A ghost in the machine?

The consumer perspective on the draft code of conduct for the credit and debit card industry

January 2010

Summary

The Minister of Finance has presented a *Draft Code of Conduct for the Credit and Debit Card Industry in Canada*. The Draft seeks mainly to address issues concerning merchant fees and purports to provide merchants with tools that could redress market practices.

Unfortunately, implementation of some of the Draft's provisions would significantly increase consumer search and transaction costs and clash with consumer rights as legislatively implemented, without providing consumers any compensatory benefit. It would also be unlikely to provide effective remedies to the problems encountered by merchants, which are real.

Interchange fees are most likely too high and increasing competition in the payments market will probably push them upwards. Mandatory payment routing by retailers and discounting raise significant consumer protection issues. Uncoupling of debit and credit acceptance is unlikely to be effective. Measures aimed at premium cards and co-badging are weak. We support, however, measures aimed at increasing market transparency.

Issues raised by the Draft have been abundantly discussed abroad. The most effective measures aimed at interchange fees have taken the form of regulatory caps. Other measures, such as discounting or dishonouring cards, have not been very effective, and have usually not even been contemplated by other authorities.

Issues concerning the Canadian payments market must not be considered in isolation. Regulating merchant fees raises consumer protection issues, which in turn touch upon network structure. It is therefore urgent that the federal government establish a process to bring stakeholders together and to elaborate a coherent regulatory framework for payments in Canada.

Table of contents

A ghost in the machine?

The consumer perspective on the draft code of conduct for the credit and debit card industry

I- The layout

A- The machine

Gold, paper, silicon.

Gold pieces once served as currency. Paper replaced metal in Europe from the seventeenth century. Electrons are now pushing paper into oblivion. One thing, however, had remained fairly constant: the State had usually been careful to regulate its currency. As we move to electronic payments, Canada finds itself compelled to review its regulatory framework for money and currency. Success, or lack thereof, in doing so will have a significant impact on our economy.

The Canadian payments market is an immense, complex machine, which is getting more than its fair share of jolts these days. Contactless card transactions, Visa debit, RBC MasterCard premium credit cards, Interac online, PayPal... Those are just some of the most obvious changes coming to our payments universe. For the financial sector, the stakes are huge and the strategies, opaque. But change is afoot, that much is clear.

Merchants already are getting a good whiff, and they are concerned. Quite concerned: it may be that change will cost them a lot. And so they dig their trenches and aim their cannons. They also try to rally their friends, among whom they hope to count a minister or two.

The machine, merchants claim, may certainly be changed (and hopefully improved), but not at their expense. Instead, they should get a bigger say in the machine's workings. Apparently, the government acquiesces, as it has delivered a new set of rules for parts of this daunting machine: a *draft Code of conduct for the credit and debit card industry in Canada*[1] , which would rearrange relationships between the financial sector and merchants. All would be well.

B- The ghost

All would be well.

Except for the ghost. That pesky ghost, the consumer, in the name of whom all change is celebrated, more often than not *in absentia*.

The ghost has experienced more than his share of problems with the new workings of the machine over the last two decades or so. He has had his cards cloned, his identity stolen, his pre-authorized debits changed without notice, and much more besides. Like J.K. Rowling's Nearly Headless Nick, however, he apparently can't inspire much sympathy, despite his plight.

Not only are the concerns he has expressed for a decade shelved, but he sees his government stand to protect merchants. That would be a lesser evil, to which he is used. The greater evil is that what the government proposes ignores rather grandly both the ghost's concerns and interests.

To put it rather more bluntly, the Draft would alter the market in ways that would significantly increase consumer search and transaction costs. It would likely result in significant price increases to consumers. It would collide with legal precepts that consumers hold dear. It would not deliver any significant benefit to consumers in order to compensate for the harm done. In addition, the Draft would probably not be successful in effectively protecting merchants against their foes.

The ghost therefore begs leave to haunt this discussion and to present dispassionate arguments in order to show that sections 4 to 9 of the Draft should be modified, in some cases drastically, that a number of concerns that have apparently been omitted must be

---

[1] The proposal (hereinafter the "Draft") was presented by the Minister of Finance of Canada on November 19, 2009 and can be found at www.fin.gc.ca/n08data/09-109_1-eng.asp.

taken into consideration and that all stakeholders should be actively involved in creating the new and necessary Canadian framework for electronic payments.

C- Our comments

1- The Public Interest Advocacy Centre

The Public Interest Advocacy Centre ("PIAC") is a non-profit organization based in Ottawa that provides legal and research services on behalf of consumer interests and, in particular, vulnerable consumers' interests, concerning the provision of important public services. PIAC has been interested in payment and other financial services issues for many years. It has been involved in recent years in the review of the *Canadian Code of Practice for Consumer Debit Card Services* and has participated in various consultations held by the Canadian Payments Association.

2- The contents

Our comments are centered on an absence: we believe the Draft is flawed in large part because it does not take into account the impact of the changes it proposes on Canadian consumers. We will therefore offer a critique of its provisions, based in large part on available scientific literature, and suggest a way forward.

The fact that we have not commented at this point on any issue concerning the evolution of the Canadian payment card market should not be construed as meaning either agreement or disagreement with any position on such issue. Rather, we see the discussion concerning the Draft as a starting point for a much broader process, without which we do not believe regulators and stakeholders can come to solutions that would benefit all Canadians.

Part II of our comments will address the Draft's provisions, with an emphasis on measures that are most directly aimed at the control of merchant fees, followed by a short appraisal of provisions centered on transparency. All in all, we conclude that sections 1 to 3 of the Draft can be implemented without any difficulty; that sections 5, 6 and 8 should be essentially discarded; and that sections 4, 7 and 9 can be implemented with some changes.

Part III will address other issues and alternatives. It will provide a short summary of developments in other jurisdictions, and then contemplate what should be, in our view, the next steps.

II- Assessing the Draft

A- The debate in a nutshell

The Draft raises numerous and complex issues, many of which have already been bitterly debated elsewhere in the world. The Draft is therefore but a chapter in a worldwide tug-of-war between merchants on the one side[2], and payment networks on the other, with consumers usually relegated to the sidelines.

For merchants, networks and the financial institutions that issue payment cards, billions are at stake: they deploy huge resources to make their point. In essence, merchants claim that they pay too much for what they get; networks and issuers retort that they provide them with a bundle of useful services for which they should pay their proper share. Academics argue relentlessly on both sides – and quite often *for* one side or another, as expert witnesses or, less obviously, as they happen to have access to data sets provided, or to have research funded, by one side or the other[3].

Consumers have their own interests in this discussion, but their representatives find themselves in a complex situation. Few experts have looked at the issues from their standpoint. They must distinguish between some consumers' short-term interest in rewards programs and the broader, longer-term interest of all consumers in getting better prices, to provide only one example of the dilemmas they face. Worst of all, sometimes consumer interests will appear to align with those of merchants, and at other moments with those of networks or issuers: they are therefore constantly at risk of looking as if they have been "captured" by one side or the other – or by both. In fact, their perspective

---

2 Rochet, Jean-Claude. *Competing payment systems*: *key insights from the academic litterature*. Paper presented at the 2007 Reserve Bank of Australia Payment Systems Review Conference. 13 p. P. 14. Hereinafter "Rochet, *Competing*". Available at www.rba.gov.au/payments-system/resources/publications/payments-au/paymts-sys-rev-conf/2007/3-com-pay-sys.pdf, p. 14.

3 From a methodological standpoint, it is therefore difficult to sort the wheat from the chaff and retain reasonably impartial research on which to base an analysis. When sources are quoted *infra*, we will therefore identify where possible affiliations or other factors which may impact a researcher's (or other author's) appearance of impartiality.

is different, and hopefully closer to the vaunted "public interest" and public welfare, which should actually hold something for all parties. In the short term, we therefore do expect to end up displeasing them all herein– not by choice, but out of necessity.

In this context, the Draft has the merit of provoking a debate, even though it does without ever confronting directly the matter of merchant fees. Instead, its provisions address tangentially most of the remedies proposed around the world to limit fees – except the most powerful one: deliberate regulation of those fees or of their most contentious component, i.e. interchange fees.

We are of the view that while some of the Draft's provisions are well-directed, others do not serve consumers', or indeed, the public, interest, and may well backfire. The Draft's impact is also lessened by the fact that it was designed in isolation, both in the sense of not having received all stakeholders' input before being released and in the sense of being aimed at a small part of a much broader set of issues which beset the Canadian payments industry. Issues raised in the Draft cannot be meaningfully considered outside of a reflection which also includes topics such as consumer liability, consumer freedom to choose payment means, the design of clearing systems or the usefulness for all stakeholders to have something resembling a level playing field in the payments universe.

As currently drafted, we believe that the Code would not serve merchants' long-term interests as much as they may expect it to, that it would significantly injure legitimate consumer interests and that it may well hinder the development of a more efficient payment system in Canada. We will suggest therefore that while some of its provisions may be implemented in the short term, others should be opened for a broader debate involving all stakeholders, consumers included.

B- The real issue: merchant and interchange fees

1- the landscape

a) two-sided markets

One of the most contentious issues lurking behind the Draft is that of merchant fees. Merchants who participate in payment networks by accepting cards (or other

instruments[4]) must pay a fee to their acquirer. In turn, it is well-known that the largest part of that fee depends on many cases on the "interchange fee" charged by the financial institution which has issued a card to the acquirer. Interchange fees are currently required by the Visa and MasterCard networks on credit card payments and are in large part based on a percentage of the transaction's value. Interac does not require interchange fees.

Networks and issuers justify interchange fees as necessary because they help to balance the market and to fund issuing initiatives, which benefit all stakeholders. Merchants increasingly believe that they are being gouged in a context where they cannot avoid, or even negotiate, fees set by networks and which mostly benefit issuing financial institutions. In all likelihood, both sides are partly right.

Most stakeholders and experts conclude, or at least concede, that payment card markets are "two-sided" markets[5]: a credit card can only be successful if there are consumers willing to use the card and merchants willing to accept it. The two sides of the market face different constraints. Once a card is reasonably established in a market, many merchants will have no choice but to accept it, since some of their customers will want to use it to make a payment. Many Canadian merchants therefore accept Interac, Visa and MasterCard cards and could not easily let go of any without losing some sales. In economic terms, their demand for network services is quite inelastic[6]. Prices imposed on merchants that wish to participate in any network can therefore be high.

Consumers, on the other hand, may well choose to hold in their wallet cash only, or cards issued through one or many networks, knowing that most merchants will accept any

---

4 To simplify and unless otherwise noted, we will use the notion of "cards" as a generic term to designate debit and credit cards and other payment instruments, such as tokens or, eventually, mobile phones.

5 Rochet, *Competing*, p. 14. For an overview, see *inter alia* McAndrews, James; Wang, Zhu. *The Economics of Two-Sided Payment Card Markets: Pricing, Adoption and Usage*. Paper presented in November 2008 at the Bank of Canada Payments Economics Theory and Policy Workshop. 34 p. The paper is available at www.bankofcanada.ca/en/conference_papers/payment_economics_workshop/pdf/wang.pdf. The authors are respectively affiliated with the Federal Reserve Banks of New York and Kansas City. See also Klein, Benjamin; Lerner, Andres; Murphy, Kevin; Plache, Lacey. *Competition in two-sided markets: the antitrust economics of payment card interchange fees*. [2005-2006] 73 Antitrust L.J. 571; the authors have served as Visa consultants.

6 Frankel, Alan. *Towards a competitive card payments marketplace*. Paper presented at the 2007 Reserve Bank of Australia Payment Systems Review Conference. 42 p. P. 29. Available at www.rba.gov.au/payments-system/resources/publications/payments-au/paymts-sys-rev-conf/2007/5-compet-card-payment.pdf. Mr. Frankel has done research *inter alia* for the Australian Merchant Payments Forum.

card they may proffer. Their demand for a card emitted by a given network is therefore much more elastic: prices must be comparatively low for a consumer to pick up a new card – or rewards must be high, which amounts to the same thing insofar as a reward acts as negative price.

Yet both sides, merchants and consumers, benefit (in principle) as the number of cards increases: more merchants will be tempted to accept them, which will make them a more useful payment method for all cardholders. The classic comparison is made with newspapers: advertisers are prepared to pay a higher price for advertising space as the paper gets more readers, but the publisher must keep the buyer's price low enough that thousands of copies will fly out of the newsstand, so he can set higher advertising rates.

In fact, the price the consumer pays for her daily will often remain below the publisher's marginal cost for a copy, while advertising rates will stand well above the marginal cost of the space provided. In effect, the market can only be balanced when no one pays exactly the marginal cost for the good one procures, in order to provide both enough readers willing to buy a copy and enough revenue to provide contents enticing readers to purchase, hence to be exposed to advertisers' messages. Such a price structure can nevertheless be socially efficient[7].

