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The Governor
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AN OPEN LETTER TO THE RESERVE BANK OF AUSTRALIA ('RBA')

In essence, the reforms to credit card schemes in Australia which have been proposed by the RBA will deny credit card holders the benefit of an interest free period, and will present reduced opportunity for interest rate reductions in the face of any future rise in credit losses. In effect, credit cards will become a 'buy now, pay now' instrument similar to a debit card. This will be caused by the inability to seek reimbursement from merchants of the costs of the interest free period, or of credit losses.

Imbalance in pricing signals between debit (EFTPoS) and credit are acknowledged by the RBA as an issue but, importantly, are not yet addressed.

All Australians and their representatives must test whether these changes are in their interest, and need to understand the impact on them individually, and on the economy as a whole.

Westpac has identified ten questions which need to be addressed before the reforms can be fully embraced by the community.

1. **Will Consumers Benefit?**

Consumers place a high value on the benefits which their credit cards offer. The cost of some of the most important benefits are met by interchange fees. There is no evidence that consumers will willingly trade away benefits, such as the interest free period, in exchange for an expected reduction in retail prices which will be difficult to verify.

Indeed, the RBA has acknowledged that the reforms provide no guarantee that card users and the community will benefit from lower prices as a result of value transfer of $500 million from card issuers and card holders to merchants. Instead, as noted by the RBA, they "may have the effect of tempering price increases that would otherwise have taken place".

At the same time, the ACCC has recognised the absence of a mechanism for monitoring price outcomes. The Chairman of the ACCC, Professor Fels, has stated that "it would not be a particularly simple monitoring role". He has suggested it would be slightly harder than monitoring for GST impacts "because there would be a general cost saving to retailers which you could not follow through in an absolutely clear-cut fashion".

2. Will Retailers Benefit?

Westpac estimates that five million Australians use credit cards for transacting (as opposed to borrowing), spending $3 billion to $4 billion monthly. These so called 'transactors' pay in full each month, or most months, without paying interest. Denial of reimbursement from merchants of this "buy now, pay later" benefit will cause cardholders to either accept an interest cost (pay card interest or realise other investments) or, as is likely, to slow spending for a period as the change is implemented. This will have a significant one-off impact on consumer spending and, hence, an impact on retail sales.

3. Will the Economy Benefit?

The RBA's objectives in reforming credit card schemes in Australia should be identical to that for the Australian payments system in aggregate - lower cost, greater transparency, greater competition, and greater efficiency. The economic benefits of achieving these objectives would be better addressed if these objectives were pursued in respect of all payment instruments simultaneously and in a complementary way.

The RBA acknowledges that its credit card reforms have clear implications for EFTPoS debit card usage, and that EFTPoS is in need of reform, yet there are no plans to undertake these reforms simultaneously in order to achieve a complementary outcome.

Additionally, as noted above, there is a risk of a once off slow down in retail sales which would likely impact on economic growth if the proposed reforms are implemented suddenly.

4. Will There Be More Competition?

The widening availability of credit as a result of credit cards has enhanced 'social capital' by broadening access to credit for lower income sectors of the community. If smaller issuers which ordinarily serve consumers in rural or economically disadvantaged areas are unable to participate in the market on a commercially sustainable basis, then those consumers will face a narrower choice of suppliers. Instead, they may have little choice but to move to less well regulated and higher cost sources of credit, such as expensive 'point of sale' credit, and payday lenders.

5. Will Foreign Owned Businesses Benefit and Take Profits out of Australia at the Expense of Australians?

The Visa and MasterCard brands have global acceptance. Australian financial institutions and their customers benefit from credit card offerings utilising these brands. Any reduction in the benefits of these brands due to the RBA reforms will result in some consumers making a shift from 'open system' credit card use to the use of 'closed system' charge and credit cards issued by non-Australian multinationals like American Express and Citigroup Diners' Club.

In terms of shareholder and economic effects, Westpac calculates that if 50% of cardholders who pay off their balance in full each month were to transfer their cardholding to American Express or Citigroup Diners' Club, then some $15 billion in credit card spend per annum would move from domestic issuers such as banks, credit unions and building societies, to these scheme operators. At 1% incremental margin to these two companies, this amounts to $100 million after tax, which may flow out of Australia by way of dividends.

