CT-95/02

THE COMPETITION TRIBUNAL

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

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

BETWEEN:

THE DIRECTOR OF INVESTIGATION AND RESEARCH

Director

- and -

BANK OF MONTREAL, THE BANK OF NOVA SCOTIA, CANADA TRUSTCO MORTGAGE COMPANY, CANADIAN IMPERIAL BANK OF COMMERCE, LA CONFEDERATION DES CAISSES POPULAIRES ET D'ECONOMIE DESJARDINS DU QUEBEC, CREDIT UNION CENTRAL OF CANADA, NATIONAL BANK OF CANADA, ROYAL BANK OF CANADA, THE TORONTO-DOMINION BANK and INTERAC INC.

Respondents

- and -

TELPAY, A Division of CTI-Comtel Inc. RETAIL COUNCIL OF CANADA CANADIAN LIFE AND HEALTH INSURANCE ASSOCIATION MIDLAND WALWYN CAPITAL INC., RICHARDSON GREENSHIELDS OF CANADA LIMITED, MACKENZIE FINANCIAL CORPORATION and TRIMARK INVESTMENT MANAGEMENT INC.

Intervenors

AFFIDAVIT OF KENNETH J. MORRISON FILED PURSUANT TO RULE 47 OF THE COMPETITION TRIBUNAL RULES

COMPETITION TRIBUNAL
TRIBUNAL DE LA CONCURRENCE

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COMPETITION TRIBUNAL
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RETAIL COUNCIL OF CANADA
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MACKENZIE FINANCIAL CORPORATION
and TRIMARK INVESTMENT MANAGEMENT INC.**

Intervenors

AFFIDAVIT OF KENNETH J. MORRISON

I, KENNETH J. MORRISON, of the City of Beaconsfield, in the Province of Quebec, **MAKE OATH AND STATE AS FOLLOWS:**

PART ONE - INTRODUCTION

1. For the purpose of my Affidavit I adopt the definition of defined terms at paragraph 2 of the Draft Consent Order ("DCO"). When referenced in my Affidavit these defined terms are capitalized.

2. Attached hereto and marked as Exhibits "A" to "H" to this Affidavit are the following documents:

Exhibit "A" - Canadian Payments Association Standard 022: "Standards of Financial Transaction Cards: Data Content of Magnetic Stripe - Track 2).

Exhibit "B" - Canadian Payments Association Standard 020: "Standards Applicable To Cash Dispensing In Networks of Shared Automated Banking Machines".

Exhibit "C" - Canadian Payments Association Standard 021: "Standards and Guidelines Applicable to Electronic Funds Transfer At The Point of Sale (EFT/POS).

Exhibit "D" - Draft Canadian Code of Practise for Consumer Debit Card Services, Prepared by Electronic Funds Transfer Group: Working Group: Revisions Draft 4: July 1995.

Exhibit "E" - Canadian Bankers' Association Submission To The Department of Finance - October 1995.

Exhibit "F" - Canadian Payments Association: "Proprietary Debit EFT/POS Implementation - March 29, 1990.

Exhibit "G" - The Mondex Report, 1995.

Exhibit "H" - Canadian Payments Association: "The EFT/POS Consultative Process: A Status Report ", October 12, 1988.

Exhibits "A" to "H" are contained in a separate document brief with the pages numbered consecutively for reference purposes.

I. Qualifications

3. My qualifications to provide expert testimony on the matters referred to in this Affidavit are as set out in Appendix "A" to this Affidavit.

II. Issues Addressed

4. This Affidavit addresses two specific issues:

(a) Whether retailers, insurers, investment companies, mutual fund companies, and other commercial entities (hereinafter referred to individually and collectively as "Alternative Entities") which cannot act as Issuers of Cards acceptable for use in Interac, will be able to participate effectively and/or competitively in Interac through the use of sweep, pass-through or zero balance accounts to provide Shared Electronic Financial Services to their customers; and

(b) The commercial viability of an entity participating in Interac as an Acquirer only.

5. Based on the evidence summarized and for the reasons provided herein, it is my opinion that:

(a) Alternative Entities which cannot act as Issuers of Cards acceptable for use in Interac, will not be able to effectively and/or competitively participate in Interac by way of sweep, pass-through, or zero balance accounts to provide Shared Electronic Financial Services to their customers;

(b) it will not be commercially viable for an entity to participate in Interac as an Acquirer only; and

(c) as a result of the opinions set out in sub-paragraphs (a) and (b) above, the DCO, as presently constituted, will not result in viable, effective competition in the consumer-initiated Shared Electronic Financial Services market.

III. How Interac Presently Operates

6. At present, the key components necessary to provide services through the Interac network are:

(a) a Card encoded with key information, including the Issuer's identification number, and the primary account number which identifies the Cardholder;

(b) a Cardholder personal identification number (PIN) which, together with the Card, provides Cardholder access to Interac network services;

(c) the Automated Banking Machines (ABMs) and Interac Direct Payment (IDP) Terminals and pin-pads attached to the Interac network by transaction acceptors and Acquirers;

(d) IDP transaction acceptors (for example retailers) who accept Cards for payment for goods and services;

(e) the cash registers, systems, and communication networks of IDP transaction acceptors;

(f) ABM and IDP transaction Acquirers and the computer systems of transaction Acquirers that provide editing, control and routing of transactions to Card Issuers, deliver transaction approval/decline responses to customers at Terminals, and deposit funds to retailer accounts for IDP transactions;

(g) the systems of Charter Members used to provide services to Sponsored Members;

(h) the systems of Charter and Sponsored Member Card Issuers which provide Cardholder identification, transaction approval/decline responses, and process transactions to Cardholder accounts;

(i) the Inter Member Network ("IMN") software used by Charter Members for IDP (CANNET communications services is used for SCD);

(j) the mechanisms for accounting and settling transactions between Financial Institutions ("FI ") participants; and

(k) the Interac Trademarks and Logo.

7. While Interac services have the complexity created by the components discussed above, the Interac electronic network is essentially an "information highway" through which messages to deliver electronic payment services are moved between network participants and their customers. To date, Interac has been used by FIs to provide access to the deposit accounts and credit card accounts of their customers for SCD and IDP services.

8. The services provided through Interac, as defined in the Interac By-laws, are:

(a) SCD

(i) making available cash disbursements; and

(ii) dispensing free promotional coupons to Cardholders on a non-discriminatory basis with cash disbursements at Terminals. Such coupons may not be issued in lieu of cash; and

(b) IDP

(i) a purchase or pre-authorized purchase transaction in payment for goods and/or services from a retailer or the Acquirer;

(ii) refund transactions for the return of goods and/or services to the retailer or the Acquirer;

(iii) correction transactions resulting from errors made in purchases, pre-authorized purchases or refund transactions; and

(iv) funds available enquiry transactions.

9. Currently, the Interac network is fully capable of providing access to an unlimited range of accounts, and accommodating the Cards of any Issuer, provided that such Cards meet physical design and magnetic stripe content standards. The Interac network components and systems in themselves do not place restrictions on participants, types of transactions, or types of accounts that can be accessed. There is no inherent technological or other reason why Issuers of Cards should be limited only to financial institutions or that access be restricted only to Demand Accounts.

10. The Respondents dominance of the relevant market has permitted them to maintain control of the Interac network, including the restrictions on accounts which can be accessed, and which organizations are allowed to issue Cards. This dominance has been maintained through the very explicit rules and standards established by Interac and the Canadian Payments Association ("CPA") both of which restrictions are under the control of the FIs. These rules and standards include:

(a) qualifications and definitions for Issuers and Acquirers;

(b) types of accounts that can be accessed;

(c) design of Cards;

(d) required content of the magnetic stripe on the Card;

(e) the message structure, the content and the routing;

(f) specifications for Terminal devices;

(g) specifications for dialogue and interface with the Cardholder;

(h) information displayed at Terminals and printed on receipts;

(i) access to transaction information by participants;

(j) security; and

(k) roles and responsibilities of each category of network participant.

IV. Continuing Restrictive Impact of the DCO and the Interac By-laws

11. Paragraph 3(a) of the DCO provides that the Interac By-Laws may continue to require that an Issuer be an FI.

12. Interac By-Law (2.03(a)) requires, inter alia, an Issuer to be:

(a) an FI; and

(b) hold Demand Accounts accessible by Cards.

13. The DCO restricts eligible Shared Electronic Financial Services to those that require, inter alia, "networked on-line electronic access to Demand Accounts" (4(f) of DCO). The DCO and Interac By-laws define a Demand Account as "An account held by an FI from which funds are payable on demand by a Cardholder". Demand Accounts, by definition, have historically included a narrow range of accounts from which customers could withdraw funds without giving prior notice to the FI (although such notice is not generally enforced).

14. There is no inherent technological, system or other reason why Shared Electronic Financial Services provided through Interac need to be restricted to Demand Accounts. This appears to be more restrictive access to accounts than is currently provided through Interac. Currently, Interac provides a broad range of access to chequing and savings accounts, overdraft privileges and lines of credit. In the case of SCD, access is also provided to credit card and other charge card accounts.

15. As well as the limitations on entry to and participation in Interac imposed by the Interac By-laws, the CPA rules and standards impose additional limitations on entry to, and participation in, Interac. A more detailed examination of the impact of the CPA restrictions on the operation of Interac is described in Appendix "B" to my Affidavit.

PART TWO - THE EFFICACY OF SWEEP, PASS-THROUGH AND ZERO BALANCE ACCOUNTS

V. Participation in Interac Through Sweep, Pass-through and Zero Balance Accounts

16. Section 3(t) of the DCO prohibits Interac from restricting the use of "so called pass-through, sweep, or zero balance accounts". This provision is intended to permit indirect access to Interac by Alternative Entities (see par. 14 of the Consent Order Impact Statement). A review of these three types of accounts, which are not defined in the Application materials, follows.

(i) **Sweep Accounts**

17. Sweep accounts are accounts from which the full balance, or the balance above an amount specified by the customer, is moved (swept or transferred) at the end of a pre-determined time period into an account of a different type. U.S. investment firms were leaders in establishing the use of sweep accounts which involved sweeping (transferring) funds between a customer's brokerage and money market accounts. Typically, the money market account would be one against which the customer could write cheques and settle for cash advances obtained at an ABM using a credit card.

18. A more common version of sweep accounts evolved through the 1980's, and involved sweeping funds from customer accounts in banks to mutual funds and other investment alternatives provided by non-banking institutions. These services were most prevalent in the United States. More recently, some US banks have begun to sweep funds into their own internal mutual fund and investment accounts.

19. Sweep accounts are common in US commercial banking due to limitations on the payment of interest on demand accounts. As a result, excess balances above customer-specified levels are swept, usually once a day, into higher yielding investment accounts. This limitation on payment of interest on Demand Accounts does not exist in Canada. Sweep accounts have not been, and are still not, common in Canada.

20. The DCO and the Interac By-laws do not define sweep accounts. I assume that the access proposed in the Consent Order Impact Statement involves a concept whereby Alternative Entities would arrange with an FI to have an account opened with

that FI for each of its customers. I further assume that the sole purpose of such accounts would be to provide customers of Alternative Entities with limited access to their funds at SCD and IDP Terminals attached to Interac.

21. I am not aware of any commercially successful examples in Canada of sweep accounts used for the purpose of accommodating customer card initiated transactions in Shared Electronic Financial Services.

22. I assume that the sweep accounts would operate as follows:

(a) The Alternative Entity would arrange for an FI to open an account for each of its customers wishing to have access to funds through ABMs and/or IDP Terminals. The account with the FI would be in addition to the account(s) the customer operates with the Alternative Entity, and to the account(s) the customer may already have with FIs.

