

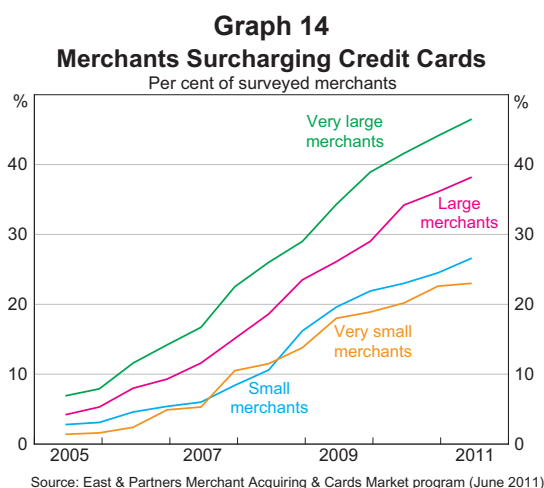
Regulatory Developments in Retail Payments

Regulatory developments included the Payments System Board's decision to consult on whether to allow scheme rules to impose caps on surcharges and consideration of competition issues related to multi-function cards. The Reserve Bank was also part of a joint taskforce that examined transparency and competition in the ATM market, as well as concerns related to the high level of expenditure on ATM fees by residents of very remote Indigenous communities.

Surcharging

The proportion of merchants that surcharge credit card payments has risen substantially since the Payments System Board required the removal of 'no-surcharge' rules by some card schemes and obtained voluntary undertakings to the same effect from other schemes. The most readily available data, from East & Partners' semi-annual survey of the merchant acquiring market, suggest that 30 per cent of merchants applied a surcharge on at least one of the credit cards they accepted at the end of June 2011 (Graph 14).⁹ According to these data, surcharging continues to be more common among very large merchants (those with annual turnover of over \$530 million), with 47 per cent applying a surcharge according to this data source.

The removal of no-surcharge rules has allowed merchants to pass on the cost of credit card and scheme debit card transactions, resulting in improvements in price signals to cardholders. The Reserve Bank's 2010 Consumer Payments Use Study (see discussion in 'Strategic Review of Innovation') indicates that around half of consumers who hold a credit card will seek to avoid paying a surcharge by either using a different payment method that does not attract a surcharge (debit card or cash) or going to another store. The results also indicate that consumers respond to differential surcharging: when faced with a surcharge that is higher on one type of credit card than another, only around 10 per cent of consumers indicated that they would complete the transaction with the card attracting the higher surcharge, while around 40 per cent indicated they would complete the transaction with the card attracting the lower surcharge.



⁹ The Reserve Bank had planned to undertake a survey of merchant surcharging practices in 2010 for which it intended to publish the results. Unfortunately, after several pilot studies, in early 2011 it became clear that the Reserve Bank would not obtain sufficient responses from merchants for a meaningful sample.

At its May 2011 meeting, the Board decided to enter into consultation on possible changes to the Standards relating to surcharging, and the Reserve Bank issued a consultation paper in June 2011.¹⁰ The catalysts for the review were two types of surcharging practices that might be reducing the effectiveness of the previous reforms:

- *Excessive surcharging:* In some cases merchants may be setting surcharges well in excess of the cost of card acceptance. There is evidence that this may be concentrated in some industries and payment channels, and that these tend to be segments where a larger proportion of transactions are surcharged (for example, online payments). A related concern is a lack of genuine payment alternatives where credit card surcharges are levied on online payments.
- *Blended surcharging:* There appears to have been some increase in the incidence of blended surcharging, where cards from different schemes are surcharged at the same rate despite significant differences in acceptance costs. While some merchants might prefer a simple pricing structure, the Board is concerned that encouragement of blended surcharges might act to blunt price signals.

The consultation paper considers several potential modifications to the Standards. These include:

- Allowing scheme rules to impose caps on surcharges. There are two alternative approaches to this: the Board could determine a specific permissible cap that schemes may choose to impose, or scheme rules may limit surcharges to an amount that is either reasonably related, or equal, to the merchant's cost of card acceptance. One possible measure of the cost of acceptance is the merchant service fee.
- Providing clarification on the ability of merchants to surcharge differentially across card types. In conjunction with a surcharging cap, the Standards would need to be modified to ensure scheme rules could not prohibit merchants from applying a surcharge that is either the cost of accepting each card within a card scheme or a blended rate for each card scheme. To enable merchants to surcharge differentially, the Board has also suggested modifying the Standards to require acquirers to pass on information about a merchant's cost of acceptance for each different card type, or a weighted-average merchant service fee, if requested by the merchant.

The Board also noted a possible case to promote disclosure of merchant service fees, either by merchants themselves or by the Reserve Bank (which could collect and publish more detailed data on merchant service fees). This would provide consumers with more information about the cost of card acceptance, against which the reasonableness of any surcharge could be assessed.

The Reserve Bank received 50 submissions and, at the time of writing, is reviewing these and considering the possible policy options.

