Submission by Visa Inc. Regarding the Payment System Board of the Reserve Bank of Australia's Assessment in the *Preliminary Conclusions of The 2007/08 Review*

Introduction

Visa Inc. ("Visa") welcomes this opportunity to provide its comments to the Payments System Board of the Reserve Bank of Australia (RBA) regarding its report, *Reform Of Australia's Payments System: Preliminary Conclusions of The 2007/08 Review*. This paper addresses the RBA's assessment of the effects of the RBA's regulation of Australia's payments system.

Visa believes the regulatory scheme applied by the RBA has not only failed to achieve its stated objectives, but has increased consumer harm and system risk while doing little to increase competition. The approach, in our opinion, has several critical flaws, namely:

- Regulated interchange rates do not reflect the value of payments derived by retailers.
- The RBA's analysis of payments costs was incomplete, leading to flawed conclusions about the nature of the market and the impact of intervention.
- Payment regulation has created serious consumer harm in the Australian market.
- Payment regulation has reduced the interest and incentives of financial institutions to invest capital and make other investments for the long-term health and security of the payments industry.
- There is no justification for a regulatory scheme impacting only two of the four major competitors in the market.

While Visa recognizes that the RBA is evaluating the impact of its regulatory interventions solely on the Australian payments marketplace, Visa's concerns extend beyond the harm that these reforms have caused in Australia. Like other general purpose systems, Visa operates a worldwide payments network, and the RBA's almost unique regulatory approach limits Visa's flexibility in improving the global efficiency and security of that system. Visa's worldwide system is less valuable to all participants – including all Australian stakeholders – because the RBA's regulation has limited the tools at Visa's disposal to encourage innovation and other improvements that make the Visa payment system safer and more reliable.

Visa participates in a vibrantly competitive payments market that includes cash, cheques, PIN-debit cards, signature-debit cards, bill payment services, and prepaid/gift cards, among other payment forms. The payments market is an ever-evolving space characterized by shifting market shares and efficiencyenhancing innovations in products and processing. To make itself a viable competitive alternative at the point-of-sale, Visa must present an attractive value proposition both to issuers, so that they will choose to provide Visa cards to consumers and encourage cardholders to pay with them, and to acquirers, so that they can negotiate with and sign retailers to accept Visa cards. This is the essence of a two-sided market: balancing the push and pull of demand between the system's two groups of customers, thereby making the system appealing to both.

The RBA's regulation of interchange rates has distorted this competitive process, resulting in harm to both competition and to consumers.

<u>Discussion</u>

The RBA's assessment concludes that regulation of the Australian payment system has met key objectives. In fact, Visa believes that the evidence shows that regulation has harmed competition, harmed consumers, and reduced investment and innovation.

A. Unregulated Interchange Rates Would Reflect the Value that the Visa Payment System Delivered to Retailers.

While the RBA recognizes that "each merchant that accepts credit cards obviously judges the net benefit of doing so to be positive (otherwise it would not accept credit cards)," it nevertheless asserts that if interchange were left unregulated the aggregate cost to retailers of credit card acceptance would exceed the aggregate benefits to retailers of credit card acceptance.[2] It claims that this is so because "part of the benefit that an individual merchant perceives from accepting cards is that of 'stealing' business from other merchants."[3]

Visa believes that this analysis is incorrect. Retailers compete for the business of their customers along many dimensions, including payment card acceptance, and Visa sees no basis for regulation of payment systems simply because some of the benefit of card acceptance comes in the form of winning customers from other retailers. Indeed, every service that a retailer offers likely reflects competition to win customers from other retailers. For example, when a retailer offers consumers exceptional services via well-trained sales assistants, it does so because the benefits – including winning customers from competing retailers – exceed the costs. One would not suggest that competition for sales assistants

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[2] *See* Reserve Bank of Australia Payments System Board, *Reform of Australia's Payments System: Preliminary Conclusions of the 2007/08 Review* 15 ("RBA 2007/08 Review"), *available at* http://www.rba.gov.au/PaymentsSystem/Reforms/RevCardPaySys/Pdf/preliminary_conclusions_2007_2008_review.pdf.

