



15 October 2004

John Veale  
Head, Payments Policy Department  
Reserve Bank of Australia  
65 Martin Place  
Sydney 2000

Dear John,

ASL is pleased to submit the views of the building society industry in respect to Visa Debit<sup>1</sup> designation. ASL's member building societies provide various payment options to its customers and believe it is important to provide consistent price signals to both the customers using these products and the merchants that accept them.

In its Final Reforms for credit cards, the RBA has established a framework for card-based payment products that involve four parties<sup>2</sup>. ASL strongly urges the RBA to adopt a consistent framework for all card payment products, including Visa Debit, and let competition and end-user preferences determine relative usage of those products.

Visa Debit is an attractive product to many consumers because it offers a unique mix of features found in other payment products.

- Funds are typically taken from the cardholder's transaction account within several days of the transaction.
- No credit line is provided as an inherent part of the product<sup>3</sup> thus minimising the possibility of incurring unwanted debt.
- The Visa Debit card can be used overseas.
- Visa Debit cardholders can pay for Internet and MOTO transactions.
- Allows a single account (e.g. a transaction account) to be accessed by multiple means such as an EFTPOS card, signature debit card, cheque, direct debit/credit, BPAY and so forth.
- The card can be obtained by consumers that may not qualify for a credit card.

Visa debit is a unique payment product, being neither exactly the same as a charge card, credit card, or PIN debit card. For example,

- The end-to-end economics are different for each product.

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<sup>1</sup> Throughout the submission reference is made to Visa Debit but this brand is a specific instance of signature debit cards as it is the only one issued in Australia.

<sup>2</sup> The four parties are the cardholder, issuer, acquirer and merchant.

<sup>3</sup> Some issuers offer overdraft on the cardholder's transaction account but this is a separate decision between the issuer and cardholder and not an inherent feature of the Visa Debit product.

- Customer preference results in them using each product in different circumstances and for different reasons.
- Equating products based on “short form” product descriptions distorts understanding of the detailed economics needed when setting payment policy and pricing principles. For example,
  - Credit card users that pay their balance in full each month effectively use the credit card like a charge card – but a “credit card” is not a “charge card”.
  - Visa Debit cardholders that make a signature-based point of sale purchase have their bank account debited, as do EFTPOS cardholders, but a “Visa Debit card” is not the same as an “EFTPOS card”.

Of course, cards issued to customers are usually multi function cards and a customer can choose to use the card as an EFTPOS card or a Visa Debit card.

Similarly use and apparently similar processing do not indicate similar costs, and it is the underlying, relevant payment product costs that should form the basis of pricing between issuers and acquirers. It is important that the Visa Debit designation process be based on a specific review of its product characteristics and economics. ASL would like to believe that the RBA feels the same way in order to have a logical and consistent payments system and economics.

ASL is concerned that the RBA views a (cardholder present) Visa Debit transaction as just like an EFTPOS purchase transaction and therefore should have the same interchange fee. Based on our experience, the economics of a Visa Debit transaction are not the same as an EFTPOS transaction. The RBA’s views in respect to EFTPOS should not be automatically applied to Visa Debit just because both are considered “debit cards” and may appear to be the same type of transaction.

The RBA has created a framework for assessing the economics of card based payment products and the fees between financial institutions, i.e. interchange fees, when two financial institutions are involved in completing a transaction (an issuer and an acquirer)<sup>4</sup>.

- The economics of a not-on-us transaction are essentially the same as for an on-us transaction. Differences typically related to the application or not of clearing and settlement fees and card association charges.
- Interchange fee involves matching revenue obtained to costs incurred as between issuers and acquirers. As was evident in the Joint Study<sup>5</sup>, the proportion of revenue and costs<sup>6</sup> incurred by credit card issuers and acquirers are not the same<sup>7</sup> and thus some type of transfer fee is appropriate. ASL believes the same situation exists for Visa Debit transactions.

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<sup>4</sup> These are often referred to as not-on-us transactions.

<sup>5</sup> Debit And Credit Card Schemes In Australia, A Study Of Interchange Fees And Access, October 2000, page 45.