(b) The accounts could operate in two ways:

Example one:

The customer could specify to the Alternative Entity the amount of funds to be placed in the account with the FI each day for SCD and IDP transaction purposes. At the beginning of each daily processing cycle, the balance in the FI account of the customer would be established at this level through a sweep process between the FI and the Alternative Entity.

Example two:

The account at the FI would start with a zero balance at the beginning of each day. Transactions initiated by the customer at ABMs and IDP Terminals would be charged to the account and accumulate as an overdraft, up to an agreed daily limit. At the end of each day, the debit (overdraft) balances would be swept into the customers account with the Alternative Entity bringing the customer's account with the FI back to a zero position. This cycle would be repeated each day.

(c) In each of the above examples, the customer would operate an account with an FI, in addition to his/her accounts with the Alternative Entity.

(d) The customer would be required to execute all necessary agreements and put in place the required arrangements with the FI for opening and operating the account. The opening of an account with a FI typically includes providing identification acceptable to the FI, signing a variety of account forms and a signature card.

(e) The FI would issue a Card to the customer, with the FI's identification number, the customer's primary account number (the customer's ID assigned by the FI), and other key information encoded on the magnetic stripe on the reverse of the Card. Under Interac By-laws the Card would be required to display a visible identification that it is the property of the Issuer. Cards require a visible Issuer identification to assist acceptors in the event of a problem with a Card and when contingency processing arrangements are in use during a system failure.

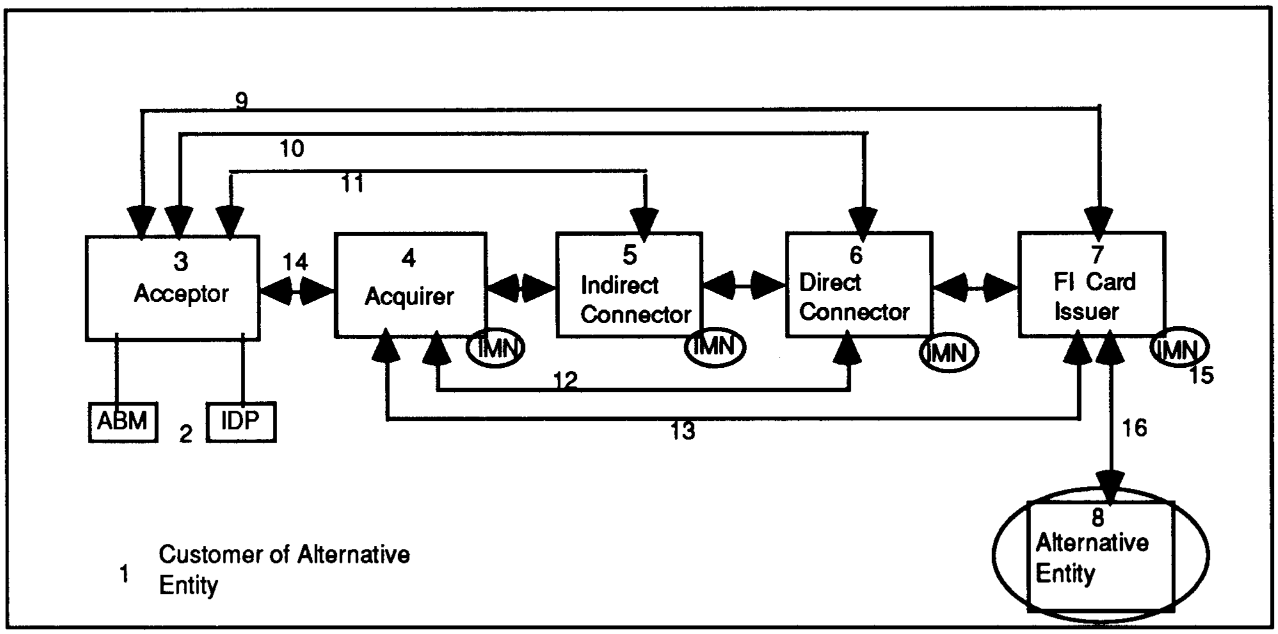
(f) The FI would deliver a Cardholder agreement to the customer specifying, *inter alia*, terms and conditions for using the Card, such as transaction limits and responsibilities of the FI and Cardholder;

(g) The customer would select a PIN with the FI, and the Card would be activated by the FI; and

(h) Transactions initiated by the Cardholder at an SCD or IDP Terminal would be processed to the customer's account with the FI.

23. The flow of transactions and operation of accounts would be as in the following diagram.

Figure One: Shared Electronic Financial Services Networks – Access via Sweep Account



NOTES

1. Customer of Alternative Entity uses card issued by FI for Interac Shared Services.
2. SCDs and IDP Terminals attached to an acceptor, that may also be an Acquirer. In the case of IDP, most acceptors are retailers.
3. An acceptor may be a commercial entity such as a retailer and may also be an Acquirer, Indirect Connector, Director Connector, and in the case of an FI, an Issuer.
4. An Acquirer may be an acceptor, an Indirect Connector, a Direct Connector, and in the case of an FI, an Issuer.
5. An Indirect Connector may be an acceptor, an Acquirer, and in the case of an FI, an Issuer.
6. A Direct Connector may be an acceptor, an Acquirer, and in the case of an FI, an Issuer.
7. An Issuer may only be an FI.
8. Alternative Entities, as they are restricted from being Issuers, are isolated from Interac as it pertains to their customers. However, they can participate as acceptors, Acquirers, Indirect Connectors, and Direct Connectors.

9. Transactions can flow directly between an acceptor and an Issuer, where the acceptor is also an Acquirer and Direct Connector.

10. Transactions can flow between an acceptor and a Direct Connector, where the acceptor is an Acquirer.

11. Transactions can also flow between an acceptor and an Indirect Connector, where the acceptor is an Acquirer.

12. Transactions can flow between an Acquirer and Direct Connector.

13. Transactions can flow between an Acquirer and an Issuer, where the Acquirer is also a Direct Connector.

14. Transactions can flow in sequence from acceptor, to Acquirer, to Indirect Connector, to Direct Connector, to Issuer, and in reverse order.

15. IMN is used for IDP, CANNET is used for SCD.

16. Funds available to customers of Alternative Entities are moved (swept) at scheduled times between the accounts held by customers with such entities and the accounts that the customers must conduct with the FI that issues the card.

24. In situations where an FI Issuer acquires transactions initiated by its own Cardholders, such transactions do not need to involve Interac. These can be recognized as "on-us" transactions and processed directly by the Issuer who is also the Acquirer.

(ii) **Pass-through Accounts**

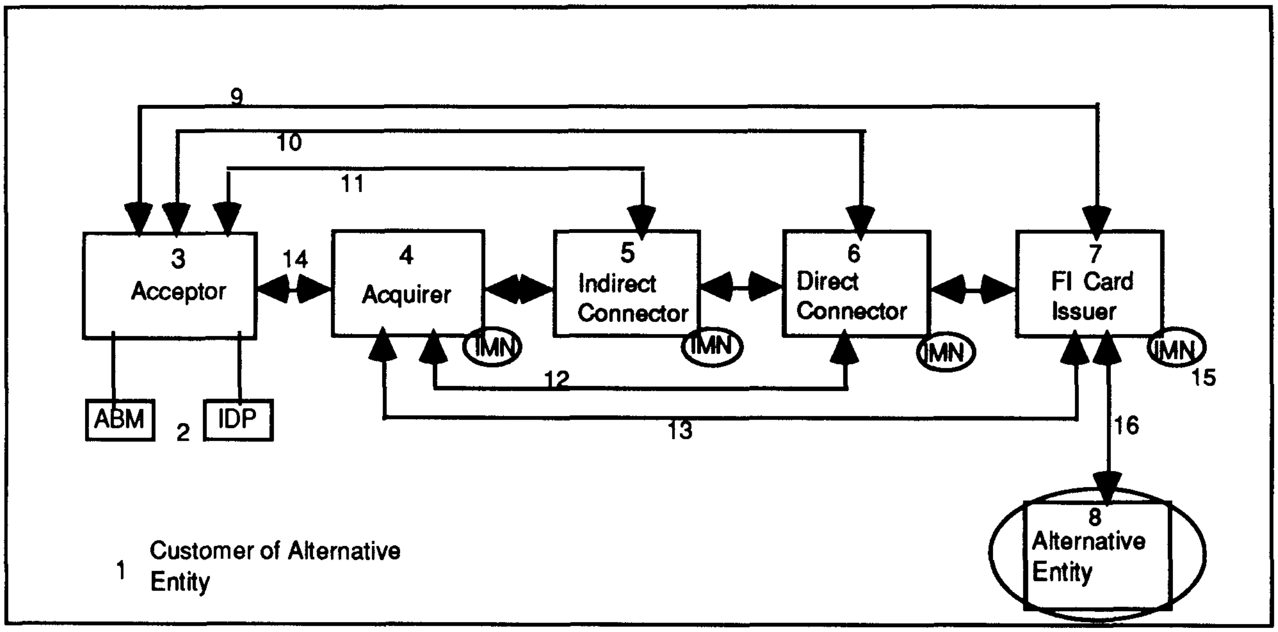
25. Pass-through accounts are not defined in the DCO or in the Interac By-laws. I assume that the access proposed in the Consent Order Impact Statement involves a process whereby the Alternative Entity would open an account for each of its customers with an FI. This account would not have a balance, and no sweep process would be used.

26. Customers of Alternative Entities wishing access to their funds through Interac would be compelled to have Cards issued by an FI in the same manner as Cards would be issued for sweep accounts. The magnetic stripe on the card would be encoded with the FI identification and the primary account number assigned by the FI to identify the customer. The customer would select a PIN with the FI. Under the

Interac By-laws the Card would be required to display visible identification that it is the property of the Issuer FI.

27. The flow of transactions through pass-through accounts is shown in the following diagram.

Figure Two: Shared Electronic Financial Service Networks – Access via Pass-through Account



NOTES

1. Customer of Alternative Entity uses Card issued by FI to access SCD or IDP service.
2. SCDs and IDP Terminals attached to an acceptor, that may also be an Acquirer. In the case of IDP, most acceptors are retailers.
3. An acceptor may be a commercial entity such as a retailer, and may also be an Acquirer, Indirect Connector, Direct Connector, and in the case of an FI, an Issuer.
4. An Acquirer may be an acceptor, an Indirect Connector, a Direct Connector, and in the case of an FI, an Issuer.
5. An Indirect Connector may be an acceptor, an Acquirer, and in the case of an FI, an Issuer.
6. A Direct Connector may be an acceptor, an Acquirer, and in the case of an FI, an Issuer.
7. An Issuer may only be an FI.

8. Alternative Entities, as they are restricted from being Issuers, are isolated from the operation of Interac as it pertains to their customers. However, they can participate as acceptors, Acquirers, Indirect Connectors, and Direct Connectors.

9. Transactions can flow directly between an acceptor and an Issuer, where the acceptor is also an Acquirer .

10. Transactions can flow between an acceptor and a Direct Connector, where the acceptor is an Acquirer.

11. Transactions can flow between an acceptor and an Indirect Connector, where the acceptor is an Acquirer.

12. Transactions can flow between an Acquirer and Direct Connector.

13. Transactions can flow between an Acquirer and an Issuer, where the Acquirer is also a direct Connector.

14. Transactions can flow in sequence from acceptor, to Acquirer, to Indirect Connector, to Direct Connector, to Issuer, and in reverse order.

15. IMN is used for IDP-CANNET is used for SCD.

16. When the Issuer receives a request message initiated by a customer of an Alternative Entity, to whom it provides the pass-through account arrangement, the transaction could be processed as follows:

    (a) FI Issuer will decrypt message, verify customer PIN, and authenticity of message. FI Issuer will look up, from a table, the customer's identification number used by the Alternative Entity holding the account, substitute this number for the FI assigned primary account number (PAN), encrypt the message again to provide security, establish a new message authentication code, and send the message to the Alternative Entity;

    (b) The Alternative Entity will decrypt the message, verify its authenticity, and decide to approve or decline the transaction. The approval or decline message will be encrypted and sent back to the FI Card Issuer; and

    (c) The FI Card Issuer will decrypt the message, look up the customer's PAN assigned by the FI, and insert the PAN in the message in place of the customer identification number used by the Alternative Entity. The message will be encrypted again, and sent back along its path to the customer at the SCD or IDP Terminal.

