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MasterCard Canada

Maintaining Competition in the Canadian Credit Card Industry

INFORMATION PROVIDED TO THE COMPETITION BUREAU

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I. INTRODUCTIONANDOVERVIEW

The presence of a vigorous and effective MasterCard organization in Canada has provided the consumer a multitude of choices and added substantially to competition in the credit card business in Canada. The proposed merger of The Royal Bank and Bank of Montreal, far and away MasterCard's largest issuer and acquirer in Canada (referred to herein as the "Merger"), has the potential to eliminate MasterCard as an effective competitive force in Canada, if the resulting entity (referred to herein as the "Merged Bank") issues VISA cards only. In this submission, MasterCard outlines the competitive issues facing the business in Canada, and the implications for competition should the Merged Bank issue only VISA cards.

The following chart provides a top line perspective of MasterCard and VISA in Canada.

	MasterCard	Visa
Entered Canada	1973	1967
Top 5 bank members	1	4
Number of members not CPA eligible	6	0
Number of cards	11.7 million	20 million
Current share split	27%	73%
Average monthly spending per card	$280	$340
Annual transaction volume	$24 billion	$65 billion
Number of merchants (estimate)	500,000	500,000
Affinity cards programs	300+	2
Average Merchant discount	25 basis points or more lower than VISA average	25 basis points or more higher than the MasterCard average

VISA and MasterCard are the only two widely accepted general purpose credit cards available to consumers in Canada, which compete with all other forms of payment. With MasterCard at 27% and VISA at 73% of the combined MasterCard and VISA transaction volume, VISA clearly is the dominant system of the two.

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MasterCard is the only general purpose credit card of significance other than VISA in Canada. Issuers and acquirers of one card cannot issue or acquire the other, i.e. there is no duality in Canada. MasterCard's presence and strength in Canada is very much dependant on the participation of Bank of Montreal as a MasterCard issuer, since it is the only one of Canada's largest five banks which issues or acquires MasterCard cards and transactions. It alone accounts for almost 60% of all MasterCard cards in circulation in Canada. It is also the only MasterCard acquirer that has active representation in all geographic regions. Should the Merged Bank decide to be a VISA issuer, Bank of Montreal's MasterCard cards will be converted to the VISA brand and, assuming substantially all Bank of Montreal MasterCard cardholders become VISA card holders, the respective shares of the combined MasterCard and VISA volume would dramatically change to 11% MasterCard/89% VISA, virtually overnight. MasterCard anticipates there would be further erosion over a short time, to approximately 7% MasterCard, with VISA at 93%. At that level of participation in the marketplace and given the elimination of budgets for advertising and support staff which will result from reduced revenues, MasterCard's brand awareness would be so reduced, and its image so tarnished, that MasterCard would no longer be a viable competitive alternative.

If this happens, then the general purpose card business will have devolved to VISA. To help the Bureau to evaluate whether this is a potential result that it should be concerned about, we submit the following for consideration:

- Over the last several years, MasterCard in Canada has pursued a carefully planned strategy to increase its business by aggressively; (i) licensing new MasterCard members, (ii) reducing fees, (iii) making its interchange fees competitive, (iv) reducing regulatory barriers, and (v) providing increased member support services.

- The process of signing up new members is slow and laborious. In spite of the eight new significant MasterCard members brought in since 1993, MasterCard's transaction volume compared to VISA has increased only about two percentage points. This represents important progress for MasterCard, but it also illustrates the vulnerability of MasterCard in Canada because of the significant time and difficulty in bringing in new members to compete. Only two of these new members would have been eligible for VISA membership.

- MasterCard and its issuers (sometimes collective referred to as the "MasterCard System") have been, and continue to be, the innovators in general purpose credit cards. For example, the MasterCard System has introduced no fee cards, flexible grace periods, low introductory interest rates, convenient arrangements to transfer balances from a prior card to a new MasterCard card, low fee or no fee premium cards, significantly higher customer service levels and emergency card services. MasterCard was also the first to offer a gold card in Canada, in 1981, and a platinum card in Canada, in 1997. The MasterCard System introduced the first affinity/cobranded cards in Canada in the mid 80's. The MasterCard System also introduced its own corporate purchasing card in Canada in 1997 VISA has yet to follow suit.

- As a result of its cost based and market driven approach to interchange fee setting, over the last several years, MasterCard's interchange fees have been less than those of VISA. In the negotiations between MasterCard members and merchants, this fact, coupled with the members' desire to expand merchant acceptance, has generally resulted in lower discounts for MasterCard transactions at merchants vis-a-vis those charged by VISA members for VISA transactions at the same merchants. We believe that the merchant discounts for MasterCard transactions tend to be lower by a factor of 25 basis points or more than those for VISA transactions. Without this competition from the MasterCard System, one might expect the VISA members' merchant discounts to increase.

We believe the above clearly demonstrates that MasterCard and its members have been a force in stimulating and advancing the intense competition found among general purpose credit cards today. We sincerely believe that the elimination of MasterCard and the MasterCard brand from Canada will reduce the utility and value of general purpose credit/charge cards to the detriment of consumers, merchants and competition in general.

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With the above in mind, there are three possible results of the Merger from the perspective of Bank of Montreal's MasterCard portfolio and MasterCard's business in Canada. They are as follows:

1. The Merged Bank may convert the MasterCard cards in Bank of Montreal's portfolio to VISA cards, and may only acquire VISA transactions. This, of course, is the worst result for consumers, retailers and MasterCard, as it would effectively eliminate MasterCard as a serious general purpose credit card competitor in Canada.

2. The Merged Bank may convert its VISA cards to MasterCard cards, which would have the effect of increasing MasterCard's share of the combined MasterCard and VISA volume in Canada from its present 27% to approximately 48%. MasterCard believes this would be a very desirable result, as it would increase the strength of the MasterCard brand in Canada and further stimulate competition amongst members to grow their portfolios by making competitive offers to consumers and retailers.

3. Although the ability to make this happen without government intervention lies with VISA, the VISA and MasterCard members in Canada could become eligible to issue and acquire both brands, so called "duality". MasterCard believes that it would be well positioned in this environment to be able to incent VISA members to issue a large number of MasterCard cards; with VISA, at the same time, attempting to achieve the same result with the present MasterCard members. Given the value offered by the MasterCard brand and the innovation demonstrated by MasterCard, MasterCard would do very well in an environment where members could issue both cards, and consumers and merchants would greatly benefit from the increased number of players issuing and acquiring both brands.

What is apparent from the above is that MasterCard and its members have been effective competitors in the marketplace, particularly, with regard to innovation as to products and product features, effective price competition, and the addition of new members and types of members to the competitive environment. As a result, consumers and merchants, alike, have benefited greatly from the efforts of MasterCard and its members in the competitive war with VISA. The question for the Competition Bureau, in reviewing this proposed merger, is whether it believes that the removal of MasterCard and the MasterCard brand from the Canadian marketplace is in the best interest of consumers, merchants and competition, given the innovation and other benefits MasterCard has provided over the years, and continues to provide. We believe the Bureau will conclude that it is essential in Canada that this interbrand competition continue for the benefit of consumers, merchants and the credit card business. If so, then we would ask the Competition Bureau to exercise its statutory authority to ensure that either the second or third option set forth above is implemented in connection with any approval of the proposed merger.

II. CONFIDENTIALITY

MasterCard Canada Inc., for itself and on behalf of MasterCard International, welcomes the opportunity to provide information to the Competition Bureau (the "Bureau") with respect to the proposed Merger. The information set forth herein is provided as background for the Bureau in connection with Mr. Heatherington's upcoming meeting with the Bureau, scheduled for May 27, 1998, and for the Bureau's further reference in its deliberations on the Merger.

Much of the information contained in this brief is highly confidential and commercially sensitive. Release of such information could severely damage MasterCard. We, therefore, rely upon the Bureau's assurances that this information will be treated as privileged and maintained in confidence by it, and we ask the Bureau to accord it the highest degree of confidentiality which it may offer. We understand that the information is provided at the request of the Bureau, in respect of a merger inquiry, and is therefore protected under section 10(3) and 29 of the *Competition Act*, and is exempt from disclosure under the *Access to Information Act*.

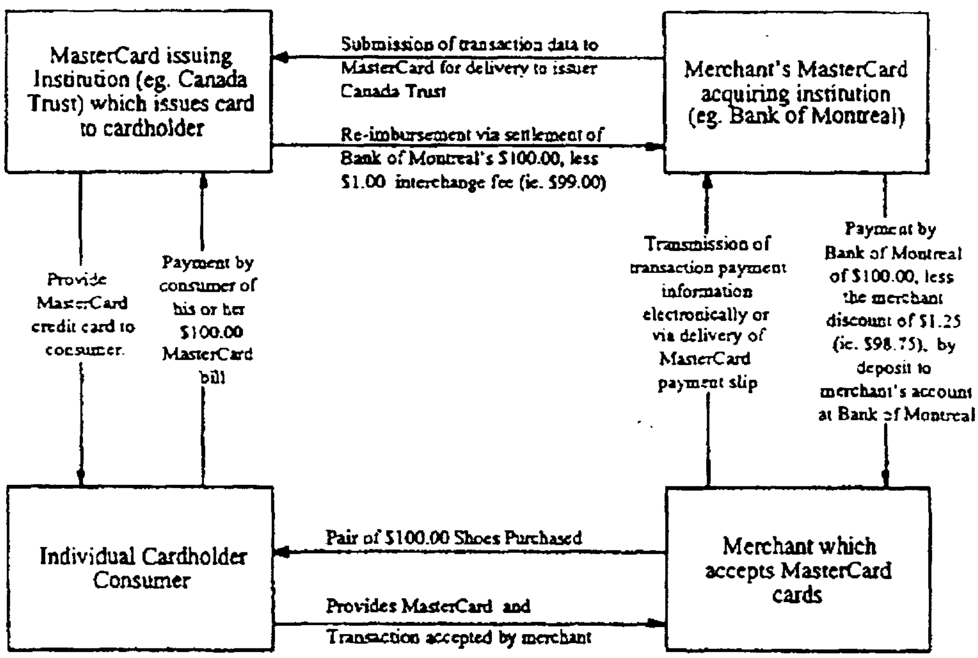
III. OVERVIEW OF THE CANADIAN CREDIT CARD BUSINESS

(a) Glossary of Terms

In connection with the explanations of the credit card business set forth below, we have attached as Appendix I a glossary of industry terms. The definitions are based on the MasterCard Program but the concepts in some instances are the same or similar for VISA.

(b) A Standard MasterCard Transaction

The following simple diagram illustrates typical MasterCard transactions, including the flow of funds. The amounts and parties chosen are arbitrary and for illustration purposes only.



In the above example, the consumer gets his or her shoes today, and pays his or her MasterCard issuing institution (Canada Trust) the $100.00 within 21 days after billing, typically with no interest. The merchant gets $100.00, less a $1.25 merchant discount, from its MasterCard acquiring institution (Bank of Montreal) today or tomorrow. Its net position is $98.75. The acquirer, Bank of Montreal, gets reimbursed $99.00 ($100.00-$1.00 interchange) from Canada Trust within a day or so. Its net position is $0.25. The issuer, Canada Trust, pays out $100.00-$1.00=$99.00 tomorrow, and gets $100.00 from its MasterCard cardholder in 21 days or so. Its net position is $1.00. If the cardholder pays after the due date interest accrues to the issuer on the outstanding balance.

(c) **Issuers and Acquirers of Card Transactions in Canada**

Within Canada, the main issuers of MasterCard cards are Bank of Montreal, National Bank of Canada, Canada Trust, Alberta Treasury Branches, the credit unions, National Trust (currently converting to VISA issuance after purchase by Bank of Nova Scotia), MBNA Canada Bank, Canadian Tire Acceptance and Capital One Financial. Other institutions are licensed to issue MasterCard cards and have issued a few cards, but the vast majority of MasterCard cards issued in Canada are issued by the above noted institutions. Bank of Montreal, National Bank and Canada Trust, taken together, account for some 87 percent of MasterCard cards in Canada, with some 91 percent of transaction value. Bank of Montreal alone accounts for approximately 57 percent of all MasterCard cards in circulation in Canada, and 59 percent of MasterCard transaction value. It accounts for approximately 21% of general purpose credit cards in Canada, with a value of 15 percent of transactions undertaken by use of such cards.

