

**Mr. Mark O'Connell:** Right. So the 0.8¢ is to process a transaction—and I won't get into the details—in a single-message transaction set. So it's 0.8¢ for each message, if you will. It's processing the transaction from the merchant terminal into the Interac member network, etc., 0.8¢, and then on the issuer side processing the transaction from the account through into the Interac member network and so forth.

**The Co-Chair (Mr. James Rajotte):** Thank you.

Thank you, Mr. Thibeault.

We'll go to Ms. Coady, please.

**Ms. Siobhan Coady (St. John's South—Mount Pearl, Lib.):** Thank you very much, Mr. O'Connell, for appearing before us today and bringing your viewpoints to the table. We certainly appreciate it.

These are going to be rapid-fire questions, because I only have five minutes, so forgive me for asking a lot of questions in a brief period of time. I want to start by following up on a couple of themes that are going here, just for clarity.

You currently have the opportunity to levy interchange fees, but you will not do so, correct? You currently have the opportunity to levy interchange fees, but you do not. You use a switch fee instead.

**Mr. Mark O'Connell:** We have not done so and have no plans to do so, because interchange is not the problem here. The change is that Interac cannot be responsive in its current structure.

**Ms. Siobhan Coady:** Okay, great. Thank you.

I want to talk about the situation in the United States with the STAR Network, for example. I think it is or was your equivalent in the United States. As you know, Visa and MasterCard are now dominant in that market, for example.

What do you think was the challenge for the STAR Network in facing the Visa/MasterCard surge in debit card?

**Mr. Mark O'Connell:** It's a great proxy. It underscores the urgency that we have here before us, the fact that Visa and MasterCard are already in the market. STAR Network was arguably the closest thing to Interac you're going to get in North America. They basically invented the PIN debit network in the United States and then, through many years of expansion, five years ago STAR Network had close to 60% market share of the United States PIN debit market—in the high fifties. That's when Interlink or Visa PIN debit aggressively entered the market. At that point they had 10%.

They employed their strategies. It was a free-for-all, unlevel playing field and so forth. Today STAR Network is, I think, at 25% and Visa is in the high forties, if not 50%, of that market.

• (1100)

**Ms. Siobhan Coady:** What was the result of Visa/MasterCard taking the predominant lead? What was the end result to consumers and to merchants?

**Mr. Mark O'Connell:** This is what I meant in my opening remarks, as we've consulted and we've learned from history. Unfortunately, the STAR Network and the NYCE network decided they were going to play a price-matching game with respect to interchange with Visa. They were different from Interac, however. Visa already had acceptance at all the merchants in credit and they

played the honour-all-cards. You remember that whole fight where, if you took a Visa credit, you had to take a Visa debit.

Visa didn't have the impediment they have today here in Canada whereby Interac debit is accepted across the country. What ended up happening was a spiralling of interchange to where I think the United States is the highest interchange market in the world today.

**Ms. Siobhan Coady:** Thank you. I have two more quick questions.

One, you're currently regulated by the Canadian Payments Association. We're all aware of that. What would be your understanding for Visa and MasterCard? Would they be settled here through the Canadian Payments Association or are they going to be settled through the Bank of America in the United States?

**Mr. Mark O'Connell:** You are correct, we settle through the Canadian Payments Association and we believe that the rules framework and a fully Canadian settlement option meets our needs. It's important for the debit system that we operate here in Canada. Our items are safe and secure and in Canada.

I must say that as far as commenting on the others goes, after reviewing the testimony of my counterparts at Visa and MasterCard, I'm not sure I understand their clearing and settlement well enough to form an opinion of its safety and soundness or of its risk.

**Ms. Siobhan Coady:** Do you understand that they'll be settled through the United States' Bank of America? Is that your understanding? Just yes or no.

**Mr. Mark O'Connell:** Again, the testimony was confusing, but I do believe that, yes, they settle through the United States and the bank balance sheets therein.

**Ms. Siobhan Coady:** I have one final question.

What would happen if we do not intervene in this particular situation? If nothing is done coming out of this and we let market forces bear, what do you think will be the outcome?

**The Co-Chair (Mr. James Rajotte):** Very briefly, please, Mr. O'Connell.

**Mr. Mark O'Connell:** I want to reiterate that I'm not prescribing a solution, legislated or otherwise, but if the marketplace either doesn't step up and follow our lead for transparency, choice, and the same rules for all three competitors in this market, and if Interac is not allowed to change its internal structure, then we will go the way of the STAR Network, the NYCE network, and so forth in the United States. We will no longer be a countervailing force and there won't be a Canadian option in the debit infrastructure in Canada, in my opinion. We just will not be successful.

**The Co-Chair (Mr. James Rajotte):** Thank you.

[Translation]

Mr. Bouchard, you have five minutes.

**Mr. Robert Bouchard (Chicoutimi—Le Fjord, BQ):** Thank you, Mr. Chair.

Welcome, Mr. O'Connell. You have told us that in the past, your debit system has always been a low-cost provider. You say that you wish to change from being a non-profit association to a commercial entity. You are even ready to make a commitment.

What sort of commitment are you ready to make? Can you guarantee to us that costs will remain low, as they always have been in the past?

