

VISA INTERNATIONAL SERVICE ASSOCIATION



REFORM OF THE EFTPOS AND
VISA DEBIT SYSTEMS IN AUSTRALIA

COMMENT ON

RESERVE BANK OF AUSTRALIA DRAFT STANDARDS AND
CONSULTATION DOCUMENT

29 APRIL 2005

Introduction

This document is Visa International's response to the draft standards and Consultation Document released on 24 February 2005 by the Reserve Bank of Australia (RBA) in connection with the EFTPOS and Visa Debit systems in Australia. Following the Executive Summary below, it is set out in three separate parts.

- First, Visa International will set out its comments from a business perspective on the RBA's proposals, without detailed reference to supporting economic arguments.
- Secondly, notwithstanding that Visa International opposes the draft standards, it will comment on a number of practical aspects in the proposals that would need to be addressed in order to render them workable if they were to be implemented.
- Thirdly, a range of economic matters arising from:
 - the draft standards and the reasons why they are proposed, as set out in RBA's Consultation Document
 - the asymmetric regulation of three-party/closed networks compared with four-party open payment card networks

are set out in a separate document prepared by Visa International's economic consultants, Network Economics Consulting Group. (See Annexure 1.)

1. **Executive Summary**

Visa Debit is popular with a particular segment of the community that wishes to enjoy the extra functionality that Visa Debit provides over EFTPOS and ATM cards, while still accessing their own money, rather than drawing on credit. Similarly, Visa Debit has traditionally been attractive to smaller issuing institutions, including credit unions and building societies that have not always been in a position to offer traditional credit cards.

The first question that must be asked in assessing whether regulation is necessary is whether there is some ill to be cured or a greater good to be achieved by such intervention. The RBA has not demonstrated either of these factors in its Consultation Document. Visa Debit offers consumers choice and gives smaller financial market players a differentiated offering that helps them compete against the major banks. Regulatory intervention that is directed at restricting the growth of Visa Debit despite these factors and that potentially harms small competitors in the payments arena cannot be justified on any basis.

1.1 **Balancing Role of Interchange**

The use of interchange has been fundamental to the development of credit and debit card markets around the world. It has enabled the card schemes to tailor the net benefits that accrue to both cardholders and merchants in order to promote growth in the overall market. Interchange allows a “balancing” of market conditions on both sides of the network, and in doing so fosters network externalities to the benefit of cardholders and merchants alike.

By proposing replacement of this market-derived and internationally accepted approach with a cost-based methodology for interchange, the RBA has embarked upon a course that risks introducing distortions that will limit choice, reduce competition, harm products with more features and deter innovation. In particular, an emphasis on reducing merchant service fees is inappropriate as a basis for assessing whether particular reform options will or will not promote social welfare and the objectives set out in the relevant statutes.

1.2 **Reductions in Merchant Service Fees**

Even if it were valid to argue that achieving reductions in merchant service fees is a justification for regulatory intervention, the RBA’s proposal in relation to Visa debit interchange rates imposes an unfair burden on Visa International as compared with its major competitor, MasterCard. This is because, as explained at 2.3 below, Visa will effectively subsidize the higher cost MasterCard transactions. This will compound the problem already recognized by the RBA whereby merchant fees for the

acceptance of credit card transactions do not generally reflect the difference between Visa and MasterCard interchange rates.

1.3 Differing Methodologies

As a general matter, Visa views with some concern the RBA's proposal to allow the interchange fee for EFTPOS to flow in a different direction from that for credit and Visa debit without providing any economic or public benefit basis for that decision. A simply expressed desire for "incremental change" without a sound economic underpinning is an insufficient basis for reform. If there is to be regulation, it should follow good regulatory practice and good regulatory practice requires consistency in the application of principle that is grounded in sound economic analysis

1.4 Calculation of the Visa Debit Cost Base

If a cost-based approach is to be used for setting an interchange benchmark for a system, then it is both logical and important to use the costs for that system as the basis for the benchmark. The approach should be consistent with, and not narrower than, the approach established in the RBA's standard for the regulation of credit card interchange.

These aspects are discussed at 2.2 and 3.2 below, as well as at 1.2.1 in Visa International's economic submissions in Annexure 1. In particular, Visa International believes that the eligible costs should be based on those of current Visa debit issuers and then adjusted at the subsequent review, should the base of supply have changed. Basing interchange for Visa debit cards issued predominantly by smaller financial institutions on the eligible costs of credit cards issued predominantly by large financial institutions may well drive out the smaller institutions from the market. This would reduce competition and provide large financial institutions in Australia with a significant competitive advantage.

Visa International has recently had its independent consultants, Bayshore Consulting Inc. (who, as the RBA is of course aware, are also the independent experts appointed by the RBA for the purpose of calculating the credit card cost benchmark under Standard No. 1), conduct a cost study in relation to the costs incurred by issuers of Visa debit cards. The results demonstrate that the costs to existing debit issuers, based on the costs allowable under Standard No. 1, are \$0.365 per transaction – significantly above the costs quoted or estimated by the RBA. Mandating a lower interchange fee will significantly impact the profitability of current issuers with obvious implications for consumer choice and competition.

