

Electronic Cash Payments: Canada Loves its Debit Cards, but Will the Cashless Revolution Happen in the U.S.?

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Everywhere you go in Canada, from major retail outlets to restaurants to gas stations to little kiosks, the ubiquitous INTERAC logo and the familiar electronic keypad or "pinpad" are present. Canadians have come to expect that they can make electronic cash payments just about anywhere for anything, from coast to coast.

Even pizza delivery drivers bring wireless versions of the pinpads when they come to your door. Just swipe your bank-issued debit card, verify the amount on the screen, select whether you want to pay from your checking or savings account, enter your PIN (personal identification number), and press Enter. A receipt prints, and the money is automatically withdrawn from your account and issued to the retailer—who also pays an acquirer fee for each debit card transaction.

In a country where even a trip to a nearby Automated Bank Machine (ABM) can be bone-chilling during the winter, Canadians don't like having to withdraw hard cash to pay for everyday purchases, and they don't like writing checks, either. Most Canadians select bank service packages in which a specific number of transactions are included along with account service fees. There are some individuals who do not select service packages, however, and a small transaction fee can be applied when a transaction occurs.

The INTERAC Generation Doesn't Rely On Cash

Even technology-challenged little old ladies have become comfortable with completing their INTERAC transactions at their local stores, where some clerks quaintly mispronounce it as "interact." Canadians have become the world's most avid users of debit cards and ABMs. Point-of-sale debit card transactions have been offered across the country only since 1994, but in just over 10 years, INTERAC Direct Payments (IDPs) have become Canada's national debit card service. Debit cards have now surpassed cash as Canadians' preferred method of payment, especially for payments between \$25.00 and \$100.00. In 2004, a record 2.7 billion point-of-sale transactions were made using IDPs at almost 400,000 merchants.

A whole generation of children is growing up without ever knowing what it was like before you could pay for a movie or a car rental with your debit card.

"INTERAC Shared Services have been successful because they are convenient, fast, secure, and ubiquitous," says Sara Feldman, Vice President of Communications and Marketing for the INTERAC Association, which is located in Toronto, Ontario. INTERAC Association is an unincorporated, not-for-profit association; was founded in 1984 by five Canadian banks; and now boasts a diverse membership of banks, other financial institutions, and non-financial enterprises. Any company incorporated in Canada is eligible to join the Association.

Feldman says, "The framework is a 'co-opetition.' On the back end, members cooperated to build the network and establish standards of service. On the front end, members are competing to sell the services to merchants and consumers in the marketplace. The reliability level of the services is well-known, and Canadians have traditionally been early adopters of new technology."

Banks Assumed Consumers Would Opt for Smart Cards

The INTERAC Association reported in 2001 that 86% of adult Canadians hold at least one banking card in Canada for electronic transactions. For these consumers, the most popular places for debit card transactions are grocery stores (52%), drug stores (45%), and liquor/beer/wine stores (33%). INTERAC members also offer Shared Cash Dispensing

(SCD) at more than 45,000 ABMs across the country. With SCD, consumers can visit any ABM that bears the familiar INTERAC logo, so they can withdraw cash from an ABM that does not belong to their own financial institution.

Dave Fletcher, Vice-President of Iders Inc., a contract electronic engineering, design, and manufacturing firm that developed the prototype pinpads for one Canadian bank, says that in the early 90s, banks assumed that consumers would ultimately opt for smart cards instead of debit cards:

There is a bit of irony here. While the banks believed electronic transactions would be significant, they were also certain debit transactions were a stopgap measure, believing the real future was in smart cards. With a smart card, the cash value is electronically located right on the card. No communications or remote banks involved. The cash goes from a chip on your card to a similar chip in the merchant's terminal. A smart card transaction costs a fraction of a debit card transaction, which is why the banks believed debit would not last because the consumer, not the bank, carries this cost.

It turns out folks were thrilled to have the convenience and were in fact willing to pay the service charges for low-value transactions. Additionally, all the bank investment into smart card pilot programs, launched in various cities back at the time, was a failure. People were not comfortable with the idea of a card actually having value stored on it, perhaps significant value. It could be lost or damaged, and folks weren't comfortable at the time with the security involved (though it's pretty good) in the smart card scheme. Similar U.S. smart card pilots have also failed or met limited success.

When Will the Cashless Revolution Happen Here?

For Canadians traveling within the United States, five Canadian financial institutions provide their customers with a cross-border debit option: They can use their Canadian banking cards at merchants in the United States who are associated with the NYCE network. However, Canadians traveling to the States are quickly reminded that they can't enjoy the convenience of the familiar INTERAC system after they cross the border. Even in a place like New York City that has it all, you can't swipe your debit card to pay for a

movie ticket or a cab ride. The American marketplace remains dominated by cash, check, and credit card transactions, with smart cards more likely to transform point-of sale-behavior than debit cards.

But why? And can the same revolution ever happen in the United States? Fletcher answers the question this way:

Debit was a phenomenon in Canada and Australia, but virtually nowhere else, including the U.S. At the time of debit's inception in Canada, you could count all the really significant banking players on one hand. At the same time in the U.S., there were over 15,000 merchant banks. A small number meant it was easy to work together to create a well-thought-out specification for something like debit, addressing a myriad of issues, then execute on it cleanly and concisely. As universal telecommunications are also required to make debit work, this also played a part. In the U.S., telecoms are fragmented. In Canada-better integrated, fewer players. Europe is much like the U.S.-lots of banks in lots of countries. Australia is more like Canada. Of course, other schemes have and will continue to emerge in the U.S., but I doubt debit, as it is in Canada, will ever get the same traction in the U.S.

Security might be another reason why Americans are slower to adopt debit cards. Debit card fraud has been on the rise in Canada. Although the terminals and back-end systems are extremely secure, Fletcher says that the debit cards issued by the financial institutions are the weakest link, with debit card "skimming" becoming a problem. INTERAC Association reports that its members reimbursed \$60 million to cardholders in 2004 because of skimming.

The Debit Card Is Here to Stay

In February 2005, however, the Association announced approval by its Board of Directors to migrate to chip technology for the delivery of INTERAC Shared Services. Currently, the Association plans to have the necessary infrastructure in place for its members in 2006, with the first INTERAC chip transaction targeted to take place in 2007.

"The debit card is here to stay," says Fletcher.

Fletcher predicts the rise of Internet debit services that will offer consumers convenience and a certain amount of security, while providing banks with a significant new revenue stream plus the ability to significantly reduce costs over the previous banking transaction model.

INTERAC Milestones in Canada

1984-Five financial institutions decide to link their own Automated Banking Machine (ABM) networks to give customers broader access to cash dispensing.

1986-The first Shared Cash Dispensing (SCD) transaction takes place.

1990-INTERAC Direct Payment (IDP) debuts in the capital region.

1994-IDP becomes available nationally.

1997-One billionth IDP transaction is logged.

2000-IDP surpasses cash as Canadians' preferred way to pay for purchases.

2001-For the first time since its introduction, IDP reaches more than two billion transactions in one year.

2004-IDP sees its busiest day in history, logging 13 million transactions on December 23, 2004.

2005-INTERAC has grown to more than 90 member organizations, with more than 47,000 ABMs that can be accessed through the INTERAC network.

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