10 February 2012

Mr Tony Richards
Head of Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
SYDNEY NSW 2001

Dear Mr Richards

VISA SUBMISSION

I am pleased to attach a submission from Visa to the Reserve Bank of Australia (RBA) surcharging review process currently underway.

The attached specifically addresses the issues raised in *A Variation to the Surcharging Standards: A Consultation Document* released on 16 December 2011.

Visa remains fully committed to working with the RBA on this important process.

Should you have any further questions about the submission, please feel free to contact either myself or Mr Adam Wand, Visa's Head of Public Affairs, Australia, New Zealand and South Pacific on 02 9253 8800 or awand@visa.com.

Yours sincerely

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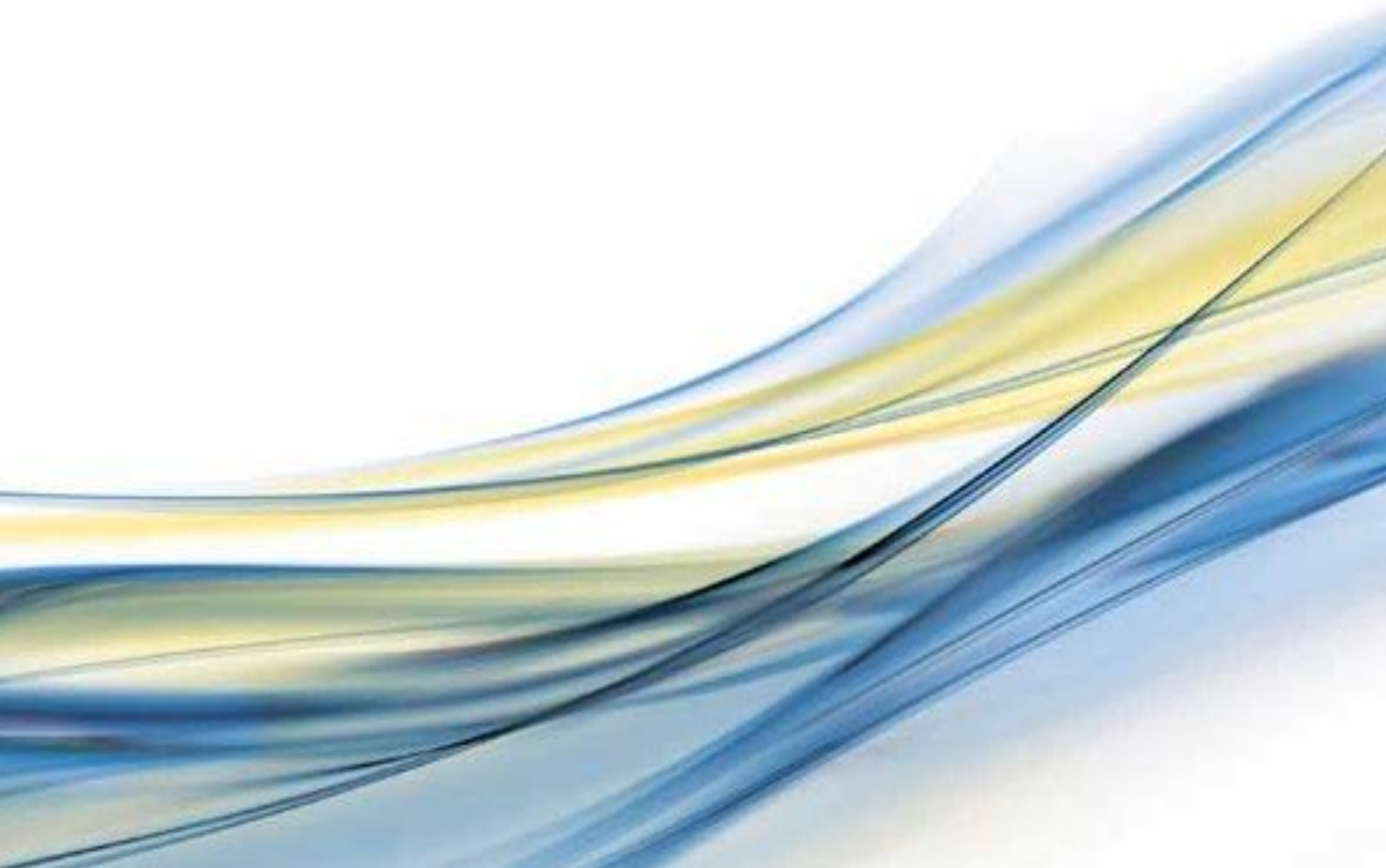
Submission to the Reserve Bank of Australia's Surcharging Review

Visa Response to *A Variation to the Surcharging Standards: A Consultation Document*

February 2012



Executive Summary

- Visa believes that permitting surcharging has led to significant consumer harm without any offsetting benefits and, as a result, schemes should be permitted to prohibit surcharging.

