3 February 2016

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Via email: pysubmissions@rba.gov.au

Dear Dr Richards,

Visa Submission to the Payments System Board and Reserve Bank of Australia Review of Card Payment Regulation

Visa welcomes the opportunity to respond to the Payments System Board (PSB) and Reserve Bank of Australia (RBA) Consultation Paper on proposals to amend the standards for card payment systems in Australia (released on 3 December 2015) and appreciates the ongoing efforts of the RBA to engage with industry.

Visa has participated actively in a wide number of reviews conducted by the RBA in previous years. More recently, Visa has provided submissions to the Federal Government's Financial System Inquiry (FSI) in 2014, and the initial consultation on the Review of Card Payments Regulation in March 2015.

In each submission, Visa has highlighted the need for balanced, equally applied and innovation-enabling approaches to the regulation of electronic payments. Visa has also raised a number of concerns with the structure and remit of the *Payment System (Regulation) Act 1998*.

In responding to the RBA's 3 December 2015 paper, this submission focuses specifically on the need for a level playing field in card regulation, the regulation of interchange fees, the guidelines around surcharging practices, the role of commercial cards in the payment ecosystem, and a range of other related matters, including the implementation timeframe for structural reform.

Visa would welcome the opportunity to provide any additional information or support to help shape the future of Australia's payment system. Should you wish to discuss this matter further or clarify any of the issues covered in this submission, please feel free to contact me at any time.

Yours sincerely,

Stephen Karpin
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Visa Submission

Reserve Bank of Australia
Review of Card Payments Regulation

3 February 2016

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Summary of Visa's position

The ongoing development of a safe, efficient, competitive and stable electronic payment system is essential to the growth and stability of the Australian economy. Payment platforms, including Visa, contribute significantly to economic growth, development and the financial inclusion of all Australians.

In recent years, the diversity of products and services available to cardholders and merchants has grown exponentially, the result of an industry focused on innovation and delivering better outcomes for all participants in the payments ecosystem.

Visa values the role of the Reserve Bank of Australia (RBA) and other regulatory authorities in delivering stability and certainty to the payment system and the economy more broadly. Keeping regulation relevant to the current and foreseeable future and allows industry the ability to innovate, however, is critical. As such, Visa welcomes the opportunity to provide input and advice to the RBA Review of Card Payments Regulation (the Review).

Visa is a global payments technology company that connects consumers, businesses, financial institutions and governments in more than 200 countries and territories worldwide. Visa is proud to adhere to its corporate vision of being the best way to pay and be paid, for everyone, everywhere. That is, we aspire to be "*everywhere you want to be*" and we deliver on this through the world's largest retail electronic payments network.

Visa's global network encompasses 2.4 billion cards making around 101 billion transactions through 14,300 financial institutions. During 2014, Visa network participants transacted US$7.4 trillion in total volume, of which US$4.8 trillion was payment volume. Around 2.3 million ATMs were also connected to our system, providing further convenience and ease of access for cardholders. This activity is powered by one of the world's most advanced processing networks, VisaNet, which is capable of handling more than 47,000 transactions per second reliably, conveniently and securely.

Visa has actively participated in reviews conducted by the RBA over the past decade, as well as the recent federal government Financial System Inquiry. In each of our submissions to these reviews, Visa has highlighted the need for balanced, equally-applied and innovation-enabling approaches to the regulation of electronic payments in Australia. Visa firmly believes that industry consultation to determine the practical implications of regulatory reform is vital to ensure the development of effective and commercially viable safeguards for all participants in the payment ecosystem.

In this submission we have outlined the proposed regulatory changes which we believe will deliver unintended consequences for the payments industry and the Australian economy. Visa welcomes the opportunity to share our global experiences and industry expertise with the RBA to help shape an outcome that is positive for all participants in the electronic payment environment and contributes to long-term economic growth.

Foreign-issued cards

Visa is concerned with the proposed inclusion of foreign-issued card transactions in the RBA's updated interchange standards. It represents a globally unprecedented regulatory intervention with potentially disruptive legal and commercial implications for markets outside of Australia. Further, the required reduction in maximum interchange rates for cross-border transactions does not acknowledge the major differences in the nature of international versus domestic transactions, including increased fraud prevention costs, greater settlement and clearance requirements, and a range of more complex processes that exist in an internationalised setting. As a result, the initiative could render the provision of cross-border payment services by foreign banks into the Australian market less attractive, with negative consequences for the sectors of the economy with high volumes of international transactions.

The integrity of Visa's existing scheme rules, systems, and regulations have and will continue to ensure that financial institutions serving Australian cardholders are based in Australia, removing the RBA's hypothetical concern that some financial institutions may seek to avoid domestic interchange regulation. Visa's rules prohibit cross-border issuance of cards, eliminating any opportunity for circumvention of interchange standards. We believe the strength of Visa's payment platform provides the ideal mechanism to safeguard payment system participants from any abuse of nationally regulated interchange standards.

To further safeguard merchants and cardholders, Visa is happy to work with the RBA to ensure clear reporting is provided to highlight our system integrity and collaborate with the RBA to encourage other industry players to deliver the same undertakings. We believe that working with the RBA to address its underlying concerns could deliver a solution that ensures compliance without creating inefficiencies.

Commercial cards

Visa requests the RBA reconsider its proposal to include commercial cards in its interchange standards because of stark differences between commercial and domestic cards. Not only are the market dynamics for commercial cards in Australia fundamentally different to the value proposition, cost structure and revenue model of consumer cards, the maturity and competitive landscape of four-party commercial card products also differs greatly from the more dominant yet unregulated three-party schemes where commercial products are well established.

Increasing the regulatory requirements on four-party commercial card products will limit the ability to compete in this emerging market environment, further biasing towards unregulated three-party schemes, and reduce the ability to deliver innovation that would otherwise benefit suppliers and buyers, in particular in the SME sector.

Business-to-business and government-to-business transactions are more likely to reflect the outcome of commercial agreements and 'terms of trade' between buyers and sellers, rather than a traditional consumer repayment model. This makes pricing regulation less relevant to the cardholder and more likely to encroach on the commercial arrangements and payment terms agreed to by the parties to a transaction.

While Visa notes the intention of the RBA to create a secure, efficient and competitive payments landscape in Australia, we believe that commercial card products should be exempt from conforming to the proposed interchange standards in Australia.

Interchange rate cycle compliance

The proposed reduction in the interchange rate reset timeframe from three years to three monthly compliance is a significant change to the existing arrangements. Visa believes that the complexity and increased operational and compliance burden on scheme operators and issuers would create significant risk for users and jeopardise the security, stability and efficiency of the entire payments ecosystem.

