



Mr David Murray AO
Chair, Financial System Inquiry
GPO Box 89
Sydney NSW 2001

Via email: fsi@fsi.gov.au

26 August 2014

Dear Mr Murray AO

Visa Inc. Response to the Financial System Inquiry (FSI) Interim Report

EXECUTIVE SUMMARY

Visa Inc. (Visa)¹ welcomes the opportunity to provide its second submission to the Financial System Inquiry (FSI) in response to the Murray Review's Interim Report dated 15 July 2014. Australia is one of Visa's top five markets globally. We see this review as significant in terms of its opportunity to set best practice regulations and legislation for the payments system in Australia, in the interests of competition, stability and efficiency.

The FSI outlines that it considers that the financial system must satisfy three principles: efficiently allocate resources and risks; be stable and reliable; and be fair and accessible. Visa submits that our evidence-based policy recommendations in our submission dated 29 March 2014 clearly achieve such policy outcomes. In addition, our submission was supported by economic modelling conducted by Deloitte Access Economics (DAE) and public opinion polling by JWS Research.

Visa's original recommendations to the FSI in our submission dated 29 March 2014 remain the same today. Visa would like to reinforce our positions in this second submission as they relate to interchange fee regulation and surcharging, namely:

1. The FSI recommend to the Federal Government that there be amendments to the *Payment Systems (Regulation) Act 1998* (PSRA) to end the regulation of interchange in Australia through the revocation of the limits on interchange fees.
2. If a full removal of interchange regulation is not adopted then we encourage the FSI to recommend that the Federal Government reform the PSRA to ensure all competing payment systems are treated the same, thus ensuring a "level playing field" among competitors.

¹Visa 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 our 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.

3. In relation to surcharging, the FSI recommend to the Federal Government that the PSRA, or any other relevant legislation, be amended to include a legislative prohibition on surcharging in Australia.
4. If a prohibition of surcharging is not adopted, the FSI should recommend to the Federal Government reforms to the PSRA, or any other relevant legislation, to clearly limit permitted surcharging and establish a public enforcement mechanism to ensure adherence to such a limit.

In addition, beyond interchange and surcharging, Visa proposes that:

5. Government must facilitate a whole of Government and industry approach and coordination on policies to combat data security issues.
6. Government and regulators must adopt technology neutral laws and regulations to allow all players in the payments sector to equally compete on innovation. Government should establish a working group on innovation which includes payment systems.

These recommendations support and address the FSI's policy intent, namely achieving competition, stability, efficiency and the impact of regulations and legislation on the end-user, Australian consumers and merchants. We are encouraged that the FSI Interim Report calls out competitive neutrality in the payments system as one of its 28 Observations.

This is a core policy issue that must be immediately addressed in Australia. The Government needs to create a level regulatory playing field which captures all participants in the payments system (this includes current, new and future entrants operating in both the traditional and non-traditional forms). Also, and at a minimum, American Express must be included in the scope of any regulation, particularly because it no longer operates under only a three-party model, but instead operates under a four party model. This will have positive effects on the economy and create more competition and stability in Australia's payments landscape. To date, competition in the Australian payments system has not been operating equitably or freely. Evidence tells us that this has created unintended and undesirable negative consequences for the market. The FSI gives us an opportunity to fix this. Visa would like to see interchange fee regulations abolished in the Australian market.

The Payments Industry would experience the same outcomes from deregulation as those highlighted by the Commonwealth Treasury namely that, *"where deregulation has been successful, it has increased economic freedom, opened up new markets, increased competition and enhanced the flexibility and dynamism of the Australian economy."*² The FSI provides an opportunity to address the issue of unfair and unbalanced regulation.

² Deregulation in Australia, Mr Justin Douglas, Commonwealth Treasury pp 53, at http://www.treasury.gov.au/~media/Treasury/Publications%20and%20Media/Publications/2014/Economic%20Roundup%20Issue%20202014/Documents/PDF/04_Douglas.ashx



Electronic payments lead to more efficient economies - use of electronic payments has injected nearly US\$21billion (AU\$20.2billion) or 0.865 percent of additional consumption to the Australian economy (according to Moody's Analytics) between 2008 and 2012. This Moody's study highlighted that "card usage makes the economy more efficient, yielding a meaningful boost to economic growth."

Visa has again worked with Deloitte Access Economics on the numerous policy options presented in the FSI Interim Report. Deloitte Access Economics' independent analysis is **attached** (Appendix A) to this submission. The analysis shows that interchange fee regulations have cost Australian merchants \$125 million in the 2013 financial year and over \$0.77 billion since the uneven playing field was first established.

The regulatory framework that Visa is advocating will unequivocally encourage the continued growth of electronic payments. This includes support of the digital economy and greater innovation for the benefit of both consumers and retailers. Our proposals will: promote fair and vigorous competition among the many payment providers, including non-traditional new technologies as well as traditional payment systems/electronic card schemes and enhance transparency; and protect Australian end users i.e. consumers and merchants whilst responding to their evolving needs.

If you have any questions regarding our response to the FSI Interim Report, please do not hesitate to contact Ms Kristen Foster, Senior Director, Government Affairs & Public Policy, Australia, New Zealand & the South Pacific (e: krfoster@visa.com) at any time.

We thank the Chair and the FSI panel for consideration of Visa's recommendations in this critical review of Australia's financial system.

Yours sincerely

Stephen Karpin

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Australia, New Zealand & the South Pacific





Visa Submission

Australian Financial System Inquiry's Interim Report

26 August 2014



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VISA'S OVERALL RESPONSE TO THE FSI INTERIM REPORT

Visa welcomes the opportunity to respond to the FSI's Interim Report. As outlined in our original submission, there are opportunities to strengthen Australia's payments system via policies (that would contribute positively to Australia's economy) that achieve competitive neutrality and a level regulatory playing field.

Visa strongly called for the inclusion of "developments in the payments system" at section 3(6) of the FSI Terms of Reference³. Given this focus, we submit that core to developments in the payments system is acknowledgement that the legislation governing the payments industry and its participants has not been reviewed since its introduction.

The *Payment Systems (Regulation) Act 1998* (PSRA) needs a review and refresh to future proof it for Australia. Payments are an ever evolving landscape and legislation needs to effectively capture all entrants in the system and achieve competitive neutrality. A lack of parity in the payments system since regulations were introduced in 2002 is creating unintended consequences and flow-on effects to Australia's economy. It is important to note that the payments marketplace has changed dramatically since 2002, and that truly transformative innovations are within our reach, both in Australia and globally. Any regulatory framework must be considered in this light and ensure that innovation is promoted and encouraged.

Visa is encouraged that one of the 28 observations in the Interim Report was regarding competitive neutrality in the payments system, namely that:

"Regulation of credit card and debit card payment schemes is required for competition to lead to more efficient outcomes. However, differences in the structure of payment systems have resulted in systems that perform similar functions being regulated differently, which may not be competitively neutral."⁴

We are concerned about the impacts of the lack of competitive neutrality on the end-user. Current inequalities are driving up bank fees, reducing benefits and resulting in a cost pass-through to consumers. Deloitte Access Economics supports Visa's position. In short, for Visa, the FSI Interim Report has shone the spotlight on companion cards and the need for competitive neutrality in the Australian payments system. The report calls out that a number of submissions suggest re-examining the current regulatory framework for retail payment systems, specifically in relation to: simplifying the current framework and inconsistent treatment of like products that may result in an unlevel playing field.

The electronic payments industry is at a unique moment in time where advances in payments are opening the door to truly transformative innovations in the way people pay and are paid. Australians are increasingly relying on electronic payments to pay and be paid anywhere, everywhere and any time.

³ <http://jbh.ministers.treasury.gov.au/media-release/037-2013/>

⁴ <http://fsi.gov.au/publications/interim-report/executive-summary/>

To recap, in its report to Visa in March 2014, Deloitte Access Economics found that this underlying regulatory weakness has led to an uneven regulatory playing field in which unregulated payment systems have disproportionately grown at the expense of regulated payments systems. This is as a direct result of the regulatory loopholes whereby the Reserve Bank of Australia (RBA) has the discretion to nominate what constitutes a payments system (this needs to be more prescriptive). Some card schemes, for example, are currently not regulated on the interchange front. Removal of interchange regulations altogether or the establishment of a licensing system for non-traditional players would go a long way to solve such unintended consequences.

According to Deloitte Access Economics analysis, this has resulted in an estimated annual cost to Australian merchants in the 2013 financial year of \$125 million and over \$0.77 billion since the uneven playing field was first established⁵.

