

Interchange Fees: Antitrust and Regulatory Perspectives

General Discussion

Chair: David A. Balto

Mr. Balto: I have about 15 questions to ask the panel, but I move quickly. Tom Hoenig paid for all of us to come out here, and he said in his opening remarks that the interchange fee was a price. Do any of you disagree with that? Nobody disagrees with that; everybody agrees interchange is a price.

Second, let's go to the issue of transparency. Somebody asked about transparency. Transparency is part of Bernhard Friess' order. Bernhard, why is transparency part of the order and how do you see it as being important to the functioning of the market?

Mr. Friess: We get a lot of feedback from customers in the acquiring market for merchants—even the very large merchants—who tell us that they simply do not know what interchange fees are. They have many questions. How high are they? How are they set? What are the components of interchange fees? So it seems to us that in a market in which the customer side has a severe deficiency of information, part of a remedy or part of a solution could be to make that information available. That is why we approached the networks to make their interchange fees more transparent, and I say this is something that, as was mentioned previously, could apply even beyond interchange fees. It could apply to other network rules that have an effect on the market, affect the way that competition is taking place.

Mr. Balto: To Renata Hesse, how do you determine a relevant market in the antitrust case?

Ms. Hesse: We use the hypothetical monopolist test, which is a lot of jargon for you all. Basically, we look at the price and we look in the context of whoever the players are in the marketplace to figure out who is constraining the ability of either the parties that are merging or the party or

parties that are engaging in allegedly unlawful conduct. We try to figure out whatever realistic constraints exist out in the marketplace on those entities' ability to raise price or reduce output.

Mr. Balto: In the cases the Department of Justice (DOJ) has brought, how has the interchange fee played a role in the analysis of market power?

Ms. Hesse: In the analysis of market power, we generally look at interchange as a price, and we apply what is called the SSNIP test (which again is a little bit more jargon than anybody needs) to interchange. In the context of the *First Data* case, we applied it to the switch fee that the merchant pays to the network. We think of it as a price and we look at whether or not the merging parties, or, in the *U.S. v. Visa* case, whether Visa and MasterCard, will have the ability to raise that price by a small but significant nontransitory amount.

Mr. Balto: We've heard a lot about two-sided markets. I'd like John Vickers to answer. How does the two-sided aspect of the market affect your analysis and your decision whether or not to bring in an enforcement action?

Mr. Vickers: Well, on the question of bringing in enforcement actions, again let me stress the difference with the U.S. case where the DOJ, or private plaintiffs or whoever, will bring a case to court. Broadly (not everywhere in Europe, but generally), an agency takes a decision which potentially is subject to very thorough and rigorous appeal from either side. There is a threshold we need to cross before we begin an investigation, which is that of reasonable grounds to suspect. That is a low hurdle and has to do with suspicion, which is some way short of belief. Bringing an enforcement action needs to be seen in that context. Some are own-initiative. Some are prompted by complainants. Some, in the old regime, were notifications, as was the MasterCard matter originally.

As to whether it is a two-sided market, clearly one takes into account the relevant facts and the economics of the situation. I am not sure how that plays into this question of whether you pursue a case or not.

Mr. Balto: The panelists in the Industry Panel talked about the importance of looking at both sides of the market. In your evaluation, is that part of the equation?

Mr. Vickers: Yes, sure. You want to get a good understanding of the whole picture, so of course you do look at both sides. As Michael Katz was saying—this is a sort of nerdy economist point—there are also some of the Ramsey pricing issues you can get in one-sided, multiproduct markets too. Of course, you look at all the facts in the round and in the light of the robust economic principles too.

Mr. Balto: Renata, same question.

