CHAPTER 4: RESTRICTIONS ON ENTRY

4.1 Introduction

The Bankcard, MasterCard and Visa credit card schemes have regulations and policies, agreed to by their respective Australian members, that restrict entry to the schemes. Broadly speaking, the regulations:

- limit the types of institutions eligible to become members of the schemes as credit card issuers and acquirers; and
- restrict the range and scale of activities that card scheme members may undertake.

As noted in Chapter 1, the Financial System Inquiry identified restrictions on participation in credit card schemes as an area of policy concern. Specifically, card scheme rules might be used to restrict the ability of non-deposit-taking institutions to compete in new payment technologies. The Inquiry therefore recommended that the ACCC maintain a watching brief over credit card rules and membership arrangements.

Prima facie, restrictions imposed by existing participants on entry to a market are anti-competitive, and against the public interest. Such restrictions inhibit normal market processes, under which resources are free to enter a market in response to profit opportunities; in doing so, or threatening to do so, new entrants drive profits down to "normal" rates. The Joint Study acknowledged that there are good reasons why credit card issuers and acquirers need to have the relevant skills and financial standing. However, it was not convinced that the card scheme restrictions on entry had struck a balance between competition and the control of risks that was in the public interest. The credit card schemes and their members, nonetheless, defend these restrictions as being essential to the safety of the schemes or, in the case of restrictions on members' activities, to the "balanced development" of the schemes.

This Chapter considers whether the restrictions imposed by the designated credit card schemes on eligibility for membership, and on members' activities, are in the public interest. Firstly, it reviews the extent of competition within the credit card market in Australia. It then analyses the nature of the risks which credit card issuers and acquirers bring to card schemes, and assesses how the regulations and policies of each of the schemes address these risks. On the basis of this review, the Reserve Bank judges that there is scope for a more liberal regime of access to the credit card schemes that will promote competition and efficiency without compromising their safety. A draft access regime with that objective, which allows for the entry of specialist credit card service providers supervised by APRA, is discussed in the concluding section.

4.2 Competition in credit card issuing and acquiring

Credit card issuing and acquiring are currently very profitable activities in Australia. Information provided to the Joint Study by card scheme members showed that the provision of credit card services generates revenues well above average costs, especially for financial institutions which are both significant card issuers and acquirers. The margins are particularly wide in credit card acquiring (Table 4.1). Although card scheme members were generally unable to supply suitable capital data, indicative figuring by the Reserve Bank – based on the main risks against which capital would be held – suggested that the margins in credit card issuing and acquiring were well above what would be required to provide a competitive rate of return on capital.

Table 4.1: Credit card issuing and acquiring
costs and revenues per transaction
$, 1999

Issuing		Acquiring		
Revenues	2.69	Revenues		1.78
		Direct costs	0.43	
		Interchange paid	1.06	
Direct costs	1.93	Costs		1.49
Margin	0.76	Margin		0.29
(mark-up over direct costs)	(39.4%)	(mark-up over direct costs)		(67.4%)
Costs of loyalty programs	0.46			

Source: Reserve Bank of Australia and Australian Competition and Consumer Commission (2000), p 45.

The strong profitability of credit card activities can be seen against the highly concentrated nature of the credit card market in Australia. The four major banks dominate both credit card issuing and acquiring. As issuers, they account for around 87 per cent of transactions undertaken on bank-issued cards, a higher level of concentration than in banking operations as a whole (Table 4.2).[147] A number of

147 This degree of concentration also contrasts sharply with the United States, where in 1997 the four largest credit and charge card issuers accounted for between 31 and 42 per cent of the market, depending on the measure used. See Evans and Schmalensee (1999), p 226.

other deposit-taking institutions, including building societies and credit unions, issue credit cards, but have only a very small market share. The acquiring market is even more concentrated, with the four major banks accounting for 91 per cent of credit card transactions acquired by banks and the next four banks for the remainder. Though open to new entry by financial institutions, the credit card market is, broadly speaking, closed to the participation of non-financial institutions in their own right. As the Joint Study noted, a concentrated market can still be competitive if entry barriers are low but where these barriers are high, the market power of incumbents is likely to be entrenched.

Table 4.2: Share of credit card issuing and acquiring
per cent of number of transactions, 2000

	Issuing	Acquiring
Four major banks	87	91
Next four banks	10	9

Source: Reserve Bank Transaction Cards Statistical Collection.

Although not challenging the data used, the ABA has submitted that margins for credit card issuing and acquiring in Australia are "not unreasonable".[148] It has suggested, first, that these margins should not be considered separately but jointly, because of the network character of credit card businesses. While a joint measure might be relevant for three party card schemes, which generally have a sole issuer and acquirer, it is not an appropriate suggestion in the case of four party card schemes, the main strength of which – according to proponents of existing arrangements – is the separate and competing interests of credit card issuers and acquirers. The suggestion is also out of line with the business models under which card scheme members in Australia manage and seek to allocate capital to issuing and acquiring as separate activities, and with the assessment of credit card profitability in previous official studies in Australia.[149]

Secondly, the ABA has argued that the Joint Study's findings used only one year of data (1999) and did not take into account losses incurred in the early years of operation of the credit card schemes. Elsewhere, however, the ABA has conceded

148 Australian Bankers' Association (2001b), pp 30-33.

149 Prices Surveillance Authority (1992) and (1994), p 27.

that such losses have not been recorded in the formal financial records of banks and that evidence of these losses is only anecdotal.[150] Nonetheless, the four major banks did provide detailed data on credit card profitability to earlier reviews conducted by the Prices Surveillance Authority, which showed that credit card activities for these banks moved into profit in 1991/92.[151] The Reserve Bank acknowledges that losses were incurred in establishing credit card schemes in Australia, but believes it is quite valid to get a reading on current levels of profitability, given that the credit card is now a well-established product and familiar to consumers.

Thirdly, the ABA has argued that the Joint Study erred in not including loyalty programs in the costs of credit card issuing. The Reserve Bank acknowledges that expenditure on loyalty programs affects issuers' accounting profits. In an economic sense, however, loyalty programs represent a rebate to certain groups of credit cardholders at the discretion of some, though not all, card issuers; they affect the price at which credit card services are provided to cardholders but are not a cost that is integral to the provision of these services. This matter was discussed in Chapter 2. Against the background of continuing high gross margins in credit card issuing, competition in this area over recent years has taken the particular form of a proliferation of loyalty schemes rather than a decline in lending margins.[152]

Concerns that competition is not working as it should in Australia are particularly strong in the case of credit card acquiring. The ARA has provided data on the merchant service fees paid by merchants, according to annual turnover (Table 4.3). Smaller merchants can pay merchant service fees as high as four per cent per transaction. After paying interchange fees to issuers, the amount retained by acquirers for providing services to merchants averages around one per cent per transaction, and can be as high as three per cent in the case of smaller merchants.