Regulatory change is needed to bring greater equality to the payments system and reduce the cost of electronic payments for the end user, consumers and merchants.

⁵ Deloitte Access Economics Report March 2014, "Competitive Neutrality in Australian Payments Markets".



ELECTRONIC PAYMENTS POSITIVELY IMPACT THE ECONOMY

In our March submission, Visa highlighted the significant contribution of electronic payments to the global and domestic economies. This is a critical point as the FSI must consider that any policy recommendations do not disincentivise the use of credit and debit cards – credit and debit cards allow the efficient and transparent transfer of payments in the economy. The speed of innovation means it is critical for the FSI to recommend changes that give the financial system room to adapt to future developments - both predicted and unforeseen.

The Australian Payments Clearing Association (APCA) released a report⁶ in July 2014, which highlighted that cash is on the way out. As such, it is timely for the FSI to consider how to regulate new and future entrants in the system that may not be in the traditional three or four party model space, given the move away from consumers using cash as a form of payment.

APCA states that, "Promoting greater use of electronic payments is therefore a necessary bridge to the digital economy, particularly for those who still rely on cash and cheques."⁷ Indeed Australians are changing the way they pay with unprecedented speed. Payments innovation is being driven in large part by consumer choice. Consumers want faster, more convenient transactions, e.g. contactless cards and mobile payments are good examples of this. A survey on Visa payWave usage revealed one in two customers choose to use contactless due to its speed and 83 percent of customers said they were satisfied with the convenience of contactless transactions. The APCA report also outlines the move away from cash payments when it states:

"Consumer use of cash in Australia, in line with international trends, is declining but cash is unlikely to disappear as a payment instrument. However, cash use is in the beginning of an accelerated decline which will result in it remaining at much lower levels in the future, which will require management by the Government, regulators and the payments industry. While acknowledging that cash will remain a "default" payment instrument (if all else fails) for the foreseeable future, APCA believes it should not be the first or only choice in any payment context, and as the industry works on payments system enhancement, it should aim to ensure that safe, convenient and cost-effective alternatives are available."⁸

The RBA also recently referred to the uptake in new forms of payments in its June 2014 paper entitled, "The Changing Way We Pay: Trends in Consumer Payments". This paper stated that, "Internet payments (which include smartphone payments) grew as a share of all remote payments made in the survey from just over half in 2007 to around 90 percent in 2013, with a corresponding fall in postal and telephone payment".⁹

⁶ Towards the digital economy: Milestones report SPECIAL EDITION: Focus on Cash, APCA, July 2014

⁷ As above, pp 3

⁸ As above, pp 4

⁹ "The Changing Way We Pay: Trends in Consumer Payments", pp8, at RBA, Crystal Ossolinski, Tai Lam and David Emery <http://www.rba.gov.au/publications/rdp/2014/2014-05.html>



(pp8). This is consistent with ABS data releases on 25 February 2014 which found that in 2012-2013 76 percent of Australia's 15.4 million internet users made a purchase or ordered goods over the internet.

There is a plethora of new players in the payments landscape with non-traditional players such as PayPal becoming more mainstream. In Australia, they are not subject to the same regulations or oversight as Visa. As one example, PayPal is fast growing and has managed to establish accounts and transactions outside traditional systems. On the innovation side, the form factors are changing – we are seeing a convergence of industries but many players are being regulated differently, or not at all – this is clearly tilting the regulatory playing field off balance.

Given the ever evolving nature of the payments landscape since the inception of the Wallis Report, it is critical that a comprehensive review of the *Payment Systems (Regulation) Act, 1998*, be undertaken by the Federal Government with simple amendments that will future proof the payments system from a regulatory and legislative perspective.

It is clear that electronic payments and other forms of payment systems will be a core part of the world in which consumers pay and merchants operate in future years. While it is difficult to envisage what other payment forms may look like, it is obvious that any legislation must account for new and future entrants to ensure there is always a level playing field and that traditional companies are not disadvantaged by regulations, particularly when it comes to innovation, versus less traditional payment forms which may not currently be captured under the *PSRA* or the RBA's definitions of what constitutes a payments system. If the Government is to follow the trends that suggest a move away from cash and cheques to more innovative payment forms then it must promote the use of electronic payments and not stifle some participants in the system, such as Visa, MasterCard and eftpos with regulations that do not apply to all payment instruments in Australia.

The FSI Interim Report noted that, to "...facilitate innovation, Government and regulators should seek to be flexible in regulatory approach and technology neutral in regulation."¹⁰ Visa supports such an approach. Visa notes that the FSI Interim Report also mentioned the establishment of a central mechanism or body to monitor and advise Government on innovation – this would be a positive move and one which we endorse – this should include participants from the private sector and with a focus on the payments industry (this could possibly be an extension of the newly formed Australian Payments Council¹¹ of which Visa is an inaugural member).

It is critical that forward thinking regulations are not prescriptive given the payments industry will continue to evolve in future years and that electronic payments will continue to be a core part of our society. It is also critical that, if regulation is maintained, that all participants in the payments system are regulated in some

¹⁰ <http://fsi.gov.au/publications/interim-report/> - pp 1-26

¹¹ APCA Media Release, 25 August 2014, <http://australianpaymentscouncil.com.au/wp-content/uploads/2014/08/media-release-announcing-the-australian-payments-council.pdf>



manner to ensure that those who are currently captured under the PSRA are not put at a competitive disadvantage.



VISA'S FINAL RECOMMENDATIONS TO THE FSI

1. The FSI recommend to the Federal Government the amendment of the PSRA to end the regulation of interchange in Australia through the revocation of the limits on interchange fees.
 - a. This would bring Australia back into line with the practice in which interchange is formally unregulated but is set by open and competitive market forces. The conduct of payment systems and other payments 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 in an anti-competitive manner.
 - b. This would also recognise the economic 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.
 - c. In addition, the FSI should propose that the PSRA or Regulations made under the PSRA be amended to include a wider, clearer definition of what constitutes a "payments system", that is consistent with competitive realities, and that the PSRA be structured so that all such payments systems are automatically required to seek a licence prior to commencing operations in Australia, including all existing schemes. This would remove the discretion of the RBA to determine through "designation" what constitutes a "payments system", replacing this with a clearer determination of the Parliament that both better reflects the current and future state of payments in Australia and that would fairly and equally capture all payments systems both traditional and non-traditional forms (as outlined in this submission).
 - d. Under such an arrangement we would support the continuation of the RBA's general oversight and data collection powers as established under the PSRA.
2. If Option 1 was unsupported and limits on interchange are to be maintained, the FSI should recommend to the Federal Government reforms to the PSRA to ensure all interchange and interchange analogues are equally regulated.
 - a. We recommend this is best achieved by the FSI proposing that the PSRA or Regulations made under the PSRA be amended to include a wider, clearer definition of what constitutes a "payments system" and that the PSRA be structured so that all such payments systems are automatically required to seek a licence prior to commencing operations in Australia, including all existing schemes. This would remove the discretion of the RBA to determine through "designation" what constitutes a "payments system", replacing this with a clearer determination of the Parliament that both better reflects the current and future state of payments in Australia and that would fairly and equally capture all payments systems, both traditional and non-traditional forms (as outlined in this submission).
 - b. All licenced payment systems would then be equally regulated, namely interchange or any interchange analogue would be limited at a common level and through a common mechanism. This common limit would be automatically applied rather than through the discretionary imposition of a "Standard" by the RBA, although the common level and mechanism would be determined by the RBA as the regulator. It is important to note that

this would not constitute “new” regulation, merely the extension of existing regulation to existing, new and future entrants offering equivalent services.

- c. Under such an arrangement we would support the continuation of the RBA’s general oversight and data collection powers as established under the PSRA.
 - d. This Option would re-set the PSRA to be much closer to the regulatory norm across other sectors, such as banking and financial services, where the automatic application of regulation to all similar participants is the norm.
 - e. This Option would also ensure the PSRA is prepared for the next 10-20 years of new entrants (both traditional and non-traditional), innovation and change in Australian retail payments.
3. In relation to surcharging, the FSI propose to the Federal Government that the PSRA, or any other relevant legislation, be amended to include a legislative prohibition on surcharging in Australia.
 4. If Option 3 was unsupported and some level of surcharging is to be maintained, the FSI should recommend to the Federal Government reforms to the PSRA, or any other relevant legislation, to clearly limit permitted surcharging and establish a public enforcement mechanism to ensure adherence to such a limit.
 5. Government must facilitate a whole of Government and industry approach and coordination on policies to combat data security issues.
 6. Government and regulators must adopt technology neutral laws and regulations to allow all players in the payments system to equally compete on innovation. Government should establish a working group on innovation which includes payment systems.

