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## Summary

In summary, the pricing of credit card payment services is sending consumers a misleading signal about the cost to the community of different payment instruments, while barriers to entry are shielding the members of the credit card schemes from the competitive pressures that non-financial corporations of substance could bring to bear.

The consequence of the current structure of price incentives is that consumers using credit cards are not necessarily those who ultimately bear the costs. The community bears a significant proportion of credit card costs: because merchants have no alternative but to pass merchant service fees into the general level of prices, the costs are borne by all consumers, whether they use a credit card or not. A much larger proportion of credit card costs are borne directly by credit cardholders using the “revolving” line of credit, who pay interest rates significantly above rates on other forms of unsecured lending. Credit card transactors contribute little directly to credit card costs.

## 3. OBJECTIVE

The objective of the Reserve Bank’s reforms is to promote efficiency in the Australian payments system and enhance community welfare by increasing competition and giving greater rein to the workings of the price mechanism.

## 4. OPTIONS

Three options are available to the Reserve Bank:

- (i) no regulatory action;
- (ii) regulatory action to remove credit card scheme restrictions on access and merchant pricing; or
- (iii) regulatory action to remove these scheme restrictions and to address the collective setting of interchange fees.

### No regulatory action

A decision by the Reserve Bank to take no regulatory action would not necessarily mean that interchange fee arrangements in the credit card schemes would continue in their current form. However, credit card scheme restrictions on access and merchant pricing would be expected to remain unchanged.

In a development separate to the Reserve Bank’s review of credit card schemes, in 2000 the ACCC instituted proceedings in the Federal Court alleging that the



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collective setting of interchange fees in the four party credit card schemes in Australia was a breach of the price-fixing prohibitions of the *Trade Practices Act 1974*. Following the Reserve Bank's designation of the credit card schemes, these proceedings were discontinued without any finding by the court. If the Reserve Bank were to take no regulatory action in this area, the credit card schemes and their members could remain at risk under that Act of actions by the ACCC or a third party. To remove this risk, the schemes and their members would probably consider the need to seek authorisation of their interchange fee agreements under that Act.

It is not possible to anticipate the proposals that might be made as a basis for authorisation. Members of the credit card schemes in Australia, which have delegated authority under card scheme rules to determine interchange fees for domestic transactions (ie transactions that involve two Australian members), have acknowledged that reform of the interchange fee-setting process is necessary and, through the Australian Bankers' Association, have accepted that interchange fees should be set in an open, transparent and objective manner. MasterCard and Visa, however, have not acknowledged that reform of interchange fee setting is necessary but have proposed that the methodologies they have applied in some other countries could form the basis for interchange fee setting in Australia.

Restrictions on access in the MasterCard and Visa schemes are international rules on which their Australian members have no delegated authority but which they must enforce; variations are made at the country level if required by local law or, in unusual circumstances, if the schemes decide to vary their membership criteria to encourage growth of particular markets. In Bankcard's case, decisions on membership are taken by its directors.

Neither MasterCard nor Visa has proposed changes to its membership criteria in Australia. MasterCard's rules make provision for participation by a financial institution (not necessarily an authorised deposit-taking institution) provided it is supervised by the relevant government authority. Visa's rules require that, other than in exceptional circumstances, applicants for membership must be authorised to accept demand deposits. In response to concerns raised in the Joint Study, Bankcard announced a significant liberalisation of access to its scheme, which allows non-traditional participants to enter provided their liabilities in respect of the scheme are guaranteed by a financial institution which is prudentially supervised (in Australia or overseas).

MasterCard and Visa prohibit their members from acting only as acquirers (so-called "net issuer" or "balanced portfolio" rules), but such a prohibition no longer applies in Bankcard. Visa has recently advised that it no longer enforces penalties on



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members whose business is concentrated on acquiring rather than issuing. Bankcard has retained such penalties despite its recent liberalisation of access to membership while MasterCard continues to defend the need for penalties in its scheme in Australia.

As with restrictions on access, restrictions on merchant pricing in the MasterCard and Visa schemes are international rules which are imposed in all countries in which these schemes operate, except in the United Kingdom, the Netherlands and Sweden where local laws prevent them doing so. Both schemes are opposed to the removal of these restrictions in Australia. Bankcard does not impose restrictions on merchant pricing.

## **Regulatory action on access and merchant pricing**

The Reserve Bank has considered whether it could achieve effective reform of the designated credit card schemes if it confined the use of its regulatory powers to ending scheme restrictions on access and merchant pricing.

The Reserve Bank's **access regime** would liberalise access to the credit card schemes by allowing non-financial corporations of substance to become eligible to apply for participation, as either issuers or acquirers or both, through a financial subsidiary that would specialise in credit card activities. Such subsidiaries would need to be authorised and supervised by APRA. They would need to demonstrate to APRA that they have the skills, staffing and operational capacity for the scale of credit card activity proposed, and would have to meet ongoing prudential standards no less strict than those currently imposed by APRA for relevant risks.

Under the access regime, all authorised deposit-taking institutions, including the new class of specialist credit card institutions, would be eligible to apply to participate in the designated credit card schemes in Australia. In assessing applications for participation, the schemes could apply any business or operational criteria they considered appropriate, but they could not discriminate between specialist credit card institutions as a class and other authorised deposit-taking institutions as a class in relation to criteria for participation, or to rights and obligations associated with participation. The access regime would prohibit the imposition of any restrictions or form of penalties on participants seeking to specialise in acquiring; it would also require the schemes to consider on its merits any proposal by an acquirer to acquire the transactions of a related entity, such as its merchant owner.

The Reserve Bank's **standard on merchant pricing** would prohibit restrictions imposed by MasterCard and Visa on the freedom of merchants to charge according to the means of payment. Merchants would therefore be free, if they so wish, to



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charge a “fee for service” for accepting credit cards. At the same time, an acquirer and a merchant would be able to agree that the amount of any such fee would be limited to the fees paid by the merchant for credit card transactions. The three party card schemes, American Express and Diners Club, impose the same set of restrictions on merchants and would be required to remove these restrictions if a standard on merchant pricing came into force.

### **Regulatory action on access, merchant pricing and interchange fees**

The Reserve Bank considered whether a standard on interchange fees would also be needed to achieve effective reform of the designated credit card schemes. While the ending of scheme restrictions on access and merchant pricing might be necessary to promote competition and market discipline, such action, on its own, might not be sufficient to ensure that the collective setting of interchange fees in Australia, by scheme members that are otherwise competitors, produces a level of interchange fees that is efficient and in the public interest. If not, a standard on interchange fees would also be needed to promote competition and the efficient pricing of credit card services to cardholders and merchants.

The Reserve Bank’s **standard on interchange fees** would provide an objective, transparent and cost-based benchmark against which interchange fees in each designated credit card scheme could be assessed. The benchmark, which would be reviewed regularly, would be based on credit card payment services which are provided to merchants and for which card issuers incur costs. Each scheme would be required to publish its interchange fees determined in accordance with this standard.

## **5. IMPACT ANALYSIS**

### **Parties affected**

The impact of the options considered by the Reserve Bank would fall, in different ways, on the following parties:

- (i) the community as a whole, including consumers who do not use credit cards;
- (ii) credit cardholders;
- (iii) merchants that accept credit cards for payment; and
- (iv) the credit card schemes and financial institutions which are members of these schemes.