Evidence on the degree of competition in credit card acquiring – apart from the wide margins being earned – comes from a cross-country comparison of the share of merchant service fees which is retained by acquirers, after payment of interchange fees to card issuers. Credit card acquiring is essentially a volume-based processing business which is subject to significant economies of scale; in major countries, strong competition and improvements in technology have driven the fees retained by acquirers down towards the floor set by interchange fees. In the United States, acquirers retain about 20 per cent of the merchant service fee and

150 Australian Bankers' Association (2001e), p 11.

151 See, for example, Prices Surveillance Authority (1994), p 28.

152 Gizycki and Lowe (2000), p 195.

Table 4.3: Merchant service fees
per cent, 2000

Annual turnover ($m)	Average	Minimum	Maximum
0.10	2.53	1.36	4.00
0.25	2.30	1.25	4.00
0.50	2.10	0.90	4.00
1.00	1.75	1.00	4.00
2.50	1.68	1.00	3.00
5.00	1.53	1.19	3.25
10.00	1.51	0.90	3.00
25.00	1.47	1.00	3.00
50.00	1.38	1.25	1.50
100.00	1.35	1.25	3.00
500.00	1.30	1.00	3.00

Source: Australian Retailers Association (2001a), p 14.

the figure is much the same, on average, in Europe.[153] In contrast, acquirers in Australia, on average, retain almost 50 per cent of the merchant service fee.

Other evidence about the degree of competition in acquiring comes from the structure of merchant service fees in Australia. With only one exception of which the Reserve Bank is aware, these fees – which cover the interchange fee and acquiring costs – are charged on an *ad valorem* basis. Because credit card acquiring is essentially volume-based, a flat fee for acquiring services would be more in line with the costs incurred by acquirers. When charged on an *ad valorem* basis, however, the structure of merchant service fees ensures that revenues from credit card acquiring continue to rise with the total value of credit card transactions, without regard to acquiring costs. This fee structure might benefit merchants with a preponderance of small-value transactions, but merchants with high-value transactions can be paying much more in merchant service fees than the costs to acquirers of providing the service.

153 MasterCard International (2001) p 8, European Commission (2000) and British Retail Consortium (1999).

In its earlier reviews of credit card pricing, the Prices Surveillance Authority concluded that *ad valorem* merchant service fees may not represent an efficient form of pricing as they do not seem to be related to costs. The Joint Study noted that competitive pressures have not led to a more appropriate two-part charging structure for merchants. If the acquiring market were strongly competitive, merchants should expect to be offered fee structures that were more closely aligned with acquirers' costs.

One major utility has advised the Reserve Bank that, despite explicit requests for alternative fee arrangements, no bank tendering for its credit card business was prepared to structure its fees other than on an *ad valorem* basis. Reviewing the results of its survey, the Australian Retailers Association noted that:

> "… smaller retailers with lower turnover have a lesser ability to negotiate lower MSFs. However the results of the survey did indicate that a few retailers with high turnover still paid high MSFs. This may be the result of a lack of knowledge on the part of the retailer, or a belief by the retailer that the fee is non-negotiable."[154]

Both interpretations are consistent with less-than-vigorous competition for merchants' business by acquirers.

In a confidential submission, the ABA has provided data showing a trend decline in average merchant service fees in Australia from 1995 to 2000 to support its claim that acquiring is a highly competitive activity. An earlier submission published by the ABA showed a smaller fall in merchant service fees over much the same period, which matched the fall in average interchange fees as credit card transactions switched from paper-based to electronic.[155] The existence of declining merchant service fees is not *per se* evidence of vigorous competition. The test for a competitive market is that participants over time earn only normal *profits*, taking account of both revenues and costs. On the revenue side, the relevant variable is revenues per transaction, which depend not only on the merchant service fees but also on the average value of credit card transactions to which the fees are applied. Over the period 1995 to 2000, the average value of credit card transactions rose by almost 20 per cent, meaning that acquirers' revenue per transaction fell only slightly despite the claimed strong decline in merchant service fees. And over the same period, acquirers' costs per transaction would have benefited from substantial reductions in processing and telecommunications costs and from economies of scale through higher transaction volumes.

154 Australian Retailers Association (2001a), p 10.

155 Frontier Economics (2001), p 33.

In the Reserve Bank's view, claims that the credit card market in Australia is highly competitive are an echo of claims made in the early 1990s that the market for residential mortgages was competitive, even with spreads between the standard mortgage rate and the cash rate of over four percentage points. It took the entry of specialist mortgage originators to transform that market, driving spreads to below two percentage points within a few years. A recent review of competition and profitability in the Australian financial system concluded:

> "[a]n important lesson from the 1990s is that the competitive pressures needed to drive margins lower are more likely to come from new entrants, rather than from firms with large existing market shares. The lesson becomes even more relevant in the current environment in which there is strong pressure for further consolidation."[156]

A credible threat of entry by non-traditional participants is needed before it could be claimed that the credit card market in Australia is fully competitive and generates only normal profits. For this reason, the public interest requires that restrictions on entry imposed by the credit card schemes are the *minimum* necessary to protect the schemes from any risks introduced by their members.

4.3 Risks in credit card issuing and acquiring

Credit card issuers and acquirers perform a range of functions in credit card schemes, which expose them to financial risks. If not prudently managed, these risks can create exposures for other scheme members.

Credit card *issuers* in each scheme assess the creditworthiness of, and issue cards to, cardholders; authorise cardholders' transactions; settle with acquirers for transactions accepted by merchants; collect payments from cardholders; deal with disputed and fraudulent transactions; and contribute as necessary to the scheme's loss-sharing arrangements. As a consequence, issuers face both liquidity and credit risks.

Liquidity risks arise because issuers must settle with acquirers within a day or so of transactions taking place, while repayments by cardholders will be spread out over many days or months. Credit risks arise because cardholders may fail to pay their outstanding credit card accounts. Issuers must be able to manage both of these risks if they are to settle their obligations to acquirers; their ability to assess the creditworthiness of cardholders is critical. For this reason, the Joint Study

156 Gizycki and Lowe (2000), p 198.

acknowledged that card issuers should have financial standing.[157] This need is reinforced by the schemes' "honour all cards" rules, which require that all cards issued by members of a scheme are honoured by merchants regardless of the identity of the issuer. Under formal loss-sharing rules in credit card schemes, the failure of an issuer to manage its risks creates obligations on other scheme members.[158] Scheme members must shoulder the loss if an issuer:

- fails to settle its obligations to acquirers in full; or
- fails to meet loss-sharing obligations in the event that another member is unable to meet its settlement obligations. Hence, each scheme member, even if it only issues cards, has an interest in ensuring that all issuers can meet their settlement obligations.

Risks to issuers need to be kept in perspective. While their settlement obligations have to be met daily, their demand for liquidity should be reasonably predictable, given normal seasonal spending patterns and established billing cycles. For credit card issuers, there is no obvious counterpart to a run on liquidity where depositors have concerns about the soundness of a financial institution; cardholders are most unlikely to run up new debts suddenly if the solvency of their credit card issuer were in doubt.