We believe our policy proposals align with the intent of the Murray Review to ensure a more efficient, competitive and stable financial system in Australia, as it relates to payments schemes, emerging models and current, new and future entrants.





FSI INTERIM REPORT'S POLICY CONSIDERATIONS

The FSI Interim Report discusses the financial system from nine perspectives and makes 28 observations on how the financial system is currently working.

The core observation of relevance to the payments sector is where the FSI calls out the need for competitive neutrality for like products of similar economic substances (we go into further detail on this in the next section). Visa endorses this observation and per our recommendations abovementioned offers some practical policy solutions to achieve this level playing field regulatory outcome.

The FSI Interim Report also provides a myriad of policy options for consideration, including the option of revoking interchange regulations, to maintaining the status quo in payments system regulation to the absolute negative end of the spectrum, abolishing interchange fees, which are the bedrock of how four party model payments systems work.

On the flipside, what would set Australia up as a prime example of a positive deregulation agenda, in the interests of consumers and merchants, would be to abolish all forms of interchange fee regulations in the Australian market.

Visa's position is aligned with APCA's on the need to review the PSRA, which ultimately has led to interchange regulations and regulations of what constitutes a payments system. APCA's recommendation 5 in its first round FSI submission is that the PSRA needs to be reviewed and widened – APCA refers to the jurisdictional reach of the regulator, refers to the RBA's power to designate and regulate payments systems and outlines that new entrants, new technology and deepening competition in the scheme space expose some of the difficulties of this approach. APCA also recommends that the RBA's jurisdictional reach under the PSRA be reviewed to ensure that it can effectively respond to new entrants, increasing technological diversity and increasing marketisation of payment systems and networks.

The Australian Retailers Association (ARA) also calls out the need for regulatory parity in its first round FSI submission. It says all schemes need to be brought under regulation, not just the four party schemes that are currently regulated. ARA says it does not believe that under current regulation there is a level playing field and strongly believes that not all payment providers are treated equally by the regulatory system. ARA highlights that in its view co-branded companion cards are now being issued as four party schemes and have a higher MSF and must be therefore regulated and designated under the <50 basis cap as a four party scheme – the same way Visa and MasterCard are regulated. ARA states, "the ARA has spoken anecdotally with retailers and we have been advised that the use of American Express cards has increased from approximately 13 percent to 18 percent over the last four years".¹² ARA reveals that as new payments systems are developed these cards will result in "undue pressure to merchants" unless they are regulated by the RBA.

¹² ARA, FSI Submission, March 2014, at http://fsi.gov.au/files/2014/04/Australian_Retailers_Association.pdf

The table below captures Visa’s position on the FSI’s policy options as they relate to interchange and surcharging for consideration by the payments industry.

FSI Policy Options for Consideration	Visa’s Position
No change to current arrangements	No - Visa does not support. The case for reform is compelling and has been set out in both our first and second round FSI submissions.
Lower interchange fee caps or ban interchange fees	No - Visa does not support lowering interchange fee caps and does not support a ban on interchange fees. Visa supports the removal of interchange regulation. Interchange plays a critical role in balancing both sides of the two-sided market that is electronic payments and provides a means for schemes to incentivize the introduction of new technologies, such as contactless payments, and encourage the uptake of electronic payments in specific sectors. The benefits of interchange are set out in detail in the table below.
Expand interchange fee caps to include payments of similar economic substance	Yes - Visa supports. Such a regulatory move would ensure competitive neutrality in the payment system and address issues such as companion cards which are currently not regulated in Australia, equally it could also apply to other participants as well as non-traditional players in the system. Our interpretation of this is it would only be applicable to those payment schemes that do not currently have interchange caps.
Remove interchange fee caps	Yes – Visa supports. Current caps do not allow the market to effectively operate and current caps also only apply to four party schemes that are regulated by the RBA. Three party schemes operating as four party schemes, such as American Express and Diners Club, can set any fees they like (i.e. and can offer more incentives as a result) as they are not subject to interchange fee caps. The current state of play creates an unfair and distorted market and according to Deloitte Access Economics cost merchants \$125 million in the 2013 financial year.
Cap merchant service fees or cap differences in interchange service fees between small and large merchants	No – Visa does not support.



<p>Require acquirers to enable merchants to choose which scheme to route transactions through</p>	<p>No – Visa does not support. Merchants already have the ability to make this decision and the merchant acquiring market will provide such services in the normal course of its operation.</p>
<p>Allow payment schemes to reintroduce ‘no surcharge’ rules or broaden the ban on ‘no surcharge’ rules to all payment systems</p>	<p>Partly yes – this is a nuanced policy proposal, i.e. Visa supports a ban on surcharging via legislation and if not a ban then enforcement of excessive surcharging by a regulator. No surcharge rules require legislative enforcement and recognition as opposed to purely being industry self-regulated (self-regulation is difficult given the obvious conflicts of interest between card schemes, financial institution clients and merchants who are all part of the same business chain). Therefore Visa proposes that any regulatory oversight and enforcement of surcharging be explicitly referred to in legislation – such powers must be afforded officially to a regulator under the PSRA.</p>
<p>Enforce reasonable cost recovery in customer surcharging</p>	<p>Yes - Visa supports. Visa has long held that there must be true calculability of surcharging rates and that consumers should not be disincentivised from using electronic payments as a transparent and efficient form of payment. We note that an easier solution would be our core recommendation on surcharging, namely its prohibition.</p>
<p>Provide merchants and customers with real-time pricing information regarding interchange fees and merchant service fees</p>	<p>No – Visa does not support. Whilst Visa supports transparency and information accessibility, this proposal is largely unworkable. Visa publishes its interchange fees publicly on our website (which is already available via our published rates/tables, see Appendix B: http://www.visa.com.au/aboutvisa/interchange/interchange.shtml). As such the market is capable of communicating in a timely manner without impeding the system with real-time pricing information which would be unwieldy and add little to consumer information during often quick transaction processes.</p>



Consumer, Merchant and Economic Benefits of Interchange Fees

There are numerous benefits to consumers, merchants and the economy that are created by interchange fees. These are listed in the table below.

CONSUMER BENEFITS	MERCHANT BENEFITS	ECONOMY BENEFITS
 <p>Funding innovation by financial institutions – new technology, fraud protection and security results from interchange fees.</p> <p>Avoids the need for higher annual fees.</p>	 <p>Financial institution’s card usage and protection programs designed to increase cardholder spend at merchant locations and displace cash payments result from interchange fees. Electronic payments create efficiency and transparency in the market.</p>	 <p>Job creation – roles in customer service, cardholder education, fraud and collections at banks result from an effective business chain created by interchange fees.</p> <p>Financial literacy programs designed to raise awareness about electronic payments result from an effective system.</p>



FSI INTERIM REPORT - COMPETITIVE NEUTRALITY OBSERVATION

FSI INTERIM REPORT OBSERVATION

Regulation of credit card and debit card payment schemes is required for competition to lead to more efficient outcomes. However, differences in the structure of payment systems have resulted in systems that perform similar functions being regulated differently, which may not be competitively neutral.

Visa Supports FSI's Competitive Neutrality Observation – The Rationale

Visa concurs with the FSI Interim Report's second observation in its paper which explicitly refers to competitive neutrality in the payment systems. We are encouraged that this has been called out in the report and contend that it should extend to all new and future entrants in the system too.

The explanatory rationale underneath the FSI's official observation is that, "the Inquiry considers that interchange fee caps have improved the functioning of four-party payment schemes. They have reduced merchant service fees. Although difficult to measure, the caps have also most likely reduced cross-subsidisation from customers who use low-cost payment mechanisms, such as cash, to those who use high-cost payment schemes. However, payment systems of similar economic substance should be regulated consistently".¹³

Arguably four-party interchange fees, companion card service fees and incentive payments under all schemes are equivalent in economic substance. We note that the RBA's submission said it would review the issuance of American Express companion cards by financial institutions and considering "*whether some change to the regulatory treatment of these cards (or those of any other scheme that is currently not designated), might be warranted.*"¹⁴ Visa's view is that the Government must tackle this via legislative reform – a review by the RBA is welcome but needs to dovetail in to any Government review of outdated legislation.

