

24 April 2015



Dr Tony Richards  
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Reserve Bank of Australia  
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Sydney NSW 2001  
Via email: pysubmissions@rba.gov.au

Dear Dr Richards

**Visa Inc.'s Submission to the Payments System Board and Reserve Bank of Australia's Review of Card Payments Regulation**

Visa welcomes the opportunity to respond to the Payments System Board (PSB) and Reserve Bank of Australia's (RBA) Issues Paper to commence a review of card payments regulation (released on 4 March 2015) and appreciates the efforts of the RBA to engage with industry.

Visa has participated actively in previous reviews conducted by RBA over the preceding decade. More recently, Visa has put forward submissions to the Federal Government's Financial System Inquiry (FSI) Review in March 2014 and August 2014, as well as the Treasury's review of the final recommendations associated with the FSI report in March 2015.

In each of our submissions to these reviews, Visa has highlighted the need for balanced, equally applied and innovation enabling approaches to regulation of electronic payments. Visa has also raised ongoing concerns about the *Payment System (Regulation) Act 1998*.

This submission focuses specifically on the need for a level playing field in card regulation, the management of interchange fees, surcharging, Dual Network Debit Cards, merchant transparency of card payments, Prepaid cards, other related matters (for example, the treatment of commercial cards) and the implementation timeframe.

If you have any further questions regarding our response contained in this submission, please do not hesitate to contact Ms Taleen Shamlian, Head of Government Relations, Australia, New Zealand & the South Pacific (e: tshamlia@visa.com)..

Yours sincerely

A handwritten signature in black ink, appearing to read 'Stephen Karpin', with a long horizontal line extending to the right.

**Stephen Karpin**  
Group Country Manager  
Australia, New Zealand and the South Pacific





**Visa's Submission**  
**Reserve Bank of Australia's Review into Card Payments**

24 April 2015



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## Summary of Visa Inc.'s position

A financially safe, efficient, competitive and stable payments system is essential to the Australian economy. It will contribute to economic growth, development and ultimately financial inclusion in the interests of all Australians. It is therefore important that any regulation of the payment system stays up to date and relevant to the state of the payments industry. The Payments System Board (PSB) of the Reserve Bank of Australia (RBA) conducted a review of its payment system regulations in 2007-08. However, much has changed since then, presenting new opportunities and challenges for the payment system. The PSB considers it is timely to review the regulatory arrangements applying to card payment systems given the growth and role of cards and electronic payments in the system.

Visa has a significant interest in contributing to this Review given the role that payments play in the economy. 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 2.3 billion cards making around 98 billion transactions through 14,300 financial institutions.<sup>1</sup> These 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.

This activity is in turn 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.<sup>2</sup> More recently, we have participated in the Federal Government’s 2013-14 Financial System Inquiry (FSI).<sup>3</sup> In each of our submissions to these reviews Visa has stressed the need for balanced, equally applied and innovation enabling approaches to regulation of electronic payments.

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<sup>1</sup> For the year ended December 2014.

<sup>2</sup> See various submissions at [rba.gov.au](http://rba.gov.au)

<sup>3</sup> Visa’s two submissions to the FSI (dated 31 March 2014 and 26 August 2014) can be found at: [fsi.gov.au](http://fsi.gov.au). Visa’s submission to the Treasury’s review of the FSI report (dated 31 March 2015) can be found at: [treasury.gov.au](http://treasury.gov.au).

## ***The future of digital payments***

Technology is fundamentally changing the relationship between consumers and the businesses that serve them. Looking forward to the next five, or ten years, we are likely to see the pace of technological change is only going to accelerate going forward. The internet based digital revolution has created an almost unlimited ability for companies – from start-ups to the world’s largest players – to participate in commerce by creating new experiences through mobile, tablets, PCs and future connected devices.

This speed of innovation means it’s critical for government and regulators to recommend changes that give the payment system room to adapt to future developments in the fast evolving financial and digital landscape.

We support the FSI’s intention that future regulations should be agnostic to any mode of technology so as to support innovation, access and use. Visa supports the Government to establish a new industry working group on these matters. We would welcome the RBA playing an active role in this group.

## ***Competitive neutrality***

As the FSI process has highlighted, there is currently a lack of competitive neutrality in the regulation of payments in Australia, particularly in relation to interchange and also more broadly (see following box).

### **Current regulations are not applied equally to all players**

The RBA has regulated traditional four-party model schemes, being Visa and MasterCard, which were in operation at the commencement of the *Payment Systems (Regulation) Act 1998*, but has not regulated traditional three-party model schemes, namely American Express and Diners Card, even as those schemes opened their traditional ‘closed loop’ model to become “hybrid” four-party schemes (such as American Express Global Network Services (GNS), and Diners Card companion cards). Further, new entrants, such as UnionPay and Paypal, are currently excluded from designation creating an unlevel playing field.

This competitive disparity has cost around A\$770 million (in 2013 dollars) to the Australian payment system end-users since the regulations were first established and after higher cost, unregulated cards entered the market.<sup>4</sup>

Visa considers that the best way to achieve regulatory parity is through legislative reform. This RBA review, however, should at a minimum result in the PSB agreeing to exercise its current powers to regulate hybrid four-party schemes such as American Express GNS and new entrant four-party schemes such as UnionPay, as well as adopt equal regulation of all other open and closed loop schemes.

### *Interchange fees*

We note that the PSB has concerns over the existing interchange fee caps, and has raised for discussion the possible movement towards a hard cap as a means to benefit consumers and merchants.

Visa continues to advocate for the strong price signal played by interchange fees in balancing a 'two-sided' economic market that brings together and balances the needs of both consumers and merchants.

Visa recommends an amendment to the PSRA to end the regulation of interchange in Australia through the revocation of the limits on interchange fees. This would bring Australia back into line with the practice in which interchange is formally unregulated but is exposed to open and competitive market forces.

Our observation on the lowering of interchange fees – both in Australia and overseas – is that it is unlikely to deliver significant benefits to consumers. Lower interchange fees are likely to drive issuing banks to adjust their business models to ensure cost recovery and sufficient revenue, resulting in higher product fees and charges for cardholders, and possibly reduced access to credit particularly for lower-income consumers.

The knock-on effect to the economy from these changes would be detrimental, particularly when the Australian economy is in a low credit growth environment, household consumption is slightly below trend growth and where consumer sentiment (as a forward looking indicator) is at average levels despite low interest rates.

Visa considers that the policy decision to reduce interchange fees should be reconsidered and balanced by a proper economic and market impact assessment.

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<sup>4</sup> End-users include both consumers and merchants. Deloitte Access Economics Report is the Attachment to Visa's second submission. Available at [http://fsi.gov.au/files/2014/08/VISA\\_Attachment\\_A.pdf](http://fsi.gov.au/files/2014/08/VISA_Attachment_A.pdf)

Moreover, Visa firmly believes that maintaining a weighted-average interchange fee is essential for allowing the market to function efficiently. Replacing the current system with a hard cap arrangement will likely see all rates migrate toward the maximum cap, distorting market dynamics with respect to larger and smaller merchants and significantly reducing the incentive for industry innovation which a weighted-average interchange allows for.

Visa would be open to discussions with the PSB regarding the most effective way of operating interchange. One key option for discussion could be a more frequent (for example, annual re-weighting of the interchange basket) so as to minimise disruption to various business models while at the same time meeting the objectives of the PSB.

### ***Surcharging***

The PSB discusses the “three-tiered” approach to addressing excessive surcharging as originally recommended in the FSI’s Final Report. The PSB is considering a faster timeline for any changes to surcharging.

Visa continues to oppose the notion that merchants should be allowed to surcharge 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 the imposition of a limit on the level of surcharging for transactions based on cost and not limited to card.

- In relation to Tier One surcharging, Visa fully supports banning of surcharging low cost products such as Visa Debit, MasterCard Debit and eftpos transactions).
- In relation to Tier Two (surcharging on regulated Credit products proposed to be Visa Credit and MasterCard Credit along with new entrant four party schemes, such as American Express GNS, Diners and UnionPay) this could amount to a significant improvement for this class of Credit transactions when compared to the problems associated with the “reasonable cost of card acceptance” approach.
- In relation to Tier Three (non-regulated Credit schemes, such as American Express’s and Diner’s proprietary cards) we firmly believe that the RBA should regulate. However, should the RBA decide not take measures to formally regulate the closed loop proprietary card schemes, then it is essential there either be:
  - no cap on the surcharges applied to such transactions; or
  - a minimum cap mechanism that reflects the non-regulated status and commensurately much higher costs to merchants. To date, merchants have not all responded to high cost payment instruments by surcharging. This environment may lead to an unlevel playing field continuing.



Regardless of whether an overall surcharge ban is endorsed, or an enhanced limitation approach is enacted, it is critical that the approach is enforced via a statutory body that can monitor and enforce surcharging rules in Australia.

### ***Merchant related issues***

Over the past decade regulatory reform of the electronic payments sector has empowered merchants in a number of new ways with little or no benefit to consumers and in some instances higher prices through surcharge.

We are therefore not currently persuaded of the need to introduce new measures to promote merchant transparency, whether that be via amendments to existing Standards or through a new standalone merchant-related Standard.

Visa strongly opposes any measure that would infringe or require the 'easing' of its global Honour All Cards rule (HACR) to allow merchants the right not to accept certain cards. Consumers would have to incur significant inconvenience in determining if a merchant accepted his or her particular card with negative consequences for the overall usage rates of electronic payments.

### ***Dual Network Debit Cards***

The PSB is also considering how competing payment options on a single device have recently arisen in the case of Dual-Network Debit Cards. These are cards issued by banks and other financial institutions with point-of-sale (POS) debit functionality from two payment networks. Visa's view is that the current industry agreement on these matters is working well and there is no demonstrable need for additional regulation. In relation to new technologies and platforms in which dual or multiple card options may arise, we also see no market failures and a high risk of unintended consequences should regulation be imposed.

### ***Prepaid cards***

The PSB sought feedback on the regulation of Prepaid cards. Visa considers that Prepaid cards should continue to be formally excluded from the regulatory framework as they comprise a small proportion of the market. To regulate Prepaid cards could stifle innovation and detract from competition in payments and financial services more generally.

### ***Commercial cards***

The PSB sought advice on any other issues concerning card payments.

Visa strongly recommends that commercial cards should be removed from the interchange fee setting standard. Commercial cards are an efficient, low cost payment mechanism utilised

in business-to-business and government-to-business transactions, where market mechanisms and pricing differ significantly from consumer cards, are more likely to reflect the outcome of commercial agreements and 'terms of trade' between buyers and sellers making pricing regulation less relevant and likely to encroach on the commercial arrangements and payment terms agreed to by the parties to a transaction. If this does not occur, it is essential that pricing within the American Express proprietary business equally regulated, given their market share in the commercial space, and the fact that the business model outcomes for Visa/ American Express, MasterCard etc. are all very similar in the Commercial Card space.