Networks and card issuers therefore argue that it is in the merchants' interest to pay a fee that allows issuers to enrol more cardholders[8], and that it may in fact represent the most economically efficient fee structure[9]. In addition, they claim to offer merchants a slew of useful services[10]. On more economic grounds, the argument has also been made that adequate interchange fees received by issuers ensure that other issuer activities do not cross-subsidize card activities within a bank or other issuer.

---

7 Rochet, *Competing*, p. 15.

8 For an economic treatment, see *inter alia* Rochet, *Competing*, p. 7.

9 That is, the structure that would maximize social welfare for all parties: see Hayashi, Fumiko. *The Economics of Payment Card Fee Structure*: *Policy Considerations of Payment Card Rewards*. Paper presented in November 2008 at the Bank of Canada Payments Economics Theory and Policy Workshop. 22 p. P. 3. The paper is available at www.bankofcanada.ca/en/conference_papers/payment_economics_workshop/pdf/hayashi.pdf. Mr. Hayashi is an economist with the Federal Reserve Bank of Kansas City. The implication is that in the process, some parties may privately not be better off, even though welfare is maximized at a broader level.

10 See for instance United States Government Accountability Office. *Credit Cards. Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges*. Washington, November 2009. 64 p. P. 30. Document GAO-10-45. (Hereinafter "GAO"): networks claim for instance that they provide marketing support.

Merchants retort that interchange fees have increased significantly in recent years, without their obtaining significantly useful new services from networks and without seeing their share of payments made by consumers increasing by any commensurate measure. In the United States, for instance, it appears likely that over the last decade or so, many consumers have switched[11] from run-of-the-mill credit cards to premium, "privilege" or "reward" cards, to which are attached substantially higher interchange fees. Merchants therefore make the same sale, but must disgorge a higher merchant fee.

In all likelihood, merchants are right: interchange fees stand higher than they should, or will in the near future, and they should be curbed. Our conclusion rests on three strands of arguments.

First, the frequency and intensity of merchants' complaints in numerous countries, coupled with available data on interchange fee increases in recent years, should be taken at least as anecdotal evidence that there is something afoot[12]. That, however, cannot be conclusive, nor can regulatory of judicial decisions made in other jurisdictions that fees were excessive in their specific context.

In addition and from an economic standpoint, it is extremely difficult to set a price such as an interchange fee at precisely the right level to make it welfare-enhancing. Stakeholders which set such a price will therefore often err in the direction that enhances their private welfare, especially when they are in output-maximizing situations, in oligopolistic positions[13], or both. It is therefore very likely that interchange fees are currently set at anything but the most welfare-enhancing level and that they happen to be higher.

---

11 or been switched: there is evidence that issuers sometimes switch their clients from a card to another without consumer request or consent, and that networks have relaxed their rules so that the bundle of rights and liabilities associated with the credit agreement can be altered without the physical card being replaced: in other words, a consumer may for instance hold what physically looks as a plain vanilla credit card, but in fact be entitled to the reward programs attached to a premium card. It is therefore impossible for the merchant, simply by looking at the card, to ascertain whether it is in fact an ordinary or a premium card. See GAO, *op. cit.*, pp. 26, 47.

12 See for instance McAndrews *et al.*, *op. cit.*, p. 1. See also GAO, pp. 13-21. We have not ascertained whether GAO's finding regarding fee trends in the United States apply to the Canadian market.

13 Hayashi, *op. cit.*, p. 5. Issuers in a market which is not perfectly competitive will tend to charge more than marginal cost: Rochet, *Competing*, p. 6, 9. Even as they compete, oligopolistic networks will tend to set similar fees: see also Frankel, *op. cit.*, p. 36.

Thirdly, it may be helpful at this point to look at the root causes of the relatively recent increases in interchange fees: they appear to result from a peculiar side effect of competition in two-sided markets and, as such, are likely to worsen in the short term.

b) oddly competitive markets

It is reasonably clear that the card issuance market is competitive in a country like Canada: all large financial institutions issue cards and seek to increase their market share. In fact, it is arguable that this market is currently more in an output-maximizing mode than in a profit-maximizing one[14]. From the networks' standpoint, having more cards in circulation (or at least maintaining market share, in Interac's case) is likely to be an overarching strategic priority in the next few years. In order to achieve that result, networks depend on issuers' decisions.

Issuers compete for card market share in many ways, including the promise of rewards and other benefits: they must convince consumers that their card is better and more advantageous than any other. Those benefits, however, must be funded somehow: interchange fees finance a large part of reward programs[15]. The corollary is that issuers seeking to increase market share will want to offer more generous benefits, hence will seek higher interchange fees. Networks, which want to attract more issuers and retain those they already have, are glad to oblige by setting high fees.

Therefore, the competition between issuers vying to attract more cardholders "naturally" results in higher merchant and interchange fees[16], and therefore higher prices imposed on merchants. As most merchants for whom accepting credit cards makes sense already do so, the acquiring market is fairly saturated by acceptors who cannot opt out, while the issuing market remains highly competitive: "naturally", fees are set in a way that bolsters consumer loyalty, since consumers are more fickle[17].

---

14 Hayashi, *op. cit.*, p. 5. Even profit-maximizing networks may seek to maximize volume: Guthrie, Graeme; Wright, Julian. *Competing payment schemes*. (2007) LV Journal of Industrial Economics 37, 41.

15 There are indications that in the United States, 45% of the amounts collected by issuers through interchange fees serve to fund reward programs: Levitin, Adam. *Priceless? The social costs of credit card merchant restraints*. [2008] 45 Harv. J. on Legis. 1, 7.

16 Hayashi, *op. cit.*, p. 8; Frankel, *op. cit.*, pp. 33, 35; McAndrews *et al.*, *op. cit.*, pp. 6,14, 19, 22. Klein *et al.* go as far as asserting that merging Visa and MasterCard would "lead to lower, not higher, interchange fees": *op. cit.*, 598; see also pp. 601-609.

17 Klein *et al.*, *op. cit.*, 575. From a structural standpoint, higher interchange fees are more beneficial to issuing financial institutions than to acquiring institutions; it is therefore not

This well-studied process should be of great concern to Canadian policymakers, as competition will most likely increase in the card issuance market. Interchange fees are therefore almost certain to increase.

Competition will rise on two fronts. First, it is trite to say that the Visa and MasterCard networks are bent on entering the Canadian debit card market. Bank of Montreal has already issued a co-badged debit card which can access both the Interac and the MasterCard networks, and other issuers are expected to do the same in coming months.

Two, and perhaps even more ominously, the Competition Bureau has ruled that Canadian financial institutions may now participate in both the Visa and the MasterCard networks[18]. Royal Bank, traditionally a Visa issuer, is already advertising two "WestJet RBC MasterCard" cards as "coming soon"[19]. Other issuers may well follow.

Credit card networks, which had long-standing arrangements with specific financial institutions, may now look at other issuers and try to convince them to issue their cards: poaching season is officially open. And the best way to convince an issuer to switch sides, or at least to issue both MasterCard and Visa in the future, will be to offer higher interchange fees. Otherwise, why would, say, CIBC, a long-time Visa issuer, decide to switch sides, or at least to allocate resources to open a new market front? Merchants are quite right to be very concerned[20].

---

irrelevant to point out that most large Canadian financial institutions still act as issuers, but not as acquirers. See Klein *et al*, *op. cit.*, 591.

18 The Competition Bureau announced on November 7, 2008 that it would no longer object to dual participation in Visa and MasterCard, on the basis *inter alia* that the Canadian arms of Visa and MasterCard are now publicly traded. With due respect to the Bureau, with Visa Canada Corporation having Visa Inc. as its majority shareholder through White Pike Financial Services International B.V. and MasterCard Canada, Inc. still listed as a subsidiary of MasterCard Inc., we are skeptical that broader shareholder participation will ensure the Canadian branches of those networks are truly independent agents. In addition, influence over an entity's "competitive decisions" can assume many shapes beside being a shareholder, many of which may be even more effective. Be that as it may, the Bureau's letter is available at www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02749.html.

19 Incidentally, they would most likely qualify as premium cards, as bonuses, point programs and "enhanced travel insurance" are associated to either or both.

20 Of course, this is not the first time that, by apparently misunderstanding the dynamics of two-sided markets and network effects, the Competition Bureau's intervention in the payments world will actually result in price increases that do not serve consumers in the least: the Interac Consent order had a very similar impact. See St Amant, Jacques. *L'erreur de Pandore – la concurrence et l'évolution du réseau Interac au Canada*. Montréal, Option consommateurs, 2003. 203 p.

Visa and MasterCard are also likely to chase after debit card market share. Again, how will they convince issuers to route debit transactions through their network, instead of through Interac protocols and Canadian Payments Association's (hereinafter also the "CPA") clearing systems? Interchange fees are one obvious answer. How will Interac defend itself? How will it retain issuers? We can only, devoutly, hope that it will not finally come to the conclusion that it too needs to implement interchange fees and that, somehow, it will be able to survive as the low-cost provider for debit card services in Canada, even though that may spell lower profitability for faithful issuers. The evolution of Interac's business model will need to be followed closely in coming years[21].

Scorpions can't help but sting available prey; networks can't help hungering after market share when given the leeway to do so. In a sense, they are therefore not the real villains of the piece. Policies which further oligopolistic competition in markets where it is almost sure to raise prices may be more questionable, but it is probably too late to put that particular genie back in its bottle. This distinction does raise issues in terms of appropriate remedies however, to which we will return *infra*.

In the meantime, it is quite likely that there will be significant pressure in the Canadian payments market for an increase in interchange fees – or, for that matter, in any type of fee which will transfer money from merchants to issuers, in order for networks to attract and retain the latter. The real issue, therefore, is whether, and if so how, merchant fees should be controlled.

There are at least three possible avenues to consider. First, there may be no specific action taken, leaving market forces as they now exist to "naturally" set proper prices. Merchants, in particular, oppose that they are unable to resist network and issuer pressure in the current market.

The State might therefore simply opt to step in and cap or set merchant fees, as authorities in Australia and the European Union have done; there is currently no obvious sign of any appetite for such intervention in the National Capital.

---

21 That is especially true as it intends to turn itself into a for-profit network. There is no doubt that such a change will increase its revenue requirements, as it will need to provide a return on investors' capital: networks which are for-profit set fees which are higher than non-profit, as noted by Rochet, *Competing*, p. 10. We sadly acknowledge, however, that Interac may not be viable in the near future without such a restructuring.

Thirdly, some action might be taken that would purport to alter the market in a way that would make it more advantageous to merchants and enable them to put pressure on networks[22]. Astutely, that appears to be the solution privileged by merchant groups in Canada over the last year, and it has apparently been espoused by the Minister of Finance. We will argue, however, among other objections, that the issues raised through the Draft's provisions are too important to be addressed in isolation and by purely private intervention.

As we noted above, nowhere does the Draft expressly address the merchant and interchange fee issues. They lurk, however, in plain sight behind sections 4 to 6 and 9 of the Draft (and less obviously behind sections 7 and 8), to which we shall now turn.

2- <u>self-regulating premium cards</u>

Section 9 purports to limit the issuance of premium cards. While there may be consumer protection aspects to this proposal, it represents undoubtedly an attempt at limiting the number of premium cards in circulation, as they usually attract higher interchange fees paid by merchants. It has been strenuously argued that merchants receive no specific advantage from the fact that a purchase is made using a premium card, rather than an "ordinary" card[23].

Premium cards are claimed to provide numerous advantages to many consumers, in the form of rebates, rewards (such as redeemable "points") or warranty on purchased goods, for instance. Consumers who may benefit from such advantages would be reluctant to see their accessibility reduced if premium card issuance criteria were tightened. While we have not been able to determine the share of the Canadian market now taken by premium cards, comparison with other jurisdictions indicates that more than half of Canadian consumers might currently hold, or eventually obtain, a premium card: in the United States at least, two-thirds of consumers apparently hold premium cards[24]. This is therefore not a minor part of the market and decisions affecting premium card issuance may impact a large number of consumers.

---

22 The challenge here, of course, is first to determine precisely which market practices cause the fee structure not to be socially optimal, and then to target precisely those targets in precisely the right manner: see Hayashi, *op. cit.*, p. 2.