Further, Visa International is concerned that excluding the cost of fraud management from the definition of eligible costs will reduce issuer revenues that are available to enable them to invest in such systems. If fraud levels rise, this will in turn erode confidence in the security of the Australian payments system generally. Fraud costs for PIN and signature based debit systems can increase rapidly – as seen by the Interac system in Canada – and the interchange structure should enable, if not encourage, early investment to address such risks.

1.5 “Honor all Cards” Rule

Visa International, along with other card schemes in Australia and overseas, has employed its “Honor All Cards” rule as a crucial element of developing a robust system that is open to a wide range of participants. Under the rule, all merchants who accept the Visa “flag” must accept all VISA-branded cards regardless of the issuer or the precise product. Similar rules require that MasterCard merchants accept all MasterCard branded cards and that American Express merchants accept all American Express branded credit and charge cards. (If the RBA proceeds with its proposed abolition of Visa International’s “Honor all Cards” rule it should, of course, avoid further asymmetrical regulation by ensuring that it imposes similar regulations on MasterCard and American Express if either of them commence issuing debit cards in Australia.)

The “Honor all Cards” rule is fundamental to improving the efficiency of, and competition within, the Visa system. It facilitates the entry and expansion of new issuers and new products, both of which would face start-up hurdles if the rule did not operate. In turn, the rule has helped to underpin the growth of the card networks to the benefit of both cardholders and merchants. It is of benefit to the travel and tourism sectors of the economy, because it ensures that foreign visitors can be confident that they can use any type of VISA card when they visit Australia.

Visa International also notes that since 1992 the European Commission has conducted inquiries into various aspects of Visa International’s conduct. On 9 August 2001 it released its findings¹ on a number of issues, including its findings concerning the competitive and efficiency effects of the “honor all cards” rule. In particular, the Commission found² that:

¹ Commission decision 9 August 2001 relating to a proceeding under Article 81 of the EC Treaty and Article 53 of the EEA Agreement (Case No. COMP/29.373 – Visa International).

² Supra, at paragraph 68.

“The fact that under the honor all cards rule, merchants are obliged to accept all valid cards with a certain brand, regardless of the type of card and regardless of the merchant fee, cannot be said to be restrictive of competition.”

The bifurcation of the “honor all cards” rule in the United States as part of the Wal-Mart retailer settlement is not germane to the position in Australia, as explained at 2.4 below.

1.6 Regulation of Three-Party Systems

In its Media Release of 24 February 2005 on Payments System Reform, the RBA argues that it is not appropriate to regulate the payments made to issuers by closed schemes (most notably American Express and Diners Club) as these payments, in its view, do not significantly affect merchant service fees.

The overriding principle should be one of competitive neutrality. In particular, Visa (and other open payment systems) should not be placed at a competitive disadvantage by regulatory intervention. Visa International discusses these points at 1.4 in Visa International’s economic submissions in Annexure 1.

2. Business Perspectives

2.1 Visa Debit – ATM/EFTPOS

Visa International is disappointed that the RBA explicitly states that:

“The Bank is concerned that, when that uncertainty is resolved, unless appropriate measures are put in place, the Visa Debit system will grow at the expense of the EFTPOS system”

and further that:

“If current arrangements were to be maintained there is a strong possibility of a migration of debit card users from the EFTPOS system to scheme-based debit systems through a combination of more attractive pricing and positive marketing of scheme-based debit by financial institutions”.

There is nothing inherently wrong with consumers being offered the choice of products and with large financial institutions, as well as smaller financial institutions, choosing to issue Visa debit in order to give their customers a wider range of product choices. Visa International is concerned that the RBA is proposing to use regulation to actively discriminate against the Visa debit product. This approach ignores the fact that today, and for the foreseeable future, the

customers of smaller financial institutions hold the majority of Visa debit cards on issue. Consequently, these cardholders and their issuers will feel any limitations placed on the product or its development first.

While volumes arising from the product are small relative to the volumes arising from EFTPOS and credit cards, Visa Debit has enabled smaller institutions to compete with much larger competitors by enabling them to offer a product which has different benefits to the EFTPOS product typically promoted currently by the big four banks. Inappropriate regulation of the product may have an unintended adverse impact on these smaller financial institutions, lessening competition and consumer choice within Australia.

2.2 Visa Debit Interchange

Visa International has made extensive submissions to the RBA in the past regarding the need for interchange fees that balance the costs and revenues of the issuing and acquiring sides of the payment network and, more generally, regarding the concepts of network economics that support its approach to interchange rate setting³. Additional comments are made in this regard in the economic submission set out in Annexure 1.

Consequently, the RBA is aware that Visa International does not consider that interchange fees are fees charged for “processing” transactions. Instead, interchange is a mechanism for balancing the costs and revenues of the issuing and acquiring sides of the payment network. Its purpose is to encourage as many merchants as possible to accept VISA-branded cards, to encourage as many consumers as possible to use such cards and to encourage as many financial institutions as possible to participate and invest in the VISA payment network. This objective does not require that fees for credit card transactions and for debit card transactions need be different, although Visa International acknowledges that they are, in fact, different in some countries outside Australia.