### ***Implementation timeframe***

Finally, we welcome the commitments made by the PSB to recognise the significant changes that may need to take place to business models in the payments industry should any number of the reforms under review actually be implemented and your assurance there will be appropriate consultation periods and timeframes for implementation.

Visa considers that any reforms (such as surcharging) implemented independently of other options being considered by the PSB could undermine the overall intent of the PSB's review given the interconnections and dependencies between various aspects of the reforms.

Further, to account for system freeze periods and development lead times required to coordinate both Visa and Australian banks and merchant development efforts, structural interchange changes in the Visa system can take up to nine months to occur. Sufficient time will be needed so that all stakeholders can make the necessary changes.

# Chapter 1: The future of digital payments

## *Key points*

- Technology is fundamentally changing the relationship between consumers and the businesses that serve them. Looking forward to the next five, or 10 years, we are likely to see emerging technologies change everything again.
- The digital revolution has created an almost unlimited ability for companies – from start-ups to the world’s largest players – to participate in commerce by creating new experiences through mobile, tablets, PCs and future connected devices.
- This speed of innovation means it’s critical for the government and regulators to recommend changes that give the payment system ample room to adapt to future developments, both predicted and unforeseen.
- We note that in the Federal Government’s FSI process, a clear intent was outlined to ensure that technology is neutral to ensure that any mode of technology is agnostic to the regulations supporting its innovation, access and use. Visa supports an industry working group on these matters and we feel the RBA should play an active role in this group given its role as the payments regulator.

## 1.1 Introduction

Technology is fundamentally changing the relationship between consumers and the businesses that serve them. It has led to significant market and industry disruption and the payments industry is no exception. Looking forward to the next five, or ten years, we are likely to see emerging technologies change everything again.

It is impossible to predict exactly what the financial landscape will look like in the future, especially in the rapidly evolving world of payments. Payments innovation is being driven in large part by consumer choice – because consumers want ease and convenience, but also security. In particular, it is the rise of digital payments including mobile and online that presents the most opportunity and challenge for the payments industry today, but in the future we expect to see payments enabled across a range of connected devices.

Our personal access to networked devices is set to grow beyond mobiles, tablets and laptops to incorporate many of the objects used in day-to-day life. From wearable technology to car dashboards, these devices will be linked to each other and to the Cloud. In a world where everyday devices add greater automation and convenience to consumers’ lives (“The Internet of Things”), it is a reasonable expectation that people will want to use these connected devices to pay for goods and services, anywhere and at any time. Wearable computing technology is

set to explode in growth. US Research analyst BI Intelligence projects that by 2019 more than 148 million wearables alone will be shipped globally annually, up from 33 million units in 2014.<sup>5</sup>

## 1.2 Australia's experience in electronic payments

Although payment innovation is happening across the world, Australia is in a position to rapidly adopt new methods of digital payments.

Australians have one of the highest rates of smartphone ownership and they are using their devices to transact online at higher numbers, with double the amount of smartphone shoppers than in the UK or USA.<sup>6</sup> Australia is leading the world in contactless payments, with Visa payWave now representing over 60 percent of all face to face Visa transactions in Australia today.<sup>7</sup> Internet penetration in Australia exceeds that of Canada, USA, UK and Singapore and Australians are shopping online at rates higher than these countries.

Further, the EMV chip technology standard has been successfully adopted by Australian financial institutions and accepted by cardholders and merchants. The United States is now also adopting EMV technology with over 575 million cards and 45% of acceptance terminals projected to be EMV capable by the end of 2015. This will lower the risk of fraud and speed up the adoption of contactless and mobile payments.<sup>8</sup>

The digital revolution has created an almost unlimited ability for companies – from start-ups to the world's largest players – to participate in commerce by creating new experiences through mobile, tablets, PCs and future connected devices. As of 2014, there were over 1,500 active payment startups.<sup>9</sup>

New players are adopting new payment technologies (for example, QR, Bluetooth Low Energy) and are leveraging card on file capabilities to create new, interesting and compelling purchase experiences before, during and after the transaction. Many are more interested in the data than the transaction itself. Most are focused on mobile. A very significant proportion of consumers are quickly adopting these methods and merchants are using them to create frictionless purchase experiences.

Visa is driving the future of payments with a number of big innovations, for example:

- Proximity (face to face) payments through Visa payWave;

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<sup>5</sup> BI Intelligence ,The Wearable Computing Market Report, November 2014

(<http://www.businessinsider.com/the-wearable-computing-market-report-2014-10>)

<sup>6</sup> Tokenisation: Why Australia, Why Now white paper, February 2015 pages 21-22

[http://www.visa.com.au/aboutvisa/research/include/Tokenisation\\_Why\\_Australia\\_Why\\_Now\\_FINAL.pdf](http://www.visa.com.au/aboutvisa/research/include/Tokenisation_Why_Australia_Why_Now_FINAL.pdf)

<sup>7</sup> VisaNet (January, 2015)

<sup>8</sup> <http://pressreleases.visa.com/phoenix.zhtml?c=215693&p=irol-newsarticlePR&ID=1958165>

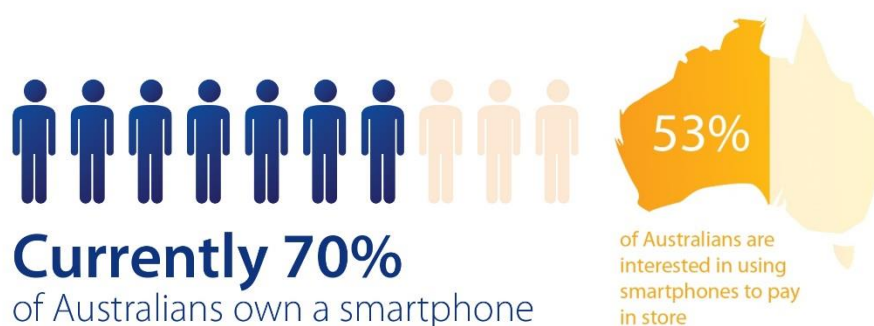
<sup>9</sup> Angel List start-up web portal, 2014 (<https://angel.co/payments>)

- Remote (online) payments through Visa Checkout;
- Peer-to-peer payments through Visa Direct;
- Enabling digital payments through Visa Token Service;

Already we are seeking Visa payWave move to the mobile. Australian consumers are choosing the convenience of contactless and the extension from cards to smartphones is a natural progression – particularly given the right infrastructure is already in place, with mobile proximity payments using the same technology as contactless cards.

Based on new research, currently 70 percent of Australians own a smartphone, providing a large potential user base for mobile payments.<sup>10</sup> This user base is ready to pay using their mobile device, with UMR Strategic Research for Visa finding that 53 percent of Australians are interested in being able to use their smartphone to pay in store.<sup>11</sup> It is these influences that give rise to the need for regulation that future proof the payments industry.

**Chart 1: Australia’s mobile commerce 2014**



The box below highlights a further example of the innovations that Visa is bringing to the market for future ways to pay.

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<sup>10</sup> Visa/UMR Strategic study, February 2015. The research was conducted by UMR Strategic Research Pty Ltd. Fieldwork was carried out between 21 November and 15 December 2014. A nationally representative sample of 1,000 consumers and 200 merchants were interviewed online, all aged 18 years and over.

<sup>11</sup> Visa/UMR Strategic study, February 2015 (see appendix for more details)

## TOKENISATION

Tokenisation replaces cardholder information such as account numbers and expiration dates with a unique series of numbers (a “token”) that can be used for payment without exposing a cardholder’s more sensitive account information. This is important, because people will transact in digital environments more and more, across multiple devices and applications.

Tokenisation hides the consumers’ confidential account information during digital transactions, making digital payments more secure. Tokenisation will bring an added layer of security to mobile and digital payments without adding friction to the shopping experience.

As new payment experiences evolve, so must the security measures that protect consumers’ confidential account information. This is core to Visa – to ensure ubiquity of secure service for everyone, everywhere.

### 1.3 The role of government in technology regulation

This speed of innovation means it is critical for regulatory settings and any regulatory reforms to ensure that the payment system has room to adapt to future developments, both predicted and unforeseen. We note that in the Federal Government’s FSI process, a clear intent was outlined to ensure that regulation is neutral to the mode of technology so as to support innovation, access and use.

Industry and regulators cannot afford to be retrospective and should aim to foster an environment that best aligns with the future market which is driven by consumer needs and will drive the industry forward. By enabling open access and competition, the industry can evolve with consumer trends and not be disintermediated by them.

More recently, the Harper Review into Australia’s Competition Policy (released on 31 March 2015), noted that innovative solutions pose challenges for regulators.

“Where regulation is inflexible, it may prevent markets from responding to innovative service offers that do not fit neatly within existing regulated categories. Regulation must be reviewed regularly to ensure that it is still required and not inhibiting the emergence of new service offerings. (Harper Review, p. 26).<sup>12</sup>

As we recently outlined in our submission the Federal Treasury’s follow-on review into the FSI recommendations, Visa supports an industry working group on these matters to identify areas

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<sup>12</sup> The Australian Government Competition Policy Review

of priority in the regulation of technology, including payments technology and new payment platforms.<sup>13</sup> We would also support inviting the non-financial system sector, such as telecommunication players given the increasing reliance on mobile handsets for payments. We feel the RBA in its role as the payments regulator, should play an active role in any such group. We firmly recommend that government and regulator policy guidelines should also explicitly incorporate technology neutrality as an additional criterion for assessing the impact of regulations to the financial services (including payments) sector.

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<sup>13</sup> Visa's submission to the Treasury's review of the FSI report (dated 31 March 2015) can be found at: <http://www.treasury.gov.au>.

## Chapter 2: Competitive neutrality

### *Key points*

- There is a lack of competitive neutrality in the regulation of payments in Australia, particularly in relation to interchange but also more broadly. This disparity has real and costly impacts, estimated at A\$770 million, for Australian merchants.
- Whilst we continue to submit that the best way to achieve regulatory parity is through legislative reform in the longer-term, the immediate review should act to equally regulate hybrid four-party schemes such as American Express GNS and new entrant four-party schemes such as UnionPay, at a minimum, but should also result in the equal regulation of all other open and closed loop schemes. Visa remains open to detailed discussions on how best to achieve this including on the issues of thresholds and the treatment of other value transfers.
- Any regulatory solution must aim to include newer models of payment schemes, such as PayPal and Alipay, along with likely future entrants enabled by the RBA's New Payments Platform (NPP).