Ms. Hesse: We think the two-sided nature of the markets is an important thing to consider. If you read the *Visa* decision, the judge in that case clearly looked at both sides of the market. She looked at the issuer side and at the merchant side. We also did that in the *First Data* case, although we ultimately found that the side of the market that was most likely to suffer substantial harm was the merchant side. So the focus of our case was on the merchant side of that market. It is an important part of the analysis and important not to ignore it. One could arguably say that in the credit card industry, the market is a little bit less two-sided, since the issuers are part of the consortium that make up the network. But, again, in the *Visa* case, we looked at it as a two-sided market and analyzed it as a two-sided market also.

Mr. Balto: Renata, John had talked about shifting burdens of proof. We had heard that before. Is the U.S. law similar to the law in the United Kingdom and the European Commission in terms of shifting burdens of proof?

Ms. Hesse: Yes, generally I like to think of these things in the most simplistic way possible. I think, particularly in a Section 2 case, which is a monopolization case, you are looking at essentially making a cost-benefit analysis. So we have the burden of proving that there is conduct ongoing that has a likelihood of harming competition.

Then the defendant in the case has the ability to come forward and give a procompetitive justification for that conduct. If that procompetitive justification is compelling, the court will decide for the defendant. There really are two sides to the case, and the defendants in our Section 2 cases have a very good opportunity to put forward their views and beliefs about why the transaction or the conduct is actually good for the market instead of harmful to the market.

If you read the *Microsoft* decision, you will see there are claims that were made in the *Microsoft* case, in which we carried our initial burden, but Microsoft gave a procompetitive justification for the conduct, and the court ultimately permitted that conduct. It is not a forgone conclusion. Again, I encourage people who are appearing in front of us or are engaged in cases with us to try to explain to us what the procompetitive benefits are, because we absolutely are not interested in either killing mergers or challenging conduct that is good for the marketplace.

Mr. Balto: Let's spend a few minutes talking about issues involving remedy. David, in the *Interac* case, which involved a monopoly network, in which the Canadian Competition Tribunal seemed to find some problems with the actions of the monopoly debit card network, rather than taking a structural relief, you did other things. Why did you do things short of structural relief?

Mr. Teal: In terms of remedies, most antitrust agencies consider the facts they are presented with and also the nature of the issue being considered. In a merger situation, where it is predictive and you are trying to anticipate problems, structural remedy is an easy, clean solution that addresses the problem in advance. When you are looking at what we term as an "abuse of dominant position" case, having a dominant position is not necessarily a problem. It is if you're engaged in practices that abuse that position and somehow harm market entry. In abuse cases, you are more likely to see a behavioral-type remedy.

With the *Interac* order, we are looking at a situation where we had a national network. We realized there were certain significant efficiencies available through the national network. If we split the national network, would we have two competing systems that were able to achieve the economies of scale that the single system could? In balancing our approach in terms of the remedies that were arrived at—and again, it was a consent order—we felt that a behavioral approach in this circumstance would be the more beneficial choice. It would protect the efficiencies in the system, but also open the system to allow for intrasystem competition.

Mr. Balto: Why don't we turn things over to the audience? Let's start off with David Evans.

Mr. Evans: I think one of the great things about these kinds of

conferences is the possibility of getting a good understanding of where the areas of agreement are and where the areas of disagreement are. I'd like to ask a question to the panel to see whether I could try to narrow down where we agree and where some of the disagreement is.

As I listen to the panelists and some of the other speeches, the sense I get is that there is agreement from the regulators and the competition authorities that one of the things that people really aren't interested in, in terms of an intervention in this industry, is no interchange fee. That is not something that people are talking about or even think is a sensible notion.

The second thing is that, at least for these large systems, the bilateral setting of interchange fees between the thousands of issuers is not something that, from a regulatory standpoint, anyone is thinking of as a possible intervention.

Therefore, the interest in policy debate is how the interchange fee should be set and at what level.

Assuming that the issue is what the interchange fee should be set at, should it be set at zero from your point of view? Or should it be set at some cost-based level from your standpoint? Also, what would the theory be on the U.S. antitrust law? Maybe, Renata, you are the relevant person to answer this: What would the antitrust theory be that Visa or MasterCard is a cartel, but the price should be fixed at zero or some cost-based level?