[3] *Id*.

has driven sales clerk wages "too high" or that their wages should be capped by regulation simply because part of the retailer's benefit from well-trained sales assistants comes from "stealing" customers from other retailers. Competition for customers via well-trained sales assistants is no more or less a "zero sum game" than is competition for customers through payment card acceptance. We submit that it therefore makes no more sense to limit interchange rates on this basis than it would to regulate the salaries of sales assistants.

Indeed, even retailers that face little or no competition (and thus are less concerned with losing sales to competitors) choose to accept payment cards where Visa's interchange rates are unregulated, just as Australian firms with large market shares accepted Visa's payment cards before interchange regulation. Fuel retailers on remote roads, hotels and resorts in distant locations, and local restaurants in small towns with very consistent clientele all accepted Visa for reasons other than concern over loss of sales to competitors. These firms accepted Visa payment cards because their value exceeded their cost even without regard to "stealing" customers from competing retailers.

The RBA's analysis does not recognize the many benefits that Visa acceptance brings to retailers. By accepting Visa cards, retailers can receive reliable, convenient, secure, and safe payment from any of hundreds of millions of cardholders throughout the world. Retailers without the resources to operate their own financing business can also attract consumers who wish to buy on credit. This can dramatically expand the markets available to such retailers. Retailers also gain access to new customers who either prefer to pay with a Visa card or who are not carrying cash or other payment methods accepted by the retailer. Other retailer benefits that Visa has seen across the world where its cards are accepted include:

- retailers can accept payments in new channels, including Internet, mail order/telephone order, and mobile payments;
- increasing the likelihood that a customer will make a purchase because Visa cards may not only offer rewards (which serve to reduce the effective cost of purchasing), they also provide chargeback protection (which increases consumer willingness to deal with an unfamiliar retailer), and may provide services that increase the value of the item being purchased;[4]
- increasing the retailer's average ticket size;[5]

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[4] *See, e.g.,* Dollar Tree Stores, Inc., *Q4 2007 Earnings Call*, Feb. 27, 2008, *available at* http://seekingalpha.com/article/66335-dollar-tree-stores-inc-q4-2007-earnings-call-transcript?page=-1 (citing benefits to Dollar Tree of accepting Visa credit cards, including better customer service and ticket lift and stating that benefits of accepting Visa credit are "[a]bsolutely" worth the cost); *see also id.* (noting that Dollar Tree customers use Visa credit cards as a substitute for cash and checks rather than debit cards).

[5] A behavioral study by economists at the Sloan School of Business at the Massachusetts Institute of Technology found that customer willingness to pay may increase by as much as 100%

- reducing checkout time;[6]
- reducing personnel expense by allowing cardholders to "pay at the pump" with an automated fuel dispenser or pay for retail purchases at a self-service checkout lane;[7]
- reducing personnel expense by eliminating time the retailer would otherwise spend preparing cash deposits;[8]
- avoiding the risk of bad debt because payment is guaranteed by Visa issuers even if the Visa cardholder defaults;[9] and
- avoiding potential financial losses from theft or loss of cash.

To the extent that the RBA's concerns are based upon the fact that a Visa transaction has a higher retailer cost than an EFTPOS transaction, that higher cost also reflects the superior value of a Visa transaction. The shortcomings in the EFTPOS system that the *Review* recognizes[10] – as well as other shortcomings (including, most prominently, the lack of international functionality) – are all addressed by the Visa system, making the Visa system far more valuable to all stakeholders than EFTPOS.