Nevertheless, if the RBA is determined to proceed with cost-based regulation of interchange in relation to Visa debit, Visa International makes the following comments in relation to the proposed regulation (in addition to the technical and drafting comments set out at 3.2 below).

2.2.1 Cost Base – Visa Credit Issuer Costs for Visa Debit Issuers

The RBA Consultation Document proposes two important elements in determining interchange for Visa Debit:

³ See Visa International’s response to the RBA’s Consultation Document in March 2002, and subsequent submissions by Visa International to the RBA regarding interchange.

- First, it proposes using cost data relating to credit card issuers to determine the cost amounts that would comprise the interchange cost benchmark for Visa debit
- Second, it provides for interchange to be calculated at a flat rate per transaction, rather than at a variable rate depending on the value of the transaction.

On that basis, the RBA estimates that Visa debit card interchange will be around \$0.15 per transaction if the proposed standard is implemented.

Visa International vigorously opposes the proposal to use credit card issuer costs in the calculation. This approach is completely at odds with the RBA's statement that pricing should be cost-based. It is not commercially logical – or sensible regulation – to use costs incurred in relation to one product by a certain set of financial institutions to determine the amount of interchange in relation to a different product issued by a largely different set of financial institutions. In particular, it has the potential to unfairly discriminate against the existing issuers of Visa debit products – generally smaller financial institutions and credit unions that play a valuable role in providing competition in the Australian financial services arena, competition that Australian consumers have shown they value.

The RBA justifies this approach in two different ways.

First, the RBA has said that it “has been mindful of the administrative costs imposed by regulation” and that, “partly reflecting this, the draft standard is based on the processing and authorization costs used in the credit card interchange standards” so that institutions do not need to calculate additional costs data for the purposes of the standard.

Visa International and its debit card issuers in Australia consider it important enough to achieve a reliable and accurate cost base for the product that they recently engaged Bayshore Consulting to carry out a cost study to determine the costs actually incurred by Visa debit issuers in Australia using the methodology previously outlined by the RBA for credit cards. The results of that cost study are discussed at 2.2.3 below.

Second, the RBA has said that:

“if the standard were based on the costs of current issuers alone, the result could be quite a high interchange fee given that most existing issuers are quite small. Should larger issuers seek to issue Visa Debit cards in the future, they could be significantly overcompensated for their costs”.

Effectively, the RBA has said that its objective is to influence the commercial decision-making of the big four banks, even if in so doing it must override the interests of smaller financial institutions and their customers.

Even if this were an acceptable approach, the proposed standard is flawed. The consultation document acknowledges that “processing and authorization costs are unrelated to the size of the transaction”. Yet the methodology described in the Standard requires that a cost base be determined by dividing the costs of credit card processing and authorization by the total **value** of credit card transactions. The resultant percentage is multiplied by the average **value** of a Visa Debit transaction. Using credit card data from the 2003 study, Visa International estimates that the cost of credit card processing and authorization across the three designated Schemes is \$0.23 per transaction (0.19 percent of the average credit card transaction value of \$120). The RBA calculates a Visa Debit cost of \$0.15 by multiplying the average percentage cost from the credit card data by the average Visa Debit transaction **value**. As noted above, however, if costs are unrelated to the size of the transaction, then the actual cost even for large issuers averages \$0.23 irrespective of the lower average transaction value applicable to Visa Debit card transactions.

In combination, the disincentive to small issuers to continue to issue Visa debit cards due to returns not being at all reflective of their costs – except by accident – and the disincentive to potential large issuers to commence to issue Visa debit due to being under-compensated for processing and authorization costs, is likely to sound a death knell to the Visa debit product in Australia and reduce the choices open to Australian consumers.

Visa International considers it quite inappropriate for the RBA to place a competitive product at a regulatory disadvantage merely because it wishes to favor a different product, EFTPOS – whether or not consumers prefer to use that product.

2.2.2 **Elements of the Proposed Cost Base**

The RBA’s cost-based benchmark for Visa credit cards includes processing, fraud and authorization costs and the costs of the interest-free period. The proposed cost-based benchmark for Visa debit cards, however, includes only processing and authorization costs. (Obviously, costs of the interest-free period would be zero, so omission of this category is not a concern.)

Visa International does not see any justification in narrowing the cost categories for Visa debit, as compared with Visa credit, by eliminating the costs of fraud from the calculation. Fraud costs and the costs of fraud prevention are real costs that Visa debit

issuers incur. Visa debit issuers should not be starved of revenue that would be available to assist them in combating fraud through technology and other fraud control techniques.

Visa International also notes that the costs of fraud in card-not-present transactions (Internet transactions, as well as mail order/telephone order transactions) is higher than in card-present transactions. Excluding fraud costs from the Visa Debit benchmark will result in the costs of fraud falling increasingly on the shoulders of Australian cardholders through increased cardholder fees, where issuers choose to continue to issue Visa debit cards in response to demand from cardholders that prefer debit cards to credit cards.

Visa International is concerned that the exclusion of fraud costs for debit products may be based on the incorrect assumption that fraud costs for PIN authenticated transactions are negligible. As seen in Canada for the Interac system (which closely resembles the EFTPOS system), fraud costs for PIN based domestic systems can be substantial. Inclusion of fraud management costs in the interchange benchmark provides a possible revenue stream and, therefore, perhaps an incentive for early investment in fraud detection and management systems – helping to prevent erosion of confidence in the payments system.