Ms. Hesse: I am probably not going to give a very satisfactory answer to your second question. Let me start with your first one about interchange and whether or not it should be set at zero.

There is a general view on our part that the banks—the issuers—are providing a service for which they should be paid, whether you call that payment interchange or something else. The question is how much should they be paid for it? I think you are right that the policy question is the question of the amount. Again, these are my views. It may not be what the Assistant Attorney General believes, but I am telling you what I think about them.

I did want to make one comment about your bilateral negotiation point. I think that is sort of an open question. One of the things that nobody has looked at very hard is whether the collective nature of the card associations is the only way that these prices can be set without there being tremendous chaos in the marketplace, which is the specter that the bilateral negotiation situation presents. That is an interesting question and one that somebody could look at and try to figure out the answer. But, if we ever were to look at the question of whether or not the collective setting of interchange by

the associations is somehow a violation of Section 1 of the Sherman Act, that is going to be a question that we will need to answer. The theory would be a Section 1 theory of collective negotiation among competitors.

Mr. Friess: Can I answer that too? To your first question, there are, of course, payment networks, in Europe at least, that do operate apparently without the interchange fee and have reached a very high market penetration without it. And there are systems which work on the basis of bilateral fee setting. We are not saying that multilateral interchange fees are inherent to such a system, but what we are saying and what we are accepting is that if a network decides to have them, we can see the efficiencies that you gain from that. We recognize these efficiencies as part of the European law, article 81, paragraph 3, rule-of-reason approach where we weigh the efficiencies with benefits to consumers.

Mr. Constantine: Renata, I have a question for you. In your reference to the Second Circuit opinion in the *U.S.* case, I am sure you noted that the Second Circuit opinion in the merchants' case said that the *U.S.* case had piggybacked upon the *In re Visa Check* case. I have a question about the two matters you referenced—the *U.S.* case and the *First Data* challenge.

You defined a market as PIN debit there. You also said that you see credit and debit as being very different. I think logically, that would say that signature debit is also a separate market. One of the results of the *U.S.* case was to reestablish dual issuance of signature debit by both Visa and MasterCard. Do you consider that to be a procompetitive outcome if signature debit is a market?

Ms. Hesse: It is hard for me to speculate about that, Lloyd.

Mr. Constantine: That is not speculation. That has come into being as a result of the remedy in your case.

Ms. Hesse: As a result of the remedy in the *First Data* case?

Mr. Constantine: No, as a result of the remedy in the *U.S. v. Visa and MasterCard* case. Prior to your case, there was a nonduality rule with respect to signature debit. As a result of the *U.S.* case, now any bank in the country can issue both Visa and MasterCard signature debit. Since you've taken the position that signature debit is a market and they are the

only two competitors in that market, do you consider the end of nonduality or the establishment of duality in signature debit to be a procompetitive outcome?

Ms. Hesse: I think the procompetitive outcome of that case is that banks are free now to issue signature debit cards for not only Visa and MasterCard, but also for American Express and Discover. I expect with the acquisition of Pulse by Discover that you are actually going to see that happen, perhaps a little bit faster with Discover than with American Express. You are probably not going to end up with a world where there are only two signature debit networks. I think that is a good thing.

Mr. Schmalensee: I'd like to give the panel an opportunity to respond to an issue that Noah Hanft raised in his keynote address. Suppose the world had turned out differently. Diners Club hadn't stumbled. The bank associations did stumble. We would have a world in which the dominant form was a three-party system. American Express, say, would take the place of Visa internationally. It had franchise agreements with banks and it gave banks such-and-such for issuing and charged acquiring banks such-and-such a percentage of the transaction. Would we be here? Would you have an interest? If the dominant form was three-party, not four-party, would there be a competition policy issue?

