Submission to the RBA

on Credit & Debit Card Schemes

The Shell Company of Australia Ltd

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NON - CONFIDENTIAL VERSION

Prepared with the assistance of

TransAction Resources Pty Ltd

Contents

1. Executive Summary

Card payment plays a large and increasingly important role at Shell retail sites. We are involved in the acceptance and processing of bank and third party cards as well as issuing and acquiring our own cards. We have made a significant investment over many years in implementing card processing systems throughout our retail network to provide our customers with secure and convenient payment options.

Some *[Confidential Information Deleted]* of Shell retail sales in Australia are paid for by card. *[Confidential Information Deleted]* Shell and its franchisees pay merchant service fees (MSFs) on credit cards of *[Confidential Information Deleted]*. This is a substantial sum and in fact, for a credit card purchase, accounts for 40% of the gross margin at the service station on a cents per litre basis.

Shell believes that interchange should be abolished. In particular, there is no case for levying an ad valorem charge on credit card purchases. If Shell pays for any costs, it should pay only for those costs which are involved in processing the transaction; not for costs which should rightly lie between issuers and cardholders such as credit risk, fraud and the cost of loyalty programs.

The inclusion of the cost of loyalty programs in the interchange fee is particularly inequitable as Shell is directly involved in 2 loyalty programs of its own (Shell MasterCard and FlyBuys). Shell should not be forced to fund issuer rewards programs which are in direct competition with its own programs.

The ad valorem fee for credit cards represents an extra burden in the oil industry. Government taxes on fuel are very high and typically represent around 50% of the cost of a litre of petrol. This means, for credit card payment, Shell is paying half its MSF on taxes. Further, every time the fuel excise increases with indexation, our MSF automatically increases, putting further pressure on already slim margins. Should the decision be made to keep interchange, we believe that a special rate for the oil industry should be established in view of the unique problems facing this sector and in line with practice in a number of overseas countries.

We believe the current setting of interchange rates is an anticompetitive practice and possibly breaches the Trade Practices Act. Both the Visa and MasterCard schemes are dominated by the large banks who are all members of both schemes. The schemes set interchange on behalf of their members at a rate which maximises benefits to their members. Such practice would not be tolerated by either the public or the ACCC in our industry, and nor should it be here.

Shell Retail International recently completed an acquiring study which looked in detail at the acquiring costs in 4 countries, including Australia. The margin made by our Australian acquirer was *[Confidential Information Deleted]*. We are forced to pay these high margins because scheme rules prohibit us from negotiating with acquirers in other countries or entering regional or global acquiring arrangements. Such restrictions should be abolished and cross border acquiring be allowed.

Shell has made a significant investment in developing, testing, implementing and maintaining card processing systems throughout its retail network. The income Shell receives from the acquirer in the form of Shell network access fees is reimbursement for this substantial cost and the fact that it has saved the acquirer from having to make this investment.

Shell believes that non issuers and non Approved Deposit Taking Institutions (ADIs) should be allowed to become acquirers. We do not see any logical reason for these constraints and believe allowing new entrants into the acquiring market would lead to increased competition, reduced prices and lower costs for both merchants and cardholders.

Similarly, Shell believes the requirements for issuing scheme cards should be reviewed to allow major merchants to become issuers. It seems incongruous that a large, well established and financially stable retailer such as Shell cannot issue these cards, but small local financial institutions are considered quite competent and qualified to do so.

Shell believes that the restrictions on merchants surcharging for credit card purchases are unreasonable and constitute a constraint of trade. There is a cost incurred by merchants in accepting credit cards and a merchant should have the ability to pass on these costs if they wish. Although Shell currently has no intention of applying a surcharge, we believe that merchants should be free to set their own prices in the market place and that the card schemes have no legal basis for restricting the pricing policies of independent third parties.

Shell also believes that the “honour all cards” rule should be abolished or at least modified, as it provides a mechanism which allows the schemes to introduce “new” cards (eg “corporate” credit cards) at higher interchange rates which push up MSF rates over a period of time.

