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General Release Information

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Dr John Veale
Head of Payments Policy
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65 Martin Place
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Dear Dr Veale:

Reform of Credit Card Schemes in Australia – A Consultation Document

I refer to the Reserve Bank's Consultation Document on the Reform of Credit Card Schemes in Australia published in December last year (the "Consultation Document").

This letter sets out the National's views on a number of key issues contained in the Consultation Document, including responses being considered by the National if the draft standards and access regime contained in the Consultation Document are given regulatory effect.

The Australian Bankers Association (the "ABA") and Bankcard Association of Australia ("Bankcard") will also be making submissions to the RBA in respect of the Consultation Document. The National was a party to the preparation of these documents and is broadly supportive of them.

1. EXECUTIVE SUMMARY

The National supports the need for reform of the credit card systems in that greater transparency in the setting of the interchange rate and in membership criteria is desirable and a widening of the membership of the open credit card schemes (ie those of Visa International ('Visa"), MasterCard International ("MasterCard"), and Bankcard) is appropriate. However, the National notes that it is not now and was not previously in breach of the *Trade Practices Act 1974* (Cth) ("TPA").

The RBA has proposed reform in respect of the methodology for the setting of the interchange rate (the "Interchange Standard"), the membership rules of the open schemes (the "Access Regime") and the abolition of the so called "No surcharge" rule (the "No Surcharge Standard").

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The National's position in relation to the membership rules does not differ in principle from the RBA's views. The National notes that it has long been a proponent of opening the membership of the payments systems as exemplified by its submission to the Wallis Inquiry. While there may be valid reasons for the "No surcharge" rule, the National believes, nevertheless, that its abolition will have little practical effect. As a consequence the National will not oppose abolition of the "No surcharge" rule, albeit with some caveats.

With regard to the Interchange Standard the National's views are:

- the proposed reform of the "No surcharge" rule and the changes to the membership rules of the open schemes logically negate the need to regulate the interchange rates; and

- the Interchange Standard is misconceived.

The RBA has not made out its case that the credit card market is inefficient or is working improperly and that there is a need for it to intervene in the market to regulate the setting of interchange rates. It has subjected the various economic models put forward by the Schemes and by their members to criticism, but then having conceded that the state of economic thought on the subject is immature, proceeds to propose reforms based on highly selective opinions.

The RBA has elected to designate only the open schemes and has thus left unfettered the closed schemes (eg American Express, Diners Club) and the schemes of the major retailers. The creation of such an asymmetry in regulation gives an unwarranted advantage to the unregulated closed schemes and major retailers who will be able to provide the same value proposition as at present whilst the open schemes will be prevented from doing so as a result of unjustified regulation. The creation of a situation in which large numbers of existing holders of open scheme cards are likely to migrate to closed schemes will ensure the failure of the RBA's regulatory aims, as we understand them.

The proposed reforms will have the effect, whether intentional or not, of encouraging the growth of the closed schemes at the expense of the open schemes, which as a consequence will decline in popularity and wither away.

There will be wide ranging adverse consequences for our cardholders, small issuers, small merchants, the open schemes and the existing participants in the open schemes. These consequences comprise some or all of the following non exhaustive list:

For our cardholders or a substantial number of them

- No or severely curtailed loyalty programs;
- No or severely curtailed interest free period;
- Increased annual fees and/or transactions fees; and
- Surcharging by merchants.

For small issuers

- Substantially lower interchange income;
- Disproportionately reduced income by reason of the dominance of the more cost efficient big four bank issuers in the cost calculations of interchange rates;
- Some small issuers will be driven out of the market; and
- The possibility that they might issue the cards of a closed scheme.

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For small merchants

- Disappearance or reduction in use of the convenient open scheme credit card product;
- Rapid growth in use of the more expensive closed scheme credit card products;
- Customer hostility to surcharges preventing or lessening the merchants' ability to recoup the cost of credit cards;
- Being forced to accept the increasingly more prevalent, higher cost, closed schemes' cards but not being able to surcharge while doing so; and
- Reduced ability to compete with major merchants that have their own proprietary credit or charge cards.

For the open card schemes

- Asymmetric regulation will encourage migration from open schemes to closed schemes;
- The possibility that Visa, MasterCard and/or Bankcard will transform their domestic businesses to closed, three-party systems; and
- The Australian market will become less attractive for the international open schemes to make further investment.

For existing participants in the open schemes

- Unlike the closed schemes, issuers and acquirers will suffer a significant loss of revenue.
- This loss of revenue will:
  (a) reduce the attractiveness of payment services as an investment opportunity, and
  (b) reduce the ability of existing participants to provide the same spectrum of services as pertains today.
- Further, regulatory intervention to reduce or redistribute profitability of a particular business, combined with the RBA's apparent belief that commercial organisations need only earn their bare cost of capital, will reduce the willingness of financial institutions to invest in Australia generally.

Recommendations

In summary, we believe that regulatory intervention in the open schemes is unwarranted, unnecessary and does not view the payment systems holistically. However, if intervention nonetheless eventuates, we recommend at a minimum that the regime provide as follows:

1. If the "No Surcharge" Standard is to be introduced, the Standard should apply equally to the closed schemes and merchant owned schemes.

2. The Access Regime covering access to the open schemes should:

   (a) set out clear principles agreed to by the Australian Prudential Regulatory Authority ("APRA") for the authorisation and supervision of specialist credit card service providers;

   (b) ensure that new participants in the open schemes are subject to the same prudential regulation as existing participants;

   (c) set out eligibility rules, but not mandate membership of a card scheme; and

   (d) provide a dispute resolution mechanism.

3. If (despite our objections) an Interchange Standard is ultimately promulgated:

(a) The cost of the interest free period should be an eligible cost as should a number of other cost categories including GST and the cost of capital.

(b) A detailed study of the cost categories, particularly Staff and Others, as shown in the table on page 45 of the RBA-Australian Competition and Consumer Commission ("ACCC") Joint Study of October 2000 (the "Joint Study"), should be undertaken to determine the extent to which these costs should be included in the calculation of interchange rates.

(c) A more detailed set of definitions for the eligible cost categories generally should be agreed and fresh data collected, with a view to calculating pro forma interchange rates, prior to issue of the Standard.

(d) Any resulting reduction in interchange rates should be made in stages over a period of years. We note that the European Commission is proposing a staggered lowering of interchange rates over a period of 5 years,[1] this would also be a suitable period for changes to interchange rates in Australia.

4. In the interests of commercial certainty, if the RBA does not intend its intervention to apply to the closed schemes, it should confirm in its Interchange Standard that it intends only to regulate card schemes that have explicit interchange rates, such as the open schemes, and not those that have only implicit interchange rates, such as the closed schemes.

5. An agreement should be reached amongst the participants of the payments systems, the RBA and the ACCC on the interchange arrangements to apply to both eftpos and Visa Debit, so that any changes can be implemented simultaneously with the implementation of the Interchange Standard.

