General Discussion
Session 1

Mr. Weiner: Thank you, Harry, and thank you, Tony. This session was rather daunting, I am sure. There is so much going on obviously in the retail payments landscape. Both of you have done a marvelous job in a comprehensive, succinct way of capturing the essence of so many of the important questions.

I should probably give Harry a chance to respond somewhat briefly to Tony's comments before we open this up for general Q&A.

Mr. Leinonen: Regarding the number of payments, we don't have really good statistics on cash payments. Cash payments are also one type of payment, so that part should also be included in the "cannibalism" total.

You could think the number of payments would increase if the overall sum to be paid were to be split into smaller individual payments. The question is, Would we do it and why? The other possibility is to recirculate payments faster, so there would be more frequent turns or there would be a larger number of companies making payments to each other on the road before the end product/service reaches the end customers, and then there would be a larger number of payments for each end-service unit. But for those kinds of structural changes (e.g., increases or decreases in external payments due to outsourcing or industry consolidation), we do not have information. I would say that when we all have limited budgets to make payments from, we fill that budget somehow and use different payment instruments for those payments.

Then, on the competition in payments, I would say that still, even though it looks like the card service providers would be forcefully competing, they are not doing it. If you compare to other industries, for instance, e-mailing, you could put up an e-mail service anywhere in the open network. Everybody can do it. You have much more competition there because of the general openness. The same is also true for mobile operators. There are not different trunk networks for different mobile telephone brands; every service provider uses the same trunk network behind it.

Now, in payments again, we have different trunk networks. We have the separate Visa, MasterCard, and others networks, which limits competition.

Then, the last question was the chicken-and-egg problem for mobile payments. There does not necessarily have to be such a big chicken-and-egg problem there because you can put the information of the normal Visa card and MasterCard in parallel in the mobile phone. You use the plastic or the mobile version of the card depending on what kind of interfaces the merchant offers. Chip-based cards use basically the same interfaces in both cases. The question is, When you go to mobile, will the cost go down? For example, at least in Finland, we are taking down the old telephone lines due to the same reason. There are almost no copper lines anymore in the country side, so when the telcos take down the copper lines, they will save so much that they can even give away the mobile handsets for free instead. We have a little bit of the same situation in payments when we go to mobile payments: The costs will go down so drastically that it is really worth investing when you do it for a longer period of time.

Mr. Grover: Tony, this question is for you. You characterized PayPal as a front-end, not a network. Isn't it actually a front-end, but it is also a proprietary network and—now with the STAR partnership, an open network—a payment network in its own right that has critical mass at least in the e-commerce space?

Mr. Hayes: Yes. I characterize it as a front end, and it clearly too is an existing payment network. In terms of the ability to fund your PayPal account in the first place, the funding is going to occur via some existing payment method.

Then separately, once the funds are in the account, it can also be a network in its own right. So, as a PayPal user, I can pay you as a PayPal user, and the money can stay within the system. Obviously PayPal started as an eBay payment mechanism. Now it's expanding, and most of its growth is off eBay. So it has its own acceptance brand. It has its own pricing. It has its own rules within the mechanism. So, by that definition, it has now become its own payment network. But, I think it could not have gotten to that point were it not for the existing payment networks. Were it not for the existing payment networks, it would not be where it is today.

Mr. Grover: But in the same regard, the traditional retail card payment networks—the open networks—rely upon existing networks and originally did fund themselves, that is, with money from outside the system coming in. Just as PayPal relies upon existing networks to fund its accounts, everything we consider a network today is reliant upon what is coming in from another network.

Mr. Hayes: Sure. I would agree.

Mr. Bolt: One comment and one question for Harry about the zero-sum cannibalism. I think the number of payments would correlate with real gross domestic product growth. So, if you have a growing economy, the number of payments would also grow with that. For example, 20 years ago, I went only once a day to the ATM. Now, sometimes I go two times or three times. For other people, the same would hold, I guess. In a growing economy, probably the number of transactions would also grow.

The second point is, suppose cash is more expensive than card payments for society as a whole, but for merchants it is actually more expensive to accept a card payment than a cash payment. How then would discounting or surcharging help get a more efficient outcome? I do not see that.

Mr. Leinonen: Regarding the growth, it is clear when the economy is growing, then the number of payments grow with that. But the question is, Do you have a stable relationship between the different instruments, or do the markets start to grow more rapidly due to internal payment service factors or just to external factors?

Mr. Bolt: The pie gets bigger.

Mr. Leinonen: That is clear. When you compare, for instance, to the telephone industry, you use your mobile phone much more than you used your traditional phones before. There you can see the difference in economies, but payments developments will not affect volumes. In mobile phone, you have a real growth worth investing in.