2. Introduction

2.1 Confidentiality

This version of Shell's submission to the Reserve Bank of Australia has had confidential commercial information removed so that the report can be released into the public domain. Where information has been deleted, it is marked by the statement *[Confidential Information Deleted].*

2.2 The Shell Company of Australia Limited

Shell's retail operation consists of some 1,600 service stations of which *[Confidential Information Deleted]*. The franchise sites and some large non-franchise sites are supplied with fuel directly by Shell; Shell distributors supply the majority of the remaining sites.

[Confidential Information Deleted].

2.3 Shell's Card Operations

Shell is a major participant in the payment card market in Australia. It is involved in all elements of the card market including acceptance, processing, and issuing and acquiring of its own cards.

Card payment plays a large and increasingly important role at Shell's retail sites. Virtually all Shell company and franchise service stations accept the full range of bank issued cards, travel and entertainment (T&E) charge cards, third party fuel cards and Shell's own cards.

Shell has spent considerable sums of money over the past 15 years developing and implementing its own card processing infrastructure. This has been done for reasons of customer service and to provide a secure, reliable card processing network that allows Shell's customers to pay quickly and conveniently by the method of their choice.

The following provides a brief description of the impact of cards on Shell's business.

2.3.1 Card Acceptance

[Confidential Information Deleted]. Table 1 shows a breakup of card sales at Shell sites in 1999.

Card Type	**Transactions (millions)**	**Value ($ millions)**
Debit cards		
Credit cards	*[Confidential Information Deleted]*	
Shell Card		
Other cards		
Total		

Note: 1 "Other cards" includes T&E cards, third party fuel cards and local account cards
2 Value for debit cards excludes cash-out

Table 1 – Card Sales 1999

[Confidential Information Deleted]

[Confidential Information Deleted]

[Confidential Information Deleted]

2.3.2 Card Issuing

Shell offers 2 card payment products:

1. Shell Card - for fleets and businesses,
2. Shell MasterCard - for private motorists.

Shell has issued **Shell Card** for some 20 years. It is targeted at the corporate fleet and commercial road transport sectors. The card is available to any business that spends more than $250 per month on fuel. There are more than 250,000 cards on issue and this business continues to grow year on year.

Shell Card accounts for *[Confidential Information Deleted]* of total sales at Shell service stations and accounts for *[Confidential Information Deleted]* transactions per year.

The card provides a number of features to help fleets control their costs. These include:

- different card types to meet differing customer requirements
- comprehensive reporting
- optional PIN security
- management controls on spend levels and products

Shell also offers a co-branded **Shell MasterCard** (with GE Capital as the issuer) aimed at individual consumers. This card has an expenditure based rewards program as part of the marketing proposition, which gives customers points based on spend levels. These can be redeemed for fuel discounts or other products at Shell service stations.

There are around *[Confidential Information Deleted]* Shell MasterCards on issue, *[Confidential Information Deleted]*.

Until recently, Shell held a 50% stake in Fleet Systems, which issues Fleet Card. Shell sold its share to the other stakeholder (Custom Credit) in 2000, although Shell maintains a marketing arrangement with the company.

2.3.3 Card Processing Infrastructure and Costs

Shell Australia has made a considerable investment in card processing infrastructure. This has included:

- Advantage card terminals,
- Intellect PIN pads for secure key storage, encrypted PIN entry and account selection,
- Solutions Technology point of sale system at franchise sites,
- Shell Touch interactive touch screen transaction kiosk which accepts credit, debit and charge cards,
- Driveway Card Acceptors at some sites.

In addition, Shell installed its own Front End Processor. *[Confidential Information Deleted]*.