6. A reasonable time following final promulgation of the RBA's Standards and Access Regime should be allowed for implementation of the new regimes. It is suggested that at least twelve months should be allowed, with any reductions in interchange rates to commence after the conclusion of the implementation period and to be introduced over a longer period (see (3)(d) above).

7. The RBA should ensure that the open schemes and their members suffer no exposure to liabilities under the TPA.

8. If ultimately introduced, the operation of each of the No Surcharge Standards, Interchange Standard and Access Regime should be reviewed by an independent body, such as the Productivity Commission, 3 years following their implementation.

[1] European Commission, Directorate-General Competition, "Notice pursuant to Article 19(3) of Council Regulation No. 17, Case COMP/29.373 – Visa International (2001/C 226/10)", *Official Journal of the European Communities*, 11 August, 2001.

2. BACKGROUND

In September 1999, the ACCC commenced an inquiry into the setting of the interchange rates of the open schemes in Australia. Shortly thereafter the ACCC and the RBA launched a wide ranging inquiry into credit cards, debit cards (primarily eftpos, but also Visa Debit) and automated teller machines ("ATMs"), which culminated in the publication in October 2000 of the Joint Study.

In March 2000, the ACCC wrote to the open schemes and their members saying that it believed that the setting of interchange rates by members might constitute a breach of the TPA and that they should apply to have the conduct authorised.

The open schemes and their members denied that they were breaking the law. Nevertheless the seven members of Bankcard (the "Review Banks") worked with the ACCC to find a solution to its concerns. The Review Banks agreed to undertake a review of interchange, including a commitment to greater transparency in the cost elements and the setting thereof. The Terms of Reference were no sooner agreed than the ACCC demanded that the review be widened to include a review of the "No-surcharge" rule and the open schemes' membership rules. The Review Banks pointed out to the ACCC that in the case of the Visa and MasterCard schemes, these matters needed to be canvassed with Visa and MasterCard themselves and that the local members had limited ability to bring about changes to the rules of these schemes.

In September 2000, the ACCC launched a legal action against the National alone alleging price fixing in the setting of the interchange rates in breach of the TPA. The National entirely rejected the ACCC's allegations. Further, the National noted that price fixing by its very nature requires more than one party and took, and continues to take, profound exception to the ACCC's entirely unwarranted legal tactics in singling out the National. Despite the significant legal problems caused by the litigation, the National, together with the banks and other financial institutions, which make up the membership of the open schemes, continued to co-operate with the regulators and sought a negotiated solution to the issues perceived by the regulators.

In January 2001 and again in March 2001, the Review Banks, representing the bulk of the membership of the open schemes by transaction volume, formally offered to the ACCC to apply for authorisation of each of the open schemes' domestic interchange rate arrangements and also agreed to an immediate lowering of interchange rates. Copies of these offers were provided to the RBA. Senior representatives of the RBA were also present at several joint meetings between the ACCC, the RBA and the Review Banks.

The ACCC effectively declined to allow any application to proceed. Instead it referred the whole matter to the RBA, which in April 2001 designated all open schemes (under the *Payments Systems (Regulation) Act 1998* (Cth) ("PSRA")), but not the very similar closed schemes, American Express and Diners Club.

Subsequent to the designation of the open schemes the ACCC discontinued its litigation against the National. The National withdrew its cross-claims against the other members of the open schemes, Visa and MasterCard, which had by then been joined to the action by the National at the suggestion of the court. The RBA observes in the Consultation Document, at page 7, that, "The ACCC reached the conclusion that the collective setting of these interchange rates was a breach of the price fixing prohibitions of the *Trade Practices Act 1974."* It is important to reiterate that at all times the National strongly maintained that the ACCC was in error in this regard. No court has ruled that there has been a breach of the law. The views of the ACCC remain merely an opinion, not a finding of law.

Since April 2000 the National, in its own right, as well as through its membership of the ABA, Visa, MasterCard and Bankcard, has been in discussion with the RBA about the future of the credit card industry in Australia as well as that of Visa Debit, eftpos and ATMs.

In December 2001 the RBA published its Consultation Document. The views expressed in the Consultation Document are fundamentally unchanged from those expressed in the earlier Joint Study. It is not apparent from the Consultation Document that an offer by scheme members to seek authorisation and to immediately reduce interchange rates was made, and rejected by the ACCC (in consultation with the RBA), a year ago.

3. COMMENTS ON THE CONSULTATION DOCUMENT

In the Consultation Document the RBA proposes reforms to three areas of the open schemes. These areas of reform are:

- The methodology for the setting of interchange rates.
- The "No-surcharge" rule.
- The membership rules.

General Comment

The reforms proposed by the RBA will necessarily lead to adverse changes in the provision of credit card payment services and consumer credit in Australia. The National understands that the RBA has stated to a parliamentary committee that any reform of the credit card system must be based on sound economic principles. However, the RBA now concedes that the state of economic thought on these issues is not mature[2]. Nonetheless, it proposes to institute reforms, based entirely on its own opinions. These reforms have the potential to cause significant dislocations in the market for credit card payment services and consumer credit, as well as flow-on anticompetitive consequences in retail markets. Consequently, the National finds it difficult to understand the public interest in the reforms.

An underlying rationale for the RBA's views appears to be that credit cards have become too attractive to consumers and impose too great a cost on the economy and in particular on merchants. In its view debit cards or a "stripped down" version of credit cards, ie. ones with no or a minimal interest free period and no loyalty schemes, would be preferable. The RBA does not appreciate that credit cards provide a very different value proposition from other payment instruments and appears to believe, for example, that because eftpos is "cheaper" it is *per se* better. It is an improper exercise of the RBA's powers under the PSRA to decide by regulatory fiat which products consumers should be allowed and which not, when there is no public interest justification for so doing. The RBA also appears to have failed to properly consider the impact that adjustments to the credit card system will have on the broader payments system.

The Consultation Document is concerned with only the credit cards issued in the open schemes and thus is silent as to eftpos and Visa Debit. However, it is understood that the RBA proposes that changes also be made to these other systems and it must be expected that these changes will include changes to the existing interchange rates, leading to changes to the fee and rebate arrangements now in place with merchants.

[2] Consultation Document, page 32

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The RBA notes at page 127 of the Consultation Document that it has received several submissions arguing that reform of the debit card schemes should be simultaneous with reform of the credit card system. The RBA states that it is sympathetic to this view, but is unwilling to slow the reform of the open schemes to accommodate this.