While Visa understands the intent of the RBA's proposal, we believe there are more effective ways of achieving the RBA's objectives without the need for three month compliance checks. Visa recommends the RBA, as a minimum, move to a 12 month moving average and a 120 day compliance window to allow scheme participants to comply with the regulation. This timeframe will allow for system and operational implementation of required changes in a manner that ensures the ongoing integrity of the payment ecosystem and minimises costs for issuers, acquirers, and ultimately, consumers and merchants due to the need to reprice portfolios caused by interchange rate adjustments.

Competitive neutrality

Visa is supportive of the RBA's adoption of our long held position that the American Express companion card scheme should be regulated in a similar manner to existing four-party schemes. However, there are a number of other schemes that continue to operate in the Australian market without adequate regulation and protection for consumers, businesses and merchants. Further, as an emerging submarket of the payments ecosystem, four-party commercial card products face significant and disproportionate competitive pressures from more costly three-party schemes that are able to use their unregulated status to capture greater market share and reduce competition.

The competitive disparity in the payments industry has cost around AU$770 million (in 2013 dollars) to the Australian economy since the regulation was first established in 2002. Visa considers that the best way to achieve regulatory parity is through legislative and regulatory reform that classifies all similarly structured payment systems under the same definition. We believe that further steps must be taken to address this imbalance by capturing schemes such as UnionPay and JCB within the RBA's regulatory framework, and also by ensuring that any future regulation in emerging product markets, such as commercial card products, prevents the formation of any anti-competitive trends.

Surcharging

While Visa continues to maintain its global policy of opposing merchant surcharging, we support the efforts of the RBA to ensure excessive surcharging practices in Australia are prohibited where a merchant chooses to surcharge cardholders.

Visa also supports the proposal to grant investigation and enforcement powers to the Australian Competition and Consumer Commission (ACCC) to ensure any newly introduced surcharging standards are enforced in an effective manner.

Chapter 1: Foreign-issued cards

Key points

- Visa supports the adoption of Option 1 to exclude foreign-issued cards from the proposed interchange standards
- Regulation of foreign-issued interchange is globally unprecedented
- Foreign-issued cards require additional investment against the costs associated with cross-border payment processing and higher fraud risk
- The regulation of foreign-issued interchange would generate a number of unintended consequences and a number of potential regulatory and legal implications for markets outside Australia
- Visa's rules already prohibit cross-border issuance and have effectively prevented circumvention of Australian regulation to date. Visa is committed to collaborating with the RBA to provide an additional degree of assurance and encourage other industry participants to do likewise

1.1 Introduction

Regulation of international interchange fees is globally unprecedented. Although more than twenty countries around the world have applied some type of domestic interchange regulation, to date no country has ever regulated foreign-issued card transactions and the interchange fee paid on them. While highly regulated markets, such as the European Union, have recently implemented advanced interchange regulations for card-based payments, these markets still do not include foreign-issued card transactions within the scope of the regulation.

By seeking to regulate interchange on foreign-issued cards acquired in Australia[1], the RBA would be in effect dictating the commercial terms between more than 17,000 credit-issuing financial institutions in more than 230 countries outside Australia[2]. We believe, the regulation of interchange on transactions for cards issued outside Australia could raise serious concerns from Australia's trade partners, given the existing reciprocity of banking regulation globally, and the understanding that cross-border transactions significantly differ in nature to their domestic counterparts. Visa and other stakeholders throughout the payment system invest to meet the specific needs associated with processing cross-border payments and in doing so, facilitate global trade and investment, connecting international consumers to Australia.

Visa understands the RBA's proposal to regulate interchange on foreign-issued cards is based on a concern that excluding international interchange creates a 'loophole' for circumventing the existing interchange regime. Visa's rules prohibit cross-border issuance of cards eliminating any possibility of interchange circumvention. The integrity of Visa's existing scheme rules, systems, and regulations have and will continue to ensure that financial institutions serving Australian cardholders are based in Australia, thus removing this hypothetical. Visa remains committed to upholding our existing rules to prevent

[1] Option 2: Clarify the definitions in the Bank's standards to include transactions in Australia with foreign-issued cards. Section on foreign-issued cards acquired in Australia. RBA Review of Card Payments Regulation Discussion Paper, pp. 17-18

[2] Including Visa Europe following the merger with Visa Inc. in April 2016.

circumvention. We would be willing to provide additional assurances to the RBA regarding circumvention and collaborate to ensure that other industry players step up to the same undertakings.

1.2 Circumvention: Visa is part of the solution

Visa recognises the RBA's concern over the cost of payment card acceptance and its intention to ensure that financial institutions serving Australian cardholders cannot avoid interchange regulation by locating outside of Australia. Visa's rules already provide a ready-made solution to address that issue. Since its inception, Visa's Operating Rules have included provisions on cross-border issuance that limit a financial institution client from issuing cards to consumers outside its jurisdiction. Specifically, Visa's membership requirements provide that each issuer must apply for a license to operate within a specific country or geographic region, and issuers are not allowed to issue Visa cards to customers outside the country for which they are licensed.

As a result of Visa's operational structure and the costs of enabling cross-border payments, in addition to the prohibition under our rules, clients lack the financial incentive to participate in circumvention to obtain preferential interchange rates. For example, to date no New Zealand subsidiary of an Australian financial institution has issued cards in Australia.

Visa would welcome the opportunity to discuss with the RBA additional and/or alternative approaches to ensure that the RBA's concerns with the potential evasion of its regulation are addressed comprehensively by industry.

1.3 Impact of capping interchange on industry and the economy

In a globalised economy, the use of foreign-issued cards will continue to grow as cross-border travel and trade increases. This increased economic activity will be vital to the future of the Australian economy. It is important that the RBA and government take steps to support and encourage cross-border transactions as a means of encouraging international business, investment and improved export activity in Australia.

Processing and ensuring the expediency and security of foreign-issued payments requires additional investment and scrutiny by the payment parties. Foreign-issued transactions differ from domestic transactions in terms of fraud characteristics, chargeback processing, and currency conversion mechanisms. Visa records substantially higher rates of fraud on cross-border purchases – on average cross-border transactions have 10 times the rate of fraud to a domestic transaction[3]. Further, primarily due to the larger size of these transactions, cross-border payments carry a greater risk for the issuer, leading to more fragile economics which can be expected to adversely influence the authorisation rates for these transactions.

Given the costs and risk associated with these transactions, the authorisation rate of international purchase transactions[4] is 5 per cent lower than for domestic transactions. This is

[3] Source: VisaNet sales volumes (MV) for trailing twelve months ending September 2015
[4] Ibid

significant for Australian merchants. Regulating international interchange would result in a decline in authorisations of transactions where the costs are higher than interchange received, creating a disincentive for issuers to approve the transaction. This scenario would lead to a rise in declines, directly and adversely impacting the Australian merchant, the consumer, and more broadly, total non-resident inbound visitor spend and the downstream benefit this drives for the Australian economy.