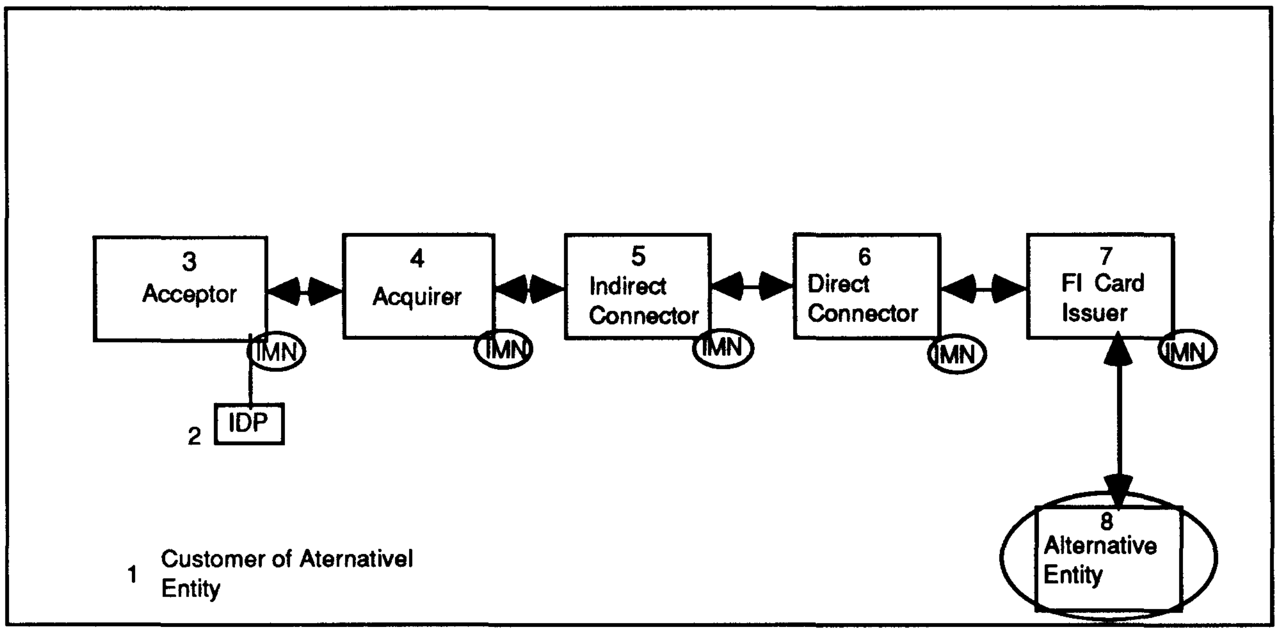
28. In situations where an FI Issuer acquires transactions initiated by its own Cardholders, such transactions do not need to involve Interac. These can be recognized as "on-us" transactions and processed directly by the Issuer who is also the Acquirer.

29. The pass-through account adds several additional steps to the processing of transactions over and above those currently required to complete an IDP or SCD transaction. For example, the transaction must be stopped at the FI Card Issuer,

unscrambled, translated, and encrypted again on its way to the Alternative Entity, and these same steps must be repeated again when the message is returned through the FI Card Issuer.

30. The following diagram and transaction examples number one and two further demonstrate the complexity and additional costs of using sweep and pass-through accounts by Alternative Entities.

Figure Three: Shared Electronic Financial Service Networks Additional Steps Involving Access via Pass-through Account



A. Transaction Example Number One: Purchase of travel insurance

1. Customer of Investment Company X (Alternative Entity) uses card to purchase travel insurance from an Insurance company. Card is issued by Bank A, that operates the pass-through accounts for customers of Investment Company X.

2. The IDP Terminal is supplied by Processing Inc., a third-party service provider that is participating in Interac as an Acquirer.

3. The acceptor is the Insurance Company **that** is selling the insurance to the customer.

4. The Acquirer is Processing Inc.

5. Investment Company X, participating in Interac as an Acquirer and Indirect Connector, acts as an Indirect Connector for Processing Inc.

6. Bank B is the Direct Connector for Investment Company X.
7. Card Issuer for Investment Company X is Bank A, which operates the pass-through account for the customer.
8. Investment Company X (Alternative Entity) holds the account of the customer.

31. In this example, the request message moves from the customer, to the insurance company (Acceptor), to Processing Inc. (Acquirer), to Investment Company X (Indirect Connector), to Bank B (Direct Connector), to Bank A (Issuer), to Investment Company X, the Alternative Entity that holds the customer's account. The approval or decline message follows the reverse path. Each point through which the request and approval/decline message passes must maintain a log of the message.

32. If Investment Company X, an Alternative Entity, was permitted to issue a card directly to its customer, the message would not move beyond step 5 in the above diagram. Investment Company X, an Acquirer, would recognize the message as being for one of its own Cardholders and process it directly. That is, the message would not move to Bank B and Bank A, and no customer identification number translation process, or pass-through account, would be required. The customer should receive better service due to the fewer number of processing steps, there will be less risk of error, and the cost to Investment Company X will be lower.

B. Transaction Example Number Two: Purchase in a retail store

1. Customer of Insurance Company Y (Alternative Entity) uses Card issued to one of its customers by Bank A, that operates the pass-through account, to make a purchase in a retail store.
2. The IDP Terminal is supplied by Insurance Company Y (Alternative Entity), that is participating in Interac as an Acquirer and Direct Connector.
3. The acceptor is the retailer.
4. The Acquirer is Insurance Company Y.
5. As Insurance Company Y is a Direct Connector, no Indirect Connector is involved.
6. Insurance Company Y is Direct Connector.
7. Card Issuer for Insurance Company Y is Bank A, which operates the pass-through account for the customer.

8. Insurance Company Y (Alternative Entity) holds the account of the customer.

33. In example number two, the message moves through five separate stages before being finalized; from Cardholder, to retailer, to Insurance Company Y as the Acquirer, to Bank A (the Card Issuer and operator of the pass-through account), and to Insurance Company Y (the account holder) and in reverse through the same steps.

34. If Insurance Company Y was the Issuer of the Card to its own customer, the transaction would not be processed through Interac. When the transaction is acquired from the retailer by Insurance Company Y, it would be processed directly to the account of its customer. This would substantially improve service to the customer, to the retailer, and would avoid all costs of the Interac network and pass-through account which will be incurred by the Alternative Entity if it is not permitted to issue Cards to its customers.

(iii) **Zero-balance Accounts**

35. Zero balance accounts are not defined in the DCO or Interac By-laws. Historically, zero balance accounts have been used as a repository for transactions during a processing cycle (usually a day), and are closed out to a "zero" balance at the end of the cycle by a single payment from the account owner. I assume that, in the absence of definitions in the DCO and the Interac By-laws, a zero balance option could be a feature of both sweep and pass-through accounts. That is, the accounts would have a zero balance at the beginning, or would be closed to a zero balance at the end, of the day.

36. Historically, in other countries, sweep accounts have been used to move funds between accounts of a customer, at regular intervals, in order to provide the customer with a higher rate of return. "Pass-through" accounts have been used primarily to accommodate the clearing and payment of "payable-through" instruments such as claim, reimbursement, and payable-through drafts. My information and belief is that sweep and pass-through accounts are not currently used in Canada as a means for accommodating transactions in electronic networks and services.

37. The Canadian Bankers Association ("CBA") and Canadian Payments Association ("CPA") are on record as not supporting "payable-through" type accounts and transactions. The CBA's reasons and basis for such concerns are identified in Appendix "C".

VI. Commercial Viability of Sweep, Pass-through, and Zero Balance Accounts

38. Sweep, pass-through, and zero balance accounts are not an effective and/or competitive alternative method of providing customers of Alternative Entities access to funds held by Alternative Entities for consumer-initiated Shared Electronic Financial Services.

39. The entry of an Alternative Entity into Interac through sweep, pass-through, or zero-balance accounts for the purposes of providing access to customer accounts held by the Alternative Entity would be subject to the following conditions:

(a) Customers of Alternative Entities would be required to open an account with, and enter into a relationship with, an FI in circumstances where these customers may not want to have a relationship with or conduct accounts with an FI;

(b) Alternative Entities would need to provide information about their customers to a competitor FI; and

(c) The card issuing FI would participate in the relationship between Alternative Entities and their customers and FIs would in fact "control" the customer relationship for Shared Electronic Financial Services.

40. As a result of these conditions upon which an Alternative Entity would be required to operate in Interac, an Alternative Entity would be placed at the following distinct and serious disadvantages when compared to existing FIs now operating as both Issuers and Acquirers in Interac:

(a) Sweep, pass-through and zero-balance accounts and the requirement to have FI issued Cards, would result in significant additional costs;

(b) customers of Alternative Entities could receive inferior service under the following scenarios:

 (i) sweep, pass-through, and zero-balance accounts will be confusing to customers, and require them to perform extra record keeping and reconciliation of transactions between their accounts with the FI and accounts with the Alternative Entity;

 (ii) in the case of pass-through accounts, the transaction could be slower, resulting in delays to the customer in both SCD and IDP transactions;

 (iii) when customers of Alternative Entities use ABMs under a sweep account arrangement, the balance showing on the transaction receipt will be the balance of their account with the FI, not their account balance with the Alternative Entity; and

(iv) when sweep accounts are used, customers at IDP Terminals will not have access to the full balance in their accounts with the Alternative Entity. Only the balance in the account with the FI will be available (and then only up to the Card transaction limits).

(c) Alternative Entities will not be in a position to effectively control and manage the relationship with their customers which will result in the following disadvantages:

(i) Alternative Entities will not be in a position to manage quality of service to their customers and to carry out their responsibilities to customers of ensuring privacy of customer and financial information;

(ii) in the event of a problem with a Card or a transaction, the Acquirer in the case of SCD, or the retailer in the case of IDP, would look to the FI Issuer to resolve the problem. The customer would not be the customer of the FI and the FI would not in all cases be in a position to resolve the problem;

(iii) the Alternative Entity may never be made aware of problems/issues involving its customers;

(iv) card issuing FIs will be in a position to collect information about transactions initiated by customers of Alternative Entities and use such information for their own marketing purposes whereas Alternatives Entities may not have access to such information about their own customers; and

(v) Alternative Entities establishing their own proprietary networks for services (such as electronic trading, ABMs, insurance issuing terminals, terminals in branch offices, etc.) will need to issue a second card to their customers. The FI issued Cards, with FI information encoded on the magnetic stripe, will not work in their proprietary systems.

(d) Alternative Entities will be restricted in their ability to negotiate new or alternative arrangements with an FI because of the substantial cost and negative customer impact on the transfer of the customer Card-base from the existing FI to a new FI; and

(e) because the FI issued Card contains information which relates only to the FI account, the Alternative Entity will not be able to offer its own proprietary network services with the FI-issued Card.

(i) The Importance of Controlling the "Card" in the Customer Relationship

41. The consideration of whether sweep, pass-through or zero balance accounts will permit Alternative Entities to effectively participate in Interac should be viewed in the broad context of both the Canadian financial services market in general and the more specific market for Shared Electronic Financial Services. Dramatic changes have occurred in these markets over the past 15 to 20 years. An understanding of the impact of these changes and the increasing importance of Shared Electronic Financial Services to the present market dominance of the Respondents is fundamental to my opinion on whether Alternative Entities can effectively participate in Interac by way of sweep, pass-through and zero-balance accounts.