The National is strongly of the opinion that implementation of the reforms should occur simultaneously and continues to be most willing to work with the RBA to this end. Failure to implement the various new arrangements at the same time will have a number of adverse consequences:

(a) Merchants will be confused and probably annoyed by a succession of price changes for credit cards, eftpos and Visa Debit. For example, if ultimately an agreement is reached whereby the interchange rate on eftpos moves to zero or reverses direction entirely, as mentioned above it is likely that acquirers will wish to change their fee and rebate arrangements with merchants to reflect this.
(b) Each pricing change will necessitate renegotiation of hundreds of thousands of merchant service contracts. A staggered series of renegotiations will be onerous for merchants and acquirers alike. Furthermore it would surely be better for merchants and acquirers to be able to negotiate with a full understanding of the new pricing arrangements for all payments instruments, rather than on the basis of incomplete piecemeal information.
(c) By introducing changes in an uncoordinated manner over a period of time, the RBA will create an environment in which opportunistic or "gaming" behaviour is likely to become prevalent as various parties seek to take advantage of the continually changing market by, for example, moving to a different payment system.

The National notes further that the various payment products, which make up the entire payments system in Australia, are highly interdependent and change to one product will have a knock on effect on all other products. The effect of altering the pricing to merchants of open scheme credit cards, eftpos and Visa Debit, together with the abolition of the "No surcharge" rule, is quite unknown. The apparent assumption that there will be a shift from credit cards to eftpos is untested. A possible end result may well be a combination of a move to the greater use of closed scheme credit cards, cash and cheques. This would be a perverse outcome increasing, rather than decreasing, the cost of the payments system to the economy.

The National employs an Activity Based Costing System. Under this system, costs are allocated to banking products and services on the basis of activity. For the electronic card payment system, shared fixed infrastructure costs are allocated on the basis of transactional volume. If debit transaction volumes increase at the expense of credit, the eftpos system will bear more of the costs of the fixed infrastructure. Such costs will be factored in by banks when pricing debit card services.

Finally, we also note the possibility that Visa, MasterCard or Bankcard (or all three) could transform their respective domestic Australian businesses into closed three party schemes or may exit or reduce their activities in the Australian market, thus removing not only intra-scheme competition between issuers and acquirers but also, by implication, lessening inter-scheme competition.

Absence of a need for the RBA to intervene

As noted above the National's position in relation to the changes to the membership rules does not differ in principle from the RBA's views and the National will not object to the abolition of the "No surcharge" rule. These two proposed reforms logically negate the need to regulate the interchange rates. If merchants are able:

- to set prices as they wish and so to recoup the cost to them of providing credit card payment services; and

- the membership of the open schemes is widened to allow for the entry of non-financial institution issuers and specialist acquirers,

then the market will operate to allow interchange rates to settle to an efficient level.

Presumably the RBA believes that the credit card market, which consists of at nine acquirers and approximately thirty five principal issuers (and many more associate issuers), will not become sufficiently competitive to ensure such an outcome. The RBA does however believe that competition in the highly concentrated retail market, despite being dominated by two retail groups, will ensure that any reduction in merchant service fees will be passed on to consumers. We note that this view of the state of competition in the retail industry does not appear to be shared by either the ACCC, a recent parliamentary committee, some politicians and other commentators.

Failure to Designate the Closed Schemes

The RBA has elected to designate only the open schemes and has thus left unfettered the closed schemes (eg American Express, Diners Club) and the schemes of the major retailers.

The credit card products provided by the open schemes and the closed schemes are fundamentally the same. The differences between the two types of scheme relate not to the product itself, but to organisational differences between the issuers. The RBA appears to be more concerned with the superficial legal form of the issuers than the actual economic and commercial realities inherent in the two products. The RBA reached its decision in this matter because, "These schemes do not have collectively determined interchange rates, nor access rules which discriminate on the grounds of institutional status."[3] The RBA also observes that the ACCC "reached the conclusion that the collective setting of these interchange rates was a breach of the price fixing prohibitions of the *Trade Practices Act 1974.*"[4] It is important to repeat that, first, the ACCC chose not to test this conclusion in court, and indeed the National strongly denies that the collective setting of interchange is unlawful and believes that the ACCC would not have succeeded in its action. Consequently, the RBA erroneously relies (at least in part) on the ACCC's opinion to justify designation of the open schemes and to draw a distinction between the open and closed schemes. Second, the fact that the setting of the interchange rates is achieved collectively is not in itself relevant to a decision whether or not to intervene in the market under the PSRA.

The decision by the RBA only to regulate card schemes that have explicit interchange rates (ie the open schemes) and not those that have implicit interchange rates should be enshrined in the regulations so that the issuers of closed scheme cards have regulatory certainty.

The RBA's reforms will not (as we understand the RBA intends) result in a migration from open scheme cards to eftpos and other payment mechanisms, but rather a migration to closed scheme and store cards. The credit card, as a viable useful product will continue to flourish, albeit at greater cost to merchants and cardholders. Only the trademarks will change.

[3] Consultation Document page 8
[4] Consultation Document page 7

4. PROPOSED INTERCHANGE METHODOLOGY[5]

The RBA rejects each of the methodologies for calculating interchange rates proposed by the ABA, Visa and MasterCard.[6] Instead the RBA proposes its own cost based methodology for the setting of the interchange rates. Over the last two years much time and effort has been expended by all parties in attempting to arrive at a "correct" economic theory to underpin an acceptable methodology. It is apparent from the great divergence of economic theories reviewed by the RBA in the Consultation Document that little common ground has been found. As noted above, the RBA proposes a standard for the setting of interchange rates, but has declined to provide the economic rationale for its proposals.[7] The National does not believe that there is anything to be gained by again going over the economic arguments,[8] but will instead focus on the likely outcomes and unintended consequences of the proposed reforms.

Under the Interchange Standard, the eligible cost types are to be limited to certain of the issuers' processing costs, the issuers' costs in respect of fraud and the issuers' costs in respect of authorisation. Specifically excluded are the costs of providing the interest-free period, loyalty schemes, scheme advertising costs, etc. The RBA wishes to limit the eligible costs to those which, in its opinion, benefit the merchant. However, the RBA's decisions on what costs benefit merchants seem to be quite arbitrary. We do not see the logic in excluding, for example, the cost of the interest-free period and the cost of capital. We assume that the omission of the cost of GST on interchange rates is an oversight, but strongly submit that the RBA should confirm it is an eligible cost by expressly referring to it in the Interchange Standard.

Interchange rates calculated using the RBA's methodology will be substantially lower than the present rate (ie around 30 basis points or less) as against the present average level of around 95 basis points. A reduction of this magnitude will lead to major changes in the way payments and consumer credit is conducted in Australia.

In arriving at the "new" interchange rates of around 30 basis points quoted above, the National has relied on the weighted average cost figures for Issuers shown at page 45 of the Joint Study. We note that there are two major cost categories, which do not appear to have been allocated in the calculation of the interchange rate, namely Staff Costs of 39 cents per transaction and Other Costs of 68 cents per transaction. We suggest that it would be appropriate for the RBA to conduct a more detailed examination of the make up of these cost categories in order that an appropriate allocation can be made. In addition we believe that there may well be considerable differences in the various banks' interpretations of the Joint Study's original request for data, which may be distorting the results. The National would be most willing to work with the RBA and an agreed independent expert or accounting firm and other interested parties to examine more fully the various cost categories and to ensure that the RBA is working from data that categorises costs in a consistent manner.

