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Business Secrets

Visa International Service Association - Response to the South African Banking Enquiry

List of Attachments

A. Copy Visa Exemption.

B. Copy of Government Gazette Notice

C. Copies of Correspondence between Visa's attorneys and the South African Reserve Bank marked "C1" – "C7"

D. Certificate of Incorporation

E. Registration Certificate as External Company of South African Branch

F. Nabanco Judgement

G. Article on theft of cash

H. Publications on electronic payments and economic growth:

Developing cashless payment systems in modernising countries. Visa International. 2005.

Out of the shadows: Card systems and economic growth. Visa International. 200?

Payment solutions for modernising economies. Commonwealth Business Council and Visa. September 2004.

Playing your cards right for economic growth. Econometrix and Visa International. 2004.

The virtuous circle: Electronic payments and economic growth. Global Insight and Visa. June 2003.

Glossary

In this document, the following words shall have the following meanings:

“Acquirer” means a financial institution that enlists Merchants to accept cards in a four-party system.

“Europay/MasterCard” means Europay International, MasterCard International, collectively.

“Issuer” means a financial institution that enlists cardholders in a four-party system and issues cards to them.

“**Membe**r” means an organisation, which is a member of Visa.

“Merchant” means a seller of goods and services who accepts cards for payment.

“**MSC**” means Merchant Service Commission.

“National Organisation” means an organisation comprised of Visa Members and set up under the Visa By-Laws.

“Payment systems” means all common means of payment including without limitation, cash, cheque, debit, credit and store cards, travellers cheques, giro cheques, etc.

“Visa” means Visa CEMEA, Visa International, collectively.

“Visa CEMEA” means the Central and Eastern European, Middle East and Africa region of Visa International, Head Office, 1 Sheldon Square, London W2 6WH, UK.

“Visa International” means Visa International Service Association, Head Office, 900 Metro Centre Boulevard, Foster City, CA 94404, USA.

“VIOR” means the Visa International Operating Regulations.

1. INTRODUCTION

Visa's approach in this matter is set out below together with background information with regard to the Visa's SA Exemption and Visa's responses in respect of material and information alluded to by the Banking Enquiry.

1.1 Visa Exemption

On 5 November 2004 the Competition Commission granted an exemption to Visa South Africa, a branch of Visa International Service Association Incorporated, and to Visa International Service Association Incorporated (herein collectively referred to as "Visa") from the provisions of Chapter 2 of the Competition Act 1998 ("the Act"). The exemption was granted in terms of Section 10 (4) of the Act for 8½ years until 30 April 2013. A copy of the judgement granting the exemption is attached marked "A" and a copy of the Government Gazette Notice in respect of the exemption is marked "B".

The background to the exemption application is that in certain jurisdictions where there is a reasonably sophisticated banking infrastructure, Visa offers its members the opportunity of participating in the operation of the Visa system in their jurisdiction. This entailed the incorporation of a new company for the new Visa National Organisation in South Africa. This new National Organisation would have Visa, and all of Visa's South African members, as its shareholders. Visa's South African members are, all, South African banks.

In other words Visa and the banks would get together through the vehicle of a new South African entity, which was incorporated as Visa South Africa (Pty) Ltd (herein referred to as "Visa SA") on 10 February 2006 under number 2006/003893/07. In getting together, these members and Visa would discuss Visa business issues including the issue of the Visa interchange rate. Visa was advised that discussions and business of this kind could be regarded as contravening provisions of the Competition Act and that it would, therefore, be prudent to endeavour to obtain an exemption from those provisions.

Prior to the granting of the exemption the Visa system had worked by the incorporation of South Africa into a sub region, for Visa business, which included various other countries. Visa members were represented in this sub-region by fellow members. In the case of South Africa, two Visa members were on the committee of the relevant sub-region and these two represented all of the other South African Visa members. The meetings of these sub-regions would discuss the operation of the Visa system, including the interchange rate, in the countries in the sub-region.

This was not a participative system in so far as other Visa members in a sub-region were concerned. Moreover, where appropriate, therefore, members in certain countries (including, for example, the United Kingdom) were afforded the opportunity of forming their own, participative, national organisation.

The shareholders' agreement for Visa SA was submitted to the Competition Commission and it was explained that the member banks of Visa SA were in a horizontal relationship, as shareholders, and would effectively control the determinations which Visa SA made and which would involve prices and could involve other trading conditions. The Competition Commission accepted that "in the absence of an exemption" the agreement would constitute a contravention of certain provisions of the Competition Act. Page 173 of the report on the National Payment System and Competition in the Banking Sector prepared for the Competition Commission also refers to the necessity for banks to obtain an exemption, albeit in a different context.

The effect of the exemption is that Visa SA came into existence and it provides services previously provided by Visa.

Banks which are members of Visa became shareholders of Visa SA and appoint the directors of, and thereby control, Visa SA subject to the shareholders' agreement. In this, regard the Competition Commission held in its judgment granting exemption in relation to this proposed arrangement that:

> "*The member banks are in a horizontal relationship, as shareholders in Visa NO, and will effectively control the determinations which Visa NO makes and which would involve prices and could involve other trading conditions. In the absence of an exemption, the agreement would constitute a contravention of section 4(1)(b)(i) of the Act*."

If it was not necessary to obtain the exemption then competitors could simply form a single company to make decisions on prices and trading conditions and, outside the umbrella of such a company, carry on their separate businesses. The Competition Commission made it clear, in its judgment, that this would not be acceptable without the exemption which it gave and for which Visa and Visa SA qualified by virtue of the particular structures and intellectual property in question.

In its judgment the Commission further stated that it had

> "*… considered the conduct which would contravene the Act, and in particular inter-bank charges and the so-called one-acquirer rule."*

The commission accepted that payment by an acquirer bank to an issuer bank required an agreement between the two banks in question on the charge by the issuer to the acquirer, which it regarded as being

> "*eventually payable by the merchant."*

In other words, the Commission considered that issuing and acquiring banks would conclude agreements which also resulted in payments being made by merchants. Much more is said about this below, including in connection with the factors which might affect the charges by acquirers to merchants.

For present purposes, it is important to note that Visa does not receive any part of the interchange fee nor of the merchants' service charge. Those monies are received by the issuers and acquirers respectively. Visa is paid a licence fee by its members.

There is a licence agreement from Visa to Visa SA which enables Visa SA to use the intellectual property of Visa, including the VISA brand. It is obviously important for the integrity of that brand to be maintained, upheld and be beyond reproach, especially since one of the objectives of Visa is to provide a payment system which is an alternative to cash.

As regards the one acquirer rule, the Commission had originally wanted it to be clear that this rule would not apply. However it found that

> "*... the South African Reserve Bank is opposed to the practice of sorting-at-source ...*
>
> *The Commission therefore did not include multiple – acquiring as a condition for the exemption*."

The notice of the exemption published in the Government Gazette, *inter alia*, states that:

> "*... the applicants have requested that they be permitted to agree on prices and set out trading conditions <u>in terms of the agreement</u> by the members to set up a Visa National Organization for South Africa, which practices are prohibited by Section 4(1)(b) of the Act….*
>
> *The Commission grants the Applicant an exemption from the application of Chapter 2 of the Competition Act ..."*

In regard to the underlined words in the above quoted passage the agreement provides, *inter alia*, that:

> "4.1 Visa South Africa will:
>
> *4.1.1* .....
>
> *4.1.2 provide a forum for Visa members to discuss matters relating to the Visa System and business in South Africa, ….*
>
> *4.1.3* ....
>
> *4.1.4 set domestic interchange rates, and domestic floor limits amongst Visa members;*
>
> ……"

It is clear from the aforegoing that the members of Visa SA (i.e. Visa NO) may engage in agreeing prices and trading conditions either as members or as directors of Visa SA – in other words at a meeting of members or directors of Visa SA.

The practical implementation of the exemption is that:

- Visa SA provides a forum for its members to discuss matters relating to the Visa system and business in South Africa.

- The shareholders' agreement amongst the banks makes it clear in paragraph 4.1.4 thereof (see as quoted above) that Visa South Africa will set e.g. interchange rates. Accordingly once the rates are set by Visa SA the member banks would be bound by those rates.

- If a member is in breach then, *inter alia*, the membership of that member can be terminated – see paragraphs 7.1, 7.2, 2.3 and 2.4 of the shareholders' agreement.

1.2 Approach

Having been exempted from the provisions of Chapter 2 of the Competition Act, there is no real need for Visa to participate in the present enquiry into The National Payment System and Competition in the Banking Sector. Visa has, however, taken the approach that, albeit Visa SA and the activities of Visa SA are exempt, it nevertheless wishes to be participative in the enquiry into an industry of which it forms part. This approach by Visa may not, of course, be construed as derogating from or prejudicing, in any way, the exemption which the Competition Commission has granted in respect of Visa SA and the activities of Visa SA.

Visa have been requested to provide information to the Banking Enquiry by the Competition Commission at the meeting of 17th of October 2006 and subsequent conversations with Visa's Legal advisers.

Visa have tried to the best of their ability in the short time frame, to provide relevant documents and information to the Banking Enquiry's request. Due to the very general nature of the Enquiry's request, Visa have thought that the best approach would be to set out the context and background of the subjects raised.

Visa have provided information on other jurisdictions where Visa believe it is appropriate and where the Enquiry has requested information. Visa has worked with regulators in several jurisdictions for many years and there is an enormous literature of documents. Visa would be happy to provide additional information on any areas of regulatory enquiry should the Enquiry provide Visa with guidance as to specific subject matter areas. As Visa were informed that the Enquiry have been speaking to other regulators, Visa understands the Enquiry may have many of these documents. If Visa are in a position to provide the Enquiry with any which the Enquiry lacks Visa would do so where it can.

Please note that Visa are happy to answer additional questions and to provide further information on any of the subjects mentioned in this document should the Enquiry so request.

1.3 Excluded Areas

At the outset Visa would say that there are certain areas where it does not have the sort of information which the Enquiry may want. These include specifically:

1.3.1 The application of "sorting at source" or "multiple acquiring"

As stated to the Competition Commission in its exemption application Visa has no difficulty with multiple acquiring or sorting at source. Visa does not take a position one way or the other. Visa does not specify rules to its members which preclude "sorting at source" or "multiple acquiring." Visa understands that the South African Reserve Bank has prohibited multiple acquiring and sorting at source, for reasons which have not been made clear to Visa, and that the South African Reserve Bank may or may not maintain this position.

In this regard there is attached marked "C1" to "C7" copies of correspondence between Visa's attorneys and the South African Reserve Bank. This correspondence emphasizes that the multiple acquirer / sort at source issue has got nothing to do with Visa, but is an issue concerning a separate governmental regulatory body.

1.3.2 The lack of an interchange rate in Finland, Denmark, Luxembourg and the Netherlands

Members of Visa are free to set their own interchange rates in terms of Visa's rules. Members can, therefore, set the rate at zero. From

Visa's perspective the members make the decision. The members in those countries may well be recovering their costs in other ways.

Visa is, however, consulting with its associated entity, Visa Europe, in an endeavour to obtain clarity in this area and this will be provided to the Enquiry as soon as it is obtained. The information could not be obtained in the short time available to Visa.

1.4 Other

If there is any other information which the Enquiry would like and which is not included in these papers, or in respect of which clarity is required, the Enquiry is urged to communicate with Visa to obtain this.

2. VISA INTERNATIONAL SERVICE ASSOCIATION

2.1 Background: Corporate Body

Visa is a corporation organised under the laws of Delaware, United States of America. Visa has a registered office in the City of Wilmington, County of New Castle, State of Delaware and its principal place of activity is: 900, Metro Center Boulevard, Foster City, SA 94404, United States of America and its offices at 1 Sheldon Square, London W8 5TE, United Kingdom.

Visa was established on the 6th June 1974. Visa carries on the business of a worldwide payment system that is organised and run at local levels. To achieve this Visa is divided into six autonomous Regions: Asia Pacific; Canada; European Union; Latin America; USA and CEMEA (Central Europe, Middle East and Africa).

Visa Members have voting rights, which are allocated according to the fees paid. They vote to appoint board directors for the respective regional boards; the regional boards in turn elect the International board of directors.