- Absent such a change in the Standards, Visa strongly agrees with the Reserve Bank of Australia's (RBA) finding that there is a case for varying the Standards to allow schemes to limit surcharges in Australia as a way of dealing with increasingly excessive and blended surcharging.

- Visa submits that this can only be done effectively by clearly defining the cost of card acceptance. Anything short of such complete clarity will undermine the ability of surcharging reforms to better protect consumers and meet the RBA's goals of improved price signals and increased overall payments efficiency in Australia.

- Visa reconfirms we are able and willing to include provisions in our Visa International Operating Regulations (Visa Rules) to limit surcharging to a clearly defined cost of card acceptance.

- Visa repeats its opinion from our previous submission that an "actual" cost of card acceptance is preferable to a "reasonable" cost of card acceptance and that the most appropriate, easiest to deploy for merchants, most consumer-friendly and lowest cost approach to measuring actual costs is to limit surcharging to a portion of the average scheme Merchant Service Fee (MSF), with the apportionment to be reflective of the flow of benefits between the merchant and the cardholder arising from card use.

    - Visa notes that this approach would be more closely aligned with significant recent developments overseas in relation to surcharging controls, particularly in the United Kingdom (UK) and European Union (EU), both of which are progressing laws that limit surcharging to actual costs faced by a merchant and do not deploy any reasonableness concepts.

- However, and subject to the above strong preference, if the limitation to be permitted by the RBA is to be that of a "reasonable" cost of card acceptance, Visa believes that to achieve an effective and workable limitation via the Visa Rules, the "reasonable cost of card acceptance" must be clearly defined.

- As such, the test contained in Section 10 of the two Draft Standards to evaluate reasonableness should be amended to deliver a clear, straight-forward definition of the 'reasonable costs of card acceptance' through the following changes:

    - First, we believe that section 10 should be amended to remove subsections (i) and (iii), leaving subsection (ii) as the single MSF test. Section 10(ii) delivers the simplest, lowest cost approach and is reflective of the prevailing acquiring pricing structure in the Australian card acquiring market, namely Blended Interchange based pricing.

    - Secondly, we recommend that the draft Standards should be further amended to limit the definition of "reasonable cost of card acceptance" to the MSF amount as calculated under Section 10(ii).

    - Thirdly, we recommend further clarity be provided that nothing in the Standards prevents a merchant imposing a surcharge of less than the section 10(ii) MSF amount, or not imposing a surcharge at all.

- Visa believes it critical for payments efficiency and accurate pricing signals that credit and debit surcharging practices are separate.

    - We submit that surcharging should be completely removed from debit transactions in Australia.

    - If surcharging of debit transactions is to be allowed, Visa submits that cost based surcharging standards be set for credit and debit payments and that blending of credit/debit cost of acceptance for surcharging purposes should not be permitted. We believe that this approach would best align with the RBA's policy of setting different interchange levels for credit and debit payments.

- Visa submits that surcharging in the card-not-present environment is fundamentally different from the card-present environment and, as such, to preserve payments efficiency and accurate pricing signals where there is no widespread non-surcharged alternative, surcharging in the card-not-present environment should not be permitted.

Detailed Submission

RBA findings

Visa believes that permitting surcharging has led to significant consumer harm without any offsetting benefits and, as a result, schemes should be permitted to prohibit surcharging.

Absent such a change in the Standards, Visa strongly agrees with the RBA's finding that there is a case for varying the Standards to allow schemes to limit surcharges in Australia as a way of dealing with increasingly excessive and blended surcharging.

Visa reconfirms we are able and willing to include provisions in our Visa International Operating Regulations (Visa Rules) to limit surcharging.

Visa also agrees that measures to curb excessive and blended surcharging are in the public interest and will lead to greater efficiency in the payments system and therefore the wider Australian economy.

Finally, Visa believes that it must be acknowledged that paying with cash also carries significant costs to merchants. As such, a consumer paying a card surcharge is also paying the built-in costs of those consumers paying with cash. We recommend that the RBA undertake a detailed cost / benefit assessment of all costs associated with cash transactions as part of its work in developing Payment related Policy.