These market pressures are not limited to face-to-face transactions. In fact, the growing e-commerce industry allows Australian merchants to reach entire new populations of consumers across the globe. With the Australian export e-commerce sector still relatively nascent relative to other markets, should the RBA proceed with regulating foreign-issued transactions, Australian e-commerce merchants that experience a lowering of authorisation rates may not capture or retain customers they otherwise may have, limiting the potential growth in the sector. This may limit future innovative solutions that help Australian merchants grow and take their brands beyond Australia's borders.

International visitor transactions are key to the strength of the visitor and online economy in Australia, and the long term sustainability of Australia's export industry. Throughout FY2014-15, the tourism sector generated a direct contribution of AU$43.4 billion to the Australian economy, an increase of 3 per cent on the previous year. More than 6.6 million international visitors arrived in Australia over the period, with China becoming Australia's largest inbound market for the first time in late 2015, eclipsing travel between Australia and New Zealand[5][6]. Digital payment infrastructure allows foreign travelers to spend in Australia seamlessly and securely, supporting the inbound tourism sector and increasing the visitor spend at Australian merchants. Ensuring a consumer experience that promotes spending because of the convenience, ubiquity, and security of electronic payments is in the longer-term interests of the Australian economy.

Placing a cap on foreign-issued interchange payments and/or including those transactions as part of the weighted interchange basket of regulated networks not only sets a negative precedent globally, it fails to account for the unique composition of foreign-issued cards.

Should the RBA include foreign-issued cards in the interchange standards, these transactions would affect the calibration of the 50 bps weighted basket across issuer portfolios and likely require substantial recalculation. Foreign-issued credit and debit transactions are far more heavily concentrated in the travel and entertainment and high-end retail segments, where paying by cash is less convenient and practical. Within the five segments of these merchant categories, cross-border transactions comprise 29 per cent of sales, versus just 9 per cent of domestic sales in the same merchant segments[7][8]. Consequently, merchants in these segments benefit heavily from cross-border purchases and often rely on the influx of inbound visitor spend to remain commercially viable.

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[5] Source: Tourism Research Australia – State of the Industry, November 2015

[6] New Zealand arrivals – 1.17 million; China arrivals – 1.19 million arrivals. December 2015.

[7] Source: VisaNet sales volumes (MV) for trailing twelve months ending September 2015

[8] Five segments include lodging (accommodation), luxury retail, airlines, travel agencies, car rental

When non-resident consumers travel to and transact in Australia, they are far more likely to do so using a credit product. Visa data shows that 73 per cent of cross-border transactions[9] occur on credit, offering cardholders greater flexibility and choice during their stay in Australia. With the steady growth in electronic payments, cash has become a less convenient medium for international transactions, due to its inflexibility and complexity, particularly when paying for large or expensive goods or services, and lack of security and safety in holding physical currency.

Foreign-issued card transactions therefore drive increased consumption yield per customer, increased diversity of product spend and improved likelihood of repeat consumer purchasing. Consumers use their cards as travel finance, budget management and as a secure alternative to cash. The cash-based alternative may see some merchants miss out on purchases as a result of the consumer having to find an ATM or currency exchange facility. Due to the size and nature of average inbound visitor transactions, particularly at merchants where the goods or services purchased are expensive, merchants are reluctant to receive cash payments because of the associated security, reconciliation and transportation issues.

1.4 Global implications of regulating foreign-issued card transactions

Changes to the nature of cross-border international payments in Australia could jeopardise the growth and sustainability of international visitor transactions in the Australian market, placing at risk the stability, efficiency and security of inbound spending. International payment networks play a vital role in facilitating cross-border commerce by allowing individual consumers to transact globally. Networks like Visa create the ideal balance of incentives for cardholders and merchants to maximise international transactions in pivotal globally focused sectors, such as tourism, trade, and e-commerce. There needs to be adequate revenue and consistency across the globe for issuers to support their international card programs. Limiting the ability of international networks to optimise the pricing of international transactions would create a market imbalance and establish a global precedent. Over the longer-term, Australian business and consumers could be adversely affected through a trend away from safe, reliable and convenient payments, back to less efficient and convenient payment methods, including cheque or money orders.

It is the right of every sovereign government to develop a regulatory regime that establishes common rules and standards for participants in its domestic financial system. However, when one country enacts regulation that impacts the businesses of entities operating within the jurisdiction of another sovereign nation, international comity issues may arise. Bilateral or multilateral cooperation agreements between antitrust enforcement authorities typically contain a negative comity' principle pursuant to which an antitrust enforcer in one country needs to take into account the 'important interests' of the other country (countries). It follows that, if it believes anti-competitive harm has occurred in its own jurisdiction, it must ask itself whether the remedy for that harm will not cause similar or greater harm elsewhere.

There are many ways in which an interchange cap on transactions made with foreign-issued cards in Australia could cause such harm. First, foreign issuers might seek to recoup the

[9] Source: VisaNet sales volumes (MV) for trailing twelve months ending September 2015

resulting losses by raising costs for their customer/cardholders. Second, the cap might distort the balance between issuing and acquiring banks globally. Take an Australian bank like ANZ and a US-based bank like Chase. Payments with a Chase-issued card accepted by an ANZ-acquired merchant in Australia (inbound traffic) would yield far lower international interchange for Chase as issuer than the equivalent interchange Chase would pay as acquirer when payments are made with an ANZ-issued card at the premises of merchants acquired in the US or any other country outside Australia (outbound traffic). As a result, in their bilateral relationship, Chase would be losing out to ANZ. Third, international merchants located outside Australia who accept card payments at their points-of-sale and face merchant discount rates that include uncapped international interchange might opportunistically decide to relocate to Australia in order to benefit from merchant service charges that would be lower as a result of the cap introduced by the RBA. International comity requires that the RBA assess that harm and refrains from intervening unless the gains of its intervention outweigh the harm at a global level.

Notwithstanding the increase in government/regulatory involvement in payment system economics over the past two decades, no national government has imposed price controls on interchange fees for international transactions. This is partly due to a respect for comity in international law, but there are practical concerns as well.

Forcing foreign financial institutions to internalise losses associated with fraud, currency volatility, or other factors that are heightened in a cross-border context, disrupts the balance in the payment system and could lead to an increase in declined transactions in Australia because the cost to issuers outweighs the revenue generated by cross-border transactions. Such policies are likely to negatively impact the Australian economy as consumers find it more difficult to pay for goods and services in Australia in a secure, efficient and reliable manner. Visa is concerned that enacting regulation on foreign-issued cards will result in reciprocal policies in other countries which would place greater cost pressures on Australian issuers and lead to a contraction of international acceptance.

As stated before, regulating interchange on foreign-issued cards will directly affect the international competitiveness of Visa versus unregulated schemes within Australia. For instance, where UnionPay or JCB compete alongside Visa and MasterCard for business in markets such as China and Japan, issuing banks will have far greater incentive to choose UnionPay or JCB products because of the higher revenue on cross-border interchange they will receive.