Visa gives its Members a framework within which each member can supply its customers with the key elements of a worldwide payment system:

- Worldwide recognisable trademark

- Infrastructure for interchange without the need for bilateral arrangements between the participating institutions

- Sophisticated and effective authorisation and clearing network

The management bodies are set out in the Visa International By-Laws and they comprise the International Board of Directors, the Visa International CEMEA Board of Directors and the Visa International CEMEA Management Committee

The principle corporate documents of Visa are the Certificate of Incorporation, copy of which is attached marked “D”, and the Visa International Operating Regulations and By-Laws (“VIOR”). The Certificate of Incorporation sets out, among other things, the business purposes of Visa, its legal status and (in outline form) the composition and powers of the Board of Directors. It provides that Visa is empowered, among other things, to administer through its membership, a worldwide consumer payment system including, but not limited to, credit cards, debit cards and traveller’s cheques, all utilising common marks. Ancillary objects include the acquisition and licensing of copyright and trademarks, the recruitment of new Members and the development of computer systems and programmes. Visa’s customers are its Members or prospective Members. Visa does not provide products or services directly to cardholders or Merchants.

2.2 Visa Organisation

Visa does not itself issue any payment instruments. It is the Members of Visa who may issue to their customers a variety of payment instruments bearing the Visa mark. Visa does not enter into contracts with Merchants to accept payment cards. Rather it looks to set minimum standards for card use on both a local and international level to protect the Visa system, the cardholder, merchants and Member banks.

In essence, Visa provides the Visa Members with key elements and standards for a worldwide payment system: Trademarks and a format recognised world-wide; Operating Regulations providing an infrastructure for Members to exchange paper ("interchange") without the need for bilateral arrangements; and authorisation and clearing services provided by a sophisticated global computer and telecommunications infrastructure. Visa gives its Members a framework, via the VIOR within which each Member can supply its customers with international payment systems for use on a scale they could not otherwise have achieved. Moreover, Visa exercises no control over the contents of agreements between cardholders and card issuing Members (save in respect to minimum standards for gold cards, infinite, platinum cards and commercial products). Visa does not control the type of financial services offered by the issuing Member (e.g. debit card, deferred debit card, charge card, credit card or commercial card), nor the terms on which that service is provided (e.g. initial or annual subscription charges, charges for credit, if any).

Visa Members participate in the authorisation process in one or both of two capacities; as an Acquirer and/or as a card Issuer. In circumstances where a transaction requires an Issuer approval prior to purchase (e.g., when the value of the purchase is above the merchants specified floor limit) a Merchant will contact his acquiring bank, which will authorise the transaction itself if the cardholder involved is one of its own cardholders (an "on us" authorisation). If the cardholder is using a card issued by another Visa Member, authorisation must be obtained from the card Issuer concerned. This is achieved by routing the authorisation request on a pre-defined processing route. The processing route may be direct to another

Member or third party service provider where a bilateral agreement exists, or to VisaNet.

Visa owns and manages an efficient and reliable global processing infrastructure, VisaNet. VisaNet provides a wide range of processing services to the Visa membership, including, but not limited to, authorisation routing, currency conversion, clearing, and risk management and settlement enablement. The processing services offered by VisaNet are optional at a domestic level and Members may elect to use these, or make their own provisions. In practice, due to the infrastructure and banking maturity in the CEMEA Region, many domestic transactions are conducted without the use of VisaNet, such as in South Africa.

It is important to set out that Visa members bank are distinct legal entities incorporated under a specific legal regime of whatever country of jurisdiction they are located in. The Visa member banks have to be financial institutions and regulated by the appropriate Central bank. They have to be organised under the commercial banking laws of their equivalent of any country. Further, VIOR requires that a Visa member has to adhere to and follow local law. While Visa lays down various requirements designed to protect the Visa mark and promote security of the system, regulation of retail banking services is determined by country of jurisdiction of the member rather than by Visa.

Visa lays down the minimum criteria on the terms on which Members contract with the Merchants to participate in the Visa system essentially for operational reasons and for the purpose of insuring relatively consistent acceptance procedures for consumers. The four principal requirements set down by Visa relate to: (a) Criteria for recruitment; (b) Honour all cards; (c) Non-discrimination (or surcharging); (d) Compliance with authorisation and other operational procedures.

2.3 Membership of Visa

Visa would stress that membership of Visa is open and non-exclusive. In order to be eligible for membership, an organisation must meet Visa International's eligibility criterion, which is set out at Section 2 Visa By-Laws. Organisations, which participate in a competing payment card system, remain eligible for Visa membership.

Generally, a Visa member must confine its card operations to the country in which it has its principal place of business.

In order to manage global risk Visa uses a series of criteria and approaches to evaluate potential members. Below, is a brief description of the mandatory requirements, which have to be met by Visa applicants. This function is carried our by a designated department in Visa, Member Risk Department:

Application for membership in Visa may be made by any organization that desires to participate in Visa card issuing and/or acquiring. Members have to be (i) organized under the commercial banking laws or their equivalent of any country or subdivision therefore, and authorized to accept demand deposits; or (ii) controlled by one or more organizations described above. Visa does have members who are not technically commercial banking institutions, and/or do not accept demand deposits, these include Post Offices and Insurance companies. As Visa guarantees interbank payments between members, Visa takes initial responsibility to cover any losses, which may be incurred by banks to ensure and guarantee the reliability and security of the system to merchants and cardholders.

The objective of the Member Risk Department, which is in charge of evaluation of status of financial institutions aiming at becoming Visa members, is to identify, advise upon, and manage settlement risk in CEMEA region, for the benefit of Visa and its members. The CAMELS approach is used as the global standard and is used, amongst others, by the FSA (Financial Services Authority) in the UK. **CAMELS** is an acronym and it stands for:

Capital

Assets

Management

Earnings

Liquidity

Sensitivity

Please note: None of the figures and ratios are acted upon on a stand alone basis and should be viewed in conjunction with other multiple factors. The points below should be looked upon as guidelines only.

Capital: Capital, capital adequacy or solvency, is the measure of whether a bank's portfolio and business risks are adequately offset with available "risk capital" (i.e. equity) to absorb potential losses. To assess the appropriate level of capital, it should be viewed in relation to the bank's credit risk, market risk, off-balance sheet (contingent liabilities) risk and business risks.

Assets: Asset quality is the most important, and most difficult, element of bank analysis and tends to be highly subjective. The majority of bank failures are due to low quality of risk assets. Banks can sometimes have substantial unrecognised asset-quality problems which are not apparent in the accounts and which could eventually crystallise and cause failure. For example, one of ratios Visa looks at is loan loss reserves/gross loans and compare it to NPL (non performing loans) for the previous year.

Management: This is a subjective area to evaluate but is best judged on the basis of:

the credit-approval culture;

the management information systems (MIS) available;

the provisioning policy;

historical success e.g. profitability.

Earnings: Earnings not only add to an institution's capital base; it is also a quantitative measure of management's ability to achieve success in the critical areas of asset quality, overhead control, and revenue generation.

Liquidity: Liquidity, or asset-liability management, is an important element of the overall assessment of a bank's soundness. Liquidity is often the primary factor in a bank's failure, whereas high liquidity can help an otherwise weak institution to remain funded during a period of difficulty. For central area banks it is 20% or higher.

Sensitivity: Sensitivity reflects the vulnerability to shifts in markets, be they interest, foreign exchange (FX), stocks and shares, indices or others. Visa evaluates the impact of Value at Risk (VaR) calculations upon balance sheets/profitability. [Note: In economics, the Value at risk, or VaR, is a measure used to estimate how the value of an asset or of a portfolio of assets will decrease over a certain time period under usual conditions. VaR has two parameters: (i) the time period we are going to analyze (i. e. the length of time over which we plan to hold the assets in the portfolio - the "holding period") and (ii) the confidence level at which we plan to make the estimate.

Compliance with Anti-Money Laundering Requirements. This is a mandatory requirement for all Principal Visa members including those in South Africa to conduct a self-certification of anti money laundering status (Anti-Money Laundering Certificate). Consistent with the legal and regulatory requirements applicable to a Visa member, a member must implement and maintain an anti-money laundering programme that is reasonably designed to prevent the use of the Visa system to facilitate money laundering or the financing of terrorist activities.

Visa does not wish to have dealings with any institution that, by virtue of its business activities, connections, ownership, etc. may cause the good name of Visa to be called into question. Visa takes the security of the Visa systems very seriously indeed and the criteria Visa uses to ensure applicant member banks are of a 'safe' standard with robust internal processes is designed to this end. That does not mean that smaller and less developed banks are refused entry to the Visa system. Indeed, there are a variety of membership classes, that we set out below, that provide a series of products and services to meet all sizes and conditions of banks.

There are eight classes of membership: Principal, Associate, Participant, Merchant Bank, Cheque Issuer (this relates to travellers cheques only), Plus Programme Participant, Interlink Programme Participant and Cash Disbursement Member.

A Member's class of membership determines its rights and responsibilities. All Visa Members in South Africa are currently Principal, Associate or Participant.

> A **<u>Principal</u>** Member may issue cards and acquire merchants (subject to Visa licensing). It may also carry out all the activities associated therewith (e.g. providing an authorisation service, interchanging vouchers and so on). The Principal can undertake these functions directly or by contact with other Members. The processing functions can also be contracted to third parties.

>> An **<u>Associate</u>** must be sponsored by a Principal. It can then carry out all the functions of a Principal subject to its written agreement with its sponsor. Visa International requires the

sponsoring Principal to give a standard-form of undertaking to Visa International accepting full responsibility for compliance with all Visa rules and regulations by its Associate Members.

A **Participant** must be sponsored by a Principal. It can then assist the sponsor in performing its functions. . Visa International requires the sponsoring Principal to give a standard-form of undertaking to Visa International accepting full responsibility for compliance with all Visa rules and regulations by its Participant Members. However, a Participant cannot enter into direct contractual relationship with cardholders or merchants.

3. VISA IN SOUTH AFRICA

The Visa registered office in South Africa's is at 97 Central Street, Houghton 2198. The current General Manager is Mr. Robert Clark. Under the, Republic of South Africa Companies Act 1973, a certificate of Registration of Memorandum of External Company (section 322 (2)) was issued on 25th September 1993 to Visa International, a copy of which is attached marked "E".

The South African Office is responsible for developing the Visa business in Southern Africa, mainly sub-Sahara Africa and the Republic of South Africa. This office provides the main point of contact for Member banks and should in turn facilitate and progress greater ties between the South African Member banks and the Visa International London offices.

Key activities that are supported by the local office in South Africa are the provision of an interface between Visa and the South African Visa Members for the following services:

Education and Training - Visa's Business Education department will continue to liaise with the Central Bank and other governmental bodies and Member banks to develop facilities with a focus on the local internal market.

Marketing - Visa will continue to provide marketing support on all aspects of payment cards.

Risk Management - The South Africa Member banks benefit from the experience gained from Visa's other regions, and particularly in the areas of fraud and counterfeit, with a focus on local Risk issues.

Operations - Visa supports Base I, authorisation systems, and Base II, clearing and settlement systems, Endpoint management, connectivity and networks.

Implementation - Visa is able to provide a quick, easy and high level of support for Member Banks.

Chip and e-commence - This is one of the fastest growing areas of Visa activity. Visa will continue to support Member banks with frequent information on technology changes. The South African market is one of our most vibrant markets in this area

The Visa office in South Africa is not responsible for any commercial issues such as product sales. Any commercial activity is run from the CEMEA Regional Office at I Sheldon Square, London. Visa is not, nor will it be, in anyway involved in banking business, (such as accepting deposits) in South Africa. This of course falls within the remit of the South African Member banks.

