General Discussion
Session 4

Mr. Ruttenberg: It is now time to open the floor to questions from the audience.

Mr. Wenning: I found the discussion to be very interesting this morning. I have a couple of observations: As one of our members said to us in an industry meeting, cooperation and collaboration may sound fine to you, but from where I sit it sounds a lot like collusion. When you talk about the role of the central bank, there is a fine line between societal interests and societal balances.

The point was made yesterday during one of the conversations that somewhere along the line, after 60 years, the Federal Reserve made the decision to have checks clear at par. Seven out of the eight countries have debit that clears at par. Gwenn made the observation of having a light hand versus a heavy hand when it comes to the role of central banks.

But at some point there should be some balance of societal interest by someone in an oversight role of a payments system in terms of monetary policy. From where some people sit, they don't see any hand in the United States as it relates to credit or debit payments systems.

I guess my question is, when I look at the title of the conference, Where do you see that in terms of U.S. policy going forward? It seems to me there has to be some role in balancing the good for societal needs.

Mr. Levitin: I am going to respond both to you and also to Gwenn, because they go to the same point.

Gwenn rightly points out there is a lot that works really well in the U.S. payments card markets. Let's be careful; we don't want to throw out the baby with the bathwater. But we do have a very particular market failure and you have alluded to it, which is the par clearance problem. The payments system can either clear at par or clear at a discount. Alan Frankel's work has shown that between the two, we actually want par clearance as there can be dead-weight loss with discounted clearance.

Payment cards in the United States are a really weird hybrid. The system has discounting in parts and then mandates par in other parts. Mainly between banks, interchange is a form of discounting. But then—and this goes to Matthew's point on surcharging—the merchant is told, "*You* can't do the discounting."

What the banks can do, the merchant can't do. To me, that's where the real problem lies. We can either have an entirely discounted payments system. That's fine. It may not be the optimal thing, but we could do that. Or, we could have an entirely par payments system. But the way the current system is set up, for both credit and debit in the United States, is that we have par for some parties and discount for others. That is where the failure lies. We could deal with that simply by fiat legislation or something like that. Just zap it, saying, "no-surcharge rules are out the window."

We could do it in theory with some sort of taxation. One of the concerns is the payments industry is pretty nimble. If no-surcharge rules go out the window, there are going to be a bunch of well-paid lawyers and economists, whose job it is to devise a runaround to whatever the regulation is. Another option is to have a competing par clearing payments system and see if that shifts the burden.

Whether ultimately the right move is going with the public option, I'm kind of agnostic. Dickson may have some arguments with me. I was more throwing that out as something we should talk about. It is certainly something the Kansas City Fed has raised with the idea of having debit transactions cleared through the ACH system. Frankly, with the Credit CARD Act, it might be more feasible to clear cards now that the cards are no longer such an "at will" line of credit.

If we like the move that happened with checks and cash—where they originally didn't clear at par and now we've moved them to being par-clearing—and we have systems that work very well, we should want to see the same thing happen with credit and debit in the United States.

Mr. Bézard: Again, I'm not saying merchants don't have issues and there is no problem. I actually run a market research company, and when some of our clients pay us with a credit card I frankly hate to pay the merchant acquiring fee. So, I understand first-hand what merchants are going through. But the broad question to me is the risk of unintended consequences when regulators step in. Look at the Department of Justice's decision in 2004 to let Visa and MasterCard issuers issue American Express cards to introduce more competition in the issuing world. This decision drove up the competition for issuers' business between Visa, MasterCard and American Express, contributing to increasing interchange. I am generally very concerned with unintended consequences of regulations. My main argument is that merchants have more options than meets the eye. There is room for them to start competing with the banks.

Mr. Levitin: I'd like to say a word in response to that. Lots of things have unintended consequences and the argument against unintended consequences of regulation is an argument against government at all. It is not an argument about particular regulation. The nature of government is to intervene in markets. Once you have a government that only requires taxation, taxation warps markets in its own way. So, if the only basis is a generic concern about unintended consequences, yes, we always have to worry about that. But, unless you can start to point to particular negative consequences you think are likely to result, not just a specter of maybe something we haven't thought of will go wrong, I don't think that argument can carry that much weight.