### 2.1 Introduction

As outlined in various submissions made both in recent years and the more recent FSI and Post-FSI Treasury Inquiry, Visa feels that the lack of regulatory competitive neutrality in relation to interchange and interchange-like transfers is the major weakness in the Australian payments regulatory space. Our core recommendation is that these competitive neutrality issues be addressed by this Review.

Recently the FSI raised similar concerns with the way interchange is regulated in Australia, and in particular, the lack of competitive neutrality in the current framework. We acknowledge this as a very clear statement of concern with the current arrangements.

Recommendation 17 of the FSI final report stated: "Improve interchange fee regulation by clarifying thresholds for when they apply, broadening the range of fees and payments they apply to, and lowering interchange fees." In the context of the present RBA Review we will address the later suggestion in relation to interchange levels in Chapter 3 below. In relation to the level-playing field issue, the FSI paper went on to detail two relevant sub-concepts, namely:

- Publish thresholds for determining which system providers will be regulated, possibly based on a combination of annual transactions values and market share; and



- Broadening interchange fee caps to include all amounts paid to customer service providers in payment systems including service fees in companion card system.

These issues have been further elaborated in the RBA Issues Paper under the heading “Competitive Neutrality and Companion Cards” (pp. 32-33). We firmly agree with the RBA’s statement that:

“The emergence of American Express companion card arrangements is likely to have led to an increase in the overall issuance of American Express cards and increased the average number of credit cards consumers hold. This may have adversely affected the competitive position of other card schemes... there has been increase in the share of American Express and Diners in the credit and charge card over the past decade” (pp. 32-33).

The lack of competitive neutrality has had a negative impact on payment system end-users. Deloitte Access Economics reviewed the economic impact associated with the market share rise of companion cards. Using RBA data, Deloitte Access Economics assessed each of the following:

- The rise in the proprietary four-party schemes’ market share (by value, measured in percentages) over the period;
- The difference in merchant service fees between the regulated four-party schemes and the unregulated schemes (proxied by American Express); and
- Total purchase value.

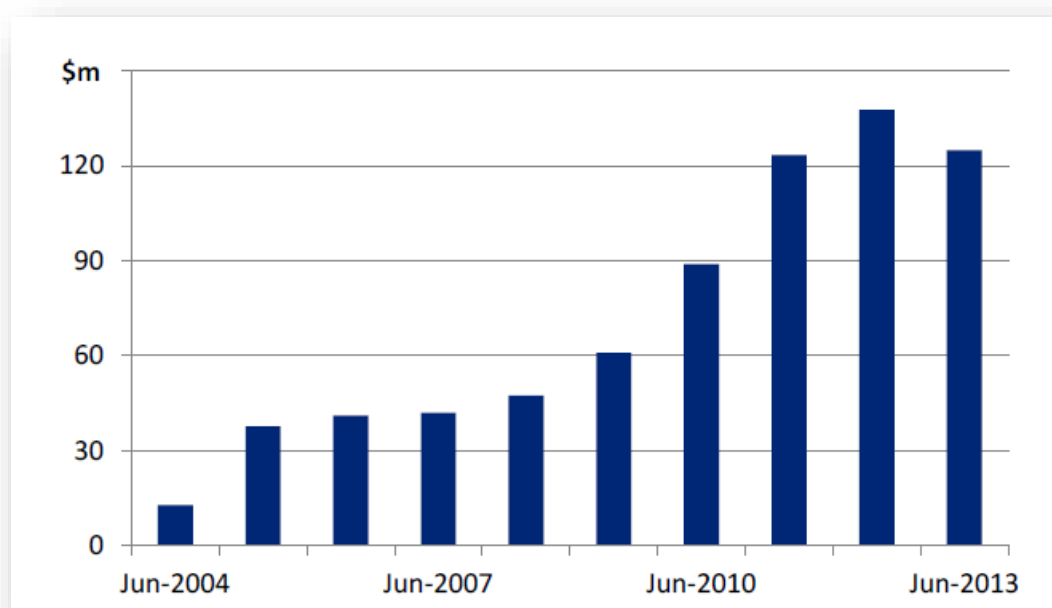
This research found that the uneven playing field has cost Australian payment system end-users A\$770 million (in 2013 dollars) since the regulations were first established and the resultant higher-cost, unregulated cards began entering the Australian market.<sup>14</sup>

In Visa’s view, the operation of surcharging alone has been ineffective in addressing this market distortion and formal regulation is required. As hybrid four-party schemes have gained market share they have gained additional market power that has in turn lead some merchants to conclude that surcharging such schemes differentially and above the surcharge levels imposed on Visa and MasterCard transactions is impossible. This leads to the practice of blended surcharging which dulls any desired price signals.

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<sup>14</sup> Deloitte Access Economics Report as the Attachment to Visa’s second submission. Available at [http://fsi.gov.au/files/2014/08/VISA\\_Attachment\\_A.pdf](http://fsi.gov.au/files/2014/08/VISA_Attachment_A.pdf)

**Chart 2: Direct cost to merchants caused by increases in American Express/Diners market share**



Source: DAE, RBA

The RBA Issues Paper goes on to ask for feedback on two specific issues, similar to those determined by the FSI in its final report, namely:

- Publishing thresholds for which payment system providers will be subject to interchange or related regulation, possibly based on transaction values and/or market shares, noting the growth and size of American Express and PayPal and the introduction of UnionPay, amongst others; and
- Broadening interchange fee caps to include payments between schemes and issuers such as marketing fees, sign-on fees, incentive fee and rebates that are present in four party and three party schemes.

Both of these issues are addressed below.

## 2.2 Publishing thresholds

As outlined in our FSI and Post-FSI Treasury submissions, Visa believes a legislative response that reforms the *Payment System (Regulation) Act 1998* (PSRA) is a more appropriate long-term solution to the unlevel playing field issues.

However, as the current RBA review is limited to reforms that would be permissible within the present powers of the RBA/PSB, we will limit our response to the questions for consideration.

However, we take this opportunity to again note our preference for amending legislation that would widen the definition of a payment system and put in place an automatic licensing regime for any entity wishing to run such a system, regardless of scheme structure and size.

Addressing the RBA's immediate question, and short of the above legislative solution, we believe both greater clarity and a degree of automaticity could be incorporated into the RBA/PSB decision-making process through the development and implementation of a threshold approach.

We would note that to determine the actual effectiveness of such an approach, much would turn on the numerical variables used to define a threshold and the level of any threshold. For example, any threshold structure that didn't immediately place the American Express four-party hybrid scheme above that threshold would be seen as fundamentally flawed by any fair observer. This is also true of PayPal and American Express proprietary.

Equally this approach would need to rest on automatic application to have efficacy. That is, we see little system benefit in the simple publication of thresholds if the passing of that threshold by a payment scheme didn't automatically trigger the entry into a level or level-like regulatory environment.

Finally, it may be appropriate to have multiple and possibly different thresholds for different types of entities. For example, for a four party scheme or hybrid four party scheme, the threshold may utilise market share or transaction volumes, whereas for a payment platform such as PayPal, it may use a different and more appropriate variable. Visa is open to sharing more detailed views on threshold composition issues as part of the ongoing consultation process.

In relation to wider regulatory rules, beyond those related to pricing, we see no basis for applying a threshold approach to the application of rules around surcharging. Our comments below cover our views on surcharging. We feel that surcharging rules are best applied to cover all schemes. For example, if one type of scheme is required to Surcharge then any scheme or payment platform with a No Surcharge Rule should also be required to repeal it.

### **2.3 Expansion of regulatory net**

The PSB is also considering the issue of broadening interchange fee caps to include payments between schemes and issuers beyond interchange, such as "marketing fees, sign-on fees, incentive fee and rebates that are present in four party and three party schemes" (RBA Issues Paper, p. 36).

We are concerned about the impact of additional or wider regulation on the Australian payments system but equally we note the RBA's reference to regulatory developments in the

United States and European Union (EU) and, more importantly, the linkage between this issue and ensuring any Australian reforms deliver a truly level playing field in relation to companion cards. There are certainly lessons from these international regulatory experiences, particularly the treatment of hybrid four-party schemes in the EU that are important to developing a way to a level playing field in Australia.

As such, Visa is open to further discussions with the RBA on this issue.

## **2.4 “Traditional” or proprietary Three Party Schemes and new models**

The above material and positions relate primarily to the way forward for creating a level-playing field between:

- currently regulated four-party schemes (Visa and MasterCard);
- new entrants schemes organised in the same manner as four-party schemes (such as UnionPay); and
- hybrid four-party schemes run by traditional three-party schemes (such as American Express GNS and Diners/Citi).

These schemes types are sometimes collectively called open-loop schemes. As discussed above, these regulatory disparities between similar open loop schemes require immediate rectification.

However, even if the above open-loop parity was achieved and a new regulatory “border” developed, there would remain an unregulated scheme type, namely the “traditional” or proprietary schemes such as the three party American Express and Diners schemes, collectively called closed-loop schemes.

We submit that closed-loop schemes should be regulated by the RBA. Without such action, a new regulatory arbitrage point will be created and the commercial entities that own and manage such schemes are likely to redirect growth and investment decisions into their expansion, leading to growth in higher-cost schemes and negative outcomes for merchants and consumers. Other schemes that currently do not operate closed-loop schemes may be encouraged to do so, potentially accelerating this trend. We are open to discussions with the RBA on how the regulation of closed-loop schemes might be achieved.

However, should such schemes not be formally regulated by the current review we note that it will prove essential that a formally differentiated/tiered surcharging structure be put in place with such non-regulated schemes eligible for surcharging in the highest tier. Equally, regulated schemes commercial cards businesses would need to be formally excluded from interchange caps so as to allow any chance of fair and sustainable competition. Both of these issues are dealt with in detail elsewhere in this submission.

Finally, beyond both open and closed loop schemes there are a range of newer models being developed and deployed in the Australian payments market, such as PayPal and Alipay. These will almost certainly be joined by likely future entrants enabled by the RBA's National Payments Platform (NPP). Visa welcomes working in market conditions that are fair, level and open to competition. However, we again underline the need for the inclusion of such schemes within the general regulatory regime (i.e. No Surcharge Rule removals) and pricing regulatory regimes.