Credit card *acquirers* in each scheme assess the ability of merchants to deliver goods and services paid for by credit cards, and sign them up to accept the scheme's credit cards; capture merchants' credit card transactions and seek their authorisation from issuers; guarantee payment to merchants for the value of credit card transactions acquired;[159] settle with issuers for transactions acquired as well as for disputed and "charged back" transactions (see below); and contribute as necessary to the scheme's loss-sharing arrangements. Acquirers also face both liquidity and credit risks, though of a different dimension to issuers.

In the normal course, acquirers are net receivers of funds from issuers at daily settlement. Because there is often a delay of a day or so between their payments to merchants and receipt of settlement funds from issuers, acquirers may face liquidity risks, although these should be readily manageable. Acquirers may also face liquidity and credit risks arising out of the rules of Bankcard, MasterCard and Visa providing for refunds to credit cardholders.

157 Reserve Bank of Australia and Australian Competition and Consumer Commission (2000), p 56.

158 See MasterCard International (2001), Allen Consulting Group (2001), p 3, p 12.

159 Provided required checks have been undertaken.

Most credit card transactions do not generate refund obligations for acquirers. Take for example a restaurant meal or groceries paid for by credit card. The meal has been consumed or the groceries purchased, the card is present and the merchant has a record of the cardholder's signature. The transaction has been completed on a "delivery-vs-payment" basis and the scope for the customer to initiate a refund to its credit card account (known as a "chargeback") is virtually nil. However, when goods and services are delivered after payment – such as airline tickets, package holidays, mail order, telephone or Internet purchases – there is a risk that delivery might not be carried out or that a cardholder might dispute the transaction. In such cases, the card scheme rules provide for a refund to the cardholder. The issuer credits the cardholder's account and seeks reimbursement from the acquirer; the acquirer, in turn, must recover the funds from the merchant. For an acquirer with a diversified base of sound merchants, this process would normally pose only minor liquidity risks. However, the acquirer does face a credit risk that a merchant cannot pay or is fraudulent; under the card scheme rules, the acquirer who has signed that merchant up to the scheme must bear the loss. Hence, acquirers also need to have financial substance commensurate with the particular risks they bear.

Under the formal loss-sharing rules, an acquirer can create exposures for other scheme members if it:

- fails to make up any shortfall in reimbursement to issuers for "chargeback" transactions; or
- fails to meet loss-sharing obligations in the event that another member cannot meet its settlement obligations. As with issuing, therefore, each scheme member has an interest in ensuring that acquirers can assess, price and bear the risks associated with credit card transactions at the merchants they sign up.

As a means of containing risks in credit card issuing and acquiring, each of the designated credit card schemes imposes restrictions which:

- limit the types of institutions that are eligible for membership; and
- in the two international schemes, prevent members of the schemes from acquiring their own transactions ("self acquiring").

4.4 Restrictions on eligibility for scheme membership

Scheme structures

The decision-making structures of the designated credit card schemes are important to the way in which restrictions on eligibility for membership operate, how they can be changed and where decision-making power lies.

MasterCard and Visa are international schemes with various levels of decision-making and responsibility. Although details and nomenclature vary, both schemes operate at three key levels. First, there is an international board for each scheme which has ultimate decision-making power. One Australian member is currently represented on the international board of MasterCard. Below that is a regional board; in both schemes Australia is included in groupings of countries in the Asia-Pacific region. Australian banks are currently represented by two members on the 23 member Asia-Pacific Board of MasterCard and by three members on the 27 member Asia-Pacific Board of Visa. Finally, each scheme has an Australian executive committee, the details of which were provided in Chapter 2. Each of the schemes' decision-making bodies has a range of delegated responsibilities and powers.

Bankcard's structure is less complex. Bankcard is an association directly controlled in all respects by its members, which are all Australian banks. Other than requirements imposed under Australian law, there are no constraints on the ability of the members to change scheme rules.

MasterCard

MasterCard has provided copies of its Bylaws to the Reserve Bank but does not wish to have them quoted publicly. However, its membership requirements have been described in its public submissions to the Reserve Bank:

> "The main rule concerning eligibility for membership of MasterCard provides that, in order for a corporation or organisation to be eligible to become a member of MasterCard, it must be 'a financial institution that is authorised to engage in financial transactions under the laws and/or government regulations of the country …'."[160]

MasterCard also requires that "… such a financial institution must be regulated and supervised by a governmental authority."[161]

160 MasterCard International (2001), p 27.

161 *ibid*, p 28.

MasterCard's rules build in a degree of flexibility. Its requirement that members conduct financial transactions rather than being authorised deposit-taking institutions means that "there are card companies in Asia which are members who are organisations which *only* issue cards and acquire transactions but do not accept deposits".[162]

Being a regulated or supervised financial institution in Australia is not, in itself, a sufficient condition to gain membership of MasterCard. An application for membership is decided by a majority vote of international directors or regional directors present, depending on which meeting considers the membership application. In Australia, new members pay an entry fee.

Visa

The Bylaws of Visa International require that applicants for membership be:

> "Organized under the commercial banking laws or their equivalent of any country or subdivision thereof, and authorized to accept demand deposits; or
>
> ...
>
> An organization (i) whose membership the Board of Directors deems necessary to penetrate a given country in which no Principal has jurisdiction, or (ii) that the Principals with jurisdiction in a given country unanimously agree should be made eligible in such country."[163]

Being an authorised deposit-taking institution (ADI) in Australia does not guarantee membership of the Visa scheme. Eligible applicants must also submit a business plan and satisfy Visa International that they have appropriate operational capacity and will "contribute to the overall operation and growth of the Visa payments system." Applicants must also meet the requirements of Visa International's Global Member Risk Policy; Visa has advised the Reserve Bank that "assessment often results in a requirement for an applicant to provide Visa International with collateral".[164] An application for membership must be endorsed by a majority vote of directors present at the Asia-Pacific board meeting, where the application would be considered. In Australia, new members pay an entry fee.

162 *ibid.*

163 Visa International By-laws, Membership Section 2.01.

164 Visa International (2001c), pp 10-12.

Bankcard

Prior to the Joint Study, membership requirements for Bankcard were characterised by their lack of transparency and objectivity. Membership applications were determined at the sole discretion of the four remaining founding banks.[165] Bankcard had refused membership to a number of banks, including Citibank, whose parent company was at the time the largest issuer of bank credit cards in the world; it also imposed a formula-based membership fee which in recent years amounted to around $1 million. The Joint Study concluded that Bankcard's membership procedures appeared to have operated to ensure that the field of competition for the issuing of Bankcard and the acquiring of Bankcard transactions remained tightly restricted to a small number of banks.

