

3. The ‘Honour All Cards’ Rule

Merchants that accept Visa credit cards are also required to accept Visa Debit cards under Visa’s so-called ‘honour all cards’ rule. MasterCard has a similar rule but, at this time, does not issue a debit product in Australia. This rule has received heightened scrutiny in recent years and, in addition to the Bank’s investigations, has been the subject of legal proceedings in the United States and an investigation by the European Union.

This section considers the ‘honour all cards’ rule in the Visa Debit system. The analysis could apply equally to similar products issued by other card schemes which applied such rules in Australia.

3.1 The Rationale for an ‘Honour All Cards’ Rule

There are two relevant aspects to the ‘honour all cards’ rule.

The first is that the rule requires merchants to accept Visa cards regardless of which bank or financial institution issued the card. This might be best thought of as an honour all issuers rule.

The second is that the rule requires merchants to accept all products issued under the Visa brand. This might be best thought of as an honour all products rule.

The main rationale provided to the Bank by Visa for the honour all cards rule largely relates to the honour all issuers aspect of the rule. Indeed, because Visa initially issued only credit cards, the ‘honour all cards’ rule related to issuers and there was no honour all products dimension. Over the years, however, Visa has expanded the types of products it offers under its brand. In particular, it now offers credit cards, debit cards and pre-paid cards (in overseas markets). Consequently, over time, the rule has gained an honour all products aspect in addition to the original honour all issuers dimension.

3.1.1 *Honour all issuers*

There is a general acceptance that the honour all issuers aspect of the rule is in the public interest. By insisting that merchants must accept Visa-branded cards regardless of the issuer, Visa is maximising the network value to cardholders and issuers. If merchants were allowed to selectively refuse cards issued by particular institutions, the value of the Visa brand and card system could be reduced. Selective refusal could generate a need for bilateral negotiation between issuers and acquirers and, potentially, merchants. This would raise the costs of participating in the system and generally impair efficiency. Cardholders could also be directly disadvantaged by not knowing whether cards issued by their financial institution would be accepted at any given merchant.

3.1.2 Honour all products

Visa has made two related arguments as to why the honour all products rule is also in the public interest.

First, it argues that the rule provides a cost effective way to offer multiple card products. For example, there is little additional cost to Visa of ensuring merchant acceptance of Visa Debit cards because it is a condition of merchants accepting Visa credit cards. Additionally, because the two products only differ in the nature of the customer account they access, there is no need for acquirer systems or the Visa network to be structured to accommodate any differences.

Second, Visa argues that the ‘honour all cards’ rule encourages the development of new products. That is, with a ready-made acceptance network, it is easier for issuers to experiment with new products. Visa argues that such experimentation is in the public interest.

3.2 Concerns with the ‘Honour All Cards’ Rule

The Bank’s concerns with the ‘honour all cards’ rule are focused on its honour all products aspect. The Bank accepts that the honour all issuers aspect of the rule provides efficiency gains and enhances the value of the Visa credit card network in a way that benefits the public. In contrast, the Bank does not view the extension of the ‘honour all cards’ rule across product types to be in the public interest. By ‘tying’ acceptance of one card product to another, normal competitive forces are diminished.

In consultation, merchants have repeatedly told the Bank that they would rather not accept the Visa Debit card on its current terms, yet they are forced to accept it as a condition of accepting Visa credit cards. A consequence of the forced acceptance is that competitive forces cannot bear upon the price of, or acceptance of, the product. In particular, merchants pay the same fees for Visa Debit as they do for Visa credit cards. This is despite Visa Debit not offering interest-free credit.

There is also the clear practical concern that competition between payment systems is being distorted by the rule. In most respects Visa Debit and EFTPOS are competing payment systems. In particular, for domestic point-of-sale transactions, which represent the largest segment of card-based transactions, they are effectively interchangeable – all that is required is the press of a different button at the terminal. Visa Debit, however, has a competitive advantage over EFTPOS because merchants are forced to accept the card when they make the decision to accept Visa credit cards and must pay a higher price to do so than with EFTPOS. Moreover, the higher interchange fee is used to encourage issuers to issue and promote Visa Debit in preference to EFTPOS. This raises concerns that, over time, the efficiency of the payments system will be impaired through the operation of the ‘honour all cards’ rule as it currently stands.