Mr. Wildfang: This is an observation. The debate here suggests the alternatives are regulation or no regulation. I've just observed, in the United States at least, there is regulation. If you've ever looked at the rules of Visa, there are thousands of pages. The difference is we have regulation by a cartel of banks instead of the government.

I think the real debate should be, assuming we are going to have regulation, Can government do a better job of regulating than a group of banks that have self interest to motivate them? I'd like to hear the panel discuss that, as well.

Mr. Ruttenberg: Maybe I'll misuse my authority here and handle the question myself. It's more than regulation and no regulation. If I look at the role of the European Central Bank and the Eurosystem as a whole (i.e., the ECB and the euro area central banks) we play much more the card of moral suasion. I think it was Dickson who was asking for public authority setting the framework but letting the markets decide on the "how." That is exactly how we do it at the moment in Europe. Of course, we have our special challenges—the integration of the retail payment markets of 27 European countries. There are also the innovation challenges already talked about. Every year, we publish nice reports describing developments we see in the market. We describe the challenges which have to be overcome by the banking community in close cooperation with end-user merchants and so on. We also describe the consequences if they don't do it—the consequences we think will happen. Over the past years, we have seen that this has been a quite successful approach. Very often you can see in banks, especially in the payments business, a lot of people are very busy with the day-to-day business in running their systems and asking for additional budgets to keep on track with whatever, but they maybe spend too little time on more strategic things: What will the market look like in 10 years' time, and what will be the role of banks, nonbanks, and so on in this market?

Maybe a very specific example of this, as a consequence of European integration, is we face the risk of losing the quite low-cost, efficient national card schemes (e.g., the PIN scheme in the Netherlands, Bancontact/MrCash in Belgium, Girocard in Germany). Those pure national card schemes will just disappear because banks have a much more European focus, not only a national focus. The larger retailers are asking for one scheme for Europe and not the more than 20 we currently have.

The risk of the SEPA project is that although we are striving for open, more competitive markets and choice for consumers, retailers, and so on, we'll end up with only two debit card schemes in Europe—Visa Europe and MasterCard International.

There we've said to the banks, "Look, Guys! Is this what you want? Because it also gives a clear indication of what your future will be in this market."

It's all about who will have, in the end, direct contact to account holders, to the account holder in your bank. What will be your role in setting the standards and governance of these kinds of schemes if they are not European-based? It triggered a debate within the banking community. And not only in the banking community, but also an initiative popped up backed by retailers, "Hey, maybe we should set up a new card scheme."

We are not there yet; whether we will get there is still uncertain.

There are now currently three initiatives working to set up a new additional pan-European card scheme, and it is purely based on public intervention by moral suasion by the ECB and the Eurosystem as such. When we pointed at the unintended risks of SEPA for the European cards market and called for an additional pan-European card scheme two years ago, people were laughing at us. They saw us as central bankers sitting in their high ivory tower in Frankfurt, not connected to the real world, but after a few months they said, "Hmm. Maybe you're right."

Maybe the market will not deliver the additional pan-European card scheme and, finally, we have to conclude that our call has not been successful. But, in the end, we can at least say that we have raised the issue and it was left up to the markets to decide how to do it, whether they would like to do it, or take the consequences if not. Concluding, moral suasion—at least in my personal experience—is a very effective, efficient role the public authorities could play before entering into the domain of setting rules by regulation.

Mr. Bolt: I'd like to raise Matthew's point again about consumer switching. The very essence of competition policy is that consumers must be allowed to switch to an alternative. Actually, you are saying they don't switch in the end. But I think there is a difference between ex post, not allowing it, or ex ante, allowing it and not observing it, because the threat of, let's say, being able to switch can already discipline the market participants.

There is a nice example in the Netherlands that, pressured by competition authorities, Dutch banks had to come up with a solution to make moving to another bank easier and they came up with that solution. Everything is automatically redirected—all your direct debits. And you can even take your account number to another bank, so you have portability.

But then, in the end, nobody moved to another bank. But still, it is there and people *can* move. If you don't observe it, it doesn't mean that it is of no use. It is still a disciplining factor. That is my first comment, and I have another comment on surcharging.