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[5] A more detailed critique of the RBA's proposals is in the Appendix.

[6] A number of methodologies for determining Australian domestic interchange rates have been proposed during the course of the ACCC and RBA inquiries into the open schemes. For example, the ABA relied on Allen Consulting's "avoidable cost" methodology, the Review Banks referred to Frontier Economic's Residual Cost Recovery Model and Visa and MasterCard have also advocated their own proprietary interchange methodologies.

[7] We note that whilst the RBA's economic adviser, Professor Katz, is critical of other submissions, he is silent as to the RBA's own proposal.

[8] The National understands that Core Research Pty. Ltd. (Professors Gans & King) has responded to some of the issues raised by the RBA and its advisers in its submission titled 'Regulating Credit Cards in Australia', 12 March 2002. Core Research is an adviser to the National, but in this respect will be acting entirely on its own behalf.

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It is essential that this exercise, including the collection of up to date data from all relevant parties and the calculation of pro forma interchange rates, be completed prior to a final decision being made as to the form and substance of the Interchange Standard.

Other important concerns regarding the Interchange Standard are as follows:

(i) It appears likely that there will be uncertainty about the scope and meaning of the RBA's eligible costs for inclusion in interchange rates.
(ii) The RBA's proposals regarding the public disclosure of the Schemes' cost data are unnecessary and anti-competitive.
(iii) The RBA's proposals do not, despite representations by the RBA in the Consultation Document to the contrary, completely remove the risk that a third party could allege that the Schemes and their members have engaged in price fixing in the setting of interchange rates in compliance with the Interchange Standard.
(iv) The timeframe proposed by the RBA for the implementation of the Interchange Standard of three months is unrealistic. The National recommends a timeframe whereby implementation occurs at least 12 months from the finalisation of the Interchange Standard.
(v) The Interchange Standard does not provide any mechanism for review of its operation after a period of time.[9] The National suggests that review of the operation of the Interchange Standard by an independent body, perhaps the Productivity Commission, should occur 3 years following its implementation.

Impacts on cardholders

The National submits that the following impacts on the open schemes' cardholders can be expected if the RBA's Interchange Standard is imposed in its current form:

- Interest free periods will be either no longer offered or severely curtailed.
- Loyalty schemes will be cancelled or severely curtailed.
- Cardholder fees will rise.
- Transaction fees may be introduced for credit card accounts.

The National believes that without an interest free period, the open schemes' credit card product will at best be of interest only to "revolvers". Unlike "transactors", revolvers pay interest from the time of a transaction and for them a credit card is in fact akin to a debit card attached to a specialised form of overdraft. As noted above transactors will in all probability move to the unregulated and widely accepted cards issued by the closed schemes (eg American Express or Diners Club). The most likely end result of the Interchange Standard will thus be the steady decline of the open schemes in Australia to the benefit of the closed schemes.

An alternative approach to eliminating or curtailing the interest free period might be to match the credit period granted to the cardholders with the settlement terms provided to the merchants. Merchants would not receive immediate settlement as they do now, but would instead be paid after the average credit period for cardholders had elapsed. This alternative highlights the benefit received by merchants as a result of the interest-free period and why it should be included as a component in calculating the interchange rate.

Impact on small issuers

As noted above, it is apparent that the Interchange Standard will result in a substantially lower interchange rate. Thus, the issuing of the open schemes' cards will be less attractive and therefore seems unlikely to attract new issuers to the Australian market and may in fact drive some smaller issuers out of the market.

[9] For more detail on these concerns see the Appendix.

It is proposed by the RBA that the interchange rates be calculated based on the costs of the participants responsible for at least 90% of credit card transactions by value. The rates thus arrived at will be driven by the costs of the four major bank issuers, which almost certainly have a lower average cost base than the smaller issuers.

The new interchange rates will thus not only be substantially lower than at present, but will additionally disadvantage the smaller issuers. The risk of squeezing out small participants is specifically acknowledged and accepted by the RBA in the Consultation Document at page 123 *et seq* .

In its press release accompanying the publication of the Consultation Document, the Governor observed that he expected credit card interest rates to fall following the entry of more issuers into the market. As noted it is unclear why a lower interchange rate would attract more issuers into the market and thus lead to the lowering of interest rates through competition. Perhaps the RBA has in mind the entry into the market of some major retailers, who would be able to cross-subsidise consumer borrowing. However, on the evidence of the interest rates now charged on the proprietary cards issued by major retailers, this is a doubtful proposition.

Implementation of the reforms will have a greater impact on the small participants than on the large ones. This is because of the greater resources of the larger participants to make system changes. It is also because the financial effect of a large drop in interchange rates will have less impact on a financial institution having substantial highly diversified income streams than it will have on a smaller institution more heavily dependant on interchange revenue.

Impact on small merchants

The provision of credit in a convenient and simple fashion through the mechanism of the open scheme credit card has allowed small merchants to effectively outsource the provision of credit to their customers. This has allowed small merchants to compete as to the provision of credit on attractive terms with the larger merchants own in house schemes.

As noted in the section on cardholders above, following the imposition of the Interchange Standard it might be appropriate to match the cardholders' average interest free credit period to the merchants' settlement terms. However, this would likely cause significant disruption to merchants' cash flow. The closed schemes, such as American Express, and the major retailers' store cards and credit extension schemes, will continue to provide this service in the Australian market, even as the open schemes find it increasingly more difficult to do so. Thus, small merchants are more likely to be affected by these consequences of the RBA's proposals than large merchants.

The merchant service fees charged by the closed schemes are higher than those charged in the open schemes. The RBA argues that the lower interchange rates that would apply under the Interchange Standard will lead to competitive pressure on the closed schemes. It is further argued that this will lead to a general lowering of merchant service fees in the closed schemes. However, if, as the National expects, the more attractive value proposition offered by the closed schemes engenders a significant move by cardholders away from the open schemes, there will be increased competitive pressure on merchants to accept closed scheme credit cards. It is submitted that any lowering of the merchant service fee in the closed schemes will not be large.

In summary the National does not believe that the ultimate outcome of the RBA's reforms will be favourable for small merchants.

Impact on open schemes

First, designation of the open schemes, but not the closed schemes will have a number of undesirable consequences:

(a) Regulation of the open schemes, but not the closed schemes creates an asymmetric market. As in any asymmetric market one group will be advantaged to the cost of another and the former will move to exploit its advantage.

(b) The unaltered value proposition offered by the unregulated closed schemes will be attractive to cardholders used to the utility and convenience of credit cards. Such cardholders are likely to switch from an open scheme credit card to a closed scheme credit card.