Shell, in addition to investments in card processing hardware and software, is also faced with major recurring costs in operating card processing systems including:

- data communications
- retail support (help desk)
- equipment maintenance
- consumables

[Confidential Information Deleted]

3. Credit Cards

3.1 Interchange

Shell is of the view that credit card interchange is a mechanism that transfers a proportion of the costs of issuing credit cards to the merchant community. We would also argue that the calculation of interchange on a percentage basis is not warranted. From Shell's perspective, it does not cost more to process and authorise an $80 transaction than it does for a $40 transaction; yet in absolute dollar terms we are paying double for the former.

Interchange is a key component of the MSF we pay. The interchange rate has always been put forward as the base for discussions on retail MSFs with our acquirer. In other words, Shell is effectively paying interchange fees to the card issuers.

The magnitude of Australian interchange rates is at times put forward as 'one of the lowest in the world'. This may or may not be the case as international interchange rates are kept secret by the card schemes (we know there are lower rates in parts of Europe), but even if it were true this does not necessarily mean that Australian retailers are better off than their peers elsewhere. We would raise the measure of **acquirer margins** as a point of comparison. We would argue that this is a more relevant measure of the Australian market versus global card markets.

Last year Shell Retail International conducted a review of card acquiring costs, comparing costs in 4 countries *[Confidential Information Deleted]*[1]. As part of this study, we compared the acquirer's margin in these countries. The data supplied in Table 2 reveals an interesting picture of the profits flowing to Australian acquirers and clearly illustrates that the margin enjoyed by our Australian acquirer is *[Confidential Information Deleted]*.

Country	Acquirer Margin (as % of spend)	Acquirer Margin (US¢ per trans'n)
[Confidential Information Deleted]		
Average		

Irrespective of whether our interchange rates are or are not amongst the lowest in the world, our comparison shows that the Australian acquirers are making margins that are **significantly** higher than those in the other countries we studied.

We are forced to pay these high margins because scheme rules prohibit us from negotiating with acquirers in other countries or entering regional or global acquiring arrangements. Such restrictions should be abolished and cross border acquiring be allowed. Cross border acquiring is discussed further in Section 3.4.

1 *[Confidential Information Deleted]*

3.2 Anti-Competitive Issues

Shell believes that the setting of the interchange rate, and indeed the setting of many of the scheme rules, possibly breaches the Trade Practices Act.

The schemes are comprised of the member banks, with the major banks being the dominant members of both the Visa and MasterCard schemes in Australia. In other words, when the schemes set the interchange rates, effectively the member banks are setting these rates under the guise of a "card scheme" Shell requests that the RBA examine the anti-competitive aspects of the schemes and possibly seek assistance from the Australian Competition and Consumer Commission to determine if certain conduct by the member banks is prohibited under the Trade Practices Act. An additional concern (although not directly related to Shell) is the "take it or leave it" approach by acquirers when negotiating with merchants. This may constitute unconscionable conduct under Part IVA of the Trade Practices Act and warrant examination by the RBA (ACCC).

If the major oil companies met to set wholesale petrol prices or transfer prices between themselves, the public would be in uproar and the ACCC would almost certainly take action. And yet, this is exactly what the card schemes have been doing for years.

3.3 Five Party Card Schemes

The main parties involved in a card payment transaction are the Cardholder, the Merchant (Shell or its retail site operator), the Acquirer and the Issuer. This has traditionally been called a 4 party payment system. Third party cards are typically a three party payment system as the issuer is usually also the acquirer.

The Merchant has a Merchant Agreement with the Acquirer, which details the contractual aspects of the relationship. Shell service stations all have at least one Merchant Agreement (for bank issued cards) and most have two or three agreements (T&E cards, third party fuel cards, Shell issued cards, etc.). The Cardholder is the Shell customer and the Issuer is the institution, which issued the customer's card.