2.2.3 Visa Debit Cost Study

Contrary to the RBA's view that a separate cost study to be conducted of Visa debit issuers would impose unacceptable costs, Visa International and its larger debit issuers in Australia recently arranged for Bayshore Consulting to conduct a cost study to assess their actual costs in issuing Visa debit cards.

The cost study was completed during April 2005 and included the categories of eligible costs included in the RBA's credit card interchange standard for the 12-month period ending 31 December 2004. The data was from eight members representing approximately 87 percent of Visa debit domestic sales transactions during that period.

The results of the study confirm that, including transaction processing and authorization costs only, the average cost of a Visa debit transaction is 25.5c, rising to 36.5c if the costs of fraud and fraud prevention and investigation costs are included. This illustrates the magnitude of the adverse impact of the RBA's standard for interchange will have on the current issuers of Visa debit.

Eligible Expense Item	By Value	Per Transaction
Transaction Processing and Authorization	0.323%	\$0.255
Fraud Prevention and Investigation	0.091%	\$0.072
Net Fraud Write-Offs	0.047%	\$0.037
Total Eligible Visa Expense	0.462%	\$0.365

These data illustrate that, even without allowing fraud costs to be included in the calculation, the benchmark should be set at around \$0.25, rather than at the \$0.15 anticipated by the RBA. Fraud costs should be allowed for the reasons already discussed, and their inclusion raises the benchmark for Visa Debit interchange to around \$0.36.

2.2.4 Summary

For the reasons set out above, if the RBA is to impose a cost-based interchange regime in relation to Visa debit cards then Visa International considers that it should:

- (a) be based on eligible costs of debit issuers, not credit issuers
- (b) not include a narrower category of costs than in the RBA's credit card interchange standard (excluding the interest free period because it is irrelevant)
- (c) if credit card data is to be used, provide for the calculation of a debit benchmark based on average cost per credit card transaction (cents per transaction rather than a percentage of credit card transaction value)

2.3 Cross Subsidization Through Blended Pricing

Visa International understands that acquiring banks in Australia typically acquire Visa and MasterCard transactions on the basis of "blended" pricing – that is, even if the interchange costs applicable to the two different card brands are different, acquirers do not provide merchants with separate pricing for each card brand, but instead price on an overall, average basis.

While it is, of course, always possible for acquirers to change their systems so that they have the ability to price separately for scheme debit cards and credit cards – and some have mentioned to Visa International that they may consider doing so – systems changes inevitably require an investment of time and money. Visa International understands that a blended rate is presently administratively easier for

acquirers to manage. Consequently, it is difficult to envisage substantial changes in this regard even in the medium or longer-term.

The result of acquirers' blended pricing is that the proposed sharp reductions in interchange rates for Visa debit cards, given that Visa debit comprises approximately 12 percent of the value of Visa transactions in Australia presently, will result in Visa International effectively subsidizing its major competitor, MasterCard. If, for example, an acquirer calculates that approximately 65 percent of the value of transactions that it acquires from a merchant will be VISA-branded transactions and that approximately 12 percent of them will relate to Visa debit card transactions, it will be able to calculate its interchange costs accordingly. Similarly, it can calculate the interchange costs of the remaining 35 percent of transactions, MasterCard transactions, which it will acquire.

The effect will be that the overall blended rate offered to the merchant – absent, for the purposes of comparison, the acquirer's margin to cover other costs and its own profit – will be higher than the average interchange rate on the Visa debit and credit transactions and lower than the interchange rate on the MasterCard credit transactions. (This is the same type of subsidization as that occurring where merchants apply a blended or average surcharge to all credit card transactions. The average rate applied by the merchant is typically in excess of the merchant's Visa/MasterCard merchant service fee, but below the merchant's American Express merchant service fee – so Visa and MasterCard effectively subsidize the merchant's American Express acceptance.)

Visa International considers this an unreasonable and unfair result of a regulatory regime.

2.4 **“Honor all Card” Rule Abolition**

The “honor all cards” rule is not unique to Visa or to four-party or three-party payment card schemes generally. All major payment card brands – including MasterCard, American Express and Diners Club – have a similar rule that they apply to their participating merchants. The rule also is not unique to Australia. It is applied internationally by major payment card brands throughout the world. The main goal of Visa's rule is to ensure that holders of VISA-branded cards can be confident that their card will be accepted at any merchant that displays the same acceptance logo anywhere in the world, including in Australia. The rule helps give payment networks the ubiquity that is so vital to their existence and growth and to the convenience and security of their cardholders and merchants.

Visa International has made extensive submissions to the RBA in the past in connection with, in particular, the retention of the “Honor all Cards” rule. (Please refer to Section 1.3 of the economic analysis in

Attachment 1 for a summary of economic arguments supporting the rule.)