(c) American Express has entered into agreements around the world, including Australia, whereby financial institutions are able to issue American Express cards bearing the financial institution's own brand. As noted many of the present holders of cards issued by the open schemes, particularly (the typically wealthier) transactors, will find the value proposition offered attractive. [redacted]

(d) The net result of the RBA's asymmetric regulation will be the migration of open scheme cardholders to closed schemes. This increase in the number of holders of closed scheme cards will encourage additional merchants to accept payment by means of a closed scheme card. Given the diminished presence of open scheme cards, there is no reason to suppose that the closed schemes will feel the need to reduce their merchant service fees following the imposition of the RBA's reforms.

Second, the RBA's proposed reforms will have the effect of rendering Australia a less desirable market for further investment.

Impact on Existing Participants

The significant reduction in the level of interchange rates which will be caused by the imposition of the Interchange Standard will cause issuers of open scheme credit cards to suffer a significant loss of revenue.

This loss of revenue will:

(a) reduce the attractiveness of payment system services as an investment opportunity;

(b) reduce the ability of existing participants to provide the same spectrum of services as pertains today; and

(c) reduce the willingness of participants to make further investments in the system eg Triple DES, PIN at Point of Sale and smart card investment generally.

The loss of revenue to issuers of open scheme credit cards may also cause some issuers to reduce their issuing businesses or to exit the business altogether.

Recommendations and conclusions on the Interchange Standard

[10] [redacted]

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The National submits that the eligible costs in the proposed interchange methodology are too narrow and inadequately defined. We would be pleased to discuss the appropriateness of the various cost categories with the RBA, but specifically the National recommends that:

(a) The cost of the interest-free period should be an eligible cost, as should certain other costs including, for example, the cost of capital. The RBA should also expressly confirm that GST is an eligible cost.

(b) A detailed study of the cost categories referred to in the Joint Study should be undertaken to determine how these costs should be allocated and the extent to which they should be included as eligible costs.

(c) A more detailed set of definitions for the cost categories generally should be agreed and fresh data collected prior to the issue of any finalised Standard.

(d) The cost of "loyalty" programs should be excluded.

(e) The cost of credit losses, in respect of revolvers, should be excluded.

The National submits that the methodology proposed by the RBA will lead inevitably to the decline of the open schemes. However, given the continued ability of the undesignated American Express and Diners Club and large merchants to issue credit cards and charge cards fundamentally similar to, if not identical with, those now issued under the aegis of the open schemes, credit cards will in fact continue to be available in Australia and therefore the very goals the RBA is seeking to achieve will not occur.

The Consultation Document does not provide guidance as to the implementation schedule proposed by the RBA. As noted above implementation will have both system and financial implications and these will be felt more by small participants than large. The National recommends that the Interchange Standard come into force 12 months after it is finalised but that changes in interchange rates occur in stages over a longer period. The National notes that the European Commission proposes introducing its much smaller reduction in interchange over a five year period.[11] The RBA must re-evaluate its timetable and must give serious consideration to the suitability of following a similar schedule in Australia.

We note that the Interchange Standard does not provide any mechanism for review of its operation after a period of time. That National submits that the Interchange Standard should provide for a review by an independent body, such as the Productivity Commission, within 3 years.

5. THE NO SURCHARGE RULE[12]

The National believes that there are good economic and commercial reasons for the maintenance of the "No surcharge" rule.

In countries where the "No surcharge" rule has been banned, it does not appear that many merchants have in fact imposed a surcharge. The National would expect that this would also be the case in Australia. We would expect surcharging to be most unpopular with customers.

[11] European Commission, Directorate-General Competition, "Notice pursuant to Article 19(3) of Council Regulation No. 17, Case COMP/29.373 – Visa International (2001/C 226/10)", *Official Journal of the European Communities*, 11 August, 2001.

[12] A more detailed critique of the No surcharge rule is in the Appendix

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Subject to the caveats set out in this letter and the Appendix the National does not oppose the proposed prohibition of the "No surcharge" rule, provided that, as foreshadowed by the RBA, the closed schemes are prohibited from preventing surcharging and that the RBA's regulation of surcharging in the open and closed schemes commenced at the same time.

The No Surcharge Standard provides that a merchant in Australia must not be prohibited from recovering from a credit cardholder the cost to the merchant of accepting a credit card issued by a participant in the Scheme. We believe that care should be taken to ensure that the ability to surcharge is not abused in situations where the merchants have significant market power, for example in remote rural areas.

The RBA should ensure that there is an adequate timeframe for open scheme members to make the necessary adjustments to their contractual arrangements with merchants after the No Surcharge Standard comes into force. Given the desirability of all of the RBA's reforms of the open schemes taking effect at the same time, the National recommends that the No Surcharge Standard come into force twelve months after the reforms are finalised.

Once again, we note that the No Surcharge Standard does not provide any mechanism for review of its operation after a period of time. That National submits that the No Surcharge Standard should provide for a review by an independent body, such as the Productivity Commission, within 3 years.

6. MEMBERSHIP [13]

The National has long proposed that payment systems in Australia generally should be open to a variety of entrants provided that all participants are required to be similarly regulated and to meet the same standards as regards technical competence, capitalisation, financial wherewithal and prudential standards as the present participants. Indeed, this position was asserted in the National's submission to the Wallis Inquiry.

The RBA's proposed introduction of specialist issuing and/or acquiring companies regulated by APRA appears to meet this need. The National notes that although the matters to be considered by APRA are set out in the Consultation Document, no mention of them is made in the Access Regime. The RBA must specify the broad principles to be followed by APRA, either in the Access Regime or in a similar APRA document, to be published contemporaneously with the Access Regime. The National would be pleased to consult with APRA in this regard (following consultation with stakeholders).

The Access Regime provides that the rules of an open scheme must not prohibit outright self acquiring, if the participant can establish to the reasonable satisfaction of the scheme or its members that it has the capacity to meet the obligations of an acquirer as a self acquirer. The RBA rejects the desirability of maintaining a division between agent and principal and advances in justification the fact that there is no similar prohibition for eftpos. However, unlike credit cards, eftpos is an irrevocable payment system with no charge backs allowed: as such the two systems are not comparable.

[13] A more detailed critique of the Membership rules is in the Appendix

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It is not always easy to predict the likelihood of business failure: witness the failure of HIH, OneTel and Ansett. As a result of the recent collapse of Ansett, the National has suffered charge back losses in excess of [redacted] million on the credit card payments it had acquired in respect of airline tickets: it suffered no loss in respect of tickets purchased through eftpos. An acquiring model for credit cards that does not maintain a division between principal and agent increases risks of loss to cardholders, not to mention disputation risks.