23 Levitin, *op. cit.*, p. 16.

24 Levitin, *op. cit.*, p. 12. Those cards were apparently used to make 80% of credit card transactions in the United States in 2005: *ibid.*, p. 13. While different, numbers obtained by GAO are in the same broad range: GAO, *op. cit.*, p. 26. The quantity of premium cards used

From a consumer standpoint, however, assessing premium cards is not a clear cut issue. First, it is quite likely that many (and perhaps most) cardholders do not effectively benefit from reward programs: they eschew claiming their points, or find that rewards have expired due to some fine print in their cardholder agreement, for instance. There is therefore a gap, and very likely a wide one, between the rewards as they are presented in card network advertising and the rewards that are effectively enjoyed by consumers. Consumers therefore pay, in one way or another, for advantages that, in fact, they never get.

It is also arguable that reward programs implicitly encourage overuse of credit cards and therefore contribute to consumer overindebtedness, an issue to which consumer organizations are highly sensitive. We are not credit card fans by any measure. But while consumer associations are quite wary of credit and overindebtedness, credit card accessibility cannot be entirely demonized. A proportion of consumers are able to use credit cards as payment tools without incurring excessive costs and overindebtedness[25]. Consumer organizations acknowledge that premium cards, when used carefully, may actually be profitable for consumers. We must also underline that credit cards are sometimes a prerequisite to some types of transactions: it is quite difficult to rent a car, reserve a hotel room or shop on the Internet without a credit card[26]. While other payment methods can occasionally be used in such cases, and while we hope that substitutes will become increasingly available, the fact remains that credit card accessibility is an important issue in our economy, for better and for worse.

A broader attack has also been made on premium cards and reward programs: as interchange fees are passed to all consumers through merchant retail prices, consumers who do not use premium cards (or who do not use cards at all) might be cross-subsidizing premium cardholders. In effect, because she disburses a little more for a loaf of bread, the unemployed single mother of four might be paying for the millionaire's ski vacations in Gstaad, Switzerland, which she purchased through the redemption of "platinum-diamond" premium card points[27]. Interchange fees and rewards would therefore act as a highly

---

in the United States appears to have climbed steeply in recent years, a situation which US merchants indicate is a major issue with regard to interchange fees: GAO, pp. 31-32.

25 And insofar as they do get overindebted, issuer policies such as unduly high credit granted to numerous consumers is certainly a matter that should be closely studied.

26 See *inter alia* Uribe, Esteban. *Credit cards and access to the digital marketplace*: *a priceless necessity?* Ottawa, Public Interest Advocacy Centre, September 2009. 92 p.

27 On this issue, see *inter alia* Berkovich, Efraim. *Cross-subsidization of consumers in the payment card market*. November 18 2009. 26 p. Available at

regressive tax on poorer consumers. The validity of the cross-subsidization argument is, however, hotly contested on theoretical grounds[28].

It has also been argued that, should premium cards be eliminated or stringently curtailed, issuers would simply raise interchange fees on plain vanilla cards to account for the difference so that, in the end, merchants would pay similar total amounts[29].

We are therefore mindful that at least some cross-subsidization may occur, which would make premium cards harmful to a significant number of consumers[30], and that premium cards may feed overindebtedness. Those are powerful reasons to be wary of premium cards. On the other hand, they do internalize advantages such as product insurance and cash-back guarantees (even where not mandated by legislation), which should arguably be offered by other providers (and primarily merchants) or legislatively mandated, but often are not. Measures to restrict access to premium cards should therefore be considered carefully. In effect, in some cases, premium cards may be offering benefits which should be legislatively required to be offered by all cards. One way to reduce consumers' appetite for premium cards would be, quite simply, to improve legislative consumer protection remedies[31].

We also note that section 9 of the Draft currently requires that issuers should restrict such access to consumers meeting "specific spending and income thresholds", without determining such thresholds or criteria to establish what should be the "well-defined group of cardholders" who may aspire to a premium card. It is therefore likely to have

---

www.econ.upenn.edu/~efraim/cross_subsidization.pdf. Perhaps the most articulate argument against reward programs (and other restraints) on the basis *inter alia* of cross-subsidization is to be found in Levitin, *op. cit*.

28 See Klein *et al.*, *op. cit.*, pp. 615-617 and, especially, Semeraro, Steven. *The Reverse-Robin-Hood-Cross-Subsidy Hypothesis: Do Credit Card Systems Effectively Tax the Poor and Reward the Rich?* [2009] 40 Rutgers Law Journal 419. Pr Semeraro (Thomas Jefferson School of Law, San Diego) has also criticized surcharging policies in Semeraro, Steven. *The Antitrust Economics (and Law) of Surcharging Credit Card Transactions*. [2009] 56 UCLA Law Review Discourse 25..

29 As we will note *infra*, this argument militates for a blended cap on interchange fees, instead of a limitation on premium cards.

30 although networks and issuers would argue that premium cards are now held by a high number, and quite likely a majority, of cardholders, as noted above.

31 Charge-back rules provide a good example: while Ontario and Québec legislation now require credit card issuers to provide a charge-back in some cases, there is no such requirement where consumers use other means of payment. Assuming a premium Visa or MasterCard debit card was offered with an equivalent protection, a consumer who would rather purchase a good through debit would rationally choose to use that premium card, rather than an ordinary debit card.

very limited impact in the market, as issuers would be free to construe its requirements as they please. We also note that, as drafted, section 9 would only restrict the emission of *credit* premium cards; this wording assumes that premium debit cards with an interchange fee would never be issued in Canada, an assumption we are not ready to make at this point[32].

Finally, we are fully in agreement with section 9 on one issue: premium cards should only be provided to consumers who have effectively and explicitly requested them. The rules applying to the issuance of credit cards in general should also apply to premium cards, and consumers should not be switched from one card to another without their formal request and consent, even where the issuer may argue that the switch would benefit the consumer.

First recommendation

Legislated consumer protection measures should be improved so that consumers no longer need to count on premium cards to obtain adequate protection.

Recommendation 2

Any provision regarding premium cards should target both credit and debit cards.

Recommendation 3

It should be expressly forbidden for issuers to switch consumers to premium cards without their prior, express request.

3- <u>self-regulating payment routing</u>

Under section 6 of the Draft, it appears that merchants would be allowed to determine which payment option, and therefore which network, would be used in order to process a transaction when presented with a co-badged card. Section 6 is obviously intended both as way for merchants to avoid more expensive functions and as a foil to networks which would provide a technological advantage for one routing over the others. Clearly, both solutions are wrong.

---

32 There are indications that debit cards providing rewards are already issued in the United States: Berkovich, *op. cit.*, p. 14.

It is the consumer who makes a payment who should always be allowed to decide how he or she will pay, and no one else. There are practical and legal reasons supporting that conclusion.

We are quite aware that routing costs, in the form of merchant fees, are supported by the merchant who, all other things being equal, would naturally prefer to route payments over the least expensive network, since, as things now stand, merchants do not surcharge or discount on the basis of the mode of payment chosen by a consumer[33]. That concern is quite understandable[34]. The problem, of course, is that "other things" are not always equal – and, in fact, may seldom be.

Let us assume that Virginia presents to the merchant a debit card that is co-badged by Interac and Visa[35]. As things now stand, the merchant would probably prefer to choose to accept the payment through the Interac network. All would be well if that choice had no impact on consumer rights. That, however, may not be the case.

Payment industry representatives whom we have met over the last month have been unable to guarantee that, in such a scenario, Virginia's rights would be identical, whatever network is chosen. The issuing institution may for instance provide an overdraft facility on the account on transactions processed through the Visa network, but not Interac (or the reverse, of course). Visa transactions may be protected by purchase insurance, but not Interac ones. In addition, the Interac transaction would benefit from any protection afforded by Interac and CPA rules, but not the Visa one. Transaction fees charged to Virginia by her issuer may be different. Worse, industry sources have been unable to assure us that exactly the same account would be accessed by the card, depending on the network being used.

Quite simply, from Virginia's perspective, a transaction processed through Interac would not be the same as one processed through Visa, and she may well prefer to pay through one network rather than the other for perfectly rational and legitimate reasons. Either the network's[36] or the merchant's choice would alter her rights and liabilities, with nobody but her being able to ascertain what the specific impact might be in the context of

---

33 We will consider this issue, addressed by the Draft's section 5, *infra*.

34 See Frankel, *op. cit.*, pp. 51-52.

35 Visa's fees as currently published are higher than both MasterCard's and Interac's for debit transactions.

36 or the acquirer's, or any other third party's choice.

a given transaction. It would therefore be wholly inappropriate for anyone but Virginia to determine how a payment should be processed, unless of course the merchant is prepared to pay her higher transaction costs or extend the overdraft protection she gets from her issuer under one type of transactions, but not the other[37].

What's more, implementation of the Draft's section 6 would face an additional hurdle in Québec. Section 1564 of the *Québec Civil Code* provides that

> Where the debt consists of a sum of money, the debtor is released by paying the nominal amount due in money which is legal tender at the time of payment.
>
> He is also released by remitting the amount due by money order, by cheque made to the order of the creditor and certified by a financial institution carrying on business in Québec, or by any other instrument of payments offering the same guarantees to the creditor or, if the creditor is in a position to accept it, by means of a credit card or a transfer of funds to an account of the creditor in a financial institution.

Insofar as the merchant is in our hypothesis able to accept a payment through two networks (or more), Virginia (the debtor) is released by the payment through either network; the gist of s. 1564, however, is to provide *the debtor* with the choice of the means of payment. The provision does not state something like "if the creditor chooses to accept the payment", but rather "if the creditor is in a position" to do so. The test is strictly objective and Virginia will be released as long as she remits the payment through a mode that the creditor "is in a position" to accept.

There can be no doubt of course that validly enacted legislation would trump a voluntary code of conduct. Even if implemented as drafted, section 6 would therefore have no effect in Québec. Stakeholders with a national footprint, be they networks, issuers or merchants, may well be wary of implementing a rule with geographically

---

37 We therefore reject Frankel *et al.*'s argument that "consumers collectively might be better off delegating network choice to merchants": *op. cit.*, p. 645. Merchants, as agents (or mandataries under Québec law), would be under specific obligations to act in the principal's interest, a commitment which they actually may not wish to undertake.

differentiated impact, and which would be ineffective in a market that holds over twenty percent of the country's population[38].

Beyond this technical argument, however, we emphasize that choice of the payment method cannot reside with the merchant, because it will in numerous cases impact consumers' rights. We certainly agree that priority routing by networks is improper and should be prohibited, but the solution, cannot be to transfer an inappropriate power to the merchants. In all cases, consumers should be provided with the ability to choose easily which network they prefer.

That is not to say that merchants should be prevented from making suggestions and seek to educate consumers regarding the impact of the choices they make on merchants' costs and, therefore, prices consumers pay. Consideration should therefore be given to relaxing slightly any network rule which would prevent merchants from providing fair information about networks' characteristics.

Another factor makes it unlikely that compulsory routing would be very effective. Merchants attempting to route transactions without regard to consumers' preferences may soon feel their wrath. As a Federal Reserve Bank economist indicates,

> As long as consumers have a strong preference for which card network to process the transaction, merchants may have little influence even if the card carries multiple card networks.[39]

In fact, it does seem that consumers tend to have clear preferences: while his research considered consumer choice between multiple cards and networks, a Boston University academic found that even consumers with multiple cards tend to concentrate their spending on a single network[40]. In all likelihood, a similar result would obtain if one compared multiple functions on one card: consumers tend to be loyal to one card[41]. Merchants' ability to steer consumers is therefore likely to raise significant dissatisfaction, which may actually doom the practice.

---

38 According to Statistics Canada, as of October 1st 2009, Québec held 23.2% of Canada's 33 873 357 inhabitants.

39 Hayashi, *op. cit.*, p. 9.

40 Rysman, Mark. *An empirical analysis of payment card usage*. (2007) LV Journal of industrial economics 1. The author had access to data provided by Visa. This result is also quite relevant to the next section: even though merchants may attempt to discount or surcharge, they must overcome significant consumer preference for a given payment method.

41 See also Frankel, *op. cit.*, p. 35.

Recommendation 4

The Draft should clearly establish that consumers shall be offered a well-informed opportunity to determine the network through which a payment is processed.

Recommendation 5

Network rules preventing merchants from providing information and fair recommendations to consumers regarding network choice shall be prohibited.

4- self-regulating pricing: discounts (and surcharges)

a) the concept

As Alan Frankel notes,

> Networks would face more competition over the amount of any interchange fees is merchants conveyed to consumers the merchants' cost of accepting various types of payment.[42]

Whether such price discrimination is feasible and appropriate in the real world is another matter.