3.1 South African Members

Initially Barclays was the only Visa Issuer and Acquirer in South Africa, and the Representative Office was originally set up, with one local employee to service the needs of that Visa member, and to expand the Visa business. Today there are 40 employees in the office and 10 Principal Members and 2 associates, which are listed below:

ABSA Group Limited	**International Principal Member**
	International Plus Acquirer
	International Plus Issuer
	International Merchant Acquirer
	International Ecommerce Acquirer
African Bank Limited	**International Principal Member**
	International Plus Acquirer
	International Plus Issuer
Albaraka Bank Limited	**International Associate Member**
	International Plus Sponsored Issuer
	International Plus Sponsored Acquirer
Capitec Bank Limited	**International Principal Member**

	International Plus Acquirer
	International Plus Issuer
FirstRand Bank Limited	**International Principal Member**
	International Travel Money Issuer
	International Merchant Acquirer
	International Ecommerce Acquirer
Investec Bank Limited	**International Principal Member**
Ithala Limited	**International Associate Deposit Access**
	International Plus Sponsored Issuer
	International Plus Sponsored Acquirer
Merchantile Bank Limited	**International Principal Member**
Nedbank Limited	**International Principal Member**

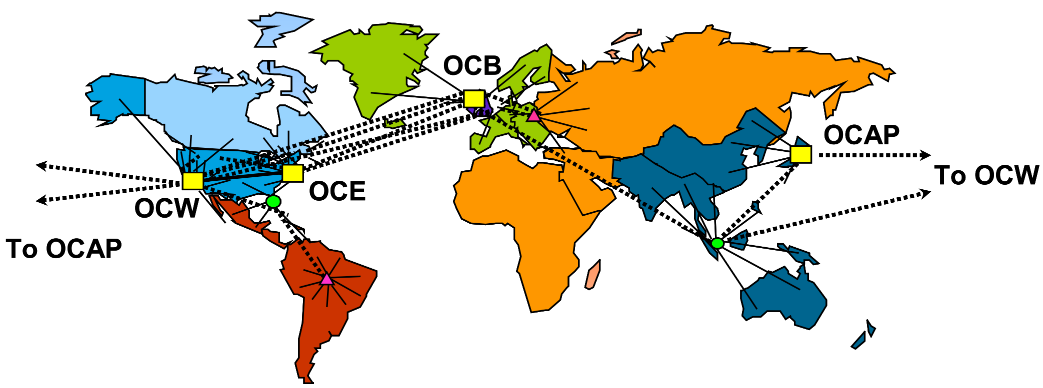
	International Merchant Acquirer
	International Ecommerce Acquirer
Rennies Bank Limited	**International Principal Member**
	International Plus Acquirer
	International Plus Issuer
Teba Bank	**International Principal Member**
	International Plus Acquirer
	International Plus Issuer
	Regional Member Acquirer
The Standard Bank of South Africa Limited	**International Principal Member**
	International Plus Acquirer
	International Plus Issuer
	International Merchant

	Acquirer
	International Ecommerce Acquirer
American Express	**Foreign Branch License**
Australia and New Zealand banking Group Limited	**Foreign Branch License**
Bank of New Zealand	**Foreign Branch License**
Barclays Bank of Canada	**Foreign Branch License**
Barclays Bank PLC	**Foreign Branch License**
Citibank, N.A	**Foreign Branch License**
Interpayment Australia Ltd.	**Foreign Branch License**
Interpayment Services Limited	**Foreign Branch License**
Overseas-Chinese Banking Corporation Ltd.	**Foreign Branch License**
Standard Chartered Bank	**Foreign Branch License**

4. SETTLEMENT IN SOUTH AFRICA

The primary operation of Visa is to administer a worldwide consumer payment system for its members, that enables them to provide their customers with the means of making payments for purchase of goods and services conveniently and securely throughout the world through various card products such as credit cards, debit cards and traveller's cheques. Providing the foundation of this consumer payment system is a global computer network called 'VisaNet' that links its members around the globe.

4.1 VisaNet Network and Operations



A detailed note on the sequence of steps involved in Visa's global payment system and on the working of the global payment system is provided below.

4.2 Sequence of Steps

The steps involved in the process have been summarised hereunder:

- Initially, a customer applies to an Issuing Member to issue a VISA Card. The issuing Member issues the VISA Card to its customer.

- An Acquiring Member has agreements with Merchant Establishments to authorise the latter to accept the VISA Card.

- The VISA cardholder goes to a Merchant Establishment desiring to make a purchase. The VISA cardholder presents his or her VISA Card to the Merchant Establishment to effectuate payment. The merchant requests authorization, which, with limited exceptions, is performed through VisaNet. This involves the VisaNet hub switching transactions from the Acquiring Member to the Issuing Member in order to enable the latter to verify cardholder data and credit status before issuing an authorization message back through to the Acquiring Member also through the VisaNet network. If the merchant receives authorization, the merchant requests that the customer signs the charge slip and deliver the goods.

- The Merchant Establishment sends its charge slip to the Acquiring Member. The Acquiring Member pays the Merchant Establishment.

- The Acquiring Member keeps the charge slips but sends the transaction details to VisaNet where the information is transmitted by VisaNet to the Issuing Member. This involves the settlement and clearing process.

- The Issuing Member sends a statement to the VISA cardholder.

- The VISA cardholder makes the payment to the Issuing Member. The Issuing Member pays the Acquiring Member via a VISA settlement bank.

Thus, in summary, when a customer makes payment through a VISA Card, the Merchant Establishment recovers the money from the Acquiring Member. The Acquiring Member recovers the money from the Issuing Member who, in turn, recovers the amount from the customer. The settlement between the issuing Member and the Acquirer Member is in the nature of an interbank settlement.

4.3 <u>VisaNet</u>

In order to effectuate the flow of transactions described above, Visa is required to maintain a secure and reliable global network to connect all its members across the world. VisaNet consists of “hubs, which are switching and data processing centres where Visa’s computer servers are situated. VisaNet is used for payment card (i) authorization and switching worldwide and (ii) for settlement and clearing operations between member financial institutions. There are four hubs worldwide; two in the United States of America, one in England and one in Japan. Each hub backs up the others. Members in that region can connect to this hub through a network of leased lines terminating with equipment called the VisaNet Access Point (“VAP”) at member’s sites.

VAPs are merely PC-based computer systems (comprising of “connectivity” software products working along with computer hardware of the requisite capabilities) with features and functions that prevent fraud and illegal access to VisaNet. The VAP is connected to the VisaNet hub in either the UK or USA.

Visa hires “leased lines” from the British Telecom (“BT”) who in turn sub contracts them from local country suppliers and for connecting the VAPs to the “node”. Leased lines are ordinary but dedicated telephone cables with high-bandwidth, which are at all times owned by the supplier. The Leased Lines are merely hired by Visa for a rental fee. Besides these connectivity tools, Visa has no other equipment in South Africa.

VisaNet provides the network to facilitate the: (a) authorization and switching; and (b) clearing and settlement for both domestic and international transactions; generally; unless the Issuing Member and the Acquiring Member are the same financial institution and are located within the same country or, in certain limited other cases. Thus, for example, if the Issuing Member and the Acquiring Member both are financial institutions located in the same country, but not the same financial institution, and notwithstanding that, the transaction is purely domestic, in most cases the transaction will go through VisaNet. In contrast, if the Issuing Member and the Acquiring Member are the same financial institution, a domestic transaction does not go through VisaNet. All international transactions go through VisaNet.

Authorization and Switching. The objective of this process is to facilitate the member banks to minimize their risks associated with fraud and default from the use of the VISA Card. The process is initiated by the Merchant Establishment with the Acquiring Member in order to seek authorization before accepting payment with the VISA Card. It involves the VisaNet hub switching transactions from the Acquiring Member to the Issuing Member, to enable the latter to verify cardholder data and credit position before issuing an authorization message back to the Acquiring Member, also through the VisaNet network. The whole process is known as "Base I" processing. The process generally is the same for domestic and international transactions.

Thus, the process is initiated in the country when the Cardholder presents the payment card to the Merchant Establishment. Through the Connectivity Equipment in the local country, the information is transmitted to the Hub. Visa's computer server performs the processing functions of switching the transaction from the Acquiring Member to the Issuing Member. This enables the Issuing Member to verify the Cardholder's data and credit position before issuing an authorisation message back to the Acquiring Member through VisaNet and from VisaNet to the Acquiring Member and the Merchant Establishment through the Connectivity Equipment.

Clearing and Settlement: The objective of this process is to facilitate members to settle amounts among themselves across the world in an orderly and efficient manner. An Acquiring Member that needs to pay its Merchant Establishment will expect to receive reimbursement from the

Issuing Member that collects money from its cardholder for his or her use of the VISA Card at the Merchant Establishment.

The process enables Acquiring Members to send all their transactions claims to the VisaNet hub, which, in turn, processes the data into a daily report of net debit and credit positions.

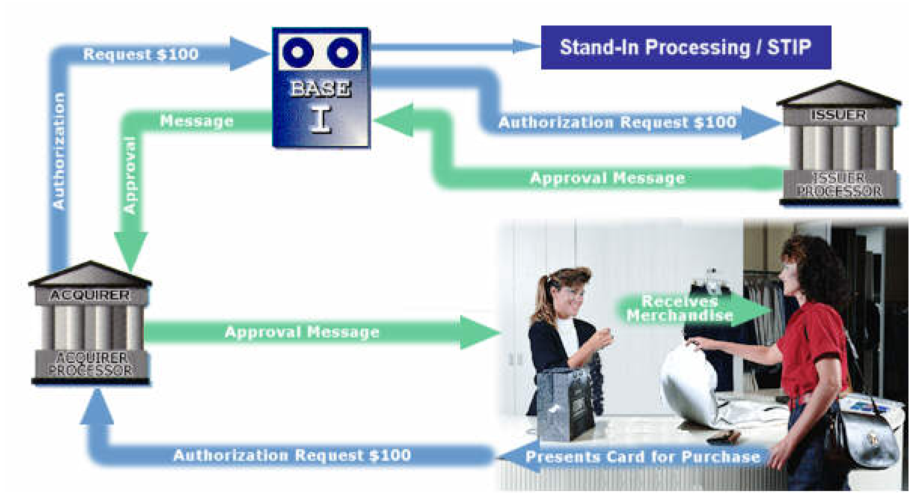
It needs to be noted that the settlement bank merely relies on the report generated by the VisaNet hub and does not perform any data processing itself.

The settlement and clearing process for both domestic and international transactions is the same, except that with respect to international transactions, the process involves currency conversion, an activity that is performed by Visa entirely outside of South Africa.

For settlement of both international and domestic transactions, the settlement bank is appointed by Visa. The settlement bank for U.S. currency settlement is based in New York, U.S.A. and the settlement bank for other currencies is based in London, United Kingdom. The Clearing and Settlement process is known as "Base II" processing.

Thus, the process is initiated in the country of the Acquiring Member, which sends, through Connectivity Equipment in the local country, information to the VisaNet Hub. The Hub processes the data into a daily report of net debit and credit positions. Once the Hub has processed the data, it transmits the information through the Connectivity Equipment to the settlement bank that clears the net debit and credit positions among the various members. The settlement bank does not perform any data processing itself; it merely takes action based on the report generated by the VisaNet Hub.

Visa Transaction Flow:



Technical Standards

In order to participate in the Visanet Network all members need to test and certify their compliance to Visa's technical standards. These standards include but are not restricted to:

Message content standards

Data and message code standards

Data Security and Integrity standards

Performance and reliability standards

Communications standards

Certification standards

The full set of the Visa manuals that document these requirements is available from VISA International if so required but they have not been included in this submission due to their size and perceived lack of direct relevance to the subject.

South Africa banks also have their own domestic settlement system, as an alternative to Visanet, which Visa does not participate in, and we estimate that approximately 97% of all transactions are routed though this local Switch system.

Visa is a member of the necessary bodies within the South African Payment systems e.g. : ATM PCH, ABCI, Bankserv).Visa also integrates into the reporting systems used by the South African Reserve Bank to monitor the integrity of the South African Payment systems.