As detailed in Appendix I, acquisition of credit card transactions is the process whereby a merchant deposits a MasterCard or VISA transaction (whether by paper slip or electronically) to its account at the MasterCard or VISA member financial institution. The merchant thereby receives payment from the institution for the transaction by way of the deposit. It can only deposit the MasterCard slip (or electronic message) in an institution which is a licensed member of MasterCard, and with which the merchant has negotiated an acquiring agreement; in an acquiring agreement the institution agrees to acquire MasterCard transactions from the merchant, pay the merchant the value of the transaction, and charge the merchant an amount (the merchant discount) for such service. Unless a merchant has such an arrangement with a VISA or MasterCard acquirer it may not accept VISA or MasterCard cards, respectively; consequently having an agreement with an acquirer which is able to acquire all of the merchant's MasterCard transactions is necessary for acceptance of the card, and therefore for the system to work. Only Bank of Montreal, Canada Trust and National Bank of Canada are significant acquirers of MasterCard transactions in Canada. Bank of Montreal acquires more than 60% of such transactions in Canada, and is the only acquirer generally active in all geographic regions. It is virtually the only MasterCard acquirer active at all in Atlantic Canada.

On the VISA side, VISA cards are issued by the Royal Bank, the Canadian Imperial Bank of Commerce, the Toronto Dominion Bank, the Bank of Nova Scotia, the Caisse Populaire, Laurentian Bank, CitiBank, VanCity, and Citizens Bank. Based on MasterCard's own estimates, The Royal Bank of Canada, the Canadian Imperial Bank of Commerce, the Bank of Nova Scotia and the Toronto Dominion Bank account for approximately 88 percent of the VISA cards issued in Canada, with a value of 93 percent of all such VISA transactions. Most VISA transactions in Canada are acquired by the Canadian Imperial Bank of Commerce, the Royal Bank, The Toronto Dominion Bank, Bank of Nova Scotia. Citibank and Caisse Populaire also acquire transactions. Attached as Appendix II is information with regard to issuing acquiring institutions in Canada.

(d) The Cards/Associations

(i) Principal Cards in Canada

The only significant general purpose credit cards in Canada are VISA and MasterCard. They are general purpose credit cards which can be used at a large variety of merchant locations - virtually every significant merchant location in Canada accepts one or, typically, both VISA and MasterCard. They are also widely accepted globally.

The third (and indeed a distant third) brand of general purpose cards in Canada is American Express ("AMEX"). AMEX differs from VISA and MasterCard in a number of important respects. First of all it is fully owned and managed by American Express, unlike VISA and

MasterCard which are financial institution membership organizations. There are approximately one-quarter the number of AMEX cards in Canada as there are MasterCard cards (perhaps one-seventh or one-eighth the number of VISA cards). Purchases on AMEX cards would represent approximately one-fifth of the value of purchases on MasterCard cards, and 10% of the value of purchases on VISA cards in Canada. As to merchant locations, MasterCard and VISA are each accepted at over 15 million locations worldwide and, according to MasterCard and VISA member surveys, at approximately 600,000 locations each in Canada. By contrast AMEX cards are accepted at about four million locations worldwide. MasterCard does not know at how many locations AMEX cards are accepted in Canada. AMEX cards are accepted primarily at travel and entertainment establishments and "high-end" retail merchants. Further, and fundamentally, most AMEX cards in circulation, and all green AMEX cards, are charge cards and not credit cards at all. They must be paid off fully on a monthly basis, unlike VISA and MasterCard cards, which are credit cards which allow the consumer to pay for a purchase, but not have to pay more than a minimum amount and carry the remainder as an outstanding credit balance against which interest accrues. Finally, American Express tends to have a very high merchant discount as compared with MasterCard or VISA.

The only other general purpose card in Canada is the Diners/En Route card. There are only about half a million such cards in Canada, and MasterCard estimates less than two billion dollars worth of transactions occur on those cards in Canada each year. The various comments with respect to the American Express card apply with even greater force to the Diners/En Route card, and in any case its numerical presence is so small as to be virtually irrelevant.

In addition to general purpose cards, a number of retailers have their own charge cards, including Sears, The Bay, Eaton's and Canadian Tire (some Canadian Tire charge cards have been converted to MasterCard cards, although Canadian Tire continues to have a significant portfolio of "red" store charge cards). These cards differ from MasterCard and VISA in a number of very significant ways, including the fact that the interest rate on such cards (typically 28.8%) is much higher than a typical interest rate on a general purpose credit card, and the fact that the cards can only be used to purchase goods at the issuing retailer.

Finally, of course, consumers can purchase goods and services in various ways in addition to credit or charge cards. These include debit cards, cheques and cash. All of these are forms of payment are useful in various scenarios. Nonetheless, the only two widely accepted general purpose credit cards available in Canada are MasterCard and VISA.

(ii) History of MasterCard and VISA in Canada in the 90's

In 1992/3 Royal Trust Corporation, which accounted for approximately 17% of MasterCard's transaction volume at that time in Canada, was purchased by Royal Bank of Canada. Due to the prohibition against a single financial institution issuing both MasterCard cards and VISA cards, ie. duality, those MasterCard cardholders were converted to VISA. Prior to that change, transaction volumes for MasterCard and VISA, taking the general purpose credit card business as a whole, were 34% MasterCard, 66% VISA. The loss of Royal Trust would have reduced MasterCard to approximately 25% (although in fact it did not fall much below 26%, because of aggressive work with the remaining members). Since that time, as you know, National Trust has been purchased by a VISA bank (Bank of Nova Scotia). Consequently a further approximately 0.77 percentage point share held by National Trust is expected to be lost to MasterCard and gained by VISA, for a shift of 1.5% overall, within the next few months.

The loss of Royal Trust and, subsequently, National Trust as members did not prompt MasterCard to pursue government intervention to protect MasterCard. Rather, as outlined in this submission, it prompted MasterCard to aggressively develop a competitive marketplace strategy which included licensing new members to issue MasterCard cards. That strategy is beginning to bear fruit, although it is a slow process and MasterCard is still well below the level in Canada in which it had achieved before the departure of Royal Trust. In fact it is below the level (35%) which MasterCard's Global Board believes is necessary to sustain a card program on a long-term basis in any region of the world. If the Merger were not to take place, MasterCard believes the strategy it has been pursuing would, in time, cause it to achieve a 35%, or even somewhat higher level of penetration, so that it would be an even more effective competitive force in Canada.

By contrast to the situation at the time of the loss of Royal Trust, MasterCard is making representations in this document to the government with respect to the potential consequences flowing from the Merger. That is because the loss of Bank of Montreal is different in kind than the loss of Royal Trust. While Royal Trust represented approximately 17% of MasterCard's volume, Bank of Montreal represents almost 60%. Bank of Montreal is the only one of the large five banks which issues or has ever issued MasterCard cards in Canada. It is MasterCard's only truly national branch network. Loss of Bank of Montreal, therefore, would not be the type of event which would spur MasterCard to even greater competitive marketplace activity. Rather, as outlined below, it is a loss that would prevent MasterCard from being an effective competitive force. It is for that reason that, in the current situation, in contrast to the Royal Trust or National Trust situations, MasterCard is making representations to the Competition Bureau. The loss of Bank of Montreal to MasterCard would do more than simply represent a challenge to MasterCard, it would represent the potential for the elimination of MasterCard from the Canadian marketplace, which would be detrimental to merchants, cardholders and the economy as a whole.

Since 1992/3, in large part as a deliberate and direct response to the loss of Royal Trust, MasterCard has been aggressively and effectively soliciting new members to issue MasterCard cards in Canada. Those efforts are outlined in section IV (c) below. Despite considerable success in signing up new members, many of which are Canadian affiliates of significant financial organizations in other jurisdictions, it is a slow and laborious process to bring a new member to a level where it can effectively compete.

In fact, despite the eight new major members brought in by MasterCard since 1993, only three are yet issuing cards in any significant numbers. In that time period MasterCard has gained almost 2% on VISA. This represents important progress by MasterCard, but it illustrates the significant time and difficulty in bringing in new competitors, and the vulnerability of MasterCard, and of competition in the card business in Canada. The loss of Royal Trust represented a huge setback for MasterCard in Canada. The loss of Bank of Montreal would devastate MasterCard and eliminate MasterCard and the MasterCard brand as an effective competitive force in Canada.

(iii) Typical use of Cards

MasterCard's consumer studies suggest that of Canadians with credit cards, 54% have only a VISA card, 18% have only a MasterCard card and 28% carry both cards. A number of factors influence which cards Canadians carry and, if they carry both, which card they use as their principal card. The three most important of these factors are, in order of declining significance: Which bank or institution the cardholder has his or her principal banking relationship with (that is cardholders will typically use the card issued by the bank where they have their principal relationship as their primary card); the benefits offered by the card (i.e. points or rewards); and, to a lesser but increasingly important extent, the interest rate or the costs associated with the use of the card. Consumer studies as to reasons for acquiring credit cards indicate that the top three reasons Canadians acquire credit cards are; (i) having received an application from their bank, (ii) that the card came with their bank account, and (iii) that a teller gave them the application. From the forgoing it is clear that credit card acquisition and use in Canada remains closely tied to branch banking relationships, although that is changing with the new entrants. This is contrary to the US experience where general purpose cards held by cardholders are most often issued to them by entities other than by the bank with whom they have their deposit account.

Given the importance in Canada of primary banking relationships determining card acquisition and usage, the primacy of VISA (which has four of the five biggest banks as members) is understandable. For Canadians who carry both a VISA and a MasterCard card, more often than not VISA will be the primary card and MasterCard the secondary or back-up card, because VISA cards are issued by four of the five largest banks in Canada. Therefore, while there are roughly twice as many VISA cards as MasterCard cards issued in Canada, transaction volumes on VISA cards exceed MasterCard by roughly three to one. Average monthly spending by Canadians on MasterCard cards is approximately $280.00, versus average monthly spending of $340.00 on VISA cards.

The importance of this primary banking relationship to credit card acquisition and usage is clear in the context of the Merger, given the potential switch of the Bank of Montreal's MasterCard portfolio from MasterCard to VISA. While MasterCard is working aggressively to introduce new MasterCard issuers, they are not the type of institutions likely to establish primary banking relationships with a large number of Canadians, at least not for many years to come.

(iv) Number of Cards of Each Type

There are between 11 and 12 million MasterCard cards, and approximately 20 million VISA cards issued in Canada. Bank of Montreal has issued more than 6 million of these MasterCard cards.

(v) Number of Locations Each Accepted

Membership surveys indicate that each of VISA and MasterCard are accepted at approximately 500,000 merchants in Canada, which have approximately 600,000 locations. Each such acceptance point requires a separate acquirer for the VISA and MasterCard transactions. Bank of Montreal is the only national acquirer of MasterCard transactions, and in fact acquires approximately 60% of all MasterCard transactions in Canada.

(vi) Dollar Value Of Transactions

Total annual MasterCard transaction dollar value is about $24 billion, of which Bank of Montreal represents in the range of $14 billion. Total VISA transactions value is approximately $65 billion, of which Royal Bank represent something in the range of $21 billion. The significance of those numbers is that both MasterCard's and VISA's revenues are based on volume of transactions, and the higher VISA volume provides VISA with more money to pursue marketing and promotional strategies to incent a preference for VISA among merchants and cardholders.

(vii) Organization and Governance of MasterCard

MasterCard International Incorporated is a United States non-stock, not-for-profit company, incorporated in Delaware, owned by its members, which for the most part are regulated financial institutions. The company was established in the late 1960s, as the Interbank Association, for the purpose of organizing a charge card plan amongst its members.

MasterCard licenses members to conduct, and perform services in connection with members' MasterCard card programs around the world. It operates directly and through various subsidiaries including, for instance, MasterCard Canada Inc. MasterCard's role is to license members to conduct MasterCard programs and use the name MasterCard in logo form with interlocking circles and/or on its own. MasterCard also is responsible for approving a business plan for new members creating new products and features, keeping current the rules by which members function in this capacity and enforcing these rules, maintaining the network platform, performing authorization and settlement of transactions between members, working with members on marketing programs and security issues, and advertising the products and marketing them through sponsorships and other programs.

At the time MasterCard commenced operations, the BankAmericard (now VISA) network was already in operation in the United States. At that time VISA members were not authorized to issue MasterCharge cards or acquire MasterCard transactions, and therefore the networks began in a non-dual environment (i.e. members could not issue the other card or acquire the other's transactions). That subsequently changed in the United States and various other jurisdictions in the world, but the non-dual environment has persisted in Canada. MasterCard understands non-duality to be a formal rule of VISA in Canada. MasterCard has no such absolute rule, but in 1992, the Board of Directors of MasterCard adopted a program of non-duality in exchange for a commitment by the Canadian members to grow MasterCard's business in Canada. While MasterCard would prefer that Royal Bank convert its VISA portfolio to MasterCard, MasterCard would also be supportive of full and open duality with respect to the MasterCard and VISA brands in Canada. It believes that the results would be pro-competitive.