Regarding transparent pricing, the real question is, Which way are we going to establish it? It could be done so that merchants are surcharging more. You can have open surcharging and can take the cash price as the basic price visible on price tags and then customers would get discounts when using debit cards and pay an extra surcharge when they want to use credit services. That would be one way of increasing transparency.

The other would be a more neutral way for merchants where they are credited in full for all different payments instruments, that is at par, and the service provider has to charge the customer directly. That would be the most efficient way because then the consumer would see all the prices in one place and there would be more competition between the service providers because the price was directed to the consumer. But in any case, it is obvious that if the different instruments were priced visibly according to cost, there will be a big change. We have made recent studies of that in Finland. In Scandinavia, when a check fee of 10 cents per empty check delivered by the bank was introduced in the late 1980s, checks disappeared almost completely in two years. Everybody went to debit cards. So, even small price changes can make a big difference in payments.

Mr. de Armas: This question is actually for Tony. Harry talked a lot about transparency and making sure the costs are transparent for customers, but I noticed you didn't discuss that in your response. How important is price transparency for consumers? What are your thoughts on that?

Mr. Hayes: I alluded to the complexity of regulating pricing in my remarks, but there is an adjacent question, Should it be transparent?

Clearly, as you well know, at Home Depot and others there is a big argument around pricing. You don't say, Here is the cost of the good, here is the cost of rent, here is the cost of labor, here is the cost of payment. These aren't broken out. You simply say, here is the cost, which includes all of your costs of delivery. In today's environment, you have the ability to discount for cash. What you don't have is the ability to surcharge for certain products. And what you don't have is the ability to differentially surcharge for certain payment products versus others.

Quite honestly, it is unclear to me whether the added ability to have differential pricing would be helpful or harmful in the marketplace. It certainly would change consumer behavior, there is no doubt. And when you look at countries that have granted the ability to have differential pricing to the end user, you do see consumers clearly change their behavior. That is evidenced in Australia, whereby you now see surcharges on credit card transactions in certain locations. You see surcharges just for American Express or Diners Club in other locations. It is a judgment call, I guess, in terms of whether there is a net positive or not.

There is a lot to be said for you as a retailer having the ability to charge as you see fit and accept the payment products you see fit. But whether or not, on balance, it will be beneficial to have a pre-payment cost price and a post-payment cost price is debatable. You would almost have a menu to say, "If STAR, then this much. If MasterCard, then this much. If American Express, then this much." It may be beneficial, but the complexity of this and the change in behavior potentially would offset the benefits. I guess I'm hedging my bets a little bit.

Mr. de Armas: Harry, do you have thoughts on if it is a toss-up? What are your thoughts on transparency?

Mr. Leinonen: In Finland, we have the situation that almost all customers are multihoming. They are using cash and both debit cards and credit cards. We normally have our debit and credit card on the same plastics. So, you have just one plastic card with both account services available. Almost all merchants take almost all cards. I made a small calculation that if the cash usage would be reduced by 30 percent—we are very low in Finland already with 60 percent of volumes and about 30 percent of value—then the costs would go down by about €200 million a year, which is quite a good savings already in Finland. Cash costs are high, but you don't see them.

You don't know and see the ATM or transportation costs to ATMs, etc. Of course, with credit cards, the question is, Into whose pocket are the benefits of credits going? With cash, it is a little bit of whose pocket, but much more what could be done with all wasted cash transportation, and all other cash service costs instead of just spending them on putting money from one ATM to the merchant and back from the merchant into the ATM again. There are more efficient uses of those resources.

There was another question I would like to comment on—the PayPal question. What these new entrants are doing is building on the old payments systems. That is the only way they can do it because the merchants have to get the money to the old systems to make their payments. Consumers also get their salaries via the old system. The basic money is in the legacy systems. PayPal has to take the money out of legacy systems to get it to circulate in the new system. This is really just because of the disinterest for development among banks and the inefficiency of the old systems that these new entrants can do it. Because if the banks would have the same services, then there would not be a market for new entrants. So, this is just, you could say, a temporary solution. I hope the banks are getting things together.

In Europe, we have bank-based e-payment systems, for example, iDEAL in Holland and Solo in Finland, where you can make real-time Internet payments on bank accounts. For the merchants, these systems credit the money directly, immediately when the transaction is made. In countries where you have these kinds of bank services, PayPal has a smaller market share. Therefore, it is more a question of when the banks are going to put up these kinds of competitive services.

Mr. Cook: This question is for Tony. Tony, your comment was—I apologize if I am paraphrasing here—"It's very difficult to make a business model or pricing mechanism that works for all."