RBA Options for Reform

The RBA set out three options for reforming the Standards to place limitations on surcharging in Australia:

i. an RBA set cap;
ii. a limit based on the actual cost of acceptance; and
iii. a limit based on a reasonable cost of acceptance.

For all of the reasons set out by the RBA, Visa agrees with the finding not to support Option (i), being a RBA set cap.

Actual cost of acceptance preferred

Visa does however continue to feel that a variation of Option (ii), being a limit based on the actual cost of card acceptance, is the best pathway for reform in Australia.

We believe that implementation of reforms based on an "actual" cost of card acceptance would be more likely to succeed than one based on a "reasonable" cost of card acceptance which would inevitably be subject to extensive merchant

(and possibly legal) interpretation of what constitutes "reasonable" costs. This, in turn, is likely to lead to substantial, time consuming and potentially costly disputes about surcharging levels. An actual cost of card acceptance approach is the most appropriate, easiest to deploy for merchants, most consumer-friendly and lowest cost option available. We suggest that, given the existing regulatory regime in Australia, the RBA-collected average scheme Merchant Service Fee (MSF) is the most appropriate indicator of what constitutes "actual" costs.

Further we believe that a cost based standard should also take into account the benefits accruing to merchants from card use. If the standard does not do so, consumers will be left paying for the entire cost of card acceptance, while merchants enjoy the full benefits. To this effect, we submit that the RBA should reflect the extensive benefits of card acceptance enjoyed by merchants by lowering the actual costs of card acceptance limit to only a portion of the average scheme MSF.

We believe that limiting surcharges levels without needing to apply a reasonableness test would be much closer aligned to significant recent developments overseas in relation to surcharging controls. Most notable of these are the recent decision of the UK Government, to legislate to "ban excessive surcharges on all forms of payment"[1] and the passage of Article 19 of the EU Directive on Consumer Rights as finally adopted on 25 October 2011 which requires all EU Member States to "prohibit traders from charging consumers, in respect of the use of a given means of payment, fees that exceed the cost borne by the trader for the use of such means"[2] .

Each of these frameworks limit surcharging to the actual costs faced by a merchant and do not deploy any reasonableness concepts. As such, Visa submits that they indicate an important trend that Australia should follow in implementing its surcharging reforms.

Reasonable cost of acceptance reform proposals

In an environment in which schemes are not to be permitted to ban surcharging outright and despite retaining our strong preference for the above outlined approach in the spirit of formally engaging with the RBA on the detail of its preferred reform option and subject to the strong caveat that we continue to believe an actual cost of card acceptance approach is both achievable and more efficient, we offer the below comments on the reasonable cost of card acceptance option.

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[1] Press Release 148/11, HM Treasury; *Government to bring forward legislation to tackle excessive card surcharges*; www.hm-treasury.gov.uk

[2] Article 19, Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on Consumer Rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council, as published on 22 November 2011 in the European Journal (OJ L 304, 22.11.2011, p.64)

Amendments to the Draft Standards to deliver a clear definition of 'reasonable'

If the limitation to be permitted by the RBA is to be a 'reasonable' cost of card acceptance (Option (iii) in the RBA's paper), Visa believes that in order to effectively achieve any workable limitation via the Visa Rules, the 'reasonable cost of card acceptance' must be clearly defined and not include subjective elements. Anything short of such complete and objective clarity will undermine the ability of any entity tasked with implementing the measures to do so successfully. This would in turn mean that the intended benefits of surcharging reforms will not be achieved.

We submit that any lack of a clear definition of what constitutes 'reasonable' costs will lead to higher administrative and compliance costs for all parties involved, potentially leading to higher consumer costs overall.

There is also very high likelihood that any lack of clarity will to lead to frequent and ongoing disputes between the various parties to a surcharged transaction with merchants, cardholders, card schemes, acquirers and issuers all potentially take differing views on the definition of reasonableness. Visa believes that enshrining a regime that has at its core an ill-defined, subjective and frequently challenged concept such as reasonableness that is unaccompanied by a clear, quantifiable definition will be a missed opportunity and will fail to meet the RBA's objective of curtailing excessive surcharging in the Australian payments system. Moreover, the costs of dispute resolution could undermine the benefits of any reduction in surcharges.

As such, Visa submits that the test contained in Section 10 of the two Draft Standards which aims to guide the evaluation of reasonableness should be refined in the manner set out below to deliver a clear, straight-forward and objective definition of the 'reasonable costs of card acceptance'.

(a) Removal of Sections 10 (i) and (iii)

It appears that the RBA is seeking through Sections 10(i) and 10(ii) to capture the two acquirer pricing structures used in Australia, known respectively as Interchange Plus and Blended Interchange. Through Section 10(iii) it appears the RBA is seeking to offer an option for merchants to introduce a radically new surcharging approach based on credit card product type.