[English]

**Mr. Mark O'Connell:** As I said at the outset, the commitment that we are here making and willing to enshrine is that we will open our books on the revenues and costs of these lines of business to the Department of Finance, or to the government, to ensure that my statements about being a low-cost provider are not hollow. They are not "trust me" statements. You will be able to see the returns inherent in our business, and we're willing to be accountable to that. We realize we do need to change to a commercial structure in this competitive environment against two very well-financed commercial companies that have long ago shed their association of governance and other status. We're willing to be accountable that there will not be excessive profit-taking in this endeavour. That is not why we're doing this.

• (1105)

[Translation]

**Mr. Robert Bouchard:** I would like to get back to the issue of your change in status. Why do you wish to change status? Is it to serve the interests of consumers, staff, or owners? Is it to make more money? What is your real motive?

[English]

**Mr. Mark O'Connell:** The driving force is to survive, and to survive on the behalf of merchants, consumers, and the entire marketplace. The viability of Interac is a benefit to the marketplace. We're seeing it even today with how Visa and MasterCard are operating to try to penetrate this marketplace.

I think it's important to be a merchant economy going forward, to have a countervailing Canadian force. It's important to Canada. After 9/11, the United States elevated payments to the status of a national infrastructure. Here we are talking about the debit infrastructure, Canadians' access to their accounts. I think it's important that we continue to have a Canadian option in this area and we're not outsourcing our debit retail payments market to the United States. I think this restructuring will allow Interac to benefit all users of the system—the issuers, the merchants, and the consumers—with a fair and balanced value proposition.

[Translation]

**The Co-Chair (Mr. James Rajotte):** You have one minute remaining.

**Mr. Robert Bouchard:** Mr. O'Connell, you talk about the market and the Canadian option. In your opening statement, you say that Interac is present from coast to coast. In your 25 years of operation, your growth has been phenomenal, or quite profitable, and you forecast very positive growth in the future.

Are your forecasts based on the assumption of your status as a non-profit association, or on your new status? I would like to hear you speak to us some more about your real motive. You stated that it is the market which is of concern to you, and that is driving you.

[English]

**The Co-Chair (Mr. James Rajotte):** Mr. O'Connell.

**Mr. Mark O'Connell:** My main motivation is ensure that Interac survives as a viable choice for merchants, consumers, and issuers in this marketplace. The success that you're talking about and the consent order was enshrined about 15 years ago in a very different marketplace.

Visa and MasterCard have proven in almost all jurisdictions around the world that they take over the market at the expense of the domestic debit provider, usually because that debit provider is hindered in these ways. We are standing up and saying no, we need to restructure and there needs to be a level playing field in this market. We can compete and succeed against Visa and MasterCard owing to our products.

**The Co-Chair (Mr. James Rajotte):** Thank you.

Mr. Lake.

**Mr. Mike Lake (Edmonton—Mill Woods—Beaumont, CPC):** You clarified that the charges per transaction aren't 1.8¢ per transaction but actually 1.6¢ per transaction. They're individual, but there are two charges of 0.8¢ per transaction. Does every transaction result in two 0.8¢ revenues to Interac? Is that accurate? One is from the buyer and one from the issuer?

• (1110)

**Mr. Mark O'Connell:** Right. It's 0.8¢ to the acquirer and 0.8¢ to the issuer.

**Mr. Mike Lake:** How many transactions do you have per year?

**Mr. Mark O'Connell:** Last year in Interac direct payment, I believe there were around 3.6 billion transactions.

**Mr. Mike Lake:** That's 3.6 billion, with a "b"?

**Mr. Mark O'Connell:** When the consent order was issued, Interac direct payment was a fledgling. It was a business case being launched. The consent order was issued when shared cash dispensing, or our ATM business, was what Interac was. Today, the Interac ATM business is 250 million transactions. It's interesting to juxtapose the two services from a transaction standpoint.

**Mr. Mike Lake:** Is there any revenue from those 250 million ATM transactions?

**Mr. Mark O'Connell:** Yes, we have a switch fee.

**Mr. Mike Lake:** So that's the same 0.8¢ per transaction.

**Mr. Mark O'Connell:** No, there are different fees, again, set on a cost recovery basis under the same model and they're flat switch fees, but they're respective of the ATM business. We don't charge any additional fees in that business, such as the convenience fees and so forth. That has nothing to do with Interac.

**Mr. Mike Lake:** Regarding other revenues, on your e-mail money transfer, what kind of charges are involved there?

**Mr. Mark O'Connell:** Again, ours is a wholesale charge to the issuers. I'll have to get back to you with respect to making sure I get all the specific charges. But again, it's a flat fee.

**Mr. Mike Lake:** I would imagine that on the Interac online it is again separate, a different type of charge?

**Mr. Mark O'Connell:** Yes.

**Mr. Mike Lake:** So you could endeavour to get us the charges for the ATM, the e-mail money transfer, the Interac online, what those numbers are?

**Mr. Mark O'Connell:** Yes, where I can, I will. All five services in the restructuring would be looked at from a competitive model standpoint.

**Mr. Mike Lake:** In terms of taking a look at what you're asking for, of course, try to take a look at it from our constituent standpoint, because it's our constituents who have a lot to say these days, probably more to say these days about the banking system in general and credit cards and debit cards and everything else.

One thing that has been a strength here in Canada is the strength of our banking system—our financial system ranked number one in the world. I think even President Obama was quoted to say that Canada has shown itself to be a pretty good manager of the financial system and the economy in ways that haven't always been there in the United States. Canadians are very protective of that system. What I'd like to hear is a little bit about how the Canadian consumers' experience will change based on the changes you're looking for right now. What would you say to our constituent who might be concerned about this? How will their experience be better?