6. Will the Reforms Lead to Greater Innovation?

Westpac believes that the Australian credit card market will be at its most competitive when commercially sustainable card issuers can offer cardholders a wide choice of value propositions. For example, around five million cardholders per month take advantage of the interest free period offered by their card, while around four million utilise the revolving credit that their card offers. Differentiating their credit card offerings by mixing these and other features requires issuers to be able to innovate. Innovation and sustainable product development is most likely to take place when issuers' participation costs are adequately covered. Competitive activity drives up value for consumers through a range of benefits, including pricing of credit.

By eroding the ability of issuers to recover their costs of participation, the reforms will put at risk the process of innovation and the outcomes which competition generates.

7. Will the Reforms Remove All Distorting Price Sgnals to Users?

If the RBA, in addressing the public interest, is genuinely motivated to remove price distortions, it is appropriate for it to focus upon the cost to the economy of all payment instruments. Importantly EFTPoS, the most efficient method of transacting, is currently mispriced in a way that accentuates the cost differential in favour of credit card use.

Westpac has long argued, and the RBA acknowledges, that correcting the mispricing of EFTPoS is an important part of overall payment system reform. Currently EFTPoS issuers pay retailers for processing transactions which require recovery of this cost from EFTPoS card holders by way of transaction fees. These are higher than they would otherwise be if common pricing principles, as proposed for credit cards, were adopted for EFTPoS.

Any increase in use of cash in response to the reforms imposes an added cost on the economy of cash handling which Westpac estimates at a premium of 1% of turnover relative to credit card costs.

8. Should the Reforms be Phased in Gradually to Enable Response to Unintended Consequences?

The growth in card acceptance and in credit usage by cardholders is testament to the competitiveness and credibility of the credit card industry in Australia. Growth has been strong over a twenty year period. Today there are 9.7 million credit cards issued in Australia, accepted by more than 400,000 businesses. This is evidence that the credit card industry is a trusted provider of payment services and of credit for Australian consumers and businesses.

The proposed reforms will impact to some extent on all of these stakeholders - some in subtle ways, others more significantly. These fundamental reforms need to be considered carefully by all stakeholders with a clearer understanding of consequences than the RBA has communicated to date.

Westpac argues that the reforms, once agreed, need to be carefully implemented in a staged manner, rather than as a once off, sudden change, so that adjustments can be made to respond to any unintended consequences. A staged implementation gives the opportunity to avoid damage to consumer confidence and credibility of this important enabler of commerce.

9. Can the RBA Assure Consumers that the Benefits of Accessing Global Payment Brands is not at Risk?

The reforms proposed by the RBA go to the very heart of the economics and value propositions driven by the global payment associations, Visa and MasterCard, on behalf of their 20,000 member banks and financial institutions. In relative terms, Australia is a small player in this global game. The precedent set by enforced reforms in Australia will cause these 20,000 members to deeply consider whether they continue to support the presence of their associations in Australia.

The benefits to Australian consumers of ubiquitous international acceptance of payment cards overseas when travelling or for overseas purchases is undoubted. Were one or more of these associations to withdraw from supporting Australian issuers, these benefits are at risk. For certain types of merchants, such as those involved in the tourism industry, withdrawal of the ability to accept these card types would significantly disadvantage them.

The RBA should seek assurances from these global payment associations that their continued presence in Australia is not at risk by virtue of the reforms.

10. What Should the RBA do to Give Proper Effect to its Proposals About Surcharging and Access?

In addition to the proposed changes to interchange pricing, the RBA proposes to liberalise rules which govern who can issue credit cards and remove restrictive practices that prevent merchants charging consumers for acceptance of alternative forms of payment.

From a public policy perspective, consumers need to consider how they would respond to retailers imposing a charge or fee for acceptance of a credit card relative to payment by cash, cheque or debit card. Elimination of this restrictive practice should be imposed upon closed card payment systems, such as American Express and Citigroup Diners' Card, because only in this manner is there any introduction of price signals to consumers as a disincentive to use these high cost payment instruments.

Westpac supports less restrictive entry criteria to issuing and acquiring of card payments. The proposal by the RBA to have APRA supervise new entrants, without any tangible performance guarantee by the entrant, does introduce added counterparty failure risk to the existing issuers of cards. The RBA must call on APRA to develop the skills required to assess and monitor the performance of new entrants to the credit card market so that confidence in the Australian payment system is not put at risk.

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Greater transparency of the likely consequences of the proposed reforms is required so that public debate occurs in a fully informed manner. In this open letter, Westpac proposes ten key questions that need to be answered so as not to surprise the public if these reforms are to occur.

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