<sup>6</sup> Costs are considered on a fully allocated basis in that they would exclude corporate type overheads but would include an allocation of direct cost where there is more than one access device – eg for transaction accounts that can be accessed with a cheque, ATM card, EFTPOS card, OTC, and a Visa Debit card.

<sup>7</sup> The Acquirer receives a higher proportion of end-to-end credit card revenue (excluding revenue related to the revolving credit facility) and incurs a lower proportion of costs (excluding funding revolving balances and credit losses) than the Issuer.

- During the credit card designation process it was clearly demonstrated that economists could provide interesting (and varied and contradicting) theoretical frameworks on the issue of interchange but a practical method to actually determine the fees was required.
- The RBA provided one such method for credit cards that can be applied to Visa Debit cards transactions.

The overarching consideration for RBA reform of the card based payments system is that the reforms are in the public interest. The public interest according to the PSRA pertains to financial safety for participants; efficiency; competitiveness; and not materially increased risk of the financial system. Card-based payment product reforms are in the public interest if they are consistently applied because they create a set of rules that apply across all designated card based payment products<sup>8</sup> and result in consistent pricing signals to consumers and merchants.

To that end, the RBA has created a framework for the calculation of card based interchange fees based on principles that will promote efficient and competition<sup>9</sup>:

- Cost-based, in a manner that is transparent
- Based on payment services that are provided to the merchant
- Excluding costs that are not related to payment network considerations
- Providing for differential interchange fees
- Data independently verified
- Subject to regular reviews

ASL finds no reason that these same principles cannot be applied to Visa Debit. Each of these is discussed below.

#### Cost Based and Transparent

The relevant costs can be measured for all Visa Debit issuers in a transparent manner as was done in establishing the credit card cost benchmark. This would involve retaining an independent third party to conduct a cost study that included the substantial majority of Visa Debit issuers; according to a cost manual approved as required by the RBA; and completed within a reasonable time period. ASL believes the cost benchmark can be established within 6 months. The costs would be based on the same payment services provided to the merchant for a Visa Debit transaction as are provided for a credit card transaction. These are detailed below based on the costs that were included in the credit card Final Reforms

- Transaction processing costs, including scheme fees for clearing and settlement. Processing costs would include those costs that are specifically and uniquely identifiable to a Visa Debit payment transaction and an appropriate proportion of relevant joint costs that are common to all transaction account activity such as the receipt, editing, reconciling and settling of incoming transactions.

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<sup>8</sup> Or those that may be subject to industry self-reform.

<sup>9</sup> Reform Of Credit Card Schemes In Australia, A Consultation Document, December 2001, pages 42-43

- Fraud and fraud prevention costs uniquely incurred for Visa Debit transactions and an appropriate proportion of all relevant joint costs that are common to fraud and fraud prevention for transaction accounts;
- Costs incurred to authorise a Visa Debit transaction
- The costs of funding the interest-free period would not be an applicable cost because there is no effective cost to the Visa Debit card issuer as a result of timing differences and funds availability in the settlement process with the acquirers.

#### Payment Network Considerations and Services Provided

By following the principles applied to credit cards and including only those costs described, the methodology is only including costs that the RBA considers related to payment network considerations and payment services provided. While this view may not be shared by all interested parties, ASL is willing to operate under that framework as created by the RBA in that it would reflect an approach consistently applied across all payment products.

#### Differential Interchange Fee

Once a cost benchmark is established, the Visa Debit issuers would set specific interchange fees such that the weighted average interchange fee would not exceed the weighted average cost. In this manner the scheme could set fees to allow the greatest (and consistent) competitive pricing for end users (cardholders and merchants) while still adhering to efficient pricing principles as proscribed by the RBA. In that manner, the payment service provider would determine if, and at what level differential interchange fees are required to meet marketplace competition, within the framework of fees not exceeding costs, in the aggregate.

#### Independent Verifications and Regular Reviews

As with credit cards, a third party would do the cost study on which interchange fees would be based, subject to appropriate oversight and review. ASL believes that the cost study would most practicably be updated every three years; interchange fee compliance with average costs would be certified annually; and the cost benchmark would be recalculated, with RBA concurrence, if changes in eligible costs or other factors warrants.