MasterCard's eligibility rules provide that, in order to be a MasterCard member, the potential member must be a regulated financial institution that is authorized to engage in financial transactions under the laws and/or government regulations of the country, or any subdivision thereof, in which it is organized or principally engaged in business. Financial transactions are defined as the making of commercial and consumer loans, the extension of credit, the effecting of transactions with payments services cards, the issuance of travelers' cheques or the taking of consumer or commercial deposits. Such financial institutions must be regulated and supervised by one or more governmental authorities and/or agencies authorized and empowered to establish and/or enforce rules regarding financial transactions and the financial condition, activities and practices of entities engaged in such financial transactions. If the financial institution does not take deposits, then financial transactions, as defined above, must constitute substantially all of the business conducted by the institution.

Members of MasterCard can be either principal members or affiliate members. Principal members are fully responsible for all of their transactions and are generally connected to the MasterCard network. They settle their transactions with other principal members through MasterCard's settlement and clearing system. Affiliate members have entered into arrangements with principal members, whereby the principal member is responsible for, and satisfies, the financial obligations of the affiliate member, including providing an ultimate guarantee of payment by settling its affiliates' transactions with other principal members. The principal member is paid by the affiliate member in whatever manner the two entities negotiate between themselves. Some affiliate members simply delegate all of the work of running a card program to the principal member, which creates the cards and manages the card program on behalf of the affiliate member. While the principal member is largely or totally invisible to the cardholder, it effectively runs the entire arrangement, including management of the card accounts, settlement, payment, etc. At the other end of the spectrum, some affiliate members run their own card programs in their entirety, and the principal member simply provides an ultimate guarantee of payment and the connection with the MasterCard system.

Attached as Appendix III is a list of major principal and affiliate MasterCard members in Canada.

MasterCard International is governed by its Board of Directors, commonly referred to as the Global Board. The Global Board presently has 29 voting and 1 non-voting director. Each voting director is entitled to one vote on each issue. Currently the MasterCard International Board contains one director who is an employee of the Bank of Montreal. There are also regional boards in each of MasterCard's six regions, one of which is Canada. The Global Board has delegated specific authorities to those boards, including the right to elect new members to MasterCard International from their respective regions.

MasterCard's Canada Region rules are designed so that the directors on the Regional Board represent, in the aggregate, the views of all the constituencies of members in the Canada Region. For smaller members, that representation may be shared with other smaller members. The Canada Region Board has two appointees from MasterCard International, as well as an individual who is an employee of each regional principal member whose transaction volume equals or exceeds 5% of the total cardholder volume for the Region. Regional principal members whose cardholder volumes are individually less than 5% of total cardholder volume are collectively entitled to elect two directors, and regional affiliate members are collectively entitled to elect t two directors.

Currently the Canada Region Board has some nine members, being two employees of MasterCard International, one employee of Bank of Montreal, one employee of National Bank, one employee of CUETS, one employee of Alberta Treasury Branches, one employee of Canada Trust, one employee of Canadian Tire, and one employee of MBNA Canada Bank. The Chairperson of the Canada Region Board of Directors is an employee of the National Bank, and the Vice-Chairperson is an employee of CUETS.

In addition to ensuring that all constituencies appoint or elect a director to the Regional Board, the region's voting rules are designed so that no one director may dominate, or carry a voting item on his or her own. To this end, no member of the Regional Board may vote more than 25 votes or fewer than 5 votes. There are a total of 85 votes on the Board. MasterCard's Canada Region Board's voting rights are explained in greater detail in Appendix IV.

(viii) Bank of Montreal Affiliate Members

Should Bank of Montreal cease to be a MasterCard member, its affiliate members would also cease to be members, unless they found other principal members, or themselves became principal members. For Bank of Montreal affiliate members which essentially control their own card systems, the transition to becoming a principal member or finding a new principal member would be disruptive in the short term but would probably not be insurmountable. For other entities such as Hong Kong Bank of Canada, Korea Exchange Bank, Banca Commerciale Italiana of Canada, Standard Chartered Bank, the Bank of East Asia (Canada) and Republic National Bank of New York, amongst others, which use Bank of Montreal as their principal member, and which effectively delegate the running of their entire card program to Bank of Montreal, the loss of Bank of Montreal as a MasterCard member if the Merged Bank becomes a VISA issuer and acquirer, would put an end to their MasterCard programs in Canada, at least for a considerable period of time. As a practical matter they might well simply switch, with Bank of Montreal, to VISA.

(e) Foreign Participation

Virtually no MasterCard cards issued to Canadian residents are issued by foreign banks, and no transactions are acquired from Canadian locations by foreign institutions. The only exception is Wells Fargo. The Wells Fargo arrangements are explained fully in Appendix V. In summary, however, Wells Fargo makes a very limited number of small business loans in Canada through the use of MasterCard cards. It is a niche business, with very few MasterCard cards issued to Canadians.

While there is no specific prohibition on the issuance of credit cards to Canadians by foreign based institutions, in consultation with the Office of the Superintendent of Financial Institutions (OSFI) about new MasterCard members generally, OSFI has been anxious to make sure that whatever institution is issuing the cards is properly regulated, because its failure to pay could have implications for Canadian acquiring institutions if they were not paid. Further, as a practical matter, foreign institutions do not seem to wish to issue cards to persons residing in other jurisdictions. That may change at some point but for now that is the marketplace reality. Thus, significant competition from foreign firms is not expected in the short term.

As to transaction acquiring, non-Canadian Payments Association members cannot take deposits, so foreign institutions are not involved in that business. Thus, while foreign institutions may be able to offer some very limited competition on the card issuance side of the business, it is indeed limited and by way of niche participation. They do not participate in transaction acquiring at all.

While in the sense noted above (issuing cards to Canadians and acquiring Canadian transactions) MasterCard participation is only by firms within Canada, in another sense of course MasterCard is truly international. Canadians with MasterCard cards can travel virtually anywhere in the world and have their card accepted. Similarly, visitors from anywhere in the world can and do come to Canada with their MasterCard cards on business and for reasons of tourism. Promotion of the MasterCard trademark, together with the functioning MasterCard settlement and clearance system,

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permits Canadians the ability to use their MasterCard cards anywhere in the world and similarly helps facilitate tourism and other visits to Canada by foreigners. Were MasterCard not able to continue in Canada, that would have negative implications for Canadians travelling abroad (and to the various regions of Canada where MasterCard acceptance will be particularly adversely affected), and will also have negative implications for foreign tourists coming to Canada.

(f) Current Growth

As a result of MasterCard's efforts over the last number of years to introduce new competitors and competitive offerings, MasterCard has now begun to make up some of the ground lost when Royal Trust switched to VISA. Over the last eight quarters MasterCard has gained share on VISA. In particular, over the past year new members such as Canadian Tire Acceptance, Capital One and MBNA Canada Bank, have begun to issue MasterCard cards in significant numbers. They are attracting business, as will be outlined in greater detail below, by providing higher levels of service, lower interest rate options, lower fees for premium cards, and generally making the marketplace more competitive. Other MasterCard members and VISA members are responding to this competition and sharpening their own offerings.

This progress is hopeful for MasterCard and for competition in the card business in Canada. It suggests that, but for the proposed Merger, MasterCard could, over the next few years, build up its share as against VISA to a sustainable level of 35%+. However the new entrants as yet represent a very small percentage of credit cards (less than 5% of total MasterCard cards and less than 2% of general purpose credit cards in circulation in Canada). That said, over the medium term the new entrants promise to make MasterCard a more effective and competitive organization in Canada. With the potential loss of Bank of Montreal, however, not only is that advance halted, the potential for effective competition is eliminated, because of the consequences of a catastrophic drop in card issuance and acceptance which loss of Bank of Montreal would represent.

This would occur for several reasons. First, with the drastic reductions in transaction value as a result of the switch of cards, MasterCard would have no revenues to promote the brand in Canada. Second, with the reduction in the number of cards, brand awareness will be diminished in the minds of consumers and merchants alike and the reduced number of cards may cause merchants to cease accepting MasterCard at all, given the limited number of transactions. Lastly, one might expect the remaining MasterCard members in Canada, in this environment, and new potential members, to themselves consider switching to VISA. Thus, the consequence of the loss of Bank of Montreal to MasterCard would be not merely to delay the impact of the new entrants, but, in fact, to prevent MasterCard from continuing as a competitive force.

IV. MASTERCARD BENEFITS TO COMPETITION

Over the last several years, MasterCard in Canada has pursued a carefully planned strategy to increase its business by providing a platform for increasingly competitive offerings, and has increased the number of competitors in Canada. It has done this through increasing membership, reducing fees, making its interchange fees competitive and market based, reducing regulatory barriers and providing increased member support and services. It has done all this because, as the second place association - and particularly after the loss of Royal Trust - it needs to increase its business to be effective in Canada. By accepting new members, and thus increasing competitive pressures, and by facilitating the introduction of new products and services by its Canadian members, MasterCard has sought to grow it business; in so doing MasterCard has provided Canadians with competitive products, prices and choices, which they otherwise would not have had.

The presence of MasterCard in Canada has clearly been an impetus to a vigorous competitive marketplace for credit cards. Various innovative products and benefits have come to Canada through MasterCard. In many cases these innovations have been followed by VISA and its members, as one would expect in a competitive marketplace. In a few cases VISA has led, and MasterCard has responded again as one would expect and demand in a competitive environment. Below we illustrate some of the specific examples of that competitive dynamic. The credit card business in Canada is very competitive, and it is competitive in significant part because of the presence of a vigorous and effective MasterCard organization. To the extent that MasterCard were not vigorous or effective in Canada, the marketplace would be correspondingly less competitive. This would represent a significant detriment to Canadian consumers and businesses.

(a) Consumer Choice

One of the key issues in this proposed Merger, for ordinary Canadian consumers, is whether or not they will continue to have the ability to choose between MasterCard and VISA. There is a similar question for merchants, large and small. As noted above, most Canadians carry either a MasterCard card or VISA card, and many carry both. Even in those cases where the consumer carries both, one card may provide air miles with purchases whereas another may accord discounts at a cobranded merchant. If MasterCard goes away not all of these programs will be continued, particularly those that provide less of a return to the issuer.

Canadians enjoy the convenience of having either or both cards accepted at virtually all retail locations in Canada. If cardholders are told they must give up their MasterCard cards, or retailers can no longer accept payment by MasterCard, they will feel, rightly, that their competitive options and choices have been foreclosed by the Merger transaction, in a very tangible and real way. Consumers will feel that someone has effectively reached into their wallet and removed a valuable and valued tool. Retailers will feel disadvantaged given the average (price) differential (merchant discount) between MasterCard transactions and VISA transaction. The proposed Merger will have foreclosed cardholders' and merchants' options and freedom of choice.

(b) New Types of Cards and Services

MasterCard and its members have been highly innovative in the delivery of new types of cards and new card related benefits to customers in Canada. For example:

(i) Low Interest/Low Annual Fee/Cost Choice

Perhaps the key distinguishing feature of MasterCard in its early years in Canada was its "no fee" nature. When VISA cards were introduced in Canada they carried an annual fee. Very shortly after the introduction of MasterCard, however, basic MasterCard cards were offered by members on a no fee basis. This was one of MasterCard's key defining features in Canada. Ultimately, VISA banks followed suit and offered a no fee VISA card.

In addition to offering low fee cards, MasterCard members have been much more innovative than VISA in promoting the availability of low or lower interest rate cards. For example, MBNA Canada Bank has offered a 6.9% interest rate card. Capital One has offered rates of 5.9% and 7.9%. Another example is that Bank of Montreal has offered lower interest rate cards, as well as more flexible grace periods, and interest rates and annual fees to suit the needs of consumers. It offers a card with 10.4% interest, and explicitly encourages consumers to make purchases on their higher interest "points" cards, and then transfer the balance on a monthly basis to the lower interest Bank of Montreal MasterCard card. MasterCard has clearly promoted competition via its introduction of new members with VISA and among MasterCard members.