In light of the deep economic ties between China and Australia and the growing inbound visitation from Chinese travelers and online buyers, this prospect presents a serious concern for Visa with real implications for the merchant community. During 2015, over 1 million Chinese visitors spent more than AU$5.7 billion in Australia, an increase of 17 per cent on 2014, representing an average of AU$4,201 per trip, per person[10]. A significant proportion of this inbound spend takes place via electronic payment mediums, and the vast majority occurring through the unregulated UnionPay system which is accepted by all major acquirers in Australia. If the intention of the proposed regulation is to further lower cost to merchants this will not

[10] Source: Tourism Australia – China Market Profile 2015

be achieved in an equitable manner as the consumers from Australia’s largest and fastest growing inbound market using UnionPay are not captured under the RBA’s draft standards.

1.5 Conclusion

Visa believes the RBA should consider the significant challenges that multiple stakeholders will face should it choose to proceed with regulation of interchange on foreign-issued cards. No country has ever regulated interchange on foreign-issued payment transactions, in part because of the political complexity and potential jurisdictional over-reach required. We maintain that Visa’s current Operating Systems already limit any risk of regulatory circumvention and, to the extent the RBA still has any concern, we are willing to deepen our partnership and provide a solution that better serves the interests of all parties.

Visa therefore recommends the RBA adopt Option 1 and retain the current approach to foreign-issued card transactions within in the interchange standards.

Should the RBA believe that cross-border transactions are permitted to remain outside the 80 bps cap, Visa firmly believes that these transactions should also fall outside of the 50 bps weighted average basket. The different cost structure and framework associated with interchange revenue on foreign-issued cards vs domestically-issued cards, including higher authorisation, settlement, fraud and chargeback costs, would create difficulties for issuers and schemes in managing the domestic 50 bps basket. Further, including uncapped cross-border transactions in the weighted average basket would require a greater number of resets, increasing compliance costs and complexity across the payment ecosystem.

Chapter 2: Commercial cards

Key points

- Commercial card payments differ from consumer payments in maturity, economic impact, product costs and competition
- Further regulation of commercial card products would reduce the incentive for banks to serve the commercial market segment, potentially driving business to higher cost solutions for credit or cash
- Visa recommends adopting Option 2 allowing commercial cards to be excluded from the regulatory regime and not included in the weighted average interchange basket

2.1 Introduction

Visa continues to recommend that commercial card products be excluded from the regulatory regime[11]. The marketplace dynamics in business to business (B2B), travel and entertainment (T&E) and government to business (G2B) payments differ significantly to consumer payments in Australia in terms of maturity, wider economic impact, and competition. These three areas of divergence should be taken into consideration in developing the approach to commercial card regulation.

Commercial scheme credit payments provide tremendous added value to participating business on both sides of the transaction. The potential impact on the wider economy of a reduction of bank-provided credit through commercial cards will be most keenly felt in the small business segment as SMEs often rely on unsecured credit for managing sustainable cash flow. When SMEs are often operating on thin margins, the value of cash flow efficiency and security provided by a scheme products makes a significant difference to business operations.

As such, investing in emerging technologies in the commercial product market provides a real economic benefit for multiple players in the value chain. However, reducing the revenue for banks through capping interchange on commercial cards will make the segment increasingly less attractive; this could reduce both the willingness to offer the product and investment in new commercial card services. Additionally, commercial card users differ from consumers; a commercial user is generally unaffected by merchant steering, i.e. the practice of a merchant influencing a consumer’s purchase method decision through financial (surcharging) or other means, and the user is generally mandated to use the card so that the user’s company can track spend and integrate the accounting data into enterprise systems.

On the issue of competitive neutrality, Visa believes the proposed regulation of commercial cards issued by the four-party payment schemes will further exacerbate the lack of competitive neutrality that already exists in the Australian B2B payments marketplace. While there is an absence of reliable industry data, the commercial cards segment is largely dominated by the

[11] Option 1: Commercial cards to be retained in coverage of interchange standards. Section on coverage of interchange standards – commercial cards. RBA Review of Card Payments Regulation, pp. 16-17

three-party schemes. This has the unfortunate consequence of allowing unregulated schemes to compete on price in the form of rebates that regulated parties cannot match.

Visa has surveyed our issuers and understands that across business, corporate and purchasing charge cards with corporate liability, rebates are attributed to only approximately 1 per cent of Visa scheme four-party commercial card contracts. This would appear to refute the RBA's assertion on rebate prevalence, unless this, as we would assert, is more common for unregulated issuers. The focus of large corporate clients, and indeed government, has necessitated issuers participate in rebate schemes to pass procurement assessment criteria.

Should the RBA not alter its preliminary view that it remains appropriate to include transactions on commercial cards in the regulatory framework for interchange payments and be assessed as part of the credit basket, Visa would suggest an additional option be reviewed and adopted beyond the two options initially proposed in the discussion paper.

To ensure the sustainability of the commercial segment, Visa recommends that commercial cards attract a higher upper limit of 120 bps in interchange than the currently proposed 80 bps with clear rules for adoption and compliance program of work to avoid circumvention. The additional 40 bps of revenue would allow regulated issuers, who rely on interchange for 97% of their revenue, to effectively compete with unregulated issuers and in some part address the cost differential between consumer and commercial as it relates to service - business customers prefer a face-to-face relationship, and credit - double limits are required for charge cards. This is also warranted given the significantly different risk profiles and skills required to assess that risk. Lastly the differential would maintain the development and innovation in B2B payments that will move Australian business payments forward.

2.2 B2B payments maturity: an emerging payments system

2.2.1 Evolution of commercial payments

The needs of commercial cardholders are materially different to the needs of consumer cardholders, and this has influenced the evolution and development of commercial card products. From paper processes and paper payments to e-invoicing and EFT or card scheme payments, the capabilities required for business payments are vastly different in comparison to consumer payments. Payment data for efficient reconciliation and maximising cash flow are the primary requirements for both the buyer and supplier for a B2B transaction.

Visa would argue that differentiation between the consumer and commercial systems is relevant and necessary when assessing the draft standards that should be applied. To take the position that the Australian B2B payments infrastructure or adoption is 'mature' and should have tighter regulation of interchange has, we believe, the capacity to constrain its future development. Of the estimated AU$2.2 trillion[12] that Australian businesses spent in 2015, Visa estimates from RBA data, that only 3 per cent was transacted through scheme accounts

[12] Source: Visa Commercial Consumption Expenditure Index; Economist Intelligence Unit (EIU) modelling and analysis, September 2013

(including both three- and four-party models) while cheques still account for 4 per cent and EFT (direct debit, direct credit and RTGS) accounts for the lion's share at 91 per cent[13].