The RBA seems to consider that the rule should be relaxed in Australia largely because Visa made concessions in relation to it in order to settle the Wal-Mart retailer suit in the United States. While the “honor all cards” rule was “bifurcated” in the United States in 2003 to make a distinction between credit cards and debit cards as part of a settlement between Visa U.S.A. Inc and a group of retailers led by Wal-Mart, the decision to proceed in this way was not in any way an abrogation of the fundamental importance of the rule. The decision occurred as a result of balancing the risks of continuing with class action litigation that involved a damages claim (US\$100 billion, with a claim that this amount should be trebled) that was so substantial as to place the continuation of the Visa system at risk even if Visa was confident of ultimately prevailing on the merits. The US retailer settlement did not address, or relate to, aspects of competition and efficiency that are relevant under the *Payment Systems (Regulation) Act 1998*, but proceeded on anti-trust grounds that were significantly different from the regulatory and competition laws applicable in Australia.

There were other more practical differences between claims in the Wal-Mart litigation and the situation in Australia. The Wal-Mart plaintiffs claimed that Visa was trying to use a dominant position in the credit market in the United States in various ways and that the “honor all cards” rule was instrumental in that context. Claims included arguments about monopolization of the debit sector through acquisition of the Interlink “PIN debit” network, arguments that Visa had prevented merchants from steering cardholders to lower cost debit alternatives, arguments that Visa tried to prevent competitive marks being placed on the back of VISA-branded cards and arguments that if there were no “honor all cards” rule there would be increased competition that would lead to an interchange rate of zero. All of these claims - specific to the United States marketplace situation - were factually wrong or unsupported. Had the matter proceeded to trial or other resolution on the merits, the theory that Visa had set out to destroy the competitive networks would have been decisively rebutted by evidence from competitors that Visa’s presence in the market actually helped them because of the contribution that it made to consumer acceptance of debit products generally and the system infrastructure. Hence, the US situation bears no relevance whatsoever to Australia.

In the Wal-Mart case, the plaintiffs claimed that Visa International’s “Honor all Cards” rule was a tying arrangement that contravened the applicable anti-trust legislation. In Australia, the equivalent is a “first line force” and falls within Section 47 of the Trade Practices Act 1974 (Cth) and is legitimate unless it has the purpose or has or is likely to have the effect of substantially lessening competition. The RBA does not so allege in connection with Visa International’s “honor all cards” rule, but nevertheless intends to bifurcate it in relation to Visa debit and

credit cards. Visa International contends that such a competition matter should be dealt with by existing competition legislation if it contravenes that legislation, and not by regulation intended to deal with the payments system.

Notwithstanding the Wal-Mart settlement, interchange in the United States continues to be set by Visa U.S.A. at commercial levels and merchant discounts negotiated between acquirers of VISA transactions and merchants. The position is fundamentally different from that proposed in Australia, with regulated interchange rates for Visa debit transactions. Given the merchants' allegation in the Wal-Mart litigation that they were injured because the "honor all cards" rule permitted Visa U.S.A. to set debit interchange too high, in the case of regulated interchange rates there is no purpose to be served by interfering with the efficiency and consumer benefits of the rule.

There is another fundamental difference between the US situation and Australia in relation to the manner in which acquirers typically price their services to merchants. Visa International understands that in the US "interchange plus" pricing – that is, interchange plus a fixed margin – is relatively common. The consequence of such pricing is of course that changes in interchange rates automatically flow through to such merchants. In Australia, while Visa International understands that there are limited instances of "interchange plus" pricing, it is not the normal approach of Australian acquirers currently. Consequently – and having in mind the comments made at 2.2 above – the commercial incentives for a merchant to have an interest in whether or not it has a right to reject some products is quite different. Visa International does not see the sense or commercial utility in applying the US outcomes to Australia given the significant differences in the underlying commercial arrangements.

In the Australian context, Visa International believes the "honor all cards" rule continues to be of fundamental importance. The rule facilitates both efficiency and competition in the payments system and these effects overwhelm any potential negative impacts. The economic arguments supporting these factors are summarized in Annexure 1.

2.5 **"No Surcharge" Rule Abolition**

Visa International believes that the "no surcharge" rule is important because it prevents merchants from increasing the price of its goods or services to a cardholder, typically in a way that is inadequately monitored, that seeks to pay with a VISA-branded card. Visa International considers it is unfair to cardholders for merchants to be able to levy a charge for accepting a Visa card payment, particularly when such a charge is not required to be reflective of costs incurred by a merchant in accepting such cards.

Indeed, if card fees increase as a result of regulatory changes, cardholders may end up paying twice – once to the issuer for the cost of issuing and administering its Visa debit cards and once to the merchant that, while enjoying any benefits from lower merchant service fees, nevertheless chooses to surcharge. (Of course, as mentioned at 2.2 above, if the merchant applies a blended surcharge, then the Visa Debit cardholder is likely to be directly subsidizing the merchant’s credit card merchant service fees, as well as the merchant’s American Express merchant service fees.) The merchant potentially receives a windfall. As mentioned in Annexure 1, Visa International’s surveys have yet to uncover real evidence of merchants passing on savings in merchant service fees to consumers.

Consequently, Visa International remains opposed to surcharging on all its payment cards.