Visa allows the SA banks to decide how they are going to route their domestic traffic. A few of the member banks do route via Visanet (e.g. Investec and Mercantile) but the majority go through Bankserv, the local payment clearing house or operator. They provide inter-bank electronic transaction switching services to the local banking sector. Their services include switching, clearing and settlement of cheques, EFTs, debit and credit cards between banks as well as settlement to the Reserve Bank:

Real-time Switching Services ATM(SASWITCH)

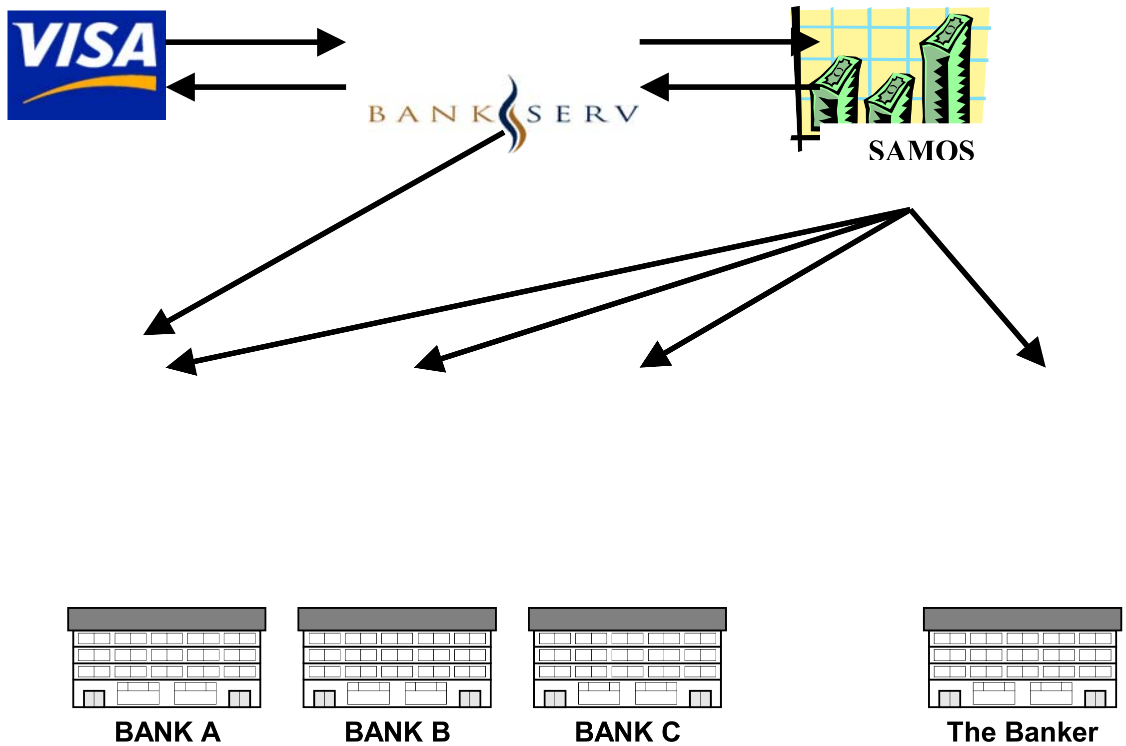
Electronic Funds Transfer (ACB EFT)

Code Line Clearing (CLC) Cheques

Banks have the option of switching their BINs via Visa Net or via Bankserv. Bankserv only switch inter-bank "not-on-us" transactions and not "on-us" transactions.

The only interaction that Visa has with Bankserv is in the form of a file download containing international transactions (the Visa nett-settlement file). Bankserv includes the Visa data in their settlement to the Reserve Bank and Visa pays Bankserv a fee for this service which is R21,000 per calendar month. Bankserv, Visa and MCI are the official operators appointed by PASA (Payments Association of South Africa).

System Diagram:



Visa works with Bankserv in the following manner:

- Visa sends settlement reports to Bankserv via secure e-mail.

Bankserv reads the e-mail, extracts the relevant information and runs the data through Bankserv Settlement System.

Bankserv produces MT298 SWIFT Messages that will contain the settlement information for the banks:

- The intention is that SBSA could be the banker for Visa.
- Each Bank either will pay Visa at its banker or be paid from Visa by its banker.

- Each MT298 message will have SBSA as either the paying bank or the beneficiary bank.

- Bankserv sends these MT298 messages to SAMOS via the SWIFT network.

- SAMOS will act on these messages and transfer money as appropriate.

- Bankserv can send MT298 messages, stating settlement situations, to each participating bank if they so wish.

- SAMOS sends a return message to Bankserv stating whether a batch has settled or not.

- Bankserv processes this message and acts on it appropriately.

- Bankserv sends this return message back to Visa via secure e-mail.

We have been asked by the Banking Enquiry to provide information with regard to the costs to the consumer of Bankserv compared to Visa.

This is an area Visa is unable to provide such a comparison. Visa charges fees to member banks for the provision of specific services and in the interests of transparency; Visa is not a bank or financial institution and is not regulated or designated as such in any part of the world. Visa provides services to financial institutions concerning use of systems, intellectual property rights and a set of global standards. We do not have information with regard to the internal pricing to the consumer of Bankserv's or the member's costs and charging structure.

5. SOUTH AFRICAN MARKET FOR PAYMENT CARDS

Visa does not have precise information as to any other competitive payment card company in South Africa. Below are estimates, to the best of our belief and knowledge, of the latest and most up to date figures.

Table 1: Total Visa market stats for end of Q2 2006 (data drawn from operating certificates submitted by members)

Card Type	**Number**	**Issued Card Sales Volume (Cash) $**	**Issued Retail Sales Volume (Purchases) $**
Credit – Visa business	**146,736**	**738,572,021**	**597,669,467**
Credit – Visa Classic	**1,535,810**	**4,043,270,945**	**2,828,448,012**
Credit – Visa Corporate T&E	**26,403**	**215,056,067**	**201,372,684**
Credit - Visa Electron	**159,237**	**127,554,827**	**62,695,595**
Credit – Visa Gold	**537,545**	**4,175,872,487**	**3,185,244,596**
Credit – Visa Platinum	**150,753**	**1,914,775,735**	**1,393,401,110**
Credit Visa Purchasing	**3,459**	**54,061,830**	**53,745,980**

Purchasing

Debit – Visa Business	**51,113**	**189,594,338**	**81,821,735**
Debit – Visa Classic	**252,141**	**2,074,543,610**	**740,452,877**
Debit – Visa Electron	**10,986,789**	**21,680,052,802**	**3,379,888,375**
Debit – Visa Gold	**109,437**	**807,280,074**	**417,044,035**
Debit – Visa Platinum	**55,684**	**423,115,460**	**242,443,247**

The major payment card Issuers apart from proprietary cards issued by the South African banks and various Store cards are:

MasterCard with, we believe, currently approximately 15 million cards, and of that figure, about 2.3 million are credit cards.

American Express, with, we believe, are currently about 150,000 credit cards.

Diners with, we believe, approximately are currently about 370,000 credit cards.

Visa, which has approximately 14 million cards, of which 2.5 million are credit cards.

Visa estimates that the South African banks issue approximately 6-7 million proprietary ATM cards, with a further 12 million or so internationally branded cards debit and debit cards. Further, Visa estimates that there are 6-7-million store cards in circulation.

6. INTERCHANGE

Visa is a world-wide payment card system. Visa does not issue Visa cards itself to cardholders, nor does it contract with (acquire) Merchants. This is done by its member financial institutions, who receive a licence to that end from Visa.

Thus, Visa cards may only be issued and Merchants may only be acquired by members of the Visa payment card system who have obtained a Visa licence. Visa uses a single membership and trademark licence agreement for all classes of membership and for all programmes. A Visa licence normally covers both issuing and acquiring activities, although members must issue before they can acquire.

The Economic Structure of the VISA Payment Card System

In the following, Visa explains the rationale and purpose or functioning of the Visa payment card system and the essential role which the Interchange Fee plays within it.

Two types of payment card systems must be distinguished: Three-party systems (e.g. American Express[1]) and four-party systems (e.g. Visa). In a three-party system the proprietor of the system is responsible for all activities in the supply of its systems services. It issues all the cards and acquires (signs up) all the Merchants in the system. In a four-party card system, there are many member banks, large and small. All member banks issue cards to cardholders within the system, and some member banks/institutions also acquire Merchants for the system. There is therefore scope for "intra-system" competition in a four-party system that is absent in a three-party system.

In a four-party system cardholders can use cards issued by one member bank to pay for goods and services sold by Merchants signed up by other member banks. Thus, as compared with a three-party system, in a four-party system an

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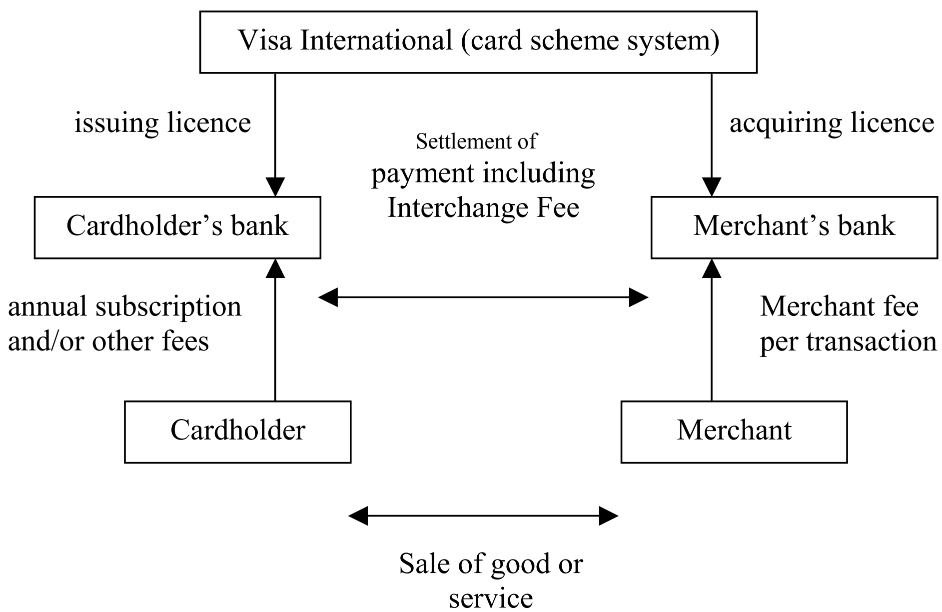
[1] American Express was until recently a pure three-party system but has now introduced limited franchising in certain countries, the impact of which is not known to Visa.

additional relationship arises from a transaction, namely the one between the bank that issued the card and the bank that acquired the Merchant which accepted the card. The four parties involved in such a transaction are the Issuer, the Acquirer, the cardholder and the Merchant. The following diagram shows the operation of the Visa four-party payment system:



Two categories of users use the payment services of three-party card system or a four-party card system: cardholders (buyers of goods and services) and Merchants (suppliers of goods and services such as retailers, hotels and taxis).

A payment card system, whether it is a three-party or four-party system, has two major features:

(i) System's services are jointly and inter-dependently demanded by cardholders and Merchants. A system's cards have no value for their holders unless there are Merchants prepared to accept them. And Merchants derive no benefit from a system unless there are cardholders prepared to use the cards when buying goods and services.

(ii) Payment card system generates positive network effects, i.e. positive externalities. The more Merchants that participate in the system, the more valuable the cards of the system are for the consumers of goods and services; and the more cardholders there are in a system, the more valuable it is for Merchants to participate in the system

The cardholders' demand for a system's services depends inter alia on:

(i) The level of the cardholder fees or charges, taking into account any benefits cardholders receive from Issuers in the form of credit facilities, services such as insurance on favourable terms, air miles, etc.;

(ii) the value the cardholder places on the convenience of using cards and on the disutility of using other means of payment; and

(iii) the number and "quality" of Merchants that accept the system's cards, "quality" meaning the appeal of the Merchants' outlets, range of goods, etc.

The same considerations apply *mutatis mutandis* to Merchants' demand for a system's services. Their demand depends *inter alia* on the level of Merchant fee paid by the Merchant to the Acquirer; the number and "quality" of cardholders in the system, "quality" meaning the spending power and spending preferences of the cardholders; and, more generally, on the benefits Merchants derive from the system discussed below.

These features present problems for any payment card system: but they also present opportunities. These problems and opportunities are handled differently in a three-party system and a four-party system.

In a three-party system, the single entity owning the system incurs all the costs of the system, both on the issuing side and on the acquiring side of the business. It also receives all the revenues, both those from cardholders and from

Merchants. Moreover, it makes the major system decisions. It decides the level of fees to be charged to cardholders and to Merchants, the level of promotional expenditures and activities to recruit cardholders and Merchants and the services to be offered to cardholders and to Merchants respectively. It can take full advantage of network externalities. It can do so by, in effect, co-ordinating the decisions affecting the two sides of the business – issuing and acquiring, balancing the demand of cardholders and the demand of Merchants.

There is no such single decision-making entity in the Visa four-party system. Moreover, there is no single entity that incurs all the costs necessary to produce the Visa payment services; and, similarly, there is no single entity that receives all the revenues from cardholders and Merchants. The individual Visa Issuer decides its own level of cardholder fees and its competitive initiatives in the light of its expected costs and revenues, and subject to the constraints imposed by competition from other Visa Issuers and other providers of payment instruments. The same applies, *mutatis mutandis*, to the individual Visa Acquirer.

It follows that, unless there is a co-ordinating mechanism in a four-party system, the special system-level problems and opportunities would not be dealt with appropriately, and the system's efficiency and performance would fall short of their potential.