The RBA's Access Regime should speak only to eligibility and should not mandate that any organisation, which meets APRA's prudential requirements, must be admitted to membership of the open schemes. The open schemes have invested heavily over many years in their schemes. The Visa and MasterCard trademarks are amongst the best known in the world and have very substantial value. To mandate who shall be a member is to remove by regulatory fiat the right of private companies to decide with whom they wish to associate and potentially to force them to accept as members organisations whose business aims and philosophy are quite inimical to those of the card scheme. So to take an extreme example, Visa should not be forced to accept American Express as a member. In summary, the open schemes themselves should make the ultimate decision on membership, subject naturally to legal oversight. Indeed, it is noted that the TPA provides adequate protection to ensure that the open schemes do not act in an anti-competitive manner. It is unclear from the drafting of the Access Regime whether the open schemes will retain such a discretion not to accept applications from persons who meet the prudential criteria but are not considered to be suitable for members for legitimate business reasons. The RBA should make it clear in the Access Regime that it is not removing this discretion.[14]

Other important concerns regarding the Access Regime are as follows:

(a) The RBA has drawn a distinction between 'specialist credit card service providers' and "traditional ADIs". However, there is no legal basis for drawing this distinction based on the RBA's proposals.

(b) The Access Regime makes no provision for compensating current participants or the open schemes for the costs associated with the implementation of and compliance with the Access Regime. For example, costs of connecting infrastructure to a new participant should be borne by the new participant.

(c) The Access Regime does not provide any mechanism for the review of its operation after a period of time. The National submits that the Access Regime should provide for a review by an independent body such as the Productivity Commission within 3 years of its imposition.

Finally, PSRA provides for arbitration of disputes relating to designated payment systems and empowers the RBA to make directions to participants who fail to comply with a standard or an access regime. However, the Access Regime itself provides no mechanism for dispute resolution nor does it contain provisions that a resolution body should take into account in deciding on the terms and conditions for access.

7. RBA'S POWERS UNDER THE PSRA

Although, as set out above, the National supports the need for reform of the credit card systems in that greater transparency of membership criteria is desirable and a widening of the membership of the various open schemes is appropriate, a number of legal issues arise when considering the RBA's proposed reforms. In particular, the National submits as follows:

[14] See section 3 of the Appendix.

(a) Section 18 of the PSRA does not empower the RBA to set interchange rates as 'standards'. Standards deal only with technical issues and therefore do not encompass interchange rates.

(b) The RBA's designation of the open schemes appears to be based in part on the erroneous assumption that the setting of interchange rates is illegal. The setting of interchange rates does not constitute a breach of the TPA and has not been found by a court to be in breach of the TPA. Further, that the ACCC has alleged that the setting of interchange rates is illegal is irrelevant to the RBA's consideration of the open schemes.

(c) The National is also concerned by the RBA's proposal for regulations to be enacted under the *Banking Act 1959* (Cth) (the "Banking Act") which would enable APRA to authorise and supervise specialist credit card providers carrying on the 'banking business' of issuing or acquiring credit cards. It is not clear how the proposed regulations may be validly enacted under the Banking Act. If such regulations may be validly enacted, then the RBA has suggested criteria to which APRA should have regard when authorising and supervising the specialist credit card providers. However, it is not clear that APRA would be obliged to have regard to these criteria. The National notes that, under the PSRA, the RBA is obliged to consider the integrity of the financial system and queries how this obligation can be fulfilled here.

Finally, the National notes that other issues relating to the validity of the RBA's proposed actions are set out in Chapter 6 of the ABA Submission. As noted above, the National was a party to this chapter and endorses the statements made therein.

8. Conclusion

The National believes that the Interchange Standard is misconceived and represents an inappropriate response to perceived problems in Australia's credit card networks. We believe that the proposal (in its current form) will have wide ranging adverse consequences for the open schemes, our cardholders, smaller merchants and smaller card issuers.

The National believes that the issues addressed in this submission can best be resolved through full and frank discussions between the participants in the payments system and the RBA. We would be more than willing to play a leading and constructive role in such discussions.

In closing, we stress that the National continues to be keen to achieve a satisfactory outcome and would be pleased to meet with the RBA to discuss these issues with you further.

Yours sincerely,

Peter J S Thomas
General Manager, Payments Policy

APPENDIX – Detailed comment on draft standards and access regime

1. Interchange Standard

The Reserve Bank of Australia (the "RBA") has proposed a standard for the setting of wholesale ("interchange") fees (the "Interchange Standard**"**) which allows for the establishment of a methodology for determining a cost based cap on the level of domestic interchange fees in the Visa, Mastercard and Bankcard Schemes (the "Open Schemes").

The National's detailed comments regarding the Interchange Standard are set out below.

(a) Paragraph 3 – definitions

- Paragraph 3 establishes a definition for 'nominated scheme participants'. Nominated scheme participants are the Open Scheme members who would be involved in the calculation of interchange fees. 'Nominated scheme participants' are defined in paragraph 3 as:

  > those issuers in a Open Scheme that issued, in aggregate, credit cards which were used in at least 90% of credit card transactions by value in that Open Scheme in the financial year prior to the year in which interchange fees must be calculated.

  There are likely to be some practical problems with determining which issuers are the nominated scheme participants. For example, the definition does not make clear which issuers would be chosen if a Open Scheme had four issuers that issued cards that were responsible for 20% of the value of transactions and there were seven other members who were responsible for the remaining 20% in equal amounts.

  There may also be some difficulty in calculating the total number of transactions by value and determining which issuers are responsible for each transaction to determine which issuers make up the 90%. For example, would an associate or affiliate member of an Open Scheme be calculated separately from the principal member that sponsors their involvement in the Open Scheme?

- The definition of 'payment guarantee' is simplistic and does not help to clarify the uncertainties raised by paragraph 8 (discussed below). Indeed, the definition of payment guarantee does not identify the guarantor, nor even state that the guarantee is to the effect that a merchant will receive payment even if a cardholder is unable to pay for the relevant goods or services.

(b) Paragraph 7 – eligible costs

- Paragraph 7 purports to identify the costs which would be included in the calculation of interchange fees in an Open Scheme. It is not clear to us that the explanations given to these categories of costs are sufficiently specific.

  It would be necessary to clarify these matters before the costly process of gathering data and calculating interchange fees is commenced.

- Paragraph 7 refers to:

  > Costs incurred in processing credit card transactions received from an acquirer that would not be incurred if the issuer was also the acquirer in those transactions.

  The National understands that in general terms these processing costs would be incurred whether the transaction was "on-us" or "not on-us". This could lead to the under-recovery of processing costs as processing costs incurred in "on-us" transactions would not be included in the calculation of interchange fees. This does not seem appropriate.

(c) Paragraph 8 – payment guarantee vs no payment guarantee

- Under the Open Schemes' current arrangements different interchange fees apply to electronic and non-electronic transactions. If the Interchange Standard was implemented this distinction would continue. The Interchange Standard would also require different interchange fees to be calculated depending on whether or not a credit card transaction was the subject of a "payment guarantee".

