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2 May, 2006

The Hon Bruce Baird MP
Chairman
House of Representatives Standing Committee on Economics, Finance and
Public Administration
Parliament House
CANBERRA ACT 2600

Dear Mr Baird,

Visa International is pleased to be able to make a submission and presentation to the Committee's consideration of regulation of the Australian payment system.

A properly functioning payment system that is capable of responding flexibly and innovatively to changing circumstances is critical to Australia's economic well being and the promotion of consumer welfare. In Visa's view the current regulatory approach puts at risk the system's ability to meet those objectives.

The attached submission summarises Visa's major observations and concerns. It also makes some recommendations about the approach regulators should take.

Also attached is a report on the impacts of the regulations produced last year.

Visa is in the process of collecting some additional data that will be of use to the committee in it's deliberations. We will provide that data as soon as it is available.

I trust that this material will assist the Committee in its deliberations and look forward to appearing before the Committee on 15 May.

Yours sincerely



Bruce Mansfield
Executive Vice President, Australia & New Zealand
Visa International

Visa International Submission to the House of Representatives Standing Committee on Economics, Finance and Public Administration

Payment System Regulation in Australia

May 2006

From early 2003, the Payment Systems Board of the Reserve Bank of Australia progressively introduced new regulations for credit card schemes in Australia. The regulations apply to Visa, MasterCard and Bankcard¹, but not to American Express or Diners' Club². The PSB has recently announced a scheme to regulate Visa Debit and the EFTPOS system.³

The credit card regulations consist of three key elements:

- requiring credit card companies to set interchange rates by reference to certain allowed 'attributable costs' (those costs do not include any scope for a return on capital invested);
- removing the scheme rule that prohibited merchants from surcharging consumers who use credit cards⁴; and
- allowing so-called 'specialist' institutions to become members of open card schemes.⁵

The evidence to date suggests that the new regulations have had either a negligible or, more likely, a negative effect on consumer welfare. Research conducted for Visa International in Australia by the Network Economics Consulting Group in 2005 (attached) and supported by subsequent data released by the Reserve Bank and others suggests that:

- merchants are paying substantially lower bank fees in relation to the regulated schemes but only marginally lower fees for the unregulated schemes;
- most merchants report that the reduced fees have either not resulted in a change to their operations or that they are increasing profits rather than passing the lower costs through to consumers;
- Visa and MasterCard cardholder benefits and rewards have declined while fees and charges have, in many cases, increased;
- the regulations have provided American Express and Diners Club with a clear competitive advantage leading to a 20 per cent market share increase for American Express;

¹ Known as 'open card schemes'.

² Known as 'closed card schemes'.

³ This submission will deal chiefly with the regulation of credit cards, although the principles set out would apply to the regulation of any product or scheme.

⁴ American Express and Diners' Club have agreed to voluntarily comply with this measure.

⁵ Detail of the regulations can be found in Chapter 2 of the attached report, *Early evidence of the impact of Reserve Bank of Australia regulation of open credit card schemes*.

- a small but growing number of merchants surcharge customers who use credit cards, leading to further cost increases for consumers;
- consumers do not feel they have benefited from the regulations; and
- despite the lower fees for merchants, the net impact of all the changes appears to have increased consumer prices slightly.

In defending the regulations the Reserve Bank has claimed that lower costs for merchants necessarily mean lower costs for consumers. However, as the Governor has admitted to the Committee, the Bank is unable to produce any evidence of this effect.

Furthermore, Visa International believes that the regulation is also contrary to good policy principles because it dampens incentives to invest by not allowing flexibility or the ability to obtain an adequate return on investment. This is despite the fact that other arms of government are encouraging payment systems participants to invest to meet other policy objectives. These include investment in systems that will:

- reduce fraud;
- assist law enforcement agencies counter money laundering and other activities that support terrorism; and
- be compatible with and support government smart card initiatives.

Finally, Visa International does not believe that it is desirable or sustainable for the Payment Systems Board to continue to set regulated prices for the industry in the medium to long term. At some point, good policy practice dictates that the regulator step back and allow the industry to develop without prescriptive regulation.

What options might the Committee explore?

Visa International believes that any regulatory regime applying to the payments system should adopt the following overarching principles and:

- be competitively neutral, applying equally to open and closed schemes;
- recognise the importance of investment and innovation and that this entails the opportunity to achieve a reasonable return on that investment;
- explicitly acknowledge other policy objectives and public benefits that are delivered by the payment system in a modern economy (such as fraud prevention or anti-terrorism capacities); and
- rely on transparency and good governance rather than prescription and price setting to achieve its objectives unless there are clear specific instances of market failure.

Specifically Visa International suggests that:

- the words 'efficient' and 'competitive' should be removed from the *Payment System (Regulation) Act* and that the ACCC be charged with monitoring competition issues in accordance with the principles that generally apply to businesses in Australia;
- rather than prescriptive pricing regulation, the Reserve Bank should outline the principles it wishes to see in the operation of the payment system and that those principles should apply equally to all participants;

- the principles should include an acknowledgement of the need to obtain a return on capital invested; and
- all payment system participants should be required to continue to report their merchant service fees (and other relevant data) to allow for transparency and permit monitoring of adherence to the Reserve Bank's principles.

If this approach is not adopted, or is not adopted in the short term, Visa International believes that, at the very least, the Reserve Bank must examine ways to bring the unregulated schemes into the regulatory regime to ensure competitive neutrality.

Finally, Visa International recommends that the Committee urge the Reserve Bank not to proceed with proposed regulation of the Visa Debit Scheme. The evidence of credit card regulation would not support the extension of this approach to Visa Debit. Indeed, the proposed regulation of Visa Debit goes further than the credit regulation by not even allowing schemes to recover any of the costs relating to fraud.

More particularly, Visa International opposes the abolition of the 'honour all cards' rule. Its abolition would disadvantage credit unions, building societies and other smaller institutions that issue only or a large proportion of Visa Debit cards. It would also disadvantage those cardholders who enjoy the convenience that Visa Debit provides.