**Mr. Mark O'Connell:** How would their experience be better if Interac...?

**Mr. Mike Lake:** If we made the changes you're asking for.

**Mr. Mark O'Connell:** So the first change is just the restructuring of Interac in order for it to be able to compete and continue to be there for consumers. I think consumers over the past 20 years have come to rely on it, and in some respects debit in Canada has been a love affair with Interac. So I think it's important that our viability be continued.

Beyond that, if you're talking about a level playing field, I think the experience needs to be different. Cardholders should understand the payment vehicle. So in this new multi-network world we find ourselves in right now—and we're no longer in the dressing room, we're out on the ice, and Visa and MasterCard are operating around us here—I think it's important that consumers continue to understand the payment vehicle they're using and not be confused, thinking they're using their Canadian Interac and they're in fact using another brand. I think it's important at the point of sale that merchants, as well, understand that they aren't having contracts put in front of them where Visa, MasterCard, and Interac rates are blended—they can't tell and can't make an overt choice between them. We shouldn't have honour-all-cards rules, as we saw in the United States.

**Mr. Mike Lake:** I just want to clarify this.

• (1115)

**The Co-Chair (Mr. James Rajotte):** This is the last question.

**Mr. Mike Lake:** I'm not talking about all the different cards people may use, but for me as a consumer, if I walk in to use my BMO bank card, as I always do, how will my experience be better? What innovation is going to improve my ability to shop and buy the things I want to buy with my card?

**The Co-Chair (Mr. James Rajotte):** Very briefly, Mr. O'Connell, please.

**Mr. Mark O'Connell:** An immediate innovation we are endeavouring to roll out in this game in the debit wars is, for example, the tap and go, the contactless. As you notice, the U.S. credit card companies have their products in market; Interac does not by virtue largely of our inability within our structure to move at other than the pace of the slowest. So that's an example, and then you move to mobile payments; you move to other information on your chip card. This market is evolving dramatically, and what I'm asking for with respect to a level playing field and Interac's restructuring will just enable Interac to provide those services to Canadians.

**The Co-Chair (Mr. James Rajotte):** Thank you.

We'll go to Mr. Rota, please.

**Mr. Anthony Rota (Nipissing—Timiskaming, Lib.):** Thank you, Mr. Chair.

Thank you, Mr. O'Connell, for coming out today.

You talk about a flat fee, and that's what the charge is, the switch fee, which is basically 0.8¢. There's no desire or requirement to change to a percentage or an *ad valorem* fee. The 0.8¢ is what you're charging. The bank then takes it and marks it up between 3% and 15% per transaction. What's to stop the individual banks from going to an *ad valorem* fee if they were doing business with you? Do you have some kind of agreement or restriction with the banks out there who are actually offering the cards to individuals?

**Mr. Mark O'Connell:** You're referring to the acquirer marking up the fee, not the banks?

**Mr. Anthony Rota:** Yes, the acquirers. You're charging a set fee. Do you have any agreements with the acquirers, with the individual banks or institutions who issue the debit cards, to restrict what they charge?

**Mr. Mark O'Connell:** I think you're getting at a concern of mine. We publish our rates on our website each year, and that's—

**Mr. Anthony Rota:** I understand that you publish them, but do you have an agreement with them that limits people from going to—

**Mr. Mark O'Connell:** Yes. And in their contracts they have an agreement that any network fee charged is a pass-through to the merchant, and then they layer on their other fees.

I am concerned that we don't have that downstream visibility. There have previously been tactics, and this is what I'm getting at. It is so important that these contracts between the merchants and the acquirers are in clear language, that costs are divided overtly so the merchant can see what his or her acceptance decision is going to mean to their costs—

**Mr. Anthony Rota:** Let me just take it one step further. We see this happening with a lot of the credit cards. We'll take it from the credit cards and bring it over for the Interac Association. As far as Visa and MasterCard are concerned, do you see these cards moving to a premium level or a loyalty card level, where there will be extra costs piled on to the merchants that eventually have to be passed on to the consumers? Do you see the cards moving to that area with increased competition?

**Mr. Mark O'Connell:** I can't speak to the strategies of Visa and MasterCard, of course, as that is not currently under Interac's purview or planning. But of course you're the network, remember, in the middle. With respect to card rollout strategies and so forth, that's the purview of the issuer largely.

**Mr. Anthony Rota:** Very good.

We talked about STAR and NYCE in the United States. What you're asking for basically is not much more than permission to restructure your governance model. That's all you're asking for. That's the main change.

Now for NYCE and STAR, what was their system of governance over there? Why did they suddenly drop in light of Visa and MasterCard's competition? What will prevent you from dropping just with a simple change in governance?

**Mr. Mark O'Connell:** I hope it hasn't been lost. There's more than an internal restructuring of Interac needed with respect to how this debit marketplace evolved. So the level playing field I'm talking about, so consumers and merchants can overtly choose Interac, away from the competitors and their various pricing schemes and so forth, is imperative to our success, as are rules of the game. Interac being the only competitor in the market that is subject to scrutiny and review of all its new products sets, which we do today through the CPA, and the other competitors rolling out contactless and PIN-less products after a decision made in Purchase, New York, or Foster City, with not the same level of scrutiny or review, is a problem. So I am trying to talk well beyond the restructuring with respect to Interac's success.