## Chapter 3: Interchange fees

### *Key points*

- Interchange fees play a critical part in balancing a 'two-sided' economic market that brings together and balances the needs of both consumers and merchants.
- Visa recommends an amendment to the PSRA to end the regulation of interchange in Australia through the revocation of the limits on interchange fees. This would bring Australia back into line with the practice in which interchange is formally unregulated but is exposed to open and competitive market forces.
- Lowering interchange is unlikely to have the effect of benefiting consumers. International experience shows that issuing banks will adjust their business models to ensure cost recovery, resulting in higher product fees and charges for cardholders, and possibly reduced benefits and access to credit particularly for low-income individuals with little or no directly linked reductions in merchant prices.
- The knock-on effect to the economy from these changes would be detrimental, particularly when the Australian economy is in a low credit growth environment, household consumption is slightly below trend growth and where consumer sentiment (as a forward looking indicator) is at average levels despite low interest rates.
- Visa considers that the policy decision to reduce interchange fees should be reconsidered and balanced by a proper economic and market impact assessment.
- Maintaining a weighted-cap interchange fee is essential for allowing the market to function efficiently – replacing it with a hard cap arrangement will likely see all rates migrate toward the maximum cap, distorting market dynamics among larger and smaller merchants, and also disincentivising innovation. The huge growth in contactless payments in Australia has been due to the larger merchants, who have substantially more investment capital aimed at increasing the efficiency of their payments process.
- A more frequent re-weighting of the interchange basket may be a more appropriate means in addressing the PSB's concerns without disrupting the current business models and market.

### 3.1 Introduction

Before dealing with the specific options that the PSB is considering, Visa would like to reinforce the important market dynamics that occur in the setting of interchange rates.

Visa advocates for the importance of interchange as a mechanism to balance a 'two-sided' economic market that brings together and balances the disparate needs of both consumers and merchants. If the cost to merchants were too high, many businesses would stop accepting

cards, thereby disadvantaging the efficiency and effectiveness of the system, or drive consumers to alternative funding sources that are potentially less transparent or efficient. Similarly, if the cost to consumers were too high, it would limit consumer use of payments cards and, as a result, inhibit consumer spending and adoption of new digital technologies.

Accordingly, the payments industry should be able to self-regulate the fees based on market demand. Visa balances interchange to maximise use of electronic transactions and benefits to both sides of the market. In effect, interchange is the mechanism through which economically efficient outcomes are achieved. Visa therefore refutes the point that interchange is used to 'drive up interchange fees and costs to merchants, with adverse effects on the efficiency of the payments system (RBA Issues Paper p. 9).

Thus, Visa has traditionally set lower rates for certain segments to reflect 'buyer' perceptions of value vis-a-vis other payment mechanisms (for example, grocery stores, petrol, even charities), while it sets higher rates for transactions at merchants where the value of Visa's network is more universally acknowledged and material (for example, merchants that represent higher risk to other participants in the payment system or higher end merchant categories (for example, e-commerce merchants, who pose a higher fraud risk, with its attendant costs on issuers, acquirers, and cardholders).

Importantly, to set interchange fees effectively, Visa must engage in a precise and nuanced analysis of the marketplace along multiple dimensions. There is no "one size fits all" solution that is likely to balance consumers and merchants in all countries.

Moreover, the electronic payments sector is a fiercely competitive marketplace that is growing more competitive. As discussed in chapter 1, an array of new competitors have entered the market, including both well-known companies such as PayPal, Google and Alipay, as well as lesser known (but increasingly successful) startups such as Square, iZettle and Weve. These entrants, as well as the traditional card companies, have all brought a host of innovations to market, including, for example, mobile payments and wallet technology.

In summary, Visa recommends an amendment to the PSRA to end the regulation of interchange in Australia through the revocation of the limits on interchange fees. This would bring Australia back into line with the practice in which interchange is formally unregulated but is exposed to open and competitive market forces. The conduct of payment systems and other market participants would of course always remain subject to Australia's competition laws, which are a fundamental limit on the ability of any firm to act anti-competitively. This would also recognise the reality that regulation has not provided clear benefits to the Australian payment system, but instead has constituted a wealth transfer from Australian consumers to Australian merchants.

### 3.2 Lowering interchange fee caps

It has been suggested that a further lowering of interchange fee caps could improve the efficiency of the payments system. The central contention here is that 'low cost' in this one component of the payment value chain, equates to efficiency; that lowering interchange fees will reduce merchant service fees, which will ultimately benefit consumers. Although the PSB recognises that there will be transitional costs and considerable disruption to existing business models as a result of lowering interchange fees, it is believed that the benefits of doing so will benefit merchants who in turn will pass on these reduced costs to consumers.

As a global electronic payment provider, Visa has unique insights into the likely outcomes of further regulatory intervention in this area. In Visa's view, no attempt to regulate interchange fees anywhere has ever effectively balanced the interests of merchants and consumers (cardholders). Unquestionably, retailers have received a windfall in lower acceptance costs and increased profits and there is no evidence to show these have materialised as lower prices for consumers at the POS. Card payments end up further subsidising the tacit and explicit costs of cash alternatives.

In their paper from 2014 entitled "Price Controls on Payment Card Interchange Fees: The U.S. Experience", Zywicki, Manne and Morris found that, following the capping of Debit interchange in the U.S., via what is known as the Durbin Amendment, most large retailers have seen significant cost reductions, yet to date there is no evidence that those cost savings have been passed-through to consumers.<sup>15</sup>

They also found that while consumers have seen large and immediate increases in the cost of bank accounts (see below), to date there is no evidence of reduced prices at retailers and they estimate that as a result of the Debit interchange caps, there would be a transfer from low-income households to large retailers and their shareholders. Further, as banks have been unable to profitably service lower income accounts where opportunities to ethically exploit fee revenue opportunities are minimal, the US has seen banks jettison customers that deliver lower profitability to maintain their commitments to their shareholders. The resulting increase in the number of 'financially excluded' customers in the US was far from what the regulators had in mind when they introduced the Durbin legislation.

Cap reductions will not only impact the respective position of merchants in the payments system, issuers too will need to respond. Issuing banks normally adjust their business models to ensure cost recovery through changes to product fees and charges and if interchange revenue is radically reduced by regulation they may need to respond in some of the following ways:

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<sup>15</sup> [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2446080](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2446080)



- increasing Credit card interest rates;
- increasing annual fees; and/or
- introducing a transaction fee; and
- diluting the loyalty program offerings and benefits.

These changes can have detrimental effects to consumers accessing credit and economic growth more generally. When used responsibly<sup>16</sup>, especially by transacting consumers, Credit cards 'smooth' the irregularities in income and expenditure patterns and can increase individual financial stability. Moreover, through funding consumption, Credit cards play an important role in Australia's economy.

As a consequence of issuers' responses, there is likely to be less credit growth in the economy as consumers are deterred from using Credit cards associated with higher fees and/or diluted rewards/loyalty offerings. The knock-on effect to the economy would be detrimental, particularly when the Australian economy is in a low credit growth environment, household consumption is slightly below trend growth and where consumer sentiment (as a forward looking indicator) is at average levels despite a low interest rate environment.<sup>17</sup>

Visa considers that the policy decision to reduce interchange fees should be reconsidered and balanced by a proper economic and market impact assessment.

For these reasons, Visa sees no clear public policy case for any further reduction of interchange rates overall. Based on international experiences (which we discuss in section 3.3 below), such a measure would see no benefits to the overall payments system, it would simply move resources towards merchants with no net gain for consumers.

As discussed in Chapter 2, if interchange fee regulation remains in Australia, then it must cover all three and four party schemes to ensure all players are competing on a level playing field. Regulating Amex on a level playing field will be the single most important step to addressing any regulator and merchant concerns with how the basket mechanism operates. Without doing so, there will continue to be a market distortion between American Express GNS cards and other schemes, such that non-regulated schemes can continue to offer higher cost programs with more rewards and other benefits to its cardholders, despite being considerably more expensive to the merchant (and likely subsidised through bundled pricing for regulated

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<sup>16</sup> All Australian credit providers are expected to lend responsibly as a consequence of having an Australian Financial Services licence issued by the Australian Securities and Investment Commission (ASIC) as set out in the National Consumer Credit Protection Act. See <http://asic.gov.au/regulatory-resources/credit/>

<sup>17</sup> See most recent RBA Chart Pack and Monetary Policy Meeting of the RBA Board at <http://rba.gov.au>

scheme and cash alternatives). This stands contrary to the objectives set out by the PSB in ensuring that merchants have access to low cost of acceptance.

### 3.4 Replacing the three-year weighted-average caps with hard caps

The FSI and PSB reviews have raised the option of replacing the three year weighted-average cap with a hard cap. One of the key reasons offered is to allow schemes to set interchange schedules to normalise and set interchange schedules between smaller merchants with less bargaining power, which claim to face higher payment costs, with larger merchants that do have bargaining power and leverage this for lower interchange. Furthermore, the PSB review notes that the current system has meant that weighted-average interchange fees for MasterCard and Visa schemes have typically been above the caps.

In the event that interchange rates are capped at a hard rate, this would essentially result in fixed interchange rates. That is, if interchange rates are hard capped this will likely see all rates migrate toward the maximum cap. There would be a number of unintended consequences associated with moving to hard capped rates:

- **Higher rates in many cases** – as outlined above, all rates below the new hard cap could be expected to move to that new cap. This has been the experience internationally. In the Australian context this could see the ending of or the tighter use of strategic merchant rates, increasing costs for key merchants, impacts on the ability to include industry rates, again impacting key sectors, and likely higher costs from what are currently “low rate” cards.
- **Limiting market innovation** – Interchange has been a key driver for the deployment of market innovation. An example of this was that interchange supported the roll out of EMV and Visa payWave through strategic rates to deploy EMV usage and payWave terminals. The huge growth in contactless payments in Australia has been due to the larger merchants, who have substantially more investment capital aimed at increasing the efficiency of their payments process. Without the investment, made possible by variable interchange, these organisations may have been disincentivised from investing in contactless terminals, resulting in net more cash being used in the economy, with the resultant economic costs.
- **Risk and Fraud management** – Interchange has been used in other markets to provide incentives to introduce risk services such as Verified by Visa. This is also used on international interchange.
- **Product differentiation** – Product differentiation is important to correctly align the value that merchants and issuers receive from different customer types. A payment provider outside of the regulations will have the ability to drive a stronger consumer value proposition.

Further, such a move would limit the ability for issuers to offer appropriate products to premium cardholders and result in greater focus on cardholders that pay interest, but deliver less value to merchants (because they are lower spenders).

Moreover, normalising the interchange rates paid by small and large merchants would disincentivise the ability for schemes and acquirers to ensure that innovations are deployed rapidly as was the case with Visa payWave and EMV.

### **3.5 Increased frequency in the interchange rate three-year reset cycle**

The PSB has proposed a more frequent benchmark observance (RBA Issues Paper, p. 36) to reduce what the PSB has described as the upward 'drift' in average interchange rates under the current three-year reset mechanism.

Visa is open to further discussions with the RBA on this issue, although we note that a reduced timeframe for interchange reset, such as one year re-weighting, could limit the desirability for launching new products as the interchange certainty to support the new product would be applied over a shortened timeframe. A slightly longer timeframe may be more appropriate in these circumstances.

### **3.3 International experiences with interchange regulation**

As referenced above, we feel it is useful to reference international experiences to underline our present policy positions.