We note that this key Observation relates to the core issue raised in Visa's submission, namely, the need for a level regulatory playing field in relation to interchange regulation. The FSI's Observation confirms Visa's core position that competitive neutrality is the best outcome for the Australian economy and Australian consumers and merchants.

This is a positive step – Deloitte Access Economics independently called out the costs of unequal interchange regulation since the early 2000s and highlighted the need for a level regulatory playing field in its March 2014 report. The report by Deloitte Access Economics highlighted that "the rising market share of unregulated four-party schemes since the first half of 2003 when the regulations were introduced has

¹³ <http://fsi.gov.au/publications/interim-report/>

¹⁴ RBA FSI Submission March 2014, Pp214-215, at http://fsi.gov.au/files/2014/04/Reserve_Bank_of_Australia.pdf

directly cost merchants an estimated \$125 million in higher fees in the 2013 financial year and a cumulative \$0.77 billion in 2013 dollars since the reforms were introduced in 2003”.¹⁵

On competitive neutrality, and particularly the role of interchange Visa’s position still stands, namely, the FSI recommend to the Federal Government the amendment of the PSRA to end the regulation of interchange in Australia through the revocation of the limits on interchange fees.

If this is not adopted then we encourage the FSI to recommend that the Federal Government reform the *Payment Systems (Regulation) Act 1998* to ensure all interchange and interchange analogues are equally regulated.

Companion Cards and Other Entrants

In short, the FSI Interim Report has shone the spotlight on companion cards and the need for competitive neutrality in the Australian payments system. In our view this extends to entrants such as China UnionPay, a bankcard association which is owned by a number of state-owned enterprises and whose market share is gaining globally.

The Interim Report calls out that a number of submissions suggest re-examining the current regulatory framework for retail payment systems, specifically in relation to simplifying the current framework and inconsistent treatment of like products, that may result in an unlevel playing field.

Visa supports creating a fair equilibrium in the payments system by either revoking interchange regulations or capturing all similar schemes, both traditional and non-traditional. The fact that similar schemes are currently regulated differently is creating market distortions and placing some companies at a competitive disadvantage, which has flow on consequences for the economy.

Other Policy Options Should Not Be Adopted

The reason it is critical that other policy options are not adopted is given the effectiveness of interchange in card scheme models. As outlined in Visa’s March submission, Visa highlighted that in setting interchange fees, it is no different from what publishers of newspapers do when they make their publications available to readers for a modest price and largely rely on revenue from advertisers.

In Australia however, issues have arisen due to interchange fees being capped. As we have previously stated, there is absolutely no incentive to set interchange at a level that is “too high” or “too low.” Accordingly, the payments industry and its participants should be able to self-regulate the fees based on market demand. Visa Inc. has an incentive to set interchange fees at a level to maximize the volume of transactions and provide benefits to both sides of the market. Simply put, capping interchange fees creates an unlevel playing field.

¹⁵ Deloitte Access Economics Report March 2014, “Competitive Neutrality in Australian Payments Markets”.

If interchange fee regulation remains in play in Australia, then it must cover all three and four party schemes.

Other Jurisdictions and Interchange Fee Regulation

Competition and innovation in the electronic payments industry is robust and rapidly evolving. There is large activity at the member state level in Europe on payments regulation – and it is expected that the EU will ultimately land on core issues for intra-regional transactions. The key being that the EU is cognizant of level regulatory playing fields– the European Commission has called for any interchange fee caps to apply to traditional three party networks where they utilize an issuer or acquirer, that is, *where they act as a four-party network*. There is no intention to disadvantage either model.

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 exclusivity and network routing arrangements of card networks and banks. As outlined in our March 2014 FSI submission, the new rules limit the size of the interchange fee that can be received by large banks. The consequences for consumers – especially low-income consumers – and small businesses have been disastrous where the average interchange fee was reduced by 52 percent. Large retailers gained a US\$8 billion windfall without passing on savings to consumers.¹⁶ Given that the interchange revenue of the banks has reduced, the banks have hit back with new charges and increasing fees to offset such costs. The cost of imposing such regulations has impacted on consumers (one study by economist David Evans cites this to the tune of US\$22 and \$US25billion), savings have not been passed on to them and it provides further evidence as to why interchange fees should not be regulated or capped in any market. One study states that:

*“Confronted with a loss of billions of dollars in interchange fee revenues, banks and credit unions have made up the revenue loss by increasing the cost and reducing the quality of bank accounts for consumers. Some banks initially sought to impose a direct fee on debit card usage by consumers – most notably an effort by Bank of America to impose a \$5 monthly fee on debit cards...Banks also responded by raising other fees and tightening eligibility for free chequing. Bankrate.com’s 2012 survey found that the average monthly service charge on a non-interest-bearing chequing account increased 25 percent from 2011, to \$5.48 per month, and that the average minimum balance needed to avoid a monthly service fee rose by 23 percent, to \$723.02 (with some accounts requiring an average minimum balance as high as \$5000) (Bell 2012b). In addition to raising fees, banks reduce costs by reducing services (such as by closing bank branches and laying off workers) (IBC Bank September 22, 2011) and shedding unprofitable customers”.*¹⁷

The same study notes that the costs of the Durbin Amendment have been borne disproportionately by low-income consumers and reveals the knee jerk reactions by some banks:

¹⁶ David Morrison. “Durbin Reg Costs big Banks More than \$8 billion.” Credit Union Times, May 3, 2012

¹⁷ ‘Credit Where It’s Due’, Ian Lee, Geoffrey A. Manne, Julian Morris, and Todd J. Zywicki, 2013, pp 15-pp16

“For example, Bank of America’s CEO stated that the bank will focus on the top 20 percent of its most profitable customers and get rid of the unprofitable ones (Bell 2012a). JPMorgan Chase estimated that new regulations on overdraft programs and price controls on debit card interchange fees made unprofitable 70 percent of customers with less than \$100,000 in deposits, which required the bank either to raise fees, reduce costs and services, or shed unprofitable customers, report Dan Fitzpatrick and David Enrich in The Wall Street Journal, writing on March 1, 2012. One industry analyst estimated that if debit card revenues fell 50 percent as a result of the Durbin Amendment and overdraft fees fell 30 percent as a result of new regulations, approximately 40 percent of bank customers would become unprofitable including most of those with incomes under \$40,000 per year (Iacobuzio 2010).¹⁸

Consumers have not benefited from the reforms – this is an unintended consequence of capping regulation fees – financial institutions will recoup lost costs in other fees and charges from consumers. Similarly, it was argued that smaller merchants would benefit from Durbin. However, according to the abovementioned study, small merchants have seen interchange fees increase.

Globally, Visa Inc. holds that the interchange experiences in the United States and in Australia, with their capped interchange fees, are an example of markets, where there are unintended consequences from the regulations. As reported by F Ian Lee, Geoffrey A. Manne, Julian Morris, and Todd J. Zywicki, *“first, annual fees increased by an average of 22 percent on standard credit cards and annual fees for rewards cards increased by 47–77 percent, costing consumers hundreds of millions of dollars in higher annual fees (Stillman et al. 2008, 13; 15). Second, Australian card issuers reduced the generosity of their reward programs by 23 percent.”¹⁹*

The evidence shows that capping interchange fees harms consumers. According to Lee, Manne, Morris and Zywicki, there are negative impacts that can be quantified for consumers, and they cite analysis undertaken on the issue:

“In short, Australian consumers on average are unambiguously paying more and getting less as a result of the RBA’s price controls. In addition, because the RBA’s price controls apply only to four-party credit card schemes but not three-party systems such as American Express and Diners Club, its interventions have distorted the competitive marketplace, prompting a growth in three-party schemes at the expense of Visa and MasterCard. The regulatory tipping of the competitive marketplace serves no coherent economic function because three-party schemes charge a merchant discount that is the functional equivalent of an interchange fee in a four-party scheme and serves the identical function of balancing the two sides of the market (Zywicki 2010, 29).²⁰

The report notes that another adverse outcome is that because American Express and Diners Club generally charge higher merchant discounts than Visa or MasterCard, as Chan, Chong, and Mitchell observe:

¹⁸ Credit Where It’s Due’, Ian Lee, Geoffrey A. Manne, Julian Morris, and Todd J. Zywicki, 2013, pp 16

¹⁹ As above, pp 17

²⁰ Credit Where It’s Due’, Ian Lee, Geoffrey A. Manne, Julian Morris, and Todd J. Zywicki, 2013, pp 18

"Merchants largely bear the cost of these more generous rewards cards through the higher merchant service fees for American Express products, on average, unless they choose to pass that cost back through to cardholders in the form of a surcharge" (2012).²¹

Therefore there is no evidence in any jurisdiction that merchants have passed on all of the savings from interchange fee reductions to cardholders. Capping of interchange fees has led to negative impacts on the economy and consumers in jurisdictions, such as Australia ("*RBA price controls encourage use of three-party systems with higher merchant discounts*" and "*there is no evidence that Australia's cap on interchange fees – the longest-lasting experiment to date with regulating interchange fees – resulted in lower retail prices for consumers (Gans and King 2003, 462; 471–472).*")²², in which they are heavily regulated and also affected the behaviours of those schemes which are not regulated – which in turn has had negative and regressive consequences for consumers.