Bankcard has subsequently undertaken a major review of its membership requirements, which has resulted in a significant liberalisation of access to membership.[166] Under its new rules, an entity is eligible for membership of Bankcard if it is:

- "an authorised deposit-taking institution (ADI) in Australia supervised by the Australian Prudential Regulation Authority (APRA); or
- a financial institution supervised by an official prudential regulator in another country that is recognised by APRA; or
- an entity whose liabilities in respect of the Bankcard Scheme are guaranteed by an APRA supervised organization (or an organization supervised by a foreign prudential regulator recognised by APRA) under a guarantee that survive[s] the commercial failure of the entity."[167]

Bankcard considered allowing unsupervised entities seeking membership to lodge collateral as an alternative to having a guarantee, but concluded that it was "unworkable in key respects in relation to the objectives of safety and stability plus efficiency."[168]

Bankcard now has a single-tiered voting structure based on turnover. Applications for membership are decided by a two-thirds majority of directors and new members no longer need to submit a business plan. The entry fee has been reduced to a flat

165 Australia and New Zealand Banking Group, Commonwealth Bank, National Australia Bank, Westpac Banking Corporation.

166 Bankcard (2001a) and (2001b).

167 Australian Bankers' Association (2001b), p 63.

168 *ibid*.

fee of $66 000 (inclusive of GST), which is stated to be comparable with entry fees in the international credit card schemes.[169]

Assessment of membership restrictions

Summing up the common features of membership restrictions, the principal route to scheme membership in each of the designated credit card schemes is being a deposit-taking institution authorised and supervised by APRA (or under a similar regime overseas). Indeed, all members of the three schemes in Australia have joined through this route. Being an ADI, however, is only a condition for eligibility, not for membership as such. Although the detail varies, all three schemes require assessment and endorsement of any application for new membership by current members. At the same time, all three schemes provide some degree of flexibility. MasterCard allows institutions which "engage in financial transactions" to be members provided they are supervised; it also allows non-traditional members if this is necessary to conform with local laws, or for any reason. Visa allows non-ADIs to be members if local members unanimously agree. As discussed below, the international schemes have taken advantage of this flexibility to admit non-traditional members in other countries, but not Australia. Bankcard's new rules allow a non-ADI with a guarantee from an ADI to become a member.

Membership restrictions are defended by the credit card schemes and their members on the basis that they provide assurance about the financial substance of participants in the schemes. On the issuing side, submissions have emphasised that the "honour all cards" rule – under which the merchant is guaranteed payment even if the issuer fails to settle its obligations – places a burden on all members to ensure the creditworthiness of all other issuers.[170] On the acquiring side, the ABA has argued that acquiring involves more than the provision of network and processing facilities and is "at core" a banking function, focused on managing the risks of merchant default or fraud.[171] Several respondents have noted that ANZ Bank, as the acquirer for Compass Airlines, was required under the schemes' rules to make good losses incurred by cardholders when Compass could not honour tickets which had been paid for using credit cards.[172] MasterCard added that schemes as well as their members can face losses because of chargebacks and merchant failure, and that in the United States it has been required to set aside funds as a buffer against such losses.

169 Australian Bankers' Association (2001b), p 40.

170 See MasterCard International (2001), Allen Consulting Group (2001), p 3, p 11 and p 18.

171 Australian Bankers' Association (2001b), p 59.

172 More recently, banks which have acquired transactions for Ansett tickets have had to bear losses when tickets were not honoured.

At the same time, submissions have claimed that it is not in the interest of the card schemes to restrict membership, since growing membership will attract larger card bases and a wider range of merchants which, in turn, benefits existing members and their customers.[173]

The Joint Study acknowledged that "… the requirement of authorisation [as deposit takers] and ongoing prudential supervision has been a long-established and effective screening device."[174] From the public interest viewpoint, however, the issue is whether current membership restrictions limit competition more than is necessary to ensure the safety and stability of the credit card schemes.

The current membership restrictions have two separate elements – a restriction on the basis of institutional status (broadly speaking, members must be deposit-taking institutions) and a restriction on the basis of regulatory status (members must be authorised and prudentially supervised). In the Reserve Bank's view, any requirement that a credit card issuer or acquirer must be a deposit-taking institution is, on its own, very difficult to defend. Deposit-taking institutions undertake a wide range of financial activities, of which the provision of payment services may be only a small part, and have a commensurate range of skills and infrastructure. Their capital requirements are determined by the often complex risks that arise. They also pursue comprehensive risk management policies designed to ensure, fundamentally, that depositors can be confident of withdrawing their funds in full on demand. Credit card issuing and acquiring are more specialised activities and generate risks, as discussed above, that are much narrower and easier to monitor and control than those across the spectrum of activities of a deposit-taking institution. The risks of merchant default for an acquirer, for example, argue for a diversified merchant base and adequate capital for acquirers that sign up large merchants providing delayed delivery of goods and services; it does not argue that acquirers should be deposit-taking institutions.

Most submissions have focused not on the issue of institutional status but on the requirement that, in general, members must be prudentially supervised. The arguments are not that the full range of prudential standards for an ADI are required to address the specific risks in credit card activities; rather, the arguments are about convenience, cost and discretion. They take the form that:

- authorisation and ongoing prudential supervision by APRA is an efficient and non-discriminatory screening device; and

173 See Frontier Economics (2001), p 43 and Australia and New Zealand Banking Group (2001b), p 7.

174 Reserve Bank of Australia and Australian Competition and Consumer Commission (2000), p 56.

- in any event, the restrictions are not "economic" restrictions that lessen competition because non-ADIs can effectively participate in issuing and acquiring through co-branding and outsourcing.[175]

Prudential supervision is efficient and non discriminatory

The main thrust of this argument is that reliance on APRA's prudential assessment of ADIs avoids the need for card schemes to undertake their own assessments, duplicating APRA's efforts.[176] MasterCard has emphasised that the consistency of prudential standards for ADIs around the world, where its scheme has more than 20 000 members, reinforces these efficiencies.[177] If the schemes were to undertake the same detailed assessments, their costs would rise. Reliance on APRA's prudential assessment is also argued to be objective and reduces the risk that the schemes will in some way apply variable standards or that a scheme's existing members may use their position inappropriately.[178]

The Reserve Bank acknowledges that there is some merit in using APRA's prudential oversight as a screening device. In practice, however, it has not eliminated the involvement of scheme members in assessing membership applications. Being an ADI does not entitle an institution to scheme membership; it is only the first hurdle and prospective members must pass further tests where the discretion and judgments of existing members come into play. Visa, for instance, subjects all prospective members to its Global Member Risk Policy and, in some cases, requires members to lodge collateral with it.[179] At the same time, members of Visa and MasterCard have also been prepared to admit non-ADIs in a number of Asian countries. In Japan, Korea, Hong Kong, Indonesia and Malaysia, a special licence scheme allows entities which are not all prudentially regulated, such as consumer credit companies and retailers, to issue cards; in the case of Visa, members in those countries have accepted that this is the best way to penetrate new merchant sectors and the Asia-Pacific Board has agreed. Inevitably, then, the schemes and their members are involved in making credit assessments of prospective members.