In addition to facilitating the introduction of low interest and low fee cards, MasterCard and its members have been leaders in the introduction of creative card features including:

> <u>Grace Periods</u> - Typically card customers have been required to pay their bills within 21 days of the date of the bill. MasterCard issuers in Canada, including Bank of Montreal, have now started to issue cards with different grace periods (15 days or 0 days) together with other distinguishing features (typically a lower interest rate) to customers who want that product offering. We believe that VISA members do not yet offer differing grace periods.
>
> <u>Introductory Rates</u> - MasterCard issuers in Canada, including Capital One, MBNA Canada Bank and Bank of Montreal, are now offering new cards to cardholders at a lower

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introductory rate for a fixed period, as a competitive incentive to consumers to take their cards instead of other cards. VISA issuers have now begun to follow this lead.

Low Fee or No Fee Premium Cards - Typically premium cards (i.e. Gold cards or Platinum cards), have carried a higher annual fee. Due to the new MasterCard participants, Gold MasterCard cards are now available without an annual fee from both MBNA Canada Bank and Capital One. In fact, a Platinum MasterCard is also available at Capital One with no annual fee. Canada Trust has responded by waiving its fee on its Gold Card. A VISA issuer, Toronto Dominion Bank, has also recently responded by offering a no fee Gold Card.

(ii) *Service Innovations*

Differential Customer Service Levels - MasterCard has introduced significant competition by issuers in customer service levels. In particular, MBNA Canada Bank is noted for its very high level of customer service. Customer service is available 24 hours a day and at a very high level of pro-customer advocacy from MBNA Canada Bank. Higher levels of customer service on Platinum cards, which service levels are required by MasterCard, are available from all those issuing Platinum cards. These service items include 24 hours-a-day live contact with individuals for emergency assistance, "warm" (the customer service representative stays on the line with the customer) telephone transfers, and global multi-lingual assistance.

Balance Transfer Options - In connection with soliciting the transfer of card portfolios, MasterCard issuers in Canada are now providing convenience arrangements whereby the existing balance on the prior card may be transferred to the new MasterCard card and, and as reward for doing so, the MasterCard issuer will waive annual fees or provide some other benefit. Such convenience options are now available from Capital One, MBNA Canada Bank, Bank of Montreal and Canada Trust. Thus far, VISA issuers have

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only offered this service to selected customers, but there is reason to believe that VISA issuers, given their pattern of following MasterCard members in order to remain competitive, will offer this feature more generally in the future.

Emergency Services - MasterCard offers its members' cardholders a program called MasterRoad Assist. This is a program whereby emergency services are available to the cardholder from reputable local service providers at pre-negotiated rates, 24 hours a day, by calling a single 1-800 number. This is an innovation which has not yet been matched by VISA. MasterCard also offers Global Service, which is a 24 hours a day, anywhere in the world, all language service to provide replacement cards, cash advances, and other services, such as an increase in available credit and other card benefits which are particularly useful to cardholders while traveling abroad.

(iii) Premium Cards - Gold/Platinum/World

MasterCard was the first general purpose card to offer a gold card. MasterCard introduced this product, both intentionally and in Canada, in approximately 1981. VISA followed suit.

In 1997 MasterCard introduced a Platinum card in Canada. It was announced first by Capital One. Bank of Montreal responded within one day, and offers its own Platinum card. Capital One's Platinum card is offered for no fee. Other issuers are preparing to launch Platinum cards. The Platinum card offers additional benefits, including a higher minimum credit limit, discounts off hotel and other purchases, access to airline lounges, and similar benefits. VISA has not yet offered a Platinum card in Canada, but is expected to do so soon, in response to the competition.

MasterCard International has developed and just introduced, internationally, the "World MasterCard" card. This is the highest level of MasterCard card available and carries with it no preset spending limit. The World card is brand new and not yet offered in Canada. VISA, even intentionally, has not yet developed a response to the World MasterCard card, although, as with other developments, VISA may be expected to follow suit in due course as part of the competitive framework.

(iv) Affinity/Co-Branded Cards

Affinity cards are cards which in some way carry a logo or designation of a charitable or public interest group. The classic examples of Affinity cards are university alumni affinity cards or Affinity cards supporting charitable works or associations. Affinity cards in Canada support organizations such as the Vancouver Symphony, the Stratford Shakespearean Festival, the Royal Winnipeg Ballet, the Royal Canadian Geographical Society, The Canadian Cancer Society, the Heart and Stroke Foundation of Canada, and the Ottawa Senators. MasterCard issuers provided the first Affinity cards in Canada in the mid 1980's. Currently there are in excess of 300 Canadian MasterCard Affinity cards, and two such VISA Affinity cards in Canada.

A related product to the Affinity card is the cobranded card. That is, a card carrying the name of a commercial organization as well as the issuer, which provides direct financial benefits from the cobrander to the card user. These work essentially the same way as Affinity cards, except that here the benefits flow to the card user rather than to the charitable organization. Probably the two best known Canadian examples of such cards are the MasterCard AirMiles card (which permits card users to collect points available for airline travel, hotels, etc.), and the GM VISA card (with which cardholders can collect points applicable to savings on a new GM motor vehicle).

There was very considerable competition between MasterCard and VISA prior to the launch of the MasterCard AirMiles card, and similarly the GM VISA card, to determine which member would issue the card and, hence, which brand the card would be issued under. Such competition leads to competitive benefits, in that MasterCard and VISA provide incentives to their members to enhance the member's bid to issue the cobranded card. For example, MasterCard and/or VISA may offer to cut or eliminate fees for the issuing institution. Competition to introduce such cards also, of course, leads to the consumer benefits of more such cards, and choices, being available. Most Gold cards in Canada now carry some sort of points system which can be collected for some benefit to the cardholder.

MasterCard estimates that, in Canada, the benefits flowing to cardholders, charities, or public service groups through various affinity and cobranded MasterCard programs in 1997 totaled between $45 million and $70 million.

(v) Corporate Purchasing and Fleet Cards

MasterCard was the first of VISA and MasterCard to introduce a corporate purchasing card in Canada. This is a card which is issued by companies to company employees and, through detailed tracking of purchases and types of purchases, provides detailed and useful reports to management on expenses and expense management systems. MasterCard introduced this card in 1996. MasterCard has developed its own computer software, "Smart Data For Windows", for use in processing the information for the corporate purchasing card. MasterCard understands that VISA is in the process of developing such a card to respond to this offering.

MasterCard was also the first to introduce fleet cards, which are targeted at businesses that maintain a fleet of vehicles. MasterCard understands that VISA in now responding by developing its own card for fleet capability.

(c) New Members

As noted above, and as detailed in Appendix VI, since 1993, MasterCard has introduced some eight new members in Canada. In that time period VISA has not introduced any new members except Citizen's Bank, which is a subsidiary of a preexisting member. MasterCard has brought in new members because it must increase the number of cards through increased membership, and introduce innovations, in order to be successful.

To succeed in Canada MasterCard needs a higher level of business, which means more members and more cards. MasterCard's Global Board has determined that, as a long-term proposition, the card is not viable in a market with much less than a 35% share. Given that four of the five largest banks in Canada are VISA issuers, which cannot, by VISA's rules, issue MasterCard cards, and particularly with the loss of Royal Trust Corporation to The Royal Bank, MasterCard needed and needs to grow to survive and continue to provide effective competition in Canada. As will be outlined below, declining share of general purpose cards and fewer merchant accepting locations leads to a vicious circle of decline. Therefore, faced with a marketplace in which the major financial institutions were committed to the other card, and the need for growth to survive, MasterCard had every incentive to introduce new card issuing competitors and new types of issuers. By contrast VISA had and has a lesser incentive. It is under less pressure to introduce members or innovations. Therefore, it is not surprising that MasterCard has succeeded in bringing new card issuing members in Canada and in fact has introduced most, if not all, consumer innovations. It needs to.

The methods by which MasterCard has achieved new member introduction include the following:

<u>Price</u> MasterCard has significantly reduced both the cost of the membership fee, and has mitigated the obligation to pay the entry fee "up front". For instance it only requires payment in respect of the first anticipated 150,000 cards to be issued, rather than on every card to be issued. Further, the payment can be made over three years, rather than in the first year.

<u>Governance</u> MasterCard's governance structure elects individuals from smaller members as well as large, thereby bringing to the Regional Board the perspective of the entire membership. Of course, the directors on the Regional Board, no matter where they are from, are required to make decisions in the best interest of the brand and, hence, the entire membership. It is important to note that no one director has enough votes to carry any issue.

<u>Interchange</u> MasterCard's interchange fee is subject to an independent study, based on actual cost. This is a benefit to members which are typically not balanced as to issuing and acquiring, at least at the outset of their membership. MasterCard is committed to ensuring that interchange fees in Canada are calculated to cover issuers' costs on an average issuers

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experience basis.

Flexibility MasterCard has worked aggressively, in consultation with federal financial officials including OSFI, and with provincial officials, to find means by which institutions may become appropriately regulated and supervised, so as to meet membership eligibility criteria. By contrast, we understand that VISA continues to require that institutions be deposit takers and/or eligible for membership in the Canadian Payments Association in order to join.

(d) Types of New Members

Of the eight members elected recently by MasterCard, seven (all but Canadian Tire Acceptance) are affiliates of large successful card issuers elsewhere in the world. However, only ING Canada Bank and MBNA Canada Bank are Canadian deposit taking eligible institutions, so only two of the eight would have even been eligible for VISA membership. The type of competition they have introduced, and the resulting consumer and competitive advantages, not only likely would not have been available had MasterCard not existed, but in fact under VISA's rules could not have been available.

(e) Increased Competition as a Result of New Members

The introduction of new members is a spur to increased competition in a number of respects. Some aspects of this competition are noted above in section IV(b). On a simple analysis, more entities offering cards will lead to greater competition. Somewhat more subtly, entities of a kind different from the traditional deposit taking institutions have and will give rise to innovative card offerings and improvement in the availability and cost of credit for Canadians. Perhaps the most clear example of this to date is Canadian Tire Acceptance. Prior to being a MasterCard issuer, Canadian Tire had offered its own credit card (the "red" card) used for purchases at Canadian Tire stores. Like many such "store" cards, in addition to the limited number of locations in which such card can be used, the Canadian Tire red card carried a high interest rate (approximately 28%). That is typical of store credit cards. On the other hand, such store cards, and particularly the Canadian Tire card, tended to be available to lower income Canadians, some of whom might not have qualified for a general purpose credit card from a traditional financial institution.

Upon the conversion of the Canadian Tire red card to a MasterCard card issued by Canadian Tire Acceptance, it issued this card to some 500,000 of its existing cardholders, bearing an interest rate of approximately 18%. Now those Canadian families benefit from a MasterCard with an 18% interest rate, which is employable generally in the marketplace, as opposed to a 28% interest rate card employable only at Canadian Tire. This is an obvious and tangible benefit to Canadians because of the competition between MasterCard and VISA, and MasterCard's admission of new members.

By way of a second example, MBNA Canada Bank launched its card program in Canada a few months ago. Despite mail strikes, etc., it has now in excess of 100,000 cards in the marketplace, including a very large number of gold cards (some with no fee), low interest rate cards, and unsurpassed service levels.

A third example is Capital One Canada. Capital One is a huge card issuer (both VISA and MasterCard) in the United States. It recently launched MasterCard in Canada, and again has well in excess of 80,000 cards now in the hands of Canadians. These cards offer low/no fee gold and platinum cards in some cases, and low interest in other cases.

In addition to these specific examples, various other new MasterCard members including Household Finance Canada, G.E. Capital Canada, Beneficial Finance Canada and ING Canada Bank are Canadian affiliates of very significant foreign based card issuers. These are large, experienced institutions which have been successful in the card business elsewhere in the world. MasterCard expects them, in time, to be successful in Canada, by providing creative, innovative and attractive consumer offerings. They will continue to enhance and, perhaps, change the manner of competition for the better in Canada. They will do so as long as MasterCard remains viable in

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Canada. They cannot do so if it does not, and they have expressed this concern to MasterCard.

(f) **Interchange Fees**

As noted above, the interchange fee is the fee paid by the acquirer to the issuer at the time that the issuer pays the acquirer for the value of the purchases. This fee is designed to compensate the issuers for the average of (i) issuers' credit losses (ii) issuers' costs of processing the transaction (iii) issuers' fraud losses and (iv) the cost of funds between the time that the issuer pays the acquirer (typically within a day of the purchase at the retail location) and the date of the MasterCard bill. So long as the bill is paid within the grace period (typically 21 days) interest is generally not payable by the consumer.