Australian Consumer's Perspective

To recap our March 2014 submission, Visa commissioned JWS Research to conduct research of consumer attitudes towards interchange regulation in March 2014. The results provide the evidence required for the FSI to recommend the competitive neutrality policy path that Visa is calling for.

In summary, three in five Australians (61 percent) support ALL three of Visa's main policy tenets: i.e. requiring payments companies to be licensed to operate in Australia (so they can be regulated uniformly), applying the same limits on interchange rates across all payment schemes and establishing an independent regulatory body within government to enforce limits on credit card surcharges (see Surcharging section below).

These consumer views are consistent with the FSI's observation on competitive neutrality. Indeed, if the current interchange regulations remain, then 73 percent of Australians support applying the same limits on interchange rates across the sector. Fairness in the marketplace was a key theme in the consumer research with 57 percent of Australians believing current interchange regulation is unfair.

Only 9 percent of Australians surveyed in March think the regulations should be left in their current state. There was also overwhelming consumer support for licensing of companies operating in the payments system, whether they be traditional or non-traditional participants, with 80 percent of Australians strongly supporting licensing requirements. Licensing would provide further protections for consumers and be viewed as a positive recommendation by the FSI.

Following the release of the FSI's Interim Report, Visa has conducted a recent round of follow-up consumer research from 22-24 August 2014 to update the evidence, with a focus on the Interim Report's Observation regarding the issue of competitive neutrality.²³ After testing general attitudes to proposals in relation to

²¹ Credit Where It's Due', Ian Lee, Geoffrey A. Manne, Julian Morris, and Todd J. Zywicki, 2013, pp 18

²² As above

²³ JWS conducted a nationwide online survey of 400 adults in the period 22-24 August 2014. Survey data was distributed and weighted to ABS population statistics to ensure survey demographics are representative of the larger

financial services organisations and caps on interchange rates, to establish trends against the March 2014 benchmark survey, we sought responses to the observation on regulation of credit card and debit card payment systems contained in the FSI Interim Report.

The results are clear and compelling:

- **72% agree, and only 11% disagree, that “payment systems that perform similar functions should be competitively neutral”.**

Building on the strong base of the nation-wide survey conducted in March 2014, this follow-up survey shows there is continuing strong support for a fair and equitable electronic payments system, backed by a strong regulatory environment.

Concerning a range of proposals in relation to financial services organisations:

- **82 percent support (53 percent strongly)** “creating one set of standards all electronic payments companies must follow when it comes to things like the fees they charge for their services”. This is consistent with the 83 percent support measured for this proposal in March 2014.
- **80 percent support (50 percent strongly)** “requiring all electronic payments companies to be licensed by the Federal Government in order to operate in Australia. This would include companies which already offer these services, like VISA, MasterCard and American Express, as well as new companies which want to offer these services in Australia”. 79 percent supported this proposal in March 2014.

This August 2014 national survey also finds continuing stronger support for the application of the same caps to interchange rates on all types of credit cards. **74 percent** of Australians **support** “applying the same caps to interchange rates for all types of credit cards, regardless of whether an American Express, VISA, MasterCard, or some other credit card is used”. This result is consistent with the 73 percent support measured in March 2014. Finally, in relation to the FSI Interim Report, respondents to the August 2014 survey were asked the following:

“The Financial System Inquiry released its interim report on 15 July 2014. It made the following observation...Regulation of credit card and debit card payment schemes is required for competition to lead to more efficient outcomes. However, differences in the structure of payment systems have resulted in systems that perform similar functions being regulated differently, which may not be competitively neutral.”

Australian adult population. The margin of error on the base sample of 400 interviews nationwide is +/- 4.9% at the 95% confidence level. Where relevant, trend comparisons have been made to the previous research conducted for Visa, the quantitative component of which comprised a nationwide online survey of 1,500 adults conducted between February 27 and March 4, 2014. Variations of +/-1% between individual category results and NETS is due to rounding.



Taking the Interim Report's Observation into account, and in their assessment, 72 percent of Australians indicated that payment systems that perform similar functions should be competitively neutral.



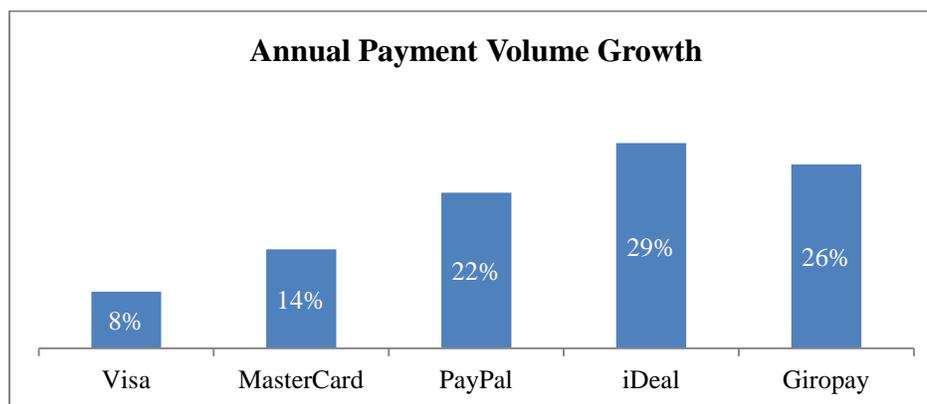
PSRA REFORM

There are simple solutions to achieve parity regulation for payment systems. As noted in Visa's March submission, under the PSRA, the RBA has discretion to take certain actions in relation to payment system operators, including but not limited to for example designation i.e. the RBA can designate a particular payment system as being subject to its regulation, can determine the rules for participation, as well as set standards relating to safety and stability (this can deal with issues such as technical requirements, procedures, performance benchmarks and pricing), and direct compliance.

A flaw in the current system is there is no automatic application of regulations to all current, new and future participants in the system. In short, to operate a payments system in Australia a company or an individual does not require a license to operate. This is almost unheard of in comparison to other sectors, i.e. to operate a bank requires an ADI license.

The global financial crisis highlighted the importance of appropriate and effective regulatory oversight of the financial system and so Visa continues to contend that there must be some form of licensing in the Australian system for players who have established accounts and transactions outside traditional payment systems.

As mentioned, there are a number of emerging new international competitors in the non-traditional payments space. There are alternative networks that operate payments by leveraging account-to-account transfers, i.e. payments that do not require the use of a card are proliferating in the market. Prominent examples of such networks include international player PayPal, iDeal in the Netherlands and Giropay in Germany. Each of these networks is growing more quickly than Visa or MasterCard, as can be seen from the chart below.²⁴ Regulations need to take this into account.



²⁴ eBay Inc., Annual Report 61 (Form 10-K) (Feb. 1, 2013); Currence Holding B.V., Annual Report 6 (2012), available at http://www.currence.nl/Downloads/Cu_uk_CurrenceJVUK2012.pdf; Visa, Inc., Q4 and FY 2012 Operational Performance Data 3 (Oct. 31, 2012); MasterCard Inc., 4th Quarter 2012 Supplemental Operational Performance Data 2 (Jan. 31, 2013); Giropay Transaction Volumes Up 26% in 2010, The PayPers (Feb. 17, 2011), available at <http://www.thepaypers.com/online-banking/giropay-transaction-volumes-up-26-in-2010/743453-12>



The payments landscape has transformed from one in which costly and inefficient paper-based methods of payment were the only option for commerce, to an environment where an array of fast, secure and reliable electronic payment methods are available. Competition is continually increasing, as new payment providers and new technologies enter the market and evolve. Electronic payments and particularly mobile payments (including e.g. mVisa) as well as national systems like M-Pesa in Africa and EasyPaisa in Pakistan, benefit national economies by permitting a far less expensive development of financial infrastructure than networks of bank branches that are necessary for cash-based economies.