Visa also believes that any formula or attempt to link interchange rates with financial institution processing costs would be misguided because processing costs represent only a small subset of the costs an issuer incurs in operating a card business. The other such costs include, but are not limited to: (i) cardholder benefits; (ii) 24 hour customer service; (iii) other operating expenses, including the cost of processing payment transactions, information technology, marketing, and support; (iv) cost of funds; and (v) fraud and credit losses. It is appropriate to consider each of these costs. Indeed, managing card issuance (and the underwriting risk) is so complex, and these costs are so significant, that Visa has

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when consumers use credit cards instead of cash. *See* Drazen Prelec & Duncan Simester, *Always Leave Home Without It: A Further Investigation of the Credit-Card Effect on Willingness to Pay*, 12 Marketing Letters 5, 5-6 (2001). A Visa study of more than 100,000 transactions at quick service restaurants found that the average ticket size on payment card transactions was 30% higher than when customers paid with cash. *See* http://merchants.visa.com/solutions/qsr.jsp.

[6] *See* David S. Evans & Richard Schmalensee, *Paying with Plastic: The Digital Revolution in Buying and Borrowing* 93 (2005) [hereinafter *Paying with Plastic*]; Daniel D. Garcia-Swartz et al., *The Move Toward a Cashless Society: Calculating the Costs and Benefits*, 5 Rev. of Network Econ. 199, 201-02 (2006).

[7] *See generally* IHL Group, *Consumers on Track to Spend $1.3 Trillion a Year at Self-Service Machines by 2011* (July 17, 2007) (analyst estimating that consumers were on pace to spend $525 billion at self-service checkout lanes in 2007), *available at* http://www.ihlservices.com/ihl/press_detail.cfm?PressReleaseID=55&filename=press.cfm.

[8] *See* Garcia-Swartz et al., *supra* note 6, at 201-02.

[9] Visa issuers lost $114 billion (approximately 3% of total charges) to uncollectible charges between 1992 and 2001. *See Paying with Plastic*, supra note 6, at 118.

[10] *See RBA 2007/08 Review* at 32.

seen a clear trend toward retailers discontinuing their own operation of card portfolios and transferring those operations and the risks and costs attendant to that business to financial institution card issuers. When all of the costs required to operate a card program are considered, interchange revenue would defray only a small fraction of issuer financial institution expense.

B. The RBA's Analysis of Payment Costs Contains Errors.

The RBA's regulation of Australia's payment system is predicated on the idea that the cost to retailers of accepting Visa cards is "too high" in comparison to the costs of other payments. Because the RBA's analysis of payment costs is inappropriately narrow, and therefore erroneous, and because Visa's credit and debit cards actually have lower societal costs net of societal benefits than competing payment systems, regulation of Visa's interchange rates and related policies cannot be justified.

As a preliminary matter, the *Review* compares only the cost of credit, debit, and EFTPOS transactions, and ignores the costs of cash and cheque transactions. Even the cost analysis on which the RBA relies recognizes that cheque transactions are more expensive than credit and debit card transactions.[11] However, more fundamentally, the analysis looks only to costs, not to benefits. As the report on which the RBA relies concedes, "costs are only one aspect of an assessment of the efficiency of the payments system; increased use of the lowest-cost payment system does not necessarily promote efficiency of the overall system. The benefits offered by various payment systems are also important to consider, as is the speed and degree of innovation over time."[12]

More comprehensive analyses that look to both costs and benefits have concluded that cash is no longer the cheapest instrument for the economy as a whole. While we are aware of no study based on Australian cost and benefit data, U.S. studies looking at societal costs net of benefits (i.e., the total of the costs and benefits faced by all participants in the payment system) show that credit card transactions actually have the lowest societal cost net of benefits for a typical supermarket transaction, closely followed by signature-debit transactions. PIN-debit transactions are more expensive, with nonverified cheque and cash payments the most expensive. The chart below, reproduced from a presentation