Multi-function Cards

During the course of 2010/11, the Board reiterated its desire for the ongoing issuance of multi-function cards. These are cards carrying an international scheme's Bank Identification Number that can also be used to initiate eftpos and ATM transactions. Such cards allow for stronger competition between payments systems at the point of sale and are convenient for cardholders.

The Board is concerned about scheme rules that require commercially sensitive data on one payment system to be provided to the operator of an alternative system, and the imposition of 'brand fees' by one payment system on a competitor's transactions. If these arrangements were to persist, the desire of schemes to

¹⁰ See RBA (2011), *Review of Card Surcharging: A Consultation Document*, June. Available at <<http://www.rba.gov.au/publications/consultations/201106-review-card-surcharging/pdf/201106-review-card-surcharging.pdf>>.

keep proprietary data from their competitors may force schemes not to support multi-function cards. The reporting burden on financial institutions may also reduce the attractiveness of issuing multi-function cards. Moreover, the existence of brand fees could place some control of pricing at the hands of a competitor as well as generate revenue for the competitor. This has the potential to distort competition among different card payment systems.

In early 2011, the Reserve Bank issued a media release encouraging relevant industry parties to seek agreement on the terms under which multi-function cards are issued. The Board's preferred course is a negotiated outcome that is acceptable to all sides *and* is in the general public interest. Although there are ongoing industry negotiations on the terms under which multi-function cards are issued, the Board will consider consulting on a suitable regulatory response if a satisfactory solution is not reached by the industry in a timely fashion.

ATM Taskforce

In December 2010, the Australian Government announced a reform package designed to promote the competitiveness and sustainability of the Australian banking system.¹¹ The package included the creation of a joint RBA–Treasury ATM taskforce, which was asked to submit two reports to the Government during 2011:

- a report on the impact of the March 2009 ATM reforms, including recommendations on the need for further measures to enhance transparency and competition; and
- a report on issues affecting Indigenous and other remote communities in relation to ATMs, including appropriate actions for dealing with these issues.¹²

The taskforce was asked to consider the impact of the reforms on the transparency and level of ATM fees, consumer behaviour, competition in the ATM market and the deployment of ATMs. For the report on Indigenous and other remote communities, the taskforce was asked to examine, in relation to these communities, the provision of ATM services, the fees for ATM services, the impact of these fees on residents, and alternatives to current arrangements and practices for accessing cash and account balance information.

In examining these issues, the taskforce analysed data from a range of sources and consulted with financial institutions, independent ATM owners, a number of industry and consumer representatives, non-government organisations and government agencies. In addition, representatives from the taskforce visited several remote Indigenous communities in central Australia. As requested, the taskforce submitted its report on Indigenous and other remote communities to the Government in February 2011, and its report on transparency and competition in June 2011. The taskforce is continuing to work with industry to help reduce the expenditure on foreign-ATM fees by residents of remote Indigenous communities.

Bank Account Portability

The switching of a customer's banking business from one institution to another can be complicated by the need for direct debits (e.g. standing bill payments) and direct credits (e.g. salary or welfare payments) to be redirected to the customer's new account. To make the process easier, the industry introduced a 'listing and switching' service in 2008. This service provides customers information on how to redirect payments, and allows them to request a list of direct debit and credit payments over the previous 13 months from their 'old'

¹¹ Commonwealth of Australia (2010), *Competitive and Sustainable Banking System*. Available at <http://www.treasury.gov.au/banking/content/_downloads/competitive_and_sustainable_banking.pdf>.

¹² The terms of reference are available at <http://www.treasury.gov.au/banking/content/_downloads/ATM_Taskforce_ToR.pdf>. Further detail on the ATM reforms can be found in RBA (2009), *An Access Regime for the ATM System*, February, available at <<http://www.rba.gov.au/payments-system/reforms/atm/access-regime/atm-access-0209.pdf>>.

institution so that they can identify those arrangements that need to be changed. Customers then need to either redirect the arrangement themselves or ask their new institution to assist in the process. To date, take-up of the formal elements of the service has been modest.

In December 2010, the Treasurer appointed Bernie Fraser, a former Reserve Bank Governor, to conduct a feasibility study into a broader range of account-switching options to improve the portability of bank accounts. The study forms part of the Government's *Competitive and Sustainable Banking System* reform plan. The Treasurer asked Mr Fraser to work closely with the Reserve Bank on the study; to this end, the Reserve Bank met with Mr Fraser in the first half of 2011 to discuss some potential options.

Mr Fraser's report was released on 21 August 2011.¹³ It recommended that the existing 'listing and switching' service be enhanced, by granting the customer's new financial institution primary responsibility for the switching process, with the customer being required to sign just one form to authorise the switch of accounts and associated direct debits and credits. The report also recommended that new switching arrangements be in place by 1 July 2012. The Treasurer accepted the report's recommendations in full.

International Developments

As in Australia, foreign regulators have acted in recent years to improve the working of competition in payment card markets. A number of countries have intervened to change the interchange fees set by card schemes and to remove restrictions imposed by card schemes on merchants' ability to pass card acceptance fees on to cardholders in the form of surcharges. Several countries have also acted to ensure that schemes do not restrict merchants' and customers' freedom to choose competing cards and card networks to make payments.