Consider network externalities. The individual Issuer's decisions and expenditures give rise to externalities. But the Issuer would not be able to capture the full value of the externalities it generated. It would incur the full costs but it would not harvest the full benefits. It would have no incentive to maximise the generation of the positive externalities even when the costs of doing so were less than the benefits to the system as a whole. The Issuer's decisions and activities prompted by its "private" incentives would not be optimal for the system as a whole. The system as a whole would under-perform and be smaller as a result of a type of failure akin to a "market failure"[2]. The same considerations apply, *mutatis mutandis*, to the decisions of Acquirers.

A coordination mechanism is therefore necessary if a four-party system is to achieve its potential. In the Visa system, the Interchange Fee is the coordination mechanism[3]. The Interchange Fee is a payment effected between Acquirers and Issuers in respect of transactions involving the use of the system's cards. It seeks to achieve indirectly, by influencing behaviour, what is achieved directly in a three-party system by its proprietor.

The Visa Interchange Fee does not deprive Issuers and Acquirers of their freedom to set their own fees, service levels, and so on. Indeed there is nothing to prevent an Acquirer from setting the Merchant Service Charge (the "MSC") below the Interchange rate because there may be other benefits to that Acquirer in having a particular Merchant as its customer (e.g. benefits from a corporate banking relationship). What the Interchange Fee does do is to influence Issuers' and Acquirers' decisions so that they contribute more than they would otherwise do to achieving more fully the potential of the Visa system as a whole. The Interchange Fee changes the situation confronting individual Issuers and Acquirers. This necessarily affects Issuers' and Acquirers' decisions. It serves, inter alia, to internalise, within the Visa system, the positive externalities generated by the decisions and activities of the individual Visa Issuers and Acquirers.

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2 A simple example illustrates the point. Suppose Issuer A incurs additional costs in order to recruit a significant number of new Visa cardholders. If A succeeds, this will attract more Merchants to sign on as Visa Merchants: they are attracted by the enlarged Visa cardholder pool to which they gain access. But, to continue, the larger pool of Visa Merchants will, in turn, serve to encourage more spending by existing Visa cardholders; and also more consumers to become Visa cardholders. But Issuer A, which incurred the costs that set the virtuous cycle in motion, would gain only a part of the additional revenue flowing from the network effects. Other Issuers would be free-riding on A's expenditure. In this situation, in the absence of a coordinating mechanism there would be under-expenditure by Visa Issuers and a smaller Visa system.

3 In fact the Visa Interchange Fee is a default or fall-back Interchange Fee, i.e. it only applies if the individual banks concerned have not reached a specific agreement on the level of Interchange to be paid between them. In the present context, however, this feature of the fee will not be considered.

To see how the Interchange Fee (which presently flows from Acquirers to Issuers) fulfils its role, consider a situation in which, for whatever reason[4], the current Interchange Fee is no longer at the optimal level. Suppose Visa or, in the case of South Africa, Visa South Africa, believes it should encourage Issuers to recruit more new Visa cardholders and to promote the greater use of Visa cards. It therefore increases the Interchange Fee. The increase gives Issuers an added incentive to seek to attract new Visa cardholders and to encourage their cardholders to use cards more frequently. Issuers can do so by reducing cardholder fees, increasing promotional expenditure and/or improving the services offered to cardholders. Intra-system competition among Issuers will provide the necessary pressure on Issuers to respond to the incentive provided by the increase in the Interchange Fee. The hypothesised increase in the Interchange Fee will, of course, have the opposite effect on Acquirers because it increases their costs. Acquirers will respond by cutting back expenditures designed to increase the number of their Merchants: and/or they will raise their Merchant fees. Merchants may decide to leave the Visa system.

It is because a change in the Interchange Fee has opposite effects on Issuers and Acquirers that Visa has to perform a difficult "balancing act". But such a balancing act has to be performed if the Visa system is to allow properly for the interdependence of cardholder and Merchant demand for Visa payment services and for network externalities. It does so without giving up the advantages of intra-system competition among Issuers and Acquirers. The proprietor of a three-party system has to carry out a similar "balancing act"[5].

It is in the interests of its Merchants that the Visa system should maximise the volume of its business and that the Interchange Fee should be set at the level

[4] The reason could be an actual or impending change in cost or in demand conditions or a change in competition among the various payment instruments with which the Visa system competes.

[5] In the Visa system there is an explicit Interchange Fee. It may seem as if there is no Interchange Fee in a three-party system. This is correct in the sense that there is no explicit fee. It would, however, be commercial folly for the owner of a three-party system to insist that its two "divisions", issuing and acquiring, were each to be treated as distinct profit centres. It is commercially sensible, instead, to allow one division to "subsidise" the other so as to maximise the profits of the system as a whole. In effect, there is an implicit Interchange Fee.

appropriate for that purpose. The collective setting of Interchange Fees is a minimalist device that serves to promote the co-ordination of the decisions and activities of individual Issuers and Acquirers in a four-party system. It seeks to bring about the fullest possible satisfaction of the joint demand of cardholders and Merchants for the system's services and the supply of those services that are provided jointly by Issuers and Acquirers, taking into account network effects and also the costs incurred by Issuers and Acquirers on behalf of the system.

In order to improve the operation and security of the Visa system, particular Interchange Fees designed to encourage Merchants to invest in equipment capable of handling new types of cards (known as "incentive rates") have been introduced. For example, Visa International has introduced special rates at inter-regional level to incentivise the move over to chip technology. These are set out in Section 9.3.A.5 of the Visa International Operating Regulations[6]. Whereas the standard rates are 1.1% and 1.6% for electronic and paper-based transactions respectively, where a chip-card is used, but the terminal is not upgraded to chip, the Interchange Fee will be 1.2%. Similarly, where the card is not chip and instead relies on the magnetic stripe, but the terminal used is chip capable; the Interchange Fee will be 1%. These are especially clear examples of a change in Interchange designed to encourage the development of the Visa system as a whole, i.e. to improve the value of its product for all its users.

For a more detailed economic analysis of the Interchange Fee in payment card systems generally, Visa refers to the seminal paper of William F. Baxter entitled "Bank Interchange of Transactional Paper: Legal and Economic Perspectives".

6.1 Visa Interchange Fees in South Africa

Under Visa International's rules, all banks are free to set their Interchange Fees on a bilateral or multilateral basis. If no such arrangements are in place, "default rates" will apply to ensure that the system is not blocked by the absence of bilateral agreements. Visa International has adopted

[6] Visa International Operating Regulations (General Rules Volume I).

default rates at the international or "inter-regional" level, i.e. which apply between Issuers and Acquirers in different Visa Regions, e.g. between CEMEA and Visa Europe. Visa has also adopted default Interchange rates at the Regional level, i.e. "intra-regional" rates which apply between Issuers and Acquirers in different countries but within the same Region Issuers and Acquirers in different Visa Regions, e.g. between CEMEA and Visa Europe. National Organisations, and members in a specific jurisdiction, are also free to adopt national default rates. If they do not do so, the applicable rates for banks within the country concerned will be the intra-regional default rates.

In South Africa, the members agreed an Interchange Fee rate on a multilateral basis for transactions taking place within South Africa.

We understand that the banks did a cost study with independent contractors. Visa did not participate in that cost study. The banks once they had decided what rates they wished Visa to apply in the Visa systems dully informed Visa in writing, as is their right under Section 6.5 of VIOR.

The Enquiry has asked us to comment on whether interchange rates in South Africa are 'too high'. Visa believes that the successful growth of the South African market with regard to payment cards appears to reinforce the success of the Visa four party model and the role of interchange as a balancing and coordinating mechanism. As a note, the electron (debit rate) in South Africa is currently, Visa believes, the lowest debit rate in the Visa CEMEA Region, and certainly lower than most electron/debit rates in Europe.

6.2 <u>Non-discrimination (or surcharging)</u>

On joining a payment card network, merchants agree not to charge an additional fee or 'surcharge' when consumers choose to pay for goods or services using that network's payment card. This is commonly referred to as the No Surcharge Rule ("NSR"). The NSR has been implemented in South Africa from the time VISA Cards were first accepted in South Africa.

The Visa International NSR does not prevent Merchants from offering to Cardholders, a discount or some other form of incentive or benefit for using an alternative payment instrument (for example, cash) in preference to the VISA Card.

The Visa International NSR also does not prevent Merchants from offering Cardholders a discount or some other form of incentive or benefit for using a VISA Card (or indeed a rival network's payment card).

Thus, under the NSR, Merchants have a large degree of flexibility to operate their businesses and price their goods and services as they please. They may encourage consumers to use one payment method over another, for instance, by offering discounts when customers use payment instruments, card schemes or payment cards issued by certain issuers that are preferred by the Merchant. The NSR only prevents Merchants from *raising* the purchase price on transactions performed by Cardholders using their VISA Cards.

Visa International leaves Acquirers to take responsibility for compliance with the NSR by their respective Merchants. If Visa International learns of any incidences of surcharging, it will ask the relevant Acquirer to investigate and stop the practice from recurring. The Visa International Operating Regulations allow the imposition of fines or penalties for contravention of the NSR, with termination of membership the ultimate penalty for continued violations if informal discussions between Acquirers and Merchants are not effective in bringing any surcharging to an end.[7]

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[7] The NSR is reflected in Section 4.1.B of the Visa International Operating Regulations. Enforcement of the NSR is covered by Section 1.5 of the Visa International Operating Regulations and Section 2.17(a)(i) of the Visa International By-Laws.

The NSR acts to prevent Merchants with an element of market power be it transient or enduring, from exploiting that market power in ways that undermine the integrity and efficiency of the Visa International Network and its ability to compete with other payments schemes, including closed loop payment card schemes.

It has been argued, that the NSR undermines the bargaining power of Merchants relative to Acquirers in a way that increases Merchant Service Commission ("MSC"). Such a claim is we believe flawed as a matter of economics, as those Merchants who had a real option of surcharging would have le**ss** difficulty in accepting high MSCs, since they could pass these on to Cardholders, in whole or in part. Knowing that, Acquirers, who are likely to pursue their own interests rather than the interests of the overall network, would be able to press for higher, rather than lower, MSCs. The outcome would involve both higher MSCs, as well as higher and more extensive surcharges.

Put in the language of the economics of bargaining, permitting surcharging reduces the costs to individual Merchants of conceding to a higher MSC. This improves the outcome to them from accepting such a high MSC relative to the "outside option" of not accepting a particular VISA Card. As a result, the bargained MSC should rise in a scheme where individual Acquirers bargain with Merchants. Of course, this effect would be offset, in whole or in part, by the reduced value of that payment card scheme (as the surcharges on the particular scheme's cards would induce consumers to shift to other payment card schemes, which in the South African case, would involve all the payment card schemes other than Visa International) which would limit its ability to secure payments from Merchants.

Visa International notes that in an 'open loop' scheme such as Visa, merchants do not negotiate with the scheme; they negotiate with individual acquirers, who compete for merchants. That competition is a desirable property of the open loop schemes. In the Visa International scheme, the acquiring dimension is organised on a competitive basis. Given this model for acquiring, the MSC is set through bilateral agreements between Acquirers and Merchants, rather than on the basis of the interests of the scheme as a whole. This in turn means that in the absence of the NSR, these bilateral agreements would likely give rise to the outcomes described above, assuming the acquiring dimension is not perfectly competitive (though it may be workably so). Those outcomes would be advantageous for individual Acquirers and Merchants, but disadvantageous to individual Cardholders, the payment scheme as a whole, and to competition between payments card schemes.

Overall, it is not an abuse of a dominant position to prevent intermediaries from acting in a way that would be harmful to ultimate consumers. Indeed, an undertaking that is operating in an effectively competitive market would have both the incentive and the ability to contract with intermediaries in a way that ensured that the overall value of its product to consumer was being maximised. It is for this reason that manufacturers, for example, often impose restrictions on dealers or distributors who may have localised market power and hence could, absent those restrictions, engage in conduct that though potentially advantageous to each intermediary, would undermine overall efficiency.[8] For these same reasons, the NSR does not amount to an abuse of dominance but rather, prevents firms that might otherwise themselves exercise transient or enduring market power, from doing so.

The NSR plays an important role in preserving the balancing effect of interchange in order to maximise the value and size of a payment card network. As explained in this paper, Interchange is a balancing device for distributing the allocation of charges within the Visa International Network between the various parties: Issuers, Acquires, merchant and cardholders so as to strike the right balance in a four party system.