2.6 **Access Regime**

The RBA has imposed an access regime in relation to credit card transactions. As was discussed extensively with the RBA at the time the RBA was developing this access regime, the VISA system is not actually divided into a credit card system and a separate debit card system. Instead, all Visa members are entitled to issue cards bearing the VISA acceptance mark and whether they choose to issue them as debit cards or as credit cards is a matter for them. The same rules apply from Visa International’s perspective, irrespective of the way in which the card may be characterized.

If it is the RBA’s intention that any “specialist credit card institution” authorized by the Australian Prudential Regulation Authority, as contemplated by the access regime, should be able to acquire Visa debit card transactions, as well as Visa credit card transactions, Visa International notes that it will be necessary for the RBA to either introduce a separate access regime in relation to debit cards or, preferably, to amend the existing access regime so that it applies to both kinds of VISA-branded cards.

3. **Technical and Drafting Comments**

Visa International’s detailed technical and drafting comments and questions in relation to the draft standards are set out below.

3.1 **Proposed Standard No 3 – The Setting of Interchange Fees in the EFTPOS Payment System (the “EFTPOS Interchange Standard”)**

Visa International has no comments in relation to the EFTPOS proposal.

3.2 **Proposed Standard No. 4 – The Setting of Interchange Fees in the Visa Debit Payment System (the “Visa Debit Interchange Standard”)**

Visa International makes the following technical and drafting comments and raises a number of questions in relation to the Visa Debit Interchange Standard.

3.2.1. **Definition of “Visa Debit Card”**

- (a) Although it follows from the designation, it should be clear on the face of the Standard that the Standard applies only to a Visa Debit card that is issued in Australia. Consequently, “in Australia” should be inserted after “issued” to remove any possible ambiguity.
- (b) Commercial arrangements may be set up from time to time under which a card accesses a deposit at, say, a related financial institution of the card issuer. The RBA may, therefore, wish to remove “at the participant” at the end of this definition.
- (c) As drafted, the definition does not cover pre-paid (debit) cards. Where a pre-paid card is issued, the cardholder’s funds may be held in an account specific to that cardholder or, alternatively, in an account that holds the balance of all pre-paid cards of a similar type. In neither case would the account generally fall within the scope of the term “deposit account”.

Currently in Australia, the only VISA-branded pre-paid debit cards that have been issued are for use in ATMs only. Visa International expects that this will change within the next 12 months, with the issuance of pre-paid debit cards for use at point of sale. It is quite possible that, in time, a range of pre-paid debit cards will be issued, including gift cards and payroll cards.

Visa International has no desire for pre-paid debit cards to be regulated. It is certainly not in the interests of Visa International or its members, however, for issuance of these products to be delayed in due course by further regulatory processes. Therefore, if the RBA intends that they should fall under the Visa Debit Interchange Standard, it suggests adding to the end of the definition:

“or, in the case of a pre-paid debit card, by accessing the pre-paid balance linked to that card”

3.2.2 Definitions of “Issuer” and “Acquirer”

Although it follows from the designation, it should be clear on the face of the Standard that the Standard applies only to Visa Debit card issuers and acquirers that are located in Australia. Consequently, “in Australia” should be inserted after “Visa Debit system” in each definition to remove any possible ambiguity.

3.2.3 Interchange Fees

Section 9 of the Visa Debit Interchange Standard provides that the “weighted average of interchange fees ... must not exceed the benchmark ...”. There is, however, no expression of when this statement must be true, other than the requirement in Section 13 for conformance “from [31 October] in the relevant year”. It is not feasible for Visa International to constantly monitor, and ensure, compliance with this requirement at all times during a year due to the changing mix of transactions over time.

Section 10 of Standard No. 1 specifies key dates (events) when the equivalent statement in that standard must be true. The same approach needs to be taken in the Visa Debit Interchange Standard in order to render it workable.

3.2.4 Methodology

- (a) As mentioned at 2.2, Visa International does not consider that the Visa debit benchmark should be calculated by reference to the costs of credit card issuers. If, notwithstanding Visa International’s submissions in this regard, credit card cost data is to be used, how is it intended that Section 10 will work to ensure that the “reference year” will remain aligned with the year in which the schemes are required to provide data under Standard No. 1, given that Standard No. 1 contemplates the benchmark being calculated at intervals other than every three years?
- (b) Section 15 in Standard No. 1 details the methodology for calculating weightings. Visa International considers that the same level of detail should be provided in the Visa Debit Interchange Standard.

- (c) Visa International has assumed that, should a MasterCard member launch a MasterCard debit program, the RBA would immediately designate the “MasterCard Debit System” and introduce a standard the same as the Visa Debit Interchange Standard. Is this assumption correct? If so, what benchmark will MasterCard be required to use and how will it be calculated given that there would not be any transaction data to which Section 11(c) of such a MasterCard standard could be applied? In addition, what arrangements would apply between the time of the launch of the MasterCard debit program and the time of the RBA designating such MasterCard system and imposing standards on it?

Visa International suggests that for regulatory fairness, Visa International should seek an enforceable undertaking from MasterCard (and American Express) that it will abide by the RBA’s standard for Visa Debit – or an applicable standard in an identical form – immediately it commences issuing any debit product in Australia.