A very difficult question, and you also pointed this out, is What is the right surcharge? Is there a coordination problem among other retailers? Actually, in theory I'm not so sure about the welfare effects of allowing surcharges. I don't know if it is better when the retailers or the merchants swallow the 1 percent discount when consumers use cards. Or when consumers are faced with this 1 percent fee and do not use cards and then more cash payments will be made.

I don't know from a welfare point of view which is better when the assumption is that cash payments are more expensive than card payments if, in the end, surcharges drive people back to cash and cash is heavily subsidized. In the Netherlands, even foreign ATM use is free. I'm not so sure whether the surcharge is the best alternative to having better outcomes for society, if it drives people back to using cash.

Mr. Bennett: The switching comment is something we heard a lot from all the banks, unsurprisingly. The fact that there's a lack of switching actually doesn't necessarily mean there is a lack of competition. The possibility of switching is enough to discipline the market.

While I buy that story to some degree, the fact that when we asked people why they didn't switch, nearly 50 percent said they perceived there being problems and out of the people who did switch, 30 percent said, "We had problems." kind of implies there were fundamental problems, rather than it was all okay and people were just choosing not to switch. If, at the point that everything is fixed and people are still not switching, then I would buy the argument. But, at this point, we still have a long way to go.

On the second point, I think it is an interesting question whether you are going to have welfare increases or welfare decreases. It's probably not the time to get into it right now, but I am happy to engage you in that discussion later on, because I think actually it is welfare increasing, but maybe I can have a chat with you about that later.

Mr. Moore: My question is about the relationship between innovation in the payments system and the regulators' ability to keep up with the changes, especially as it relates to consumer protection regulation, for instance.

There are two examples I'm thinking of. One is you look where innovation has happened in the past few years. PayPal is a great example. You have this new network of networks, as Dickson described. One implication of this is you try to use your PayPal account to pay someone else and by default everything is set up to go through bank transfers, because the costs are lower. One side effect of having PayPal facilitate bank transfers is you don't have the same consumer protection regulations in the event of unauthorized transactions. Regulation E doesn't apply to bank transfers the same way as it does to credit cards.

You also see this in the UK with movement to chip and PIN. This was arguably innovation and improved the security of the payments system there, but one of the ways which banks have responded, since chip and PIN's introduction, is to deny reimbursement to claims of fraudulent transactions to consumers whenever the PIN has been shown to be used. I am wondering, as we start to see movement toward new payments methods, whether there is going to be always an associated move in an attempt to circumvent or sidestep existing regulatory efforts.

Mr. Levitin: I can answer very briefly—Yes! To the extent consumer protection is costly for payments systems, there is a cost with that. To the extent that is a cost that can be reduced by having less consumer protection, then it makes perfect business sense to do so. This is a case where you may see the market driving against consumer protection rather than for it.

There is a case to be made that sometimes the market will drive for consumer protection, but in these cases consumers don't even know the difference between Regulation E and Regulation Z protections. If you can push them to Regulation E, rather than Regulation Z, you want to do that.

Mr. Gove: I'd just like to make one brief comment on surcharging, because a lot of the discussion has been about the impact of surcharging. A lot of the value in the Australian environment over surcharging has not been that people have actually been introduced to it. It's been as a negotiating tool and what can be achieved as a result of surcharging. So we're seeing a lot of the merchants and merchant associations use the threat of surcharging as the ability to negotiate better deals and lower prices in other areas.

In terms of the actual impact on cash, we're not seeing any move to cash in Australia as a result of surcharging. First, because there is not a lot of surcharging. Again, it is really being used as a negotiating tool. Second, when surcharging has been introduced, it is often only introduced on the more expensive cards. So really retailers surcharge on American Express and Diner's, but not on the scheme cards and the association cards, because they are now a lot cheaper.

And, of course, the EFTPOS domestic debit is also a lot cheaper again. Where there is movement, it is actually from one card type to another card type, rather than from card to cash. I can't really overemphasize the importance of surcharging as part of a suite of tools increasing competition in negotiations. To one of the points that Gwenn has made earlier, it is part of that role of merchants becoming more involved. And surcharging on its own is probably not likely to achieve a lot of these results in Australia. It has been that suite of changes, the ability for non-deposit-taking institutions to become members of Visa and MasterCard, to become self-acquirers, for new acquirers to enter the market, for merchants to do a whole range of fees that has been part of the improvement in the overall scene.