

Submission by Visa Inc. Regarding the Payment System Board of the Reserve Bank of Australia's Discussion of Major Policy Issues and Options Regarding Interchange Fees in the *Preliminary Conclusions of The 2007/08 Review*

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*. In the accompanying paper Visa addresses the effects of interchange regulation and abolition of Visa's no-surcharge rule. In this paper Visa addresses the policy issues identified in the review and identifies a number of questions regarding ambiguities in the *Review's* discussion of options for future regulatory changes.

I. The RBA's Conclusions Regarding Major Policy Issues.

The RBA has set forth a number of conclusions and recommendations regarding major policy issues surrounding the future operation of payment schemes in Australia. As discussed, Visa believes continued regulation is inappropriate given the failures of regulation to date. If the RBA continues with regulation, however, Visa believes the RBA's report leaves a number of essential questions and concerns about the nature of that regulation unanswered.

A. The Honour All Cards Standard.

Visa has consistently opposed any dismantling of its Honour All Cards rule. The rule is important to the VISA brand and crucial to cardholders – especially those consumers that choose not to carry both credit and debit cards – to know that their particular type of card will be accepted by all retailers displaying the VISA acceptance mark.

While the RBA argues that the existing bifurcation of the Honour All Cards rule (allowing a retailer to accept Visa debit cards or Visa credit cards) gives retailers more bargaining power when negotiating merchant service fees with acquirers, Visa's discussions with its acquiring members have revealed little or no anecdotal evidence of any such bargaining.

Expanding the present credit/debit bifurcation to also allow retailers to selectively refuse prepaid cards would result in greater harm to both consumers and to the integrity of Visa's brand. While consumers may be able to distinguish between credit and debit cards, any further fragmentation of the Visa brand is likely to result in consumer confusion, delays at the point of sale, and cardholder dissatisfaction with both the retailer and with Visa that harms retailers and the integrity and value of the Visa brand.

There are wider issues, in any event, in relation to acceptance of prepaid cards, an increasingly popular though relatively new innovation in Australia. The Federal Government, for example is seeking open-loop prepaid solutions to remedy problems associated with the control and dissemination of welfare payments. Those solutions – with their potential for significant cost savings versus distributing benefits by check – would be undermined by any regulation that decreased acceptance of prepaid cards.

Moreover, retailers are currently allowed to vary their acceptance policies at their whim, and even to inform cardholders that their card will not be accepted only after the cardholder has brought her purchase to the cashier point (or even after a cardholder has eaten her meal). The marketing and branding challenges for issuers are thus untenable.

Finally, if the RBA persists in further dismantling Visa's Honour All Cards policies, there is no basis for differential treatment of MasterCard or American Express.

B. Access Regimes.

1. Visa Credit and Debit.

Visa disagrees that the RBA's Visa Credit and Debit Access Regimes have delivered competitive benefits. The examples cited by the RBA are not, with one possible exception, a result of these regimes. Indeed, their terms have placed hurdles in front of participation in the Visa network in Australia that do not generally exist elsewhere in the Asia Pacific region.

In Visa's opinion, therefore, the access regimes should be set aside. If the RBA elects not to follow this path, the debit access regime certainly should not be amended so as to become *more* restrictive of potential competition.

2. EFTPOS.

Subject to satisfactory resolution of any issues arising under the *Trade Practices Act 1974*, Visa would welcome discussing the possible use of VisaNet as the processing network for EFTPOS transactions. VisaNet does not suffer from the bilateral technical links identified as a limiting factor by the RBA and does not require separate connections to all participants. Indeed, it is already connected to most of them and therefore satisfies the most desirable element identified by the RBA.

C. Bypass Rules.

The RBA concludes that "there would seem to be some benefit in the schemes making a clear statement on the criteria that alternative switches need to meet" so that such alternative switches could consider providing services to smaller

retailers similar to the switching services provided to two large retailers by their own switches.

Visa is more than a brand; it is the VisaNet processing system that delivers the benefits of a Visa transaction to cardholders and to retailers. Moving Visa transactions off VisaNet would not serve the interests of any participant in the Visa system.

D. Retailer Choice of Scheme.

Visa believes that the RBA has properly rejected the idea of allowing retailers to determine the network through which transactions will be processed. While the RBA based its view on the technological impediments to implementation of such a regulation, Visa believes that the most important reason for rejecting this idea is that it would seriously harm inter-system competition, and undermine consumer choice. Where consumers have no ability to control which system is used to process their transactions and which system's accompanying benefits to receive, payment systems would lose all incentive to differentiate their products for there would be no way for cardholders to ensure that they would actually receive the benefits of that differentiation.

E. Transparency of Fees.

1. Transparency of Visa's Service Fees.

Information regarding the service fees that Visa charges to the financial institutions that issue Visa cards and acquire Visa transactions is highly competitively sensitive. Disclosure of such information is obviously inappropriate, not least because it will become available to competitors. Obviously, Visa would see MasterCard's fees and vice versa; American Express would be in the particularly advantageous position of seeing both sets of fees without having to disclose any information about itself.