Mr. Friess: My answer is that I don't know. I don't want to speculate about what would be if. By the way, the world has turned out differently in Europe. For example, we have multiple debit networks of different systems, quite apart from Visa and MasterCard. We have the issue. It is a little bit the endgame. Will they prevail? Will they remain with an efficient, low-cost approach or will it move to a more Visa-MasterCard-style shape of the industry?

More directly to your question, if there are systems that have market power in whatever form (we have not really looked into that), maybe there is a better antitrust issue there. But that is pure speculation. At the moment, we have the industry as it is.

Mr. Vickers: The question "Would we be here?" is one for Tom Hoenig really. On the hypotheticals that Dick Schmalensee talks about, it is a question of facts and law at the European community level and in the member states—and since May of last year, all the member states don't just have an

option to apply the European competition rules, they *must*.

You have, first, the question of whether arrangements of the kind you describe nevertheless came within the bit of law that deals with agreements, because there would be a number of agreements as a part of a system. They might deal with price. It all depends on the facts.

There have been some cases in quite different sectors to do with what an agreement is in settings where it is very fact-dependent. It might or might not come within that, depending upon how much market power there was. There is also provision of law dealing with a dominant position. So it might or might not come within that, again depending upon the facts. Other than giving a hasty summary of bits of competition law textbooks, I don't know what more to say.

Mr. Triflidis: Historic consideration aside, as an antitrust authority, I must evaluate the legality of Visa and MasterCard's current bank agreements and network rules. If American Express had become the dominant player, then I would need to determine if American Express, not Visa and MasterCard, was abusing its dominant position. In this manner, the question for the antitrust authority is the same.

I would like to ask the panelists if they think the interchange fees could be a bigger problem for the antitrust reason, for all other rules that there are in the network, such as no-surcharge, duality membership, honor-all-cards, and so on.

Mr. Friess: It is difficult to say. I wouldn't call it a big problem. I think that our approach to interchange fees is to look at whether they have distorting effects on competition, whether they have groups of customers who do not benefit from as much competition as they could. If that is the case, we seek to address the issue. That can be because of an interchange fee arrangement, or it can be because of rules in these payment networks.

Mr. Balto: I have a question for Renata. We have heard a lot about competition for card issuers in terms of higher interchange fees. Are interchange fees ever the source of competition between merchants? That gives you a chance to say a little more about the *First Data-Concord* case.

Ms. Hesse: I think the combined merchant discount, which is interchange and switch, certainly is a matter that the merchant attempts to negotiate with the networks on the PIN debit side at least. I am sure it is

true in the other cases, but since you wanted me to focus on the *First Data* case, I'll say that we did see substantial evidence that merchants used a variety of tools to try to negotiate down the merchant discount.

As Bernhard mentioned about transparency, one of the really interesting things about that case that we learned is there is a pretty large amount of information out there for merchants to use. Their processors keep a lot of data about the costs of routing transactions. Some of them do regularly, very stringently manage how they route transactions over the least costly network, which reduces the fees they pay for PIN debit transactions.

Obviously the network then has to figure out how to balance the interchange demanded by the issuer with the merchant side. There is evidence, at least, that the merchants do have some power. The more networks they have to deal with and the more choice they have for PIN debit networks, the greater power they have to choose not only the least costly route, but also to threaten to drop small networks that are trying to raise prices to them.

Mr. Katz: Just one thing. Although we should judge everybody's statements by the merits of the statements, I think it is unfortunate that the conference did not require people to disclose their involvement in things more. I will say, because I have a question for Renata, that I was the government's expert economist testifying in *U.S. v. Visa*, and I worked and appeared in court for First Data, on the other side of the government in *First Data-Concord*.

The question I have for Renata is a factual question. I was puzzled by your response to Lloyd. Are you saying that it is your reading of the judge's decision in the *U.S.* case that it mandates that Visa and MasterCard go to duality and that they get rid of their exclusivity rules in debit?

And the second question is are you aware of any banks that in fact do issue Visa and MasterCard signature debits simultaneously?