42. The rapidly expanding applications of technology to provide customers with more timely and convenient access to financial services has changed one of the fundamental paradigms of the financial services industry. Customers no longer visit a branch office location as frequently to deposit and withdraw funds, as evidenced by the rapid growth of installation and use of ABM machines, ABM transactions, IDP

Terminals, IDP transactions, telephone banking, and more recently, services through the Internet.

43. Today, Cards play a key role in the shift in financial services towards greater convenience and flexibility for customers and lower delivery costs. The customer's Card and PIN are the means of obtaining services in or from virtually any location.

44. The relationship of FIs with their customers has shifted significantly to use of a Card. Cards continue to remind the Cardholder who the Issuer is, and where and what services the Card can be used for. They are a primary means for identifying a customer with a FI. Increasingly, competition for customer relationships is based on the value an organization delivers to its customers through the Card, such as the services the Cardholder can access, and value-added features such as merchandise points, travel points, or insurance benefits. Most FIs have Cards of different colors for classes of customers, and also vary the Card transactions limits, such as the maximum amount for IDP payments and ABM withdrawals allowed in a single day.

45. The Card Issuer builds on its relationship with a customer through the process of issuing the Card and the Cardholder agreement, customer selection of the PIN, and coaching the customer to use card-based services. Opening an account and issuing a Card are key points of customer contact in an environment in which customers visit branch offices less frequently.

46. The restrictions in the DCO that allow only FI's to issue Cards, provide FIs with exclusive control over customer initiated Shared Electronic Financial Services. That

is, FIs will have control over the relationships with all customers to whom Cards are issued, including the customers of Alternative Entities.

(ii) **"Splitting" The Customer Relationship**

47. Under the proposed use of sweep, pass-through, and zero-balance accounts, the Card can only be issued by an FI, not by the Alternative Entity that holds the customer's accounts. This proposal unnecessarily splits the relationship between the Alternative Entity and its customers.

48. In accordance with Interac By-law 5.01(f), the Card must bear the Issuer Identification Number of the Issuer Member, an FI. Also, to comply with CPA standards, the primary account number will be assigned by the issuing FI. The Issuer identification number and the primary account number are encoded on the magnetic stripe on the reverse of the Card. (CPA Standard 022, "Standard for Financial Transaction Cards: Data Content of Magnetic Stripe - Track 2"- Exhibit "A")

49. There is no provision in the Interac By-laws or CPA standards to identify the Alternative Entity electronically on the magnetic stripe on the Card. Placing a second account number on the magnetic stripe was determined not to be possible when SCD and IDP standards were developed.

50. Only the magnetic stripe on the reverse of a Card is read by a Terminal device. Accordingly, a Card issued by an FI to a customer of an Alternative Entity will be a Card of the issuing FI. Also, as specified in Interac By-law 5.01(g) "---the Card shall

clearly display on its face that the Card is the property of the Issuer". This presents a number of major and serious service issues to the Cardholder, the acceptors of Cards, and the Alternative Entities where the customers' funds are managed.

51. If the Cardholder is using an ABM owned by the issuing FI, the Cardholder may be subject to promotion messages displayed by the issuing FI. This would represent a further loss of control over the customer relationship by the Alternative Entity.

52. An Alternative Entity's relationship with its customers need not be split if the Alternative Entity were allowed to issue Cards to its own customers.

(iii) **Additional Costs to Alternative Entities**

53. The proposed use of sweep, pass-through, and zero-balance accounts will result in additional costs to Alternative Entities to provide their customers access to Shared Electronic Financial Services through Interac, including the following:

(a) The FI will incur a cost to set-up the sweep, pass-through or zero-balance accounts and associated system. This can be passed on to the Alternative Entity as either a flat fee based on costs incurred or a fee per account;

(b) The FI will incur costs for operating the customer accounts for the Alternative Entity. As accounts of the exact nature contemplated in the DCO do not exist in Canada, I assume an FI may charge a basic account maintenance fee in the range of $150 to $200 per annum. This is in the range of prices currently charged by some US banks to operate sweep accounts;

(c) The FI will incur a cost for issuing the Card, managing the selection of the customer PIN and executing the Cardholder agreement. From my banking experience, I assume that, based on the costs involved, the FI charge for this service could vary from $10.00 - $25.00 per Card;

(d) The FI will incur costs for processing transactions through the account that the customer must operate with the FI. I assume a typical FI fee structure might be used and, based on their published service price schedules, these fees may be $0.50 for an ABM transaction, an additional $1.00 charge for using an ABM owned by an FI other than the Card Issuer, $0.30 for an IDP transaction, and a monthly fee ranging from $0.00 to $2.50 for an account statement;

(e) The Alternative Entity might be charged a fee for each sweep transaction between its account for the customer and the account held by the FI for the customer. I assume this charge could be in the order of $1.00 to $2.00 per day for each account; and

(f) In the situation where the account with the FI starts with a zero balance and an overdraft position accumulates during the day, I assume the FI might charge interest on the daily overdraft balance.

54. If an Alternative Entity participated directly in Interac as an Issuer, no fees would be paid to an FI. In that case the costs associated with an Alternative Entity directly participating in Interac (in addition to its own set-up costs) would be:

(a) An intercharge fee of $0.75 when a customer uses an ABM of another member;

(b) An SCD switch fee, presently in the range of $0.12 to $0.17 per message (the fee now charged to Sponsored Members); and

(c) An IDP switch fee to Interac, which, in accordance with the DCO will be structured to recover Interac operating costs plus a portion of IMN recoverable costs.

The Alternative Entity would not incur the cost of issuing a second card to each of its customers for access to its own proprietary services.

55. Based on the above comparative cost structures, the additional cost of sweep and pass-through accounts contemplated by the DCO would place Alternative Entities at a major competitive disadvantage to FIs in providing Shared Electronic Financial Services to their customers. The following table illustrates some of the comparative costs of an FI and of an Alternative Entity using sweep, pass-through or zero-balance accounts.

TABLE 1: COST TO PROVIDE CUSTOMERS WITH ACCESS TO SHARED ELECTRONIC FINANCIAL SERVICES

Cost Element	Financial Institution as Defined in DCO	Alternative Entity
Interac initiation/entry fee as per DCO	$0	Cannot be estimated at this time.
One-time fee to set up arrangement for sweep, pass-through accounts with an FI.	$0	Will depend on specific arrangements negotiated.

Annual maintenance fee to operate each sweep, pass-through account.	$0	Estimated $150 to $200, per year, per account.
Issue card to each customer for use with sweep, pass-through account	$0	Estimated $10 to $25 per card issued.
Fees for ABM transactions	Switch Fee, plus $0.75 Interchange Fee when customer uses ABM of another FI	a) FI may pass on Switch Fee & Interchange Fee; or b) FI may charge ABM transaction fees in the range of $0.50 - $1.35, plus the $1.00 fee when the customer uses an ABM of another Member.
IDP transactions	Switch Fee	a) FI may pass on Switch Fee; or b) IDP transaction fee - typically $0.30.
Account statement fee	$0	$0 to $2.50 per statement
Sweep transaction, between account with FI and account with insurance, investment entity	$0	Estimated $1.00 to $2.00 per account per day.
Sweep account which incurs debit balance though the day	$0	Transaction fees plus interest on debit balance incurred during each day.

(iv) **Accountability and Responsibility for Transaction Problems**

56. The real test of any consumer financial transaction is how the system responds when there is a problem, not when the system works. It is critical that when problems arise they are dealt with effectively, quickly, and, from the customer's point of view, fairly. Placing an intermediary between the customer and the institution with which the customer thinks he or she is dealing will obviously make resolving problems more complex, confusing and time consuming. By adding an additional layer of complexity, the opportunity for problems to occur increases.

57. When the customer is using an ABM in the Interac network, the Cardholder will be a customer of the FI that issued the Card. In the event of problems with the Card, or access to the account, there is a serious question as to whether the FI Issuer would be responsible for resolving the problem promptly. This requirement to quickly solve such problems is critically important to the continuing goodwill and relationship between the Alternative Entity and its customer.

58. According to CPA standards 020 and 021 (Exhibits "C" and "D"), the issuing FI is responsible for resolution of problems with Cards occurring during a transaction. However, the customer of an Alternative Entity with an account at an FI will likely view the Alternative Entity as being responsible for both the problem and an efficient and timely solution.

59. If the customer of an Alternative Entity is using an FI issued Card based on a sweep, pass-through, and zero-balance account in a retail store, and there is a problem with the Card, PIN, or transaction, the retailer likely will deal with the issuing

FI (identified on the card). For various reasons, the issuing FI may not be in a position to resolve the problem thereby further delaying completion of the consumer's transaction with the retailer.

60. With sweep, pass-through or zero-balance accounts, the Alternative Entity will not be in a position to perform its responsibilities to the account holder, as defined in CPA Standard 021 - 6.4 (a) (Exhibit "C"). Such entities will be placed in the position of having to rely on the issuing FI to resolve problems such as duplicate charges to a Cardholder account, errors in amounts charged, or an entry charged to the wrong account.

61. Quality of service is fundamental to building a strong relationship with a customer in an electronic services environment. When using an ABM or the IDP service, customers are "on-their-own" and the entire process must be smooth, friendly, efficient and error free. FIs have made substantial investments in systems to manage their Cardholder relationships, to track utilization of Cards, and measure service response times. Equally, Alternative Entities must be in a position to manage the quality of service to their customers. Under the sweep, pass-through, and zero-balance account arrangements, they will be prevented from doing so.

(v) **Timing of Transactions**

62. In the case of pass-through accounts, Card transactions likely will take longer to process at an ABM or IDP Terminal. The additional time results from stopping the transaction at the issuing FI level, translating customer account and identification data into information that is meaningful to the Alternative Entity and having to encrypt the

message for onward processing through the Alternative Entity's systems. The reverse flow of the authorization or decline message would likewise have to be translated and encrypted for routing back to the Terminal. While such delays measure in seconds when the system is functioning properly, a few seconds are very noticeable to customers standing at an ABM or waiting in line for approval of IDP transactions. All times required to process such transactions will be in addition to the time required to process transactions for direct FI customers, and thus customers of Alternative Entities likely will receive a lower level of service.

(vi) **Privacy and Confidentiality**

63. Privacy and confidentiality are critically important in managing the financial assets of a customer. This has been dealt with extensively in CPA and CBA documents and the draft Canadian Code of Practice For Consumer Debit Card Services (Exhibit "D"). The CBA, in its submissions to the Department of Finance on "Banking Industry Views on Access to the National Payments System: Balancing Rights and Responsibilities", October 1995 (Exhibit "E"), states:

> "In the 1986 CPA document entitled The Framework for the Evolution of the Payments System, the CPA Board stated that one of the five basic principles on which the future evolution of payments systems in Canada must be based is, that "*the means of access to deposit accounts at CPA member institutions must be controlled by those institutions, and by contractual relationship between them and their account holders*". Two of the other four principles were integrally related to this: that "*the privacy of depositors and the confidentiality of their financial affairs must be rigorously maintained*", and that the "*techniques for identifying depositors and authorizing their payments must be the responsibility of the account-holding institutions.*" In our view, these principles are as valid today as they were a decade ago." (page 38)

64. Alternative Entities if compelled to use sweep, pass-through, or zero-balance accounts will be denied the right to perform these same critically important privacy and confidentiality responsibilities for their customers.

(vi) **Collection/Retention of Customer Information**

65. With Card based financial services, Issuers collect information about when, where and how frequently their Cards are used and for what purposes. This information is critically important in building and tracking customer relationships. Under the sweep, pass-through and zero-balance account structure, the Card issuing FI will be in a position to collect, maintain and analyze information about the Card activity of Alternative Entities' customers.