I guess I would ask you to reflect on Interac in Canada as a great example of what was a pricing mechanism that worked for all, in that it was beneficial for the merchant, the consumer, and the financial institutions in that case. And everyone did benefit from it. As we see now with MasterCard and Visa and their efforts to enter that market in Canada and perpetuate the fraud-prone product of signature debit, do you see that as being the pie will get bigger or that there will be a tender shift, or do you just see higher costs of debit coming for merchants in Canada?

Mr. Hayes: Interac in Canada is a great case study of debit and debit transactions per capita, clearly one of the big success stories, and it is done with zero interchange. I don't pretend to have all the facts here but certainly the Canadian banking system is clearly very different than the U.S. banking system. It is highly concentrated.

Interac came into being largely through getting a waiver from the competition authorities for the banks to cooperate and with explicit price regulation around the fees. It has been run as a not-for-profit since that time. The account structure model in the Canadian system is most consumers pay a monthly fee of, let's say, $10 a month, which gets them a package that includes a certain number of debit card transactions. Or you can have an a la carte, pay-as-you-go model whereby the consumers then pay something like 50 cents per transaction.

At the end of the day, somebody is going to pay. In the Canadian model, the consumer is paying explicitly to their bank, either on a per-transaction basis or bundled within the account structure. In the U.S. system, consumers are paying, and it is embedded within the fees the retailer charges. If the Canadian model changes and does adopt an interchange pricing model, then assuming there is healthy competition among the banks in Canada, then one would expect to see the account structures being changed to reflect that they'll now get income on the card side, which therefore means there will be less pressure to get revenue through explicit consumer charges.

The whole debate is around who is going to pay the freight. There it is paid through direct consumer charges, either with an a la carte where you can be charged a fixed fee per transaction or all you can eat. It hasn't served as a barrier to debit card use. Debit card use is very high.

Here in the United States, there is no explicit charge to the consumer for almost all cardholders; instead that is embedded within the cost structure of retail pricing. One of the great challenges here in the United States is with competition. In many markets, as you have competition, price comes down. Though here in the United States there is very, very strong competition, we haven't seen prices come down in terms of interchange rates. In fact, in some cases, the opposite has been true.

Mr. Cook: Harry, did you want to comment on that?

Mr. Leinonen: Yes, the interchange debate is a very interesting one. The true story from Finland is that I was once in a group, because I was in private banking then, and the director was asking us what would happen if an interchange fee were introduced. At that time, all banks were both acquirers and issuers; it was quite balanced. That meant that we would have had a difference of about $10,000 a year for the bank getting the largest benefit with a quite big interchange fee because everyone was so balanced. Banks would have paid as much out as they would have received back. The gross sum was very big, but the net sum was very small. That is when you are in a balanced situation.

When you are in an imbalanced situation, the question is, What is the difference between acquiring and issuing? Basically, the customers will see the service charges better if the acquirers just covered the acquiring costs and the issuers take the issuer costs. Then you have a good balanced situation and will get competition between acquirers, and you will get also more competition between issuers. Sufficient competition is the main issue. I don't really believe a high interchange fee would increase the number of card transactions. If you look at the European scheme (I have tried to get the information), based on everything you can already see, in those countries where there is a higher interchange fee, there is a lower number of card transactions.

In all the Scandinavian countries, where we have no interchange fee on debit card transactions, you can see very high volumes of debit card transactions. Those countries in the south of Europe, where they have high interchange fees, they have almost no card transactions at all. How much is due to other reasons like tax evasion and so on is difficult to say, but at least you can clearly see there is at least something saying that a low interchange fee on debit card transactions really served to get high volumes of debit card transactions, and then the share of cash and credit card transactions will be lower.

Mr. Peirez: If for no other reason than to ask a question to get off interchange fees, can you both comment on which market around the world you believe has had the greatest innovation over the last few years? And which markets have the greatest consumer choice? Then we can go back to the conversation as to what does and does not work.

Mr. Hayes: Good question. In terms of consumer choice, I do not claim to know all the markets around the world, but I think the United States has to be near the top of the list around consumer choice because certainly we have cash; we have checks—many countries have moved away from checks; we have two forms of debit in terms of PIN-based and signature-based—both very healthy. We have credit. We have prepaid. We have new products to serve the low-end, unbanked customers; products to serve bank customers; and products to serve very affluent customers. So, in terms of choice and access, as well as a whole variety of online payment methods, I would have to point to the United States as being—if not the most choice-filled—near the top of the list.

In terms of being advanced, I would have to point to a number of the Asian countries. I spent some time in Singapore recently, and the government mandate was to move toward the cashless society. It is very advanced in terms of use of card-based payments and the use of mobile payments. Basically all the toll roads now automatically charge the cars as you drive, that is going to the parking system, that is going to the bill-payment system, and that is going to the transit system. So I guess Singapore and other markets like that where there has been a very concerted effort by only a few banks that dominate the marketplace, and where the government and regulator are very involved, ratcheted up to move quite quickly and leapfrogged some of the legacy systems we have.