These concerns are reinforced by the experience of the United States. As discussed in Section 2, the combination of higher interchange fees and the ‘honour all cards’ rule has enabled Visa Debit and the similar MasterCard product to significantly increase their market shares in the US at the expense of alternative debit products. A significant spur to this was the higher revenue issuing banks could earn by issuing scheme-based debit cards over other debit cards.

These arguments were central to recently concluded litigation between US retailers, led by Wal-Mart, and the credit card companies. In this case, a number of US retailers sued Visa and MasterCard under US anti-trust laws to force Visa and MasterCard to remove the tying provisions between their debit and credit card products. The litigation was settled when Visa and MasterCard agreed to: pay \$US 3 billion to the retailers; reduce their debit card interchange fees; and untie the two products. Debit cards issued in the United States by Visa and MasterCard are now separately identified and subject to separate acceptance decisions by US merchants.

Finally, as discussed above, available cost data suggest that the Visa Debit system requires more resources to process a transaction than the EFTPOS system. These cost differences are not currently reflected in prices to consumers. The Bank's proposed regulation of interchange fees is aimed at reducing this discrepancy. Nonetheless, even with reduced interchange fees, the 'honour all cards' rule means that merchants will be unable to respond freely. Efficiency of the overall Australian payments system is likely to be enhanced if cardholders and merchants are in a position to freely evaluate the benefits provided by Visa Debit against the costs and make acceptance decisions based upon that evaluation. The honour all products rule significantly restricts this possibility.

3.3 Consultation and Summary of Submissions

The Bank invited submissions from interested parties at the end of January 2004 on whether it was in the public interest to designate the Visa Debit system. These submissions are available on the Bank's website. The Bank has also been engaged in ongoing discussions with Visa and Visa Debit issuers over the product.

As discussed above, Visa argues that there are a number of reasons why the 'honour all cards' rule is in the public interest. In addition, Visa's consultant, NECG, has detailed what it sees as the benefits for efficiency and competition of the 'honour all cards' rule. According to its analysis, the rule reduces consumer transaction costs and enhances efficiency by increasing the ability of a scheme to offer a wide choice of card products.

The issuers of Visa Debit and Visa also argue that the rule should be retained because Visa Debit is mainly issued by small financial institutions as a way of competing with the credit card issuance of the large banks. These smaller institutions would be disproportionately affected if merchants decided not to accept Visa Debit cards. They also argue that removing the rule would allow the large acquirers who do not issue Visa Debit to refuse to acquire Visa Debit transactions – thereby unfairly limiting competition.

MasterCard argues that retention of the rule is essential if it is to introduce a product to compete with Visa Debit on equal terms.

A number of industry participants suggested that the distinction between a debit product and a credit product will be increasingly difficult to make. For example, they raised the question of how a Visa card attached to a mortgage account should be classified. Also, it was argued, consumers may be confused if there are multiple variants of the Visa product available and significant expenditure would be required to educate consumers and merchants about the differences.

Some of those arguing for retention of the honour all products rule concede that, if something must be done, the no-surcharge rule could be formally removed, giving merchants the ability to charge a different amount for accepting Visa Debit than for accepting Visa credit cards. This possibility is raised because the no-surcharge rule has not been formally removed for the Visa Debit system – previous Bank standards applied only to the credit card systems, although *de facto* they also applied to Visa Debit as it is currently not possible to distinguish credit and debit cards. If Visa Debit cards were to become separately identifiable, as is canvassed in this document, the Bank proposes that the no-surcharge rule in the Visa Debit system be formally removed for the same reasons as applied in the case of credit cards. A number of submissions argue that most of the benefits of untying could be obtained by such an action without some of the perceived costs of a full untying.

The merchants, on the other hand, argue that the honour all products rule should be removed. They argue that Visa Debit offers them no benefits over and above those they receive from EFTPOS, yet it costs them considerably more. Given this, they would like the freedom to decline acceptance, and/or negotiate over the terms of acceptance. They point to examples from the UK and the recent Wal-Mart settlement in the United States to support the view that there is no detriment from abolition of the rule and, in particular, that consumers are not confused. Finally, the merchants argue that a pre-requisite for the abolition of the ‘honour all cards’ rule to have any effect is the separate identification of Visa Debit cards, both at the merchant/customer level and the issuer/acquirer level. There was little opposition amongst financial institutions to the proposal for separate identification on its own.