- (d) Section 11(c) requires use of “the average value of a Visa debit card transaction in the reference year” to yield a benchmark rate. Visa International queries where, or from whom, the RBA will obtain this information in order to perform the calculation. The Visa Debit Interchange Standard does not specify whether (and when) this information is to be provided by Visa International or whether the RBA will obtain it from Visa debit issuers or in some other way. The matter should be covered as the Standard should be complete on its face.

We note, in this regard, that if the Visa Debit Interchange Standard is amended to provide that this data is to be provided by Visa International to the RBA, time will need to be allowed for Visa International to set up the necessary process to enable Visa International to obtain the information. It cannot be determined from Visa International’s processing system at present because Visa International does not process “on us” transactions for members. (Of course, members may choose to change their processing options in the future and any solution reached now for deriving this information needs to be flexible to allow for future change.) Alternatively, the RBA may consider that “on us” transactions can be excluded, with

interchanged transactions providing a sufficient measure of values across the entire Visa debit portfolio.

Visa International also queries whether the RBA intends the average transaction to be based on gross transactions or net transactions (that is, gross transactions less credits and chargebacks). While one would logically not expect either approach to yield a widely different outcome, Visa International is not presently in a position to comment on whether or not this holds true in practice.

- (e) As mentioned earlier, Visa International does not consider that credit card issuer costs should be used in calculating an interchange benchmark for Visa debit. If credit card issuer costs are used, however, the RBA should provide for the calculation of a Debit benchmark based on average cost per credit card transaction (cents per transaction rather than a percentage of credit card transaction value)
- (f) Section 12 of the Visa Debit Interchange Standard requires the RBA to “calculate the benchmark by 15 September of the relevant year” using data gathered from a cost study under Standard No 1.

Section 14 of Standard No 1 requires that the credit card cost-based benchmark be “calculated by the end of ... the third month of every third year after the date [Standard No 1] comes into force”. Standard No 1 came into force on 1 July 2003, so the cost-based benchmark must be calculated by 30 September of each third year after 2003. Experience in 2003 showed that completing all calculations and other requirements of Standard No. 1 required most, if not all, of that available time and this is expected to continue to be the case in the future. This is because the data collection cannot begin in many instances until at least mid-July – financials, monthly or annual, need to be closed and signed off first. Several weeks are required to extract the data and to allow for verifying it and investigation of any apparent discrepancies.

There is, therefore, a need to amend the date in the Visa Debit Interchange Standard so that it aligns with, or is later than, the date in

Standard No. 1. Visa International proposes that the RBA should have calculated the debit benchmark by no later than 2 October.

- (g) Standard No. 1 allows for the credit benchmark to be recalculated if “changes in eligible costs or other factors warrant” and the RBA approves. The Visa Debit Interchange Standard should include the same flexibility. It should also include a provision to ensure that recalculation of credit and debit benchmarks remain in alignment and, consequently, avoid the need to do additional cost studies at different times.
- (h) Visa International notes that the date, 31 October is indicated tentatively in Section 3 of the Visa Debit Interchange Standard. This date should be adopted to align the rate setting dates and calculations of credit and debit cards.

3.2.5 Transparency

- (a) Section 17 of the Visa Debit Interchange Standard requires Visa International to “certify in writing to the [RBA] by 30 September each year, that interchange fees complied with [the] Standard over the previous financial year”.

The equivalent section of Standard No. 1, Section 18, requires a certificate “at 30 November to cover the period to 31 October”. For administrative ease and convenience to all parties, Visa International suggests aligning the requirements in the Visa Debit Interchange Standard to those already established in Standard No. 1 for Visa credit cards – both as to the time at which certification is required and as to the period for which it is required.

- (b) Section 12 provides for the RBA to publish the debit benchmark on its website and Section 16 requires Visa International to publish the debit interchange rates similarly. (Visa International assumes that only the benchmark will be published, not the key data comprising it. The Visa Debit Interchange Standard should be clarified in this regard as Visa International would be very concerned if the intention or requirement were to publish the key data, which is commercially sensitive.)

Visa International notes that this is different from the requirements under Standard No.1, where publication of the interchange rate is required but not publication of the cost benchmark. In Visa International's view, the debit proposal should be amended to conform with the credit requirements.

Publication of both the benchmark and interchange rates is likely to engender confusion among merchants due to lack of understanding between the two different concepts. Any merchant that checks the websites, as intended, and discovers a benchmark and a different set of interchange rates is likely to seek further information from the RBA, Visa International and/or members and an explanation of the differences. This would be time consuming and unproductive, given that the merchant's only real interest is the interchange rate applicable to its transactions.

3.3 Proposed Standard No. 5 – The “Honor all Cards” Rules in the Visa Debit and Visa Credit Card Systems and the “No Surcharge” Rule in the Visa Debit System (the “Rules Proposal”)

3.3.1 Definitions

- (a) Although it follows from the designation, it should be clear on the face of the Standard that the Rules Proposal applies only to a Visa Debit card that is issued in Australia. Consequently, “in Australia” should be inserted after “issued” in the definition of “Visa Debit Card” to remove any possible ambiguity.
- (b) Commercial arrangements may be set up from time to time under which a card accesses a deposit at, say, a related financial institution of the card issuer. The RBA may, therefore, wish to remove “at the participant” at the end of the definition of “Visa Debit Card”.
- (c) As drafted, the definition does not cover pre-paid (debit) cards. Where a pre-paid card is issued, the cardholder's funds may be held in an account specific to that cardholder or, alternatively, in an account that holds the balance of all pre-paid cards of a similar type. In neither case would the account generally fall within the scope of the term “deposit account”.