Mr. Leinonen: I have some problems with the question because consumer choice is perhaps not so interesting in this area because we talk about infrastructures. Infrastructures should work as efficient as possible. Then you somehow have to limit consumer choice also. You can't have as many highways in all directions from every point. Somehow you are limited because of cost issues. Any payment is just a debit from one account and a credit to another. The question is, How many highways do we have to put in parallel to do exactly the same thing? The merchant will get money, and I will pay the merchant. Nothing more will happen. Is there really a need for so many different alternatives when the end result is the same? It is really in the interface where you have a difference. There should be different kinds of interfaces, but, as in the mobile phones, there can be different kinds of mobile phones but you speak through all of them. You need to get the speaking infrastructure to work well. If you would have a lot of different mobile infrastructures, I think it would be a mess.

Mr. Hayes: I have clearly lived in the United States too long. I think choice is good. Yes, payment is moving money from account A to account B. But we have the credit card business, which is a pay-later model; we have debit that did very well, which is pay-now; we have prepaid that also is doing very well, which is a pay-before mechanism. All of these products are designed to meet different needs. They have all found their own niches and segments of the marketplace for them to do well.

There are still check writers, and people value either the security that comes with a check, the idea of writing the check on a Friday, knowing they are getting paid on a Monday or whatever the case may be. There is value in cash, and there are certain segments that like the cash for reasons beyond tax evasion: for example, the idea of knowing how much money is in your wallet and spending as you go. People are self-selecting what the right payment mechanism is for them based upon the attributes of each method.

Even within debit, Why is there PIN and why is there signature? There is a long argument that can be had about this. But the fact is, we do consumer surveys and you ask consumers which one they prefer. Half of you will say signature and half of you will say PIN. You ask the people the second question—Why?—and no matter which answer you chose, the number 1 reason in both categories is *security*. So the people who sign say, "I sign because it is more secure," and those who enter their PIN say, "I use my PIN because it is more secure."

So "beauty is in the eye of the beholder" here. By creating choice, you can select payment methods that offer the right proposition for the end user. It is hard for me or for any central body to determine what is right or what is appropriate in the absence of that person's mindset.

Mr. Leinonen: Would you want to have a talk-before or talk-later telephone or a talk-just-now telephone?

Mr. Hester: One country where there are no consumer options currently available is Canada. Right now, as an individual, you cannot use a debit card over the Internet in Canada. With Visa debit, consumers will have that choice.

Mr. DeCicco: I have a comment and then a quick question. Harry, you talked about the account number in the United States being messy. I am part of the standards-setting organization X9 here in the United States that does all the American National Standards Institute standards for the community. And we are working on an International Bank Account Number initiative for the market. Hopefully that comes to fruition in 2010.

I also want to go to another efficiency you talked about—the transaction ID —and being able to track payments. A great idea! You know the FedEx model. It was brought up about five years ago at a SWIFT-Sibos conference about why the payments market can't develop this level of efficiency. Clearly, there are differences between a closed-end model that the packaging companies have and the payments system we will participate in. Nevertheless, our customers ask for it frequently and there have been some market infrastructures in the past five years or so that have looked at it, tried to get some traction around it, and alas just haven't been able to get that traction to develop a good compelling business case to pursue.

What are your thoughts in terms of how we get that from concept to reality?

Mr. Leinonen: One of the main issues in the payment industry that we have to get corrected is the business model and the business incentives. In the package handling and most other industries, they have good development incentives. Therefore, they make these kinds of developments based on customer needs. We don't have the right incentives to do that within payments. The slow development of standards and services is due to the fact that banks don't make revenue by putting those kinds of service developments into the market.

Banks don't have that business interest or case because of the non-transparent pricing, the low competition level we have today, and the closeness of the industry networks. Developments can always be stopped by saying that the ACH doesn't support this. This is really what is inherited in the current way we operate. We need to change that. In Europe, when these topics were discussed, many banks were saying to the authorities, "Please, Authorities, do something because it is very difficult to agree among ourselves on the level of punishment." How much self-punishment would be sufficient was the problem they took up. In this kind of situation, there must be an outsider giving the operational service requirements. For instance, the Payment Services Directive, in force since November 1 in Europe, determines now the deadline of one day for processing interbank credit transfers with credit in full value in "share" mode—that is, with no interchange fees. Important processing requirements are now defined in regulations. Unfortunately, you will probably say that I'm in favor of regulation here, but what I would want to say is that we have to get regulations that put in correct incentives, then the market competition will work. Now we have regulations and business models that have biased incentives, and that is the problem behind all these issues.