Section 5 of the Draft proposes that merchants be allowed to provide discounts for different methods of payment. The intent behind the provision is obviously to allow the merchant to transmit to consumers a price signal about the various costs it must support. Discounting may also be claimed to limit or eliminate the cross-subsidy between those who do not benefit from a given payment method's advantages (such as rewards), but must pay for them through higher prices charged by merchants facing higher fees. The ability to discount provided to merchants may also serve as an argument against networks or issuers: as merchants would be able to steer payments away from a costlier method, they might be in a better bargaining position to negotiate more reasonable merchant fees.

---

42 Frankel, *op. cit.*, p. 38.

Unfortunately, discounting is unlikely to serve effectively those purposes. Worse still, insofar as it becomes a significant practice (which we doubt it would), it would significantly increase consumers' search costs and both merchants' and consumers' transaction costs, which would in all likelihood make it an inefficient practice.

b) sending a price signal

Merchants' costs vary along with the payment method chosen by a consumer. While it is clearly an inexact science, studies have attempted to distinguish between costs associated with cash, cheque, debit or credit card payments, for instance. Conclusions vary[43], but credit cards usually come up as the costliest payment method for merchants. Additionally and as noted above, merchant costs are also likely to vary with the specific credit card tendered by a consumer, since the interchange fee may be different.

In such a setting, it is tempting for merchants to either surcharge consumers who would otherwise prefer costlier payment methods, or provide discounts to those who opt for less expensive processes. A merchant might therefore provide a five-cent (5 ¢) rebate to a debit card user, a two-cent (2 ¢) rebate to non-premium credit card users and no rebate at all for premium credit card users, for instance. Hopefully, consumers would therefore choose the payment method with the higher rebate, thus reducing both the price he pays and the merchant's cost.

The Draft opts for discounts. Unfortunately for merchants, behavioural economics studies indicate that discounts are not very effective. In fact, consumers react more swiftly to surcharges than to discounts: even a small penalty stings, but it takes a significant advantage to overcome inertia. To take the example in the previous paragraph, a three-cent discount may well be insufficient to convince Virginia to put her MasterCard basic credit card back in her wallet and take out her Interac debit card, for instance, whereas a surcharge for the same amount might (almost) do the trick.

Put in different terms, consumer decisions are altered by a framing effect whereby they perceive quite differently gains and losses, even when they are quantitatively identical[44]. For discounts to impact the market, they therefore need to be comparatively

---

43 In particular with regard to the relative cost of cash payments: while merchants tend to see it as an expensive process, studies that take into account the longer time required to process card payments seem to indicate that cash actually remains a reasonably effective process to remit smaller payments. See appendix.

44 Levitin, *op. cit.*, pp. 18-20 and sources quoted therein.

high. Virginia might switch cards for a ten-dollar rebate, equal to, say, 2% of a $500 stove. But of course, the rational merchant would not offer a 2% discount to save 1.8% on merchant fees. Caught between consumer inertia and merchant fees, discounts are therefore likely to be frequently too low to be effective.

The obvious implication is that, in order to gain some pricing "space" so as to offer discounts, merchants may then be inclined to set normal, non-discounted prices close to the level corresponding to the highest payment cost[45]. Let us look at the problem facing Gary's Grocery Store and assume that the price Mr. Gary would set for a loaf of bread would be one dollar, absent any concern about payment costs[46]. Let us further suppose that, according to his estimates, payment costs would add the following to the loaf's price:

cash	0 ¢
Interac debit	6 ¢
MasterCard debit	8 ¢
Visa debit[47]	16 ¢
MasterCard or Visa credit[48]	18 ¢

Should Mr. Gary set the loaf's price at 1$, he cannot offer any discount and still make money on his loaf. If the price is set at $1.07, he will offer a 1 ¢ discount to Interac debit users, a 7 ¢ discount to cash users, and no discount to others: the inducement to consumers not to use credit cards is low, and likely ineffective. Assuming only a small number of his customers hold Visa debit, he figures that he can spread the cost of those transactions over his whole customer base[49] and he thus sets the price of his loaves at $1.15 each. Mr. Gary can therefore provide a 15 ¢ discount to cash users and an array of other discounts to other consumers (except credit card and Visa debit users); he is thus able (in principle) to send a more accurate – and potentially more effective – price signal to clients. In order to do so, however, he must align his "normal" price close to the highest payment cost, which will be detrimental not only to consumers using the more expensive

---

45 Even Levitin acknowledges the problem: *op. cit.*, p. 25.

46 We therefore assume that his blended payment cost is included in the $1.00 price.

47 We understand Visa debit has announced that its interchange fee would be set at 15 ¢ plus 0.25% of the transaction value: Flavelle, Dana; Trichur, Rita. *Credit giant's debit tactics called unfair; Visa's auto-enrolment feature a 'murky' practice merchants say, as the credit-debit conflict heats up*. Toronto Star, October 29 2009, p. B 01.

48 We assume the interchange rate would be a percentage of the price, plus a set minimum amount.

49 or else he will opt out of Visa debit, of course.

payment methods[50], but also for instance to consumers who forget to claim their discount[51], all of whom would have paid $1.00 if Mr. Gary had not decided to provide discounts and had kept to his former pricing strategy.

c) implementing discounts

Another issue, raised even by academics who oppose interchange fees and may therefore welcome discounting, is that since goods offered to consumers have different elasticities of demand, "a discounting scheme that provides a single discount rate is likely to be inefficient and create transfers within the economy."[52] Mr. Gary may then need to set different discount rates for bread, canned soup and ice cream. Needless to say, such a practice would lead to nightmares at the point of payment. In addition, the challenge is setting all appropriate discount rates may well suffice to discourage him from even considering the practice[53].

Another challenge merchants would face in order to implement discounts is the requirement to know when to apply them. As noted above, differences between cards for which networks charge a high interchange fee and those for which they charge a lower amount are not always obvious on the face of the card. Even when they are, merchants would need to train their staff in recognizing situations where a discount should apply, in determining the proper discount to be applied and in informing (if not guiding) consumers. Such a process entails both training and transaction costs, and legal risk. Merchants will need time to train staff, transactions will take longer to process and, in cases where staff does not provide accurate information or does not apply the proper discount, which may have been advertised, the merchant would be liable for false advertising.

---

50 but who are theoretically getting an equivalent economic advantage from their issuer, through rewards or otherwise; in many cases, however, they may not receive that advantage, and would therefore be net losers.

51 Mr. Gary's decision would also be inflationary, but that raises an altogether different set of issues.

52 Berkovich, *op. cit.*, p. 23.

53 Hayashi, *op. cit.*, p. 12. Even if the merchant did try, he may well be unable to set accurate rates because he would lack the information required to do so. Discounting would therefore likely be economically inefficient.

d) factoring consumer search and transaction costs

A fundamental strategy of consumer law is to provide clear and accurate information to customers so that they can make informed choices. Market effectiveness demands accurate and available information. Discounting practices would therefore run in the face both of consumer law and classic economics.

Let us suppose that Virginia wishes to purchase a new camera. A recent study has looked at the online market for cameras and has found that there are dozens of products, offered by a number of retailers[54]. For Virginia, comparing prices is therefore fairly challenging, but let us now imagine that she must also compare the various merchants' discount practices to determine how much she would have to pay, depending on whether she uses her RBC WestJet MasterCard credit card, her CIBC plain vanilla Visa credit card, TD Visa debit card or TD Interac card. Market transparency would not be improved, to say the least: it is in fact quite possible that increased price dispersion would facilitate price increases in the market. From a public welfare standpoint, it is questionable whether the eventual impact of discounts on merchant costs would surpass the increase in consumer search costs.

Nor would the situation be simpler at the point of sale. When stopping on a whim at a clothes store or bookstore she does not patronize on a regular basis, so that she is not familiar with their specific discount policies, Virginia would be confronted when taking out her wallet either with a billboard or with an attendant informing her of the various discounts attached to the cards in circulation. One shudders at the thought: for instance, RBC currently offers thirteen (13) different credit cards, broken down in five categories[55]; CIBC also offers thirteen (13) different Visa credit cards[56]. BMO offers over one hundred MasterCard credit cards[57]. Let us not even consider cards issued outside Canada, which

---

54 Ireland, Norman. *Posting multiple prices to reduce the effectiveness of consumer price search*. (2007) LV Journal of industrial economics 235. The author's focus was on marketing practices whereby merchants advertise a variety of prices that are apparently independently set, while they are not. Examples include multiple subsidiaries of a same group or "no-name" products. The broad conclusions regarding the impact on consumer confusion are nonetheless relevant to our issues.

55 Categories are: rewards cards, travel cards, low interest rate cards, student cards and no annual fee cards. Website at www.rbcroyalbank.com/cards/index.html and other pages consulted on January 16 2010. Interestingly, 11 of the 13 cards are classified as "rewards" cards.

56 Website consulted on January 16 2010 at www.cibc.com/ca/visa/index.html.

57 Including an astounding variety of affinity cards, many of which admittedly would mostly be used in limited geographical networks (such as, say, the BMO University of Winnipeg

visitors may hold out. Even if retailers break cards in some sorts of categories, confusion is likely to smother any consumer's attempt at making an informed choice, especially if it happens to be December 23d and fifty other people are waiting in line. Paying cash will be so much simpler...

As a practical matter, most merchants are therefore unlikely to even consider pricing appropriate discounts and attempting to provide accurate information. At best, discounts would therefore serve as a very crude instrument. Since they are effectively capped by the merchant rate itself, discounts are also unlikely to be very high, and may well have very limited impact on consumer behaviour. If we may borrow from the Bard, they are likely to amount to much ado about nothing.

Most merchants will probably not discount, therefore will not send a price signal to consumers and, indirectly, to networks. If they do, marketplace confusion is likely to exceed any advantage resulting from this price signal in terms of public welfare. Discounting is therefore most likely to be ineffective.

e) surcharging

Needless to say, we do not believe that surcharging would be a better idea. While even fairly small surcharges may influence consumer behaviour, making them more practical at first glance, they would raise similar search and transaction cost issues as discounts. Since it would be practically impossible for merchants to determine the perfectly welfare-enhancing surcharge rate, surcharges may in some cases be too high and could be appropriated by merchants, a situation some analysts believe is already happening in Australia[58].

In addition, we note that ten States in the United States, with over forty percent of the country's population, prohibit surcharging in relation with credit card payments[59]. According to California legislation, for instance,

---

MasterCard): website at www4.bmo.com/creditcards/0,4987,35649_77830843,00.html on January 16 2010.

58 Surcharging practices, which are now allowed in Australia, have been slow to emerge and are still mostly used by very large retailers, as we will develop *infra*. For the problems associated with setting a proper surcharge and retailer appropriation of excessive surcharges, see *inter alia* Rochet, *Competing*, p. 8.

59 Such States include California, New York and Texas. See Levitin, *op. cit.*, p. 9. In addition, Minnesota limits surcharges to 5% and New Hampshire has banned them in the specific case of travel agencies.

> 1748.1 (a) No retailer in any sales, service, or lease transaction with a consumer may impose a surcharge on a cardholder who elects to use a credit card in lieu of payment by cash, check or similar means. A retailer may, however, offer discounts for the purpose of inducing payments by cash, check or other means not involving the use of a credit card, provided that the discount is offered to all prospective buyers.[60]

It may also be noted that, in line with the provision's second sentence, federal United States legislation prohibits issuers from preventing merchants to offer discounts[61]. Sorting through the double negation, discounting is permitted. Nonetheless, it has remained a quite marginal practice, perhaps indicating that merchants do not believe it is either practical or effective[62]. All in all, the United States example does not militate for discounts or surcharges, either because those remedies are not used where available or because they have been made illegal.

There is a reason why surcharging is frowned upon. Merchants would be faced with very significant legal risk, as both the *Competition Act* and provincial legislation strictly prohibit exacting a higher price than advertised for goods and services. Obviously, merchants could not easily provide accurate surcharge information in most of their advertising. Let us imagine a toaster on sale at Zellers, advertised in the merchant's flyer as available for $34.99. In fact, depending on various discounts and surcharges, the price Virginia pays at the point of sale might be one of the following:

cash	34.99
Interac debit (55 ¢ discount)	34.44
Visa debit (0.25% + 15 ¢ surcharge)	35.23
Visa Premium credit (3% surcharge)	36.04
MasterCard credit (2% surcharge)	35.69
MasterCard debit (Monday 1% discount)	34.64

60 *California Civil Code*, subs. 1748.1 (a).
61 15 USC §1666f. Section 1748 of the *California Civil Code* is to the same effect.
62 See Klein, *op. cit.*, pp. 619-620.

In three cases, the price posted on the flyer would therefore practically amount to false advertising, as the price really paid by Virginia would be higher than the one indicated in the flyer[63].