175 Visa International (2001a), MasterCard International (2001), Australia and New Zealand Banking Group (2001b) and Allen Consulting Group (2001).

176 Australian Bankers' Association (2001b), p 8, Visa International (2001a), pp 44-45, MasterCard International (2001), pp 28-29 and Allen Consulting Group (2001), p 12.

177 MasterCard International (2001), p 28.

178 Visa International (2001a), p 44.

179 This contrasts with Bankcard's conclusion that it would be unworkable for its scheme to accept collateral as a way of guaranteeing members' obligations.

This involvement of scheme members highlights an underlying tension in credit card scheme arrangements that can reinforce any anti-competitive impact. While it may well be in the interests of a scheme to admit new members and expand the network, it may not be in the interests of some existing members whose own issuing or acquiring business may be threatened. Before its recent rule changes, Bankcard's restrictive approach to membership was a clear illustration of this tension.

Bankcard has now, however, accepted that ADI status need not be the minimum entry requirement for credit card schemes in Australia. Non-supervised institutions may become members of Bankcard, provided they have a guarantee of their credit card obligations from an ADI. These new arrangements, though yet to be tested, may go some way to liberalising access to membership of Bankcard, because there is a reasonably long list of ADIs which are not in this scheme and may be prepared to offer such guarantees. Nonetheless, the guarantee would add an explicit cost to the credit card operations of a non-ADI which would reduce its competitive impact. Moreover, the use of guarantees is unlikely to be a practical solution for liberalising access to the international card schemes in Australia. Non-ADIs may find it very difficult to secure a credible guarantor that was not already a member of MasterCard and Visa.

In any event, several submissions have questioned whether the Australian members of the international card schemes could achieve any changes to the membership restrictions of these schemes.[180] They note that Australian members constitute only a very small proportion of the Visa and MasterCard membership of more than 20 000 institutions, and argue that the international schemes would be reluctant to countenance changes that might be workable in Australia but would set "undesirable precedents" if they were to be applied elsewhere. On the other hand, the schemes' rules do contain flexibility which would allow Australian members, if they so wished, to admit or recommend the admission of non-ADIs to scheme membership in Australia.

"Economic participation" not "membership" is what matters

This argument has been put in a number of submissions.[181] On the issuing side, the argument is that co-branding provides organisations that are not scheme

180 See Australian Bankers' Association (2001b), Australia and New Zealand Banking Group (2001b), Allen Consulting Group (2001).

181 See Australian Bankers' Association (2001a) and (2001b), Allen Consulting Group (2001), Australia and New Zealand Banking Group (2001b) and MasterCard International (2001).

members with a form of "economic participation" in credit card issuing equivalent to that provided by actual membership. The ABA, for example, argues that:

> "In Australia, not only large corporates such as Telstra and Qantas, but also organisations of considerably smaller scale (such as sporting organisations) have been able to conclude apparently satisfactory agreements effectively (in economic terms), giving them participation in issuance – if not actual membership."[182]

On the acquiring side, it is argued that third-party processors, network operators or transactions switches can undertake operational roles which are outsourced to them by acquirers who are scheme members. The acquirers retain the financial obligations while reducing costs and providing business opportunities to their outsourcing partners.

The Reserve Bank accepts that co-branding may provide non-members with a degree of economic participation, but this is not equivalent to membership. Co-branders do not have the same rights to participate in scheme governance and strategy as members. They have no role in setting scheme rules or interchange fees. Importantly, they do not have the same relationship with cardholders as scheme members that issue cards and extend credit; in particular, they do not have access to data on customers' spending patterns. They have to share revenues with members, even if they provide the bulk of the distribution network. In short, scheme members can extract an "economic rent" from co-branders because they have access to a scarce commodity not available to the co-brander – viz, scheme membership.

The same arguments apply to the outsourcing of acquiring functions. The scheme members remain the formal acquirers and earn the merchant service fee, part of which is passed to outsourcing partners. These partners, however, have no input into scheme governance, rule-setting or strategy, even if they perform most of the work and have substantial investment in infrastructure. Again, this may result in an "economic rent" to the scheme member.

In the Reserve Bank's opinion, the submissions have not advanced a convincing reason why a number of the organisations cited as examples of successful co-branding – organisations with a good credit rating, an extensive distribution network and a long history in credit assessment, billing and debtor management – lack the financial substance to be credit card issuers in their own right. Similarly, the submissions have not explained why institutions that understand the acquiring business and have the substance to deal with the associated risks need to be ADIs.

182 Australian Bankers' Association (2001b), p 58.

To sum up, the Reserve Bank is not persuaded by the arguments that credit card issuers and acquirers must be deposit-taking institutions, authorised and supervised by APRA, to be able to manage the risks involved in credit card activities. It acknowledges that reliance on APRA's prudential assessments does lend some objectivity to membership procedures and defrays scheme costs but, under the schemes' rules, it provides no guarantee of membership. However, in the Reserve Bank's opinion, the requirement that members must be deposit-taking institutions makes the barriers to entry more restrictive than the minimum necessary for the type and scale of risks involved. As discussed below, alternative membership regulations can be devised that provide, in the public interest, a more appropriate balance between the promotion of competition and efficiency, on the one hand, and the control of card scheme risks on the other.

4.5 Restrictions on self-acquisition

Restrictions on eligibility for membership are the main means by which the designated credit card schemes seek to contain risks. As part of their risk control framework, the international schemes also have policies (rather than formal rules) that prohibit members of the schemes from acquiring their own transactions.

Policies against self-acquisition are largely redundant when card scheme membership, and the provision of acquiring services to merchants, are restricted to ADIs. However, these policies could take on importance if non-traditional participants were admitted to credit card schemes. An example would be a telephone company that issued a scheme's credit cards in its own right and had an acquiring capacity. A policy against self-acquisition would prohibit that company from acquiring the credit card transactions made by customers to settle their telephone accounts; those transactions would have to be acquired by another scheme member (presumably an ADI).

MasterCard

MasterCard has stated that its policy against self-acquisition is quite flexible:

> "If there were to be some minor amount of self-acquisition by an acquirer, this would not of itself cause MasterCard undue concern. For example, if some incidental goods or services offered by a member were paid for by credit card. There is more concern if an acquirer were proposing to self-acquire a substantial volume of transactions.
>
> The policy has not been the subject of application in Australia to date as there has not been any occasion when a member has sought to acquire a significant volume of its own transactions. The policy has

> been applied in the U.S. where there are instances of merchants owning financial institutions which are members of MasterCard."[183]

Visa

The ABA says that:

> "Within the Visa system there are understood to be a number of rules which impact upon the issue of self acquisition, including some of the membership rules, but are not rules *per se* against self acquisition. It is understood that the impact of such rules can only be assessed in the context of specified factual situations and that with respect to Visa the issue of a self acquisition policy has not arisen for concrete consideration in the Australian context."[184]

Visa argues that the question simply does not arise under its rules:

> "A merchant as a merchant cannot acquire its own transactions. It would be feasible, however, for an acquirer to sign up only one merchant – that is, the merchant that is part of the same group of companies as the acquirer … however, Visa does not allow a member to be an acquirer only …
>
> Having satisfied those requirements, Visa has not to date encountered [in the Asia Pacific region] a situation where self-acquisition … has raised any particular policy issues."[185]

Assessment

The justification for policies against self-acquisition focus on the principal-agent relationship said to exist in the usual arms-length contract between an acquirer and a merchant. As principal, an acquirer has the dual role of ensuring that merchants conform with the scheme rules (though many merchants have complained to the Reserve Bank that, because of confidentiality clauses, they are prevented from actually seeing these rules), and standing in the settlement chain between the merchant and the issuer. This dual role could, it is claimed, generate two main risks if self-acquisition were permitted.