66. FIs are in the investments business. The proposed use of sweep, pass-through, and zero-balance accounts provides them with access to very valuable, competitively sensitive information about the customers of their competitors. Giving customer lists and information to competitors, thereby placing them in a position to promote their services to such customers, is contrary to reasonable commercial practice in a competitive environment.

67. As well, FIs are participants in the insurance business. The proposed use of sweep, pass-through and zero-balance accounts would require insurance firms to give information about their customers to FIs, which would then be in a position to use such information for their own marketing purposes to an Alternative Entity's customers.

(viii) **Lack of Flexibility in the Provision of Services**

68. The proposed use of sweep, pass-through, and zero-balance accounts gives rise to significant inflexibility to Alternative Entities by requiring them to have Cards issued to their customers by FIs.

69. If an Alternative Entity is not satisfied with the service provided by the FI Issuer, or if the FI increases its prices for the service beyond an acceptable level, the Alternative Entity is restricted in its ability to efficiently switch to another FI. Switching the FI relationship will require the Alternative Entity to open a new set of accounts with an another FI, and to arrange for its customers to obtain new Cards. Each customer of the Alternative Entity would need to obtain a new Card and select a new PIN. The new Card would contain different information on the magnetic stripe, the identity of the new Issuer on the face of the Card would be different, and the new Card may be subject to different limits for SCD and IDP transactions. The customer would be subject to the terms of a new Cardholder agreement. This process could be confusing and time-consuming to the customer of the Alternative Entity, and impact negatively on the relationship between the Alternative Entity and its customers.

70. The practical difficulties in moving from one FI Issuer to another could be severe. Not only would additional costs be incurred in establishing a new relationship, but all of the Alternative Entity's customers would need to be convinced to establish a new relationship with the new FI Card Issuer. This could result in customer dissatisfaction and loss of customers by the Alternative Entity. The practical difficulties of an Alternative Entity switching its Card Issuer may be apparent to the FIs, thereby

providing an opportunity for the FIs to establish a higher price for sweep, pass-through and zero-balance accounts.

71. Furthermore, if an insurance company were to establish sweep or pass-through accounts, the arrangement would involve significant investment of time and infrastructure costs. Therefore, the Alternative Entity would require a long-term contract to recover its investment. Long-term contractual commitments are, however, not conducive to the innovation and flexibility required to compete effectively in providing Shared Electronic Financial Services.

(ix) **Offering New Services**

72. The DCO makes provision for two or more members to offer a qualifying new service. Where an Alternative Entity wishes to introduce/participate in a new service, it could be prevented or delayed from doing so by its Card issuing FI. That is, the issuing FI may not accommodate the new service through the sweep, pass-through or zero-balance accounts, or with the Cards it has issued to the customers of the Alternative Entity.

73. An Alternative Entity could decide to install its own proprietary ABMs or other electronic service facilities for use by its own customers to purchase, for example, travel insurance, buy and sell securities or make deposits to investment accounts, whether or not such systems are attached to Interac. The Cards issued by an FI to provide access to Interac services would not provide access to the proprietary services of the Alternative Entity. Such Cards would only have an FI identification on the

magnetic stripe, be associated with a PIN the customer selected with the FI, and would be usable only against accounts held with the FI.

74. To provide customers with electronic access to its own proprietary network and services, an Alternative Entity would need to issue an additional, separate Card to its customers. This would place such Alternative Entities at a competitive disadvantage to FIs, which can issue a single Card to each of their customers for use in accessing all electronic services, both shared and proprietary.

75. In 1986, the CPA proposed a two-card concept whereby both the retailer and the FIs would issue separate Cards to a customer, and both Cards could be used in each IDP transaction. This approach was rejected as being cumbersome and costly. (CPA report "The EFT/POS Consultative Process: A Status Report", October 1988, page 19 - Exhibit "H")

VII. Guidelines for Proprietary Debt EFT/POS Implementations

76. Starting in the mid-1980s, retailers expressed a need to allow their proprietary cardholders access to funds held in accounts at FIs through EFT/POS (IDP) Terminals. As a result, in 1990, the CPA agreed on guidelines for "Proprietary Debit EFT/POS Implementations" (Exhibit "F"). These guidelines enabled a retailer to provide its customers with a card, which displayed the retailer's identity on its face and could be used by a customer to pay for purchases, using IDP, by debiting a customer's accounts with an FI. Under these guidelines, an FI would encode information on the magnetic stripe on the reverse of the Card, and would manage customer PIN selection.

77. The development of these guidelines involved consideration and recognition of many of the same problems outlined above for the use of sweep, pass-through and zero-balance accounts, including sharing the customer relationship, increased costs and customer confusion as a result of the requirement that only an FI could issue and encode information on the Card.

78. These guidelines were approved and have been in place for six years. To my knowledge these guidelines have not been implemented. In my opinion, retailers have not taken advantage of this opportunity because it would involve splitting the customer relationship, additional costs for issuing a second card to its customers and an additional layer of transaction processing. It was, and is not today, a viable competitive option.

VIII. Inefficiency of Sweep, Pass-through and Zero-Balance Accounts on a System-Wide Basis

79. In the "Statement of Grounds and Material Facts", the Director recognized that consumers and commercial entities in Canada demand a convenient, comprehensive and speedy method of communicating instructions to carry out various financial services. In my opinion, the inefficiency of sweep, pass-through and zero-balance accounts is contradictory to this need.

80. To retailers accepting IDP transactions, quick and efficient authorization response times are critical in providing efficient service to their customers. In my opinion, the extra steps that pass-through accounts require lowers this efficiency. Similarly, the confusion about who is responsible for the customer relationship in the

case of sweep and pass-through accounts, in the event there is a problem with a Card or transaction, will decrease the level of service to both the Cardholder and the retailer as the acceptor of the transaction.

81. Consumers are demanding access to, and use of, their funds in all types of accounts. FIs have already recognized this fact by providing customers with access at ABMs to credit cards, charge cards, and account overdraft facilities. The CPA and CBA have stated that such access is to deposit accounts, rather than to the more restrictive category of Demand Accounts. Evolving technology permits the "storage" of money in new and novel media. For example, two of the large banks in Canada will this year (1996) introduce "electronic wallets", which "store" money in a memory chip embedded in a card. These cards will be "cash" to the consumer, and will be recognized as such by the FIs. (The Mondex Report, 1995) (Exhibit "G") .

82. All locations where a consumer "stores" money in a form which is electronically accessible, and which represent purchasing ability to a consumer, irrespective of where such "stores" are held, should be readily accessible through Interac. There is no technological, system or other reason why the Interac network needs to restrict consumer access to their "stores" of money. Rather, the limiting factors are the current rules and standards and the proposed DCO, all of which limit innovation in services to consumers and access to all of their "stores" of money.

83. The use of sweep, pass-through or zero-balance accounts is cumbersome, is not necessary, and is not commercially viable. In proposing the use of sweep, pass-through and zero-balance accounts, the Director recognized the right of consumers to have access to funds held in accounts with Alternative Entities. There is no

technological, security, or other reason why access to such accounts should not be provided directly, with Cards issued by Alternative Entities. In fact, leaving out the additional layer and complexity of sweep, pass-through or zero-balance accounts would provide better security, as customers would be selecting a PIN with the organization directly responsible for the account, and the Issuer would be in direct control of how the Card can be used by its customers.

84. Virtually any system can be forced to work from a technological perspective. However, the sweep, pass-through, and zero-balance account process adds costs to transactions, will be inefficient, could violate the privacy and confidentiality right of consumers, negatively impact the ability of Alternative Entities to build and manage relationships with their customers, and adds unnecessary confusion. Such arrangements also introduce unnecessary costs in providing electronic services, and overall, will have a negative impact on achieving the shared electronic services objectives of Alternative Entities.

PART THREE: The Commercial Viability of Acting as An Acquirer Only in Interac

85. The DCO and Interac By-laws define an Acquirer as "A Member that obtains a request Message from a Cardholder for delivery to an Issuer".

86. Interac By-law 2.03(b) defines the criteria for an entity to be an Acquirer and to perform the function of an Acquirer as including:

(i) must be a corporation;

(ii) must provide one or more Terminals capable of satisfying the standards in the Operating Regulations and provide access to one or more services to Cardholders of other Members;

(iii) must be prepared to, and judged by the Board as able to, perform the functions of an Acquirer in the Service to which it seeks admission;

(iv) must promise to pay authorized items received from Issuers to persons entitled as provided in the Operation Regulations and with respect to the Shared Services, demonstrate its own capability to receive settlement and to settle, or an agreement satisfactory to the Board with a member of the CPA to receive settlement and to settle on its behalf; in both cases, in accordance with the procedure established in any Shared Service to which it seeks to be admitted;

(v) must comply with the standards and procedures for the operations of the Service as provided in the Operation Regulations and indemnify all other Members against losses or liabilities incurred by other Members as a result of the Member's failure to comply;

(vi) must provide adequate assurance of ability to perform the payment and indemnity in (iv) and (v) above; and

(vii) must complete an application in a form satisfactory to the Board.

87. Having met the criteria, and having been approved by Interac as an Acquirer, the potential business for an Acquirer can include:

(a) renting or selling IDP Terminals and pin-pads to retailers or other IDP acceptors, and this only if potential non-FI Acquirers are allowed to participate in the PIN management process as defined in CPA standards;

(b) supplying and operating ABM's for SCD transactions; and

(c) acquiring transactions from owners/operators of ABMs and IDP Terminals.

88. In the Director's Statement of Grounds and Material Facts, par. 61(b), the Director recognized that Sponsored Members were disadvantaged vis-a-vis Charter Members. In the situations described in par. 61(b), Sponsored Members were allowed to be Card Issuers, were members of the CPA, could own and operate ABMs and could deploy IDP Terminals only if they were Issuers. However, the DCO and Consent Order Impact Statement suggest that it will be viable for a commercial entity acting as an Acquirer only to participate in Interac. In my opinion, a commercial entity acting as an Acquirer only, would be more disadvantaged than a Sponsored Member currently in Interac. Commercial entities acting as an Acquirer only will not be allowed to issue Cards, must deploy Terminals and will not have the advantage of being a CPA Member to assist in their negotiations with an FI for settlement services.