Visa and our partners are committed to continuing our investment in the space, providing value to business, governments, and the broader economy alike. However, by regulating commercial interchange, particularly at the proposed rate, banks and schemes will be financially discouraged from investing in commercial programs to the detriment of business.

2.2.2 Issuer economics and the impact on product development

A number of factors impact the commercial card issuing business model that are unique when compared with the consumer cards model.

Cost of acquisition and servicing - Across all commercial scheme payment products there is a high cost of acquisition and customer service. Acquisition costs include credit assessment, which is costly, time consuming and essential. Business liability, while being costly to manage, does ensure that credit limits are appropriately set to allow a business to manage the generally larger value and higher frequency of transactions.

Cost of credit for commercial issuers – Australian banks issue charge card products with normal payment terms being greater than 14 days past statement date. This increases the cost of credit provision to a commercial charge card issuer as they must assess for double the exposure of the credit limit available. Limits for commercial facilities are, in general, much higher than consumer cards regardless of whether the product is charge or a revolving line of credit.

Interchange revenue is a higher proportion of overall revenue - Those institutions that issue commercial products rely heavily on interchange revenue to support the economics of their programs. For issuers of commercial products targeted at large corporate and government organisations (corporate and purchasing cards) approximately 97 per cent of their commercial card revenue originates from interchange. In this large market segment, organisations are generally cash positive and do not look for additional longer-term lending i.e. revolving balances. This means issuers do not earn interest income. For lower margin issuers, there is the strong possibility that lower interchange levels mean the commercial segment is not viable, removing competition across the market.

2.3 Macro implications of current draft standards

2.3.1 Implications for SMEs

Credit availability for business is vital for its ongoing sustainability, particularly where business relies on narrow margins for survival. One of the benefits of card- or scheme- based payments is that they provide additional liquidity into the marketplace, specifically in the SME segment. Large corporate buyers are renowned for putting their supply chains under financial strain to

[13] Source: Visa Commercial Payments Analysis Study; Adept Insight, August 2015

benefit their own working capital position, and SMEs often feel the pinch of these restrictive payment terms. Most recently in the UK[14], Diageo, an international beverages manufacturer, extended their terms of invoice payment to 90 days, beyond the traditional payment term that many SMEs rely upon. This was called out by the UK corporate watchdog and the decision reversed but serves as a barometer of where supplier credit terms are headed, especially where the buying organisation operates with market power. Anecdotally this is a prevalent trend in Australia, particularly in the mining and resources sector but also more widely in global commercial payments[15].

To address this gap in the market, card-based payment products are beginning to provide a working capital solution for SMEs with suppliers receiving payment in under two days and buyers receiving anywhere up to 55 days credit from the issuer. This provides significant flexibility for SMEs to continue operations when large enterprise organisations stretch out payment periods for services rendered.

Should the current regulatory proposal be adopted, it is highly likely that extended payment terms offered by issuers would be reduced as the cost of credit forms one of the most expensive portions of issuers' commercial product costs. This could undermine the value that commercial cards are beginning to provide to SMEs and remove access to these facilities.

2.3.2 Stagnation of business processes

A reduction in business credit availability increases the risk of eroding the significant benefits associated with commercial card products. A recent Deloitte study on B2B payments[16] in Australia surveyed both buyers and suppliers and their attitudes to card- or scheme-based payments. It found that for buyers:

- 82 per cent of respondents stated that paying by cards was faster
- 74 per cent had reduced approval processing time
- AU$53 per transaction was saved using a card for payment over traditional methods

The last statistic has been validated by the UK Government's National Audit Office who have used a figure of £28 per transaction saved by using cards over traditional methods.

For suppliers that accept cards for payments from other businesses it was found that:

- 73 per cent had improved cash flow and rated faster payment as an important factor in accepting card
- 61 per cent spent less effort in chasing payments
- 51 per cent experienced improved reconciliation of payments
- 49 per cent indicated that cards reduced the cost of doing business

As the above market analysis indicates, the regulation of commercial interchange creates a significant barrier to investing in programs that provide more efficient and reliable means of doing business.

[14] http://www.ft.com/intl/cms/s/0/8af854a4-c9ab-11e4-b2ef-00144feab7de.html#axzz3ythosNwf
[15] http://www.nytimes.com/2015/04/07/business/big-companies-pay-later-squeezing-their-suppliers.html?_r=0
[16] Source: B2B Payments 2015 Australia and New Zealand Research; Deloitte, August 2015
http://www.visa.com.au/business/corporate/include/B2B_PaymentsReport2015.pdf

2.4 Competitive neutrality

2.4.1 Current market dynamics and share

The exclusion to date of three-party schemes from the RBA's payments regulation has significant impact on the commercial credit card landscape. The different economic model and cost base for commercial payments has meant that three-party schemes have been able to gain significant market share through offering higher incentives (rebates) to corporate and government clients from the higher costs to merchants. If three-party schemes remain excluded, this distortion in the marketplace would be significantly exacerbated under a 'hard cap' interchange regime for four-party schemes.

Three-party schemes have an especially strong presence in the corporate travel and entertainment sector. For instance, American Express is a seen as a 'must take' card for merchants operating in travel, accommodation, restaurant, car hire and entertainment services. Diners Club similarly is a 'must take' card for merchants that wish to provide travel services to Federal Government.

Under the draft proposal, financial institutions would lack incentive to continue to invest in commercial solutions offered through regulated schemes, while unregulated three-party schemes will continue to expand in the commercial space. Where the RBA intends, through this proposed regulation, to lessen the gap in acceptance cost between large and small businesses, the regulation will in effect exacerbate any existing acceptance burden by stifling an alternative to the predominance of higher-cost three-party schemes.

2.4.2 Rebates

The RBA has justified its proposed changes on the basis that:

> *"…rebates to corporates were common in this sector, implying that effective pricing arrangements for commercial cards may in fact not be that dissimilar to those for personal credit cards."*

This is not the case. At an aggregate level, and specifically relating to business, corporate and purchasing charge cards with corporate liability, only 1 per cent of contracts between issuers and end businesses that attracted a financial incentive or rebate. Anecdotally, rebates are only offered on the largest programs to compete with unregulated schemes and are used to support the implementation and ongoing management of card program infrastructure.

2.5 Conclusion

Given the complexity of the commercial payments space and the significant investment needed to maintain these programs by issuers, Visa recommends the RBA adopt Option 2[17] and exempts commercial cards from interchange regulation.

[17] Option 2: Commercial cards to be exempted from interchange regulation. Section on coverage of interchange standards – commercial cards. RBA Review of Card Payments Regulation

However, should the RBA believe that commercial cards require regulation of some form, Visa believes the RBA should adopt a higher interchange cap of 120 bps with clear rules for issuance and compliance to avoid circumvention. This would allow the four-party schemes and their issuing clients to remain commercially viable in the commercial card segment.