First, there would be no independent third party to enforce the scheme's rules on the merchant or to provide an independent check on merchant fraud, because the self-acquirer would be playing both roles. Secondly, because there would be no

183 MasterCard International (2001), p 49.

184 Australian Bankers' Association (2001b), p 64.

185 Visa International (2001d), p 2.

independent party standing between the merchant and issuers in the settlement chain, issuers would be at greater risk. As noted earlier, if a particular good or service is paid for using a credit card but is not delivered, the issuer would credit the cardholder's account and seek reimbursement from the acquirer under the scheme's chargeback arrangements; the acquirer, in turn, debits the merchant, which has ultimate responsibility for repayment. If the merchant cannot pay, the acquirer must do so. Both the merchant and the acquirer would have to fail before the scheme's loss-sharing arrangements needed to be invoked. However, in the above example of a telephone company joining a credit card scheme as issuer and acquirer, the merchant and the acquirer would be the same entity and the independent guarantee to the issuer would disappear.

Several submissions have emphasised these types of risks in explaining why, in the United States, a scheme refused to allow a retailer to use a bank which it owned, and which was a member of the scheme, to acquire the retailer's transactions. Another case quoted was that of an airline whose acquirer required it to lodge a bond to cover credit risks. The card scheme refused to let the airline avoid this requirement by buying a bank that would acquire its transactions.[186]

Others, however, have questioned the strength of the argument that acquirers ensure merchants conform with scheme rules – exactly which rules are of concern has not been spelled out. Merchants have commented that there is no policy prohibiting self-acquisition in the debit card system in Australia where one merchant already acquires its own transactions – though in limited circumstances – under the rules of the Australian Payments Clearing Association. In any case, an acquirer is contractually bound to conform to all rules in the respective card schemes, whether it has membership as an ADI or, potentially, as a non-traditional participant.

Bankcard has rejected the arguments against self-acquisition and decided that it will not prohibit this activity. It has done so on the basis that any institution that passes its new membership requirements will, in the normal course, be able to meet its obligations as acquirer. Bankcard's expectation is that APRA, as prudential supervisor, will ensure that a member is able to deal appropriately with any particular risks that might arise. Where a member is not itself supervised, a guarantee from an APRA-supervised institution is expected to ensure that other Bankcard members will not be exposed to risks from that member's acquiring activities (including self-acquisition), should it fail.

In the Reserve Bank's opinion, policies against self-acquisition are potentially anti-competitive. If a large merchant were to become eligible for card scheme membership, but was required to pass credit card transactions at its stores to another

186 Frontier Economics (2001), MasterCard International (2001).

acquirer, its competitive impact on the acquiring market would be constrained. For this reason, the Reserve Bank believes that any outright prohibition by the international card schemes on self-acquisition would not be in the public interest. Rather, scheme policies should provide some flexibility in balancing safety and competition concerns. The Reserve Bank acknowledges that acquirers can face significant credit risks if their merchant base is concentrated on merchants – such as airlines, theatres or Internet retailers – where payment is made before delivery (eg airline tickets) or credit card signatures cannot be verified (eg phone transactions). However, there is a wide range of credit card transactions that do not have these characteristics. Credit risks would be much lower in the case of service stations or supermarkets, for example – two areas where merchants could be well placed to undertake an acquiring role.

4.6 Restrictions on competition in acquiring

The designated credit card schemes have separate sets of regulations which restrict the range and scale of activities that card scheme members may undertake. These involve:

- a requirement in the international card schemes that acquirers must also be issuers and hence, broadly speaking, must be ADIs; and
- financial penalties or loadings in all three schemes on members that tend to specialise in acquiring, rather than issuing.

MasterCard

MasterCard's Bylaws require that once members are admitted to MasterCard, they must issue and continue to issue a "reasonable" number of cards. Issuers that fail to do so must pay an "Acceptance Development Fee" to MasterCard calculated on the basis of each member's ratio of acquiring volume to the total volume.

Visa

Visa's "Balanced Portfolio Rule" states that:

> "… the dollar value of acquired transactions by a member must be no more than twice the dollar value of transactions for which the same member is the issuer. Violations of this rule attract a financial penalty of 0.03% of the volume of those transactions which exceed the balanced portfolio restriction".[187]

This fee is paid by the acquirer to Visa.

187 Visa International (2001a), p 45.

Bankcard

Under its new rules, Bankcard allows members to specialise as issuers or acquirers. It does, however, impose an "Incentive Fee" on members whose total volume of transactions acquired is more than double the volume of transactions on cards it has issued. This fee, paid to Bankcard, is 0.03 per cent of the value of transactions acquired from the second year of Bankcard membership.

Assessment

Although the details vary between the schemes, the effect of "net issuer" or "balanced portfolio" rules is that members whose acquiring business is large relative to their issuing business in a particular scheme must pay a loading to that scheme. This raises their cost of providing acquiring services compared with other scheme members and constrains their ability to compete. In the Reserve Bank's opinion, these rules are anti-competitive.

The card schemes have not sought to defend "net issuer" rules as being necessary to protect the safety and integrity of the schemes. The rules and the loadings do not address any of the specific risks facing card issuers and acquirers. The justification, instead, is that such restrictions are necessary to foster the "balanced development" of the credit card schemes. A number of arguments have been put forward.

First, some submissions have argued that "net issuer" rules are needed because specialist acquirers will attempt to "free ride" on the efforts of issuers; a scheme's business interests will be better promoted if all members are "typically *substantial issuers and acquirers*."[188] (The argument is not symmetrical – there is no corresponding claim that incentives are needed to encourage acquiring). Issuing is said to generate relatively large externalities but also has relatively large costs; hence, it is argued, some rebalancing of issuers' and acquirers' costs is needed.[189] However, no evidence has been offered to support the claim that externalities associated with issuing are so much greater than for acquiring. In any event, the Reserve Bank has reached the view, for reasons set out in Chapter 2, that claims of extensive externalities in credit card networks are significantly overstated.