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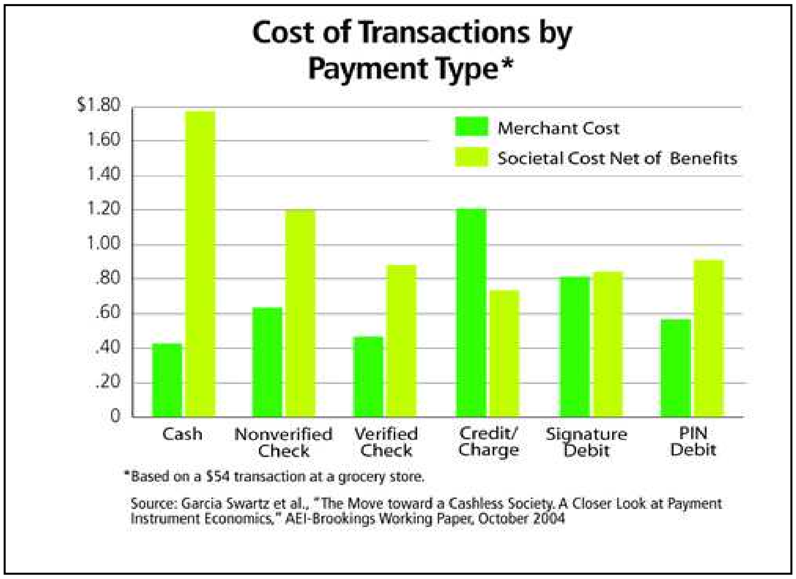
[11] The RBA's report relies upon Schwarz et al, *Payment Costs in Australia* (2008), *available at* http://www.rba.gov.au/PaymentsSystem/Publications/PaymentsInAustralia/PaymentsSystemReviewConference/2007/7_payment_costs.pdf. *See* p. 117 (cheque cost is more than 6 times the cost of credit cards in point of sale environment); p. 119 (cheque cost is more than 4 times the cost of credit cards in non-point of sale environments).

[12] *Id*. at 128.

by a vice president of the Minneapolis Federal Reserve Bank in the United States, demonstrates these costs.[13]



Other reports reach similar conclusions.[14] Given that credit and debit cards have a lower societal cost net of benefits, the RBA's concern that credit card users are subsidized by other consumers is misplaced. Indeed, it is cash and cheque users that are being subsidized the most.

Most consumers have ready access to multiple credit cards of different brands, debit cards, personal checks, and cash and coins. This is not a case of one set of consumers subsidizing another; it is a case of individuals exercising an option to choose one payment method over another. From a consumer perspective, welfare is enhanced by the availability of these options. Retailers benefit as well when the consumer has the option to utilize a number of different methods of payment.

C. Payments Regulation Has Not Been in the Public Interest.

1. Regulation of Interchange Rates Has Increased Costs to Australian Consumers.

Financial institutions use interchange revenue to reduce cardholder costs and increase cardholder benefits. Given the highly competitive business of issuing credit cards, the benefits of increases in interchange revenue are passed along

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[13] *See* James M. Lyon, First Vice President, Federal Reserve Bank of Minneapolis, *The Interchange Fee Debate: Issues and Economics* (June 2006), *available at* http://www.minneapolisfed.org/pubs/region/06-06/interchange.cfm.

[14] *See, e.g.*, Garcia-Swartz et al., *supra* note 6.

to consumers, meaning that reduction of interchange revenue also comes at the expense primarily of consumers, not the financial institutions that issue Visa cards.

The *Review* recognizes that consumers have faced higher prices and reduced benefits for use of their Visa cards, noting that "[l]ower interchange fees in the MasterCard and Visa credit card systems have resulted in a reduction in the value of reward points and higher annual fees, increasing the effective price of credit card transactions facing many consumers."[15] While the *Review* does not attempt to quantify the harm to consumers, the economic consulting firm CRA International has estimated that Australian cardholders have seen their costs increased and benefits reduced by as much as AU$480 million per year.[16] Another analyst estimates that consumers have faced increases in card-related fees (annual fees, over-limit fees, cash advance fees) of about 40%.[17]

The RBA set out to increase the costs to credit card holders. When the RBA achieved its objective of increasing the costs to Visa and MasterCard cardholders, both American Express and Diners Club opportunistically took the opportunity to raise their annual fees on rewards-based charge cards at rates similar to the increases on rewards-based Visa and MasterCard cards.[18] It is thus not only Visa and MasterCard cardholders that have faced increased costs as a result of the Australia's payments system regulation.