- The Interchange Standard does not specify which of the eligible costs would be included in the "payment guarantee" interchange fees and which would be included in the "non-payment guarantee" interchange fees. The National notes that in the Consultation Document, the RBA characterises costs associated with credit losses, fraud, authorisation and some other unspecified costs as costs related to the payment guarantee facility (at page 47). However, these matters are not made clear in the Interchange Standard.

(d) Paragraph 9 – data provided to independent expert and the RBA

- It is also unclear from the Interchange Standard who would be responsible for the cost of the independent expert but presumably the RBA intends that the costs would be incurred by the Open Schemes and their members. It appears to us that it would be appropriate for these costs to be incorporated into the interchange fee calculation.

The National also notes that the Open Scheme members who were required to participate in the calculation of interchange fees under the Interchange Standard would not be compensated for the costs they would incur in doing so. The National considers that appropriate arrangements should be put in place for these costs to be recovered.

(e) Paragraph 12 – publication of aggregated eligible costs

- Paragraph 12 of the Interchange Standard requires the Open Schemes to publish the aggregate data used by the independent expert in calculating interchange fees. The RBA considers this is in the public interest because it would increase transparency of the Open Schemes' arrangements.

  As noted in section 7 of the letter to which this is an Appendix, the power to make standards does not empower the RBA to make standards in relation to interchange fees. However, even if this were the case, paragraph 12 is not justified by the standards making power of the PSRA. Specifically, it is not clear how these requirements would improve the financial safety, efficiency or competitiveness of payment systems. In fact, an Open Scheme's cost data is likely to be of value to the closed schemes and the other Open Schemes in conducting their businesses and therefore may be contrary to the public interest because of the competitive advantage it would give the closed schemes and the other Open Schemes.

  Given the information to be published would be provided to the RBA, it seems to the National that this requirement is unnecessary at best and, at worst, quite harmful to competition between the Open Schemes and between the Open Schemes and the Closed Schemes. Paragraph 12 should be excluded from Interchange Standard.

(f) Paragraph 13 – interchange fees a maximum

- Paragraph 13 of the Interchange Standard states that interchange fees for an Open Scheme 'must not exceed the interchange fee calculated by the expert for that specified transaction in accordance with this Standard'. The Consultation Document states that the Interchange Standard 'aims to provide legal certainty to the designated credit card schemes and their members' (see page 55).

  As the Standard would still require the Open Schemes and their members to determine the level of interchange fees, it does not overcome TPA concerns which may arise if the Open Schemes' members reach an agreement on the level of interchange fees.

As the litigation by the ACCC against the National demonstrated, such an agreement could be alleged to contravene section 45 of the *Trade Practices Act 1974* (Cth) (the "TPA") (for example, on the basis that such an agreement would be deemed by section 45A of the TPA to substantially lessen competition because it would have the purpose, effect or likely effect of controlling or maintaining merchant service fees). In this regard, we note that in the Consultation Document, the RBA states that interchange fees calculated in accordance with the Interchange Standard 'would be the maximum interchange fees for the [S]cheme, but individual issuers would be free to "post" lower interchange fees': see page 55 of the Consultation Document. The RBA has also asserted that:

> [T]he draft standard does not require the credit card schemes or their members to act in a way that would put them in breach of the *Trade Practices Act* 1974: see pages 55 to 56 of the Consultation Document.

However, despite these assistances, it would remain open to a third party to allege that the Open Schemes and their members have contravened Section 45 on the basis described above. This uncertainty must be addressed by the RBA in the imposition of the Interchange Standard.

(g) Paragraph 14 – timeframe for implementation

- The Interchange Standard currently proposes that interchange fees of a Open Scheme be calculated and published within three months of the Standard coming into force. Given the significant amount of work that will be involved in the calculation of these interchange fees and the clarification of the various definitions in the Interchange Standard this would seem to be an unrealistic timeframe. The National submits that the Interchange Standard should provide for a 12 month implementation period with any variations in interchange fees to occur gradually over a number of years.

(h) Other observations

- The Interchange Standard does not provide any mechanism for review of the operation of the Standard after a period of time. The National submits that the Interchange Standard should provide for a review by an independent body, such as the Productivity Commission, within 3 years of its imposition.

2. No Surcharge Standard

The RBA's proposed standard for Merchant Pricing for Credit Card Purchases (the ***No Surcharge Standard***) would require the Open Schemes to abolish the 'no surcharge' rule which prevents merchants from charging an additional amount to those customers who purchase goods or services using their Visa or Mastercard credit cards (Bankcard does not have such a rule). The No Surcharge Standard would also ensure merchants could charge cardholders for the costs they incur in credit card transactions.

The National's detailed comments and recommendations regarding the No Surcharge Standard are set out below.

(a) Paragraph 6 – date No Surcharge Standard comes into force

- Paragraph 6 does not currently specify when the No Surcharge Standard would come into force. However, it is possible under the PSRA for a standard to come into force on the day on which it is introduced by the RBA. We request of the RBA that a significant lead time be given between the making of the Standard and the time it comes into force. This will allow the National (and other participants in the Open Schemes) to make any necessary adjustments to their contractual arrangements with cardholders and merchants and for the Open Schemes to make the amendments to their rules required by the Standard. Given the desirability of all of the RBA's reforms of the Open Schemes taking effect at the same time, the National recommends that the No Surcharge Standard come into force 12 months after the reforms are finalised. (Whilst the Open Schemes and their members may not require 12 months to bring about the changes required by the No Surcharge Standard, it is likely that a 12 month time frame will be necessary for the implementation of the Interchange Standard.).

Paragraphs 7, 8 & 9 - prohibition of restrictions on merchant pricing

- The No Surcharge Standard appears to allow merchants to charge different surcharges for different types of credit cards and different types of credit card transactions. Indeed, if, as the RBA suggests, an acquirer were to limit a merchant's "fee for service" to the cost to the merchant of accepting a credit card, in order to comply with such a provision, merchants would need to charge a multiplicity of surcharges depending on the type of credit card used and the type of transaction (eg card present or card not present) for each of its goods or services. This would increase transaction costs and confuse consumers.

(c) Other observations

- The No Surcharge Standard does not provide any mechanism for review of the operation of the Standard after a period of time.

The National submits that the No Surcharge Standard should provide for a review by an independent body, such as the Productivity Commission, within 3 years of its imposition.

3. Access Regime/Membership

If implemented in its current form, it is intended that the Access Regime would:

- make 'specialist credit card service providers' eligible to participate as issuers and acquirers in the Open Schemes. Specialist credit card service providers would be supervised by the Australian Prudential Regulatory Authority (***APRA***).
- prohibit Open Scheme net issuer rules (which stipulate that members whose acquiring business is large relative to their issuing business in a particular Open Scheme, must pay a loading to that Open Scheme).
- prohibit Open Scheme rules that prevent a participant in a Open Scheme from being a "self-acquirer" (that is, act as a merchant and acquirer in the same transaction) provided the participant can establish to the reasonable satisfaction of the Open Scheme that it has the capacity to meet the obligations of an acquirer as a self-acquirer.