There are, in addition, difficulties in calculating meaningful averages of service fees. Of course, some artificial way of calculating them can be devised, but the usefulness of such information is highly questionable. Methods of calculation would need to be specified in considerable detail by the RBA, both to improve the chances of producing data that is comparative across the two regulated schemes and to achieve an outcome that does not stifle change in fee structures or lead to accusations that changing fee structures over time distort the aims of transparency.

The possibility of severe commercial detriment, weighed against any possible marginal benefit, renders the RBA proposals regarding service fee disclosure inappropriate.

2. Transparency of Interchange Rates.

Visa already provides complete information regarding the interchange rates that are paid by Australian acquirers to Australian issuers for domestic Visa credit card and Visa debit card transactions on its website.³³ Providing weighted-average interchange is not necessary for transparency -- retailers readily understand the interchange rates that apply to their transactions -- but would disclose highly competitively sensitive information to Visa's competitors. Visa is happy to continue to discuss the competitive concerns it has with the RBA, as well as any perceived benefit the RBA believes would be achieved by this sort of disclosure.

II. The RBA's "Options" Regarding Interchange Fees.

A. Alignment of Scheme Debit Interchange Fees with EFTPOS Interchange Fees.

Visa believes that the RBA's proposed alignment of scheme debit interchange fees and EFTPOS interchange fees is illogical given that scheme debit offers card-not-present functionality not available from EFTPOS. While we believe that all regulation of debit interchange fees disserves consumers and harms competition, if there is to be any alignment of fees across debit cards it should be limited to rates that are applied to card present transactions.

There are valid justifications for higher interchange fees applicable to card-not-present transactions within Visa Debit. As such, looking to weighted average rates under the existing Visa Debit Standards while ignoring that EFTPOS has no card-not-present volume to apply in calculating its weighted average would lead to undesirable consequences. Indeed, it might result in the setting of Visa Debit electronic transaction interchange fees at a rate lower than EFTPOS (lower than \$0.05) even though the RBA accepts that there is valid cause for an interchange fee of \$0.05 for such transactions.

B. Clarification of the RBA's "Options."

Visa notes that the following appear to be the RBA's conclusions regarding interchange regulation, but would appreciate either the RBA's confirmation that its understanding of these options is correct.

The RBA *Review* identifies three options that we discuss below.

³³ See <http://www.visa-asia.com/ap/au/mediacenter/factsheets/interchange.shtml>.

1. Option 1.

The RBA refers to Option 1 as the “*status quo*,” though a number of technical amendments “would also be considered” with the aim of improving the function of the existing regulations. The *Review* does not, however, clearly describe the RBA’s contemplated process for deciding whether or not technical amendments would be made if Option 1 is adopted or its timeline for reaching a decision.

a) Cost Studies – Adjusted Benchmarks.

Were the *status quo* to be maintained (without amendment), the next cost study would be required to be completed in mid 2009 so that the credit and debit interchange benchmarks would be reset with effect from 1 November 2009. One of the proposed technical amendments would set aside the need for regular cost studies, leaving the existing benchmarks in place on an ongoing basis if Option 1 is implemented. The RBA notes that if at some future point it decided to review the level of average interchange rates, a new cost study could be undertaken or the costs included in the standard could be amended.

While Visa generally considers the removal of the expense burden and managerial disruption of cost studies every three years to be a positive step, the caveats the RBA raises of possible re-introduction of cost studies (apparently on an *ad hoc* basis) or of changes in included costs raise countervailing concerns about uncertainty and process. It is also not clear whether the RBA intends to refer back to the 2006 cost study (perhaps with adjustments to the cost categories considered) rather than complete an up to date cost study. Nor is it clear whether the RBA intends to implement these changes only after the consultation and other requirements of the *Payments System Regulation Act 1998* had been fulfilled in the future specifically in relation to such proposal, or whether some other process would be adopted.

b) Compliance Arrangements.

Visa is pleased to see that the RBA has acknowledged, albeit only in relation to premium cards and commercial cards, that Visa as a four-party card scheme competes against the three-party card schemes. As Visa has long discussed with the RBA – and as in the past the RBA has repeatedly rejected – Visa competes fiercely with American Express and its smaller rival, Diners Club, in Australia and in many other countries.

The RBA seeks feedback on the costs and benefits of requiring that weighted-average interchange fees be below the relevant benchmark once a year, rather than every three years (or when interchange is varied). Visa does not see the relevance of any such requirement.

The RBA also seeks feedback on the question of whether there are other schedules or options that would address concerns over the effect of the

compliance arrangement on scheme competition and average interchange fees. Here, the concern seems to be that Visa and MasterCard are using every tool available to them within the RBA's regulatory construct to compete intensely with each other for business. Visa is not, therefore, in a position to suggest changes in this regard.

Again, Visa requests clarification of the process and timeline the RBA would adopt if it were to make changes to the compliance arrangements.

c) Cash Out for EFTPOS.