MasterCard understands that the VISA interchange fee in Canada was set at a price of 1.75% of the transaction value, less 25 cents per transaction approximately 30 years ago when VISA commenced operations in Canada. To the best of MasterCard's knowledge that fee has never changed. By contrast, MasterCard's interchange fee was set originally at 1% of the transaction value. However, commencing in the early 1990s MasterCard has undertaken a process of bi-annual review, by an independent audit organization, of the relevant costs, for the purpose of determining the interchange fee. Over the last few years, MasterCard's interchange fee has been adjusted in accordance with the results of that survey. The relative interchange fee payable for a transaction as between MasterCard and VISA will vary depending on the value of the transaction. In some cases the VISA fee will be higher, and in some cases the MasterCard fee. On average however, the MasterCard fee tends to be quite a bit lower. The lower interchange fee tends to affect the merchant discount, thereby benefiting Canadian businesses.

(g) **Lower Merchant Discounts**

As noted above, merchant discounts are the amount which the merchant's acquirer charges the merchant for the transaction. The institution will pay the merchant the purchase price of the goods sold (say $100), less the agreed discount amount. This discount amount is the payment to the acquirer for accepting the transaction, processing it for payment through the MasterCard system and paying the merchant. In addition to its administrative costs, etc., this discount amount must cover the institution's principal out of pocket expenses in relation to the transaction, including payment of the interchange fee to the cardholders' issuing institution and expenses incurred in the processing of the transaction and processing of chargebacks by issuers of invalid transactions. Logically then, a lower interchange fee should lead to a lower average merchant discount, given that the interchange fee is a component of the cost borne by the acquiring institution, but the amount of the merchant discount is the sole prerogative of the acquirer, by agreement with its merchant.

Since merchant discounts are set in negotiation between the merchant and the acquiring institution, and not by MasterCard, MasterCard does not know the amount of all such discounts, but it believes that merchant discounts for MasterCard transactions tend to be lower, by a factor of 25 basis points or more, than merchant discounts in respect of VISA transactions. American Express merchant discounts tend to be higher still. Because these discounts are individually negotiated, MasterCard has no central registry of this information. However, we encourage the Competition Bureau to consult with relevant parties, including the Retail Council of Canada, to confirm our understanding of this fact.

This is not an insignificant fact. Given the value of purchases on MasterCard cards each year in Canada, an increase of 25 basis points in merchant discount would represent a transfer of some $60 Million from merchants to financial institutions.

(h) **Merchant Choice**

In addition to the effect on merchant discounts and expansion of the number of acceptance locations, the existence of two major brands has led to competition in other key areas of importance to merchants, such as service, accurate transaction completion, timely payments, and fraud control. MasterCard also pioneered secure electronic transfers (SET) on the internet in Canada, and launched the first SET pilot in Canada, in June 1997. MasterCard has been a leader in these areas in Canada.

The existence of two systems promotes competition in all of these areas, which are important, not only for MasterCard members and merchants, but to consumers, who ultimately pay the costs.

We note that in its submission to the Competition Bureau in relation to the Merger Enforcement Guidelines as applicable to financial institutions, the Retail Council of Canada identifies impacts on retailers flowing from credit card consolidation as an important issue to consider in respect of bank mergers. This aspect of competition would be diminished without the presence of an effective MasterCard organization and the MasterCard brand, through its members, in the marketplace.

V. POSSIBLE OUTCOMES OF THE MERGER AND IMPACT ON COMPETITION

(a) Duality - All institutions May Issue and Acquire Either Brand

(i) Beyond Control Of The Parties

The first point to note is that duality is a matter which is beyond the control of the merging parties. MasterCard would be prepared to move to a dual environment in Canada. Indeed the non-dual environment has been a significant hindrance to MasterCard in Canada, because four of the five largest banks are VISA banks, and because of the problems posed by both the proposed Merger and previous mergers. However, VISA, which is not party to the Merger, must choose to change its rule against duality in order for duality to be possible in Canada.

(ii) MasterCard Would Be Pleased To Compete Effectively In A Dual Environment

Should VISA waive its non-duality rule, MasterCard would respond by welcoming dual members in Canada.

(iii) True Full Duality

In the judgment of MasterCard Canada, it could succeed and indeed prosper in a truly dual environment in Canada. If all banks or other financial institutions could issue both MasterCard cards and VISA cards, and acquire both types and transactions, MasterCard believes that it would be an effective competitor. Such arrangements would in fact, eliminate a very significant difficulty which MasterCard has faced, given the relatively small number of significant financial institutions in Canada. MasterCard has struggled at around a one-third or less share throughout its existence in Canada. This low share, together with the threat of significant reduction in such share, poses real problems. A card payment system, like most systems, requires critical levels of participation to work, and has increasing value as more and more persons participate. A non-dual environment is a serious competitive problem in a system which requires acceptance ubiquity and very widespread card distribution for its success, in a country with a relatively small number of large financial institutions. This problem is heightened, and would be exacerbated by the proposed Merger. Further, the potential for subsequent mergers in an environment like Canada drives home this point that much more.

Were Canada to move to a dual environment there would be no overnight shift of any kind in share. However, over time, because more opportunities would be open to MasterCard, it believes that it would gain share on VISA. Thus MasterCard would not be the dominant card, but it would move closer to parity with VISA, and future difficulties with regard to mergers of financial institutions would not give rise to the crisis now facing MasterCard specifically, and competition in the card business in Canada generally.

With dual issuing and acquiring major financial institutions would be free to issue both MasterCard cards and VISA cards, and acquire either or both types of transactions. Insofar as they chose to do so, or chose to emphasize one card over the other, that would be based on the competitiveness and the offerings of each of the card systems. Therefore, there would be continuing pressure, on a day by day basis, as choices are made within financial institutions, to be the most competitive, low cost, efficient and effective card system. With duality, the ability to switch from focusing on one brand to the other allows the issuers to quickly enjoy the benefits of innovation from either system.

Thus a true dual issuing environment would be a competitive environment in which MasterCard believes it could do well, and which would preserve and enhance the interbrand competition in the short term and ensure that in the longer term there was continuing day to day competition between the brands.

We note, however, that it is important that any such switch to duality be complete. For instance, it is not possible for MasterCard to compete in a system in which only one bank (the Merged Bank) would be dual, but other banks would continue as non-dual for both issuing and acquiring. This is because MasterCard would expect that if the Merged Bank were a dual issuer it would lean, at least for a time, towards VISA. That is, because the larger partner in the Merger, The Royal Bank, is historically a large VISA issuer. A likely outcome would be erosion of the Merged Bank's MasterCard portfolio and activities, in favor of VISA. Were the credit card environment in Canada to be truly dual, such that MasterCard could pursue opportunities with, for instance the CIBC, the Bank of Nova Scotia, or other VISA issuers, then the erosion of MasterCard within the Merged Bank would be offset by MasterCard gains at other VISA institutions. Both VISA and MasterCard would have an opportunity to compete on the merits across the marketplace. In a generally non-dual environment, where only one institution is dual, however, and where that one institution is likely to lean toward VISA, MasterCard foresees that its marketplace participation would erode very quickly. From the equally important acquirer perspective, no other significant branch network would be available to MasterCard, because no other exists on the MasterCard side, and that would represent a fatal blow.

(b) Non-Duality - Merged Bank Becomes a MasterCard Issuer

(i) Within Control of Parties

Should the Merged Bank choose to become an exclusive issuer and acquirer of MasterCard, MasterCard believes that this would be pro-competitive for the marketplace. No such negotiations have occurred, but MasterCard is of the view that it would be able to admit, and indeed would welcome, such a member as a MasterCard issuer, on its normal commercial terms for admission of members. We note that a commitment to the Merged Bank being a MasterCard rather than a VISA issuer, as a condition of proceeding with the proposed transaction, is a matter entirely within the control of the parties to the merger.

(ii) Would Preserve Credit Card Competition

An environment in which the Merged Bank issued MasterCard cards would not only preserve credit card competition, but actually enhance it. On a complete overnight conversion, recognizing that not all cards will be converted because of consumer preference, or inertia, or other reasons, MasterCard would represent approximately a 48% share, with VISA at 52% of general-purpose credit transaction value in Canada. This result would enhance competition, as MasterCard has been struggling to maintain sufficient critical size to be an effective competitor.

(c) Non-Duality - Merged Bank Becomes a VISA Issuer

Like an issuing environment in which the Merged Bank chose to issue and acquire MasterCard rather than VISA, the choice by the Merged Bank to issue and acquire VISA only would be within the control of the parties to the merger, subject to the exercise of the Bureau's statutory powers to prevent an anti-competitive result. Unlike a choice to issue MasterCard cards, however, the choice by the Merged Bank to issue only VISA cards would not be pro-competitive. In fact it would be a choice which would result in the effective elimination of MasterCard in Canada as a competitive force, since revenues and brand awareness would be reduced drastically, a significant number of merchant locations would be lost and members would no doubt then switch to VISA as their only real alternative. VISA would be the only general purpose credit card widely available and accepted throughout Canada. The competitive pressure which MasterCard has introduced into the marketplace would be lost.

Given the fundamental importance of Bank of Montreal to MasterCard in Canada, both as an issuer of cards and, even more so as an acquirer of transactions, the consequences for MasterCard of the loss of Bank of Montreal are reasonably obvious, simply from the perspective of the raw numbers.

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VISA would be approximately 10 times the size of MasterCard which is an unsustainable position. In Appendix VII to this submission we set out the additional detail as to the specific consequences which might be expected as a result of such a decision, if it were permitted by the Competition Bureau to go forward.

VI SUMMARY AND CONCLUSION

MasterCard has been an effective force for innovation and product, service and feature competition in the credit card business in Canada. It has aggressively introduced new members and new types of members, in stark contrast to VISA. Through the efforts of the MasterCard System, the brand has been an effective price competitor on both the issuing and acquiring sides of the business. It has promoted new types of cards, including premium cards, business cards, affinity and co-branded cards, and low interest/low fee or no fee cards. Again this is in contrast to VISA, which, as the dominant player, has tended to prefer the status quo and to be reactive, rather than innovative. The MasterCard System has led to the provision of lower cost general purpose credit cards previously not available to low income Canadians. It has introduced new services in conjunction with its cards and new features such as differentiated service levels, different grace periods for payment, introductory rates and balance transfer options. It has provided competition to VISA with respect to the acquiring of credit card transactions and the provision of services to merchants. It provides a significantly lower cost alternative to VISA, both as to interchange fees and its members' merchant discounts.

Many of the benefits which a particular MasterCard member has introduced have spread to other card issuers. Even within the MasterCard System, some of the innovations introduced by certain (often new) MasterCard issuers have been adopted and offered by other MasterCard issuers. As well, many of the MasterCard System innovations have been copied, or in some cases, improved upon by VISA. These are precisely the benefits which one expects in a competitive environment, and these benefits would be lost were MasterCard System no longer a viable competitor in Canada.

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The financial implications to MasterCard's business of the loss of Bank of Montreal, and the downward spiral and ultimate demise of MasterCard in Canada which this would precipitate, are detailed in Appendix VII, and are readily predictable in the concentrated Canadian bank environment. The following summarizes the expected results of the conversion of Bank of Montreal's portfolio to VISA:

- MasterCard loses more than one third of its acquiring locations (ie. branches), and its only national branch network. In a short period of time, this will result in a loss of the majority of its merchant acceptance locations and acquiring volume.
- MasterCard's transaction volumes will sink to 7% of combined MasterCard/VISA volumes.
- As a result of the above, MasterCard's revenue will be drastically reduced and will not be sufficient to provide the necessary services or support to members or merchants, or to advertise and promote the brand.
- MasterCard will not be able to recruit new members and most likely will lose existing members.

As a result, MasterCard would not be viable in Canada. Were that to happen, the competitive benefits which MasterCard and its members have brought to Canada and Canadians, both cardholders and merchants, would be lost. In addition to the competitive loss, such a situation would result in millions of Canadians being asked to reach into their wallets and hand over their MasterCard cards, and being offered a VISA card, or nothing, in replacement. Canadians would viscerally sense this to be a reduction or elimination of competition and choice. They would also regard it as an unwelcome interference with their personal life. Simply stated, Canadians will have lost the freedom to choose between MasterCard and VISA.

If the Bureau concludes, as we think it should, that the loss of MasterCard competition in Canada would be detrimental, the Bureau should not permit the Merger to proceed unless it is assured that it will do so in a way which will preserve competition.