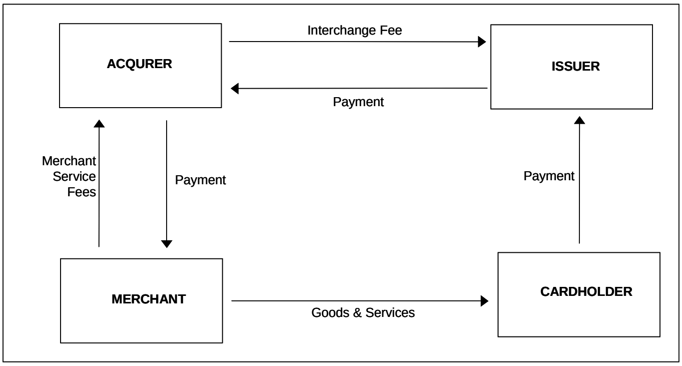

Diagram 2 - Relationships in a 4-party credit card payment system.

Shell pays a Merchant Service Fee to the Acquirer for each transaction and the Acquirer, in turn, pays an Interchange Fee to the Issuer. The Acquirer is therefore left with the difference as its margin for providing acquiring services.

If the customer's card was issued by the acquiring institution then the Acquirer retains the entire Merchant Service Fee. For this reason, Acquirers who also have a large share of issued cards generally have more margin to play with.

While the relationships in a 4-party system are the accepted norm, there is in fact a fifth party to the bulk of credit card transactions globally, the credit card schemes.

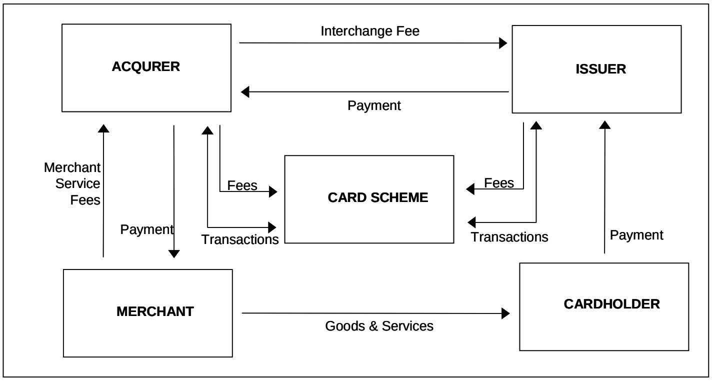

Diagram 3 - Relationships in a 5-party payment system.

This is a significant point, as the financial impact of the card schemes in the majority of transactions has not been well publicised. Shell believes that all transactions except "on us" transactions are subject to a flat fee payable by acquirers to the schemes. In addition routing domestic transactions via the card schemes would appear to have little merchant benefit. Both Visa International and MasterCard have large sophisticated processing systems designed to manage transactions from all global locations. Merchants are therefore directly funding via the MSF, the ongoing functions of the credit card schemes in addition to the contributions made to issuers' revenue streams.

We believe this to be inappropriate, as processing domestic transactions via the card schemes does not add any merchant value, when both the issuer and acquirer are domestic organisations. Routing of domestic transactions in this manner and passing costs to Shell appears to be an example of our company contributing to 'scheme monitoring' costs of membership bases.

3.3.1 Redistribution Argument

The argument has been advanced that interchange is necessary in order that the 'network benefits' generated by credit cards can be distributed more equitably amongst the parties in a transaction (specifically, from merchants to card issuers).

We believe this is an incorrect argument. There is no recognition within such logic that Shell provides <u>any</u> value in a credit card transaction. It assumes the card issuer adds more value to the "network" than the merchant. This assumption has been made by those who clearly stand to benefit from putting forward this idea. We question what value the issuer's card would have if it was not accepted by merchants such as Shell.

Further, if card issuers are to be compensated for the benefits they bring to the network, via interchange, then Shell and other retailers should be compensated for making the retail outlets available for use by cardholders.

While the concept of “network benefits” may have some validity in itself; it does not follow that any flows of money should occur because of the existence of the concept. **There is no validity to the suggestion that the concept of “network benefits” somehow justifies the imposition of a credit card interchange fee.**

3.3.2 Credit Risk

The inclusion of credit risk in the calculation of interchange is a further point that does not pass a logical examination.