Ms. Hesse: The short answer to that question, along the line of McLaughlin, is no and no. I was merely suggesting that even if it were true, the purpose of the case and the point of the case were to put two more competitors into that marketplace. That is a procompetitive, good thing.

Mr. Negrin: I have a question for John Vickers. In your paper, you describe a possible way of intervening and that is through cost regulation. The problem there is what kind of costs you would introduce, because in the European Commission, they authorize different costs than what you

are considering, on the one hand. On the other hand, you also have a problem of whose costs you would use—those of the most efficient bank or those of the average bank.

The other issue I see is that cost regulation has lots of problems in other industries that would be the same in this industry. How are you planning on dealing with that?

Mr. Vickers: There is a little bit in my paper about it, if you like a regulatory approach as distinct from a competition law approach. I think cost considerations, despite all that is in the newly emerging literature on two-sided markets, are very important in the competition law assessment as well, and indeed, they were featured in the European Commission proceedings that Bernhard described.

In a number of places at a number of times, those defending existing arrangements themselves have relied heavily on arguments to do with different cost categories and why whichever cost is appropriate. In some contexts, that has been part of the defense of the arrangements too. The principal distinction I was drawing in the paper was between costs of the payments service—the transaction completion service, if you like—and other costs. Of course, for an issuer, there are all sorts of other costs to do with the extension of credit, credit risk, interest-free period, etc., which seem to be another kind of cost. The broad question of principle is whether we should focus, at least when setting some benchmarks for where burdens of proof might shift, on the costs relating to the payments services.

Credit has been, if you like, one of the non-barking dogs at this conference. There has been very little discussion about the extension of credit. Of course, credit cards are a means of payment that leads directly to a particular form of debt for the multitudes who don't pay off their accounts in full. Maybe in the next session this may be of interest to central banks. That is another piece of the equation that might have received a little bit more discussion. That cost-based benchmark principle is what I was alluding to in the paper. I understand that cost regulation, in the utility sense, can be a laborious and detailed business.

There was an earlier question which I didn't have a chance to respond to on remedies. In general, when it is a case where the question is an anticompetitive agreement, then the remedy is that the unlawful bits of the agreements—or the bits which fall on the wrong side of exemptability—are changed. That is the remedy. Whether you want to call that regulation or not is one of those semantic questions.

Ms. Posner: This is a question for Renata, but perhaps other panelists as well. Earlier we heard analysis of two-sided markets. One of the conclusions was that, without better theory and data, we could not decisively explain or predict the direction of interchange rates or merchant pricing in the United States. Alan Frankel articulated a hypothesis, one that some of the other speakers seem to support. The hypothesis is that in the United States, we are experiencing at present a race to monopoly, where the DOJ case has, in effect, put pressure on Visa and MasterCard to raise their interchange fees to prevent banks from defecting to the American Express network, which publicly advertises premium economics for would-be bank partners.

My question to you, Renata: Is the DOJ's intervention done if one can at least plausibly consider this race-to-the-monopoly hypothesis?

Ms. Hesse: I am trying to think how to answer that question. I think the DOJ's intervention is done in the context of the case that we brought, which was a case alleging that these card associations had violated the Sherman Act. Were we to look at interchange again, it would have to be at least in a different context or with different facts about why something that is happening with interchange constitutes an antitrust violation. It's undeniable that we believe that concentration at any part of this two-sided market—at the network level, at the bank level, or at the issuer level—has the potential to distort prices in a way that is not good for consumers. That is something that we review every time we look at something in these markets. We are going to continue to do that.

Whether or not there is something here that suggests that the rising interchange rates in the United States are the result of anticompetitive conduct is an open question. If there are people out there who believe they have evidence or a good theory for why they think that is the case, then obviously we are happy to hear from them. We will continue to look at it, as I said, as things come to us. It is hard for me to speculate about how that is going to turn out.