One such method to preserve competition would be to condition Merger approval the Merged Bank issuing MasterCard cards, rather than VISA cards. That would bring the two brands close to parity, and ensure a sustainable competitive situation. It is also a result within the control of the merging parties.

A second approach, which would also provide a highly competitive environment, would be to condition approval of the proposed Merger on the emergence of full and open duality, i.e. a dual issuing and acquiring environment in Canada. Should VISA permit duality in Canada, MasterCard believes that also would ensure continuing and highly effective competitive rivalry, with the benefits of competition flowing directly to Canadians.

Should the merger result in the Merged Bank issuing VISA cards only, that would, as demonstrated herein, give rise to a substantial lessening, if not elimination, of competition in the general purpose credit card business in Canada, with the elimination of MasterCard as an effective competitor. MasterCard, therefore, requests that the Competition Bureau pursue a strategy to avoid that result.

As noted at the outset, MasterCard would be pleased to provide additional information should the Bureau require such information.

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As noted at the outset, MasterCard would be pleased to provide additional information should the Bureau require such information.

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APPENDIX I - GLOSSARY OF TERMS

The following are some terms of art used in the credit card business which are referred in the document, and which we hope will be helpful to the Bureau in the future as it talks with others about the proposed merger and the card business. These terms are defined in the context of the MasterCard program, but the principles generally will apply, with modifications in some instances, to the VISA program as well.

Acceptance – This is the process by which a qualifying merchant accepts a MasterCard card presented by a consumer/cardholder for the purchase or lease of goods or services from that merchant. In order to qualify to accept MasterCard cards, the merchant must have an agreement with a MasterCard acquiring member, who processes the transactions submitted to it by the merchant into the MasterCard System and then pays the merchant the agreed amount, after deduction of the applicable merchant discount. All such merchants are required to prominently display the MasterCard logo to inform MasterCard cardholders that it is a MasterCard accepting merchant.

Acquirer or Acquiring Member – This entity would be a licensed member of MasterCard which contracts with merchants to accept MasterCard cards. The acquiring member will investigate the background of, and solicit, potential merchants to accept MasterCard cards and, upon a decision to sign such merchant, it will (i) enter into a contract with it, regarding each of their rights and obligations, including the merchant discount (ii) provide the necessary instructions as to acceptance of the cards, and (iii) train the merchants' employees as to how to validly accept a MasterCard card for payment. In addition, the acquirer often will provide an authorization and/or draft capture terminal to process the transactions as well as merchant sales drafts to complete transactions, where appropriate. Upon acceptance of a transaction, the merchant will submit it to the acquiring member, who will process it and pay the merchant the appropriate amount, after the deduction of the appropriate and agreed merchant discount for each transaction.

Affiliate or Affiliate Member – An entity which has been elected as a member of MasterCard and is licensed to issue and/or acquire MasterCard transactions in accordance with its agreement with its principal member. The MasterCard transaction executed by an affiliate member is the responsibility of that affiliates' principal member. The principal member is responsible to the MasterCard system for all activities of its affiliate members in connection with its MasterCard program.

Cardholder – A person or company (typically a consumer) who is solicited, screened and approved by a MasterCard issuer for a line of credit accessed by a MasterCard card issued by the MasterCard issuer. The cardholder may use the card either to purchase goods and services from a merchant or to obtain a cash advance from the issuer, and the cardholder is billed for his or her transactions monthly.

Clearing and Settlement – The MasterCard process by which acquirers and issuers exchange financial data and value resulting from sales transactions, cash advances, merchant credits, etc. In connection with a transaction submitted by an acquirer, the issuer remits through MasterCard's clearing and settlement system the amount of the transaction completed by the merchant less the applicable interchange fee.

Gold MasterCard Card – A card which is gold in color and which accesses a credit line that equals or exceeds a minimum amount specified by MasterCard, and which has expanded services above those available on a standard MasterCard card.

Interchange – The exchange of MasterCard transaction data between acquiring and issuing members.

Interchange Fees – Amounts paid by the acquirer to the issuer that are netted by MasterCard, on behalf of the issuer, against the transaction amount due to the acquirer in the settlement and clearing process to compensate the issuer for transaction related costs, i.e. fraud losses, credit losses, transaction processing costs and the issuer's cost of funds. These fees are established by MasterCard on an annual basis pursuant to an established formula

Issuer – A MasterCard member licensed to issue MasterCard cards to cardholders. The issuer issues a MasterCard card to cardholders who meet its criteria for a card and who sign the issuer's standard cardholder agreement specifying their respective rights and obligations. The issuer receives and pays for transactions that its cardholders have completed using their MasterCard card, and the issuer bills and collects the transactions amounts from its cardholders.

MasterCard System – The term used when collectively referring to MasterCard and its members, considered together.

Merchant – Any business which sells or leases goods or services, and having met the qualification standards of MasterCard and, having been approved by a MasterCard acquiring member, accepts MasterCard cards as payment for goods and services

Merchant Agreement – Contract between the merchant and the acquirer which details their respective rights, responsibilities and warranties.

Merchant Discount – The fee the acquiring member charges the merchant to cover the member's costs, including payment of the interchange fee to the cardholder's issuing institution, expenses incurred in the processing of the transaction and processing of chargebacks by issuers of invalid transactions. The merchant discount is established independently, on a case by case basis, via negotiation between merchants and individual MasterCard acquirers.

Platinum MasterCard Card – A new card program introduced by MasterCard offering cardholders higher credit lines, and more services and enhancements than those available with a gold or standard MasterCard card.

Principal Member – Any regulated financial institution entity elected to membership and licensed to issue and acquirer MasterCard transactions and contract with affiliate members (for which it is then responsible to the MasterCard System). Principal members are connected to the MasterCard network either directly through their own host computer or through processors on their

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behalf. In addition to the right to conduct a MasterCard program, a principal member is eligible to vote on issues submitted to the membership pursuant to Delaware non-stock company law.

<u>Purchasing Cards</u> – Cards designed to help companies maintain control of purchases, while reducing the administrative cost associated with authorizing, tracking, paying and reconciling those purchases. This is accomplished by a sophisticated MIS software system that enables the issuer to provide information to the cardholder not available on other types of MasterCard cards.

APPENDIX II - ISSUING AND ACQUIRING INSTITUTIONS IN CANADA

	MASTERCARD MEMBERSHIP						
	Cards Issued	Standard	Gold	Corporate	Gross Dollar Volume[**]	Acquiring Volume[***]	Merchant Locations
Bank of Montreal[#1]	8,731,666	6,121,482	583,012	47,192	13,961,937,788	13,240,618,000	395,630
National Bank of Canada[#1]	2,096,725	1,759,646	221,245	115,834	3,770,329,750	4,404,673,000	81,613
Canada Trust[#1]	1,462,806	1,002,108	460,698	-	3,714,985,722	3,970,439,000	95,644
CUETS[#1]	645,222	609,114	36,108	-	1,260,030,952	421,845,900	21,516
Alberta Treasury[#1]	71,901	71,901	-	-	174,803,720	15,898,900	5,559
Canadian Tire Acceptance Ltd[*2]	554,577	554,577	-	-	515,985,622	-	-
National Trust[#1]	141,387	141,387	-	-	212,665,730	12,667,000	-
Trans Canada Credit Corp.[*2]	10,690	10,690	-	-	8,695,073	-	-
Household Finance[*2]	132	-	-	132	408,630	-	-
Wells Fargo[*2]	946	946	-	-	1,645,404	-	-
Capital One[*2]	26,261	26,261	-	-	54,609,819	-	-
MBNA[*1]	N/A				N/A	-	-
Ge Capital[*2]	N/A				N/A	-	-
	11,742,315	10,298,094	1,281,063	163,158	23,676,078,210	22,086,141,800	599,962

Notes:
[#] Issuer and Acquirer
[*] Issuer only
[**] Gross Retail Volume + Cash Advance $ Volume
[***] Approximation
[1] Principal Member
[2] Affiliate Member
[3] Canadian Branches only

	VISA MEMBERSHIP				
	Cards Issued	[redacted]	Gross $ Volume	Acquiring Volume	Merchant Locations
Total Membership	20,061,054	[redacted]	64,843,970,000	N/A	482,134
Royal Bank of Canada (est.)	5,258,000	[redacted]	21,460,200,000	N/A	N/A

	Number of Branches							
MasterCard Members	**Alberta**	**Atlantic**	**British Col.**	**Man/Sask**	**Ontario**	**Quebec**	**NWT/Yukon**	**Total**
Bank of Montreal[1]	133	90	207	119	496	196	5	1,246
National Bank of Canada	2	41	3	4	136	537	-	723
Alberta Treasury Branches	154	-	-	1	-	-	-	155
CUETS (est.)	69	-	117	194	220	-	-	600
National Trust (est.)	-	2	10	10	160	10	-	192
Canada Trust	62	26	83	23	374	18	-	586
Sub-Total	**420**	**159**	**420**	**351**	**1,386**	**761**	**5**	**3,502**
Visa Members								
Bank of Nova Scotia	126	210	130	90	535	116	2	1,209
CIBC	148	79	178	145	636	170	14	1,370
Royal Bank of Canada	171	165	210	177	849	260	6	1,838
Caisses Populaires	-	85	-	18	42	1,275	-	1,420
Toronto Dominion	124	70	129	106	609	91	3	1,132
Citibank	N/A	N/A	N/A	N/A	N/A	N/A	N/A	-
Laurentian	9	1	17	10	104	228	-	369
Sub-Total	**578**	**610**	**664**	**546**	**2,775**	**2,140**	**25**	**7,338**
Grand Total	**998**	**769**	**1,084**	**897**	**4,161**	**2,901**	**30**	**10,840**

[1]Includes Hong Kong bank

Canadian Bankers' Association - Visa and MasterCard combined
Public Consolidated Bank Card Stats - for both MasterCard and Visa

	Year end '97
# of Issuers	633
# of Merchants	756,695
Merchant Outlets (total locations)	1,082,096
Total Cards in Circulation	31,803,369
Gross Transaction Volume*	$ 88,534,198,626

* Gross Retail Volume + Cash Advance Volume

APPENDIX III - MAJOR PRINCIPAL AND AFFILIATE MASTERCARD MEMBERS IN CANADA

MasterCard's principal members in Canada are: 1) Bank of Montreal; 2) National Bank of Canada; 3) Canada Trust; 4) Credit Union Electronic Transaction Services (CUETS); 5) MBNA Canada Bank; 6) Alberta Treasury Branches; 7) National Trust (soon to cease to be a member as has been purchased by the Bank of Nova Scotia-a VISA bank); and 8) ING Canada Bank.

Affiliate members of MasterCard which are significant, and effectively run or will run their own card programs with a guarantee of payment by their principal members, are as follows:

1. Canadian Tire Acceptance (Principal Member Bank of Montreal)
2. Capital One Financial Canada (Principal Member Canada Trust)
3. Household Finance Canada (Principal Member Bank of Montreal)
4. G.E. Capital Canada (Principal Member National Bank of Canada) (very low level of activity as yet)
5. TransCanada Credit (Principal Member Bank of Montreal)
6. Beneficial Finance Canada (Principal Member Bank of Montreal) (not yet active)

Finally, there are a number of Canadian affiliate members which do not run their card programs in detail, but rather delegate all or most of the running of the operation to the principal member. These include:

1. Various Credit Unions (Principal Member CUETS)
2. Hong Kong Bank of Canada (Principal Member Bank of Montreal)
3. Korea Exchange Bank (Principal Member Bank of Montreal)
4. Banca Commerciale Italianá of Canada (Principal Member Bank of Montreal)
5. Trust General du Canada (Principal Member National Bank)
6. Standard Chartered Bank of Canada (Principal Member Bank of Montreal)
7. The Bank of East Asia (Canada) (Principal Member Bank of Montreal)
8. Republic National Bank of New York (Principal Member Bank of Montreal)
9. Various Credit Unions (Principal Member Bank of Montreal)

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Appendix V - Wells Fargo Situation

Wells Fargo is a California based bank, which, in the United States, issues both MasterCard cards and VISA cards. Wells Fargo specializes in small business loans as its particular area of focus. Some years ago Wells Fargo determined that an effective way to make small business loans would be to issue credit cards with high (typically somewhere between $30,000 and $75,000) credit limits, to the principals of small businesses. That program was very successful in the U.S. and, approximately a year and a half ago, Wells Fargo decided to employ essentially the same business strategy in Canada. That is, it has issued MasterCard cards to certain Canadian residents who are principals of small businesses. Its legal ability to so was uncertain, and MasterCard understands, although it was not privy to the discussions, that Wells Fargo reviewed this issue with OSFI. OSFI apparently concluded that, as structured, the Wells Fargo program was not contrary to Canadian law. As a result of this MasterCard granted Wells Fargo an extension of area of use of its license to use MasterCard trademarks, so that it may now use the marks in both the United States and Canada.