You talked about STAR and NYCE. In answer to a previous question...they were private and then became public companies. The difference between our two strategies and our two markets—and as I said, it's a massive difference because this is a two-sided market—is that when Visa went in aggressively to the debit market, they were already there. They already had an acceptance base from coast to coast in the United States. So when that acceptance base is ubiquitous among all the brands, what happened there was that the competition shifted to how they could keep issuer cards within their brand, and unfortunately in STAR's case, their demise was when they started raising interchange to try to incent the issuers, because it was a card battle only. It's not the case here in Canada. You've heard prior testimony that one of the main problems for Visa and MasterCard—and we see it in their pricing strategies—is trying to get merchant acceptance.

So at Interac, I believe our restructuring, through partnering with the merchant community, can have a low-cost model, and if the merchants are architects of their own future in choosing Interac in the majority of the segments, I think we have a viable strategy with respect to Visa and MasterCard.

• (1120)

**The Co-Chair (Mr. James Rajotte):** Thank you.

We'll go to Mr. Dechert, please.

**Mr. Bob Dechert (Mississauga—Erindale, CPC):** Thank you, Mr. Chair.

Good morning, Mr. O'Connell.

We've heard from merchant groups and other organizations that Interac is the lowest-cost form of payment to the merchant, even lower than using cash itself. I doubt that most consumers know this, however. I certainly didn't know it until I had listened to some of the witnesses.

As you may know, the finance committee is currently studying consumer financial literacy. Do you think merchants should make this fact known to consumers, and do you think it would be a fair or good idea for merchants to offer their customers a discount for payments using their Interac debit card?

**Mr. Mark O'Connell:** I'm certainly in favour of informing consumers as to the cost of the debit and the electronic payment method. I don't know if it is only the merchant's responsibility to do that. I think all stakeholders in the market should be doing that and I think it would be good for the economy if that were to happen, because we'd take some costs out of the system.

**Mr. Bob Dechert:** Does Interac have any plans to make that fact known to consumers?

**Mr. Mark O'Connell:** If we had any marketing budgets I sure would. And I think it's important that you do find already in the merchant community...I'll bet that each of you at some point has run into a merchant who was beginning, as they do in the United States, to suggest a preferred brand to lower their costs. I get sent pictures all the time of signs going up, saying "Help us and use Interac Debit".

So I think that groundswell is happening, and that underpins our strategy on the merchant acceptance side.

**Mr. Bob Dechert:** I think if we all used debit a little more, we could probably reduce the costs of things, and that would be good for consumers and everyone in our economy.

As you know, since 2006 the Conservative government has lowered the GST from 7% to 6% to 5%. What impact did that sales tax reduction have on the volume of sales enjoyed by merchants across Canada and the volume of payments processed by Interac?

**Mr. Mark O'Connell:** I'd have to take a look at that from a transaction standpoint and do some data mining to see if we could find a correlation with the date from a transaction, but I'd be happy to take a look at that to see if we can find it.

**Mr. Bob Dechert:** If you can do it, I think it would be interesting to know. What is your guess? Was that a good thing for the Canadian economy?

**Mr. Mark O'Connell:** I can't hazard a guess.

• (1125)

**Mr. Bob Dechert:** Thank you.

**The Co-Chair (Mr. James Rajotte):** There are two minutes left.

Mr. Lake, do you want to follow that up?

**Mr. Mike Lake:** You've referenced the phrase "low-cost provider" several times, but I'm not clear on what definition you're attaching to that. I'd like to hear it defined a little bit more, especially as we talk about the future. You say that Interac will continue to be a low-cost provider, but I think my constituents, hearing that, would probably want to know what that means—low cost relative to what?

**Mr. Mark O'Connell:** I say "a low-cost provider". You've heard the testimony regarding MasterCard's current pricing strategy into the market. We have been historically, for 15 years since Interac debit began, a low-cost provider. No one can argue that 0.4¢ to 0.8¢ isn't low cost.

What I'm saying is that our strategy in the future is to offer a balanced value proposition going forward to maintain that primacy. I spoke of the need for us to partner with the merchant acceptance community. If I layer on too many costs—and internally I'm willing to open those books up to the federal government as far as any excessiveness is concerned—the merchants are going to begin to make a choice other than Interac and choose MasterCard and Visa.

**Mr. Mike Lake:** But the question I have, and the concern that some would have, is that for low cost right now, at 10¢ per transaction, or if you were to be at 12¢ in the future, that would be low cost in one way. Another way of looking at it would be that if a competitor is charging 2.5% and you're charging 2.25%, that would be low cost in a completely different way. Maybe you can shed some light on which way you're talking about that.

**Mr. Mark O'Connell:** It's a great point. We feel we need to have a distinct choice for merchants, because if the price compression happens on the merchant and he says he's going to accept all three cards, our acceptance advantage will erode before long.

We feel we have the ability, having been a not-for-profit for so many years and having this strategy and this ubiquitous acceptance, to have a distinct choice for merchants and a distinct cost advantage.

**The Co-Chair (Mr. James Rajotte):** Thank you.

We'll go to Mr. McKay, please.

**Hon. John McKay (Scarborough—Guildwood, Lib.):** Thank you.

Thank you, Mr. O'Connell. Your testimony has been very clear and very helpful today. Thank you for it.