[8] See Office of Fair Trading, "*Vertical restraints and competition policy*", (Dec 1996), by Paul Dobson and Michael Waterson, Research paper 12.

The NSR preserves the balancing effect of interchange by preventing Merchants from passing on to Cardholders, charges that were otherwise intended to be borne by the Merchants. When Merchants are able to pass on these charges, Merchants can act in their own interests to increase profits without regard to the impact this will have on the scheme as a whole, including the long-term interests of Merchants. When Merchants transfer their charges to Cardholders, the balancing effect of interchange is seriously undermined and the scheme is unable to capture the positive network externalities that are described elsewhere in this paper.

In effect, surcharging undermines the balancing role of the system, resulting in a relative under-provision of Visa International payment card services.[9] Surcharging by Merchants in the Visa International Network would shift the obligation to fund the scheme onto Cardholders. This reduces the attractiveness of holding and using VISA Cards to Cardholders, causing a reduction in the size of the Visa International Network. A reduction in the number of Cardholders also adversely impacts on Merchants, due to the existence of interdependent demands, reducing the value of VISA Card acceptance. When the Visa International Network is no longer able to capture positive network externalities, all Visa International Network participants are worse off.

The NSR also performs a vital role in supporting the HACR. If a Merchant decides to participate in the Visa International Network, the HACR obliges the Merchant to accept all VISA Cards equally. This is because failure to obligate Merchants in this way would harm the reputation of the Visa International Network and diminish its value to Cardholders.

If Merchants were able to surcharge VISA Cards, they could undermine the HACR by applying a prohibitively high surcharge to selected VISA Cards (or for example, on all small value transactions, all transactions on

[9] Rochet, J.-C., and J. Tirole 2002, "*Cooperation among competitors: Some economics of payment card associations*," RAND Journal of Economics, 33: 549-570

VISA Cards issued by a particular bank or banks, all foreign issued VISA Cards, etc). Discrimination against VISA Cards, or some VISA Cards, even if only by relatively few Merchants, would reduce the utility and appeal of the VISA Card, effectively altering the nature of the VISA Card and damaging the reputation of the Visa International Network.

The NSR is not unique to the Visa International Network or to open loop payment card schemes. Closed loop payment card schemes including American Express, Diners Card and JCB, we believe, impose a NSR that has the same purpose and effect as Visa International's NSR.[10]

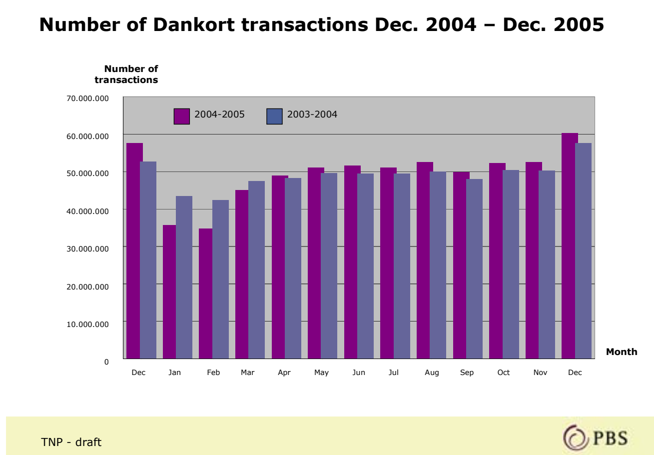
Under Visa International's Operating Regulations, Companies or Merchants must not add any surcharges to card transactions. This is a firm principle of Visa International unless local law expressively requires that a Merchant be permitted to impose a surcharge. No surcharging rules ensure certainty and transparency, and freedom for merchants to surcharge means the loss of that certainty. Any surcharge, regardless of the amount, can be expected to reduce the utility of cards to cardholders. Accordingly, even though surcharging where it is permitted, may only affect a minority of transactions[11], it can still have profound effects on the reputation and reliability of the payment card system which can consequently lead to a reduction in the number of cardholders and/or card usage, in particular, as cardholders will tend to "blame" the system and not the merchant if they are surcharged.

Where regulatory intervention has occurred recently in some jurisdictions, the results are interesting to observe, despite the limitations of inter-country comparisons.

[10] For these payment card networks, the terms and conditions of merchant agreements include restrictions on surcharging by merchants.

[11] This was recognised by the Commission in its decision of 7 August 2001 in which it negatively cleared, inter alia, Visa's no surcharging rule.

One recent example of the impact of abolishing no surcharging rules is the experience in Denmark following changes to the Danish Payment Act, which permitted from 1 January 2005 charging only a capped MSC to merchants and to surcharge Dankort (the Danish national debit system) transactions. The total number of Dankort transactions fell from 42 million in January 2004 to 33 million transactions in January 2005 following the introduction of surcharging. Similarly, the average number of Dankort transactions per card fell from 175 in 2004 to 167 in 2005 due to customer's fears of being surcharged. Due to opposition from cardholders, pre-election debate created political pressure to change the legislation again with the result that surcharging has not been allowed on Dankort transactions since March 2005 and on any Danish issued card since June 2005. The following graph illustrates the sharp drop in Dankort transactions in January and February 2005 because of surcharging or fears of surcharging.



Although the Danish Competition Authority estimated that only approximately 19% of (mainly the very large) merchants initially surcharged in Denmark, the effect on cardholders across the board was substantial as it resulted in the loss of certainty for cardholders that a payment card could be used anywhere which accepted that particular payment card, without penalty or unpleasant surprises and consequently without damage to the payment card's reputation.

In Australia, following regulatory intervention in 2003, payment card systems are no longer able to prohibit surcharging. In the limited time in which surcharging has been permitted, one can observe the following effects of note.

First, cardholders are paying more for card usage at certain merchants but there is no evidence that consumers who use other means of payment have received any benefit from reduced prices because of merchants' ability to charge cardholders more.

Secondly, merchants tend to apply the same surcharge for all cards, regardless of what it costs to accept that particular card. The blended surcharge rate means that Visa cards would, on the Interim Report's view, effectively "subsidize" the use of American Express and Diners cards, which have much higher merchant service charges than Visa cards.

Thirdly, experience has shown that customers are most likely to be surcharged where they are "captive" card-using customers. A captive card-using customer is one who, on a particular buying occasion, does not have ready access either to a non-surcharged means of payment, such as cash, or to a card-accepting merchant who is not levying a surcharge. The high cost to cardholders is particularly onerous where merchants, taking advantage of the fact that the customer may have no choice but to pay with a payment card, seek to make a profit from surcharging by imposing a surcharge with no reference to what it costs the merchant to accept the card. Foreign and out-of-town consumers are those likely to be most at risk.

Permitting surcharging allows a merchant to require a card issuer or acquirer to pay the merchant for honouring the card.

This could be applied in a discriminatory way against small banks with relatively few cards in issue and could, anti-competitively, keep such banks out of the card market.

Although the incidence of surcharging is low[12], significant damage can be caused to a payment system as explained above.

6.3 Inefficient switching to expensive means of payment

Removal of no surcharging rules is likely to have the undesirable effect of promoting the use of cash, on which there would be no surcharge, and discouraging the use of payment cards, which the European Commission has recognised provide a more efficient means of payment than cash and cheques, thus generating negative welfare effects for society as a whole

This would clearly not be in line with the objectives set out by the Commission in the Impact Assessment in relation to the draft Payment Services Directive that seeks to steer consumers to the most efficient means of payment.

Whilst recognising that surcharging may be limited, Visa believes that the removal of no surcharging rules is more likely to result in an increase in the use of cash rather than have any impact on encouraging other types of electronic payment. Promoting the use of cash – which means carrying cash – in a high crime society such as South Africa, is questionable.

6.4 Honour All Cards

Visa International submits that the HACR plays a central and vital role in the Visa International Network. The HACR enables Visa International to guarantee wide acceptance of VISA Cards to Cardholders. A guarantee of

[12] According to the Reserve Bank of Australia, survey evidence suggests that less than 5% of merchants surcharge. See remarks by Dr. Philip Lowe, Assistant Governor, Reserve Bank of Australia, made at the House of Representatives Standing Committee Review of the Reserve Bank and Payment System Board annual reports 2005, 15 May 2006.

wide acceptance is a necessary condition for the success of any payment method, including any payment card network. The guarantee of wide acceptance to Cardholders that the HACR delivers is in effect, the quid pro quo of the guarantee of payment and other benefits conferred to Merchants by other Visa International Network rules.

The HACR preserves the balancing effect of the Interchange system, which is a device for distributing the allocation of charges within the Visa International Network between Cardholders and Merchants, so as to strike the right balance between incentivising Cardholders to hold and use VISA Cards on one side of the Visa International Network, and incentivising Merchants to accept VISA Cards on the other side of the network. The HACR preserves the balancing effect of the Interchange Fee by working in combination with the No Surcharge Rule (***NSR***) to enforce vertical separation of the acquiring and issuing dimensions. It achieves this vertical separation by preventing a Merchant or an Acquirer, or both, from undermining contracts between Cardholders and Issuers, through their refusal to honour certain VISA Cards (for example, VISA Cards issued by a foreign bank or certain local banks).

The HACR allows the Visa International Network to take advantage of available economies of scale and scope to lower unit costs through the use of a common acceptance network platform. This serves to lower the hurdle rates of return that Issuers must achieve to justify (to their shareholders) the rolling out of new and innovative (and possibly untested) payment card products, which may have the potential to further raise the productivity and sales of South African merchants, with an associated benefit to consumers.

The HACR of ‘open’ loop and ‘closed’ loop payment card schemes, such as Visa International and MasterCard, have been the subject of several investigations and private actions around the world. The need for a HACR is borne out by the fact that all payment card networks administer a HACR. To the best of Visa International’s knowledge, the HACR applies in every jurisdiction in the world where Visa International operates, although the "honour all products" dimension of the HACR is bifurcated in the US and Australia.

The European Commission (***EC***) and the Reserve Bank of Australia (***RBA***) have recently reviewed the purpose and effects of the HACR, while in the United States; the HACR has been the subject of a private class action.

To Visa International's knowledge, the HACR has never been prohibited in its entirety in any jurisdiction, in spite of the investigations undertaken in a number of jurisdictions, which have examined and analysed the HACR. This clearly demonstrates that the HACR does not raise significant competition concerns, which in turn, reinforces the fact that it is integral to the efficient operation and growth of a payment card network.

In the United States, as part of the Wal-Mart settlement, Visa USA, Inc. and MasterCard agreed to bifurcate the "honour all products" dimension of the HACR (i.e. both payment card schemes no longer oblige merchants to accept debit cards and credit cards in the package of products covered under the acceptance contract).[13] In Australia, Visa International and MasterCard were compelled by regulation to bifurcate the "honour all products" dimension of the HACR.

6.5 European Commission

In August 2001, the EC released its decision in relation to Visa International's HACR and other Visa International Network rules in the

[13] It should be noted that under the terms of the US Wal-Mart Settlement, bifurcation only applies to domestic cards issued in the US.

European Union region.[14] It found that Visa International's HACR falls outside the relevant provisions of the EC Treaty and the EEA Agreement.

In particular, the EC agreed with Visa International that the HACR promotes growth of the Visa International Network and is indispensable to the Visa International payment service:[15]

> *"The Commission agrees with Visa that the honour all cards rule promotes the development of its payment systems since it ensures the universal acceptance of the cards, irrespective of the identity of the issuing bank. The Visa payment system could not properly function if a merchant or an acquiring bank were able to refuse, for example, cards issued by a bank established abroad (or, for that matter cards issued by other domestic banks). The development of a payment system depends on issuers being able to be sure that their cards will be accepted by merchants contracted to other acquirers. Without such assurance, a brand or logo on a payment card loses most of its meaning and utility, especially where an international card is concerned, and cards are often relied upon by travellers for foreign payments."*

The EC also agreed with Visa International that the HACR does not restrict competition and in fact has a pro-competitive effect:[16]

> "*The fact that under the honour all cards rule, merchants are obliged to accept all valid cards with a certain brand, regardless of the type of card and regardless of the merchant fee, cannot be said*

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

[15] Commission decision of 9 August 2001 relating to a proceeding under Article 81 of the EC Treaty and Article 53 of the EEA Agreement (Case No. COMP/29.373 – Visa International), paragraph 67.