Currently in Australia, the only VISA-branded pre-paid debit cards that have been issued are for use in ATMs only. Visa International expects that this will change within the next 12 months, with the issuance of pre-paid debit cards for use at point of sale. It is quite possible that, in time, a range of pre-paid debit cards will be issued, including gift cards and payroll cards.

Visa International has no desire for pre-paid debit cards to come within the Rules Proposal. It is certainly not in the interests of Visa International or its members, however, for issuance of these products to be delayed in due course by further regulatory processes. Therefore, if the RBA intends that they should fall under the Rules Proposal, we suggest adding to the end of the definition of "Visa Debit card":

"or, in the case of a pre-paid debit card, by accessing the pre-paid balance linked to that card"

- (d) Although it follows from the designation, it should be clear on the face of the Rules Proposal that the Standard applies only to Visa Debit card issuers and acquirers that are located in Australia. Consequently, "in Australia" should be inserted after "Visa Debit system" in the definition of both "Issuer" and "Acquirer" to remove any possible ambiguity.

3.3.2 Honor all Cards Rule

The RBA proposes tentatively that Section 10 of the Rules Proposal would come into effect on 1 July 2006 with the effect that on and from that date Visa International would no longer be able to require that a merchant accept Visa debit cards as a condition of accepting Visa credit cards or vice versa.

Visa International considers that implementation of this change should be deferred by four months to 31 October 2006, so as to align with the proposed implementation of the new interchange arrangements contemplated by the Visa Debit Interchange Standard. This will ensure that merchants are able to make their decisions in relation to the continued acceptance of Visa credit and debit cards with knowledge of the regulated interchange rates for those products.

3.3.3 Identification of Visa Debit Cards

Section 11 of the Rules Proposal requires Visa debit cards to be identifiable as such, both visually and electronically. Practical aspects of this proposal require consideration.

Visual Identification

The RBA tentatively proposes that the requirement for Visa debit cards to be visually distinguishable would come into effect on 1 July 2006. Such a date will impose unreasonable costs on Visa debit issuers through otherwise unnecessary card re-issuance.

As the RBA may be aware, Visa International has recently announced a proposal to “refresh” its branding, so a redesign of all VISA-branded cards will be taking place over the next few years. Visa International will phase in the new branding over a period of three years, which reflects the fact that card re-issuance is a relatively expensive process (with a cost of between \$1 and \$2 for each re-issued card) and that issuers typically issue cards with a three-year expiry date (although many adopt longer expiry dates and a few adopt shorter expiry dates, at their discretion). In addition, many issuers order relatively large quantities of card “blanks” from their card manufacturers in order to obtain volume discounts and other savings. Issuers have told Visa International that wasting stocks of card “blanks” would be costly for them.

Visa debit issuers will need time to arrange with card manufacturers for the re-design of the Visa debit cards so as to ensure compliance with the Rules Proposal. While it is feasible for cards to be issued with a new design by 1 July 2006, it would result in undue cost and wastage if all cards were required to be re-issued by that time, irrespective of their expiry date. These costs would likely be compounded by a desire to specify staggered expiry dates on the newly re-issued cards to avoid them all expiring at the same time in, say, three years.

In summary, Visa International proposes that Visa debit issuers be required from 1 July 2006 to ensure that all new, renewal or replacement cards issued by them are identifiable as Visa debit cards, subject to replacing all cards within three years from that date.

Electronic Identification

Visa International assumes that the requirement for electronic identification would be complied with by its acquirers being allowed to provide their merchants with Bank Identification Number (BIN) ranges, card number ranges or other identifiers that can be used to distinguish Visa debit cards from Visa credit cards. Visa International is not assuming that the magnetic strip on or chip embedded in, the card will be required to signal to the merchant's terminal that the card is a debit card. (Please note that Visa International is not aware whether or not this would require changes to some or all merchant terminals.) If these assumptions are not correct, please let us know. The Rules Proposal needs to be amended so as to be explicit regarding what is required.

3.3.4 Transparency

- (a) Section 12 of the Rules Proposal requires Visa International, as the administrator of the Visa debit system in Australia, to certify compliance with it by all participants in its debit and credit card system. Visa International is able to certify compliance with its own obligations – that is, that it has set aside the relevant rules in Australia – but it cannot be in a position to so certify compliance by its members. Any such certification could only be provided based on reliance by on a certification given to it by each of its members in Australia, which may not be forthcoming.

Consequently, any certification in relation to compliance by card issuers and acquirers required by the RBA should be required by the Rules Proposal to be given to the RBA by those entities.

- (b) Visa International notes that Standard No. 2, which removed Visa International's "no surcharge" rule in relation to Visa credit card transactions in Australia, imposed an obligation on acquirers to ensure that merchants were notified. We suggest an amendment to the Rules Proposal to impose a direct obligation on acquiring members to notify their merchants of the changes it affects if and when ultimately promulgated.