We note in passing that surcharging would also raise a complicated issue. In essence, a segregated price is added to, say, the toaster's price to account for the payment service provided. Insofar as the payment service is priced separately, and as it is provided not by the merchant but by other parties, is this service taxable and who is responsible for remitting the tax?[64]

In addition, the only information provided to consumers by the merchant would in most cases be the surcharge (or discount) rate, not the final price for each product in each case, and comparisons may well be made harder by the combined use of percentages and flat fees in any given occurrence, as in the example above. Add to this mix the fact that 55% of Canadians aged sixteen and over have low numeracy scores[65], and it becomes

---

63 Contrary to Levitin's argument (*op. cit.*, p. 21), this situation must be distinguished from the fact that taxes are often not included in advertising prices on two grounds. First, consumers know that taxes are usually added and know the rates, which are fixed; second, legislation usually provides for the fact that taxes may be added to the advertised price. By contrast, surcharging rates could vary widely by merchant and by payment method, and there is of course currently no legislative exception allowing for the addition of payment surcharges to advertised prices. Levitin's suggestion that goods could be tagged for two prices, with or without a surcharge, also fails both because there would probably be more than two prices per product, and because merchants are unlikely to consider increasing their costs and legal risk as significantly as a double-pricing practice would entail. In fairness to Levitin, he does expect that surcharging and the elimination of the honor-all-cards rule would lead to a significant simplification of networks' interchange fee schedules (*op. cit.*, p. 24).

64 A clear difference must be made between cash payments and other forms of payment. Cash payments are remitted in physical currency having legal tender, they do not carry a price and enure directly to the creditor. Legally, debit card payments constitute the transfer of a specific part of the debt the issuer has to the consumer to the benefit of the creditor, without currency changing hands and with services being provided to enable the debt transfer. Credit card payments must also be analyzed in terms that clearly show they cannot be equated to cash payments, and may therefore raise their own set of issues in matters that may include goods and services taxation. In other words, transferring money is not the same as transferring a legal claim to money, to borrow from Frankel, Alan; Shampine, Allan. *The economic effects of interchange fees*. [2005-2006] 73 Antitrust L.J. 627.

65 *Building on our Competencies*: *Canadian Results of the International Adult Literacy and Skills Survey 2003*. Ottawa, Statistics Canada, 2005. 242 p. Catalogue no. 89-617-XIE. Pp. 16, 27. Level 3, which we use here as a boundary, is deemed to be the "minimum for persons to understand and use information contained in the increasingly difficult texts and tasks that characterize the emerging knowledge society [...] " (p. 26): 55% of Canadians score below Level 3. Twenty-five percent of Canadians stand at Level 1, the lowest in the scale. The report is available at www.statcan.gc.ca/pub/89-617-x/89-617-x2005001-eng.pdf.

quickly obvious that counting on discounts or surcharges in order to send consumers a clear and meaningful price signal is a pipe dream.

f) price coherence

If that were not enough, price discrimination's effectiveness depends on merchants' willingness to implement it, and therefore on consumers' tolerance of such practices. In jurisdictions where discrimination has been allowed, such as Netherlands, Sweden, Switzerland, the United Kingdom and the United States, it remains a fairly marginal practice, and it is therefore not very effective as a weapon deployed against networks[66]. Even in Australia, after more than five years, less than a third of all merchants surcharge, and often do so in a limited fashion. In that context, merchants' ability to effectively threaten networks through discounts or surcharges appears to be limited[67].

There is a broader issue at stake here, which economists term "price coherence"[68]. Up to now, payment costs have been treated by merchants as overhead and blended in consumer prices. That is how markets have worked for decades, and how consumers still expect them to work. That is also how legislation has been enacted.

With regard to payment costs, price coherence did not raise serious concerns in the past, because most payments were made through a single method[69]. Growing cost differentiation now prods merchants into questioning price coherence. Admittedly, it does seem at first glance to be a simple way to address the challenges they face.

As we noted above, however, moving away from price coherence raises a number of practical, legal and economical issues. Once the door is opened to surcharging or discounting in relation with payment costs, other issues may well be raised that would

---

66 See *inter alia* Hayashi, *op. cit.*, p. 13. *Contra*, Levitin, *op. cit.*, p. 26.

67 Frankel maintains a different view: *op. cit.*, p. 53. The author does acknowledge that "merchants find it difficult to surcharge when their competitors are not [...] and it is costly to explain surcharges and the existence of lower cash prices to consumers [...]."

68 See *inter alia* Frankel, *op. cit.*, p. 42. Frankel also acknowledges that price coherence, coupled with the theoretically optimal interchange fee, may maintain merchant welfare: p. 43. The challenge, of course, is to set interchange fees at their optimal level... Otherwise, merchant prices rise for all customers, with cardholders receiving rewards profiting more and thus being bent on increasing credit card use (and interchange fees paid by merchants): pp. 44-45.

69 Most merchants simply accepted cash; merchants offering more expensive products or services were mostly paid with cheques but, in both cases, a high proportion of merchants probably received the vast majority of their payments through the same method.

logically command a similar answer. Such price in-coherence would add significantly to search and transaction costs[70]. Before it opens Pandora's Box and break with decades of market practice, we submit that government should consider very carefully whether, in fact, practices like discounting (or surcharging) would truly be welfare-enhancing.

In short, we believe that discounting is unlikely to work, because it is simply too unwieldy to implement and too limited in its capacity to influence market practices. Should it become entrenched nonetheless, we believe that it would raise very serious economical and legal concerns. This is a tool that should not be deployed without utmost caution.

Recommendation 6

Discounting should not be implemented with a view to countering excessive merchant payment costs.

5- <u>self-regulating card honoring</u>

Section 4 of the Draft would require that merchants that accept a network's credit cards be free to decline its debit cards. This is of course an attempt at reducing the impact on merchants' costs of the "honour-all-cards" rule that was traditionally imposed by networks. In its most stringent form, the rule requires a merchant to accept all cards related to a given network, however high the merchant fees associated to a specific card may be. Since they need to accept at least some cards in order to serve consumers who expect to be able to pay with a credit card from a given network, they find themselves compelled to honour all that network's cards. In competition law terms, this network practice has obvious similarities with tying.

Networks, however, oppose that the "honour-all-cards" rule's purpose is to provide clarity and certainty to consumers[71]. Any Visa cardholder, for instance, therefore knows that her card will be accepted at a merchant indicating that it accepts Visa, whatever card she may hold. The rule would therefore reduce significantly search and transaction costs

---

70 That may explain why, while price coherence prevents payors from facing "the true marginal costs associated with their payment decisions" (Frankel *et al.*, *op. cit.*, 648), markets actually prefer coherence: the cost of imperfect information is more than balanced by the savings associated with reduced search and transaction costs.

71 An author such as Frankel acknowledges the existence of that benefit, but argues that it is offset by its negative impact on competition: Frankel, *op. cit.*, p. 54. For Klein *et al.*, the rule "is the essence of a payment card system because it assures each cardholder that his card will be accepted at all merchants that display the mark [...]": *op. cit.*, 592.

for consumers. It would be especially beneficial to foreign customers. The rule also prohibits, for instance, merchant discrimination between card issuers, forbidding a merchant, say, to accept only cards issued by a national institution and decline cards issued by local banks[72].

In 2003, Visa and MasterCard agreed to a consent order that requires them to uncouple credit and debit cards in the United States[73]. There is therefore clear precedent for the rule proposed in the Draft's section 4[74]. We are concerned however that while it certainly provides more short-term leverage to merchants in opposing excessive interchange fees on debit cards, in particular, it may not address adequately all the issues raised by the honour-all-cards rule.

In the United States, issuing banks have been able through various incentives to orient consumers towards the use of the most expensive forms of debit card transactions, notwithstanding the consent order. In fact, there does not appear to have been a truly significant number of merchants who have declined to accept Visa or MasterCard debit. In short, the rule may not be very effective. In the Canadian market, where Visa and MasterCard can be expected to be quite aggressive in their attempts to grab market share away from Interac, both pressure by consumers and a variety of incentives offered by financial institutions in their acquiring capacity or other acquirers may put merchants in a position where they will not see much interest in declining to offer Visa or MasterCard debit.

---

72 The latter argument has been emphasized especially in the United States, for reasons obviously related to the structure of the US banking industry. Interestingly, Connecticut has legislated to enforce the honour-all-cards rule with respect to credit cards: Conn. Gen. Stat. §42-133 ff (b). We are also mindful that the rule has also been used by networks as a tying rule that had at the very least anticompetitive effects, and most likely anticompetitive inent: see *inter alia* Constantine, Lloyd; Shinder, Jeffrey; Coughlin, Kerin. *In re Visa Check/Mastermoney antitrust litigation*: *a study of market failure in a two-sided market*. [2005] Colum. L. Rev. 599, pp. 607-608. The authors were counsel for the plaintiff class, i.e. merchants.

73 *Notice of Settlement of Class Action, In re Visa Check/MasterMoney Antitrust Litigation*, No. CV-96-5238, 297 F. Supp. 2d 503 (E.D.N.Y. 2003), § 14, aff'd *sub nom. Wal-Mart Stores, Inc.* v. *Visa U.S.A. Inc.*, 396 F.3d 96 (2d Cir 2005), cert. denied *sub nom. Leonardo's Pizza by the Slice, Inc.* v. *Wal-Mart Stores, Inc*, 125 S. Ct. 2277 (2005). The settlement is available at www.inrevisacheckmastermoneyantitrustlitigation.com/notice.pdf. For the judicial history, see *inter alia* Constantine, *ibid*.

74 We also note that a least one network present in Canada has already decided to uncouple credit and debit card acceptance.

That may be partly why, in 2001, the European Commission did not require Visa to abolish its honour-all-cards rule, since it would not meaningfully raise competition[75]. Authors are also arguing that the rule may in fact be welfare-enhancing in a great variety of scenarios[76].

From the consumer's standpoint, uncoupling would generate confusion. As Virginia enters a Sears store, for instance, she notices the Visa logo on the door, and again as she gets near the point of payment. She therefore reaches for her Visa debit card, only to be told by the attendant that the store accepts Visa credit, but not debit. She may opt not to purchase, or will need to fish for another card (or cash) in her wallet – and possibly her Visa platinum credit card, which will saddle the merchant with the highest interchange fee it can face. In a context where merchants strive to shave seconds from each payment interaction, this will not help.

One way around this problem would be to require networks to market debit products under another name. MasterCard already does so to some extent, with the Maestro brand. Visa could do the same. The credit and debit products would therefore be more clearly distinct in consumers' minds. Of course, such a course entails higher marketing costs both for the networks and for merchants – and networks may worry about losing some brand cohesion[77].

On a slightly different front, we are painfully aware that allowing networks to issue both credit and debit cards is theoretically likely to result in a reduction of credit card interchange fees and an increase in debit card fees[78]. This result is especially likely in Canada, where Interac has levied no interchange fees in the past and where network competition to win debit card issuers is likely to be fierce: even small debit interchange fees offered by Visa or MasterCard may attract issuers which receive none from Interac. The market could therefore evolve over the next few years in a direction where credit card transactions cost no more than debit transactions and are therefore as advantageous

---

75 Klein *et al.*, *op. cit.*, 592, footnote 38.

76 Rochet, Jean-Charles; Tirole, Jean. *Tying in two-sided markets and the honor all cards rule*. (2008) 26 International Journal of Industrial Organization1347.

77 See Klein *et al.*, 574.

78 Rochet, *Competing*, p. 13. Under some conditions, a tie-in could however be "weakly beneficial to all parties", a conclusion that would militate against the kind of prohibition envisioned in section 4 within the specific (and quite narrow) set of assumptions where it holds; otherwise, some merchants (but not all) may be disadvantaged by the honour-all-cards rule.

to many parties as debit transactions, if not more. That is precisely the kind of market which Australian authorities attempted to rebalance. This trend, if it did develop, could also have implications for consumer overindebtedness[79].

All in all, we therefore dot not expect section 4 to be especially effective in limiting interchange fees, but it may increase consumer confusion[80]. The latter risk could be counterbalanced in part by requiring that networks brand separately credit and debit transactions. The negative impacts of the honour-all-cards rule could also be mitigated somewhat by prohibiting issuers to switch consumers from basic cards to premium cards, thus reducing migration towards cards that generate higher interchange fees against merchants.

Recommendation 7

Uncoupling between credit and debit card acceptance should not be considered as an effective mechanism in order to counter excessive merchant payment costs.

Recommendation 8

Insofar as networks allow for decoupling, they should be required to brand both services clearly and separately.