Generally, competing with yourself doesn't work, and you have built into your structure inherent conflicts. It's very difficult to see how this is actually going to be resolved. You have on your board the Bank of Montreal with an interest in MasterCard and TD with an interest in Visa, etc. I can't even imagine all the other conflicts.

So you want to move out of that conflict. You acknowledge conflict and you want to move to get a change to the consent order. What I don't understand is, as long as those conflicts exist, how can you actually ask for a change in the consent order? If the board itself, even moving to a kind of non-interest board model, still has these inherent conflicts. Aren't you simply the financial version of a dead man walking?

**Mr. Mark O'Connell:** So clarify for me how we can proceed with the bureau with the board we have and the governance challenges.

**Hon. John McKay:** I don't understand how you're going to ask the Competition Bureau for a variation on your consent order if those conflicts still exist.

**Mr. Mark O'Connell:** Well, I can't go into the specific deliberations. The major purpose of the consent order deliberations and the change we're requesting is to ensure that the organization, going forward, is governed independently by its users and that

decision-making is defined by competitive terms, not any other factors, and so forth. That very board has sponsored that restructuring project. It has been in discussions with the bureau, and they are ready to move to that, recognizing that this is what Interac needs.

**Hon. John McKay:** Why would Bank of Montreal, for instance, want you to get a change so that you can compete with their Maestro product? That doesn't make sense to me.

• (1130)

**Mr. Mark O'Connell:** Just because the Bank of Montreal may support competition in the debit market doesn't mean they de-support Interac. I think Interac is very important, and they are demonstrating this in the costs and time that they have put into this endeavour over the past two years. You'll have to ask more details of them, but from an issuer standpoint I think it's very important to have Interac as a countervailing force with respect to their dealings going forward.

**Hon. John McKay:** I agree with you from the standpoint of competition in the marketplace, consumers, and what's in the best interests of the public. I don't quite see it from the Bank of Montreal's standpoint.

When MasterCard was here, they said, "Maestro delivers more value to consumers and merchants than Interac through enhanced security, greater network reliability, and international reach". I was surprised by that statement, because I didn't think their security was all that much greater than yours, nor their reliability that much greater than yours, nor their international reach that much greater than yours.

Could you offer your observations on those statements by one of your board members?

**Mr. Mark O'Connell:** As I said in my opening comments, I support those statements. I understand the need for MasterCard and Visa to try to convey a value proposition on why they are absolutely needed in this marketplace, and they've chosen to take the tenets that they're more secure, that Interac isn't online, and that they're international. In my opening statements I hope I was able to clarify what is true and untrue there. We are online. We are one of the most secure debit networks in the world by almost any measure, and I pointed out some of what is happening on credit card fraud, credit cards being their very systems.

I would agree with you. Interac as a service is not broken; it is a world-class infrastructure and a great national payment system. Interac as an organization, in a new marketplace and needing to compete in this multi-network environment, is the issue.

**Hon. John McKay:** Thank you for flatly rejecting that concept.

MasterCard claims its fee per debit card transaction is 0.5¢. Yours is 0.8¢. It looks like predatory pricing; it smells like predatory pricing; it might even be predatory pricing. You're pretty experienced with this market and you're running it on a break-even basis. On the face of it, it looks like they are trying to muscle your markets. Is that correct?

**The Co-Chair (Mr. James Rajotte):** Please be very brief, Mr. O'Connell.

**Mr. Mark O'Connell:** As I said, their pricing is very different from what they have anywhere in the world, either the MasterCard debit or the Maestro. Yes, I'm in a cost recovery model. I know my marketing and R and D budgets, and I know that we vacillate from 0.4¢ to 0.8¢ without any return—

**The Co-Chair (Mr. James Rajotte):** Thank you.

We'll go to Mr. Chong, please.

**The Acting Co-Chair (Hon. Michael Chong (Wellington—Halton Hills, CPC)):** Thank you, Mr. Chair.

Good morning, Mr. O'Connell.

You're here on behalf of the Interac Association and its board of 61 members, I believe it is.

**Mr. Mark O'Connell:** The board is 14. It has 61 members in total. Actually, it's a little over 60 members.

**The Acting Co-Chair (Hon. Michael Chong):** That's my understanding of the current structure of the organization. My understanding also is that there is an interim board that has been tasked with negotiating the new terms of what Interac's fee structures would look like, provided that the Competition Bureau amends the consent order. Is that correct?

**Mr. Mark O'Connell:** That is correct. The current board recognized that for the future restructuring, there is a limited mandate of an independent board. It's composed of senior merchants; an issuer; the former founder and CEO of STAR, who loves to tell us what not to do; and a number of other acquirers. Its purpose is, number one, to look at the future competitive model of all five services and what pricing structure is going to respect and entail success there. Also, because all the members of the association will become clients if the restructuring goes through, it was obviously felt that an independent board was needed to oversee those things.

• (1135)

**The Acting Co-Chair (Hon. Michael Chong):** So this interim board of seven members will form the basis of the new board of the new for-profit entity if the transition to a new organization, a new for-profit commercial entity, is allowed. So the views of this interim board, I think, are pretty important with respect to the future of the Interac system in Canada, provided that the Competition Bureau grants that amended consent order.