We understand that Wells Fargo runs the entire business within the United States. Card issuance is subject to California law. Obviously this would give rise to serious issues of administration, enforcement etc., were a large portfolio of borrowers involved. As it is, the Wells Fargo program is targeted to a small number of highly creditworthy and high value borrowers, so apparently it can be reasonably efficiently administered by Wells Fargo from the United States. Nevertheless there are a very small number of credit cards involved (less than 1600) and the arrangement works only because of this fact and the particular nature of the borrowers.

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APPENDIX VI - NEW MASTERCARD MEMBERS SINCE 1993

1. MBNA Canada Bank
2. ING Canada Bank
3. Canadian Tire Acceptance
4. Capital One Canada
5. Household Finance Canada
6. G.E. Capital Canada
7. TransCanada Credit
8. Beneficial Finance Canada

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Appendix VII Consequences of Switch by Bank of Montreal to Visa

The following section outlines the impact on MasterCard's ability to compete, which would result from a switch by Bank of Montreal to issuing Visa, not MasterCard cards, and acquiring Visa, not MasterCard transactions.

Bank of Montreal currently provides MasterCard with a solid presence in Canada. It represents 60% of MasterCard's acquiring volume and 59% of its issuing volume. MasterCard's ability to compete effectively in the Canadian marketplace would be eliminated if it were to lose Bank of Montreal, its premiere Canadian member. The loss of Bank of Montreal would initially lead to negative consequences on a number of fronts – dramatically reducing MasterCard's share of transaction volume (by transaction value) down to 7%, while simultaneously increasing Visa's to 93%. Additionally, MasterCard's cardholder base, merchant acceptance network and revenues would suffer severe losses. The reduction of revenues would then drive an elimination of MasterCard Canada marketing, substantial personnel cuts and reductions in service quality. MasterCard's brand awareness with consumers and merchant locations would fall as a consequence. These factors would feed on each other, leading merchants, members and consumers to question the value of accepting, issuing or holding MasterCard cards. The continued losses on all three fronts would further minimize MasterCard's ability to compete.

1. Loss of Bank of Montreal card portfolio

Currently 37% of general purpose cards in Canada are MasterCard cards. With the proposed merger, should Bank of Montreal MasterCard cards flip to Visa cards, the effect on the number of MasterCard cards in circulation would be devastating. A reduction from 37% to 16% would result overnight.

Share of Cards

	Pre-Merger (1998)	Pre-Merger Share	Result of Flip to Visa	Post Flip Share
MasterCard cards	13.7 (mm)	36.9%	5.0 (mm)	15.7%
Visa cards	20.1 (mm)	63.1%	26.8 (mm)	84.3%

Source: The Nilson Report, MasterCard International Analysis

Given that there will be fewer merchant locations accepting MasterCard cards, as is explored below, there will be many merchant locations which will only accept Visa. As a result, there will be a need for continuing MasterCard cardholders to acquire a Visa card for utility purposes at merchant locations. This would further increase Visa's share, as such consumers would make at least a portion of their credit card purchases on Visa cards.

MasterCard's gross transaction dollar volume will be reduced most in the year of the switch by Bank of Montreal to Visa, but will continue to fall in subsequent years. The remaining MasterCard issuing banks will make a logical assessment of the marketplace, and see Visa's market presence strengthening and MasterCard's weakening. They will see Visa's acceptance gap (i.e., the number of locations at which Visa is accepted and MasterCard is not) widen significantly, coupled with a robust advertising campaign and a full staff to service members' needs. At the same time they will see a decline in MasterCard's spending per card as acceptance declines, as well as reduced revenue and profitability of their MasterCard portfolios. As a result, MasterCard believes that some other Canadian MasterCard members will make the logical decision to flip their portfolios to Visa. Specifically, MasterCard can expect that by the year 2000 it will be weakened (and Visa strengthened) to the point where MasterCard is likely to lose even more members to Visa. At that point, it is unlikely that MasterCard will be able to remain viable in the Canadian marketplace. The chart below shows the initial result of the loss of Bank of Montreal's MasterCard volume to Visa, assuming that the merger takes effect on January 1, 1999.

MasterCard & Visa Share of Volume

	1998 Transaction Volume ($000's)	1998 Share	Volume After Flip to Visa- One year later ($000's)	Share After Flip to Visa
Bank of Montreal	15,358,000	15%	0	0%
Other MC	12,502,000	12%	7,698,898	7%
MC Total	27,860,000	27.5%	7,698,898	7%
Visa Total	73,458,722	72.5%	103,817,092	93%
Canada Total	101,318,722	100%	111,515,990	100%

Source: MasterCard International Analysis
Note: 1999 volume is forecasted.

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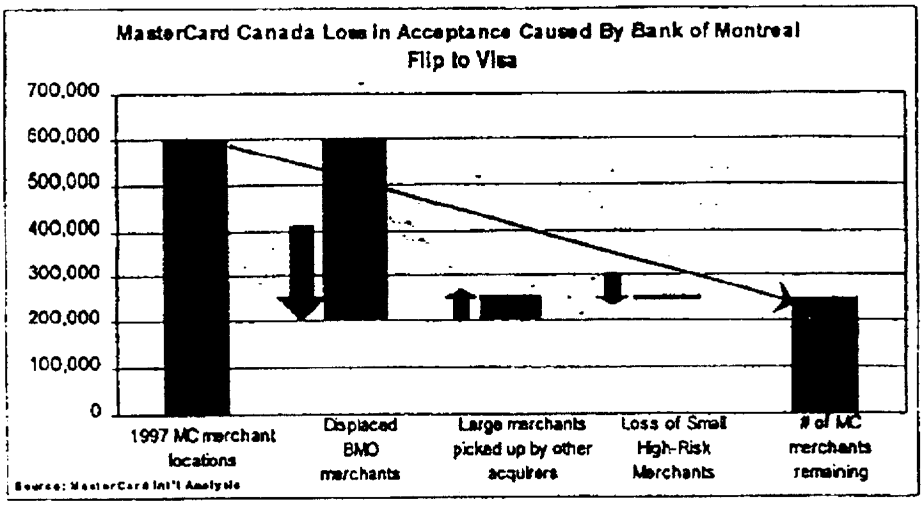
2. Acceptance Implications for MasterCard

By the year 2000 the loss of Bank of Montreal's acquiring capabilities will reduce MasterCard's acceptance presence drastically, to below that of the current third place acquirer. A potential Bank of Montreal flip to Visa would not only cede the Bank of Montreal card volume to Visa acquirers but it would also put a tremendous strain on other MasterCard acquirers. This is true because Bank of Montreal is MasterCard's dominant acquiring member in all of Canada's provinces and the only acquirer of significance in all but two of Canada's provinces. While remaining acquirers would have opportunities to capture business that was previously acquired by Bank of Montreal, it is doubtful the remaining MasterCard acquirers would have the resources or geographic presence to absorb more than 25% of these merchant locations. These are likely to be the larger merchants. Many small volume, paper-based merchants with no easy access to a MasterCard acquiring member branch will have no MasterCard option and would be unlikely to pursue a relationship with MasterCard (see discussion in Section 5 on Bank Branches.) Assuming that the remaining MasterCard acquirers have the resources to actively solicit the Bank of Montreal merchants and aggressively grow their acquiring network 25%, MasterCard will have an acceptance gap of some 350,000 merchant locations that will have no other option than Visa.

The chart below shows how the number of MasterCard merchant locations would fall dramatically as a result of the Bank of Montreal's flip to Visa. Initially, MasterCard has approximately 600,000 merchant locations (based on 500,000 overall merchants, some of whom have multiple locations), of which the Bank of Montreal acquires at 395,000 locations. The immediate effect of the Bank of Montreal's flip to Visa is the loss of these 395,000 merchants. Quickly thereafter, however, the remaining MasterCard acquiring banks could absorb up to 51,250 of the displaced merchants. This number is based on the likelihood that these remaining acquirers will have the capacity to grow at a rate of up to 25% over their current merchant base. Finally, MasterCard would likely lose an additional 10,000 small merchants in such high-risk categories as travel agencies, tour operators, direct marketers and mail order retailers, because the higher costs- due to a higher rate of charge backs- associated with these merchants makes them less desirable to acquirers. The result is that MasterCard ends up with a reduced merchant base of 246,250.



Due to the loss of Bank of Montreal cards in circulation, and the fact that most transaction volume would be on Visa cards (projected 93% share of volume as a result of a Bank of Montreal flip to Visa), merchants would be presented with a Visa card much more often than a MasterCard card. This volume and cardholder disparity will further reduce merchant brand awareness and decrease their perceived need for a MasterCard acquiring relationship.

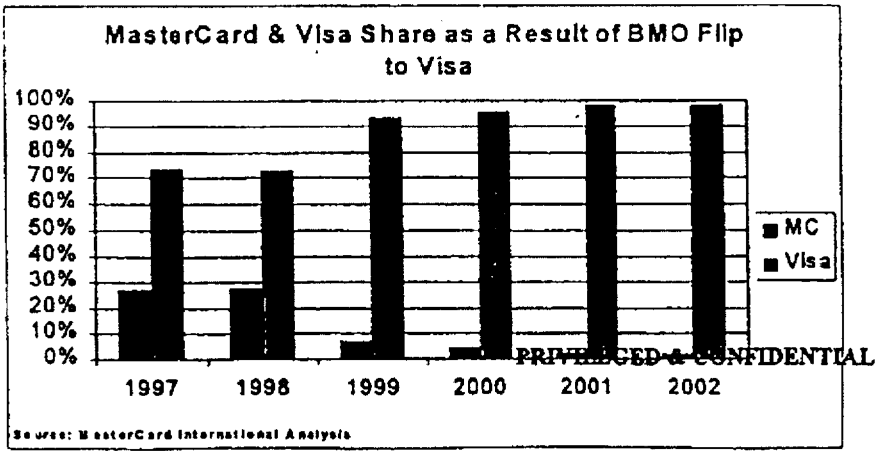
3. Volume Implications for MasterCard

MasterCard expects that within the first year after the Bank of Montreal flips its card portfolio to Visa, the remaining MasterCard issuers' volume will drop significantly due to the reduced number of MasterCard merchants and the reduced number of MasterCard cards in circulation. Assuming that the switch takes effect on January 1, 1999, MasterCard expects that in addition to losing 100% of Bank of Montreal's MasterCard volume, it would also lose approximately 38% of remaining issuers' MasterCard volume, simply because the number of merchants accepting MasterCard will have dropped significantly. These volume losses would leave MasterCard with a share of 7% by the end of 1999. MasterCard expects that at that point, its market presence will have weakened to the point where at least two more of its card portfolios would switch to by Visa by 2002.

As we discuss in the next section, the poor economics of merchant acquiring would also negatively impact MasterCard presence at merchant sites. The initial decline in MasterCard volume as a result of the flip to the Bank of Montreal (estimated to be 72%) would, in turn, reduce the revenues of merchant acquirers. Since a large portion of their expense base is composed of fixed costs necessary to run the acceptance network, their per transaction cost will increase substantially. This loss of revenues and increased unit cost base will make acquirers significantly less likely to pursue new accounts and begin the process of purging many of their existing accounts. The MasterCard acquirers' other alternative would be to dramatically increase their merchant discount rate (which is currently estimated to be 25 basis points or more below Visa) to offset their lost volume. These higher acquirer costs would either lead to a reduction in merchant acceptance, or higher merchant expenses. These additional merchant expenses would probably be passed onto the consumer in the form of higher prices. Given the choice, the merchant would have additional impetus not to accept MasterCard cards. Card suppression at the merchant location would further erode MasterCard's share.

The chart below illustrates how MasterCard and Visa would be affected, in terms of volume share, in the years following a Bank of Montreal flip to Visa.