[16] Commission decision of 9 August 2001 relating to a proceeding under Article 81 of the EC Treaty and Article 53 of the EEA Agreement (Case No. COMP/29.373 – Visa International), Paragraph 68.

to be restrictive of competition. The fact that the fees that acquiring banks may charge to merchants may be different does not demonstrate that different types of Visa cards are unrelated products. Moreover, the merchant fee is decided by merchant acquirers, not laid down by Visa International, and in many cases, merchant fees are negotiated on a case-by-case basis. ... Finally, the Visa International honour all cards rule does not oblige merchants to accept future types of Visa card, since merchants are free at any time to stop accepting Visa."

Lastly, the EC agreed with Visa International on the detrimental impact to the Visa International Network if the HACR were to be removed:[17]

"*Leaving it up to an individual merchant whether to accept or not a particular Visa card, solely on the basis of the merchant fee which it is charged by its bank, would seriously endanger the universal acceptance of Visa International payment cards. Cardholders would not know in advance whether their Visa card would actually be accepted. It has also to be taken into account that the type of Visa card issued may vary from issuer to issuer and in particular from one country to another. Clearly, if it were left to merchants whether or not to accept a particular Visa card, solely on the basis of the merchant fee they may have to pay, this would endanger the international function of the card.*"

6.6 United States

In the US, the HACR has never been prohibited. Rather, it was bifurcated by both Visa USA, Inc. and MasterCard in order to settle the Wal-Mart lawsuit, which was brought against them by various retailers in a class action suit, including Wal-Mart (***US Wal-Mart Settlement***). Under the

[17] Commission decision of 9 August 2001 relating to a proceeding under Article 81 of the EC Treaty and Article 53 of the EEA Agreement (Case No. COMP/29.373 – Visa International), Paragraph 68.

terms of the settlement, Visa USA, Inc. and MasterCard agreed to bifurcate the "honour all products" dimension of the HACR so that merchants that accept credit cards are no longer obliged to accept debit cards bearing the same acceptance mark (and vice versa).[18] Other payment card schemes, including American Express and Diners Club, were not involved in, and were not affected by, the US Wal-Mart Settlement.

While the HACR was bifurcated in the US in 2003 to make a distinction between credit cards and debit cards as part of the private settlement between Visa USA, Inc. and the group of retailers, the decision to settle did not in any way undermine the fundamental importance of the rule. The US Wal-Mart Settlement was made taking into account the interests of the stakeholders in Visa USA, Inc. and was catalysed by the change in position adopted by MasterCard on the eve of the trial. The decision to reach a private settlement occurred because of the need to balance the risks (however remote) of continuing with class action litigation, which could have resulted in a substantial treble damages claim, against the commercial interests of the Visa USA, Inc. stakeholders and the continuation of the Visa International Network. That is to say, the US Wal-Mart Settlement was a purely commercial decision made in order to protect the long-term interests of the Visa International Network. This was so even if Visa USA, Inc. was confident of ultimately prevailing on the merits.

The US Wal-Mart Settlement did not address any aspects of competition that are relevant under the Act, but proceeded via private settlement on purely commercial grounds. It is extremely important to note that no court or authority in the US has at any point of time concluded that the HACR violates US competition or antitrust laws.

[18] The US Wal-Mart Settlement specifically recognizes that nothing in the Settlement Agreement prevents Visa USA, Inc. from seeking to ensure that the HACR is complied with, within the credit card or debit card categories.

Visa International believes that there is nothing to demonstrate that the bifurcation of the HACR in the US has brought about increased competition amongst competing payment card schemes as well as in the wider payment systems market, in the US.

Visa International strongly believes that the "honour all products" dimension of the HACR is essential to the continued growth of the Visa International Network. The need for a HACR in a payment card network, as recognised by the participants of the network, is demonstrated by the fact that post-bifurcation in the US, Visa USA, Inc. has not witnessed a dramatic shift by Merchants to accept only one type of payment card (i.e. debit or credit). Visa International understands that the number of Merchants choosing "limited acceptance" of domestic US-issued VISA Cards is, essentially, negligible.

6.7 Australia

In Australia, the RBA intervened in the Australian payments system in respect of the HACR in 2006. The HACR was neither prohibited nor abolished, but rather, reduced in scope by the Standard determined by the RBA under Section 18 of the Payment Systems (Regulation) Act 1998 (***Standard***). Under the Standard issued in April 2006, the RBA called for international card schemes to remove the requirement that merchants wishing to accept a particular payment card network's credit cards must also accept debit cards issued by the same network (and vice versa). The RBA also required that VISA debit cards be distinguished from VISA credit cards both visually and electronically to allow Merchants to decline acceptance if they so choose.[19]

It is worth noting that the regulated bifurcation of the "honour all products" dimension of the HACR in Australia was sought by the RBA, on the basis of its view that the "honour all products" dimension of the

[19] http://www.rba.gov.au/MediaReleases/2006/Pdf/honour_all_cards_standard.pdf

rule eliminates or dulls price signals to cardholders. The RBA believes that regulated bifurcation of the "honour all products" dimension of the HACR will "*provide the basis for more soundly based competition in the payments system*".[20]

However, Visa International submits that the regulated bifurcation of the "honour all products" dimension of the HACR in Australia erroneously fails to recognise that:

- Bifurcation will cause shrinkage of the Visa International Network, which will adversely impact Merchants. Merchants benefit from accepting both debit and credit card transactions by virtue of the interdependent demands of cardholders and merchants in a two-sided network such as the Visa International Network. That is, by increasing the value that Cardholders derive from VISA Cards, the HACR encourages more transactions on the VISA International Network, thereby generating more sales for Merchants and making VISA Card acceptance more attractive for Merchants.

- Bifurcation has a detrimental impact on Merchants by raising the effective cost of making purchases to budget-constrained and time-constrained Cardholders, thus leading to lower sales for Merchants.

- The method by which bifurcation is to be achieved in Australia imposes additional transactions costs on Acquirers and Merchants, which are likely to be passed on to all consumers, not just Cardholders.

- Regulated bifurcation has introduced a new form of regulatory risk (i.e. the risk that future products may not be allowed to benefit from access to economies of scope associated with a common acceptance network platform) for Visa International Issuers and MasterCard issuers, which

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[20] Lowe, Philip (Assistant Governor of the Reserve Bank of Australia) 2006, "Opening Statement to House of Representatives Standing Committee on Economics, Finance and Public Administration – The Australian Payments System", Sydney, 15 May, page 3.

must accordingly be factored into their product development and investment decisions. This regulatory risk serves to increase the hurdle rate of returns that Visa International Issuers must earn on new VISA Card products before deciding to launch them in the market. This will have an adverse impact on the extent of innovation in the Australian payment systems market. As will be explained in Section C.3 of this Application, this can delay dissemination of the next generation of productivity enhancing payment card products in Australia, which works to the further detriment of Merchants.

- Bifurcation is not likely to be well understood by visitors to Australia. The increased search costs that visitors will incur to ascertain whether a Merchant is willing to accept their particular VISA Card is likely to adversely impact on Australia's reputation as a shopping-friendly destination.

- In the long run, bifurcation will cause the shrinkage of the Visa International Network and the loss of incentives to Issuers to develop new VISA Card products. Ultimately, both Merchants and Cardholders (and consumers generally) are more likely to be worse off than better off.

Taken together, such effects are more likely to undermine rather than enhance competition and leave Merchants, Cardholders and consumers generally worse off. It is also likely to reduce the intensity of non-price inter system and intra system competition.

7. RELEVANT MARKET

7.1 Introduction

In Visa's view, the correct definition of the relevant market comprises all means of payment used on the territory of South Africa. This includes cash and cheques and all types of payment cards including debit, deferred debit and credit cards whether national or international. The relevant market also includes proprietary payment cards, also known as “store cards”.

Visa would submit that all means of payment are clearly substitutable for one another within the meaning of the above definition from the point of view both of the Merchant and of the consumer.

Although different means of payment may have different features, for example one method may be more convenient for the purposes of carrying out a particular payment transaction than another, Visa submits that these differences are not significant for the purposes of market definition. It does not necessarily follow from the fact that other means of payment may not each bear all the characteristics of payment cards, that payment cards therefore form an “own market”. Whether other means of payment are to be considered as falling within the relevant market for Visa cards, can be determined through considering the application of the “SSNIP” test. This test aims to identify all products to be included within the relevant market by considering which products or services consumers would switch to in the event of a small but significant non-transitory increase in price by a hypothetical monopolist of the product under examination. Should a sufficient number of consumers switch to other products, such as would make the increase in price unprofitable to the hypothetical monopolist, then these products should be included within the relevant market.

Visa submits that Visa cards have the same intended use as all other means of payment, i.e. they are used by customers to pay for goods or services provided by Merchants. Likewise, they are accepted by Merchants as value in return for goods or services provided. The payment card transaction represents money (cash), in the same way as a cheque, traveller’s cheque or money order represents money.

Visa submits that if Visa Issuers or Acquirers were to raise the "price" of Visa cards to their customers (i.e. the issuing or transaction costs to cardholders or Merchants respectively), then a sufficient number of customers would switch to other means of payment so as to make such increase unprofitable.

Visa also notes that there is significant evidence available which demonstrates the existence of competition between different consumer payment methods such as payment cards, cash and cheques, as is set out below.

7.1.1 The relevant market includes inter alia all types of payment card

7.1.2 Firstly, Visa submits that the relevant market comprises inter alia all payment cards. Following on from its submissions above, Visa believes that all payment cards are sufficiently substitutable for one another to be considered as falling within the relevant market. For the avoidance of doubt, Visa submits that this includes store cards, and other payment cards issued by non-banks.

Considering first of all store cards, or "proprietary cards", i.e. cards issued by Merchants, together with banks to their regular customers, Visa notes that loyalty programmes have become the most effective form of attracting and keeping customers over the last years. In South Africa there are more than 20 different loyalty credit cards issued by trade chains like Woolworths and Clicks. Some store cards are issued independently such as Edgars and Foschini;, some co-branded with Visa and MCI such as Woolworths Visa issued with Mercantile . All these store cards are used to purchase goods and services as are Visa cards. As regards other bank cards, Visa actively competes with three-party systems such as American Express as well as other four-party payment card systems.

7.1.3 The relevant market includes inter alia cash and cheques

In addition to all types of payment cards, Visa submits that the relevant market includes cash and cheques and other forms of personal consumer payment.

As legal tender, cash is accepted by all Merchants accepting Visa cards and can be used by all customers. The fact that Visa payment cards are substitutable by cash and cheques was also recognised in the *NaBANCO* case in the USA, this case is attached and marked F. The US District Court Florida held that the cross-elasticity of both demand for and supply of Visa and other payment devices is quite high and concluded that cash and cheques were sufficient to provide close substitutes for a Visa card in any possible context[21]. This is what the Court considered to be the relevant market.

Payment cards are used in South Africa much more today than they were, for example, 10 years ago. This fact indicates substantial substitutability between payment cards and cash and cheques and thus that these products all compete in the same market. Indeed, the relative growth of payment cards can only have occurred in consequence of thousands of customers having chosen to pay by plastic cards for purchases which they would have otherwise paid for by cash or cheque.

Visa submits that the relevant market also comprises cheques. According to a survey of consumers commissioned by Visa and carried out by independent research agencies in seven EU countries in 1995 on attitudes towards surcharging for payment cards[22], the vast majority of respondents would pay by either cash or cheque in the event of surcharging of cards.

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21 596 F. Supp. 1231, 1257, *National Bancard Corporation (NaBANCO) v. Visa USA*. These findings were upheld by the US Court of Appeals, 779 F. 2d 592, 604 (11th cir. 1986).

22 "Consumer Attitudes towards Card Surcharging" by the Research Factor, 1995.

Visa would point out that the practical substitutability of cards for cash and cheques has been recognised in the European Union in the context of the introduction of a single currency. Commissioner Monti has stated: "Electronic money is not only the lifeblood of electronic commerce, but also has the potential to replace a sizeable share of cash payments, notably during the period before Euro notes and coins are available.[23]

In conclusion therefore Visa submits that the relevant market for the purposes of this investigation includes all means of payment, including all types of payment card and all other means of payment including cash and cheques which can be used in payment for goods or services from a Merchant in South Africa.