89. It is my opinion that a business restricted to acquiring transactions in Interac is not commercially viable for the following reasons:

(a) The Respondents, which operate as both Issuers and Acquirers, constitute an established, extensive network in Interac. This existing network represents an insurmountable barrier to a commercial entity wishing to participate profitably as an Acquirer only in Interac;

(b) There is inadequate revenue which could be generated from the acquiring side of the Interac system to operate profitably as an Acquirer only;

(c) The DCO and the Interac By-laws place substantial restrictions on the services which could be offered by Acquirers;

(d) Before a commercial entity can participate in Interac as an Acquirer only it must overcome potentially high costs and the time-consuming process of achieving changes to CPA standards and thereafter complying with such standards;

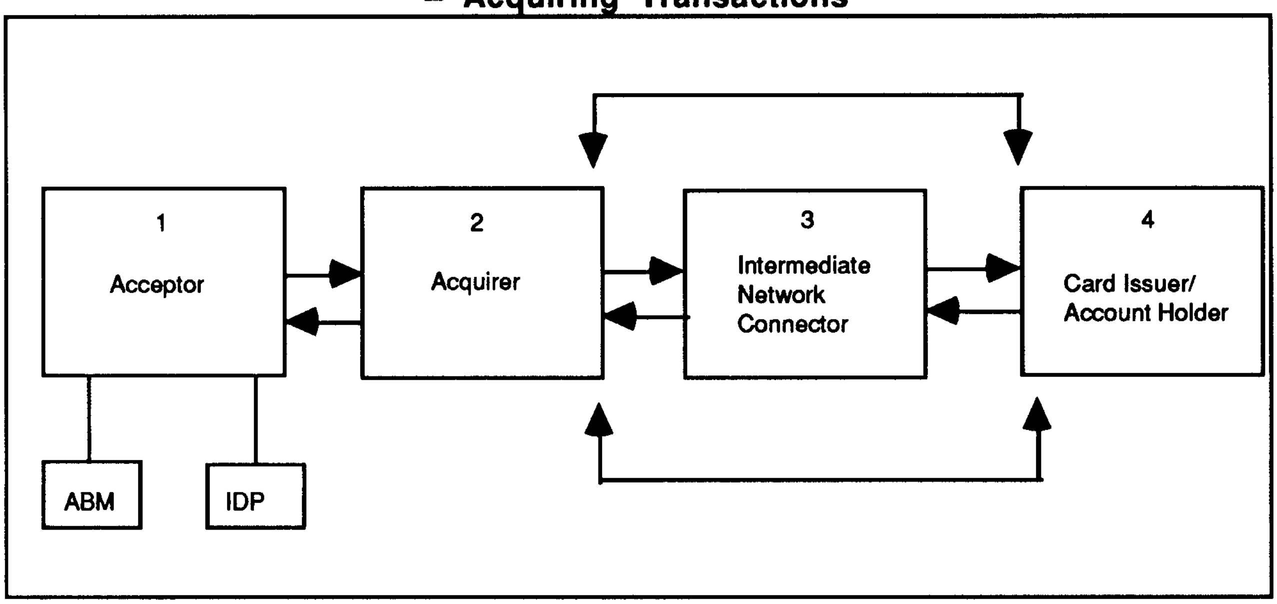
(e) Acquirers only are locked-out of the profitable business of acting as an Interac Issuer and, as an Acquirer only, will not generate sufficient revenues to be commercially viable.

(i). How Acquirers Would Likely Operate Under the DCO

90. Proposed Interac By-law 2.03(a) relies on paragraph 3(a) of the DCO to continue to require that a Card Issuer be an FI and hold Demand Accounts that would be accessible by Cards. This means that a commercial entity, that is not an FI, can participate in Interac only as an Acquirer of SCD and IDP transactions and not as an Issuer.

91. The present Interac network can be viewed as four closely integrated roles, as shown in Figure 4 below.

Figure Four: Present Roles in the Interac Network – Acquiring Transactions



(1) The acceptor of transactions, that is an operator of ABM and IDP Terminals;

(2) The FI Acquirer of transactions, that also may be an acceptor and an Issuer; Sponsored Members are Acquirers and Issuers;

(3) *Intermediate Network Connector, who on behalf of an Issuer or Acquirer, provides access to Interac. At present, Intermediate Network Connectors are the Charter Members that provide access for Sponsored Members.*

(4) *Issuer, that must be a qualifying FI.*

92. The present Charter Members of Interac can perform all of the Interac roles identified in Figure 4: acceptor, Acquirer, Intermediate Network Connector and Issuer. Sponsored Members can perform the roles of acceptor, Acquirer and Issuer. In the case of IDP, acceptors are primarily retailers which operate point of sale terminals, although such terminals are almost exclusively owned/supplied by FIs. Retailers currently have no direct role in establishing the rules and standards for SCD and IDP services.

93. At present, Acquirers of transactions are primarily the Charter and Sponsored Members of Interac. The Charter Members own or control more than 90% of the Terminals attached to Interac.

94. The Charter Members of Interac have full control over the operations of the Interac network by virtue of the Interac By-laws, Operating Regulations and CPA standards. For example, FIs control the "keys" for providing message security (encryption/decryption), and thus are in control of all transaction processing stages from Terminals through to the account of the Cardholder.

95. FIs are SCD Acquirers for the full range of transactions initiated by the bank issued Cards, including co-branded cards. Some FIs may also acquire transactions of foreign card issuers with Plus and Cirrus network labels. Commercial entities, which are not FIs, may not be able to acquire this full range of transactions as many of these are outside of the terms of the DCO.

96. In the case of IDP, FI Acquirers accept IDP transaction authorization requests from retailers, and when transactions are complete, are in a position to confirm the credit to the retailers' accounts. That is, they handle the complete transaction with the retailer. Commercial entities, which are not FIs, will need to negotiate an agreement with an FI to process and settle each credit to retailers' accounts.

97. The DCO, and to a lesser extent the Interac By-laws, allow qualifying FIs and other commercial entities to connect directly to Interac. The key "roles" in Interac under the DCO are described in more detail in Appendix 'D'.

(ii) Existing Market Domination by Respondents

98. A commercial entity, which is not an FI, faces the following general market conditions in attempting to participate as an Acquirer only in Interac:

(a) There are approximately 13,850 branches of Canadian chartered banks, credit unions and caisses populaires, trust and loan companies, and government savings institutions in Canada, one branch for every 2,125 people. The chartered banks have over 8,000 branches, one for every 3,680 people, which is the highest ratio of full-banking branches to population in major industrialized nations.

(b) There are over 17,000 ABM's in Canada, one for every 1,730 people. Only Japan has a higher ration of ABMs to population than Canada. ABMs are owned by CPA members and about 95% are owned by the chartered banks. About 98% of ABMs are connected to Interac.

(c) Members of Interac have more than 170,000 IDP Terminals installed, in more than 140,000 retailer locations.

(d) IDP transactions totaled about 390 million in 1995, a 111% increase over 1994.

(e) Interac members have issued 42 million Cards with the capability to access ABMs. 26 million are bank issued Cards that consumers can use for IDP, and in December 1995, 8.2 million persons used the IDP service.

99. These extensive Canada-wide networks of branches provide FIs with all the tools necessary to promote, market and service Shared Electronic Financial Services to both consumers and retailers. This existing presence, at all levels of the market, gives FIs a significant competitive advantage which commercial entities would need to overcome before they can provide Shared Electronic Financial Services profitably and competitively. In addition, it is a fact that virtually all consumers and commercial entities are already customers of FIs.

100. It is my opinion that there is no significant remaining potential for installing ABMs in Canada, as a viable business venture, particularly for a commercial entity not allowed to be a Card Issuer, and which is acting only as an Acquirer. For example, Alternative Entities are not allowed to directly issue Cards to their customers to access Interac. This means that if an Alternative Entity were to install a network of ABMs connected to Interac the system could only accept cards issued by FIs for SCD. Any proprietary services such Alternative Entities provide through these proprietary networks would require issuing a second card to the customers.

101. FIs, particularly the Respondents, have a substantial lead in the installation of ABMs and IDP Terminals. The anti-competitive practices described in the Director's Statement of Grounds and Material Facts prevented other entities from becoming established when the market for Shared Electronic Financial Services was growing through the late 1980's to the present.

102. Visa and MasterCard, the two dominant networks providing both on-line and off-line IDP equivalent services in the US, have not become significant participants in the provision of Shared Electronic Financial Services in Canada. The Canadian operations of these entities is largely controlled by groups of the Respondents.

103. In the Director's Statement of Grounds and Material Facts, the Director recognizes the limited potential for networks to compete with Interac, and the necessity to have a large deposit base in order to be a commercially viable network as follows:

(a) Par.51 states "Although a few small shared electronic financial services networks exist in Canada, they lack access to a sizable deposit base and broad geographic ABM coverage. Accordingly, these networks are of limited scope and convenience to consumers, retailers and other service providers and are not competitive alternatives to the Interac Shared Services".

(b) Par.52 states: "Circuit is a shared electronic financial services network in Canada comprised of BMO (which controls Circuit) and certain Sponsored Members of Interac, that are sponsored by BMO. The limited size and geographic coverage of Circuit is such that access to its shared electronic financial services network is not a viable substitute for access to those supplied by Interac."

(c) Par. 54 states: "---- it became essential for financial institutions to connect to the Interac Shared Services in order to retain their customer base and to compete effectively in other retail financial services markets. Access to Interac's Shared Electronic Network Services is equally and increasingly essential for other financial institutions, retailers, service providers and others who compete with FIs in retail financial services markets." This statement, given its use of the words "customer base" may also be referring to the necessity to be Issuers in order to compete effectively.

104. During the early stages of ABM and EFT/POS (IDP) growth in Canada, networks such as Express, Access ATM, and Sunrise were not successful. (Par. 22 and 32: - Director's Statement of Grounds and Material Facts) In my opinion, key restrictions limiting their success, in addition to those mentioned in the Statement of Grounds and Material Facts, were:

(a) that transactions generated by Cards that were not issued by FIs, were not eligible for clearing; and,

(b) the strict account eligibility requirements imposed by the FIs.

105. The Charter Members of Interac have acquired and maintained control over a large segment of the financial services industry in Canada. Given their entry into the insurance industry and their investment business activities, it is very unlikely that they will co-operate with an Alternative Entity wishing to enter the business of acquiring SCD and IDP transactions. In my opinion, FIs, as Issuers, and having existing business relationships with virtually all retailers (acceptors of IDP) are likely to retain the acquiring business for themselves. By limiting Alternative Entities to being only Acquirers, such entities therefore will not be in a position to provide a service competitive with that provided by FIs.

(iii). The Costs of Establishing an Interac Acquirer Only Service

106. The minimum costs required of a potential new transaction Acquirer only entrant in Interac include:

(a) the capital and financial resources necessary to meet the financial qualifications to become a Member of Interac as set by Interac from time to time;

(b) the resources to establish a competitive presence to market and support services. This is not insignificant given the extensive marketing and support networks which FI's already have established in the marketplace;

(c) resources to create the software and purchase the hardware to acquire transactions and operate the IMN software;

(d) resources to establish the necessary communication networks to acquire transactions with the capacity to meet Interac specified performance standards and retailers' needs;

(e) resources to establish the necessary administrative structures and personnel to operate the business;

(f) payment for necessary arrangements with one or more FIs to process and settle IDP transactions with retailers and to settle with other Members; and

(g) purchasing, having certified by FIs, and installing ABMs and/or IDP Terminals, as required by the Interac By-laws.

107. An Acquirer will also need sufficient financial resources to compete with FIs for IDP business in situations where FIs can price IDP transactions to retailers at a “zero” fee in order to retain their relationship with their retailer customers.

(iv). Revenue Sources for an Acquirer Only Operating in Interac

108. Each of the above costs would be incurred against the very limited potential for revenues in an acquiring only business.

(a) **Revenues from SCD**

109. The revenue sources for a commercial Acquirer only entity, which is not an FI, on an SCD transaction, consists of only the Interchange Fee and potential Surcharges.

110. It is unlikely that an Acquirer only can generate sufficient revenue from SCD transactions to pay the direct costs of operating an ABM. For example, the average volume of SCD transactions through an ABM in Canada in 1994 was 16,377. These transactions would generate approximate interchange revenue of $12,282 per ABM. After switch fees (assuming the typical switch fee presently charged to Sponsored Members), net revenues would be $10,316. This is less than the annual cost of supplying and operating an ABM. The potential revenue to a commercial entity acting as an Acquirer only, would be limited to Interchange Fees and potential Surcharges, as they will not have the benefit of fee revenues from Cardholders for use of credit Cards at ABMs, and for other ABM transactions, such as deposits. They may also be excluded from revenues for international Cardholder use of ABMs, since the arrangements with international networks are negotiated with FIs outside the parameters of Interac.

(b) **Revenues from IDP**

111. In the case of IDP, the revenues available to a commercial entity Acquirer only, which is not an FI, will be limited to:

(a) Terminal rental fees charged to retailers; and

(b) transaction fees charged to retailers.

(c) **Potential Revenues from Surcharges as Permitted by the DCO**

112. The DCO contains a provision for a Surcharge to be charged to Cardholders at both SCD and IDP Terminals.

113. In the case of SCD, an Acquirer which imposes a Surcharge would be at a competitive disadvantage with FIs that may not impose a Surcharge since the Acquirer's service to Cardholders would be more costly.