In our view, the provision of credit is a matter clearly between a borrower and lender. In the case of credit cards, this is a matter between the cardholder and card issuer. We do not believe that we as a merchant have any responsibility to fund the credit risk borne by the card issuer in their dealings with the cardholder. Shell has no say in who is issued with a card and no control over any aspect of the cardholder / issuer relationship.

We simply view the credit associated with issuing a card as another loan to a consumer. **If a consumer borrows money to purchase a car is the car dealer then obliged to fund the lenders risk via some mechanism?** This is clearly an idea that cannot be sustained.

3.3.3 Card Fraud

The costs associated with credit card fraud, in our view, are largely the result of policies pursued by card issuers in Australia over the years. Shell has invested large sums in developing and installing sophisticated EFT systems capable of managing large numbers of transactions securely via PINs.

Lower fraud technology has been available for many years, such as the PIN based system used for debit cards. The banks have chosen not to implement more secure processing for credit cards. This is despite the fact that Shell and most other merchants have in place a perfectly secure method for processing credit cards, **should issuers and acquirers wish to avail of it**, namely credit card PIN entry at the point of sale.

We suspect that the reason why PIN entry for credit has not been implemented to date is two fold:

- signature based credit enhances volumes and,
- the fraud risks are being passed on to the merchants

Under the above scenarios there is no financial incentive to move to more secure processing methods, as issuers are being shielded from the full costs of fraud. Card fraud costs should therefore remain as a cost between issuers and their customers, particularly where merchants such as Shell, have in place secure card/transaction management systems.

The banks should not be allowed to claim these costs from merchants because of the failings of the system they have mandated.

3.3.4 Card Loyalty Programs

The use of interchange for funding credit card loyalty programs is a matter that we take particular exception to. It is quite evident to us that banks generate greater revenues and profits from credit cards than debit cards. For example, a $50 purchase on a credit card costs Shell 80 cents more in merchant fees than if the transaction were conducted on a debit card. The introduction of loyalty programs was clearly intended to encourage the use of credit over debit. This has been a resounding success as illustrated by Diagram 4. **The current situation, where all merchants subsidise the issuers' credit card reward programs whether they choose to do so or not, is neither fair nor reasonable**.

Shell is a direct participant in two rewards programs (The Shell MasterCard program and FlyBuys) and as such we do not believe it is justified that we also fund someone else's rewards programs which are in competition to our own. Such an occurrence would not be tolerated in any other industry, yet the banking / credit card sector is able to effectively impose it on all Australian merchants who wish to accept credit cards for payment.

3.3.5 Ad Valorem MSF & The Oil Industry

Ad valorem MSFs increase as the value of a transaction increases. The cost of processing a transaction does not vary with its value and there is no reason why Shell should pay ad valorem fees to our acquirer. We also see no reason why acquirers or issuers should pay ad valorem fees to each other.

The costs that do vary with a transaction's value are related to spending-based rewards, credit risk and fraud. These are costs that should lie between the issuer and the cardholder except where a fraud is committed by a merchant.

The effect of ad valorem fees is compounded in Shell's case. The fuel industry, as is widely known, is subject to an extremely high level of government taxes and charges. The imposition of such fees effectively results in the fuel industry paying a percentage fee on an amount that is remitted as taxation. While this may not be totally unique in the Australian merchant community, the tax component of each sale subjected to ad valorem MSF is around 50% for petrol in Australia, depending on the pump price for the fuel.

A further problem with credit card MSFs on fuel purchases is that the fuel tax is indexed in line with CPI increases. This means every time the price of fuel rises due to tax increases, the acquirers' and issuers' income automatically rises, even though the cost of processing the transaction is unchanged.

This has a significant impact on Shell's overall retail business due to the large value of credit card purchases *[Confidential Information Deleted].*

[Confidential Information Deleted]

In the case of Shell (as in the case of most other retailers) the non-acceptance of credit cards is simply not an option. Card acceptance is necessary simply to gain entry to consumer consideration.