8. MULTATERALISM

8.1 The multilateral setting of the Interchange Fee is necessary

Visa submits that there is no realistic commercial alternative to the multilateral setting of the Interchange Fee. It is a fundamental tenet of a payment network that its cards be universally accepted and the multilateral pre-determination of the Interchange Fee plays an important part in the realisation of this aim. As Visa explains below in the case of any given payment card transaction, the banks are obligatory partners. Without certainty as to the terms upon which the member banks participate in the system including interchange, this fundamental tenet would be severely undermined[24]. Moreover, any other situation would open opportunities for opportunistic free-rider behaviour.

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[23] As Financial Services Commissioner, see "Electronic money: Commission proposes clear regulatory framework": http://europa.eu.int/comm/internal_market/en/finances/general/727.htm.

[24] This fact was recognised by the District Court In *NaBANCO*, *supra,* note 21 at p. 1253, where it stated: "*The principle purpose of these agreements…[is] to provide a service which each member bank could not alone provide, namely universal payments service which ensures that a Visa card will be honoured by any Merchant regardless of which bank issued it so long as that Merchant displays the Visa logo on its door*".

A series of bilateral agreements on Interchange is neither a practical nor an efficient alternative. This would necessitate negotiations between (currently) 89 pairs of South African banks which would greatly increase the costs of running the system, at little benefit to consumers. The European Commission has recognised the inappropriateness of bilateral agreements on Interchange due to cost considerations. Similarly, the United States Court of Appeals in *NaBANCO* held that individual price negotiations were impractical, would produce instability and higher fees and could result in the demise of the product offered[25]. It therefore concluded that the Interchange Fee was necessary for the functioning of the Visa system and pro-competitive in effect.

The multilateral setting of the Interchange Fee does not lead to a significant limitation of competition between Acquirers

Visa submits that there is effective competition amongst Acquirers. Acquirers compete with one another for Merchants. Acquirers participating in the Visa system are entirely free in their individual pricing policies and thus compete by means *inter alia* of the level of their MSCs. Accordingly; it is in their interests to keep MSCs to the necessary minimum.

If an outlet chooses to accept payment cards, and is acquired by a Visa Acquirer, Visa would point out that the Merchant is free to be acquired by a different Visa Acquirer, to cease to be acquired by a Visa Acquirer altogether, or can be acquired by another payment card system Acquirer. The Merchant has the choice of which payment instruments he will accept, or to issue his own store card[26] In South Africa, the majority of outlets accept Visa and MasterCard cards This indicates that most Merchants realise the benefits of accepting association branded cards

[25] S*upra,* note 21 at p. 605. See also per the District Court in *NaBANCO*, *supra,* note 21 at p. 1263, where it stated: "*...to remove the fee to permit negotiations for interchange charges among Issuer and Merchant banks would result in loss of competitiveness and chaos with the eventual destruction of the enterprise".*

however there are a number of closed loop systems such as Amex or Dinners, or Storecards so it is clear that Merchants have a real choice whether to accept cards or not.

Importantly, when choosing whether or not to accept payment cards, Merchants must base their decision on an economic cost/benefit analysis i.e. they must assess whether the acceptance of one or more brands of payment cards will allow them to effect more sales than they otherwise would. If a Merchant does not expect a net benefit in accepting a particular brand of payment card, he will choose not to accept it. There are Merchants who do not expect to benefit from accepting some or all payment cards, and thus do not accept them.

Acquirers are aware of Merchant's sensitivity to MSC levels and they actively compete on the basis of MSC levels. Visa would also point out that many Merchants are extremely sensitive to differences in other financial terms such as the date of settlement as negotiated between them individually and competing Acquirers. Acquirers have a clear incentive to maximise efficiency of, for example, the processing of transactions so that MSC levels can be minimised.

The Interchange Fee is also only one element of the MSC: If the Interchange Fee is passed on to Merchants, it is only one element of the price which Acquirers negotiate with Merchants. The actual price which Acquirers charge Merchants is comprised of a number of different elements, each of which contributes to providing Acquirers with the ability to compete against one another. These include the costs of, for example, recruitment, processing, transaction proof and capture, Merchant servicing (including risk management), Merchant bankruptcy and fraud

[26] Importantly, Visa notes that store cards are widespread in South Africa.

write-offs[27]. There is thus ample scope for Acquirers to compete on price, despite the existence of the Interchange Fee.

Price is furthermore not the only means of competing. Visa would also draw attention to non-price competition in Merchant acquiring. Competition through means such as speed and quality of core services e.g. authorisation, a bank's terminal offering, Merchant requirements for management information, system capacity and resilience, chargeback handling, floor limits, effectiveness of account management, innovation and overall competence are also important factors for many Merchants.

Acquirers also are eager to attract additional card business not only for the sake of this business alone, but also because it generates goodwill and may lead to the development of a broader banking relationship with the Merchant.

Moreover, Visa would point out that where there is sufficiently strong inter-system competition, as is the case here, this can additionally restrain the effects of an Interchange Fee on fees charged to cardholders and Merchants[28]. Visa submits that it is subject to intense competition in South Africa from other means of payment, including other payment card systems, especially store cards. Thus, even if the joint determination of the Interchange Fee were to represent a restriction of competition in other relationships in the system (quod non), the existence of sufficiently strong inter-system competition from other means of payment would restrain such effects.

The multilateral setting of the Interchange Fee does not adversely affect consumers and merchants

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27 These cost elements are significant enough to warrant Acquirers taking great care in formulating their offers, particularly with regard to larger customers.

28 This economic fact is noted in the European Commission's Notice on Cross-Border Transfers, OJ C 251/3 [1995].

Since cash is legal tender available to all, at no direct cost, it is often assumed that cash is "less costly" to Merchants than commercial means of payment such as payment by card. There are, however, significant indirect costs for Merchants associated with the handling of cash which should be taken into account when comparing the cost of cash to the cost of payment cards. In addition to costs incurred in receiving, handling, safeguarding and delivering cash to the bank, (together administrative and logistics related costs). Moreover, one has to keep in mind that the costs of cash are to a large extent subsidised by the central bank which takes over the costs for issuing, replacing, counting and delivery of cash. These are costs for society in general.

It must also be recognised that, like other means of payment, accepting payment cards does not only involve costs but also has advantages. The immediate advantage for Merchants of card acceptance over for example cash are the money management benefits. Cash management is a time consuming and burdensome task which carries significant risks with it. A considerable portion of profits can easily be lost through bad cash management. These inconveniences and risks are eliminated through "electronic cash", a more sophisticated and secure means to obtain payment. Ultimately therefore, the cost to Merchants of accepting Visa cards as a means of payment may be less than the cost of cash and cheques.

Furthermore one has to consider the safety issue. The cost involved in cash related crime is not simply expressed in economic terms: the cost of loss of life and damaged cannot be adequately expressed. Whereas a payment card is "personal" in that it is of value only to its rightful owner, cash is "impersonal", of value to the bearer and as such the risk of theft from Merchants accepting cash is greater than with Merchants accepting payment by cards. This applies firstly to theft by employees dealing with cash and secondly to theft loss through break-ins and robbery. In South Africa the number of reported assaults on individuals grew by 74% in 2006 and the number of bank robberies has recently doubled. Cases of theft of cash upon leaving a bank or upon withdrawal from an ATM have become common in South Africa and are often very violent, an example of a press article is attached and marked "G".

The view that payment by card is more expensive than payment by cash also ignores other indirect benefits associated with accepting payment by card. Visa would stress that Merchants benefit from accepting cards and that these benefits are numerous and significant.

The fact of accepting Visa cards as an additional means of payment is an additional facility which customers value. The value to a Visa cardholder of a Merchant accepting Visa cards, over and above the value placed on the usual payment service offered by Merchants, such as acceptance of cash or cheque, is represented by incremental sales[29].

These incremental sales can be generated as a result of the convenience of using a card when cash may be difficult to obtain[30]. Incremental sales can also be generated through the offering by some Merchants of Visa related services such as cash back facilities or by the offering of interest free credit periods, and rolling credit by Issuers. This permits cardholders to make purchases when they have no funds on their account. The fact that a Merchant accepts Visa cards, means that the chances of a purchase being made at this outlet at this particular time rather than at another outlet are increased. The Merchant could also achieve this by offering his own credit facilities to customers but this would involve him in extra costs and risks.

The superior speed of card transactions over cash and cheque payments also represents a benefit to the Merchant which can be viewed both in terms of cost savings and also as a benefit which will be felt by customers. Since card transactions take less time, more customers can be served with a given staff. The efficiency of such service is likely to be appreciated by customers and will encourage them to return.

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29 This was recognised by the court in the *Bally* Judgment (The ECJ held that the card organisation performed a "service" to the Merchant, which included… "the promotion of the supplier's business by enabling him to acquire new customers, possible publicity on his behalf and the like". ECJ, Case C 18/92 ECR [1993], p. I-2871, at paragraph 9.

30 Cash may be difficult to obtain either because banks or ATMs are located too far away, or because the service is simply not available or too expensive, or the account is empty. In scenarios such as these, Visa cards will be used to make a purchase at a Merchant accepting

Finally, the fact that rapid payment of the debt contracted by the cardholder is effectively "guaranteed" by the Acquirer to the Merchant, provided that the Merchant has followed certain basic procedures, is clearly a significant advantage to the Merchant. In accepting cards as payment, the Merchant can eliminate the risk of default. This is not the case for cheques[31], the provision of credit facilities[32] nor to some extent for cash, e.g. if it is forged money. This guarantee is possible because Issuers bear the cost of fraud in the system and will guarantee payment to Acquirers, provided they and their Merchants follow certain basic procedures[33]. That Merchants obtain payment very rapidly through payment by Visa card represents a significant cost saving to them. Merchants save on collection costs and are able to benefit almost immediately (in a matter of days) from the increased funds in their accounts. This in turn enables them to turnover their inventory more quickly, leading to maximised profits for their business.

It is clear from the foregoing that the benefits which Merchants obtain from Visa's extensive cardholder network are substantial and numerous.

Merchants offer various additional services to their customers with a view to encouraging their custom. For example, most supermarkets in South Africa offer a free car park service to their customers. They do not discriminate between those which use this service and those which do not, however. Not all customers will have the same need of those additional services and therefore some will benefit from them more than others. For example, a customer with a car will not benefit from the provision of the free bus service, a customer who knows exactly what he wants to buy, will not benefit from the advice of a sales

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Visa. It follows that Merchants who do not accept Visa cards, will not make these incremental sales.

31 Other than guaranteed cheques which are rare.

32 For example, rather than requiring immediate payment for individual purchases, a Merchant may only collect payment in full at the end of the month.

33 See Section 2.9 of the Visa International Operating Regulations (General Rules Volume I). In such circumstances, the Acquirer would normally guarantee payment to the Merchant, although this is within the Acquirer's discretion.

assistant. Yet, those customers who do have a car, or need advice for example, are not as a general rule charged for these services.

9. CONCLUSIONS: SOUTH AFRICAN MARKET

Visa would like to stress that the retail banking market in South Africa is experiencing significant growth and development at present. Visa submits that competition in this market is extremely active and that the payment card business is far from mature. Banks and payment card systems alike are fiercely competing through the improvement and diversification of the products and services which they offer to consumers, both cardholders and Merchants alike. The positive effects of this competition can be seen in the introduction of the newest technologies in this sector in South Africa and the increase in the number of bank accounts opened in recent years. The South African banking sector started to change in the mid 1990s with banks starting to offer much more sophisticated products in the retail sector. In 1998 the debit card was introduced in the SA market and already by the end of 2006 South Africans held close to 14 million payment cards. At the same time, the number of online ATMs in South Africa grew from 6,600 to 12,400.

Moreover, American Express and Diners Club have both successfully established their products in the South African market and compete actively with Visa and other payment card brands and other more traditional means of payment such as cheques. The market performance of Visa is a result of Visa's innovative approach and wide product offering, as well as the considerable investments made by Visa. Visa and its member banks aim to offer services in South Africa of a quality comparable to that which took over thirty years to achieve in Western Europe. Visa would stress however that all payment card systems in South Africa compete actively.

Finally, Visa would make the following comment about the effect of the development of payment cards in South Africa: The development of cards (especially on-line Visa Electron cards) in South Africa has helped the retail banks in building deposits. These deposits have in turn had a positive effect on the rapid development of the banking system in South Africa. (The banking industry has experienced significant growth and improvement within the last 10 years.) By increasing the banking population generally, there are now resources in the banking system that benefit the economy in general, and in particular Merchants. We further attach marked “H” some relevant publications that demonstrate the economic benefits of electronic payments to developing economies.