Understanding the RBA's concerns around circumvention, Visa is committed to maintaining tight controls around business liability, annual attestation of issuing banks, clear review and upholding of issuing bank terms and conditions, further strengthening of Visa Rules, and instigation of an analytics programs that could measure the compliance to these standards.

Chapter 3: Interchange rate cycle compliance

> ***Key points***
> - The proposed reduction in the interchange reset timeframe from three years to three months will create additional compliance and operational requirements across the financial services sector
> - A more stable and predictable interchange environment is readily achievable without quarterly compliance checks
> - Annual assessments would be more than adequate to meet the Review's objective of managing a weighted average interchange basket

3.1 Introduction

The RBA has recommended altering the frequency of the interchange rate reset cycle from the current three yearly timeframe to quarterly compliance checks[18], requiring payment system operators to conduct a reset should the weighted average interchange basket exceed 50bps. Further, payment system operators would be required to complete the reset within 45 days following the end of the quarterly period.

Visa does not believe that the proposed shift from three-yearly interchange rate resets to three-monthly compliance checks is a workable solution. This will create an increased and unnecessary burden on participants within the payments ecosystem and generate instability within the broader economy. Visa firmly believes that a minimum 12-monthly interchange rate reset window would meet the requirements of the review while reducing the impact on payment system participants.

Visa understands the RBA's intent is to reduce fluctuations around the weighted interchange basket by shortening the scope of the reset cycle. However, the RBA's current proposal would create an operational undertaking across the payments system – from acquirers, to merchants, to issuers – where the additional compliance efforts needed to uphold the regulation would potentially undermine the intention of the changes. Rather than ultimately reducing the cost of acceptance, it would create an unreasonable additional burden on all participants in the payments eco-system. The increased cadence of compliance requirements also creates potential volatility to issuers and acquirers revenue and additional administrative costs, reducing both the resources available and incentive for investment in product development and innovation. For the payments networks, it would require significant additional resources.

From a technical perspective, the recommended 45 day period within which to complete the reset would be impossible to achieve under a quarterly reset environment. Visa and its partners are heavily coordinated around technical interchange release dates and compliance requirements to maintain the safety, integrity and security of the payments system, a process that requires a longer time period than 45 days to manage sufficiently.

[18] Option 2: Quarterly compliance. Section on benchmark compliance. RBA Review of Card Payments Regulation, pp.20-22

Instead of the proposed quarterly compliance cycle, Visa strongly advocates the introduction of an annual cycle as a realistic option that would meet both business needs and the RBA's objectives.

3.2 Operational requirements

Visa believes the management of Australia's interchange regime needs to be practical, workable and effective for all participants in the payments ecosystem. A quarterly reset cycle would be an unworkable solution to the requirements of the RBA from a business perspective.

Interchange rate resets are highly complex, time-consuming, and balance the needs of multiple parties throughout the payments system. Each interchange rate reset generates significant costs across the payments ecosystem, including management and implementation costs, pricing changes by acquirers, and results in potential shifts in the product portfolio range offered by issuers. Further, payment system operators and other participants in the payments ecosystem would also be required to invest heavily in technological infrastructure and back-of-house systems to support the requirement for more frequent compliance and, potentially, more frequent resets.

Coordinating system changes and rate resets also requires extensive planning between payment system operators, acquirers and issuing banks to ensure minimal disruption to consumers and merchants. To support this process, Visa's global payment network releases interchange rate changes globally twice per year on pre-scheduled dates at the lowest risk times of the year for both issuers and acquirers, and to provide increased stability, Visa implements a system freeze over the peak transaction period of November to January. However, under the proposed recommendations, interchange rate changes made during the December quarter would generate significant complexity and disruption to the payment system, generating volatility at time where seasonality places a significant impact on transaction volumes.

Visa takes great efforts to ensure that its network is available 24/7, 365 days a year globally. Visa's system reliability is over 99.99999 per cent and this is a result of decades of experience which requires extensive planning and coordination with all system participants. Visa's system changes and rate resets requires extensive planning between Visa, issuing and acquiring banks.

Seasonality of spend, or the shift in spending patterns by cardholders during high consumption periods such as Christmas or Chinese New Year, causes volatility in the interchange mix throughout the year. Furthermore, payment volume within a quarter can vary significantly, both with seasonality and in response to unforeseen global events. While this variance can be addressed across a period of 12 months or longer, there is very little ability to factor in these market conditions strictly within a three month compliance period.

Quarterly compliance could also impact issuer, acquirer and merchant revenue, leading to income volatility and a potential reduction in product investment. With issuers and acquirers relying on the stability of card product portfolios over a long period of time with predictable revenue, should quarterly resets require frequent changes to product portfolio, it would create uncertainty over revenues and profit. That, in turn, may reduce the incentive for banks to invest and innovate in new products which deliver benefits to industry, consumers and merchants.

3.3 Reset compliance window

The Review also recommended changing the compliance window for the reset of the weighted average interchange basket to 45 days from the end of the quarter. This proposal would prove highly problematic for industry, requiring significant restructuring in process and investment in infrastructure, adding substantial costs to the provision of electronic payment platforms.

In order to ensure the safety and security of the payments system, Visa believes that 120 day period is the absolute minimum timeframe by which an interchange rate reset could be implemented. This provides sufficient time to assess, rebalance and communicate new interchange rates with card issuers and acquirers while providing the appropriate time for systems development, testing and coding while coordinating with all issuers and acquirers.

Under the existing, three year reset regime, card transaction and interchange rate flow information only becomes available between four and seven days from the end of the month. From here, Visa then requires a minimum of three weeks to coordinate the internal rates structure and model the appropriate change to interchange rates, factoring in the impacts these changes place on the existing issuer and acquirer portfolio and the costs for merchants.

Once new interchanges rates have been developed that meet the requirement to balance to 0.50 per cent, Visa must coordinate internally and externally with issuers and acquirers for a systems change. This process is rigorous and requires both significant time and resources[19]. A system update requires a minimum of three months' notice for implementation to provide sufficient planning and execution time for other electronic payment system participants.

3.4 Conclusion

Visa recommends the creation of a 12-monthly interchange reset cycle and the creation of a 120 day reset implementation window to ensure the safety and stability of the card payment ecosystem. This will ensure the impacts of any change on issuers, acquirers and merchants is comprehensively understood and incorporated, while also minimising the impacts of any potential instability on the payments ecosystem.

[19] Visa needs to develop internal business requirements, coordinate with our internal systems group which must code and test new rates. Additional testing is done to ensure that other rates have not been affected by any of the coding changes. The revised interchange rates and the related technical details must be communicated to issuers and acquirers and an implementation date is set in order to coordinate a systems change. In order to ensure the safety, security and reliability of the network extensive internal and external development, testing and coordination is required.