ASL believes this approach would provide a consistent set of economics on which consumers and merchants would decide whether to use or accept Visa Debit compared to credit cards and other payment cards. The interchange fee would be based on the same types of payment services provided to the merchant as for other payment products such as credit cards. The merchant would not be in a position of paying for them in one instance and not the other. If this was to occur it would distort efficiency in the payments system.

ASL submits that a similar framework should be applied to EFTPOS. However that is not a subject within the scope of this submission, which is to ensure consistency of treatment of Visa Debit with credit cards for which the RBA has already formulated an economic and commercial framework. If the RBA treatment for EFTPOS is different than for credit cards, it does not necessarily follow that Visa Debit is “more like a debit card than a credit card” and should be dealt with in the same manner. Visa Debit is a unique product with its own unique set of product features that can and should be assessed within the framework the RBA has already established.

ASL cannot provide an estimate of the level of average costs because that would involve disclosing confidential cost data in a document that will be a matter for the public record.

In terms of surcharging, ASL believes that surcharging as currently implemented for credit cards and charge cards could be improved. For example, merchants currently can surcharge in excess of the merchant fee they pay to accept cards. This may allow business in certain highly concentrated industries or certain geographic areas to price significantly in excess of costs, distorting the consumer's decision as to which payment option to use. However, ASL does acknowledge that to follow the RBA framework for payments system reform consistency requires the ability for merchants to surcharge for Visa Debit.

Scheme access is an issue related to Visa scheme rules and ASL defers on this issue to the RBA and Visa.

Whatever the arguments for and against the reform agenda and the current inequitable state of implementation, there is no doubt that reforms must be consistently applied across all payment products. Efficient markets require clear pricing signals and clear pricing signals are developed in large part when similar costs are included in the determination of prices.

Visa Debit is very important to the financial well being of ASL' member building societies. Should interchange fees for Visa Debit fall below the cost of the payment services provided to acquirers/merchants, they would not have a viable signature debit product. To continue with Visa Debit would significantly impact their financial well being.

Building society customers require and want a payment product that can be used in place of cash, for Internet and MOTO purchases, and in many instances for international travel. Without a viable Visa Debit product, the building societies would have no choice but to offer an alternative product in a manner that most closely meets it customers' needs. Issuing credit cards and / or charge cards would be the only logical course of action, which may not be a desirable outcome in the context of payments system reforms.

- Merchants would pay higher merchant fees.
- More and higher levels of surcharging would take place.
- Cardholders would not have the product feature set they most desire.

But it is a very likely outcome if the pricing principles developed by the RBA are not consistently applied to other card products such as Visa Debit. ASL believes that the lack of consistent reforms would drive Visa Debit cardholders to greater use of charge cards and credit cards particularly in those situations for which payment cannot be made, or is not easily made, with cash or EFTPOS.

### Conclusions

1. Fees for transactions using the Visa debit as a PIN-based EFTPOS transaction card should be based on the agreed interchange fee for EFTPOS.
2. Fees for Visa debit, when used as a substitute credit card for face-to-face transactions and/or where only credit cards are accepted, i.e. MOTO, internet, bill payments, etc, should be based on a scheme debit cost model (see point 6).

3. The choice of which type of transaction to use should be at the discretion of the card holder.
4. Where the scheme debit card is used, the card is subject to the same rules as applies to a credit card, in particular merchant surcharging.
5. The honour all cards rule should remain on the basis that the cardholder can choose the way the transaction performs and the merchant has the right to surcharge for credit type transactions including those performed on scheme debit.
6. The cost model used by the RBA for credit card should be used to determine the basis of the cost associated with scheme debit cards. The cost for scheme debit should be reduced slightly by not including the interest free criteria that is the only difference between a credit card and a scheme debit card transaction.

ASL would be pleased to expand on this letter in more detail as the RBA may request and to work with the RBA in developing the specifics of applying consistent pricing principles based on the particular economics of Visa Debit.

Yours sincerely

A handwritten signature in black ink, appearing to read 'John Toms', with a stylized flourish at the end.

JOHN TOMS  
CHIEF EXECUTIVE OFFICER

