



MasterCard
Worldwide

19th June 2007

Payment Cards & Interchange

Presentation to Banking Enquiry

Introduction

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**MasterCard International Inc.
Payment Cards and Interchange**

Banking Enquiry,
South Africa Competition Commission

19 June 2007

Overview

- Section 4(1)(b), MasterCard and interchange
 - applicability
 - legitimate joint ventures
 - characterising interchange
 - effects of interchange
- Policy issues
 - contrasting Australia
- Potential risks of regulation



Section 4(1)(b): inapplicable

- MasterCard is not an association of banks
- MasterCard's setting of default terms is independent of banks
- MasterCard occupies a vertical position vis-à-vis customer banks
- MasterCard scheme is not subject to the section 4(1)(b) Competition Act prohibitions



MasterCard and section 4(1)(b): legitimate joint venture

- MasterCard scheme is a legitimate joint venture
 - Default interchange fees set for success of joint venture
 - thereby removing scheme from ambit of section 4(1)(b)
- Characterisation of scheme as a legitimate joint venture is supported by the SCA's decision in *Ansac* at para. 49:

"It does not follow that price-fixing has necessarily occurred whenever there is an arrangement between competitors that results in their goods reaching a market at a uniform price."
- To determine whether unlawful price-fixing has occurred, it is necessary to characterise the purpose of the arrangement



Legitimate joint venture argument cont.

- Inquiry into existence of legitimate joint venture is preferred model under US and SA jurisprudence
- In *NaBanco* (1986), the Court of Appeals held that:
 - the interchange fee was “**a potentially efficiency creating agreement among members of a joint enterprise**” (page 602) (although MasterCard does not concede that setting of interchange constitutes an “agreement” with its customers)
 - interchange is not only *per se* lawful, but also passes the rule of reason test (page 603-606) (confirmed by both district and appeal courts)



Characterising interchange

- Without interchange
 - the four-party system cannot operate effectively; or
 - compete with other modes of payment
- MasterCard's interchange setting methodology has pro-competitive effects
 - optimises widespread issuance and acceptance of cards
 - promotes inter- and intra-brand competition
 - ensures level playing field for new entrants
 - increases electronic payments, creating socio-economic welfare



Price structure v pricing policy

- Examining level of interchange under section 4(1)(b) is wrong
 - section 4 examines “prohibited practices” ie structure
 - section 8 (abuse of dominant position) analyses “excessive price”, ie level
- Examining level of interchange requires policy decision from a non-competition law regulator
 - to control price; and/or
 - deter consumers from using credit cards, eg Australia
- Reaffirmed even in context of excessive pricing and abuse of dominance in *Mittal Steel* (2007) at para 79-82 and at para 73:
“...the theory and practice of competition law and economics is dominated by an ... unambiguous maxim that asserts that the task of a competition regulator does not extend to the determination and fixing of prices.”



South Africa v Australia

- Large unbanked population
- Low card usage
- High acceptance levels (led by 4 party schemes)

(millions)	Australia	South Africa
Population	20.5	44
Bank Accounts (Debit Card)	26.3	25.5
Financial Cards	39	31.5
Card Transactions	3,714	632
Credit Cards	19.6	7.2
POS Terminals	0.57	0.66

Interchange methodology

- MasterCard will publish its domestic default interchange rates
- MasterCard's methodology recognises
 - merchant categories are different
 - transaction criteria
 - card product

Potential Risks of Regulation

- Favoring one four-party system over another
- Favoring three-party systems over four-party systems
- Favoring one form of payment (*e.g.*, cash) over another (*e.g.*, credit cards)
- Favoring large merchants or banks over smaller ones
- Discouraging investment in new payment products, services and/or technologies

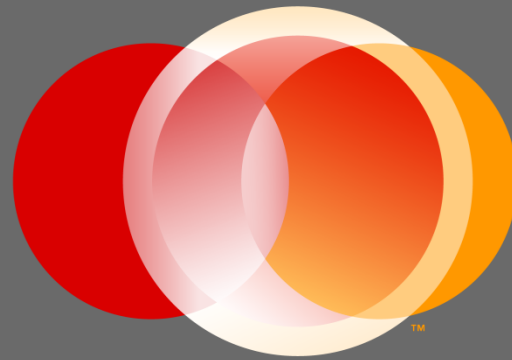
Actual Risks of Regulation

- These regulatory failures are evident in Australia, which is now saddled with a more expensive payments system that
 - delivers fewer benefits to cardholders,
 - distorts market competition,
 - suppresses technological innovation, and
 - allows large merchants that enjoy near monopoly market power to take advantage of the situation in relation to their customers

Conclusion

- MasterCard scheme does not fall under section 4(1)(b):
 - MasterCard is a single economic entity
 - MasterCard in a vertical relationship to banks
 - MasterCard scheme constitutes a legitimate joint venture
 - Interchange essential to competitive functioning of the four-party system
 - Four-party system gives rise to pro-competitive effects
- Level of interchange is outside s. 4 inquiry
- Regulation of interchange carries significant risks

Thank you.



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