So my question to you is this. In your opening remarks you remarked on the fact that internal changes to Interac are not enough and that three additional things need to happen in order to ensure a competitive payment system in Canada: first, a need for greater transparency in cardholder choice; second, a need for greater transparency in merchant choice; and third, having the same basic rules for all providers. Can you tell this committee what the views of the new interim board are with respect to these issues, and more generally with respect to the future of the payment system in Canada?

**Mr. Mark O'Connell:** I would say they echo that. They would completely underscore the need. Beyond intelligent and proper pricing and an independent board that's governed independently, if it's users, they support that if merchants are not being given an overt choice or a clear understanding of Interac's value proposition versus the other two competitors, if the two competitors are subject to

different rules in bringing out new products and different levels of scrutiny, then Interac is not going to be successful. So they support those, in addition to cardholders needing to understand the brand they're using and the payment vehicle they are using on the debit card.

**The Acting Co-Chair (Hon. Michael Chong):** In terms of choice at the point of sale, when somebody's using debit would they be given a choice as to which debit system they wish to use?

**Mr. Mark O'Connell:** They would echo that if the Interac brand is confused in any way in a multi-brand situation on the card, it's to our detriment, and it doesn't adhere to our tenets of consumer choice and then merchant choice.

**The Acting Co-Chair (Hon. Michael Chong):** In other words, it's allowing the consumer to choose which of two or three debit systems they can use at the point of sale.

**Mr. Mark O'Connell:** Right, and that has to be overt. These tactics are very important. Take a look at the U.S. debit wars and the tactics that were employed around whether the brands of the two debit networks were not disadvantaged in any way, whether they were both prominently displayed in an equal fashion. You have seen the Air Canada case around Air Canada putting itself first on the screen to select, and WestJet and everything else below it. Well, you get this default behaviour happening. That can't happen with the Interac brand or it's going to be detrimental to our future success.

Those are the types of things, in addition to the rules framework and the scrutiny that we're talking about.

**The Acting Co-Chair (Hon. Michael Chong):** Thank you.

**The Co-Chair (Mr. James Rajotte):** Thank you, Mr. Chong.

We'll go to Mr. Thibeault, please.

**Mr. Glenn Thibeault:** Thank you, Mr. Chair.

I want to finalize what we were talking about earlier. So we've figured out it's about 1.6¢ per transaction, 0.8¢ from either side, which is low cost—I'm not going to disagree with you on that. At about \$4 billion worth of transactions, that's about \$400 million, and it's all cost recovery, correct? Is all of the money you're getting back cost recovery?

**Mr. Mark O'Connell:** I can't divulge. You're way off on the amounts.

**Mr. Glenn Thibeault:** No, but that's fine. The whole point is that it seems to be that you're successful in what you're doing. You're a successful organization, correct?

**Mr. Mark O'Connell:** We have been successful in a single debit provider market with no well-financed U.S. competitors, when everyone was on the same page at the same time and instituted a national debit service, yes. As we've seen around the world, we are the last remaining association in North America, and one of a handful left in the entire globe, and that's for a reason. The market evolves too fast now. There are too many competitors. The technology has changed so much. If you think about where the card is going, you already have a chip on the card. Then you think about what happens to that in a mobile world with our cell phones. You can have multiple payment applications on your cell phone.

We need to react faster than ever before, and we're in a very different marketplace. That's why we need to change.

• (1140)

**Mr. Glenn Thibeault:** With that success, though, why do you think Visa and MasterCard and the financial institutions that were issuing these cards have—in your opinion, of course—decided to promote their debit products in Canada now, and at the same time? Can you give me your opinion on that?

**Mr. Mark O'Connell:** Okay.

Visa and MasterCard, although MasterCard a while ago, five years ago.... Visa is newly public. It has shed its association status. It is aggressively penetrating many markets around the world. With 3.6 billion transactions, it's an attractive piece of business. When you layer on other things like chip technology, with Canada moving to chip, it required a wholesale infrastructure change out to the terminals and it enabled somewhat the ability for multiple applications to more easily sit on the same card. The terminals were being updated anyway, so they could come in. And as you've heard from testimony, they sent the acquirers to make sure those terminals are all set up to accept their transactions.

So it was the confluence of factors that really is a perfect storm with respect to.... They have tried to get into this market before, but both in their own internal capability and in addition to some of the market imperatives, they're here. They are active. There are cards in market, there are transactions in market, and they're actively trying to take my customers and members away from me.

**Mr. Glenn Thibeault:** If you can bear with me for a second, the picture that has been painted for me over the last little while is that we have a debit system that the consumers perceive as working well. I know you've mentioned there are some things that you need to change, and I respect that, but consumers see a system that's working well.

**Mr. Mark O'Connell:** I would agree. I would agree that the system itself works well.

**Mr. Glenn Thibeault:** I totally love debit. I rarely carry cash in my own pocket, but it's a system that people rely on right now. We then hear about Visa and MasterCard wanting to come in, and they're using the word “competition”. We all know the word “competition” usually lowers costs, but what we're hearing more and more now is that this competition is actually going to increase the costs for SMEs—small and medium-sized enterprises—and consumers, potentially because merchants will have to raise their costs if the fees go up.

I've heard you speak about the need to make this a level playing field. I agree. How do we make it a level playing field for you? Maybe you can give me some of the specifics. In your opinion, will this benefit the small and medium-sized enterprises, and ultimately the consumers, down the road?

**Mr. Mark O'Connell:** Interac's viability will benefit the small and medium-sized businesses. I can't comment on their strategies or any fee trajectory that they have demonstrated in other markets, but I can say—and we're willing to stand up and be accountable—that I'm not going to adopt that fee strategy.