Visa has announced to its clients the introduction of cash-out as an available function in the Visa Debit system. This follows the industry implementation of PIN@POS in June 2008. The RBA's consideration of altering its rules raises uncertainty regarding the regulatory scheme that will be applied to this new product offering. While the present Visa Debit Standard applies to POS transactions and any related transaction activity, Visa believes that alignment of the applicable rules is necessary if the RBA specifies how EFTPOS cash-out is to be treated or excluded from an interchange management perspective.

2. Option 2.

The RBA says that Option 2 would reduce interchange fees below existing levels, while eliminating differences between scheme debit and EFTPOS interchange rates and perhaps setting a benchmark of around five cents. The credit card interchange benchmark would be reduced to around 0.30%. The RBA would "also consider" making the technical changes discussed above.

Visa strongly believes that further reduction of interchange fees would harm consumers, competition, and innovation in the same way as the current interchange fee benchmark, but to a greater extent.

Regardless, as a procedural matter, Visa wishes to understand the decision-making process and time line if Option 2 were adopted, including the way in which the RBA envisages arriving at the proposed reduced interchange rates.

3. Option 3.

The RBA says that it has ruled out the option of stepping back unconditionally from interchange regulation, but raises various possibilities – as a package – in Option 3. As previously stated, Visa interchange regulation should be discontinued as a positive step for consumers, retailers, and the payments industry in general. However, it is not at all clear that Option 3, even with the removal of explicit interchange rate regulations, would be a move toward such helpful deregulation. The threat of more severe rate regulation, in part conditioned on factors outside the control of market participants, and further

Honour all Cards restrictions would all detract from benefits of eliminating explicit interchange rate regulations. The net result is far from certain and Visa therefore has many questions regarding the detail of the RBA's thinking in relation to Option 3 before offering final comments.

The *Review* states that if its regulation of interchange were removed "close oversight" would in any event still be required. It is not clear, however, what is meant by "close oversight," or how would it be conducted by the RBA within the parameters of the *Payment Systems Regulation Act 1998* (or otherwise) and in the context of two publicly listed companies with global operations (i.e. Visa and MasterCard).

The RBA notes that it is contemplating merely the "possibility" of removing the interchange standard and that, if it were to do so and average credit card interchange fees were to "increase materially," it would consider re-imposition of interchange regulation. Any such re-imposition would probably involve a substantial reduction from existing levels of interchange and include the technical changes discussed under Option 1 (above).

Option 3 would involve Visa "voluntarily" agreeing to a number of changes (discussed below) relating to rules and other issues of fundamental concern to it. Any such agreement could only be reached within the very highest levels of Visa's global management. Consequently, Visa needs clarity as to the "ground rules" envisaged by the RBA in connection with this option.

- It is not clear what increase in interchange fees would constitute a "material increase" or what process the RBA would use in order to determine whether an increase were material. For example, the *Review* does not state whether materiality would be judged in terms of the absolute scale of interchange rate changes or the rate of interchange movement over time.
- The *Review* discusses credit card interchange fees in this context, but not debit card interchange fees. It is not clear whether this omission was intentional.
- If only MasterCard's interchange rates increased "materially," would the RBA envisage re-imposing its interchange standard on both schemes or only on MasterCard? In any such re-imposition, would the RBA follow the consultation and other processes required by the *Payment Systems Regulation Act 1998* or does the RBA see itself as having the power to proceed immediately if it identified a material increase?

The RBA has also said that it would not remove the interchange standard unless Visa and MasterCard voluntarily changed their respective Honour All Cards rules so that, in transactions at point of sale (POS) in Australia, retailers could make independent acceptance decisions for each type of card or transaction for which

a separate interchange fee applies. Visa also seeks clarification from the RBA regarding a number of issues relating to this point.

- As in the case of only MasterCard increasing interchange “materially,” if Visa voluntarily adjusted its Honour All Cards rule but MasterCard did not, would the RBA move to regulate both schemes or only MasterCard? In either case, is Visa correct to assume that the RBA would follow the process required by the *Payment Systems Regulation Act 1998* in amending the existing Honour all Cards Standard (or in introducing a new/replacement Honour all Cards Standard)?
- Some cards issued by Visa issuers specify their card type on the face of the card, while others do not. Is the RBA considering mandating all cards being re-issued with product identifiers? If so, would such a mandate extend only to cards issued in Australia or would the RBA seek to impose the same requirements on issuers of cards outside Australia?
- Must foreign-issued cards be included in the dismantling of the Honour All Cards rule? If so, what rights would the RBA require retailers receive with respect to cards issued outside Australia?
- American Express and Diners Club issue commercial cards, as well as “platinum” and other premium cards. These cards compete directly with Visa’s commercial and premium products. Visa understands that American Express and Diners Club maintain their own Honour All Cards rules that are enforced against retailers. If Visa’s Honour All Cards rule is further dismantled by the RBA, then in order to maintain a level playing field, any such American Express and/or Diners Club rule should be similarly dismantled.