Visa’s view is the FSI should propose that the PSRA or Regulations made under the PSRA be amended to include a wider, clearer definition of what constitutes a “payments system”, that is consistent with competitive realities, and that the PSRA be structured so that all such payments systems are automatically required to seek a license prior to commencing operations in Australia, including all existing schemes. This would remove the discretion of the RBA to determine through “designation” what constitutes a “payments system”, replacing this with a clearer determination of the Parliament that both better reflects the current and future state of payments in Australia and that would fairly and equally capture all payments systems including both traditional and non-traditional forms (as outlined in this submission and in the table below).

Payment Systems that Should be Captured Under the PSRA

Payment System	Regulatory Framework
<p>Traditional three and four party schemes (this list is not exhaustive):</p> <ul style="list-style-type: none"> • American Express • China Union Pay • Diners Club • Visa • MasterCard • EPAL (eftpos) 	<ul style="list-style-type: none"> ○ If interchange fee regulations are not revoked then all these schemes should be regulated as like products of similar economic substance. This will create competitive neutrality in the payments landscape and create a level playing field for competition in the market. An appropriate, wide and clear definition of “payments system” would need to be adopted and with amendments to the PSRA. ○ Should hold a license to operate in the Australian market (similar to an ADI under APRA’s oversight). This could include oversight, access and data collection powers.
<p>Non-traditional payment instruments (this list is not exhaustive):</p>	<ul style="list-style-type: none"> ○ These payment instruments should be regulated similarly to three and four party



<ul style="list-style-type: none"> • PayPal • Google Wallet • Amazon • Apple 	<p>schemes, particularly if there are any like practices on either interchange or surcharging as those of the three and four party schemes. An appropriate, wide and clear definition of "payments system" would need to be adopted and with amendments to the PSRA.</p> <ul style="list-style-type: none"> ○ Should hold a license to operate in the Australian market (similar to an ADI under APRA's oversight). This could include oversight, access and data collection powers.
<p>Future payment instruments yet to be established/launched.</p>	<ul style="list-style-type: none"> ○ As above.

Electronic payments are a critical component of the Australian economy, and important to financial institutions, Governments, merchants and consumers. As such, Visa submits that the regulatory frameworks under which payment systems operate must capture all payments instruments. Simple amendments to the PSRA as highlighted in the above table would level the playing field. Without reform of the PSRA to either remove interchange regulation or create an automatically applied level regulatory environment, these inequities will continue to disadvantage Australian end-user consumers and cost the economy as outlined in Deloitte Access Economics March 2014 Report.

SURCHARGING

Visa's position on surcharging remains the same. The optimal outcome for consumers would be to **ban surcharging** in Australia as has occurred in other markets. Our full views are contained in our FSI submission dated 29 March 2014.

If this is not enacted then we would highlight that it is critical for a regulatory body to be given the powers to monitor and enforce excessive levels of surcharging in Australia. Currently no regulatory body in Australia has legislative authority to do this.

Evidence indicates that in jurisdictions that permit surcharging today, including Australia, some merchants hit their customers with excessive surcharges that far exceed the cost of card acceptance. This has obvious negative impacts on the price that the consumer pays and disincentivises the use of credit and debit cards.

If we look for global evidence regarding surcharging, most countries support prohibitions on excessive surcharging, this includes through Visa's rules. In the United States a significant number of the major States (e.g. California and New York) prohibit surcharging.

In the United Kingdom the Office of Fair Trading has powers to enforce action against merchants who practice unacceptable levels of surcharging, a move which came into play in 2012. Such moves have positive outcomes for consumers and consumers support such policies, with the JWS Research from March 2014 finding that Australian consumer support is strong for policies which would limit (84 percent net support, 59 percent strongly support) or eliminate (81 percent, 58 percent) merchant surcharges on credit card purchases. 79 percent of Australians also support enforcement of surcharging levels by an independent Government agency.

The follow up JWS Research conducted from 22-24 August 2014 found that **81 percent support (58 percent strongly)** "*prohibiting merchants and retailers from adding surcharges to customers' bills when they pay with a credit card*". **78 percent support (44 percent strongly)** "*establishing an independent regulatory body within Government that is responsible for enforcing limits on credit card surcharges and other fees*". In August 2014, **85 percent of Australians support (60 percent strongly)** "*setting limits on credit card surcharges, the fees retailers add to customers' bills when they pay with a credit card*". 84 percent supported this proposal in March 2014.

There is strong consumer support for surcharging to be banned in the Australian market.

INNOVATION

FSI INTERIM REPORT OBSERVATION

Technological innovation is a major driver of efficiency in the financial system and can benefit consumers. Government and regulators need to balance these benefits against the risks, as they seek to manage the flexibility of regulatory frameworks and the regulatory perimeter. Government is also well-positioned to facilitate innovation through coordinated action, regulatory flexibility and forward-looking mechanisms.

Innovation in the payments world is ever evolving and rapidly changing and the FSI Interim Report calls out technological innovation as a major driver of efficiency in the financial system. Visa agrees and as such recommends technology neutral mechanisms to ensure that innovation is not stifled, having said that all participants in the payments system must be regulated in a similar manner to ensure that all have an equal footing in terms of being able to innovate. The competitive landscape in the payments industry is dynamic with moves towards digital, virtual and mobile products.

According to Mercator Advisory Group, *"the digital revolution is reshaping the payments industry. While plastic cards remain the dominant form of electronic payments, they face increasing competition from other types of payments including virtual cards and mobile payments"*.²⁵

Visa payWave is just one example of innovation that benefits consumers and the economy and for which there should remain technology neutral regulations. Visa's contactless payment technology enables "wave and go" payments at the shop counter, for purchases under \$100. Consumers are adopting the cards because they bring ease, convenience and security to the checkout. Visa payWave transactions have proven to be around three times faster and more convenient than paying with cash; and it meets all the same security standards as a traditional chip card. For merchants, electronic payments offer greater efficiencies with reduced cash handling costs and shorter queues. There are over 10 million²⁶ Visa payWave cards on issue in Australia. There are over 40 million²⁷ Visa payWave transactions made each month. Fifty per cent²⁸ of face to face Visa transactions are contactless and there are over 100,000 contactless terminals in place across the country. Merchants have invested in the terminal infrastructure to accept contactless payments and describe the benefits that have accrued to merchants from this investment.

²⁵ 'Embracing a Digital Future: Three Case Studies in Prepaid Card Distribution' Mercator Advisory Group, 2014 pp5

²⁶ VisaNet, March 2013

²⁷ VisaNet, January 2014

²⁸ VisaNet, July 2014

As such, Visa would support the adoption of the principle of technology neutrality, for future regulation recognising the need for technology-specific regulation on an exceptions basis. Visa would also support the establishment of a body to advise Government on technology and innovation – to be effective this must include private sector participants and from a payments perspective should work collaboratively with the Australian Payments Council (under the leadership of APCA and the RBA).

CYBER SECURITY

FSI INTERIM REPORT OBSERVATION

The financial system's shift to an increasingly online environment heightens cyber security risks and the need to improve digital identity solutions. Government has the ability to facilitate industry coordination and innovation in these areas.

Security is a top priority for Visa. Fighting fraud and protecting cardholders is fundamental to Visa's success. We invest heavily in advanced fraud-fighting technologies, and develop and deploy innovative programs that protect cardholders, merchants, and our clients. Today, the global fraud rate within the Visa system remains at near historic lows. Globally, fewer than 6 cents of every \$100 transacted on Visa cards are lost to fraud. And when fraud does occur in Australia, Visa cardholders are protected through Visa's Zero Liability policy, which guarantees that cardholders won't be held liable for fraudulent purchases made with their Visa card when processed through VisaNet.

Everyone in the payments system – merchants, financial institutions, networks, and cardholders – is affected when data compromises occur, because they jeopardize the trust we have worked to establish for more than 50 years. We work to maintain that trust every day by placing security foremost in everything we do. The payments industry has adopted a layered approach to data security. First, we protect consumers from financial harm through Zero Liability policies that ensure they are not held liable for fraudulent use of their accounts. Then, we work behind the scenes to protect their personal information and prevent fraud before it happens.

Visa believes security is a shared responsibility and all participants in the payment system have a role to play in protecting it. We are committed to educating, sharing best practices and collaborating with all key stakeholders to strengthen the payments infrastructure. We work directly with clients (Issuers and Acquirers), active participants in the system like third parties (e.g. Payment Facilitators, Card Vendors, and Independent Sales Organizations), Government and law enforcement, and consumers to improve data security and minimize fraud. In Australia, we coordinate and drive industry-wide initiatives such as the Australian Industry Working Group on Security.