The RBA concedes that in the five years since the imposition of interchange regulation, "no concrete evidence has been presented to the Board regarding the pass-through of [retailers' interchange] savings."[19] Indeed, the vast majority of retailers that reported a reduction in the merchant discount applicable to their transactions did not reduce prices to consumers.[20] In short, the Australian experiment with interchange regulation has brought consumers higher prices with no demonstrable direct financial benefits.

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[15] *See RBA 2007/08 Review* at 17.

[16] Robert Stillman et al., *Regulatory Intervention in the Payment Card industry by the Reserve Bank of Australia: An Analysis of the Evidence* 13 (Apr. 28, 2008), *available at* http://www.crai.com/ecp/assets/Regulatory_Intervention.pdf.

[17] *See* Mercator Advisory Group, *Australian Interchange Regulation: Credit Card Issuer Effects* 17 (Dec. 2007).

[18] *See* Stillman et al., *supra* note 16, at 12.

[19] *RBA 2007/08 Review* at 23.

[20] David S. Evans, *Turbulent Times: Recent Developments in the Payment Card Business in the United States, European Community, and Japan*, Modern Bankers Bankcard Seminar, Beijing, China (June 29, 2006) ("No change in relevant prices at point of sale to consumer"); Howard Chang et al., *The Effect of Regulatory Intervention in Two-Sided Markets: An Assessment of Interchange-Fee Capping in Australia*, AEI-Brookings Joint Center for Regulatory Studies 18 (Dec. 2005).

2. Interchange Regulation Has Restricted the Ability of Visa to Compete with American Express, Diners Club, and Other Forms of Payment.

Because interchange regulation has raised the costs of using a Visa card and decreased the benefits of its use, Visa has been disadvantaged in competing with American Express, Diners Club, and other forms of payment.

Visa must compete for the card issuance decisions of financial institutions in Australia, which also have the option of issuing American Express and Diners Club cards. When choosing between issuing an American Express card, a Diners Club card, or a Visa card, a financial institution will look to which card is more attractive to cardholders, because that is the card that will be used more often and thus generate greater returns to the issuer. Because regulation of Visa's interchange rates means that its cards cannot offer the same benefits as American Express or Diners Club cards and have a higher cost of usage than those cards, financial institutions in Australia have chosen to issue American Express and Diners Club cards.

Consumers typically carry multiple payment cards, and Visa must therefore also compete for cardholder usage. Interchange regulation has given \American Express and Discover an unjustified regulatory advantage in this competition for the consumer.

The net effect of these two factors – an advantage in winning issuing decisions and an advantage in encouraging cardholder usage – has been a shift in payment share away from Visa's and MasterCard's regulated payment cards to the unregulated cards of American Express and Diners Club. By limiting Visa's ability to compete, payments regulation has artificially skewed the competitive dynamics of the Australian payments marketplace. In particular, by winning issuance decisions because it can offer issuers superior interchange, American Express is advantaged in the battle for cardholder usage in the future.

3. Interchange Regulation Has Reduced Innovation.

Where interchange is unregulated, Visa has successfully used interchange to encourage innovation that makes the Visa payment system more efficient, safer, and more valuable to cardholders and retailers. As an example, by using interchange rates to create incentives for retailers to implement technologies that reduce fraud rates, Visa makes its network more attractive to issuers (who generally bear the cost of fraud), to retailers (who bear the cost of fraud in some circumstances), and to cardholders (for whom dealing with fraud is troubling and time-consuming, even if their direct financial exposure is limited).

The effects of these efforts can be seen in the results of Visa's initiatives to create incentives for electronic authorization of transactions in lieu of manually looking up card numbers in a book listing stolen or otherwise unauthorized cards.

Although implementing electronic authorization imposed costs on retailers (for card terminals and telecommunications), Visa nonetheless was able to create incentives for the rollout of these terminals by offering favorable interchange rates on electronically authorized transactions. The percentage of Visa transactions processed electronically rapidly increased after the introduction of favorable interchange rates for electronic transactions.

