RBA CREDIT CARD QUESTIONS

Interchange Fees

1. Is an interchange fee necessary to the functioning of an open credit card scheme? If so, why? If not, what are the alternatives?

Yes, interchange fees are vital to the functioning of an open credit card system. Interchange fees are designed to reimburse the issuer for costs associated with card issuing, particularly costs relating to benefits to merchants. Merchants benefit from the expansion of card networks. One of the significant revenue drivers to be included in the business case for card issuing is an interchange fee.

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2. In the open credit card systems operating in Australia, are there competitive forces that generate an equilibrium interchange fee? If so, what are they?

If interchange fees are too high, merchant service fees will be too high and merchants will not accept cards. Acquirers therefore have an interest in containing interchange fees.

3. How do you think interchange fees for the card schemes operating in Australia should be determined in practice? Please spell out the advantages and disadvantages of your proposal?

We do not object to a more transparent process for setting interchange fees. Interchange fees should reflect costs and network benefits. We are concerned about disproportionate impacts and unintended consequences if reforms are made to one aspect of the card payments system, such as Visa cards, in isolation from other parts, such as EFTPOS.

4. How frequently should interchange fees be revised? Please detail the arguments for and against your proposal?

As mentioned in question 1, there is a significant lead-time before investments in the credit cards business show a profit and recover previous losses. Therefore in order to invest in a business, it is important that volatility of earnings is anticipated and can be managed over a reasonable period of time. Our suggestion is that interchange rates be reviewed every 5 years.

Access

5. What specific risks do acquirers bring to a scheme, independent of their status as issuers?

Acquirers act as a buffer between the card issuer and merchant. That is, the card issuer has a relationship with the cardholder and in certain circumstances (chargeback) rejects transactions back to the acquirer, which deals with the merchant. Under Scheme regulations, it is the acquirer that bears the primary liability to the card issuer. Therefore failure of an acquirer would impose added risk to the issuer in not being able to meet the requirements of cardholders to chargeback transactions. This could ultimately lead to a restriction or elimination on the circumstances in which cardholders can chargeback transactions.

6. What specific risks do self acquirers bring to a scheme? Please note where those risks are different from the risks for third party acquirers.

The area where self-acquirers bring added risk relates to circumstances where there are disputes between merchants and acquirers about the validity of a chargeback. In these instances, the cardholder and issuer are insulated from this dispute and the matter is resolved between the acquirer and merchant. Where both of these are the same, it makes a chargeback relationship more complicated and would impose added costs on the issuer in circumstances where there is a dispute between the issuer and self-acquirer.

In times of financial difficulty, liquidation or administration of a merchant, the acquirer assumes the financial liability to meet chargebacks from issuers. Where there is a self-acquirer, it would likely lead to the issuer bearing liability for chargebacks from a cardholder. This could ultimately lead to a restriction or elimination on the circumstances in which cardholders can chargeback transactions.

7. In the presence of an interchange fee and membership fees, what is the justification for net issuer penalties? How large are such penalties?

This question is best answered by the card schemes.

No Surcharge Rule

8. Do you agree that the no surchange rule is integral to the success of the open credit card schemes? If so, why and if not, why not?

We have previously supported removal of the ‘no surcharge’ rule. We advised Minister Hockey last December that CUSCAL supports the RBA/ACCC study’s view that merchants “should not be prevented by the credit card schemes from passing on some or all of the merchant service fee through surcharges.”

We note that until recently credit laws prevented differential pricing.
Of course, merchants may choose for their own commercial reasons not to impose such a transaction fee on their customers.

As the study recognises, the arguments against ‘no surcharge’ rules also apply in relation to charge card schemes.

9. If the no surcharge rule were removed from the scheme regulations, do you think it would be removed from merchant agreements?

Yes it should.

<u>Competition</u>

10. Which payment instruments do open card schemes compete with? How do they compete in each case?

Credit Cards compete with the following payment instruments:

- Cash;
- Cheques;
- Direct Entry;
- BPay;
- Closed loop schemes (Amex, Diners, store cards); and
- Debit Cards.

11. Open credit card schemes appear to have much larger card bases and wider acceptance than three party schemes. Why is this so?

Open card schemes are more popular than three party schemes because:

- Greater consumer demand for extended payment facilities - up until recently three party schemes did not allow extended repayment terms;
- Greater value for money as three party schemes had higher interest rates and fees than credit cards;
- Greater merchant acceptance, due to lower merchant service fees, thereby allowing certainty of usage for cardholders;
- Investments by issuers in market positioning and brand awareness; and
- Leveraging of existing relationships by credit unions, banks and other card issuers has led to a greater penetration into the customer bases - three party schemes have not had this natural catchment and have largely relied on advertising and generic mailing lists.

However over recent times, three party schemes have significantly grown their card bases on the back of new products (introduction of Amex Credit Card), alliances with co-branded groups and greater merchant acceptance. Increasingly, we see three party schemes as a significant competitive threat.

12. How are the schemes promoted:

  a. At the scheme level?
  b. At the individual bank level?

Schemes are promoted via a variety of mechanisms including, branch sales, telemarketing, press, radio and television advertising, Internet, direct mail and sponsorships.

13. Why are credit card interest rates around 3 percentage points higher than rates on other unsecured personal lending?

Credit Cards have traditionally been a high maintenance product for the following reasons:

- High acquisition costs (exacerbated in times of customer churn);

- Operational costs associated with supporting and processing multiple transactions per account;
- High levels of customer service including lost/stolen reporting (24 hours x 7 days), account maintenance, dispute processing and investigation, replacement plastics both at reissue (every 2 years) and in cases of card failure and changes of detail to customer records;
- Consumer Credit Code requirements for statement processing frequency; and
- The nature of the product which presents itself as ideal to deal with small value transactions (average $100) which manifests itself in a low average balance per account. This relatively small balance (as opposed to personal loans for example), the resultant small repayments and the inability of the consumer to connect a credit card debt to a tangible asset (such as a car with a Personal Loan), means that the consumer does not perceive a significant risk where a payment has not been made. Accordingly, a relatively high level of accounts are in arrears and ultimately, written off. It is easy for a cardholder to default and the small balances do not make it financially viable to expend vast sums on protracted recovery actions. This leads to relatively high levels of write off.

14. Which of your cards offer loyalty points? What is the role of loyalty points? What evidence is there that they achieve the issuers' objectives?

The MyCard MasterCard offers loyalty points. The program is designed to achieve two objectives:

- Attract new cardholders that have accounts at other institutions where loyalty schemes are available. It is our judgement that consumers, once used to a card with a loyalty scheme, quickly adapt their expectations to the level of benefits they achieve from the scheme. Therefore if a new card offering was made available to them, a significant factor in the buying decision is the level and perceived benefits of the loyalty scheme. Most consumers now see a loyalty scheme as a base requirement in an attractive credit card product.
- Reward cardholders for their usage of the card and establish a pool of points that are aimed at retaining the cardholders usage of your card until they reach their next point redemption target.

Given that the program has only existed for 2 years, we are not in a position to categorically establish that our objectives are being met. However, anecdotal evidence from credit unions indicates that the rewards scheme is a major factor in member decision-making on a credit card.

15. Does the ability of issuing banks to offer a number of different brands of cards result in more competition between schemes that would be the case if they could only issue one brand? Please detail your analysis.

Yes.

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