#### ***The United States experience*<sup>18</sup>**

The effects of the Durbin Amendment for consumers – especially low-income – and small businesses have been very negative where the average interchange fee was reduced by 52 percent. Large retailers gained a US\$8 billion windfall without passing on savings to consumers.

Given that the interchange revenue of the banks has reduced, the banks implemented new charges and increased fees to offset costs. The cost of imposing such regulations has impacted on consumers – a study by David Evans cites this to the tune of between US\$22 and \$US25billion.<sup>19</sup> Savings have not been passed on to them and it provides further evidence as

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<sup>18</sup> If we turn to the United States, the Durbin Amendment enacted on July 21, 2010 as part of the Dodd-Frank Act, required the Federal Reserve Board to develop a set of rules on Debit card interchange fees and to regulate network exclusivity and routing arrangements of card networks and banks. The new rules limit the size of the interchange fee that can be received by large banks. Available at <http://www.gpo.gov/fdsys/pkg/FR-2012-08-03/pdf/2012-18726.pdf>

<sup>19</sup> David Evans, *Payments Innovation and Interchange Fee Regulation: How Inverting the Merchant-Pays Business Model Would Affect the Extent and Direction of Innovation* (June 27, 2011).

to why interchange fees should not be regulated or capped in any market.<sup>20</sup>

Reducing access to bank accounts for these consumers may drive them to more costly forms of financial services, as payday lending and pawn shops has increased approximately 125 per cent since 2008.<sup>21</sup> The Australian Securities and Investment Commission has recently expressed their concern about the payday lending sector and the need to improve compliance and that the sector was 'on notice' given that consumer protections such as responsible lending obligations were in breach.

In sum, the Durbin Amendment has been a benefit to some retailers, but at severe costs to the consumers, banks, other retailers and payments innovation generally. Further, consumers have yet to reap any benefits from the Durbin Amendment, as retailers have not passed on cost savings.

### ***The European Union experience***

As mentioned in the RBA Issues Paper, the EU has recently undertaken wide consideration of payments regulatory issues, including approaches to the regulation and management of interchange.

Most relevantly to the matters raised by the PSB we note that the EU has agreed that hybrid four-party schemes should be regulated. In addition, the EU has determined that merchant choice cannot override consumer choice (addressed in chapter 5 below) and that interchange associated with Commercial Cards should be excluded from regulation (addressed in chapter 7 below).

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<sup>20</sup> See Ian Lee, Geoffrey A. Manne, Jilian Morris and Todd Zywicki *Credit Where It's Due*, (2013) for more detailed account.

<sup>21</sup> ASIC, *Payday lenders and the new small amount lending provisions*, (March 2015), p. 7 available at <http://download.asic.gov.au/media/3038267/rep-426-published-17-march-2015.pdf>

## Chapter 4: Surcharging

### *Key points*

- Visa continues to oppose the ability for merchants to surcharge 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 the ongoing imposition of a limitation on the level of permissible surcharging of transactions.
- Regardless of whether an overall surcharge ban is endorsed, or an enhanced limitation approach of some form is enacted, it is critical that the position be enforceable via empowering a statutory body with powers to monitor and enforce surcharging rules in Australia such as the ASIC or ACCC.

### 4.1 Introduction

Visa has been concerned for many years now that the prevalence and excessive levels of surcharging in Australia are negatively impacting Australian consumers. The surcharging problem in Australia is more extensive and widespread than nearly any other advanced market in which Visa operates. Changes and reforms to regulations in past years have, unfortunately, insufficiently addressed the problem despite the best of policy intentions, with excessive surcharging still being a widespread practice across the country. Excessive surcharging has also been raised by the PSB and FSI final report.

It is Visa's position that excessive surcharges in Australia have been an unfair cost burden on consumers. Penalising consumers via surcharges for using secure, transparent and reliable electronic payment systems is a practice we have always strongly opposed in the best interests of consumers. There is no evidence that shows that surcharging has led to a reduction in prices charged by merchants. Visa's view about the need to limit surcharging remains despite the changes put in place by the RBA in 2012 and which took effect from March 2013 that allowed a voluntary "reasonable cost of card acceptance" limitation to be put in place by card schemes.

Visa is committed to playing a role in addressing excessive surcharging, although we believe that the current means of implementing the "reasonable costs of card acceptance" test places Visa squarely as the quasi-regulatory umpire with merchants and acquirers – a position which is problematic on many levels.

### 4.2 Prohibition on surcharging

In line with Visa's global policy positions, we believe that surcharging should be banned as we believe surcharging disincentivises the uptake of efficient electronic payments to the detriment of consumers and is very frequently in excess of the merchants true costs of acceptance.

Surcharging, especially excessive surcharging, also reduces the overall efficiency of the payments system and is usually concentrated amongst merchants who have control of certain industries or captive consumers, such as airlines, hotels and taxis. Surcharging is now prevalent across not just Credit card transactions but also Debit card transactions.

We contend that a 'no surcharge rule' for transactions in Australia, coupled with a clear approach to enforceability of such a rule via a statutory authority, would be a pro-consumer policy package. It would certainly be the case that for regulated schemes, if interchange caps were lowered beyond current levels, there would be no justification for allowing any surcharging on regulated transactions, either Debit or Credit.

Policymakers need to balance industry regulations with consumer benefits. On surcharging, despite recent intervention, the market is failing consumers with excessive surcharges still a feature. As such, a direct intervention is warranted by policymakers.

### **4.3 Enhanced limitations on surcharging**

If surcharging is not to be prohibited in the Australian market, Visa supports the imposition of a limitation on the level of permissible surcharging of transactions. However, we believe that the limitation could be improved so as to provide improved market outcomes, enhanced consumer protections and clearer arrangements for merchants and acquirers in order to avoid excessive practices, including profiteering.

An environment with no limitation in place, as occurred between 2003 and 2013 is untenable and not in Australian consumer end-user interests. It is important however that this limitation be clear, quantifiable and commonly understood by all parties.

We do not feel that a blanket continuation of the status quo (i.e. the current RBA developed approach which uses the "reasonable cost of card acceptance" as set out in the RBA Guidance Note) is tenable, although this may form an effective element in the below tiered approach.

#### ***Ban Debit surcharging***

It is Visa's strong view that at a minimum, surcharging on Debit transactions should be prohibited. Debit is a highly regulated, low cost and very popular form of electronic payment in Australia. Schemes have largely priced Debit intentionally to be a mass consumer use payment option. Visa would contend that with the rise of contactless Debit, including with the forthcoming introduction of contactless technology by EPAL, the cost of Debit in Australia is arguably lower to the system than cash and comes with all the additional benefits of electronic payments over their cash alternatives, such as transparency, revenue collection and lower security costs. Enforcement of a blanket ban would also become significantly easier, regardless of who had carriage of that the enforcement role, i.e. a public regulatory or schemes.

As such, regardless of the surcharging arrangements covering other forms of electronic payment such as Credit cards, the RBA should take this opportunity to ban surcharging on Debit cards.

### *Tiered approach*

Chapter 5 of the RBA's Issues Paper discusses as one option, the "three-tiered" approach to addressing excessive surcharging as originally outlined and recommended in the FSI's Final Report. Under this approach firstly surcharging on Debit would be banned (this would include Visa Debit, MasterCard Debit and eftpos transactions as Tier One). Secondly, surcharging on regulated capped Credit products, ideally those currently regulated (Visa Credit and MasterCard credit) along with new entrant four-party schemes, such as American Express GNS, Diners companion cards and UnionPay would be limited to a numerically quantified cap set by the PSB, forming Tier Two. Then finally, non-regulated Credit schemes, such as American Express's and Diner's proprietary cards businesses would operate under the existing "reasonable cost of card acceptance" limitation as Tier Three.

Visa immediately offers our support for the approach proposed for Tier One – as outlined above we recommend that this measure be implemented regardless of how or if other tiers are established and limited differentially.

In relation to Tier Two, we believe this could amount to a significant improvement for this class of Credit transactions when compared to the problems associated with the "reasonable cost of card acceptance" approach. Almost immediately several industries with egregious surcharging practices would have to significantly cut their surcharge levels, such as the taxi industry, and enforcement would become easier, although not as simple as for the Debit environment.

However, there are some areas of concern for discussion prior to implementation of such an approach. The fact some merchants who today do not surcharge such Credit transactions may start doing so once such a "regulated" cap is created is of some concern as are questions of how the PSB would calculate the level. The approach contained in Tier Two would be a system enhancement over today's arrangements for this class of products particularly as a means to send differential price signals vis-à-vis any higher prices schemes that may continue to operate outside formal interchange/interchange-like pricing regulation.

We note that the recently concluded EU regulatory framework completely excludes surcharging on all regulated transactions, that is, if applied to Australia, all transactions in Tiers One and Two would be merged into one tier and surcharging prohibited across that full tier. We submit that this outcome is certainly worth consideration by the PSB.

In relation to Tier Three, we firmly agree that should the RBA decide not take measures to formally regulate the closed loop proprietary card schemes (and as outlined in the Competitive Neutrality section above we firmly encourage that such systems are brought within the regulatory net to avoid a new wave of arbitrage), then it is essential there either be no cap on the surcharges applied to such transactions or a cap mechanism that reflects the non-regulated status and commensurately much higher costs to merchants.

There has been some suggestion that this third tier may also be extended to include sub-types of Credit products offered under the regulated capped schemes. We feel that this would be inappropriate. Under the regulated basket mechanism in place today there is already downwards pressure exerted on the higher end of the interchange hierarchy as a result of the need to balance the tri-annual interchange basket. Presupposing an averaging mechanism was maintained in some form, even with possible modifications, this pressure would continue. Those schemes that could continue to sit wholly outside any regulatory net would experience no such pressures so placing both offering in the same tier would, in our view, be unfair and unjustified. That is, all regulated offerings should remain in Tier Two, or non-regulated offerings should remain in Tier Three. We feel that it is appropriate this also apply to newer or other previously unregulated payment means such as PayPal and BPay.

Finally, while Visa is encouraged that this tiered model would potentially provide significantly greater clarity to consumers, merchants, acquirers and schemes on what types of transactions can and cannot be surcharged and how, there is inherently some degree of complexity in this approach. As such we believe that a tiered system would need to be complemented by a robust approach on enforceability, including an empowered statutory body which could monitor and enforce the rules (see below).

Visa would be happy to discuss together with RBA and industry partners the pros and cons of such an approach, in order to better understand whether this could be a realistic policy solution.

### ***Sector specific surcharge limits***

The concept of specific limits or caps on permissible surcharge levels by sector is raised in the RBA Issue Paper. A particular possibility of allowing schemes to adjust their rules to allow the inclusion of caps on surcharges that are not percentage-based at some low fixed-dollar amount, resulting in lower surcharges for low-value purchases. Overall, Visa is more supportive of system-wide solutions such as a ban or the tiered approach. Having said that, we are open to considering RBA measures for sectors where past approaches have proven unsuccessful in addressing excessive surcharging behaviours.