Visa submits that Section 10 should be amended to remove subsections (i) and (iii).

First, the use of three alternative tests to determine the MSF level is an unnecessarily complex approach. Implementing this series of alternatives in the Visa Rules will be extremely challenging and the net effect of the proposed three method definition is to diminish the level of certainty for all parties involved. Having three alternative definitions introduces doubt and complexity and will

lead to higher administrative and compliance costs for all parties involved. Again this approach has the very real potential to lead to higher consumer costs overall.

Secondly, specifically in relation to Section 10(i), based on our understanding of the marketplace, only a small number of merchants are charged by their acquirer financial institutions using an Interchange Plus pricing model, so the ability to access this MSF method is equally limited. We feel that in light of this fact, and applying the important principle of regulatory simplicity, we do not see a strong economic efficiency or public policy case for this additional alternative to be included in the Standards.

In addition, the effect of a merchant applying Section 10(i) would be a very confusing, potentially high cost outcome that would result in hundreds of different surcharges being applied across Australia. Due to the fact that cards carry a number of different interchange rates based upon card type, merchant category and other factors, and because interchange rates are subject to a variety of different "Plus" components negotiated by merchants and their acquirers, the result would be a wide variety of different permissible surcharge caps. Visa does not believe that the administrative and compliance complexities necessitated by a variety of permissible surcharges are justified.

We also note the widespread support in submissions to the previous round of this review process for improved consumer disclosure of surcharges, whether at point-of-sale or online. It is extremely challenging to see how a scenario with so many different surcharges being levied could be effectively disclosed to consumers. The deployment of this approach runs the very real risk of undermining any efforts to improve transparency and disclosure, both very important consumer goals supported by Visa.

Thirdly, specifically in relation to Section 10(iii), we know of no face-to-face merchants currently implementing card surcharging in this 'by card product' tiered manner. This approach is a radical departure from standard pricing practices and we submit, if it was used to determine the permitted 'reasonable' surcharge, it would suffer from the same problems outlined above in relation to Section 10(i). Namely, the administrative and compliance complexities are not warranted given the lack of deployment in the Australian marketplace of this type of surcharging.

In addition, due to the deployment of both strategic merchant rates of interchange and a number of segment-specific "acceptance" rates, a considerable portion of the volume even at major merchants who are most likely to be on IRF Plus acquirer pricing structure are processed under a single interchange rate, regardless of what sub-product is used.

Finally, the RBA itself in developing and implementing the overall interchange regulatory framework has used a blended approach. Interchange is the core component of the relevant rate of MSF and we feel there is a compelling case to maintain a matching framework in relation to calculating surcharge limits. We

thus feel there is no sound payments efficiency or public policy basis for the inclusion of this option in the amended Standards.

Following the removal of Sections 10(i) and 10(iii), the remaining provision (being Section 10(ii): "the average cost to the merchant of acceptance of all credit cards of all types issued under the Scheme") would be reflective of Blended Interchange acquirer pricing. As a result, the amended Section 10 would be significantly simplified and reflective of the most common acquiring pricing structure present in the Australian card acquiring market. Under this approach the surcharge cap would be tied directly and fairly to what the merchant pays to their acquirer.

It is important to also note that the small number of merchants on Interchange Plus acquirer pricing can easily use their pricing data to calculate the applicable base MSF under the remaining Section 10 test.

(b) Removal of 'above MSF' component

As outlined above, any uncertainty in what the RBA considers to be the definition of the 'reasonable costs of card acceptance' will undermine the impact of any reforms. As such, the proposed inclusion of a possible 'above MSF' component as currently contained in Section 10 would mean, if implemented, the inclusion of considerable doubt, uncertainty and have all of the abovementioned negative impacts.

Visa submits that definitional certainty is essential. To deliver this degree of certainty the draft Standards should be amended so that the MSF, as calculated under the remaining calculation method (current Section 10(ii)), is the complete extent of the defined reasonable costs of card acceptance.

(c) Less than MSF can be total surcharge

Finally, Visa submits that the draft Standards should be amended to make it clearer that nothing contained in the Standards prevents a merchant from using a surcharge level less than the MSF amount calculated under Section 10 and that this ability extends to the right for a merchant not to impose a surcharge.

(d) Rounding and merchant/acquirer confidentiality

Visa would also not object to the inclusion of the ability for moderate rounding of permissible surcharge caps as a means to improve workability for merchants and consumers and to preserve the confidentiality of the commercial pricing arrangements between merchants and their acquiring financial institution.