**The Acting Co-Chair (Hon. Michael Chong):** Thank you very much, Mr. O'Connell, and thank you, Mr. Thibeault.

Mr. Garneau.

• (1145)

**Mr. Marc Garneau (Westmount—Ville-Marie, Lib.):** Thank you, Mr. Chair, and thank you, Mr. O'Connell.

I want to focus on the level playing field as well. You mentioned that it's in all our interests to have a level playing field. You talk about transparency for all users. In fact, I believe you said you would be prepared to enshrine in your operating rules that you would open your books. What I would be interested in knowing is, do the banks, which are part of your membership, if you like, support that as well?

**Mr. Mark O'Connell:** You'd have to specifically talk to each of the banks. It depends on which aspect. Are you specifically asking about cardholder choice or merchant choice, because there are differing views as to what constitutes cardholder choice, as we've heard. You heard from the Bank of Montreal, which believes there's cardholder choice in the customer choosing which financial institution and which debit card they're going to use. They have the choice. If they don't like the brands that are part of that debit card strategy, they can choose away from that institution. Others would have differing views, but I cannot comment on their specific views.

**Mr. Marc Garneau:** Okay, I was simply interested in knowing overall if they support what you have said on page 8.

Talking about retailers, I can understand their wanting to understand and have a level playing field, so they have a better appreciation of how it's going to impact them, depending on which system they choose to go with.

From a consumer point of view, I have a little more difficulty. I can understand what you're suggesting, but I've never met a consumer who was particularly preoccupied with knowing what payment system.... In fact, most of them are totally ignorant; they know they can do certain things with their card, but they don't really build into their thinking that there are different ways to pay and that they can make an informed choice. Whether it's presented to them or not, they tend to be incentivized by things such as reward programs and others.

So are you hoping the consumer is going to somehow make a decision about which system is better, for whatever reason, other than possibly their own personal gain?

**Mr. Mark O'Connell:** There are certainly segments of the consumer base who have no understanding of networks and what they mean—this Visa card versus that Visa card, or Interac. But there are different terms and service features ascribed to these products. In debit we're not cognizant, because our history has been that debit is just debit. It's your bank card. We have a lot of information that people have an affinity for Interac, understand that it's Canadian, and understand that it's safe and secure. You can imagine the marketing blitz they're going to be doing to get Canadians' heads around the idea that they're not just credit—they're debit or super debit. You're going to start to get these distinctions in the marketplace. Consumers are going to be bombarded and there are going to be different terms of service within the payment vehicle. It's important that they understand what they're choosing. It may not be Interac on the back and it may look like a Visa card on the front. These are important things that will allow us to compete and succeed.



**Mr. Marc Garneau:** As I understand it, you also want to change from a not-for-profit to a for-profit independent commercial entity. The arguments are related in part to modernizing your governance, and I think I understand what you're talking about. The other has to do with generating additional capital for investment in your business. Do you not have that latitude already through your option to increase the switch fee?

**Mr. Mark O'Connell:** We don't have it in any efficient fashion, given the governance challenge, the consent order prescriptive rules around everything from voting levels and areas in which we.... The switch fee is one of the only ways to raise fees. It's really about putting in place an independent board that can make decisions based on competitive realities and have the retained earnings to invest in the business on a timely basis. This cannot be done today. To agree to a uniform switch fee, you have to have everyone on the same page at the same time in the same budget cycle. This has many elements to it, and consensus building is Herculean. It didn't used to matter when Visa and MasterCard were associations and also took four board meetings to go through a single decision item, but now on a relative basis we are the only ones remaining under this structure, so we are at a severe competitive disadvantage.

• (1150)

**The Co-Chair (Mr. James Rajotte):** Monsieur Carrier.

[Translation]

**Mr. Robert Carrier (Alfred-Pellan, BQ):** Thank you, Mr. Chair.

Good morning, Mr. O'Connell. I commend you on your presentation and for agreeing to be in the hot seat for two hours. I wish to talk to you about problems concerning credit cards. Retailers greatly deplore the fact that credit card issuers are billing higher interchange fees for the use of premium or rewards cards, specifically. That is one of the issues we are currently studying.

You are seeking to enter into greater competition with credit card companies, which are also seeking to issue debit cards; however, have you considered that in order to attract new clients, those very same companies could begin offering debit cards in return for rewards or bonuses, similar to their credit cards? To be truly competitive, will you not be forced to go the same route? I would like to know how you would prepare for such a possibility.

[English]

**Mr. Mark O'Connell:** Not from the network level, no. Those points programs and so forth are the purview of the issuing bank and how it deals with its customer base.

You are correct that in other jurisdictions around the world, the United States being a prime example, when you look at Visa or MasterCard debit, there are indeed points and rewards and different features and so forth put around those cards. That's one of the elements of competition. I cannot comment on whether that would be the case in Canada or what the future holds, but you're correct that there's certainly a precedent for that.

[Translation]

**Mr. Robert Carrier:** If I understand correctly, you are saying that as concerns your current debit card, costs are low for retailers and consumers. If there were to be no change to the system, would debit-

card issuing banks be able to bill higher interchange fees in return for bonuses or rewards? Is this allowed under the legislation?