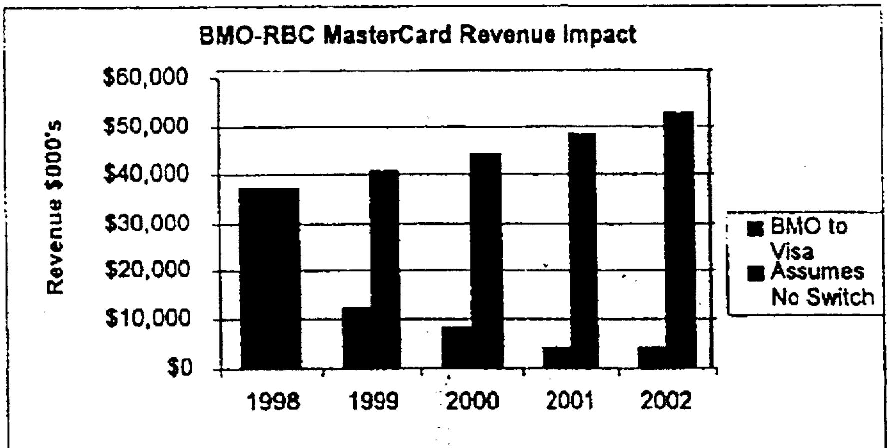
Share of Volume over Time



4. **Revenue implications for MasterCard**

Given that the Bank of Montreal is MasterCard's largest issuer and acquirer, the revenue loss to MasterCard would be significant if Bank of Montreal were to convert its cards to Visa. Projected revenue loss will be 67% in the first year, with losses in subsequent years projected to be in the 40% range. Three quarters of the revenue loss in the first year is directly attributable to the loss of Bank of Montreal assessment and operational fees. The remaining loss is due to the decrease in volume generated by other MasterCard issuers whose cardholders have fewer merchant locations at which to use their cards. In subsequent years additional brand flips to Visa by MasterCard issuing banks, coupled with declining brand awareness and cardholder spending, would account for continued losses.

The chart below illustrates how MasterCard's revenues would be affected if the Bank of Montreal flipped to Visa, as well as the projected revenues under the current environment.



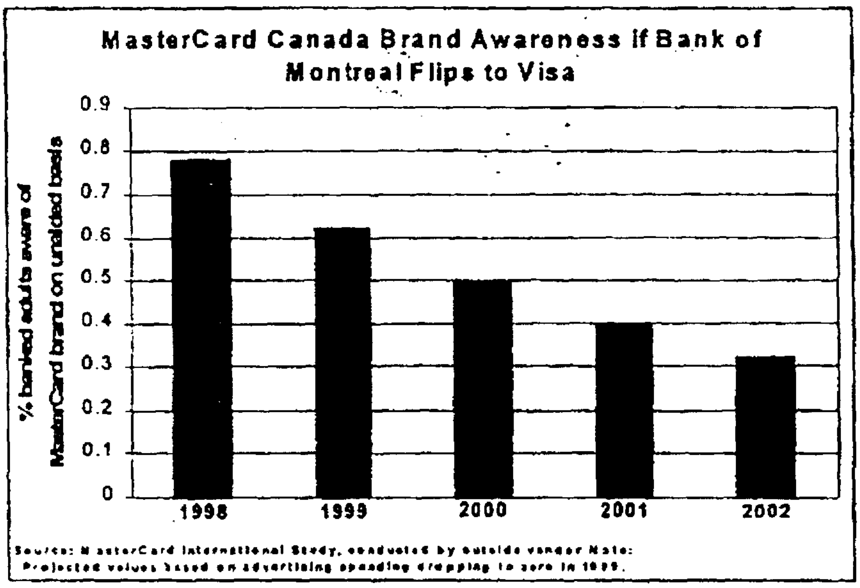
Source: MasterCard International Analysis

The loss of revenue directly reduces the amount of money that MasterCard can allocate to advertising and promotional expenditures. As a result of a 67% loss in revenue, coupled with the substantial fixed costs necessary to maintain MasterCard's operational infrastructure and Canadian franchise, MasterCard's budget for marketing, promotions, and advertising, would have to be eliminated. MasterCard would also need to significantly reduce staff, technical support and sales personnel to offset the revenue reductions. MasterCard would not be able to provide material long-term financial support from other regions or some "corporate" fund since our governance structure requires that regions are capable of maintaining an adequate level of profitability. This loss of staff and marketing funding would have devastating impacts to existing members as well as new entrants.

Existing MasterCard Canada members will be disadvantaged in the marketplace since the loss of Bank of Montreal volume will eliminate MasterCard's ability to advertise or conduct local promotions and sponsorships to support the brand. Additionally, a projected 45% reduction in staff will reduce MasterCard's ability to provide customer service, develop joint marketing campaigns, resolve technical issues and develop the innovative products and services that have made it a successful competitor in the past.

MasterCard's ability to attract new market entrants will also be affected by MasterCard's financial loss, as these potential members make brand decisions based on the strengths that an association exhibits in the key areas of issuing and acquiring. Such potential members will choose the association with the appropriate resources (people, capital, brand presence, etc.) and which can best support their products. MasterCard has successfully promoted competition in the marketplace in the past by bringing new members into Canada, but a MasterCard Canada with no advertising budget and a significant acceptance gap would be ineffective in competing for the brand allegiance of new members. MasterCard's projected market weakness, coupled with Visa's historic lack of sponsoring new Canadian members, would decrease the likelihood of new members entering Canada, further contributing to a decline in competition in Canada. In addition, if mergers in the Canadian financial services sector continue, and Canada remains non-dual, it becomes increasingly unlikely that the combining parties will choose MasterCard if they must make a brand decision. This will result in continued member, cardholder, merchant and revenue losses for MasterCard.

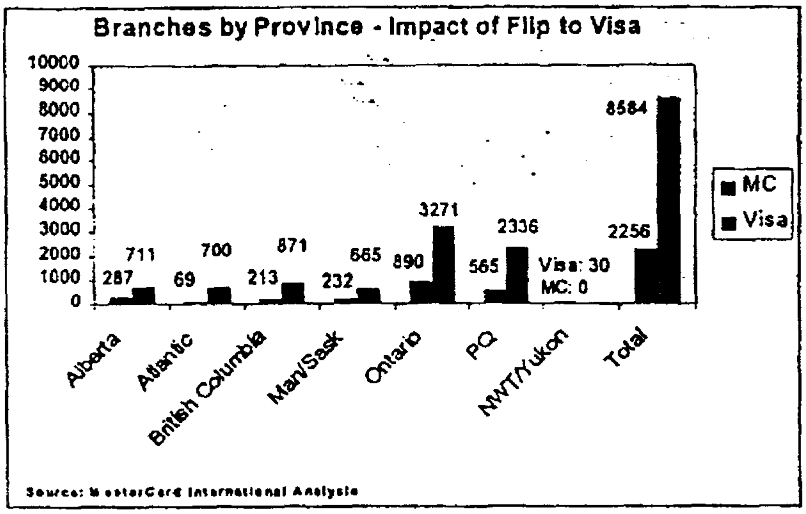
Brand awareness is an industry measure of success that is affected by advertising and promotional spending. The elimination of funds allocated to advertising and promotional spending will directly affect the awareness for the MasterCard brand. Additionally, the decreased merchant acceptance, reduced volume and cardholder base will further fuel the reduction in brand awareness. In the first year of the merger it is expected that consumers will remain relatively aware of the brand especially due to the press coverage that the merger will produce. However, beyond the merger year, MasterCard's awareness is expected to decline at a steady rate, as indicated in the chart below.



5. **Branches issuing – region by region**

The loss of the MasterCard bank branches has a direct effect on both consumers and merchants. Studies have shown that 59% of MasterCard cardholders made their card decision as a result of an influence at their branch bank. This could have been the result of obtaining an application at their branch bank, receiving a card that accompanied the opening of an account, or teller advice. Branch presence is also significant because it is through these branch relationships that the majority of small-to-mid-sized merchants sign their acquiring contracts. For merchants who are paper-based and not electronically connected to their acquirer, it is imperative that they be in close proximity to a branch bank for the purposes of depositing their receipts. These merchants represent up to 25% of the existing merchant base. Even non paper-based merchants tend to establish acquiring relationships with local bank branches. If Bank of Montreal converts its card business to Visa, there would be a 34% reduction in the number of "MasterCard" bank branches from 3,502 to 2,256.

The chart below illustrates how MasterCard's presence throughout Canada's provinces would be severely diminished if the Bank of Montreal flipped to Visa.



The impact on branch locations would be particularly acute in several regions. Manitoba, Saskatchewan, the Northwest Territory, the Yukon, British Columbia and the Atlantic provinces will all have very limited MasterCard bank presence. MasterCard's presence in these regions, both as an issuer and as an acquirer, will be negligible. Even in Ontario MasterCard will fall to 21% of bank branches.

The loss of MasterCard acquiring capacity affects domestic use of the card as well as international tourists who travel to and expect to use their cards while in Canada. With reduced acquirers, hence reduced merchants, these tourists will be restricted in their choice of which card to use at point of sale. Since the loss of branches will be felt in all geographic regions, all tourists will be affected. Such effects will be particularly acute in regions that effectively lose entire branch networks. This may well have an impact on tourism from abroad and even on internal travel within Canada

6. Implications for merchant discounts and fees

MasterCard understands that the merchant discount rate charged by its members is approximately 25 basis points or more lower than the rate paid to Visa's acquirers. Thus, in the event that the merged bank's card portfolio is converted to Visa, Bank of Montreal's charge volume will become an incremental gain to Visa's total Canadian volume. This additional volume would be incurred under the higher Visa merchant discount rate, which is likely to cost Canadian merchants an additional amount of $64.8 million in 1999, and incrementally more in each year thereafter, for a total additional cost of $300.7 million by 2002, conservatively assuming only a 25 basis point difference. These higher costs will likely be borne ultimately by the Canadian consumers through higher prices, as merchants act to preserve their profit margins. This represents a simple transfer of value from the Canadian consumer to the Visa association and its members. Of course, without a vigorous MasterCard competitor keeping pressure to reduce merchant discount rates, and with MasterCard's merchant discounts likely to rise to reflect higher per unit costs, Visa's merchant discount rate is likely to trend upward after the switch of Bank of Montreal to Visa, although merchants and cardholders may have other options which will adversely affect Visa's efforts to increase the merchant discount. The chart below illustrates the additional cost that will be borne by merchants and consumers over the next few years, in the event that Bank of Montreal switches to Visa, simply due to Visa's existing higher discount rate.

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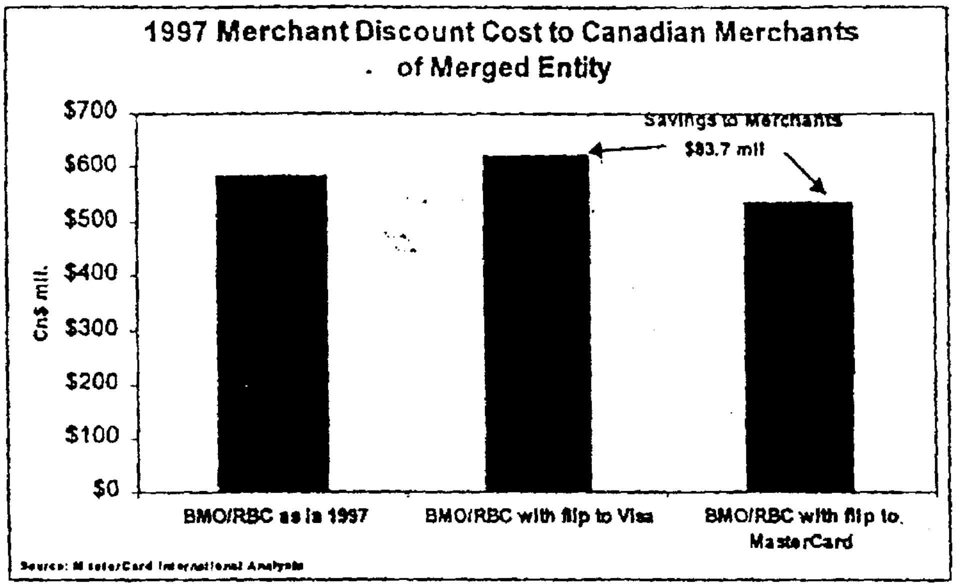

The flip of the merged bank's card portfolio to Visa, as discussed above, will reduce MasterCard's credit volume to about 7% of the Canadian bankcard usage, creating an environment where further erosion of share is imminent. Visa, being the dominant player in the card market, will be able to increase advertising and marketing, building an unquestionable lead in brand loyalty and acceptance. This will heighten the risks and costs for the remaining MasterCard players. Ultimately, it will eliminate MasterCard as a competitive force in Canada.

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