## 4.4 Enforceability

Regardless of whether an overall surcharge ban is endorsed, or an enhanced limitation approach is enacted, it is critical that the position be enforceable. As such we strongly support creating enforceability of any policy approach to surcharging via empowering a statutory body with powers to monitor and enforce surcharging rules 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 very challenging. In our view it is empirically clear from actual events since the 18 March 2013 commencement of Visa's efforts to enforce the current regime that a statutory authority will stand the best realistic chance of bringing about a reduction in excessive surcharging. This holds true whether a ban or an enhanced tiered limitation mechanism is supported and implemented.

It could be argued for example that existing regulators have the infrastructure that may allow them to effectively discharge enforcement responsibilities more effectively than card schemes. For example ASIC and the ACCC both have consumer hotlines that could be utilised for consumers to inform them about excessive surcharging practices in the market. It is certainly the case that Australian consumers perceive of the need to be able to access such reporting mechanisms in relation to surcharging. In a 2013 UMR poll 74 percent of Australians (77 percent of cardholders) believed the then Government was not doing enough to protect them from excessive surcharges. Solutions that consumers supported in the 2013 research include:

- 79 percent (80 percent of cardholders) support a complaints phone line or website where customers can report excessive surcharging; and
- 67 percent support a Government agency to resolve disputes and enforce any rules on surcharging where customers feel they have been unfairly surcharged

As an example, legal developments in the UK on surcharging have included appointing the UK Office of Fair Trading with this task. In the Australian context, we feel that one of either ASIC or the ACCC are already established statutory authorities that are natural candidates who would be well equipped to take up this function.

Visa understands the limitations that currently exist in relation to the RBA's powers under the PSRA in relation to enforcement of merchant surcharging limitations. As such, we submit that the RBA (i) convene a cross-regulator working group between itself, ASIC and the ACCC to determine, finalise and publish the roles and responsibilities of each agency in relation to this issue, including gaps in enforcement responsibility and resourcing, and (ii) formally recommend to the Government any legislative and amendments and funding approaches to close identified gaps.

## Chapter 5: Merchant related issues

### Key points

- Over the past decade regulatory reform of the electronic payments sector has empowered merchants in a number of new ways with little or no pass through to consumers.
- We are therefore not currently persuaded of the need to introduce a number of the measures to promote merchant transparency whether that be via amendments to existing Standards or through a new standalone merchant-related Standard.
- Visa strongly opposes any measure that would infringe or require the 'easing' of its global Honour All Cards rule (HACR) to allow merchants the right not to accept certain cards. Cardholders would have to incur significant inconvenience in determining if a merchant accepted his or her particular card. This would ultimately have negative consequences for the overall usage rates of electronic payments.

### 5.1 Introduction

Over the past decade regulatory reform of the electronic payments sector has empowered merchants in a number of new ways. In some cases, limits have been imposed on long-standing pro-consumer schemes rules in favour of merchant positions and the regulated lowering of some costs. The benefit of these types of changes both in Australia and globally has flowed primarily to merchants with little or no evidence of a pass through to consumers.<sup>22</sup>

Visa believes in an open, fair and competitive payments environment in which all parties add value for the benefit of Australian consumers and the wider economy. Markets work most efficiently when competition is allowed to happen. In our view, commercial arrangements should be left separate when considering policy initiatives to enhance transparency for merchants. The addition of further regulation, specifically in favour of merchants risks undermining existing commercial relationships, reducing consumer choice and slowing the uptake of electronic payments.

We are therefore not currently persuaded of the need to introduce a number of the measures discussed in the RBA Issues Paper (Chapter 4, pp. 25-26) to promote merchant transparency, particularly at the transaction level, whether that be via amendments to existing Standards or through a new standalone merchant-related Standard.

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<sup>22</sup> See: "Plastic stochastic - Capping fees on card transactions has not worked out as planned" *Economist* 4 Oct 2014 <http://www.economist.com/news/finance-and-economics/21621882-capping-fees-card-transactions-has-not-worked-out-planned-plastic-stochastic>

## 5.2 Transparency

Visa is fully committed to managing a modern payments scheme that is both transparent and effective for all participants. Visa's rules are published and our management processes are fully transparent. Our system is carefully designed to strike the right balance between system transparency, appropriate commerciality and the costs to all players of managing large volumes of complex data. Our partner financial institutions take a similar approach.

On the specific issues raised in Chapter 4 for review, Visa has the following initial observations.

### *The need for a visual and electronic identification of Credit versus Debit cards*

Visual identification that allows players to distinguish between Debit and Credit cards is already widely implemented, offering useful disclosure to both cardholders and merchants.

Requiring by regulation that all cards be further identifiable both visually and electronically by exactly the level of interchange applying would impose a considerable regulatory burden on business with significant additional costs. In the majority of cases, especially in high volume commercial situations, neither merchants nor consumers are likely to be able to assess or benefit from detailed additional information on interchange rates at the point of sale.

Other technical issues further establish the unworkability of this proposal including the fact that the card duration of physical cards, based on expiry date, can overlap differently with interchange re-set periods hence it would be unfeasible to keep the relevant interchange cost current. Furthermore, interchange is only one component of the merchant service fee cost hence is not a straight line relationship.

Moreover, as form factors change and we move towards new payment technologies such as mobile platforms, the visual display of plastic cards will increasingly become obsolete.

### *The ability for merchants to obtain reliable and timely lists of Debit and Credit BINs from the international schemes*

Visa has made all BIN tables available not only to acquirers, but also directly to merchants. While Visa does not hold direct contractual relationships with merchants, we have developed tools for merchants who desire detailed BIN information to access this from Visa Online. Any merchant is entitled to access this information – they are able to obtain access to Visa Online by contacting their acquirer. Merchants could then choose to use this information to develop technical capabilities in their POS technology in order to recognise between Debit and Credit BINs on cards at the POS.

Going forward, Visa is willing to assist industry through a more targeted communications campaign to ensure that both merchants and acquirers are aware of the availability of this tool.

We do not believe that this issue requires formal regulatory intervention.

### ***A requirement for acquirers to price their electronic payment services to merchants in a fully unbundled manner***

Pricing is a commercial contractual matter between two entities, and, in our view, market based solutions are the most appropriate approach. Current market practice is that many acquirers offer merchants “interchange plus” pricing as well as a range of single payment fixed monthly charges to meet varying needs. We would also note, however that for many merchants a single, simple price might be preferable. Some merchants (such as small and medium enterprises in quick-service environments for example, an independent coffee shop) might prefer obtaining a blended rate from their bank, to ensure quick service and ease of accounting when tallying up sales. That, however, is a commercial matter.

### **5.3 Honour all Cards Rule**

Honour All Cards rule (HACR) is an international rule that forms the basis of Visa’s global value proposition. The policy ensures that a Visa card issued in one market will be accepted anywhere that a Visa logo is displayed around the world. Most international payment systems, including proprietary systems (such as American Express and Diner’s Card), along with regional ATM networks all deploy similar policies, whether globally or regionally in the case of the latter example.

The RBA Issues Paper (p. 38) raises the question as to whether the HACR might be altered to allow merchants to decline to accept cards with “high” interchange rates, that is, schemes would effectively prevented from enforcing their HACR, except with respect to products below a certain rate of interchange.

For the reasons below, Visa is of the view that the RBA should not require that card schemes allow merchants to refuse acceptance of some cards.

HACR is pro-competitive and benefits all those along the value chain of a transaction, including consumers, merchants and the member financial institutions of the relevant scheme. For consumers, the rule guarantees their card will be accepted anywhere at the 35 million Visa acceptance points globally, without worrying whether their card might be accepted regardless of the card’s issuing bank or product type. This is critically important in an international environment where language and culture may be an issue. Consumers have the full ability to choose how they want to pay for what they are purchasing.

For merchants, the rule is the basis of the guarantee that merchants will be paid when a transaction is authorised and approved, no matter where the Visa-branded card comes from. It also guarantees that consumers have the broadest variety of methods available to them to pay, which has clear demonstrated benefits in terms of increasing merchants sales volumes. For their part, Visa’s banking partners benefit from the ability to issue cards knowing that they can be used with universal acceptance no matter where the consumer is making a transaction.

For consumers, modification of the existing HACR would have negative consequences. Absent the assurance from HACR, the cardholder would incur significant inconvenience and uncertainty (and in some cases significant cost finding an alternative merchant that accepted

the card – for example, if a hotel refused to accept a card at check-in), thereby diminishing the value of the card to the cardholder. Cardholders would have to incur significant inconvenience in determining if a merchant accepted his or her particular card.

These negative experiences could also harm the overall usage rates of electronic payments. Facing this increased inconvenience outlined above, fewer cardholders would carry the card, and those that did would use it less. As they did so, given the two-sided nature of this market, the card then would become less valuable to merchants and fewer merchants would accept the card, making it less valuable to cardholders and setting off another cycle of diminished use and acceptance.

Given the above, Visa strongly opposes any measure that would infringe or require the ‘easing’ of our global HACR to allow merchants the right not to accept certain cards. We would also propose that the RBA treat merchant transparency and differential surcharging separately from the HACR.

#### **5.4 Differential surcharging**

Please refer to Chapter 4 on Surcharging for Visa’s views on differential surcharging as they relate to merchant transparency.

#### **5.5 Consumer choice and the routing of transactions**

Visa strongly supports the principle that consumers in Australia should have a choice of preferred payment options and channels. Any regulation which undermines that right would infringe consumer rights and undermine the longer term viability of the electronic payments system.

The introduction of mandated routing and exclusivity requirements would eliminate consumer choice and the ability of payments companies to deliver secure, reliable and innovative services to the consumer. Routing requirements would potentially undermine data security, innovation and customisation, all in an effort to artificially drive down retailer costs and issuer revenue.

At present consumers in Australia can set up their Visa-eftpos Dual Network Debit cards (DNDCs) to access multiple accounts that are linked to the ‘Cheque’, ‘Savings’ and ‘Credit’ buttons on the POS terminal. This functionality is managed by the issuing bank and offers convenience to the consumer who can manage their usage of multiple transaction accounts on one card, for example, their transaction account and home loan offset account that is linked to one card. A consumer can choose which account funds are drawn from when they make an EMV contact transaction, therefore being able to manage their funds and overall liquidity position.

Since 2009, issuers have had contactless cards available, and consumers have been adopting these transactions based on the convenience, security and control they expect from a Visa transaction. Customers have built expectations that their contactless transactions on a Visa Debit card will be debited from the same account the “Credit” button is linked to. In many

cases this includes their mortgage offset account and is therefore vital to their financial management planning that this transaction mapping continues.