Allen Consulting Group has taken this argument further by claiming that present levels of interchange fees in Australia "do not provide to issuers rewards for issuing commensurate with the positive externalities to the respective schemes flowing

188 Australian Bankers' Association (2001b), p 66.

189 *ibid*, p 9, p 66.

from their efforts".[190] On this view, an additional penalty needs to be levied on acquirers that are not sufficiently large issuers; this penalty can be used by the card schemes for promotion and will encourage members paying it to issue more cards. There is, however, no evidence backing the assertion that card issuers have not been appropriately rewarded for their efforts, and the argument ignores the fact that card scheme members have always had the discretion to vary interchange fees to achieve appropriate incentives.

The argument that "net issuer" rules are necessary to ensure balanced development of credit card schemes was also put to the recent enquiry into competition in UK banking (the Cruickshank Report).[191] Cruickshank noted that the argument might have had some merit when the schemes were in their infancy and the primary need was to promote cardholding but concluded that it was not clear how restricting the supply of acquirers would serve to increase the number of cards in circulation.

A second argument is that specialist acquirers in Australia would have little interest in promoting a particular credit card scheme, since they will typically offer acquiring services for all three schemes as a package.[192] "Net issuer" rules are therefore required to ensure that such institutions contribute to the promotion of the respective schemes. This argument fails to acknowledge that acquirers have a clear interest in promoting any scheme for which they acquire, since without transactions they earn no revenue. It also fails to acknowledge the merchant perspective – competition amongst a larger number of acquirers, especially with low-cost bases, would put downward pressure on costs and merchant service fees. A more complex variation of the argument, put by Allen Consulting Group, is that members that acquire but do not issue in one scheme, but which issue in another, may benefit from undermining the scheme in which they are only an acquirer.[193] The Reserve Bank believes it is highly unlikely that a member of one scheme would deliberately set out to undermine another of which it was also a member, while trying to retain its merchant base.

Other submissions (though not from the international card schemes or their members) have claimed that manageability and good governance require that scheme members should issue as well as acquire; that is, governance will be more difficult if members have markedly different interests. However, no practical examples are given of governance issues that have been more efficiently resolved because of the existence of "net issuer" rules.

190 Allen Consulting Group (2001), p 15.

191 Cruickshank (2000), p 241-242.

192 Bankcard (2001b), p 5.

193 Allen Consulting Group (2001), p 3.

The conflict of interest argument was also considered, and rejected, in the Cruickshank Report. Cruickshank argued, to the contrary, that specialised acquirers would be committed to maintaining the card schemes of which they were members because their merchant customers are likely to continue to use those schemes and they will have invested in the necessary infrastructure. In Cruickshank's view, a conflict of interest is more likely to exist if the same institution is both an issuer and an acquirer.

A third justification for "net issuer" rules is that having members that are both substantial issuers and acquirers can improve bargaining over interchange fees and help ensure that the resulting fees are in the best interests of the schemes. Specialist acquirers, it is argued, would have particularly strong bargaining power because issuers have already invested heavily in the schemes; if so, interchange fees may be "too low".[194] A variation on this argument is that if all members are significant issuers and acquirers, getting the interchange fee "wrong" (at least from the members' viewpoint) will not matter too much. The Joint Study confirmed that the average cost per transaction is much higher for credit card issuing than for acquiring, but no evidence has been provided that card issuers also have higher sunk costs. Acquirers make substantial investments in terminals, networks and switching facilities, and these investments are commonly cited by card scheme members to justify Australia's debit card interchange fees, which flow from issuers to acquirers. The argument that members need to be both issuers and acquirers also sits uneasily with the notion that interchange fees are determined by competitive negotiations between parties with differing business interests.[195]

A final argument, which was put to the UK banking review but not to the Reserve Bank, is that it would not be "fair" to issuers that act as acquirers if non-issuers are also allowed to acquire transactions. Cruickshank dismissed this argument on the basis that card issuing "… is a profitable activity, not a social obligation"; the argument was another that might have had some merit when the schemes were in their infancy but not now they are well-established.[196]

Notwithstanding the justifications offered by the international card schemes, the ABA and others, confidential submissions by some scheme members have argued for the removal of "net issuer" rules, which they claim are "onerous". In their view, the rules discourage small issuers from actively competing in the acquiring market by markedly increasing their cost bases relative to large issuers. This leads to outcomes which, the submissions claim, cannot be considered efficient.

194 *ibid*, p 14.

195 Visa International (2001a), Executive Overview, p 2.

196 Cruickshank (2000), p 242.

In the Reserve Bank's opinion, the justifications for "net issuer" rules in credit card schemes do not outweigh their anti-competitive impact on the acquiring market. That market is extremely concentrated in Australia; barriers to the entry of non-financial institutions imposed by the card schemes are restrictive and every indicator suggests profitability is very strong. Whatever contribution "net issuer" rules might have made to their early development, the designated credit card schemes are well-established in Australia and the rules now mainly serve to increase acquiring costs for new scheme members and entrench the market power of incumbents. From the public interest viewpoint, the consequence is that merchant service fees are higher than they might otherwise be, the market is not contestable by specialist acquirers that might have new skills and efficiencies to offer and incentives for innovation and cost reduction are likely to be dampened; it is difficult to claim, therefore, that the acquiring market is efficient in an allocative or dynamic sense. The Reserve Bank has therefore concluded that "net issuer" rules are not in the public interest and should be abolished.

The Reserve Bank also understands that, in response to the conclusion of the Cruickshank Report that there is a lack of competition in the acquiring market in the United Kingdom, MasterCard/Europay (UK) has removed its "net issuer" rules in that country.[197]

4.7 Liberalising access to credit card schemes

In the Reserve Bank's opinion, the current restrictions on access to the designated credit card schemes in Australia, agreed to and applied by their Australian members, create barriers to entry that are more restrictive than needed for the safety of these systems, and hence unduly limit competition. The card schemes have not argued against admission of new members as such – their rules make specific provision for this – but that new members should, broadly speaking, be deposit-taking institutions authorised and supervised by APRA. These are broad-brush requirements, however, that do not directly address the particular risks generated to the schemes by credit card issuers and acquirers. The Reserve Bank has therefore concluded that a more liberal access regime, imposed under its payments system powers, is needed in the public interest to promote competition and efficiency in the provision of credit card services in Australia.

Under the *Payment Systems (Regulation) Act 1998*, the access regime imposed must be one that the Reserve Bank considers appropriate, having regard to the public interest, the interests of current participants, the interests of institutions who, in the future,

197 Lea (2001).

may want access to the system and any other matters the Reserve Bank considers relevant.

The Reserve Bank's proposed access regime seeks to promote competition and efficiency, without compromising the safety of the designated credit card schemes, by ensuring that membership restrictions:

- do not inhibit competition more than is necessary to protect the financial soundness of the schemes;
- are clearly targeted at the risks incurred by credit card issuers and acquirers; and
- do not discriminate between members whose business is focused on issuing or acquiring.

In so doing, the proposed access regime meets the intent of the Wallis reforms that non-traditional institutions participate in the payments system as a means of spurring competition.