We as an industry need to collaborate as effectively, if not more so, in order to prevent fraud and protect the payments ecosystem. Sharing information effectively is imperative.

Visa's strategy, which was first announced in 2008, aims to significantly reduce all types of card fraud and provide cardholders with a higher level of confidence in the security of their transactions. This work has been paying off. Today, payment card data is more secure and when data compromises at merchants or at independent processors do occur they are more quickly addressed and effectively managed. Technological advancements have aided in not only preventing fraud and detecting it sooner, but also in making stolen data less valuable to thieves.



Since rolling out chip-and-PIN cards in Australia when counterfeit fraud peaked in 2008, we have observed that counterfeit fraud has fallen from \$23.3 Million in 2008 to \$5.1 Million in 2013. From April 2013, all Australian issued Visa credit and debit cards carried chip technology, all merchant terminals were chip activated and from August 2014 cardholders will need to use a PIN instead of a signature to authorize transactions.

During 2013, 83 percent of compromises in Australia involved ecommerce merchants. Based on this trend, further steps have been taken by Visa to mitigate the threat for ecommerce merchants. In January 2014, Visa introduced an incentive to encourage ecommerce merchants to implement solutions with embedded security controls to improve data security and to reduce the threat of potential compromise. In the program, merchants will be granted safe harbor from non-compliance fines associated with a data compromise if the ecommerce merchants implement specific risk controls.

As cybercrime becomes more prevalent across the world, industry and Governments need to work together to address regulatory issues and laws to support the prosecution of criminals wherever they may be located.

As part of our Seven Point Security Plan, Visa is cooperating with industry members on a number of other initiatives:

- Financial institutions were required to enroll Visa cards and the majority are now in the process of implementing or upgrading existing services with dynamic authentication. We need both cardholders and merchants to adopt Verified by Visa.
- CVV2 – merchants accepting Visa cards over the internet, phone or by mail are required to ask for the three-digit card verification value (known as CVV2), to help ensure that cardholders using their cards in these circumstances are actually in possession of the card.
- Programs focused on enhancing awareness and increasing compliance with the Payment Card Industry Data Security Standards (PCI DSS) among small and medium sized businesses.

A critical first step in data security is to limit the amount of data that needs to be protected. Years ago, we campaigned successfully to eliminate the storage of sensitive data in the large merchant environment. This made it more difficult for cyber criminals to steal large volumes of data. But more sophisticated criminals are now stealing data in transit.

Therefore, strong data security remains fundamental to our program to protect the payment system.

Visa submits that Governments must provide leadership on cyber security and collaborate with the industry and law enforcement agencies to achieve the best outcomes. Approaches that are effective include the following:

- Set clear and high goals. To have a secure interoperable system that is reliable and safe, we must not compromise on the principle that entities – be they public or private – that handle crucial data must invest in top-notch security. This works by setting industry standards and working together in collaboration.



- Make standards clear and risk-based. For entities being asked to invest resources in security, it is critical to demonstrate that the areas they are bolstering are those where the most significant potential vulnerabilities exist. Adherence to global standards is also key, as it helps ensure interoperability and should ensure a proven and cost-effective path to compliance.
- Allow organizations to adapt their own solutions. There are rarely one-size-fits-all solutions in a large, diverse economy. The approach a mid-size grocery chain takes to security may be very different from a hotel chain's solution. The key is that both entities do what it takes to meet strong security standards, while enhancing rather than detracting from their operational goals.
- Finally, oversight is essential. In the spirit of "trust but verify", validation must be more than a one-time event, but rather an ongoing dialogue that encourages a culture of security within the entire network.

The role of Governments and industry working together is a core part of a successful strategy to combat cyber security compromises. The Federal Government certainly has the ability to facilitate industry coordination and innovation in these areas.

CONCLUSION

Visa welcomes the opportunity to provide further commentary to the FSI on its Interim report. We contend that the Interim Report's Observation on competitive neutrality in the Australian payments system is on the right track.

Our policy solutions are backed by strong evidence and we therefore resubmit for final consideration. Maintaining the status quo on interchange fee regulations and surcharging in this market is both undesirable and producing negative impacts on the economy, competition and system stability. Future proofing Australia's payments system with evenly applied regulations is also required to ensure that all innovators can compete on an even keel. Technology neutral legislation and regulation is therefore needed.

We submit the following policy recommendations to the FSI for adoption and recommendation to the Federal Government.

In summary, Visa recommends:

1. The FSI recommend to the Federal Government the amendment of the PSRA to end the regulation of interchange in Australia through the revocation of the limits on interchange fees.
 - a. 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 payments 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 in an anti-competitive manner.
 - b. This would also recognise the economic 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.
 - c. In addition, the FSI should propose that the PSRA or Regulations made under the PSRA be amended to include a wider, clearer definition of what constitutes a "payments system" that is consistent with competitive realities, and that the PSRA be structured so that all such payments systems are automatically required to seek a licence prior to commencing operations in Australia, including all existing schemes. This would remove the discretion of the RBA to determine through "designation" what constitutes a "payments system", replacing this with a clearer determination of the Parliament that both better reflects the current and future state of payments in Australia and that would fairly and equally capture all payments systems both traditional and non-traditional forms (as outlined in this submission).
 - d. Under such an arrangement we would support the continuation of the RBA's general oversight and data collection powers as established under the PSRA.
2. If Option 1 was unsupported and limits on interchange are to be maintained, the FSI should recommend to the Federal Government reforms to the PSRA to ensure all interchange and interchange analogues are equally regulated.

- a. We recommend this is best achieved by the FSI proposing that the PSRA or Regulations made under the PSRA be amended to include a wider, clearer definition of what constitutes a “payments system” and that the PSRA be structured so that all such payments systems are automatically required to seek a license prior to commencing operations in Australia, including all existing schemes. This would remove the discretion of the RBA to determine through “designation” what constitutes a “payments system”, replacing this with a clearer determination of the Parliament that both better reflects the current and future state of payments in Australia and that would fairly and equally capture all payments systems both traditional and non-traditional forms (as outlined in this submission).
 - b. All licensed payment systems would then be equally regulated, namely interchange or any interchange analogue would be limited at a common level and through a common mechanism. This common limit would be automatically applied rather than through the discretionary imposition of a “Standard” by the RBA, although the common level and mechanism would be determined by the RBA as the regulator. It is important to note that this would not constitute “new” regulation, merely the extension of existing regulation to existing, new and future entrants offering equivalent services.
 - c. Under such an arrangement we would support the continuation of the RBA’s general oversight and data collection powers as established under the PSRA.
 - d. This Option would re-set the PSRA to be much closer to the regulatory norm across other sectors, such as banking and financial services, where the automatic application of regulation to all similar participants is the norm.
 - e. This Option would also ensure the PSRA was prepared for the next 10-20 years of new entrants (both traditional and non-traditional), innovation and change in Australian retail payments.
3. In relation to surcharging, the FSI propose to the Federal Government that the PSRA, or any other relevant legislation, be amended to include a legislative prohibition on surcharging in Australia.
 4. If Option 3 was unsupported and some level of surcharging is to be maintained, the FSI should recommend to the Federal Government reforms to the PSRA, or any other relevant legislation, to clearly limit permitted surcharging and establish a public enforcement mechanism to ensure adherence to such a limit.
 5. Government must facilitate a whole of Government and industry approach and coordination on policies to combat data security issues.
 6. Government and regulators must adopt technology neutral laws and regulations to allow all players in the payments sector to equally compete on innovation. Government should establish a working group on innovation which includes payment systems.



Visa looks forward to the adoption of our policy recommendations in the interests of competition, efficiency, stability and the overall health of the Australian economy.





Appendix A

Deloitte Access Economics Response to the FSI Interim Report - August 2014

See separate attachment.





Appendix B

Interchange Rates Currently Published by Visa Inc.

Visa Interchange on Domestic Transactions in Australia

The fees listed here are payable by Australian acquiring institutions to Australian issuing institutions in relation to domestic Visa Credit and Debit purchase transactions processed through Visa's National Net Settlement Service.