The National's detailed comments and recommendations regarding the Access Regime are set out below.

(a) Paragraph 3 - definitions

- The definition of "self-acquirer" indicates that 'an acquirer is a "self-acquirer" if it or a related body is the merchant in a transaction'. However, 'related body' is not defined in the Access Regime.
- Although defined in the PSRA and referred to on a number of occasions in the Access Regime, the Access Regime does not define 'participant'. Further, the definition of 'participant' in section 7 of the PSRA does not sufficiently clarify the meaning of participant for the purposes of the Access Regime. This matter is discussed in more detail below in relation to paragraph 6.

(b) Paragraph 6 – eligibility for participation

- In the Consultation Document, the RBA indicates that '[t]he APRA Board has agreed in principle that APRA will authorise and supervise specialist credit card issuers and acquirers': see page 108 of the Consultation Document. In order to establish APRA's power to do so, the RBA has proposed that a regulation be enacted under the *Banking Act 1959* (Cth) (the "Banking Act") to deem credit card issuing and acquiring as 'banking business'.

The RBA also sets out in broad terms the criteria that credit card service providers would need to meet: see pages 108 to 109 of the Consultation Document.

A difficulty with this proposal is that pursuant to section 8 of the Banking Act only the RBA and ADIs may carry on a 'banking business'. The RBA has implied that credit card service providers would be ADIs (as a body corporate that is authorised by APRA to carry on 'banking business' under subsection 9(3) of the Banking Act is an ADI). However, in paragraph 6 of the Access Regime, the RBA has distinguished between ADIs and 'specialist credit card service providers'. There is no legal basis for drawing a distinction between an ADI and a credit card service provider based on the RBA's proposals. Rather, the correct characterisation is that credit card service providers would be ADIs as a result of the proposed amendments to the Banking Act foreshadowed by the RBA.

- In the Consultation Document, the RBA recognises that under each Open Schemes' rules, being an ADI is in general terms a pre-requisite to membership but that the Open Schemes retain a discretion to reject an ADI's application for membership.

  The Access Regime should clearly state that it only addresses eligibility and that it does not mandate that a particular class of organisations would be allowed to become members of an Open Scheme *as of right*.

(c) Paragraph 7 – no discrimination between "traditional ADIs" and specialist credit card service providers

- As noted above, the RBA has drawn a distinction between ADIs and specialist credit card service providers when there will be no legal basis for doing so. As a consequence, the provision in paragraph 7 that 'the rules of a Open Scheme must not discriminate between ADIs and specialist credit card service providers' has no meaning.
- The RBA has only broadly set out the prudential requirements for credit card service providers in the Consultation Document (see pages 108 and 109 of the Consultation Document), but there are no protections built into the Access Regime to ensure that credit card service providers and "traditional ADIs" are supervised by APRA in a fashion which ensures there is a level playing field for participants. The Access Regime should ensure there is a level playing field for participants in regard to the way in which they are supervised by APRA.
- There is also some risk that there will be some unintended consequences caused by extending the definition of 'banking business' under the Banking Act so as to capture credit card issuing and acquiring.

For example, absent appropriate arrangements being put in place by APRA, it may be possible for a specialist credit card service provider who is authorised to carry on 'banking business' pursuant to subsection 9(3) of the Banking Act, to expand its operations into deposit taking without requiring further authorisation from APRA. The RBA should carefully consider, in consultation with APRA, the consequences of altering the operation of the Banking Act in this way.

(d) Paragraph 11 – publication of eligibility rules

- Paragraph 11 requires the Open Schemes to publish their rules regarding eligibility for participation. The purpose of this paragraph is to improve the transparency of the Open Scheme's governance arrangements. However, it is not clear why the inclusion of this paragraph is appropriate in light of the public interest matters the RBA is to have regard to in subsection 12(2) of the PSRA. Instead of the release of this information increasing competition or efficiency or in some other way benefiting the public interest, it would appear that this is an unnecessary intervention into the private arrangements of the Open Schemes.

  It may be that an appropriate interim arrangement is for these rules to be made available to the RBA. We note in this regard that paragraph 13 of the Access Regime provides that the RBA must be provided with prior written notice of any proposed changes to the Open Scheme's rules governing eligibility for participation and the terms of participation in the Open Scheme. Consequently, the National submits that paragraph 11 should not be included in the finalised Access Regime.

(e) Paras 11, 12, 13 – notification

- By contrast to paragraph 11, paragraphs 12 and 13 require the Open Scheme administrator or, if none, **each of the participants in the Open Scheme** to provide certain information to applicants or the RBA. Paragraph 11 does not contain a requirement that **each of** the participants in the Open Scheme provide information on eligibility for participation. A requirement that each of the participants in a Open Scheme all send identical information to an applicant or the RBA is duplicative and unnecessary.

(f) Other Observations

- The National notes that the Access Regime does not provide any compensation to current participants or the Open Scheme Administrators for the costs they will incur as a result of the imposition of the Access Regime. This is contrary to the requirement in the PSRA that access be 'on a commercial basis on terms that are fair and reasonable': see definition of access in section 7.

The Access Regime should allow for the recovery of costs of access by the Open Schemes and their members. These costs would include the costs associated with connecting infrastructure to a new participant.

- There is no criteria setting out how disputes in relation to access would be resolved. We note that the PSRA provides for the arbitration of disputes under sections 19 and 20 of the PSRA and that a person denied access can seek a direction from the RBA (section 16) or an order from the Federal Court (section 17).

  The RBA is able to give directions under section 21 of the PSRA but it is unclear on what criteria it would reach any decision in relation to an access dispute.

  By way of comparison, the National notes that the Competition Principles Agreement (which sets out general access principles that were agreed to by the Commonwealth, State and Territory governments in 1995) provides that an access regime should include provisions that a resolution body (such as the RBA acting in its capacity under sections 20 and 21) should take into account in deciding on the terms and conditions for access. These include:

  (i) the owner's legitimate business interest and investment in the facility;

  (ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in the upstream or downstream markets;

  (iii) the economic value to the owner of any additional investments that the person seeking access or the owner has agreed to undertake;

  (iv) the interests of all persons holding contracts for the use of the facility;

  (v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility;

  (vi) the operation or technical requirements necessary for the safe and reliable operation of the facility;

  (vii) the economically efficient operation of the facility; and

  (viii) the benefit to the public from having competitive markets.

  In the National's view, similar provisions should be included in the Access Regime (along with provisions dealing with negotiation of access 'on commercial terms that are fair and reasonable') to govern the manner in which the RBA deals with access disputes.

This is particularly important in light of the fact that there is no appeal mechanism available under the PSRA, in contrast to other access regimes.

- The Access Regime does not provide any mechanism for review of the operation of the Access Regime after a period of time. The National submits that the Access Regime should provide for a review by an independent body, such as the Productivity Commission, within 3 years of its imposition.

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