114. In the case of IDP, Surcharges are absolutely prohibited pursuant to Interac By-Law 5.11. Interact ByLaw 5.11 provides as follows: "Any Acquirer Member in the IDP Service must include in its merchant agreement and enforce a clause prohibiting the Merchant from charging a fee to any Cardholder for the use of the IDP Service".

(d) **Cross-subsidization of services to retailers.**

115. FIs are in a position to cross-subsidize their acquiring and issuing services. FIs, in addition to the large revenues and cost savings associated with being an Issuer,

collect fees from retailers for operation of the accounts to which IDP transactions are credited. They are also in a position to bundle services to retailers such as, IDP, credit card authorization, credit facilities, deposit accounts, and the supply of cash, and to price competitive "transaction" aspects of the IDP service at "zero". Participants which are not FIs, being restricted to the business of acquiring transactions, will not have this same flexibility of service cross-subsidization.

116. The potential revenue to Acquirers who are not FIs in Interac is further limited by the DCO and Interac By-laws by requiring that a new shared financial service must have networked on-line access to Demand Accounts. This restriction means that an Acquirer is substantially limited in providing innovative new services as a source of additional transaction acquiring revenue.

(v). Financial Benefits Available to Interac Issuers

117. Since the introduction of Shared Electronic Financial Services, in my opinion, the majority of revenues have accrued to Issuers of Cards. These include large fee revenues, as well as the less-quantifiable benefits of building customer relationships through attaching more service access privileges to the Cards, providing convenient service access to customers, and attaching value-added products such as insurance and merchandise points.

118. The quantifiable financial benefits of being an Interac Issuer include the following:

(a) Customer transactions are removed from branches, thereby reducing the cost of in-branch customer service and the need to expand physical facilities. ABMs, IDP, and other electronic services have reportedly removed as much as 80% of routine customer-initiated transactions from branches of some FIs;

(b) Card issuing FIs are in a position to deliver their services to customers in and from all locations, and to generate additional revenues, without the need to establish a costly physical branch presence;

(c) The cost of delivering a cash withdrawal at an ABM, for example, is in the vicinity of $0.40, whereas the cost of delivering the same service in the branch is in the order of $1.60;

(d) FIs collect substantial revenues from Cardholders for Shared Electronic Financial Services, including:

(i) Fees charged to customers for the use of an ABM of another Member were in the order of $271 million in 1994.

(ii) ABM transaction fees, using a very conservative $0.50 per-transaction service charge, would have a value in the vicinity of $600 million using published volume numbers for 1994.

(iii) IDP transaction fees to Cardholders, using a conservative per transaction charge of $0.30, produced revenue of about $117 million based on 1995 volumes.

(iv) IDP transaction fees to retailers, using a per transaction fee of $0.12, produced revenue of about $47 million.

(v) Terminal rental fees charged to retailers produced revenue of about $75 million.

119. A summary of potential fee revenue sources to commercial entities, which are not FIs, and FI Acquirers/Issuers appears in the following table.

TABLE 2: SUMMARY OF POTENTIAL FEE REVENUE TO NON-FI ACQUIRER AND FI ACQUIRER/CARD ISSUER

Source of Revenue	Non-FI Acquirer	Potential Revenue to: FI Acquirer/Card Issuer
SCD Interchange fee	$0.75 per transaction	$0.75 per transaction
Fee to Cardholder using ABM of another Member	$0.00	$1.00 to $1.25 per transaction fee to Cardholder
Plus, Visa, Cirrus, MasterCard, etc. transactions	$0.00	$1.00 to $2.00 per transaction
ABM transactions through Cardholder account	$0.00	$0.50 to $1.35 per transaction to Cardholder
IDP Transaction Fee to Retailer	$0.00 to $0.18 per transaction	$0.00 to $0.18 per transaction
Fees for deposit to Retailer's Account, reconciliation of transactions, etc.	$0.00	Varies depending on retailers overall relationship and services with FI
Terminal Rental Fee charged Retailer	$30 to $50 per month, per Terminal	$30 to $50 per month, per Terminal
Recovery of IMN Cost	$0.00	$0.003 per message in year 1 reducing to $0.0006 per message in year 10, to Respondents (each transaction consists of 2 messages)

(vi) Commercial Viability of a Commercial Entity, Which is Not an FI, Operating as an Acquiror Only.

120. For the reasons set out in paragraph 89, as further articulated in paragraphs 90 to 119 of my Affidavit, it is my opinion that a commercial entity restricted to acquiring transactions in Interac only is not commercially viable.

This affidavit is sworn pursuant to Rule 47 of the *Competition Tribunal Rules*.

SWORN before me)
at the City of Toronto)
in the Municipality of Metropolitan)
Toronto, this 2nd day of March, 1996.)
)
)
A Commissioner for Taking Affidavits, etc.)
Frank P. Monteleone

KENNETH J. MORRISON

APPENDIX "A" - Experience and Qualifications of Kenneth J. Morrison

(i) **Education:**

Bachelor of Commerce, Concordia University, 1972

(ii) **Employment History:**

- Royal Bank of Canada - 1960 - 1993 including the following positions:

  (a) 1960 - 1972 Various positions in branch banking and Head Office

  (b) 1972 - 1975 Manager, Clearings Control and Cost Analysis

  (c) 1975 - 1976 Assistant to General Manager, Finance and Investments Division

  (d) 1976 - 1979 Manager, Management Control Systems

  (e) 1980 Assistant General Manager, Business Systems Development

  (f) 1981 - 1985 Vice President, Systems Development

  (g) 1985 - 1986 Vice President, Technology, Planning and Financial Management

  (h) 1987 - 1988 Vice President, Information Technology Strategy

  (i) 1988 - 1990 Vice President, Technology and Distribution Networks

  (j) 1990 - 1992 Vice President, Network Planning and Automation, and

  (k) 1992 - 1993 Vice President, Quality Service and Planning, Retail Banking Division

- Private consulting business including payment systems and electronic services distribution networks - 1993 - 1996

(iii) **Specific Positions/Committees Relating to Banking, Banking Networks and Payments/Clearing:**

(a) 1983 - 1984 Member of Royal Bank management committee to study future of financial services industry.

(b) 1973 - 1992 Member of various Canadian Bankers Association Clearing and Payment Systems Committees.

(c) 1980 - 1983 Member of Committee consisting of representatives of banks responsible for the Visa Canadian Authorization Network project.

(d) 1983 - 1984 Chaired Royal Bank Committee to develop Information Privacy Policy.

(e) 1983 Participated in the initial meetings of Canadian banks to consider the formation of a shared Automated Banking Machine ("SCD") network in Canada.

(f) 1984 - 1991 Member and Alternate Member of Canadian Payments Association Senior Planning Committee.

(g) 1981 - 1990 Responsible for various systems development and technology functions at Royal Bank during the period when systems for providing ABM services and shared electronic network services were being developed.

(h) 1985 - 1986 Faculty Member - Royal Bank Management and Technology Program.

(i) 1985 - 1989 Participated in committees involved in the development and approval of Canadian Payments Association ("CPA") Standard 020: "Standards Applicable to Cash Dispensing In Networks of Shared Automated Banking Machines".

(j) 1981 - 1985 & 1990 - 1992 Responsibilities for Royal Bank's communication networks and services.

(k) 1990 - 1991 Advisor to Institute of Canadian Bankers on development of curriculum and texts for Technology and Banking Courses for chartered banks' staff.

(l) 1990 - 1992 Responsible for Network Planning and Automation in Royal Bank including developing strategy and policies for ABMs, expanding the network of ABMs, programs to increase customer use of ABMs, managing the marketing and operation of Sponsored Member services, and managing overall quality of service, costs and revenues associated with ABMs. Implemented ABMs in the Caribbean.

(m) 1980 - 1993 Participated in developing Royal Bank of Canada strategy and plans for electronic delivery of consumer financial services, in which the client card was a key component.

(n) 1992 Managed development and pilot launch of Telephone Banking Service

(o) 1990 - 1992 Managed Royal Bank of Canada client card operations, including card design, cardholder agreements, card issuance, card utilization, and participated in strategy and plans for building customer loyalty in card-based electronic service environments.

(p) 1992 Established Royal Bank branches in two (2) retail stores.

(q) 1985 - 1992 Participated in Royal Bank of Canada's strategy and plans for introduction and expansion of IDP services.

(r) 1985 - 1990 Participated in the development and approval of CPA Standard 021: "Standards and Guidelines Applicable to Electronic Funds Transfer at the Point of Sale.

(s) 1989 - 1990 Chaired a CPA Committee, which included financial institution and retailer representatives, to discuss alternatives for using retailer -issued cards to access funds in FI deposit accounts for IDP payments. The Committee developed a document "Proprietary Debit EFT/POS Implementations" which specified the manner in which retailer cards could be issued and used. The process was approved by the CPA and is referenced in CPA Standard 021.

(t) 1976-1992 Participated as a member of various Canadian Bankers Association ("CBA") and CPA Committees which included dealing with the broad policy issues of clearings, access to deposit accounts, security, standards, and other aspects of Payments Networks and Services.

(u) 1984 - 1985 Participated in Federal Government Task Force on Transborder Data Flow and Privacy. and

(v) 1983 - 1988 Member of the Board of AST TransAct, a company providing data processing and EFT/POS switching services in the U.K.

(iv) **Speeches, Papers, Conferences on Electronic Payment Networks:**

Delivery of papers and speeches to various organizations on payments systems and electronic services distribution networks including the following:

(a) "Information Technology and Personal Privacy in Canada" - Science Council of Canada (1984);

(b) Presentations on "Information Privacy" - McGill University (1987-90);

(c) Presentation on the "Need for Competition in the Telecommunications Industry" - CBA; McGill University; and Communications Industry conferences (1986-89);

(d) "Payments Systems Security" - CBA Conference (1987);

(e) "Computer Crime" - Treasury Management Association (1989);

(f) "Security in the 1990's: Getting Management Involved" - CPA conference (1990);

(g) "Computer Crime and Fraud" - Treasury Management Association (1990);

(h) "The Only Secure Solution: Total Quality Management" - Canadian Computer Security Symposium, Ottawa (1992);

(i) "Computer Security in Payment and Delivery Systems" - Society of International Treasurers (1992);

(j) "National Payment Systems", India, September 1994;

(k) "Managing Customer Relationships", Philippines, October 1994;

(l) "National Payment Systems", China, November 1994;

(m) "Electronic Payment Systems", American Bankers Association, Atlanta, March 1995;

(n) "Payment Systems in Emerging Economies", Dayton, April 1995;

(o) "Electronic Payments: The Economic Justification - Who Are the Winners in an Electronic Environment", CPA conference, Montreal, June 1995;

(p) "Doing Business Securely on the Information Highway", EDI World Institute Conference, Montreal, August 1995;

(q) "Payment Systems: Winning in an Electronic Environment", Saskatchewan Credit Union Conference, Regina, September 1995;

(r) "Payment Systems for VietNam", October 1995;

(s) "The Role of Debit Cards in the Virtual Delivery System", Financial Services Industry Summit, Toronto, December 1995; and

(t) "Payments Systems: A Need for Change" - Retail Council of Canada Submission to Department of Finance (November 1995).

(v) **Private Consultations and Retainers:**

From December 1993 to November 1995, a consultant and advisor to AT&T Global Information Solutions and other AT&T subsidiaries on payment systems and networks worldwide.

From June, 1995 to the present, a consultant and advisor on payment system matters relevant to retailers.

APPENDIX "B" - CPA Rules and standards Restricting Operation of Shared Electronic Financial Services

1. The introduction to CPA EFT/POS standards states, for example:

   " The domain of the standards and guidelines extends from the point of transaction origin through to the point of authorization, data capture, and subsequent inter-member settlement. Therefore, these standards and guidelines apply to all levels of an EFT/POS network, including those components under the control of account holders, card Issuers, acceptors, Acquirers, and intermediate network connectors".