As an example, if a merchant was to re-route a contactless Visa Debit transaction without the consumer's knowledge, funds could be drawn from another account that the customers did not expect or want, potentially impacting transactional account balances and the customer's liquidity position for example, reducing the balance in an offset account.

There are further consequences that could occur if a Visa transaction was rerouted without the consumer's knowledge or consent (see following box).

#### **EFFECTS OF VISA TRANSACTION BEING REROUTED**

1. A Visa transaction gives cardholders the following benefits that may not exist from another network:
  - Visa Zero liability policy protects cardholders from fraudulent charges or unauthorised purchases made through a Visa transaction. Visa Zero Liability is a policy that all Visa issuers in Australia subscribe to and offer to their cardholders.
  - Visa chargeback rights give cardholders a framework to dispute erroneous transactions, for example when there is a clerical error and a transaction has been processed twice, if goods purchased are not delivered and if the quality of the item is not as had been described. These chargeback rights have strict guidelines to protect the cardholder and merchant, and are proprietary to Visa.
  - Fraud monitoring from Visa systems that raises alerts to the issuer who can monitor and manage fraudulent transactions.
  - The opportunity for cardholders to experience Visa marketing assets through participation in competitions through usage such as winning a trip to the Olympics, tickets to a concert or a trip overseas which are run regularly and on an annual basis.
2. Visa issuers attach various proposition benefits to Visa-only transactions. One such example is where that Visa Debit cards offer travel insurance, purchase protection and extended warranty. If a transaction is routed by a different network cardholders would no longer be eligible for these benefits without the cardholder knowledge at the point of sale. Routing via a different network will impact the consumer experience by removing these expected benefits.
3. Impact on issuer customer service.
  - Consideration should also be given to the impact on issuers dealing with customer queries and complaints in branches and contact centres relating to transactions being routed via another network. These could include

transactions debiting wrong accounts, loss of consumer benefits such as protection, for example, zero liability and proposition benefits such rewards and marketing.

These reforms would also negatively impact merchants through confusion over which scheme rules would govern each transaction and, therefore, when a merchant may or may not be liable for chargebacks.

Visa believes that the preservation of customer choice must be upheld in Australia, and that the experience of a potential re-routing of a transaction selected by a merchant would have a very negative impact for the customer and issuer as outlined above.

## Chapter 6: Dual Network Debit Cards

### *Key points*

- Visa remains committed to not prohibiting or inhibiting the issuance of Visa-eftpos Dual Network Debit Cards.
- Visa does not support the mandating of dual issuance, believing the current sector-wide commitment not to prohibit dual issuance strikes the right balance.
- The industry Deed of Understanding signed by Visa, MasterCard and eftpos in 2013 and covering both contact and contactless DNDCs remains current and has proven to be effective. It stands as a successful example of a quasi-regulatory approach under which private parties reached agreements, in cooperation with the RBA, but in a manner that avoided the additional cost burdens of formal regulation. As such, we see no compelling case for the RBA to further regulate this area.
- Visa believes that Deed strikes the right balance between promoting competition and innovation and protecting fair investments made by schemes in new technology, consumer education, infrastructure investment and legal rights.
- Visa would be open to the publication of a summary of the content of the three Deeds should that be seen as in the public interest.
- Visa does not currently see the need for regulation in relation to payment wallets, although we remain open to constructive industry discussions in the same manner that achieved the DNDC Deed, should this be felt necessary and as the deployment of this technology evolves.

### 6.1 Introduction

In the Australian market, Visa has always maintained a position that it would not prohibit through our Rules, or inhibit in any other way, the issuance of Visa-eftpos DNDCs on Visa-owned Bank Identification Numbers (BINs).

During 2011-13, the RBA, Visa, MasterCard and Eftpos Payments Australia Ltd (EPAL) conducted a series of bilateral industry discussions on “rules” to govern the issuance of such cards, first in the contact environment, and then in relation to the nascent contactless card environment. These very detailed discussions culminated in at least three bilateral industry Deeds of Understanding signed by Visa, MasterCard and eftpos in August 2013 in favour of the RBA.



As mentioned, the respective Deeds cover both contact and contactless DNDCs. They outline very clearly a voluntary and agreed approach between the industry and the regulator covering the non-prevention of the issuance of DNDCs, the placement of competing brand marks, the management of data related to DNDC transactions, the process around technical application certification, acceptable application hierarchy arrangements for contactless DNDCs and the acknowledged rights of merchants by operation of Australian regulatory decisions.

## 6.2 Current Situation

Since August 2013 when the Deeds were signed, Visa believes the parties to the Deeds have generally honoured their intent and content, something also acknowledged by the RBA in the current consultation paper where it is stated “the [DNDC] agreements are consistent with some principles set out by the [Payment System] Board and to date the Bank’s understanding is that the networks have worked constructively in relation to dual-network issues” (p34).

It is Visa’s strong view that these Deeds remain current in terms of their content and have proven to be effective in their implementation. They stand as a successful example of a quasi-regulatory approach under which private parties have reached enduring agreements, in cooperation with the RBA, but in a manner that avoided the additional economic and system cost burdens of formal regulation. Furthermore, through the role of the RBA both in the negotiations and as the entity for which the Deed obligations are made, ensures the incorporation of broader RBA public policy principles of efficiency, competition and public interest. Importantly, the current arrangements strike the right balance between promoting competition and innovation and protecting fair investments made by schemes in new technology, consumer education, infrastructure investment and legal rights.

As such, we see no compelling case for the RBA to further regulate this area and propose the ongoing utilisation of the Deed approach. Should other impacted parties, such as issuing and acquiring financial institutions and/or merchants wish greater visibility into the terms of the Deeds, Visa would be open to the publication of a summary of the content of the Deeds should that be seen as in the public interest.

Whilst we recognise that the RBA has not proposed mandating dual issuance in the RBA Issues Paper, Visa sees value in placing on the record that we not support the mandating of dual issuance, believing the current sector-wide commitment not to prohibit dual issuance strikes the right balance. Visa and other networks should be free to invest in technology, form factor, POS and cardholder product innovation and compete healthily and vigorously with other networks to drive benefits to Australian consumers, merchants and banks. Requiring that networks reside side-by-side on the same card or payment device will impair network-level competition and differentiation and undermine what we feel should be the objectives of their payments regulation. The current industry agreed approach is a suitable middle way.

### 6.3 The Industry Outlook

The RBA has also raised the emergence of wallet applications, both in the e-commerce and m-commerce environments, noting the latter includes contactless payment technologies.

Visa does not currently see the need for either a specific industry agreement or any formal regulation in relation to payment wallets, regardless of form factor (i.e. e-commerce or m-commerce). In some cases these are emerging technological platforms (i.e. Near Field Communication linked m-wallets) and no case for a regulatory step-in has been made. Further, due to their nascent nature, the risk of significant unintended consequences is particularly high and should be avoided. In relation to more established platforms such as e-commerce wallets, noting that several such concepts have been available to consumers for many years, we feel arrangements for access to and arrangements within such wallets are appropriately commercial issues to be determined by commercial parties. This approach has worked effectively to date and we see no reason it would not continue to do so.

Visa remains open to constructive industry discussions in the same manner that achieved the DNDC Deed, should this be felt necessary at some stage in the future and as the deployment of these technologies evolves.

## Chapter 7: Prepaid and Commercial Cards

### Key points

- Prepaid should continue to be excluded from the regulatory framework as it comprises a small proportion of the market. To regulate it will stifle innovation and thereby competition in payments and financial services more generally.
- In relation to commercial cards, Visa strongly recommends that commercial cards should be removed from the interchange fee setting standard. Commercial cards are an efficient, low cost payment mechanism utilised in business-to-business (B2B) and government-to-business (G2B) transactions, where market mechanisms, more costly post-payment services and pricing differ significantly from consumer cards, and where pricing regulation is less relevant and encroaches on the commercial arrangements and payment terms agreed to by the parties to a transaction.
- If Visa commercial products remain part of the standard and as part of a 'hard cap' then the disparity in regulation of three party proprietary schemes needs to be addressed to ensure continued competition in commercial payments.

### 7.1 Prepaid Cards

The PSB Issues paper sought views on the appropriate regulatory arrangements for prepaid cards.

In Visa's view, there is no case for the formal regulation of prepaid cards and, as such, they should continue to be excluded from the regulatory framework; it comprises a small proportion of the market. To regulate it will stifle innovation and thereby competition in payments and financial services more generally. Prepaid is seen as the gateway to full participation in financial services by many non-traditional players globally.

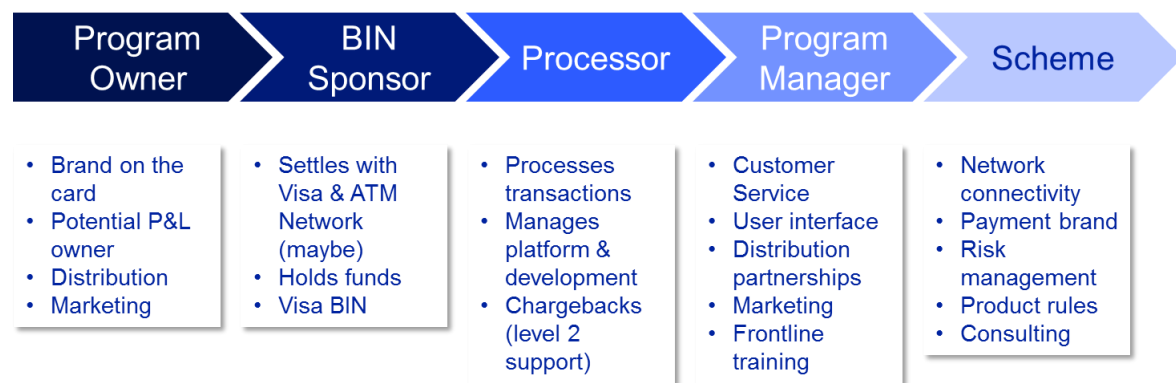
Moreover, prepaid is not similar to debit given the cost of flexibility delivered by additional participants in the product's delivery. The product set has a significantly different operating model to either debit or credit with more participants in the product value chain which provides the flexibility that is so highly valued by financial services start-ups and non-traditional providers. As such, any similarity in applying the debit interchange rates would not be suitable.

Whilst the above sets out Visa's preferred position in relation to prepaid cards, should the RBA genuinely wish to take another component of Australia's card payments environment into formal regulation via a further Standard under the *Payment System (Regulation) Act 1998*, such a step would present a requirement to undertake a proper cost-based analysis of the prepaid card market, which we believe would actually highlight a different, and higher, economic cost base versus debit cards, for example. The establishment of a separate cost study would ensure

the continued viability of the prepaid card product set in a regulated environment. Without this it is likely that prepaid and the innovation and competition that it fosters will be significantly hampered in Australia.