[English]

**Mr. Mark O'Connell:** In the debit market and under our current association model governed by the consent order, yes, the consent order does allow the interchange fee to be set by the Interac Association board, if there's a majority vote to do so. It's currently set at zero and has always been kept at zero for the past thirteen years.

[Translation]

**Mr. Robert Carrier:** Thank you.

However, by converting your organization to a profit-making enterprise, you would be competing with companies such as Visa and MasterCard, who in turn may choose to issue debit cards as a way of increasing their market share, keeping their client base, or stealing from yours. You are saying that this is possible, but that it is not the case now because you are the only player on the market. As far as I am concerned, I do not believe that you will be spared. You may not be able to boast any longer about being a low-cost provider. You would become a company just like the others, and seek to make as much profit as possible.

• (1155)

[English]

**The Co-Chair (Mr. James Rajotte):** Make it a brief response, Mr. O'Connell, please.

**Mr. Mark O'Connell:** On a switch fee basis, I am confident that we will continue on a low-cost basis and will respect the roots of Interac, and we'll be opening up the books.

When you talk about interchange, remember that it's not a revenue for the network. You are right that it's a mechanism that my competing networks will be utilizing to try to take away my issuers on the bank side. That's the competitive reality I face: a multi-network environment that is occurring.

When you look at this movement to provide an incentive to move and at the fact that the issuers' costs are also rising—fraud, for example.... I mentioned we had a great success in 2008 at \$104 million. Well, I can tell you now that due to organized crime, they have gone back to their usual trajectory. The issuers share in the burden of all fraud costs, which are well north of \$100 million, and they have customers who are increasingly demanding in respect of the new payment vehicles and the features they want. So the issuers have these costs. They believe they're not readily able to recoup these costs, and so there is a point at which the incentives being offered by my competitors are going to amount to an offer the issuers can't refuse.

So in our strategy, we need to look at, in terms of the issuing value proposition, what I call a keep-from-going rate, if you will. But given the base of our acceptance, you have to realize that the keep-from-going rate can be significantly and distinctly lower than what Visa and MasterCard have to offer as they penetrate this market. And I believe that if we stay true to our roots with the merchant value proposition we have, the merchants will be the architects of their own cost future and will continue to accept Interac on a preponderance basis, which will allow our rates to be significantly lower than those of our competitors but still give the issuers a value proposition they need and deserve.

**The Co-Chair (Mr. James Rajotte):** Thank you.

We'll finish with Mr. Lake, although I understand you may be sharing your time, Mr. Lake.

**Mr. Mike Lake:** Mr. Chair, I'm just going to, right off the start, let Mr. McTeague ask a quick question he wanted to follow up on.

**Hon. Dan McTeague:** Thank you, Mr. Lake, for that cooperative spirit.

It's very simple. Do you anticipate a demand from issuers for an interchange fee? We know it's zero right now. Do you see this happening as part of these changes down the road?

Thank you, Mr. Lake.

**Mr. Mark O'Connell:** I think the competitive dynamics that I just described mean that I'm going to need an issuer value proposition in a multi-network environment, and I'm going to have to make sure I have my merchant value proposition. I think it is a reality that we're going to be able to look at charging this keep-from-going rate. But leveraging our acceptance from coast to coast, when you play that across 3.6 billion transactions, you have a very fair return at a lower rate than what my competitors can provide.

**Mr. Mike Lake:** Okay.

Now, just following up on the line of questioning that's come up a few times regarding this MasterCard switch fee of 0.5¢ per transaction, I'm interested in hearing a little bit more about what Visa and MasterCard have done in the U.S. Maybe that would provide us with a little bit more context for what we might see here, as we move forward, because it does seem like that 0.5¢ per transaction might be kind of an artificial number, a temporary number right now.

What are they doing in the U.S. with Visa and MasterCard debit?

**Mr. Mark O'Connell:** Are you asking where is the current switch fee or interchange rate in the U.S.?

**Mr. Mike Lake:** Switch fees, interchange rates, whatever the case may be—the overall package, from a debit standpoint. What are we seeing in the U.S.?

**Mr. Mark O'Connell:** I believe that interchange rates—now, I'll predicate this that this is my latest belief, I don't know if it's completely up to date—are very similar. The compression is unbelievable on the interchange between STAR, MasterCard debit, and Visa, and you're up north of a quarter a transaction, I believe, for interchange.

With respect to switch fees, there are so many fees and assessments in their business models, I can't comment on or discern them.

And remember, my counterpart at MasterCard was talking about the distinction that in the U.S. it's really MasterCard debit, and that means signature debit. For PIN debit or Maestro, you have to look to the U.K. to draw some parallels as to their pricing. I believe the interchange there is north of 10 basis points or so forth. We'd have to look at the specific fees.

But I think the point is that the pricing in these other markets is, to say the least, markedly different from the current switch fee only, with interchange set at zero basis points.

● (1200)

**The Co-Chair (Mr. James Rajotte):** You have forty seconds, Mr. Lake.

**Mr. Mike Lake:** Actually, I had some other questions, but they'll take longer than 40 seconds, so I'll leave it at this.

I just want to commend you, if I could, for being the only witness up here. When there are four, you have some time to catch your breath. But it's not easy when you're the only one and you're answering all the questions. I commend you for taking the time with us today.

**The Co-Chair (Mr. James Rajotte):** Thank you, Mr. O'Connell. Thank you for being with us here today, for responding to our questions.

Thank you, members.

The meeting is adjourned.







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