(Exhibi "C", page 2). This definition appears to cover all processes in providing an IDP or SCD service, including activities of customers in locations such as retail stores.

2. The rules and standards applicable to SCD and IDP services were developed by FIs. It is evident that these rules and standards were designed to protect the market interests of FIs. For example, current standards require encoding of a financial institution primary account number on the magnetic stripe on a Card. (Exhibit "C", page 10, 2.7), (Exhibit "F", page 4, (c)), and (Exhibit "A"). The initial digits of the primary account number must identify the Account Holder, which is defined as a CPA member. (CPA Standard 020, Definitions). Control over the content of the magnetic stripe on the card, as defined in these standards, gives FIs exclusive control over the ways in which Cards can be issued, and used, in Shared Electronic Financial Services.

3. The proposed Interac By-laws and the DCO, are more restrictive than current Interac practices and CPA standards. CPA standards use the term deposit accounts, defined as "A chequing or savings account where funds standing at the disposal of the Cardholder are, as defined by the account holder, transferable by order to a third party". (CPA standards 020 & 021). This broader deposit account term has been used

by the FIs for several years when referring to electronic networks. (The Framework For the Evolution of the Payments System, CPA, February 1986).

4. The CBA submission on Banking Industry Views on Access to the National Payments System: Balancing Rights and Responsibilities, October 1995, goes even further by recognizing that the services offered by banks, trust companies, credit unions, insurance companies and other financial services companies "have become increasingly similar" (page 2). This statement is a recognition that customers now hold funds in accounts with a variety of institutions that serve the financial needs of Canadians.

APPENDIX "C"- CBA Statements Re Payable-Through Accounts

1. Canadian financial services literature, including documentation produced by the CBA and CPA, does not separately define the specific nature of sweep, pass-through and zero balance accounts. Rather, they are more commonly referred to using "payable-through" terminology and in the context of the types of transactions eligible for the clearing system.

2. The CBA is on record as not supporting the use of payable-through type accounts and transactions, as evidenced by the following statements in the CBA submissions to the Department of Finance on Banking Industry Views on Access to the National Payments System: Balancing Rights and Responsibilities, October 1995. [Exhibit "E"].

1) "Deposit-taking activities must be engaged in only pursuant to specific legislative authority. 'Backdoor' deposit-taking activities, such as those facilitated by 'payable through' arrangements raise substantive risks to consumers and counter-party institutions and so, must be curbed." (page iv)

2) "Indeed, an increasing number of companies, including those subject to little or no regulatory supervision, are entering the deposit-taking field by way of the 'back door', and are offering 'deposit accounts' with chequing and electronic payments services attached. For example, some corporate entities have set up 'payable through' account arrangements with CPA members, with customers of the corporate entity who have no direct relationship with the CPA member able to issue 'payable through drafts' (usually looking very similar or identical to cheques, but without the same legal attributes) drawn on the corporate entity. These companies are not subject to the same regulatory control and scrutiny as banks and other financial institutions expressly provided with deposit-taking powers. Without effective regulation of existing legislative restrictions over deposit-taking activities, the security of depositors could be affected detrimentally and government jurisdiction and control over the area will become increasingly meaningless."(page 7)

3) "Concerns have previously been identified and expressed by the CPA with respect to certain types of 'payable through' account arrangements and 'payable through drafts'. These concerns include the risk of possible confusion by the payee as

to the nature of the instrument received, given that it may look identical to a cheque but may have very different rights and liabilities associated with it." (footnote, page 7)

4) "A broadening of CPA membership would not necessarily require an amendment to the sections of the Act relating to 'cheques', since bills of exchange drawn on any new CPA member would automatically qualify as 'cheques'. However, consideration should be given to putting regulatory parameters around the issuance of instruments which look like cheques but which are not drawn on CPA members and are therefore not cheques. Such instruments may be drawn on investment brokers, insurance companies or others and simply be 'payable through' (i.e. collected and processed by) a CPA member. The fact that these instruments are not subject to the rights and responsibilities provided in the *Bills of Exchange Act* relative to cheques and because they may be linked to other than deposit accounts (e.g. investment accounts subject to market fluctuations) makes them fundamentally more risky than cheques for consumers. Furthermore, since 'payable through instruments' are often visually indistinguishable from cheques, their appearance may mislead the payee, who may have accepted the instrument on the belief that it is a cheque. The banks therefore recommend that regulatory authorities address the risks associated with 'payable through arrangements', which might include a prohibition in the *Bills of Exchange Act* against the issuance of instruments with all the visual attributes of cheques, but drawn on a non-CPA member. Issues relating to the clearing and settlement of 'payable through' instruments are being considered by the CPA." (page 12).

3. Given the CBA's formally announced position on the matter of payable-through type accounts and transactions, it is highly unlikely that FIs will accommodate sweep, pass-through, and zero-balance accounts as contemplated in the DCO.

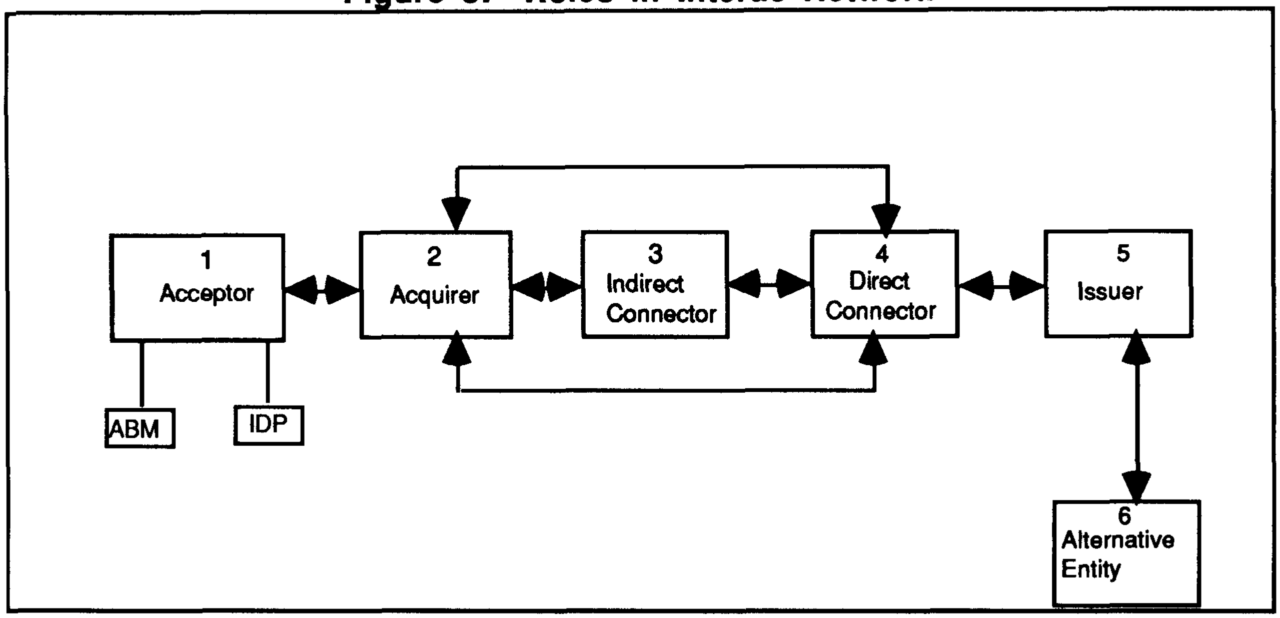
5) "The Interac Association provides inter-member network facilities for shared cash dispensing services using ABMs and shared direct payment (or POS) services. The shared ABM network allows the customer of one Interac member to obtain cash from the ABM of another Interac member. The shared POS service allows the holder of a debit card issued by one Interac member to purchase goods and services at the place of business of a retailer or service provider banking with and using the Terminal of another Interac member. Interac has a body of By-laws and rules which members must comply with in regard to the operation of its networks, and the transactions flowing through it. All transactions must be "CPA eligible" and, therefore, CPA rules and standards are applicable as well." (page 27)

6) "Another issue is whether such parties should be given the "keys" to the deposit accounts held by deposit-taking financial institutions. This would be fundamentally irreconcilable with the legal duty of care owed by a deposit-taking financial institution to its customer, and the duty only to take payments on the customer's behalf with proper authorization. Moreover, it is at odds with one of the main purposes of

regulatory control over the business of deposit-taking - to protect the deposits of consumers - and with such consumer-oriented regulatory measures as the Canadian Code of Practice for Consumer Debit Card Services, which provides a framework of requirements to be followed by card issuing financial institutions with respect to disclosure, redress, liability, and other matters. There are, however, opportunities available for participation by third parties with respect to the exchange and processing of transaction messages." (page 28)

APPENDIX "D" -

Figure 5: Roles in Interac Network



NOTES:

(1) An acceptor is defined under CPA standards as the owner or operator of the Terminal. Acceptors could be FIs or other commercial entities, including retailers.

(2) The DCO and Interac By-laws define an Acquirer as: "A Member that obtains a request Message from a Cardholder for delivery to an Issuer." An Acquirer could also be an acceptor, a Direct Connected Financial Institution (DCFI), a Direct Connected Non-Financial Institution (DCNFI), or an Indirect Connector (IC).

(3) An Indirect Connector (IC) can connect to Shared Services only through a Direct Connected institution.

(4) The DCO defines a Direct Connector as "Any commercial entity or FI using the IMN to communicate directly with other Members for the purpose of accessing a Shared Service or a Bilateral/Multilateral Service". This is essentially the same role as is performed by the Charter Members, for Sponsored Members, in the current Interac structure. On the other hand, the Interac By-laws are more restrictive and require that the purpose of a Direct Connector be "accessing a Service through its own facilities or facilities operated for its own account and benefit". That is, a Direct Connector must provide Terminals.

(5) An Issuer must be an FI, as defined in the DCO and Interac By-laws.

(6) An Alternative Entity is allowed to provide its customers with access to IDP and SCD services only through sweep, pass-through, or zero-balance accounts conducted with an FI. Such entities could, however, be an acceptor, Acquirer, IC, DCNFI, or any combination of these roles in Interac.

1. On the basis of these definitions, a commercial entity, which is not an FI, may only acquire transactions, irrespective of whether it is a Direct Connector or Indirect Connector. It may also be an Acceptor and own Terminals, although not required to do so by the DCO.

2. SECURITY, TERMINAL CERTIFICATION AND SETTLEMENT

(a) Cardholder PINS and other critical message components are encrypted at all times as they move between the Terminals and the Card-issuing FIs in Interac. The "keys" required to encrypt and decrypt messages are contained in Terminal devices and the systems of the FIs, and are under their control. The FIs have, since the early 1980's, taken the position that they will not share the "key" management process with entities that are not part of the CPA. Retailers, for example, have requested that they be allowed to participate in "key" management, or that a different encryption process be used, in order for retailers to have more control over the selection and configuration of Terminal devices in stores. These requests were denied.

(b) Under the provisions of the DCO, a two-thirds majority vote of the Interac Board is required to change matters which constitute Fundamental Changes, which includes all security issues.

(c) FIs control the certification of Terminals.

(d) In order to qualify as a DC Acquirer, a Member must certify that it has met testing requirements for the functions and services to be performed, and have executed an agreement with Interac to gain access to the IMN.

(e) Commercial entities, which are not FIs, will need to establish arrangements with an FI to meet the requirements for finality of payment transactions and settlement, as defined in the Interac By-laws and CPA standards and will also need to establish arrangements for interactive exchange of messages during the day (CPA Standard 020, page 4).

(f) Commercial Entities, which are not FIs, will need to arrange through the CPA for an acquiring institution ID code to identify itself as a participant in the message format (CPA standards 020 and 021).