Domestic Visa Credit Interchange Rates

Effective 28 June 2013, the following interchange rates apply to domestic transactions processed through Visa's National Net Settlement Service*:

Description	Rate inclusive of GST
Charity rate	0%
Strategic Merchant Program rate	0.22% - 0.44%
Recurring Payment Transaction rate	0.33%
Government rate	0.33%
Transit rate	0.33%
Utility rate	0.33%
Service Station rate	0.33%
Supermarket rate	0.33%
Education rate	0.33%
Insurance rate	0.33%
Electronic rate	0.33%
Standard, Card Not Present and Paper rate	0.33%
Platinum rate	1.023%
Super Premium (Visa Rewards), Non-qualified rate	1.65%
Super Premium (Visa Rewards), Qualified rate	1.87%
Super Premium (Visa Signature) rate	1.98%
High Net Worth, Non-qualified rate	1.98%
High Net Worth, Qualified rate	2.20%
Business rate	1.067%
Commercial Premium rate	1.43%
Business Signature rate	1.98%
Corporate rate	1.32%
Purchasing rate	1.32%



* Domestic transactions not processed through National Net Settlement Service will receive an interchange rate of 0.759%

Domestic Visa Debit and Prepaid Interchange Rates

Effective 9 November 2013, the following interchange rates apply to domestic transactions processed through Visa's National Net Settlement Service**:

Description	Rate inclusive of GST*
Charity rate	0.0%
Strategic Merchant Rate	2.2 cents – 66 cents
Recurring Payment Transaction rate	6.6 cents
Government rate	6.6 cents
Transit rate	6.6 cents
Utility rate	6.6 cents
Recurring Payment Transaction rate	6.6 cents
Service Station rate	6.6 cents
Supermarket rate	6.6 cents
Education rate	6.6 cents
Insurance rate	6.6 cents
Electronic rate	8.8 cents
Standard, Card Not Present and Paper rate	0.286%
Premium rate	0.55%
Business rate	0.935%
Corporate rate	0.935%

* All fees are represented in Australian Dollars

** Domestic transactions not processed through National Net Settlement Service will receive an Electronic interchange rate of 8.8 cents and a Standard rate of 0.33%

% = % of the transaction value

Cents = cents per transaction

Different fees apply when a Visa transaction involves either an overseas cardholder or an overseas merchant. Merchants should direct all questions relating to interchange fees to their Acquiring Institution.

There is a precedence in which interchange fee programs and rates are applied. Generally, acceptance based rates (e.g., utility, insurance, and recurring) take precedence over product-based rates (e.g., platinum and business). The following table provides a brief description of Visa's domestic interchange fee programs in Australia.

Interchange Fee Programs	Definition
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Charity rate

Payable on Visa transactions for merchants who are non-political fundraising organisations (organisations engaged in soliciting contributions) and social service organisations engaged in social welfare services, including advocacy groups, community organisations, and health agencies.

A charity is characterized as an entity:

1. That is also a trust fund or an institution
2. That is non-profit
3. That exists for the public benefit or the relief of poverty
4. Whose purposes are charitable within the legal sense of that term
5. Whose sole or dominant purpose is charitable

The charity must be recognized by the Australian Tax Office as a charitable organization, and must only be used for donations / payments that may be claimed as a tax deduction.

Strategic Merchant Program

Payable on Visa transactions for merchants designated by Visa to be strategic in which they meet certain volume and/or growth thresholds. The range of interchange rates available to this program is displayed.

Recurring Payment rate

Payable on Visa transactions initiated at a merchant who has entered into an agreement with their Acquiring Institution to participate in the Recurring Payment Transaction Service, where the cardholder has signed an agreement with the merchant to authorize the merchant to bill their Visa card for recurring payments, the transaction details are sent to the Issuing Institution, the Issuing Institution authorizes the transaction and the merchant sends the transaction to its Acquiring Institution for clearing and settlement with the Issuing Institution within four days.

Government rate

Payable on Visa transactions initiated at any merchant defined as a Government entity (meeting Visa's merchant classification requirements).

Service Station rate

Payable on Visa transactions for retail sellers of automotive gasoline and receive payment either at the counter through signing a sales slip or through the use of an Automated Fuel Dispenser (AFD). Automated Fuel Dispensers enable cardholders to purchase fuel by completing the transaction at the pump.



Supermarket rate

Payable on Visa transactions for merchants that sell a complete, full line of food merchandise for home consumption. Most of the food merchandise is perishable, including self-service groceries, meat, produce and dairy products. In addition, they also sell canned, frozen, prepackaged, dry foods, a limited selection of house wares, cleaning and polishing products, personal hygiene products, cosmetics, greeting cards, books, magazines, household items, and dry goods. These merchants may also operate specialized departments such as an in store deli counter, meat counter, pharmacy, or floral department.

NOTE:

Merchants typically known as convenience stores that sell a limited selection of products or specialty items are not eligible for this rate.

Education rate

Payable on Visa transactions for designated schools that accept Visa for payment. Schools include elementary, secondary, universities, correspondence schools, business and secretarial schools and vocational and trade schools.

Insurance rate

Payable on Visa transactions for merchants that sell all types of personal or business insurance policies. This includes merchants that provide the following types of insurance: automobile, life, health, hospital, medical, and dental insurance, homeowners and renters insurance, real estate title insurance, pet health insurance and flood, fire or earthquake insurance. This also include direct marketing insurance services e.g., accidental death, travel insurance, etc.

Transit rate

Payable on Visa transactions for merchants that provide local and suburban mass passenger transportation over regular routes and on regular schedules,

NOTE: Taxicabs, limousines, and bus lines are not eligible for this rate.

Utility rate

Payable on Visa transactions for merchants that provide the generation, transmission and/or distribution of electric, or gas power, or other utility type services on an ongoing basis. This also includes merchants providing water supply system services and merchants primarily engaged in the



collection and disposal of refuse.

NOTE: Merchants providing telecommunication services are not eligible for this rate.

Electronic rate	Payable on Visa transactions initiated at any merchant where a cardholder presents a consumer magnetic stripe card or a chip card, the card is used at an electronic terminal, all data on the card is successfully transmitted to the Issuing Institution, the Issuing Institution authorizes the transaction and the merchant sends the transaction to its Acquiring Institution for clearing and settlement with the Issuing Institution within four days.
Standard, Card Not Present and Paper rate	Applicable to all transactions on a standard consumer card that do not qualify for any other rate detailed. Typically these are transactions on Visa Classic and Gold cards that are used in a card not present environment (e.g., internet) or a non-electronic transaction (paper based). An electronic Classic or Gold transaction that is not settled within 4 days would receive a standard interchange rate.
Non-qualified rate	Applicable to transactions on accounts that do not meet the Spend Qualification Threshold of a given product as defined by Visa.
Qualified rate	Applicable to transactions on accounts that do meet the Spend Qualification Threshold of a given product as defined by Visa.

Other Key Definitions

- › **Commercial card** – a generic name given to the following card products: Visa Business Card, Visa Corporate Card and Visa Purchasing Card
- › **Business card** – a commercial card product targeted at small businesses
- › **Corporate card** – a commercial card product targeted at larger organisations for travel and entertainment and general purchases
- › **Purchasing card** – a commercial card product targeted at larger organisations for general purchasing and procurement
- › **Standard consumer card** – a generic name given to the following card products: Visa Classic, Visa Gold and Visa Electron
- › **Premium consumer card** – a generic name given to the following card products: Visa Platinum and Visa Enhanced
- › **Super Premium consumer card** – a generic name given to the following card products: Visa Rewards (including the Commonwealth Bank Visa Diamond and ANZ Black Visa cards) and Visa Signature.
- › **High Net Worth consumer card** – a generic name given to a Visa high net worth product such as Visa Infinite
- › **Acquiring Institution** – a Financial Institution which has applied and been granted membership to Visa in Australia for the purpose of acquiring payment card transactions in Australia
- › **Issuing Institution** – a Financial Institution which has applied and been granted membership to Visa in





- › Australia for the purpose of issuing payment cards in Australia
- › **Cardholder**– a person who has a Visa card issued by an Issuing Institution which is a member of Visa in Australia
- › **Merchant**– an entity which has entered into an agreement to accept credit cards for the purchase of goods and services with an Acquiring Institution which is a member of Visa in Australia
- › **Domestic Visa Credit card transaction**– a transaction in Australia between an Australian cardholder and an Australian merchant involving the purchase of goods and services using a Visa Credit card
- › **Domestic Visa Debit and Prepaid card transaction**– a transaction in Australia between an Australian cardholder and an Australian merchant involving the purchase of goods and services using a Visa Debit or Prepaid card