6- self-regulating functional separation

Section 8 of the Draft raises an issue that is partly related to card issuance, in that in can contribute to market confusion. Section 8 purports to require a strict separation between credit and debit functions, which could not co-reside on the same payment card. Such a rule would most likely complicate somewhat the entrance of the Visa and MasterCard networks in the Canadian debit market, since issuers could not add a debit function to a credit card they have already provided to a consumer. In fact, the Desjardins customer would find himself required to hold both a Desjardins Visa credit card and a Visa debit card, for instance, should he want to benefit from both types of functionality.

The comments attached to section 8 seem to indicate that the rule is proposed in a spirit of consumer protection, in order to separate clearly debit functionality from the

---

79 As to the availability of credit and the spending restraint and other biases, whereby consumers tend to spend more with "plastic", Levitin, *op. cit.*, pp. 37-42.

80 Not to mention occasional merchant staff confusion at the point of sale when trying to establish whether, say, a Visa card is a credit or a debit instrument – or both, an issue we will revisit in the following section. Levitin, among others, acknowledges the challenges associated with recognizing the various types of cards: *op. cit.*, p. 17.

more dangerous credit functionality, which is deemed to lead more quickly to overindebtedness. We certainly share any concern the Minister may have with consumer overindebtedness; we are skeptical that section 8 effectively addresses that issue and we believe the proposed provision is, first and foremost, another tool provided to merchants to escape the impact of the honour-all-cards rule and resist to higher interchange fees.

The fact is that, in the consumer's own perspective, which does not consider issues such as merchant fees, debit and credit cards are likely to become increasingly interchangeable. An overdraft facility may be attached to a debit card account, making it in effect a credit-granting card; a disciplined consumer may well be able to use her credit card without ever keeping a balance, therefore using it in effect as a debit card, with the advantage of enjoying a three-week float period. In the consumer's mind, market rules that discriminate between interchangeable products for reasons that are not apparent are unlikely to make much sense, or be easily understood[81].

Section 8 raises another difficulty: it is aimed at cards. In the next few years, it is quite possible that devices such as mobile phones will be increasingly used for payment purposes. Will section 8 be construed as preventing a consumer from adding credit and debit applications to her phone? Will she then be required to carry two or more mobile phones in order to be able to perform both credit and debit payments? Such a solution would obviously be absurd. Section 8 therefore also fails insofar as it is not technologically neutral. It may also well become an obstacle to innovation.

Recommendation 9

Functional separation between credit and debit activities on the same device should not be considered as an effective mechanism in order to counter excessive merchant payment costs.

Recommendation 10

Regulatory provisions related to payment mechanisms should strive for technological neutrality.

7- <u>self-regulating co-badging</u>

81 Academic research acknowledges that substitutability between debit and credit cards needs to be considered more closely: Rochet, *Competing*, p. 15.

Section 7 of the Code purports to address a transparency issue, and would therefore seem at first glance to fit better into part II-C of our comments. For the record, we agree that co-badged cards should be fairly branded. Fairness should also extend to merchant marketing of network acceptance and information presented on a payment terminal, so that consumers are adequately informed about all available payment methods.

Fair branding, however, is only the tip of the iceberg. A more significant question is whether co-badging should be allowed at all. Interestingly enough, it appears that Visa vehemently criticised the idea when it was floated by the European Commission[82]... Others have indicated that co-badging may be appropriate where co-badged networks are complementary, instead of competing. For instance, it makes sense for an Interac card to be co-badged with a network offering debit card services in the United States or abroad.

While it would provide more flexibility and choice to consumers and foster competition, we are quite aware that co-badging of competing debit card networks in Canada would in effect benefit competitors and be potentially detrimental to Interac. In essence, competitors would be piggybacking on Interac cards, which already enjoy broad distribution, and get a nice, (comparatively) free ride to consumers' wallets.

Whether it is desirable is a complicated question. We do note that, clearly, issuers that would co-badge on Interac cards are Interac members, and all the larger issuers are actually represented on Interac's board of directors[83]. Some of those issuers at least are presumably willing to coax Interac into co-badging and to put another brand on the debit cards they issue. With insufficient information on issuer strategies, we are reluctant to express firm opposition to co-badging at this point, as long as practices such as priority routing are banned and that consumer choice determines the card's functionality that is used for any payment. In addition, once networks have allowed co-badging with another network, they should not be allowed to reverse course later on and then forbid such co-badging, except for reasons involving systemic or demonstrated operational risk, or similar causes[84].

Recommendation 11

---

82 Frankel, *op. cit.*, p. 51, footnote 70.

83 See the list of directors at www.interac.ca/about.php.

84 To be clear, if Visa and MasterCard allow co-badging with Interac at this point, they should not be permitted to forbid it starting, say, in 2017, once they will have gained significant market share.

Co-badging of competing services should be conditional on fair branding on devices and at the point of sale, and on informed and free consumer choice of the network to be used for a given transaction.

Recommendation 12

Networks allowing issuers to co-badge competing services should be prohibited from cancelling their authorization without demonstrated due cause.

C- Transparency

Sections one, two and three of the Draft address various transparency issues. We support these proposals. We do note, however, that they embody consumer protection principles that governments are occasionally reluctant to apply to consumers, but are found here to be willing to implement on behalf of Wal-Mart or Shell. We would therefore like to see it as a precedent...

Recommendation 13

On the basis of the foregoing, measures proposed in sections 1 to 3 of the Draft should be implemented in the near future; those proposed in sections 5, 6 and 8 should be essentially discarded; and those proposed in sections 4, 7 and 9 should be improved upon before being implemented.

III- Looking at alternatives

As noted above, we do not believe that the measures proposed in the Draft would effectively address the problems associated with merchant fees in the Canadian payment market. We do believe, however, that they should be addressed. We also believe that other issues must be considered together with the structural issues behind the Draft's provisions.

In order to provide some perspective, we will first take a quick (and partial) look at recent developments in other jurisdictions. We will then summarize issues which have not been addressed in the Draft and propose a way forward, both on substantive issues and in terms of process.

A- Recent developments abroad

1- Australia

Following an October 2000 joint report by the Reserve Bank of Australia (the "RBA") and the Australian Competition and Consumer Commission, the RBA designated Visa, MasterCard and a domestic network under legislation similar to Part II of the *Canadian Payment Act*[85]. Following a lengthy consultation process[86], RBA then determined in 2003 that interchange fees should be capped and that merchant surcharging should be allowed[87].

Crucially, the primary impetus for the Australian reform was the concern that the market was unduly favourable to credit card transactions, to the detriment of debit cards[88]. As things now stand, it is unlikely that the same conclusion could be applied to the Canadian market, a point that should be kept in mind when contemplating the eventual transposition of the Australian reform to Canada.

While Visa and MasterCard challenged RBA's directives, their claims were rejected by the Federal Court in 2003. The standard eliminating the no-surcharge rule came into effect on January 1st 2003, while the one setting interchange fees came in force July 1st of the same year, mandating networks to implement their new fee schedules by October 31st[89].

Interchange fees are capped through a weighted average, established on the basis of the issuers' costs to be recovered through the fees. This method requires that the types of

---

85 R.S.C., c. C-21.

86 Chang, Howard; Evans, David; Garcia Swartz, Daniel. *The Effect of Regulatory Intervention in Two-Sided Markets*: *An Assessment of Interchange-Fee Capping in Australia*. (2005) 4 Review of Network Economics 328, 331-332. Authors benefitted from the financial support of Visa.

87 See *inter alia* Bos, Pierre. *International scrutiny of payment card systems*. [2005-2006] 73 Antitrust L.J. 739.

88 Rochet, *Competing*, p. 12. RBA was also concerned *inter alia* with cross-subsidization by consumers who did not use credit cards: Bos, *op. cit.*, 740. See also Epstein, Richard. *The Regulation of interchange fees*: *Australian fine-tuning gone awry*. [2005] Colum. Bus. L. Rev. 551, 562. The research leading to the paper was supported by Visa. See also Chang *et al.*, pp. 329, 331. Recent evidence apparently indicates that Australian consumers are now attracted by debit payments, rather than by credit card operations: Payments System Board. *Annual Report 2009*. Sydney, 2009. 46 p. P. 6. Available at www.rba.gov.au/publications/annual-reports/psb/2009/pdf/2009-psb-ann-report.pdf.

89 Chang *et al.*, *op. cit.*, p. 332.

costs to be included in the calculation be determined[90], and then that those costs be calculated: stakeholders can be expected to have diverging views as to which costs should be added to the mix, and at what level they should be assessed[91]. There is no guarantee either that this method will lead to a welfare-enhancing fee structure, and other methods, such as basing fees on merchants' transactional benefits from card transactions (assuming they can be determined) may actually be more effective[92].

Under RBA's determination, Visa and MasterCard first went from 0.95% of the transaction value on average to 0.55%[93]. It is therefore arguable that Visa and MasterCard interchange fees were roughly twice as high as was necessary for the system to work[94]. It is certain that, since November 2003, merchants have saved hundreds of millions of dollars.

In a separate process, Australian authorities also investigated the EFTPOS scheme and first required it in 2003 to abolish "negative" interchange fees, which flowed from the acquiring to the issuing institution[95]. Administrative and judicial debates ensued, finally leaving in place negative fees in 2004, after which RBA designated EFTPOS and established a multilateral fee regime in 2006[96].

Interchange fees are currently set at fifty basis points (0.50%) for credit card transactions and twelve cents (12 ¢) per Visa debit card transaction, while EFTPOS fees must remain between four and five cents per transaction[97]. Since the caps are based on a weighted average, this allows networks to set specific interchange fees as high as 1.15% for some types of credit cards[98], and as high as 37 ¢ for some Visa debit transactions involving governments and utilities as payees, for example. Capping the fees has therefore not eliminated stratified fee schedules.

---

90 In particular, issuer costs associated with providing consumer rewards are excluded from the calculation: Klein *et al.*, *op. cit.*, p. 611.

91 See Hayashi, *op. cit.*, pp. 14, 16.

92 *Ibid.*, pp. 16-17.

93 Chang *et al.*, *op. cit.*

94 Levitin, *op. cit.*, p. 52.

95 Bos, *op. cit.*, 741.

96 *Ibid.*, 742-743; as of his writing, Bos expressed the view that the new EFTPOS regime would raise cardholder EFTPOS debit prices above those of Visa debit or credit transactions.

97 Payments System Board, *op. cit.*, p. 12.

98 *Ibid.*, Table 4, p. 13.

There is no doubt that merchant fees have fallen in line with the drop in interchange fees since the reform[99]. As merchants have benefitted from lower interchange costs, however, and Australian markets not being perfectly competitive, there is scant evidence that they have passed on these savings to consumers[100]. They are therefore suspected of having pocketed the savings, leaving consumers with higher card prices and stable product and service prices.

Objectively, there does not seem to be any convincing empirical evidence that merchants have lowered their prices following the reduction of interchange fees. In fairness, it may well be that such evidence is impossible to adduce. Interchange fees have been lowered by approximately one half of one percent, a reduction which would have concerned probably less than half of all consumer purchases in Australia. The impact of the fee reduction on total consumer prices could therefore not be expected to surpass perhaps 0.25%[101]. Given that multiple other factors constantly jostle prices, quite a few of which may have a more significant effect, proving a cause-and-effect relationship is very likely undoable. It is still possible, however, to formulate hypotheses.

In the absence of clear factual evidence, what is the likelihood that merchants would have passed on a reduction on the order of 0.25%? In a perfect market, they theoretically would. Markets are imperfect however, and prices are known to be "sticky"[102]. In particular, they tend to be more sensitive in the upwards direction, where even a very slight cost increase may affect prices, whereas merchants will need a more significant cost decrease to reduce their prices. Canadian drivers, for instance, are quite convinced that the gas market is stickier going down than going up.

If so, it is unlikely that much of a 0.25% cost reduction would have been passed on to consumers. While the proportion may look insignificant, one four hundredth of the national retail market makes for a meaningful amount, which would have mostly been kept by merchants. Capping interchange fees would therefore not have enhanced public welfare[103].

---

99 Frankel, *op. cit.*, p. 59.
100 Chang *et al.*, *op. cit*, p. 334.
101 Chang *et al.* put it even lower: *op. cit.*, pp. 340-341.
102 See *inter alia* Chang *et al.*, *op. cit.*, p. 335.
103 See *inter alia* Rochet*, Competing*, p. 8.

Consumers have therefore not benefitted from significant price reductions on the merchant side, while they are facing more expensive payment services on the issuer side[104]. Issuers are also targeting higher interest income from cardholders who maintain a balance[105], in order to replace interchange fees, so that so-called "revolver" consumers increasingly cross-subsidize those who pay their balance on a monthly basis.