As stated earlier in this document, we believe that interchange should be abolished. However, should the decision be made to keep interchange, albeit at a lower level, we believe that a special rate for the oil industry should be established in view of the unique problems facing this sector and in line with practice in a number of overseas countries such as Germany and USA.

3.4 Cross Border Acquiring

A further area which we believe warrants attention from the RBA in its current review of credit card schemes, is the inability of merchants to enter into acquiring arrangements with global or regional acquirers as they choose. The card scheme rules expressly disallow acquirers from entering into agreements with merchants outside the acquirer's country of domicile. These rules are grouped as 'cross border' regulations to which acquirers must adhere.

We believe that such cross border rules enforced by MasterCard and Visa are designed to protect the franchises of members within particular countries or regions. The requirement that acquirers only deal with merchants in the country within which they (acquirers) are domiciled is unjustifiable. This rule (apart from restricting the rights of merchants to have their transactions processed as and where they wish) does not acknowledge a number of realities:

1. that there are many merchants who have regional and global operations, and as such would derive significant benefit in having one merchant agreement globally and one conduit into the global credit card networks,

2. that the card schemes have selectively chosen to allow cross border acquiring for certain industries. There is 'formal' approval for acquirers to enter into agreements with airlines globally. That is, any passenger airline is able to enter into an acquiring arrangement with any acquirer globally. It is also common practice for the card schemes to allow this activity (although it is against scheme rules) for hotel chains and other travel related operators. The enforcement of the cross border acquiring rule is therefore subject to 'interpretation' by card schemes. We would question the rationale behind allowing certain industries to enter into agreements while disallowing others. On what basis is the global fuel industry excluded from such arrangements? There is no rationale for such restrictions, and as a result they should be disallowed,

3. that technology has made physical location quite irrelevant in determining where an organisation processes credit card transactions. The card schemes themselves process transactions on a global basis, yet they deny this opportunity to the merchant community,

4. that such restrictions in a number of countries (including Australia) may be anticompetitive and breach Trade Practices laws or constitute an unlawful restraint of trade. In the European community, this matter has been resolved with both Visa and MasterCard being forced to formally allow cross border acquiring for all merchant categories.

Despite the above however, the card schemes are still able to restrict open global or regional access to their card networks.

The ability for organisations with global merchant requirements, being able to enter into merchant agreements with any acquirer globally, will also deliver the lowest possible cost to the merchant and consequently to the consumer.

3.5 No Surcharge Rule

[Confidential Information Deleted].

3.6 Honour All Cards Rule (HACR)

The "honour all cards rule' is sensible and reasonable in principle. However, there have been instances when it appears to have been misused. For example, the schemes have introduced "corporate" card products in recent years <u>at an increased interchange rate</u>. As the number of transactions on these card types increase, the average interchange fees will increase accordingly. Over time, this will impact our credit card MSF as it is based on the total interchange costs incurred by the acquirer.

We have been advised that the reason for the higher MSF is that these "corporate" cards present a higher risk to the issuer and therefore necessitate a higher charge. **We would see this quite differently: we would argue that corporations are much less likely to default on their credit cards or their staff to abuse cards issued to them and therefore the credit risk of these cards is <u>lower</u>**.

We believe that, on occasions, the HACR has simply been used as an opportunity to increase the take from card issuing and merchants should receive some protection from this practice. The abolition of interchange would remove this problem completely. If it is decided to retain this rule, then some amendments should be made which do not allow new card types with higher interchange rates to be automatically covered by this rule.

4. Interchange and Infrastructure Costs

While we believe interchange should be abolished, we do believe there are some elements of the current debit card fee structure that should be retained under a "fee for service" regime (see later). Large retailers who have made investments in developing and implementing their own card processing systems have been able to earn some reimbursement from acquirers in recognition of the savings made to the acquirers who would otherwise have had to make this investment themselves. Shell is one such retailer under its arrangements with *[the Acquirer]*.