Transactions at retailers that have high chargeback rates (which reflect either high fraud rates or a large number of customers dissatisfied with the retailer's product or service performance) also incur higher interchange rates. When these higher interchange rates are reflected in higher merchant discounts, retailers have an incentive to improve their fraud performance and customer satisfaction. Visa has also offered preferred interchange rates on "high-quality" transactions that are submitted to cardholders quickly or require extra validation by the retailer. Cardholders benefit because faster clearing times reduce holds on their accounts and more quickly identify fraud.

Interchange regulation in Australia limits Visa's flexibility to create these incentives to implement new technologies and other improvements and thus risks making the Visa system less valuable to both retailers and consumers.

In the Asia Pacific region, consumers and retailers in Japan, Singapore, Hong Kong, Malaysia, Taiwan, Thailand, and Korea have embraced and enjoyed the convenience of contactless EMV chip-based Visa payWave since 2005. Contactless transactions have replaced cash for small payments efficiently and conveniently for both cardholders and retailers, while generally speeding up the payment process compared with cash. In addition, this product has almost eliminated counterfeit fraud in such transactions. Visa payWave is an ideal product for consumers in Australia as well, but neither it nor MasterCard's competing product has yet been introduced into Australia in any substantial manner due in good measure to the reduced economics forced upon card issuers by the interchange rate regime. In effect, innovation has been stifled in Australia. CRA International interviewed Australian issuers and reported:

> Each of the banks in Australia we interviewed told us that the interventions have made it more difficult to develop a "business case" for investments related to four-party cards. Banks cited the introduction of EMV/Chip and PIN and the provision of prepaid cards to commercial clients as examples of projects that have been adversely affected by the RBA's interventions.[21]

While Visa payWave provides one clear example, other technologies and products are also lagging comparatively in Australia against expectations given its state of economic development. For example, uncertainty regarding the

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[21] Stillman et al., *supra* note 16, at 47.

regulation that will apply to prepaid cards has limited investment in that important new product area.

4. Consumers Have Been Harmed by Elimination of Visa's No-Surcharge Rule.

Australia's payment system regulatory interventions required Visa to eliminate the ban under its rules on retailer surcharging of Visa transactions. This change has harmed consumers without any offsetting competitive benefits.

Without a prohibition on surcharging, consumers are subject to a "bait and switch" at the point-of-sale. They shop at a store after viewing an advertisement or proceed to the checkout counter after making a purchase decision based on a price on a shelf tag only to be told that the actual price they will pay is higher. Consumers without a payment alternative also are subject to gouging by retailers. Visa has a strong interest in protecting its cardholders from being subjected to these kinds of tactics.

Our research and global experience suggest that where retailers do surcharge, it is most common among those retailers that are likely to have market power or otherwise have the ability to "hold up" unsuspecting consumers.[22] For example, as the *Review* recognizes, in Australia surcharging is far more common among the very largest retailers.[23]

The surcharge imposed by Australian retailers often exceeds the retailer's cost of accepting cards. According to the RBA the average surcharge for Visa and MasterCard transactions is about 1%, which is fifteen basis points higher than the average merchant discount paid by retailers.[24] In other words, retailers earn an average of a fifteen basis point *profit* on accepting Visa and MasterCard transactions as a result of surcharging (not factoring the negative impacts on shift in consumer behaviors, including downstream costs). Retailers that impose the same surcharge on Visa debit transactions receive an even larger profit spread. Data from shortly after surcharging was permitted in 2004 indicates that retailers may have been marking up their merchant discounts as much as eighty-one basis points.[25] This is clear evidence of retailer opportunism at the expense of

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[22] *See* Parliament of the Commonwealth of Australia, House of Representatives Standing Committee on Economics, Finance and Public Administration, *Review of the Reserve Bank of Australia and Payments System Board Annual Reports 2005*, at 63 (June 2006) ("Surcharging – and in particular excessive surcharging – occurs in markets not subject to high levels of competition."), *available at* http://wopared.aph.gov.au/house/committee/efpa/rba2005/report/fullreport.pdf.