In addition and while they have enjoyed lower payment costs, a growing minority of merchants have started to surcharge. By June 2009, a third of very large merchants had started to surcharge on at least one of the credit cards they accept; less than twenty per cent of smaller merchants' surcharge, but the proportion of retailers who do surcharge has increased significantly since 2006 and is expected to keep on growing[106]. Moreover, studies have found surcharges to be on the order of 1.8%[107], which makes them significantly higher than interchange fees. Surcharges therefore exceed merchant costs in some cases at least, and represent an appropriation by merchants that has no economic justification, to the detriment of consumers.

What, then, did the Australian reform achieve? In a nutshell, interchange fees have fallen, merchant prices have not followed, an increasing proportion of merchants are surcharging at least occasionally (and sometimes beyond the value of merchant fees), issuer revenue has dropped and issuers have therefore cut into cardholder benefits by almost half.

There is therefore reason to fear that Australia has gone from a regime that benefitted issuers and, to a lesser extent, consumers, to a regime that essentially benefits merchants, which pay lower merchant fees and pocket the difference.

It may finally be noted that a review of the honour-all-cards rule is still underway[108].

---

104 According to Frankel, issuers "have recovered 30 to 40 per cent of the lost interchange fee revenue by charging higher fees to cardholders": *op. cit.*, p. 63, quoting Chang *et al.*, *op. cit.* See also Payments System Board, *op. cit.*, pp. 8, 14-15.

105 Frankel, *op. cit.*, p. 64.

106 Payments System Board, *op. cit.*, pp. 15-16. It should be noted however that "surcharging" does not necessarily mean "surcharging regularly".

107 Chang *et al.*, *op. cit.*, p. 341.

108 Payments System Board, *op. cit.*, pp. 24-25.

2- European authorities

a) the European Commission

The European Commission's directorates responsible for antitrust issues have expressed concern with transborder interchange fees since 1985, when they started an investigation into Visa practices[109]. Following lengthy investigations and discussions, the Commission issued a first decision in 2001, which *inter alia* validated the "honour-all-cards" rule and the rule against surcharging, on the basis that they had minimal competitive effect[110].

The Commission addressed interchange fees in another decision, handed down in 2002. Following discussions between authorities and Visa, the network proposed rule changes so as to make the process and the fees more transparent and to cap the fees through a cost-based method. The Commission therefore granted Visa an exemption under Article 81 (3) of the European Community Treaty[111].

More recently, after the Commission found in 2007 that it had behaved as a cartel in the way it set interchange fees[112], MasterCard has agreed to temporarily repeal its cross-border interchange fees[113]. As in the Visa case, the Commission did not conclude that interchange fees were *per se* anticompetitive, but that the network had set them at an unduly high level.

Beyond specific investigations, the Commission is concerned with the development of the Single Euro Payments Area ("SEPA") and therefore seeks to keep the kind of issues

---

109 Bos, *op. cit.*, p. 744. See also Gyselen, Luc. *Multilateral interchange fees under E.U. antitrust law: a one-sided view on a two-sided market?* [2005] Colum. Bus. L. Rev. 703. The author is a partner of a law firm which has acted on behalf of Visa. Discussion of Commission decisions in this section takes it for granted that its jurisdiction is limited to transborder transactions, and not with purely national activities.

110 *Ibid.*, pp. 745-746. The decision was appealed, but was never adjudicated as some parties withdrew their appeals while Visa (and MasterCard) policy changes made the remaining issues before the court essentially pointless: *ibid.*, pp. 746-747.

111 Bos, *op. cit.*, 747-748. The Commission also looked at other cases involving networks, but they raise issues that are not directly germane to the Draft's content, and we will therefore leave those cases aside. See *inter alia* Bos, *op. cit.*, pp. 748-750.

112 Commission of the European Communities. *Antitrust: Commission prohibits MasterCard's intra-EEA Multilateral Interchange Fees*. Brussels, December 19 2007. Document IP/07/1959.

113 See *inter alia* Commission of the European Communities. *Antitrust: Commission notes MasterCard's decision to temporarily repeal its cross-border Multilateral Interchange Fees within the EEA*. Brussels, June 12 2008. Memo/08/397.

raised by the Draft in the broader perspective of the development of electronic payments in the unified European economic space. It is therefore unsurprising that, for instance, while consumer payment issues were not expressly identified as a prominent concern in the Commission's 2007 green paper on retail financial services, the document does note that practices such as those that prohibit surcharging may be questioned, insofar as they may restrain competition in the unified market[114].

In a related development, European authorities have also tackled interchange fees governing direct debits, i.e. the type of transactions known in Canada as pre-authorized debits. As it happens, five countries that are EU members operate direct debit schemes with interchange fees[115]. Under a recent regulation[116], interchange fees related to cross-border euro-denominated direct debits are capped at EUR 0.088 until November 1st 2012, unless issuing and acquiring institutions involved in a given payment have agreed multilaterally to a lower fee[117]. The fees are therefore capped by the regulation, but can be also capped at a lower level by the industry.

b) some national developments

German authorities opposed the implementation of interchange fees in the debit card industry in 2001[118]. While the United Kingdom's Office of Fair Trading concluded in 2005 that MasterCard had limited competition by setting an interchange fee, its decision was set aside on procedural grounds in 2006[119]. OFT's findings, however, remain interesting, *inter alia* as it concluded that setting an interchange fee was not anticompetitive in itself, but that it could well be set much too high by networks and issuers[120].

---

114 Commission of the European Communities. *Green Paper on Retail Financial Services in the Single Market*. Brussels, April 30 2007. 20 p. P. 8, footnote 36. Document COM (2007) 226 final.

115 European Commission. *Applicability of Article 81 of the EC Treaty to multilateral inter-bank payments in SEPA Direct Debit*. Brussels, October 30 2009. SEC (2009) 1472. P. 5/15. Fees reach as much as 25 cents in Italy.

116 *Regulation (EC) No 924/2009 of the European Parliament and of the Council of 16 September 2009 on cross-border payments in the Community and repealing Regulation (EC) No 2560/2001*. O.J. L 266/11, October 9 2009. The Regulation is in force. EU regulations have immediate and direct legal effect in member countries.

117 *Ibid.*, Article 6.

118 Bos, *op. cit.*, pp. 754-756.

119 Bos, *op. cit.*, pp. 761-763.

120 *Ibid.*, p. 766.

In short, European authorities have been mostly concerned with issues related to payment networks and interchange fees from an antitrust perspective. The Commission has sought to lower interchange fees through a cost-based methodology established in negotiations with the networks[121], but has not expressed much concern about practices such as honour-all-cards rules.

3- the United States

While interchange fee issues have been hotly debated in the United States over the past twenty years or so, and especially the latter ten, stakeholders have tended to privilege judicial fora, rather than regulatory or legislative processes. As briefly noted above, a turning point was the consent order agreed to by MasterCard and Visa in 2003, which allowed for the decoupling of the acceptance of credit and debit cards. Unfortunately, as also noted above, that decision was unable to impact significantly issuers' ability to steer consumers towards signature debit payments instead of electronic payments, even though the former are less efficient: they do provide, however, higher interchange fees to issuers.

Antitrust authorities did sue Visa and MasterCard for exclusionary practices and won a judgment in 2003; they are apparently currently investigating the impact of some of the network's rules[122].

Another class action is currently pending, where merchants attack interchange fees as anticompetitive[123].

More recently, a bill was introduced in the federal House of Representatives which, if eventually enacted, would implement a number of merchant suggestions[124]. The bill provides *inter alia* that:

– interchange and other fees cannot be set at a higher level for premium cards than for other cards;

---

121 It being understood that networks had the choice between negotiating or being compelled by the Commission.

122 GAO, *op. cit.*, p. 41.

123 *Ibid.*, pp. 41-42

124 *A bill to amend the Truth in Lending Act to prohibit unfair practices in electronic payment system networks, and for other purposes*. 111th Congress, H.R. 2382. The bill's short title is the Credit Card Interchange Fees Act of 2009. The House Committee on financial services held hearings regarding the bill on October 8 2009, but there does not appear to have been further progress in the legislative process since that moment.

– honour all cards rules are prohibited;

– networks may not "inhibit the ability of any merchant to direct consumers to the merchant's preferred form of payment", thereby allowing merchant routing;

– networks must provide complete operating rules and other documents to merchants; and

– interchange fees would be disclosed by the issuer to a consumer who requests a credit card.

Another bill has also been introduced in June 2009, which would mandate a collective negotiation of interchange fees by representatives of (almost) all interested stakeholders[125]. Subsection 2 (d) (3) (A) implies that negotiated fees would be at least in part cost-based.

Considering the vagaries of the Congressional process, it is less than certain that either bill will eventually be enacted. They do illustrate however that merchants have gained the ear of at least some legislators, and the Draft is not an isolated initiative.

The situation in the United States is therefore anything but clear, and it provides no certainty to any of the stakeholders. Unsurprisingly, GAO's assessment of the various types of remedies which could be implemented is cautious, with the office concluding that "each option has implementation challenges" and that a mix of various ingredients may lead to the least bad solution[126].

B- The Canadian environment

1- the cost challenge

What, then, should be done? Competition between networks is actually likely to worsen efficiency or welfare distribution; a reduction in merchant fees – and, consequently, consumer rewards[127] – may, under given conditions, improve social

---

125 As usual, representation of consumer interests is not mentioned. *A bill to amend the antitrust laws to ensure competitive market-based rates and terms for merchants' access to electronic payment systems*. 111th Congress, H.R. 2695. The bill has been referred to the House Committee on the Judiciary on June 4 2009, while a Senate companion bill (S.1212) has been referred to the Senate Committee on the Judiciary on June 9 2009.

126 GAO, *op. cit.*, pp. 44-48. GAO has considered setting or limiting interchange fees, disclosing interchange fees to consumers, prohibiting network rules and allowing stakeholders to negotiate fees.

127 As it is likely that oligopolistic issuers set cardholder prices at a level below the one which maximizes welfare, the implication is that rewards are currently too high: Hayashi, *op. cit.*, pp.

welfare[128], as the welfare-maximizing rate will generally be lower than the monopolist (or oligopolist) rate. Yet up to now, Canadian authorities have opened the door to competition and have chosen not to address directly fee control, hoping that market forces might somehow get it right. It is unlikely that they will in the foreseeable future.

In all likelihood, interchange fees are currently too high in Canada, or are likely to become so as competition between issuers worsens. It would be unwise not to address the problem.

In all likelihood, in our view, the measures proposed in the Draft would be either ineffective, and therefore detrimental to merchants, or detrimental to Canadian consumers, and sometimes both. We do not believe that the Draft provides anyone with the tools for doing the job. The obvious alternative is to put in place a mechanism that would set, or more likely would cap, interchange fees.

Obviously, networks can function without an interchange fee (or with a fee set at zero): Interac provides the most obvious example[129]. One option might therefore simply be to prohibit interchange fees in Canada. On the positive side, it would seem to be a simple solution, which merchants (and, presumably, Interac) would greet gleefully.

As noted above, however, economic theory tends to conclude that interchange fees are highly relevant in a two-sided market. From a more practical standpoint, it is also somewhat unlikely that networks (or, more precisely, issuers) would placidly accept the loss of a significant income stream. Issuers, directly or through networks, would therefore probably engage in increasing other rates and fees charged to consumers and merchants both. Rewards would be reduced, annual cardholder fees would increase, interest rates would possibly climb and merchants would be stiffed with higher networks fees or other costs.

6-9. Care should be taken however, in overhauling reward programs, that issuer-provided consumer benefits such as non-mandatory chargebacks or extended warranties are not eliminated in the process. The easiest way to do so would be to improve legislated consumer protection measures in the payments area. See also Hayashi, *op. cit.*, p. 19, for another aspect of such "rewards" extended to consumers and the practical near-impossibility of eliminating consumer rewards offered by issuers.

128 See Hayashi, *op. cit.*, p. 2; McAndrews *et al*, *op. cit.*, pp. 24-25 who point out that setting the "correct" interchange fee level is a non-trivial challenge.

129 Visa debit transactions in New Zealand and Australia's EFTPOS network also settle at par, without an interchange fee: Frankel, *op. cit.*, p. 50.

As also noted earlier, setting a proper interchange fee is a complex matter. Cost-based solutions may not be effective. Authors have suggested relying instead on merchants' net avoided costs in order to set a fee cap[130], a solution that would have the advantage of distinguishing more clearly between credit cards' dual functions as payment and credit instruments. Elsewhere, cost-based caps on debit card interchange fees have been found to be inefficient[131]. We note that the fee structure itself – i.e. based as a percentage of the transaction value, or on a flat fee – may have a significant impact on any policy's ability to lead to a welfare-enhancing result: proportional fees tend to make it harder to achieve welfare-enhancing efficiency and competing structures based on different methods may make the determination of the ideal mix quite complex[132]. All these issues should be discussed with the various stakeholders, including consumers, in order to frame the best possible responses to the challenges facing our economy.