3.4 Possible Regulatory Responses

Through consultation three distinct options have emerged. First, there is the option of doing nothing. Second, some Visa Debit issuers have suggested that the honour all cards rule be retained but that separate product identification be required, thereby, allowing for differential charging by merchants. Third, there is the option of removing the honour all products aspect from the ‘honour all cards’ rule and making associated changes to ensure the effectiveness of this change.

Regardless of the option chosen, the Bank proposes to require that the no-surcharge rule be removed. This proposed change is essentially a housekeeping matter to ensure that Visa Debit cards are treated identically in this respect to other card payment products in Australia. A comprehensive discussion of the no-surcharge rule can be found in the consultation document on the credit card standards issued in December 2001.

3.5 The Bank’s Preferred Option

In the Bank’s view, current arrangements whereby it is not possible to treat Visa Debit cards and Visa credit cards differently are not in the public interest. In its opinion, the efficiency of the system would be promoted by Visa Debit competing against other debit and card products on its merits – something that it currently does not do. Thus, the Bank believes that no change is not in the public interest.

The first option for change is to mandate separate identification of Visa Debit and credit cards. This change would offer the possibility that a merchant could impose different charges on Visa Debit cards and Visa credit cards. If Visa Debit interchange fees are lowered in line with the draft Standard 4 outlined in the previous section, Visa Debit is likely to be cheaper for merchants to accept than Visa credit cards and this may be reflected in any charges levied by the merchant. Similarly, merchants may elect to impose a charge on Visa Debit transactions but not EFTPOS transactions.

The option would require Visa issuers to develop visually distinctive Visa Debit cards so that merchants would be in a position to identify the cards at the point of sale and impose different charges if they chose to do so.

The benefits of this option are, however, limited. It is unlikely that many merchants would take advantage of the ability to differentially charge for Visa Debit cards. Many merchants do not currently charge for accepting credit cards and fewer impose differential charges; as such, it is unlikely that many would differentially charge for Visa Debit cards. Consequently, in the Bank's view the implementation of this option would, at best, have little effect on market dynamics. And, to the extent that there are benefits, they are unlikely to outweigh the costs involved. As such, the Bank does not favour this option.

The second option for change is to require separate identification and modify the 'honour all cards' rule such that a merchant's decision to accept Visa credit cards did not automatically require him or her to accept Visa Debit cards (and *vice versa*).

By separating the acceptance agreements, Visa Debit would be required to compete with other payment systems on its own merits. If merchants do not see value in accepting the card at the price charged by their financial institution they will be free to decline acceptance. This would move the payments system closer to the benchmarks discussed in Section 1, enhancing the efficiency of the overall system.

Visa argues that there are higher costs involved in maintaining a separate brand for debit cards. Visa also argues that there may be increased customer confusion if Visa Debit cards were distinguished from Visa credit cards. In evaluating these arguments, the Bank noted that separate electronic identification of Visa Debit cards is, as a practical matter, required if differential interchange fees, as discussed in the previous section, are to be implemented. It views physical identification of the cards to be a natural complement to this change. Separate identification is also necessary if merchants are to be able to exercise their ability to accept just Visa credit or Visa Debit cards. Furthermore, recent advertising by Visa promoting the Visa Debit card suggests that Visa perceives some benefit from separate promotion of the product even absent regulatory changes. Ultimately, there has been little objection to the proposal to have separate product identification. On balance, while this approach would involve greater costs to implement than the previous option, it has larger potential benefits.

As noted above, concerns have been raised that, because Visa Debit is predominantly issued by small financial institutions, any restrictions on Visa Debit would harm their competitive position. While the Bank recognises this argument, it does not believe that limiting competition to protect the current issuers is in the long-term interests of the Australian payments system. There is the significant prospect that any regulatory authorisation of the 'honour all cards' rule

would contribute to rapid growth in issuance of scheme-based debit cards by larger financial institutions at the expense of EFTPOS. Furthermore, any action by large acquirers to refuse Visa Debit acquiring services to their merchants, as has been suggested might happen, would seem to be likely to raise further regulatory attention. More importantly, it is unlikely to be a profitable strategy for acquirers to follow.