Chapter 4: Surcharging standards

Key points

- Visa continues to oppose merchants surcharging customers for using secure, transparent and reliable electronic payment systems such as Visa
- If surcharging is not to be prohibited in the Australian market, Visa supports limiting the level of permissible surcharging on transactions to the cost of acceptance for the merchant
- Visa supports the RBA recommendation to grant investigation and enforcement powers to the Australian Competition and Consumer Commission (ACCC) to act as an independent watchdog for consumers

4.1 Introduction

Visa has been concerned for many years that excessive surcharging practices in Australia by some merchants negatively impacts Australian consumers and unfairly disadvantages those who choose to perform a transaction using an electronic payment method. Broadly speaking, surcharging in Australia is more extensive and commonplace than in almost all other advanced markets in which Visa operates.

On numerous occasions, the RBA has acknowledged that the development of a safe, reliable and open electronic payment system delivers a wider range of benefits to the Australian economy over cash, despite the fact that allowing surcharging creates a disincentive for consumers to choose card payment options. Penalising consumers via surcharges for choosing secure, transparent and reliable electronic payment systems is a practice Visa has always strongly opposed in the best interests of consumers.

Visa welcomes the efforts of the Australian Government and the RBA to address excessive surcharging. The RBA's proposed draft standards provide greater certainty and cost outcomes for consumers, and will ensure merchants are better informed about the responsible way in which electronic payment acceptance costs can be accurately reflected[20]. Visa also welcomes the proposal to grant investigation and enforcement powers to the Australian Competition and Consumer Commission (ACCC) to ensure that surcharging practices are limited only to the intent of the policy objective, and Visa looks forward to working with the ACCC to address this concern on behalf of all consumers.

4.2 Enhanced limitations on surcharging

Should surcharging of electronic payments continue to take place in the Australian market, Visa supports an imposed limitation on the level of permissible surcharging of transactions. Visa welcomes the steps taken by the RBA and federal government to create clear guidelines limiting surcharging to the cost of acceptance. These improvements seek to provide greater

[20] Option 3: Modifications to the cost of acceptance framework. Section on surcharging. RBA Review of Card Payments Regulation, pp. 28-35

market outcomes, enhanced consumer protections and improved clarity and transparency for merchants and acquirers.

While the proposed reforms appear to provide greater understanding for merchants and acquirers on the ability to surcharge, it will be important to ensure that it is not impossible to exploit the ambiguities that may exist when seeking to calculate the merchant acceptance costs. For example, merchants may claim that a number of ancillary business costs associated with broader financial transaction process, including those that capture cash or other non-electronic payments, should also be included in the allowable surcharge. This may create a situation where inconsistencies between different merchants and different acquirers on card acceptance cost structures could open loopholes.

The draft standards include recommended changes to the calculation methodology for acquirers that increase the administrative complexity in reporting the cost of acceptance of electronic payments. Visa encourages the RBA to work with industry to ensure that acquirers and merchants are aware of any new requirements and educated on how the new system should operate.

4.3 Enforceability

Visa strongly supports the RBA's recommendation to grant enforceability and investigation powers to the ACCC to monitor and police surcharging standards in Australia.

The current approach which calls on payment schemes to implement and enforce surcharging limitations through a two-step process involving acquiring banks is both challenging and complex. It is clear since the March 2013 commencement of Visa's efforts to enforce the current regime with merchants that a statutory authority will have a far greater ability to induce a reduction in excessive surcharging than any industry-led initiative will.

The ACCC has a clear and defined role in consumer protection, and has taken on the responsibility as official watchdog across a number of other industries, including telecommunications, energy, aviation and water. The ability of the ACCC to discharge enforcement and investigation responsibilities is far more effective than any industry-led framework, carrying legislative weight to compel organisations to comply with its rulings.

Visa welcomes the ability to engage closely with the ACCC in an ongoing manner to share international best practice in surcharge management, along with any knowledge or experience gained in Australia and other markets internationally.

Chapter 5: Competitive neutrality

Key points

- The lack of competitive neutrality remains a key weakness in the Australian payments regulatory space
- The exclusion of existing unregulated schemes from this regulatory review, which only captures some four-party schemes, continues to deepen the competitive disparity that exists in the payments system
- While Visa supports the inclusion of the American Express GNS program in the proposed new interchange standards, it is critical that the RBA take this opportunity to level the playing field for all participants and future-proof its regulatory regime

5.1 Introduction

Visa continues to view the lack of regulatory competitive neutrality as the key weakness in the Australian payments system[21]. Visa believes that while this Review has taken a number of steps to address this concern, such as the recommendation to capture the American Express GNS or 'companion card' scheme in the interchange standards, further steps must be taken to deliver a truly level playing field across the Australian market.

Visa is pleased that the RBA acknowledges that the existence and recent proliferation of the American Express GNS platform is tantamount to an unregulated four-party payment scheme, operating with an almost identical business model and revenue structure to the regulated four-party payments networks. Ongoing concerns at the continued unregulated operation of the American Express GNS scheme has seemingly also resonated with Government, seen in the recently completed Financial System Inquiry (FSI) which highlighted similar concerns around the lack of competitive neutrality in the current framework.

In Visa's view, payment systems in Australia should operate on a competitive, fair and neutral playing field, with balanced regulation capturing all participants in the market. Therefore, designation of new, emerging or future issuing schemes, for example, UnionPay, JCB or PayPal, should also be included in existing legislation to protect both consumers and merchants.

5.2 'Traditional' or proprietary three-party schemes and new models

While Visa supports the RBA's recommendation to bring the American Express GNS scheme, the de facto American Express four-party scheme, under the interchange regulations, a number of 'traditional' or proprietary three-party schemes, as well as a number of four-party schemes, remain unregulated in the Australian market. This exclusion continues to highlight the competitive disparity that exists in the payments environment.

[21] See previous Visa submission to RBA Review on Card Payments Regulation (April 2015) and Visa final submission to Financial System Inquiry (March 2015)

Visa has argued consistently that closed-loop, three-party schemes should be regulated by the RBA in a similar manner to the open-loop, four-party schemes. Additionally, a number of unregulated four-party schemes have continued to grow in the Australian market without any regulatory intervention by the RBA. While this ongoing disparity and regulatory dichotomy continues, the operators of the unregulated schemes are likely to continue taking advantage of the competitive advantage that shields operators from cost management regulation, leading to growth in higher-cost schemes and negative outcomes for merchants and consumers.

In addition, beyond both open and closed loop schemes, a range of newer models are being developed and deployed in the Australian payments market, such as PayPal and Alipay, which also operate in the payment system without any regulatory intervention by the RBA. These emerging platforms continue to grow without any structural or cost regulation, allowing operators to charge consumers and merchants at whatever level they choose.

To futureproof the regulation of the Australian payments industry, Visa urges the RBA to include in its review clear provisions signaling an intention to designate and regulate when a payments company reaches material volumes in the Australian market. Material volumes should be clearly defined by the RBA to understand when this threshold is met.