The current fee flow from issuer to acquirer recognises that acquirers have to make significant investments in a number of areas, including:

- large-capacity fault-tolerant transaction processing and switching systems
- maintenance of records and security data for each of the merchant terminals which it acquires for
- certification of equipment
- settlement and commercial arrangements
- merchant acquisition and maintenance
- purchase and maintenance of tens of thousands of retailer card terminals
- data encryption and key management for thousands of secure PIN pads

The issuers pay the acquirer a fee to recognise and compensate for the high level of investment required **which is in line with normal business practice where the party providing the service is paid by the user of that service.** Thus, if an organisation invests in a system to acquire transactions for an issuer, they should be paid for that service. Similarly, if a merchant invests in card processing infrastructure at the POS, they also should be compensated for the service it provides.

In summary, while we advocate that all interchange should be abolished, we also believe it is reasonable for merchants to seek a return on investment from their acquirers. The abolition of interchange does not mean that some fixed value fees will not continue to be exchanged between acquirers and issuers in some form. However, these fees should be negotiated on a bilateral basis in a way that is open and transparent.

5. Debit Usage

Despite the major uptake in debit cards in the Australian market over the past 10 to 15 years, there has been a shift in usage away from debit cards by Australian consumers in recent times.

As is illustrated in Diagram 4, debit card usage has in recent years started to trend down while credit card usage continues to increase at a relatively constant rate.

We believe that deceleration in debit card growth since late 1999; can be directly attributed to the success of the credit card loyalty programs operated by credit card issuers in Australia.

We would argue that banks in Australia commenced an aggressive campaign to increase the usage of credit cards, at the expense of debit card usage, in the early to mid 1990's for several reasons:

- profit opportunities are greater in the credit card market than debit particularly for issuers. Generating percentage revenues from credit card transactions (from retailers) is certainly more profitable than small fixed fee charges from cardholders and paying debit card interchange,
- debit card acquirers often pay a transaction fee to larger retailers. While this is an equitable arrangement as discussed below, sharing of a fixed debit interchange fee with retailers is certainly less attractive than retaining part of an ad valorem fee,

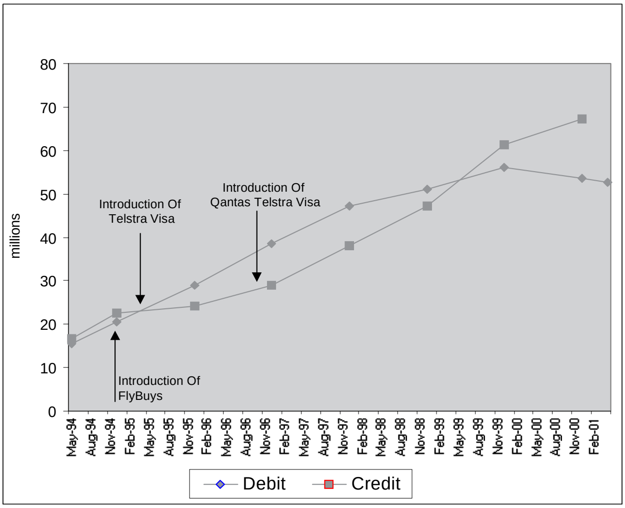

Diagram 4 - Credit & Debit Monthly Volumes 1994 ~ 2000

Source: Reserve Bank of Australia

- merchants are a softer target in the generation of profits. Creating demand for credit cards results in merchants, as we have detailed above, picking up the majority of costs for both issuers and acquirers, via MSF. In the case of debit transactions, consumers, in certain cases, are asked to pay for these.

6. Fee for Service

The replacement of interchange and ad valorem MSF with flat ‘fees for service’ is in our view the most logical way to compensate all parties for costs incurred in handling credit card transactions. Current interchange fee mechanisms are inappropriate in both magnitude and execution.

There must however, be a recognition within such a system of the infrastructure investments made by merchants for card processing. While not all merchants will elect to make such investments, those that do must have these acknowledged via an appropriate fee structure. Regardless of the magnitude, the fee for service process should be a transparent negotiation.