Penalties and enforcement

Under the Visa Rules, merchant enforcement is largely undertaken by acquiring financial institutions in a manner established under the Visa Rules. We would propose that this well established approach be continued in relation to the enforcement of any new Visa Rules in relation to surcharging.

Visa would remain cognisant of the cost and other impacts on acquirers and merchants in developing and deploying any new arrangements. We would also develop such arrangements in consultation with key stakeholders to ensure a workable, streamlined but effective outcome.

Visa's existing consumer complaints process will continue to apply, in that cardholders are able to lodge complaints to Visa for investigation, via their issuer. It is likely that this avenue will remain a valuable conduit for identifying additional non-compliant merchant practices, over and above any acquirer or Visa-initiated compliance monitoring effort.

Ultimately, as with other areas of the Visa Rules, acquirers would be responsible for ensuring non-compliant merchant are brought back into compliance with Visa Rules and, where non-compliance persists, a graded sanction approach could be imposed on acquirers. Visa would always work with acquirers well in advance of such steps to avoid the need to arrive at a point of non-compliance that would result in a financial penalty.

Differential treatment of Credit/Debit

Visa believes it critical for payments efficiency and accurate pricing signals that credit and debit are dealt with differently in relation to surcharging. This approach again replicates that employed by the RBA in relation to interchange which recognises the differences between credit and debit by imposing differing interchange basket caps.

No surcharge on debit

Visa submits that the Standards reform process presents an appropriate opportunity to remove surcharging from debit transactions in Australia.

Surcharging is not permitted in Australia on other non-credit forms of payment such as cash and BPay, both of which can cost more than debit card transactions. Aligning the treatment of debit transactions with these other non-credit forms of payment is an important policy goal and would deliver an important efficiency and public policy outcome for the Australian payments system and overall economy

No blending if debit surcharging permitted

MSF rates in relation to credit are different, and usually higher, than those related to debit. Yet, we increasingly see the presence not just of surcharging on debit transactions but the same level of surcharge being imposed on both debit and credit transactions, and that single combined surcharge level being almost always reflective of the credit MSF (or higher), not the debit MSF. So whilst the relevant credit transaction may be surcharged only at the cost of acceptance, the surcharge on the debit transaction is being significantly blended upwards.

Should a no-surcharge position for debit transactions be unsupported by the RBA, Visa submits that in light of the abovementioned credit/debit blending practices it remains critical for overall payments efficiency and accurate pricing signals, even with a "reasonable cost of card acceptance" limitation in place, for credit and debit surcharging practices to be strictly separate with no permissible credit/debit blending. In an environment that permits debit surcharging, debit transactions being surcharged above the relevant MSF are unacceptable, unfair and inefficient.

We believe this is the intention of the RBA in maintaining separate Standards for each of credit and debit, but this should be clearly confirmed.

Improved disclosure to consumers

Visa also feels that enhancements can be made in the level of disclosure to coinsumers via operation of the Visa Rules. Similarly to the arrangements in place in New Zealand we would suggest an addition to the Visa Rules that would require merchants who choose to surcharge to apply several clear principles such as:

- inform the cardholder that a surcharge is to be applied, including the amount or rate;

- not describe the surcharge as, or inform the Cardholder that the surcharge is, assessed by Visa or a financial institution; and

- Include notices, signs or decals disclosing that the merchant assesses and applies the surcharge, and that such notifications must be in a conspicuous location or locations at the physical point of sale, or, in the absence of a physical point of sale, prominently during an e-commerce transaction or communicated clearly in a telephone order.

Card-not-present surcharging

Visa again submits that surcharging in the card-not-present (CNP) environment is fundamentally different from the face-to-face or card-present environment.

If a core part of the rationale behind why surcharging has been implemented is to seek to make the costs of different forms of payment transparent and in turn to allow merchants to "direct" their customers to other payment forms or to allow customers to choose alternatives, we believe there is no role for surcharging where the merchant does not actually offer alternative payment options to which customers may be directed.

If these alternatives do not exist, or exist only in form and not in a practical and usable way, then allowing surcharging on card payments cannot deliver on the efficiency outcomes the RBA is seeking.

As such, to preserve payments efficiency and accurate pricing signals, where there is no widespread non-surcharged alternative, surcharging in the CNP should not be permitted.

Parity regulatory treatment

Visa submits that any reforms to the regulatory framework applicable to surcharging in Australia should be developed and implemented with the aim of parity treatment of all card schemes.