Chapter 6: Other matters

Key points

- Visa believes that, given the extent of the recommendations likely to flow from the RBA's Review, at least a 12-month period will be necessary for Visa to implement changes at a scheme level
- Visa encourages the RBA to consult widely with all participants in the payments ecosystem to ensure the compliance deadlines match achievable industry timelines beyond the requirements of scheme operators

6.1 Implementation timeframe for reform

As identified by the RBA throughout this and previous reviews, policy and regulatory reform of the card payments industry in Australia involves addressing a number of highly technical issues with significant downstream ramifications to economic activity within the economy. Further, given the complex nature of the payments landscape, an extended period of consultation and implementation is required by industry to understand the policy intent of Government and adequately incorporate any required changes with minimal impact to our key stakeholders.

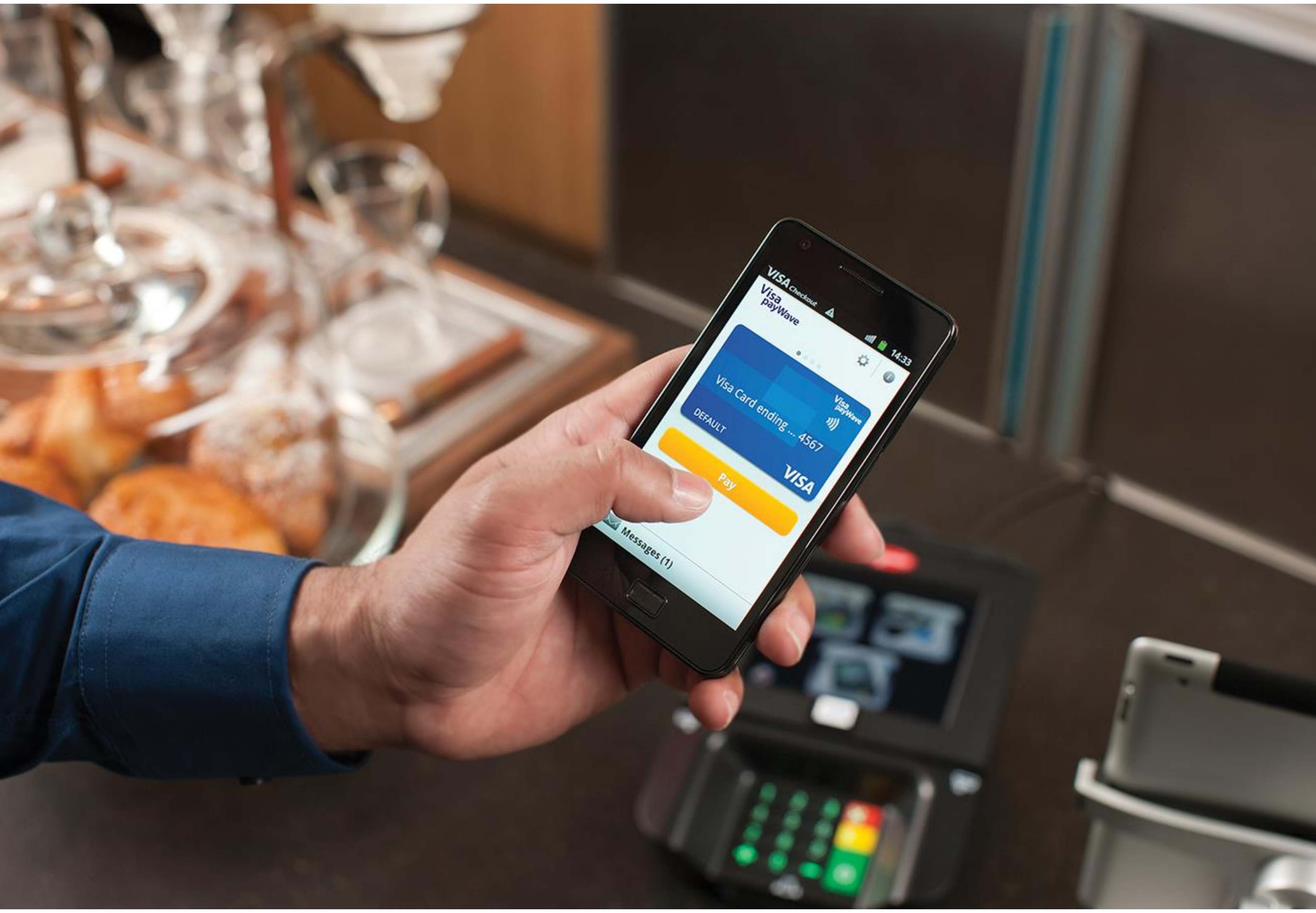
A number of the proposed recommendations, particularly the inclusion of foreign-issued cards in the interchange standards, would involve significant changes to business models in the payments industry, while other changes may include significant systems changes for and by schemes, issuers, acquirers and merchants.

Visa believes that the impact to the payment system industry and individual downstream four-party scheme participants should be at the forefront of the RBA's considerations, viewed through the lens of lower cost, improved product outcomes and a more secure transaction environment for consumers. It is therefore important that all participants, not just schemes issuers and acquirers have sufficient time to consider and implement the new regulatory provisions and the subsequent practicalities of any change to ensure minimal disruption to existing operations.

While Visa understands that the RBA wishes to implement changes to surcharging regulations on a faster timeline ahead of the May PSB meeting, it is important that the full range of reform options is comprehensively understood by the market ahead of any changes. During the consultation phase, Visa has engaged with a wide range of market participants who have voiced concerns over the practical implications of the proposed changes and the need to have sufficient time to ensure full compliance with any new provisions. As such, Visa recommends that the RBA undertake a comprehensive education campaign to ensure merchants and acquirers fully understand how the new standards should be executed. Further, the RBA should ensure that any changes to systems or processes are outlined with sufficient lead time to avoid any costly or disruptive organisational changes.

Visa is also concerned with the intended timeframe for the implementation of any changes to interchange standards. It is understood that the PSB intend to announce the final reform measures following the May PSB meeting, with the proposed implementation taking place before the end of 2016. Implementation of changes in the Visa system cannot begin until all of the details are known and the final requirements are published. In addition, to account for system freeze periods and development lead times required to coordinate portfolio variations and infrastructure improvement for both Visa, Australian issuers and acquirers, structural changes to the interchange rate system in the Visa system can take up to nine months to implement without the inclusion of any foreign-issued cards. Should this reform measure also be included, Visa anticipates that system changes and global coordination of interchange settings will take at least 12 months to implement from a scheme perspective.

As such, Visa recommends ensuring sufficient lead time is factored into any compliance requirement for payment scheme participants to allow for the material changes to existing system architecture. Further, Visa also recommends the RBA better understand the requirements of all payment system participants ahead of any proposed compliance introduction.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