United States

In July 2010, the United States Congress passed the *Dodd–Frank Wall Street Reform and Consumer Protection Act*. Section 1075 of the Act (the Durbin Amendment) instructs the Federal Reserve Board to write regulations to ensure that debit interchange fees are 'reasonable and proportional' to the issuer's cost of the individual transaction, and to limit networks' exclusivity arrangements and routing restrictions. The Federal Reserve has released its final regulation on debit interchange fees. Effective from 1 October:

- debit card interchange fees will be capped at 21 cents plus 0.05 per cent of the transaction value; and
- up to 1 cent extra interchange fee may be received if the issuer meets standards to develop, implement, and update policies and procedures to limit fraud, although this is still under consultation.

Exemptions from the interchange provisions will apply to issuers with assets under US\$10 billion, three-party networks, transactions made using cards issued under government-administered programs, and certain reloadable prepaid cards.

The Federal Reserve has also introduced exclusivity provisions that require issuers and networks to have at least two non-affiliated networks enabled on a debit card. In addition, networks must not limit an issuer's ability to contract with non-affiliated networks (e.g. rules that prohibit the logo of an enabled non-affiliated network from appearing on a debit card). Merchants must also not be restricted from routing a transaction over any of the networks enabled on a debit card or from promoting the use of a particular network. This is effective from 1 October 2011 for networks and from 1 April 2012 for issuers.

¹³ The report *Banking Services – Switching Arrangements* is available at <<http://www.bankingreforms.gov.au/content/Content.aspx?doc=reports.htm>>.

The United States Department of Justice (DOJ) and seven states filed a lawsuit in October 2010 against Visa, MasterCard and American Express regarding their merchant restrictions. The DOJ reached a settlement with Visa and MasterCard, which was approved by the Federal Court in mid July. Under the settlement, MasterCard and Visa must allow their merchants to influence consumers to use a particular credit card network, type of card within that network, or other forms of payment, by:

- offering consumers an immediate discount or rebate or a free or discounted product or service;
- expressing a preference for a particular card;
- posting information or other communications to consumers; and
- communicating to consumers the cost incurred by the merchant.

American Express is still contesting the lawsuit.

Europe

In December 2010, the European Commission officially dropped its case against Visa Europe's multilateral interchange fees (MIFs) for immediate debit transactions.¹⁴ Visa Europe committed to lowering its weighted-average immediate debit MIFs to 20 basis points for cross-border transactions and national transactions in EU states where domestic interchange rates have not been set among local Visa participants. Visa Europe has also committed to maintaining the improvements to transparency that it approved in 2009.¹⁵ These commitments are in line with the 2009 agreement between the European Commission and MasterCard. Visa Europe's credit card MIFs and the honour-all-cards rule remain under investigation.

In July, Groupement des Cartes Bancaires, France's national interbank network, agreed to reduce its interbank (interchange) fees for domestic debit card and ATM transactions following an investigation by the French competition authority; interchange fees will be 28 basis points (on a weighted-average basis) and €0.57, respectively, from 1 October, a reduction of 36 per cent and 21 per cent. In September 2010, 11 banks were fined for fixing of interchange fees for cheques.

Germany initiated direct charging for foreign ATM withdrawals in mid January 2011 to replace payment of interchange fees. The change came following pressure from the Government and general public over perceived excessive foreign fees; in some instances these were as high as €10 per transaction. Data collected by a consumer advocacy group, Biallo, suggest that fees are on average €1.70 lower since the changes took effect.

Canada and the United Kingdom – surcharging

In December 2010, Canada's Competition Bureau made an application to the Competition Tribunal regarding Visa and MasterCard under the price maintenance provisions of the *Competition Act 1985*. The Bureau is seeking the removal of scheme rules deemed as 'merchant restraints'. While some of these restrictions were lifted following the adoption of a Voluntary Code of Conduct for credit and debit card networks in April 2010, a successful application to the Competition Tribunal will allow merchants to surcharge (argued by the Bureau to be more effective than discounting) and discriminate by card type (e.g. standard versus premium).

¹⁴ An immediate debit transaction is one where the funds are debited from the customer's account at the time of sale. A delayed debit transaction is one where funds are debited from the customer's account at a later date.

¹⁵ These include: providing unblended merchant service fees; publishing MIFs; separate honour-all-cards rules for each of Visa's brands of immediate debit (Visa, V-Pay and Electron); unbundling of acquirers; and the physical and digital identification of commercial cards.

The UK Office of Fair Trading (OFT) has been investigating the surcharging practices of merchants, following a complaint by 'Which?', a UK consumer advocacy group. The complaint focused on the transparency of surcharging, especially in situations where there is no practicable alternative (such as internet transactions), and excessive surcharging. Which? singled out the passenger transport and tourism industries.

As a result of its investigation, the OFT has recommended that:

- the Government introduce measures to prohibit surcharging on debit cards; and
- merchants in the travel industry improve transparency of surcharges as required by consumer protection laws.