[23] *See* Mercator Advisory Group, *supra* note 17, at 16.

[24] *See* Stillman et al., *supra* note 16, at 28.

[25] *Id*.

Australian consumers, with no offsetting benefit to competition or consumers.[26] And although the RBA suggests that the ability to impose disproportionate surcharges might give retailers leverage to negotiate a lower merchant service fee, in fact this assertion is entirely hypothetical, and Visa is aware of no retailer that has actually done this. Such hypothetical benefits plainly do not outweigh the concrete consumer harms from surcharging.

Where surcharging is imposed, it appears in most cases to have nothing to do with steering consumers to cash or payment methods with lower acceptance costs. For example, Qantas was the first major retailer to implement a surcharge after imposition of the payment regulatory interventions. When Qantas introduced the surcharge (a uniform surcharge on all credit and debit cards, regardless of the Qantas cost of acceptance), it did *not* cut prices for those few customers that paid for their airline tickets by cash or cheque.[27] In other words, Qantas used the right to surcharge as an excuse to raise prices on almost all tickets while trying to deflect "responsibility" for the price increase to credit card companies. No procompetitive purpose is served by allowing this type of surcharging, which is nothing more than a wealth transfer from consumers to retailers. (After negative customer reaction, Qantas introduced an unworkable cash payment option on its website and switched from a percentage surcharge to a flat dollar-based surcharge.[28])

Permitting retailers to surcharge Visa transactions also interferes with Visa's ability to use interchange to create incentives for retailer behavior that benefits consumers or otherwise improves the operation, security, and effectiveness of the Visa system as described above. For example, because surcharging is permitted, if Visa raises interchange rates on transactions at retailers that refuse to implement technology designed to reduce fraud, retailers can simply pass those costs along to consumers, thus limiting the impact of Visa's efforts to encourage adoption of technology that protects consumers and makes the Visa system safer and more efficient. While passing increased costs along to cardholders might reduce the retailer's sales, that effect is mitigated by the fact that cardholders typically will not see the surcharge until they have committed to making a purchase, particularly at retailers with few repeat customers. Finally, Visa's efforts to drive additional cardholder usage by lowering interchange can be muted by retailers, whose focus on realising additional profits through surcharging may lead them to ignore any interchange reductions and preserve surcharges at the same level.

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[26] *See* Howard Chang et al., *supra* note 20, at 18-19.

[27] *See Qantas to Introduce Credit Card Surcharge*, The World Today, Feb. 10, 2003, *available at*: http://www.abc.net.au/worldtoday/stories/s780783.htm.

[28] *See* Qantas, *Qantas Announces Online Cash, Introduces Flat Fee for Credit Card Payments*, Apr. 7, 2006, *available at*: http://www.qantas.com.au/regions/dyn/au/publicaffairs/details?ArticleID=2006/apr06/Q3417; *see also* http://qantas.custhelp.com/cgi-bin/qantas.cfg/php/enduser/std_adp.php?p_faqid=526.

While elimination of Visa's no-surcharge rule has plainly harmed consumers in Australia, it has done nothing to alter the competitive dynamics of the Australian payments market. As discussed above, American Express and Diners Club have *gained* share at the expense of the far less expensive Visa and MasterCard systems. Nor has the elimination of Visa's and MasterCard's no-surcharge rules caused a shift to other ostensibly less-expensive payment forms, such as the EFTPOS system.

In sum, the evidence shows that the elimination of Visa's no-surcharge rule has led to consumer harm without leading to *any* increase in interbrand payment competition.

5. The RBA's Conclusion That Regulation Has Increased Efficiency is Unsupported.

Given the clear evidence of harm to consumers, competition, and innovation as a result of payment system regulation, Visa does not believe that the RBA's conclusion that regulation has increased efficiency is justified.