**Box 7.1: The economics of prepaid cards**

There are marked differences in the operating model and thereby economics of prepaid programs specifically relating to the number of participants required for the delivery of these products. The roles typically managed by a bank or financial institution being program owner, BIN sponsor, processor and program management are typically managed by separate entities in a prepaid program (see below). Due to the number of participants, each with their own profit and loss requirements, the cost to provide a full prepaid program is higher than credit or debit.



**Competitive Position**

Anecdotally, the prepaid landscape in Australia is dominated by closed loop and eftpos programs with open loop programs (Visa and MasterCard) only recently gaining traction mainly in the international travel segment. Market forces, especially costs for data processing and brand fees, ensure that there is choice of scheme depending on the use case of the cardholder. There is therefore already an efficient marketplace for prepaid as card holder use case will define which model or network is used by the issuer, be it closed loop, eftpos or open loop. If the RBA were to pursue regulation of prepaid as an additional product set, it would be important that all providers of said set were encompassed by that regulation, regardless of model or network type.

**7.2 Commercial cards**

This section considers the case for removing of Commercial Credit Card transaction volumes from the RBA's *Standard for The Setting of Wholesale ("Interchange") Fees in the Designated Credit Card Schemes*.

## *Regulatory Background*

The RBA's Wholesale Interchange Fee Standard sets out the requirements for a cost-based methodology for the setting of interchange fees by four party schemes only. The standard requires that the weighted average of a four-party scheme's credit card interchange fees must not exceed the common benchmark set by the RBA, calculated as the weighted average of eligible Scheme participant's costs. By inference all scheme credit card products are captured by the standard (including commercial cards), and therefore must be included in the scheme's weighted average interchange fee calculation.

At present three-party schemes are not incorporated into the regulatory environment which has had a significant impact on the commercial credit card landscape. As detailed below, the different economic model and cost base for commercial credit has meant that three-party schemes have been able to gain significant market share through offering higher incentives (rebates) to corporate and government clients. This distortion in the marketplace would be further exacerbated under a 'hard cap' interchange regime for four-party schemes if three-party schemes are excluded.

In Europe it was deemed that capping the interchange fee for commercial cards would have significant unintended consequences, without any tangible benefit for merchants. On the contrary, businesses or governments would find themselves faced with more costly commercial cards and would have turned to less efficient forms of payment, leading to fewer cost savings and even greater expense. In addition, the argument was accepted that some issuers of commercial cards would have abandoned the business leading to more consolidation and less competition within commercial cards. Commercial cards should be excluded from the scope of proposed regulations for these reasons.

## *The economics of commercial cards*

There are a number of factors that impact on the commercial cards issuing business model that are not relevant in a consumer cards model. These include:

- **Cost of acquisition and servicing** – Business customers, from micro to large corporate and government, generally require face to face sales and account management by dedicated business bankers. The provision and management of data to help business and government more easily reconcile payments and the software to manage that data comes at significant cost to the network and the issuer that is unrecoverable. This significantly increases the cost of ongoing management of these accounts.
- **Competitive market forces** - In competitive tenders for large corporate and government programs there is an expectation of rebate to fund development of the program within the client organisation. Most large corporate and government programs also attract a

rebate from the issuer at point of acquisition and throughout the program which is analogous to a rewards program on consumer but is generally higher due to market forces, competing with unregulated three party schemes.

- **Credit scoring for business liability** – Most, if not all, business liability credit facilities are manually assessed. This is due to the complexity of business balance sheet assessment especially in small business. This adds significant cost to the acquisition process given the specialisation of the resources involved and the time taken to review the required level of detail for the assessment. To discount this difference in cost structure could significantly impact small business access to credit.
- **Interchange revenue is a higher proportion of overall revenue** – in larger corporate deals for commercial cards revenue from interchange is estimated at 97% of total revenue based on discussions with Visa’s partner issuers of commercial products. These types of programs have a high cost of acquisition and credit underwriting, card fees are waived, there is an additional significant cost for data and reporting at no cost, and as charge cards there is no interest revenue. Even in smaller business programs there is a lower percentage of interest revenue as the credit card is not normally used as a longer term financing mechanism. This means that issuers rely more heavily on the interchange portion of revenue.
- **Cost of funds for commercial issuers** – in large market commercial cards, issuers generally only issue charge card products with normal payment terms being greater than 14 days past statement date. This increases the cost of funds to a commercial card issuer as they may have double the exposure of the credit limit available on a charge card. These 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.

### **Competitive Position**

As discussed in Chapter 2, even under today’s regulatory arrangements there is a competitive imbalance afforded to the non-regulated schemes. Even if three-party schemes were regulated on their offerings that resemble four-party cards, this uneven playing field would continue in relation to commercial cards.

Furthermore, this imbalance would move from challenging to chronic if the regulated component of the Australian commercial card market was further limited through either a lower of the interchange basket averages and/or the limitation of the operation of that mechanism. Under such a scenario this exemption for closed loop schemes’ proprietary cards would have a number of consequences:

- **Creating an uneven playing field** for four party issuers to compete on commercial terms for large corporate deals. As noted above, interchange is effectively the primary revenue

source and through disparity of regulation, three party schemes are able to offer significantly better financial terms.

- **Reduced willingness for regulated commercial card issuers to pursue innovation in payments.** In other jurisdictions such as the United States, Canada and United Kingdom without regulated commercial interchange we have seen a movement to electronic payments that increase efficiency, both in process and working capital for businesses. Three party schemes have made developments in commercial data, especially GST reporting, due to their larger returns on investment in innovation. GST reporting was provided as a major factor in the decision by the Federal Government to award the 2011 travel cards tender to Diners International.
- **Increased Business-to-Business (B2B) and Government-to-Business (G2B) transaction and merchants' costs.** We have previously argued that there would be share shift to three-party schemes as an unintended consequence of the further exacerbation of the existing uneven playing field. Three party schemes generally operate on higher costs to the merchant / supplier. The most recent data on average costs for all schemes provided by the RBA as of December 2014 were:
  - American Express – 1.73 percent;
  - Diners International – 2.11 percent; and
  - Visa / MasterCard – 0.84 percent.<sup>23</sup>

For all the reasons outlined above, Visa strongly recommends that commercial cards should be excluded from the interchange fee setting standard calculation for the following reasons:

- Commercial cards are akin to invoice financing which is not subject to a regulatory pricing regime.
- Product differentiation should be taken into account when considering the formation of the interchange basket. Commercial cards represent a B2B and G2B supplier payment relationship, and regulation of pricing is encroaching on the agreed commercial arrangements and payment terms between those parties.
- Price signals are not relevant to a commercial cardholder in the same way they may be to a consumer. The decision to utilize a commercial card for payment is an organisational one, based on company policy and an agreed commercial arrangement with the card provider.
- A commercial card is a more efficient and cost effective payment mechanism than alternative payment methods available in the commercial segment. Pricing regulation is impeding the innovation and growth of the product, and so is impacting overall market efficiency.

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<sup>23</sup> <http://www.rba.gov.au/payments-system/resources/statistics/index.html> – Table C3, Average Merchant Fees for Debit, Credit and Charge Cards.

## Chapter 8: Other matters

### Key points

- Any suggestion of mandating the forced separation of payment card scheme and processing entities is unwarranted and potentially detrimental to ongoing innovations in the payments industry.
- We welcome the commitments made by the PSB to recognise the significant changes that may need to take place to business models in the payments industry should any number of the reforms under review actually be implemented and your assurance there will be appropriate consultation periods and timeframes for implementation.
- Visa considers that any reforms (such as surcharging) implemented independently of other options being considered by the PSB could undermine the overall intent of the PSB's review given the interconnections and dependencies between various aspects of the reforms.
- Further, to account for system freeze periods and development lead times required to coordinate both Visa and Australian banks development efforts, structural interchange changes in the Visa system can take up to nine months to occur. Sufficient time will be needed so that all stakeholders can make the necessary changes.

### 8.1 Introduction

This chapter seeks to address the following matters:

- scheme and processing entity separation; and
- transitional and implementation arrangements

### 8.2 Entity separation

Visa believes that any *forced* separation of payment card scheme and processing entities is unwarranted and potentially detrimental to ongoing innovations in the payments industry in Australia, with no apparent consumer or system welfare enhancing benefits from any forced separation.

Visa would like to reiterate its strong belief in the benefits of an integrated scheme and processing service. Indeed, we do not see the brand and its processing services as distinct elements that can be effectively separated. Rather, Visa's ability to process its transactions is a fundamental pre-requisite to the delivery of our brand promise to financial institutions, cardholders and merchants.

Allowing a legal and decision-making linkage between a scheme and processor enables the reliable delivery of network-based innovations to consumers. For example, innovations such as mobile alerts, or real time point of sale redemption, or even advanced fraud detection technologies would not be reliably available to a consumer if the processor is not operationally and legally associated with a transaction. A scheme would have no incentive to develop and



provide new network driven innovations given it would not be able to reliably provide these to cardholders, and the processor would not have an incentive to develop consumer driven benefits given a lack of ability to control whether it is chosen to process a given transaction, along with the reality that the consumer may well simply blame the brand for any transaction difficulties.

### **8.3 Implementation timeframe**

The PSB notes that a review of card regulation involves complex issues with some potential reforms needing an extended period of consultation and implementation. Moreover, the PSB recognises that some of the reforms may involve significant changes to business models in the payments industry, while other changes may include significant systems changes by schemes, issuers, acquirers and merchants. Importantly, the PSB will consider these issues as the Review proceeds so as to minimise adjustment costs for the industry (RBA review, p. 39).

These commitments are a welcome and realistic intent by the PSB to ensure that all participants, not just schemes, have sufficient time to consider the new business environment, to prepare systems and to ensure minimal disruption to existing structures.

Although the PSB wishes to implement surcharging on a faster timeline, Visa considers that the reforms implemented independently of other options being considered by the PSB could undermine the overall intent of the PSB's review. Visa believes that the reforms may be enhanced by ensuring that all aspects of the reforms are considered holistically given the interconnections between various issues. For example, any changes to surcharging would be deeply connected to any changes to the interchange rate structure, which in turn, in Visa's view, is deeply connected to levelling the playing field by bringing non-regulated schemes into the regulatory regime.

Any final reform package may not be released by the PSB until later in 2015 (at the earliest). Implementation of changes in the Visa system cannot begin until all of the details are known and the final requirements are published. Further to account for system freeze periods and development lead times required to coordinate both Visa and Australian banks development efforts, structural interchange changes in the Visa system can take up to nine months to implement. Sufficient time will be needed to ensure that all stakeholders can make the necessary changes.

# VISA