There's one other thing I want to point out about the Visa case. I know there are a lot of merchants who think having American Express and more competitors in the market is going to cause interchange to go up as the different networks compete for issuers, but there was a lot of evidence in the Visa case about how keeping AmEx and Discover out of the market actually inhibited innovation. And there were innovations in the card market that were occurring in foreign countries that weren't occurring in the

United States, or that were at least substantially delayed in the United States, because of the lack of competition. That is a really important thing people need to remember, because there are positives to that competition. I am not going to take a position here on whether they balance out what may be potential negatives in terms of the interchange going up, but there are certainly positives to that competition in terms of the products and services that cardholders can get.

Mr. Orenbuch: Following up on that question, did you consider the probability that interchange would rise as a result of that case? How much weight did that carry versus the theory of suppressed innovation when you decided to bring the case?

Ms. Hesse: I think part of the striking thing about the case for us was that it presented a situation where there was a duopoly of bank-issued credit cards that was being maintained by exclusionary rules in the card associations. That was really the thing that drove the case. The exclusionary rules appeared to be having negative effects on the marketplace, including loss of innovation and less competition for issuers. It is a situation where, as I said before, it is going to be very hard for us to look at something that appears to create a duopoly structure, being maintained by exclusionary rules, where we thought there was substantial evidence that those rules harmed competition. On balance, what is the procompetitive reason for that happening? The efficiency justifications that the card associations provided in the case didn't hold up very well, and the court ultimately rejected them. I know that is not a direct answer to your question, but really the thing that we were striving for was ending exclusionary conduct that was resulting in a duopoly in bank-issued credit cards.

Mr. Bouchard: Let's presume for a moment that merchants got together and created a network involving the private-label cards. As probably most of us know, the private-label cards are controlled by three players (80 or 90 percent of the market). If we decided that zero interchange was what we wanted to have between us and decided that because the other card networks were priced higher we would not accept them, would that be a regulatory issue?

Secondly, let's go down the road. We only accept private-label cards, and the networks or the banks want to have their cards accepted and they are willing to come in at zero interchange or we require them to come in at

zero interchange. Is that us balancing the system? Or would you consider that merchants' price fixing?

Ms. Hesse: I was going to say that I would advise you to get a good antitrust lawyer. I am not going to sit here and suggest there is not a way that the merchants could not get together and form their own payment network and do that in a way that would not violate the antitrust laws. I cannot sit here and speculate about how that could be done. I think it could probably be done in a way that did not violate the antitrust laws. I would, as Lloyd just said, advise you to seek a business review letter before you did it. It is collective action, and I understand the point, which is that you think it is collective action on the other side. I don't know how to answer that other than to say that we have not seen a case to bring on the collective action side.

I don't know the answers to, for example, the efficiency question. That is, is the only way that the provision of the card services can happen is to have this collective action on the network side? That is a question that has not been answered, and I don't know if anybody has looked hard at it. Answering that question is going to be a critical part to finding out the ultimate answer of whether or not this particular joint venture is functioning in a way that violates the antitrust laws.

Ms. Hanna: A follow-up: Can you name any other industry in which a coalition of financial institutions gets together, makes the rules, enforces the rules, and sets the fees that will be applied to everyone?

Ms. Hesse: Off the top of my head, I can't, but I wouldn't hold me to that answer, in the sense that there might be. The point that you have to look at is that there is a joint venture that has been formed, that has created a new product (new at the time it was formed), and that it is providing to people. The ultimate question is whether or not the conduct that it is engaging in, in its joint venture context, is ancillary or necessary for the joint venture to be able to provide the product. Sitting here today, I don't know the answer to that question, but that is the question.

Mr. Balto: Let me interpose one question. If something is reasonably necessary at the origins of the joint venture—because there are a lot of speakers who have made points about Visa and MasterCard at their origins—how does that affect the analysis maybe 10 or 15 years later?

Ms. Hesse: I think it just depends.