On the issue of consumer harm, the *Review* notes only that while it has received various submissions arguing that its regulations have harmed consumers, it "does not accept this argument."[29] Visa believes, however, that the marketplace evidence does in fact establish demonstrable consumer harm with no off-setting competitive benefits.

Rather than base its claim that the payment regulations have increased consumer welfare, the RBA's conclusion seems to rest solely on its belief that: (a) its regulations have induced a significant number of consumers to use EFTPOS debit cards instead of credit cards; and (b) this shift from credit cards to EFTPOS has improved allocative efficiency because EFTPOS transactions have lower societal costs than credit card transactions. Specifically, the RBA asserts that payment card regulation has shifted 5% of total payment transactions from credit cards to EFTPOS debit cards, and that this substitution has reduced societal costs by about AU$100 - AU$150 million per year.[30]

Visa believes this conclusion is incorrect. Indeed, as demonstrated above, the share of the EFTPOS system has fallen substantially from its pre-regulation heights, and there is no evidence that absent reform its share would be even lower. Nor, as discussed above, is there any good evidence that debit systems deliver lower societal costs net of benefits than the use of credit card systems. Finally, even accepting the RBA's conclusion that the shift to EFTPOS has reduced societal costs by AU$100-$150 million per year, this purported benefit

[29] *RBA 2007/2008 Review*, at 19.

[30] *Id*.

offsets *less than one third* of the estimated AU$480 million increase in additional fees that cardholders are paying as a result of the regulation – a figure that does not even include the implicit costs to cardholders of reductions in cardholder benefits, let alone the harder-to-calculate costs of reduced innovation.

D. There is no Justification for Regulation of Visa's Interchange Rates While American Express and Diners Club Remain Unregulated.

The *Review* continues to justify the differential treatment of Visa and MasterCard versus American Express and Diners Club on what it claims to be "differences in the structure of the [four party] schemes."[31]

These differences no longer exist, and thus provide no basis for continued disparate treatment. With third party issuing, American Express and Diners Club now operate four-party schemes. Moreover, last year Visa undertook a global restructuring, and earlier this year Visa became a publicly-held company, with its financial institution members owning only a minority stake in the new Visa Inc. Interchange-setting in Australia and elsewhere is now in the hands of Visa's management, and the financial institutions that issue Visa cards can no longer even be alleged to play any role in setting interchange rates. Rather, Visa's management sets interchange rates to optimize total participation in its network, provide data quality and other processing incentives to strengthen network performance, and ultimately maximize over the near and long term the number of transactions processed securely through the Visa network. Because interchange is paid by acquirers to issuers and is not Visa revenue, Visa's primary interest in interchange fees is setting them at a level that balances demand on both sides of the network and maximizes system output.

Visa is now a unitary enterprise, so there is no longer any basis for treating it differently than unitary enterprises like American Express and Diners Club. There is no difference between an issuer's ability to receive "interchange" when issuing an American Express or Diners Club product, as compared to a Visa or MasterCard product, and yet these schemes remain unencumbered by the RBA's actions. Indeed, the RBA has recommended "the introduction of a scheme to replace the existing bilateral contracts," used by EFTPOS, "with the scheme able to make decisions about multilateral interchange fees."[32] Because – as the RBA has recognized with respect to EFTPOS – it is *procompetitive* to establish default multilateral interchange fees, regulation of Visa's default interchange fees should be abolished.

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[31] *RBA 2007/2008 Review*, at 20.

[32] *RBA 2007/2008 Review*, at 32.

Conclusion

Imposing government price controls and related regulation on an efficient and highly competitive payments market was unjustified, and has harmed competition, consumers, and innovation. Without full control over interchange rates, Visa has had less ability to balance the two sides of its payments system and to create incentives for the implementation of technologies and practices that make Visa's payment network more useful and more valuable by reducing fraud, speeding transactions, and otherwise improving cardholder and retailer satisfaction.

In the end, Australia's payment regulation has led to higher costs, reduced output, and a payments network that is less attractive to issuers, to cardholders, and ultimately to the very retailers that sought price controls.