Many will argue that regulation is either inappropriate or premature in this area. They would be overlooking a crucial fact: interchange fees are already regulated, by the networks. This is therefore not a matter of regulating more, but of regulating otherwise, with more attention given to social welfare.

But merchant fees are only one aspect of the profound changes altering the Canadian payments machine. Two other sets of issues must be also be considered, both because of their importance and because all three are interconnected.

2- the consumer protection challenge

The Draft comes a little over a year after the Department of Finance has apparently shelved belated efforts at reforming the *Canadian Code of Practice for Consumer Debit Card Services*, even though many stakeholders – and certainly consumer representatives – have asked (at the very least[133]) for a reasoned and very substantial updating of a code which is woefully unsuited to current developments in the payments market. Instead, we are presented with a project that addresses exclusively merchant's concerns, and that was prepared with scant consumer input, if any.

---

130 See *inter alia* Rochet, Jean-Claude; Wright, Julian. *Credit card interchange fees*. Working paper series no 1138/December 2009. Frankfurt, European Central Bank, 2009. 32 p. Available at www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1138.pdf.

131 Rochet, *Competing*, p. 15.

132 See Hayashi, *op. cit.*, p. 10.

133 As other stakeholders well know, consumer representatives would actually prefer a legislative framework to a new code, but they also recognize practical political limitations.

Yet implementation of the Draft's provisions would have significant consumer impact, as we noted above. There is no certainty that consumer prices would come down. Consumer search and transaction costs would be likely to increase, perhaps significantly. Consumers would be denied the elementary right to choose how they pay for goods or services. In addition, they might therefore find themselves unable to pick a payment option that provides them with better privately designed protection, in the absence of an adequate legislative framework.

We share merchants' concerns that excessive costs should be controlled. We also share networks' and issuers concerns that consumers should be able to reap all the benefits their huge networks and their policies, such as they are (and are implemented), may offer purchasers of goods and services. The way forward, however, will not be found without taking full account of consumer concerns regarding electronic payments.

Within the last few years, Canadian consumer groups have put forward a set of overarching principles which should govern any attempt at modernizing the regulatory framework governing payments in Canada[134]. These principles are the following:

– **universality:** the broadest range of payment technologies should be regulated;
– **neutrality:** all technologies should be regulated by similar rules;
– **security:** payment technologies and processes should be secure and sound;
– **accountability:** risk should be supported by the party which creates it;
– **transparency:** rules, responsibilities, risk, and prices should be clear for all parties;
– **liberty:** payors should be allowed to choose the payment method they prefer;
– **enforceability:** parties should be able to ensure the framework is effectively enforced;
– **legitimacy:** the framework should be persuasive, authoritative, and it should compare favorably with best-in-class comparable instruments worldwide.

Quite obviously, the Draft does not comply with at least six of those principles (universality, neutrality, transparency, liberty, enforceability and legitimacy). To consumer groups, it cannot be anything therefore but a very inauspicious step in the process of adapting the regulatory framework to the new realities.

---

134 See for instance St Amant, Jacques. *Comments regarding the creation of a new framework for electronic fund transfers and Canada*. Ottawa, Public Interest Advocacy Centre, December 2007. 39 p. The paper is available at www.piac.ca/files/piac_eft_comments_final.pdf. The set of principles was first developed and endorsed by the Canadian Consumer Initiative, of which PIAC is a member.

3- the structural challenge

Others are also highly concerned by recent developments in the Canadian payments market. Last summer, the Canadian Payments Association ("CPA") raised in a discussion paper dated July 22 a number of very significant issues regarding the clearing, settlement and generic regulation of Canadian payments processed through the Visa and MasterCard proprietary clearing networks. These concerns include the following:

- **extraterritoriality:** payments clear outside Canada, raising issues including the protection of personal information;
- **risk management:** payments are settled through commercial banks, instead of the Bank of Canada, thereby potentially increasing systemic risk;
- **consistency:** payments which are identical from the consumer perspective are governed by different rules;
- **transparency:** stakeholder input in the development of Visa and MasterCard network rules remains extremely limited, and in fact practically non-existent.

While we found ourselves unable to fully support any of the options proposed by CPA at the time, we unequivocally share its concerns and misgivings. We believe, however, that they must be placed in their proper perspective, as we indicated in this excerpt from our response to CPA's July paper:

> The issue at stake is not whether CPA should be granted a *de facto* monopoly on regulation of a number of payment mechanisms (option #2) or on clearing and regulation of the same (option #3). The question is how electronic payments will be regulated in the future in Canada.
>
> When Visa and MasterCard were content with credit card operations, and CPA and Interac in their respective capacities were by far the dominant players in other markets such as direct debit, the situation was reasonably clear (if less than ideal). That time is over.
>
> There is a need for consistent and fair regulation, which no network or alliance will be able to provide by itself. There is a need for effective risk management. It is simply not one clearing operator's mission to fulfill those needs.
>
> CPA should be relieved of its responsibility as a default regulator and concentrate on clearing and

> settlement issues, becoming a competitor and stakeholder like others in the payment market. The payment infrastructure should be acknowledged for what it is: a utility, and regulated as such by an appropriate entity where there is otherwise a significant risk of market or regulatory failure. We are obviously aware that such a view will be wildly unpopular with the industry, and quite possibly with government. That does not change the facts.
>
> It would be impractical and wrong to have one competitor regulate others. It is not appropriate, nor is it fair to CPA, to expect it to remain a *de facto* regulator of market conduct by payment service providers and retailers. The status quo will not hold for long.
>
> If not the CPA as regulator, what else? The United Kingdom has the Payments Council, whose members however are financial institutions that hold about two thirds of the seats on the board of directors, while the Visa and MasterCard networks have not joined. The Australian Securities and Investments Commission, which claims to be "Australia's corporate, markets and financial services regulator"[135], monitors the application and evolution of the *Electronic Funds Transfer Code of Conduct* and other industry codes, while the Reserve Bank of Australia is involved in issues such as Visa Debit and EFTPOS interchange fees, or the reform of card payment systems. The United States has its own model. There are, therefore, alternatives, and a need for a public discussion.[136]

There are increasingly problems with our payment systems. Merchants have been raising issues over the last year or more, which the Draft addresses. Consumers have been raising issues for years, which unfortunately remain for the most part unaddressed. CPA and Interac have also voiced various concerns. Many of those issues are actually related to one another. Any attempt at addressing only a few, in isolation from the rest, is bound to fail, because they are bundled together.

4- <u>looking at next steps</u>

---

135 Australian Securities and Investments Commission. *Our role*, taken from its website at www.asic.gov.au/asic/asic.nsf/byheadline/Our+role?openDocument.

136 PIAC letter to Mr. Guy Legault, President and CEO, Canadian Payments Association, dated September 14 2009.

At this point, we somehow suspect that we have probably managed to make all other stakeholders equally unhappy. Merchants will not be pleased that, in our view, those tools the Draft would provide them, and which purport to be the most powerful, would be at best ineffective, and quite possibly harmful to public welfare and consumer interests. Networks and issuers will be for the most part rather concerned that we suggest regulating merchant fees and strengthening the Canadian payments regulatory framework in a consumer protection perspective. The Department of Finance is likely to be somewhat annoyed to have consumers reject significant parts of its proposal. We do not, quite, apologize. And so much for the suspicion of capture: consumers do have their own, independent, views, and minimally understand the stakes.

Canadian consumer groups have publicly maintained for years that the regulatory framework supporting consumer payments needs to be overhauled through a process which would encompass all relevant issues and which would actively involve all stakeholders. Bits and pieces, concocted in the absence of important participants, are unlikely to work in the long run (or even the short) and will simply not be acceptable.

If nothing else, the Draft provides at least a clear example of the shortcomings which unavoidably come with a piecemeal, half-cooked solution to specific problems that doesn't take into account all stakeholders' interests. Our position in this consultation is simply coherent with those we have taken in the past, and which have for the most part fallen on apparently deaf ears.

We are admittedly stubborn. We take inspiration from Australia, where admittedly imperfect solutions to the merchant fee problem were implemented only once all parties had had a fair chance to have their say and where, again, admittedly imperfect consumer protection solutions have been put in place and are reviewed on an ongoing basis, with full stakeholder input. Australia is way ahead of Canada in terms of developing a coherent framework for electronic payments.

We therefore insist that piecemeal solutions won't work, that consumer concerns must be fully considered and that stakeholders need to confer and determine how best to address the changes that will come, whether we are ready or not.

In the short term, stopgap solutions may be considered, such as the implementation of sections one to three and seven of the Draft, establishment of a weighted cap on

interchange fees through voluntary network undertakings[137] and review of *Code of Practice for Canadian Debit Card Services*. Those may last a year, maybe two, while stakeholders come together with governments[138] and discuss both the strategic orientations and the nuts and bolts[139] of a new framework before it is embedded in legislation.

Recommendation 14

In cooperation with all stakeholders, federal authorities should establish a process whereby a coherent regulatory framework for payments could be elaborated in Canada.

There is no simple solution, and none that a voluntary, unenforceable code is likely to provide in the face of the gathering storm.

---

137 or, if necessary, through the designation of the Interac, MasterCard and Visa networks under Part II of the *Canadian Payments Act* and the issuance of guidelines or directives under ss. 39 and 40 of the Act.

138 Insofar as credit and payment issues may also come within provincial jurisdiction, it may be apposite to have interested provincial (and territorial) authorities participate in the discussions.

139 We underline the fact that, due the complexity of technological and commercial issues related to payment systems, broad stakeholder participation in such discussions would be most helpful.

Appendix

One assumption that likely lurks behind the Draft is that credit card payments are more expensive than other methods, so that their volume should be limited in order to enhance welfare. As noted, it was certainly considered in Australia. However, it raises some complex issues. First, payment mechanisms that seem more expensive may also perform additional functions[140], and therefore be actually more welfare-enhancing in the long run[141]. In addition, empirically gauging the costs associated with various payment methods is anything but simple.

Interestingly, theoretical papers[142] and merchant estimates often peg cash as the costliest payment method, quite possibly because processing expenses associated with cash handling and security risks are the most obvious. Empirical research, however, leads to somewhat different conclusions.

According to more recent research, payment costs in Australia amount to approximately 0.8 per cent of the gross domestic product, half of which are absorbed by cash payment costs, yet cash appears to remain the least expensive payment method and is used for 75% of payments performed by consumers[143]. Credit cards appear to be one of the costliest methods: on average, a credit card transaction costs the issuer $2.38 and the merchant $0.95, while a point-of-sale debit transaction costs the issuer $0.22 and the merchant, $0.34[144].

---

140 Epstein, *op. cit.*, p. 568.

141 Merchants would answer that networks require them to incur a broad array of expenses in area such as security, which cut into any benefit they may receive from networks: see GAO, *op. cit.*, pp. 33-35.

142 See *e.g.* Frankel *et al.*, *op. cit.*, p. 654, footnote 82.

143 Schwartz, Carl; Fabo, Justin; Bailey, Owen; Carter, Louise. *Payment costs in Australia*. Paper presented at the 2007 Reserve Bank of Australia Payment Systems Review Conference. 40 p. P. 89.

144 *Ibid.*, pp. 95, 110. Estimated average amounts are provided in Australian dollars. Interestingly, rewards are estimated as figuring for a little more than a quarter of credit card issuer costs, at $0.65 (27.3%).

A Canadian team has also sought to determine merchants' payment costs[145]. In fact, debit card transactions have turned out to be the least costly, according to their methodology, which assumed a payment value of $36.50. As in the Australian study, credit cards turned out to be the costliest payment method.

The latter results raise two questions, to which we do not hold the answer. Are the benefits associated with credit card payments high enough to justify their fairly common use[146]? And, as the Canadian market evolves, will debit at the point of sale maintain its cost advantage? That leads in turn to a policy question: what mix of payment methods should policy seek to achieve, or at least to facilitate?

---

145 Arango, Carlos; Taylor, Varya. *Merchants' Costs of Accepting Means of Payment: Is Cash the Least Costly?* (2008-2009) 4 Bank of Canada Review 15. For a somewhat different assessment, see GAO, *op. cit.*, pp. 31-32.

146 Consumers using credit cards certainly value aspects such as security, rewards and float. See *inter alia* Epstein, *op. cit.*, and Arango, Carlos; Taylor, Varya. *The Role of Convenience and Risk in Consumers' Means of Payment. Discussion Paper 2009-8*. Ottawa, Bank of Canada, 2009. 23 p. As to merchants benefitting from credit card acceptance, see *inter alia* GAO, *op. cit.*, pp. 30-31.