

Our ref. GM: 01/129

6 April 2001

Confidential communication

Mr I. J. Macfarlane
Governor
Reserve Bank of Australia
65 Martin Place
SYDNEY NSW 2000
Fax (02) 9551 8030

Dear Mr Macfarlane

The Australian Credit Card System

I refer to your letter to me in my capacity as Chairman of Bankcard Association of Australia ("**Bankcard**") dated 21 March 2001 and to the meeting between representatives of Bankcard and the Reserve Bank on 27 March 2001.

The Board of Management of Bankcard held a special meeting this week to discuss your letter and the issues raised at the above meeting.

Bankcard is very concerned by the haste with which the Reserve Bank is indicating it might act in deciding to designate a credit card payment system. Your letter, for example, stated that the Reserve Bank was only proposing to hold a two-week period of consultation with interested parties beginning 26 March 2001 before taking "the decision to designate the Australian credit card system".

The purpose of the meeting on 27 March 2001 was for the representatives of the Reserve Bank to elaborate upon the issues which the Bank saw as relevant. Bankcard believes that meeting could not be regarded as adequate consultation with Bankcard in respect of any decision to designate a payment system which affects Bankcard.

Designation is clearly a significant decision for the Reserve Bank which will break new ground in the Australian financial system. It is important that the Reserve Bank gets it right - not only in the sense that the decision is made validly in accordance with the requirements of the legislation that gives the Reserve Bank its powers of designation and with the intended reserve nature of these powers, but also in terms of the proper scope and definition of the system that is designated.

Under the relevant Act, and as part of its responsibilities as an administrative body, the Reserve Bank has a number of responsibilities, including:

- (a) identification of the relevant system the subject of any proposed designation;
- (b) identification of the relevant criteria for designation;
- (c) providing interested parties with an adequate opportunity to be heard (both as to the time to be heard and the subject matter on which to be heard); and
- (d) consideration of relevant submissions and evidence.

In particular, Bankcard wishes to have the opportunity to make a submission as to the appropriate scope and definition of the system to be designated. The most efficient way to do this may be for the Reserve Bank to set out a draft description of the payment system it is considering designating, and Bankcard (and other interested parties) would then be able to make submissions in respect of that system.

At present, it is unclear what payment system is under consideration by the Reserve Bank. For example, your letter refers to a decision “to designate the Australian credit card system”, yet at our meeting, the Reserve Bank representatives indicated that it was only “open” or four party credit card schemes which might be designated. This is obviously an important matter both technically (for example, would the Bankcard scheme be regarded as a credit card payment system as the scheme itself does not provide for credit?) and in terms of competitive impacts as between four party credit card schemes and “closed” or three party credit card schemes and other payment instruments.

Another preliminary issue in making a decision to designate a payment system is whether the Reserve Bank has exhausted alternative regulatory approaches and voluntary arrangements (see paragraph 5.13 of the Explanatory Memorandum in respect of the relevant Act).

Your letter raised three specific issues:

“the rationale for and size of interchange fees paid by acquirers to card issuers, restrictions on access to individual card schemes and the effect of the ‘no surcharge’ rule imposed by the international card schemes.”

Whatever criticisms may be levelled at Bankcard, it would be a mistake to ignore what Bankcard has done and is committed to do to address these issues and to achieve the desired goals of increased efficiency and competitiveness.

Review of interchange fees

Bankcard is committed to adopting an efficient and transparent cost-based methodology for its interchange fees.

Bankcard has already taken a number of steps to address the concerns expressed by the ACCC in its investigation into interchange fees. In accordance with arrangements made with the ACCC, Bankcard commissioned an expert economic report by PHB Hagler Bailly (now PA Consulting) from Washington, DC, to advise on a cost-based methodology for the calculation of interchange fees. Additional work is being commissioned through another consultant, Edgar Dunn, for the purpose of developing and refining the new methodology for interchange fees.

Bankcard has also, as an interim measure, mandated to its members that they must modify their computer systems and introduce the lower electronic interchange fee which Bankcard had previously decided to adopt, but the adoption of which had been delayed by an inability of some members' computer systems to handle two different rates for Bankcard transactions.

Access restrictions

As Bankcard has already advised the Reserve Bank in its letter of 6 March 2001, Bankcard has also reviewed its entry requirements and its membership fees. Bankcard commissioned two expert reports on new membership criteria and fees (from The Allen Consulting Group) and has considered those reports and has passed resolutions which will make entry to Bankcard more widely available, at a much lower cost and on a much more objective and transparent basis than in the past.

Bankcard is in the process of drafting the changes to its Constitution and related documents in order to implement those resolutions. Once they are implemented over the coming weeks, Bankcard plans to write to institutions which would qualify for membership under the new rules to inform them of the new entry rules and fees.

Bankcard believes, therefore, that it has addressed the concerns in respect of access raised by the Reserve Bank and the ACCC in their joint report. If the Reserve Bank disagrees with this view, Bankcard would welcome a reply to Bankcard's letter of 6 March 2001 or some form of specific feedback to Bankcard in respect of Bankcard's resolutions.

No surcharge

The third issue raised in your letter was the "no surcharge" rule. As your letter implies, Bankcard does not have such a rule and so this is not an issue in the case of Bankcard.

Conclusions

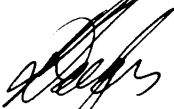
Bankcard submits, therefore, that the Reserve Bank does not need to invoke its powers of designation in respect of the Bankcard scheme to achieve its goals of increased efficiency and competitiveness, and has not exhausted the other means available to it.

Bankcard is committed to making the above changes and is happy to work with the Reserve Bank in doing so, without the need for the Reserve Bank to make a designation in respect of the Bankcard scheme.

Please confirm urgently that the Reserve Bank agrees that it will not make a decision to designate a credit card payment system that affects Bankcard until it has provided Bankcard with an adequate opportunity to be heard in respect of the above issues, including whether or not the Reserve Bank has exhausted consideration of alternative regulatory approaches and voluntary arrangements.

I look forward to your urgent response.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ken Douglas', written over the typed name below.

Ken Douglas
Chairman