Mr. Floum: I wanted to return to something that I thought I heard Sir John Vickers say, which I think is quite important. I thought I heard you say that, when you are talking about cost-based formulas, what you are concerned with is regulation of utilities. When you are talking about competition law and the issues that competition authorities ought to be looking at, and indeed, if you are talking about litigation, the analysis is whether there is a difference in the price that is charged and what would occur absent any kind of market dysfunction, what the demand curves would look like, and what the value of the products and services offered is.

My question for the panel is does anyone believe that the card associations are utilities? Given the kind of dynamic change that we've seen, the tremendously dynamic environment in payments, the kind of innovation that it has brought, the data security issues which are paramount, the new products that are introduced every day, and absent thinking of the associations as fungible utilities, is there any role for cost-based thinking? Isn't the analysis really value? Isn't the question whether the value that is brought to consumers and merchants appropriate and out of sync? And where is the role of any kind of cost-based calculation absent a finding or a thinking that what we are is simply a fungible utility?

Mr. Vickers: I repeat that a number of defenses of existing arrangements that I am aware of have been very cost-based, so that is not a question just for agencies. I was drawing the distinction between the competition law approach, where you have the question, "Is it appreciably anticompetitive?" If so, with the burden shifting, are the exemption tests passed? And, as a benchmark for looking at that question, my paper talks about a more-than-all-the-costs standard. I wasn't saying that these payments systems are just like utilities; I wasn't seeking to draw that point at all. A core economic point in all this—and it goes back to the very interesting question we had a moment ago—is that when associations are of a certain importance, there is this issue of being a must-have product for a wide range of retailers. That is where the issues of market power arise. Referring to your point about value, that is where the normal economics of measuring value or relying on the market to do that break down, because—I am talking in theory here—the average merchant benefit of card acceptance can be way lower than the marginal benefit or the fee. That is one place where the potential economic distortion arises.

What I liked about the earlier question was a thought experiment I had gone through (which is perhaps the ultra free markets approach), which is to say, “Let’s have an association on the other side too.” You would have the association of merchants, and you get in a room with card associations and haggle.

Similar to what Renata said about the position that might occur under U.S. antitrust law, under European law—I speak of domestic as well as community-wide law—such an association of retailers would be extremely well-advised to get legal advice before contemplating entering into any such arrangement. But that underlies the asymmetry. It is not one that matters for a card that isn’t a must-have or approaching a must-have. The question there doesn’t arise. But when it is in that category, there is a very serious public policy question about the potential for distortion between different means of payments. The race-to-monopoly point also came up earlier, if you do have a situation where on the facts these are in effect must-have networks and with the flow of loyalty payments and so on. Ian McFarlane from the Reserve Bank of Australia has likened it in some ways to the ancient Gresham’s law. The consumer is king and will use the means of payment that is the most rewarding for the consumer, without regard to the underlying efficiency benefits of the system. I am talking about the potential for harm here. It is a very serious potential, and if it is realized, it could be a very serious harm.

Mr. Friess: I want to add two points to that. The first point is that the cost-based approach which we took in 2002 was taken as a proxy. I am not saying this is the eternal truth or something that is cast in stone forever and, I guess, partly arose and led by some of the various explanations that the networks themselves stated about the nature of interchange fees. The networks partly told us that interchange fees are tools to shift costs, to reimburse for costs, within a system.

My second point is more of a question. If you were to abandon that approach and go more toward understanding interchange fees as a kind of balancing tool that helps internalize externalities, then I think it leads us back to the question of what really are the two-sided aspects of the market? Certainly what is a two-sided market is the payment function, but, of course, we need to be aware that a number of other products or services are being bundled into a credit card product and consumer credit.

We saw the presentation of the Visa representative about travel insurance. I wonder whether these are really products that are being sold

in a two-sided market. One could ask whether selling insurance products is an activity of a one-sided market; setting consumer credit is a one-sided market. If you go down that road, you will have many questions to answer, and I am not entirely sure that the existing economic models fully take this diverse aspect of the nature of the product into account. But I haven't an answer to that. It is a question that I am asking myself.