On the basis of this discussion, the Bank's preferred approach is to require the modification of the 'honour all cards' rule to remove its honour all products aspect and make associated changes to support this.

3.6 Draft Standard on Visa Debit Identification and Acceptance Restrictions

This standard deals with two matters. The first is the abolition of the no-surcharge rule for Visa Debit transactions. Although the rule was removed for Visa credit transactions on 1 January 2003, there is still scope for it to apply to Visa Debit transactions. Paragraphs 8 and 9 of the Standard address this using language consistent with that in the standard for credit cards.

The second is the 'honour all cards' rule that requires merchants to accept Visa Debit cards if they accept Visa credit cards. Paragraph 10 would disallow this rule while paragraph 11 would provide for separate identification of Visa Debit cards.

Standard No. 5

The ‘honour all cards’ rules in the Visa Debit and Visa credit card systems and the ‘no surcharge’ rule in the Visa Debit system

Objective

The objective of this Standard is to ensure that the rules of the Visa Debit system and the Visa credit card system promote:

(i) efficiency; and

(ii) competition

in the Australian payments system.

Application

1. This Standard is determined under Section 18 of the *Payment Systems (Regulation) Act 1998*.
2. This Standard applies to the payment system operated within Australia known as Visa Debit, which was designated as a payment system on 18 February 2004 and to the Visa credit card system operated within Australia known as the Visa system or the Visa network card system which was designated as a payment system on 11 April 2001.

3. In this Standard:

an ‘acquirer’ is a participant in the Visa Debit system that provides services to a merchant to allow that merchant to accept a Visa Debit card;

‘credit card’ has the meaning it has in Standard No. 1;

‘credit transaction’ means a transaction in Australia between a credit cardholder and a merchant involving the purchase of goods or services using a credit card;

‘financial year’ is the 12-month period ending 30 June;

‘Visa Debit card’ means a card issued by a participant in the Visa Debit payment system, under the rules of the Scheme, that allows the cardholder to make payments to merchants for goods and services by accessing a deposit account held at the participant;

‘Visa Debit card transaction’ means a transaction in Australia between a Visa Debit cardholder and a merchant involving the purchase of goods and services using a Visa Debit card;

an ‘issuer’ is a participant in the Visa Debit system that issues Visa Debit cards to its customers;

‘merchant’ means a merchant in Australia that accepts a Visa Debit card for payment of goods and services;

‘rules of the Scheme’ means the constitution, rules, by-laws, procedures and instruments of the Visa Debit system and the Visa credit card system as applied in Australia, and any other arrangement relating to the scheme by which participants consider themselves bound;

terms defined in the *Payment Systems (Regulation) Act 1998* have the same meaning in this Standard.

4. Each participant in the Visa Debit system and the Visa credit card system must do all things necessary on its part to ensure compliance with this Standard.
5. If any part of this Standard is invalid, the Standard is ineffective only to the extent of such part without invalidating the remaining parts of this Standard.
6. This Standard is to be interpreted:
 - in accordance with its objective; and
 - by looking beyond form to substance.
7. This Standard comes into force on [1 July 2006.]

Merchant pricing

8. Neither the rules of the Scheme nor any participant in the Visa Debit system shall prohibit a merchant from charging a Visa Debit cardholder any fee or surcharge for a Visa Debit card transaction.
9. Notwithstanding paragraph 8, an acquirer and a merchant may agree that the amount of any such fee or surcharge charged to a Visa Debit cardholder will be limited to the fees incurred by the merchant in respect of a Visa Debit card transaction.

Honouring cards

10. Neither the rules of the Scheme nor a participant in the Visa Debit system or Visa credit card system may require a merchant to accept Visa Debit cards as a condition of the merchant also accepting Visa credit cards. Likewise, neither the rules of the Scheme nor a participant in the Visa Debit system or Visa credit card system may require a merchant to accept Visa credit cards as a condition of the merchant also accepting Visa Debit cards.

Transparency

11. Visa Debit cards must be identifiable as such, both visually and electronically.

12. The administrator of the Visa Debit system and Visa credit card system must certify in writing to the Reserve Bank by 30 September each year that the Visa Debit system and Visa credit card system and participants in those systems complied with this Standard in the previous financial year.