Deposit-taking institutions authorised and supervised by APRA are eligible for membership of all three credit card schemes operating in Australia. The Reserve Bank has concluded that restrictions on the basis of institutional status – that members be deposit-taking institutions – are excessive; ADIs in Australia have traditionally undertaken a wide range of banking business of which participating in four party credit card schemes has usually been a small part. At the same time, the Reserve Bank acknowledges that reliance on APRA's prudential supervision of members has lent some objectivity to, and reduced the costs of, membership procedures in credit card schemes.

To preserve these benefits, and to assist in promoting competition in credit card schemes, the APRA Board has agreed in principle that APRA will authorise and supervise specialist credit card issuers and acquirers. To this end, a regulation will need to be enacted under the *Banking Act 1959* to deem credit card issuing and acquiring to be "banking business"; this matter is being progressed with the Treasury. Any specialist institutions wishing to undertake the "banking business" of issuing credit cards and/or acquiring credit card transactions in four party credit card schemes will need to obtain an authority from APRA and be subject to its on-going supervision. As an assurance to the credit card schemes and the community generally that such institutions have the necessary competence and financial standing, they will need to:

- be established as special purpose vehicles with a separate corporate identity;
- be separately capitalised. The adequacy of start-up capital will be assessed on a case-by-case basis having regard to the scale of operations proposed;

- demonstrate to APRA that they are of financial substance and able to meet their settlement obligations;
- have in place appropriate risk management policies, particularly controls for monitoring credit risk, IT risk and liquidity risk; and
- meet prudential standards, as determined by APRA, in relation to credit quality and liquidity management that are no less strict than would apply to an ADI's credit card business.

The proposed access regime is therefore consistent with the objectives of the credit card schemes that their members have sufficient financial substance to undertake credit card activities. It specifically targets the risks generated by credit card issuing and acquiring and so does not compromise safety and stability. Since all scheme members will continue to be authorised and prudentially supervised by APRA, there are no particular implications for the international card schemes. The access regime does not prevent continued co-branding or outsourcing arrangements but it does allow institutions participating in those arrangements to participate directly, if they are prepared and able to meet APRA's requirements. It also obviates the need for non-traditional participants to seek guarantees from ADIs which might otherwise be competitors in credit card acquiring and issuing.

The proposed access regime precludes any outright prohibition in the designated credit card schemes on participants acquiring their own transactions. The Reserve Bank believes the sensible way for credit card schemes to proceed on this issue is on a case-by-case basis. As a minimum, however, the schemes' regulations and policies must have sufficient flexibility to accommodate proposals by participants wishing to self-acquire that address the particular risks involved.

Finally, the proposed access regime precludes any "net issuer" rules, and associated financial penalties or loadings, in the designated credit card schemes. The Reserve Bank has concluded that these rules do not contribute to the control of risks in credit card acquiring but act to protect the dominant position of the four major banks in the acquiring market. These restrictions on competition are not in the public interest.

The proposed access regime is set out below.

Draft Access Regime for Designated Credit Card Schemes

Objective

The objective of this Access Regime is to ensure that, having regard to:

(i) *the interests of current participants;*

(ii) *the interests of people who, in the future, may want access to the systems; and*

(iii) *the public interest,*

any restrictions imposed on participation in the three designated credit card systems do not inhibit competition any more than is necessary to protect the financial safety of those systems.

Application

1. This Access Regime is imposed under Section 12 of the *Payment Systems (Regulation) Act 1998*.

2. This Access Regime applies to the three credit card systems designated on 12 April 2001 by the Reserve Bank of Australia under Section 11 of the *Payment Systems (Regulation) Act 1998*, being:

   (i) the credit card system operated within Australia known as the Bankcard Scheme;

   (ii) the credit card system operated within Australia known as the MasterCard System or MasterCard Network Card System; and

   (iii) the credit card system operated within Australia known as the Visa System or the Visa Network Card System,

   each referred to as follows as a Scheme.

3. In this Access Regime:

   an "acquirer" provides services to merchants to allow the merchant to accept a Scheme's credit cards;

   an acquirer is a "self acquirer" if it or a related body is the merchant in a transaction;

   "credit card transaction" or "transaction" means a transaction between a credit card holder and a merchant involving the purchase of goods or services on credit by that credit cardholder using a credit card;

   an "issuer" issues a Scheme's credit cards to its customers;

"rules of a Scheme" or "rules" include the constitution of a Scheme, rules, by-laws, procedures or any arrangement in relation to a Scheme by which participants in the Scheme in Australia may consider themselves bound;

a "Scheme's credit card" is a credit card issued in accordance with the rules of that Scheme;

a "Scheme Administrator" is the administrator of the Scheme, if any;

use of a credit card includes use of a credit card number.

4. This Access Regime is to be interpreted:
   - in accordance with its objective; and
   - by looking beyond form to substance.
5. This Access Regime comes into force on [ ].

Eligibility for participation

6. Any person supervised by the Australian Prudential Regulation Authority (APRA) as an authorised deposit-taking institution or as a specialist credit card service provider must be eligible to participate in a Scheme in Australia.
7. The rules of a Scheme must not discriminate between authorised deposit-taking institutions and specialist credit card service providers supervised by APRA in relation to the rights, obligations and entitlements of such participants in the Scheme.

Terms of participation

8. The rules of a Scheme must not prevent a participant from being:
   (i) an issuer; or
   (ii) an acquirer; or
   (iii) both an issuer and an acquirer.
9. The rules of a Scheme must not impose on a participant in a Scheme any fees, charges, loadings or any form of penalty as a consequence of, or which are related in any way to, a difference in the value or number of transactions in which that participant is the acquirer in comparison to the value or number of transactions that involve the use of credit cards issued by that participant.

10. The rules of a Scheme must not prohibit a participant from being a self acquirer if the participant can establish to the reasonable satisfaction of the Scheme Administrator or, if none, to a majority of the participants in the Scheme that it has the capacity to meet the obligations of an acquirer as a self acquirer. The rules of a Scheme may allow the decision on the capacity of a self acquirer to meet its obligations to be reviewed by the Scheme Administrator or, if none, by the participants in the Scheme upon the giving of reasonable notice to that self acquirer.

Transparency

11. The Scheme Administrator or, if none, participants in the Scheme must publish the rules of a Scheme which govern the eligibility for participation, and the terms of participation, in the Scheme in Australia on the Scheme Administrator's website or, if none, on another relevant website.

12. The Scheme Administrator or, if none, each of the participants in the Scheme must give a person that has applied to participate in the Scheme, and who is eligible to participate under paragraph 6 of this Access Regime, reasons in writing if the application is rejected.

Notification of Reserve Bank of Australia

13. The Scheme Administrator or, if none, each of the participants in the Scheme must give the Reserve Bank of Australia prior notice in writing of any proposed changes to its rules governing the eligibility for participation, and the terms of participation, in Australia.

Reserve Bank of Australia
SYDNEY