6.1 Issuer-Acquirer Fees

The removal of ad valorem interchange fees between issuers and acquirers would ultimately translate to a removal of percentage based merchant service fees. For this reason the nature and magnitude of fees between issuers and acquirers is of vital importance in any system going forward. We believe that issuer /acquirer interchange removal would need to be mandated by the RBA. This action would then open the way for negotiated issuer / acquirer fees and would provide, in conjunction with a more competitive acquirer market, the opportunity for a more transparent and market driven merchant fee regime.

Unless it is mandated that fees cannot flow from acquirers to issuers, the current arrangements will continue.

6.2 Cardholder Fees

The card schemes have argued that interchange must be retained because the only other option for recovering costs is cardholder fees. The schemes claim that increasing such fees will lead to reduced numbers of cardholders and decreased card usage. They have argued that in order for the entire system to function, interchange is necessary to compensate issuers for their activities (the network benefits argument).

We would put forward the following for consideration on this point:

1. the introduction of cardholder fees over the course of the 90s has not seen a reduction in credit card usage. Despite some initial levelling out after the introduction of fees, usage has increased dramatically over this period,
2. **cardholder fees have not resulted in any reduction to interchange rates.** It would be reasonable to assume therefore, that such fees have simply increased the level of profitability of issuing portfolios,
3. if as a result of the RBA's current actions, interchange was to be removed completely and cardholder fees were to reflect in a more realistic manner, the cost of services provided to cardholders, then the outcome would be a more equitable pricing regime.

We believe that costs to cardholders have been less than would otherwise be the case, because retailers have been meeting a disproportionate share of the card issuers costs.

6.3 Merchant - Acquirer Fees

The mandated removal of interchange fees would deliver a negotiated fee regime between merchants and acquirers. In order to ensure the most efficient fee / service levels we believe it is necessary to allow organisations other than approved deposit taking institutions (ADIs) and card issuers to act as transaction acquirers. In the case of Shell, the option to conduct our credit card business on a self-acquiring model would be seriously examined. (refer Section on Scheme Membership - Acquiring).

7. Scheme Membership

7.1 Acquiring

7.1.1 Current Structure

The current credit card scheme membership rules have a number of restrictive criteria for membership applicants:

- an organisation must be an approved ADI in Australia,
- they must meet certain risk policy requirements,

- they must satisfy the schemes of their ability to conduct a credit card business,
- they must demonstrate the ability to be a net issuer of the schemes' cards.

Organisations wishing to become acquirers for the major credit card schemes gain this right automatically on being accepted as issuers within the respective schemes.

As far as we can ascertain, where members acquiring activities are such that they are not a 'net issuer' of cards then financial penalties are imposed on them.

It is therefore impossible, under the current scheme rules for an organisation to solely acquire credit card transactions. One must be a net issuer of credit cards in order to:

- have the ability to acquire credit card transactions
- avoid financial penalties for failing to meet the net issuer requirement

We can only conclude from these rules that the intent is to both restrict membership and ensure that all member activity is directed toward the enhancement of scheme revenues. **These rules protect the interests of the current members from external competition**.

It is also worth mentioning that before any applicants can become a member of a scheme they must submit a detailed business plan before they will be approved. This effectively means that the schemes have detailed knowledge of any new entrant's business strategies in advance of their membership and can act accordingly if they see these plans as threatening to existing members' status.

7.1.2 Alternative Scenario

It is our view that credit card issuing and acquiring should have discrete and largely unrelated requirements in the interests of achieving real competition.

In many parts of the world, third parties perform the acquiring function in all but name. Even in Australia, for example, EDS conducts most of the acquiring functions for CBA. An organisation wishing to perform credit card acquiring functions, in our view performs computing, data communications and transaction switching services as well as managing settlement values between issuers and merchants. For this reason we would argue that credit card acquiring should be open to organisations that are commercially sound and meet prudential criteria as determined by the RBA, APRA, or another appropriate authority.

Organisations wishing to acquire credit card transactions should not be obliged to issue credit cards and should not be required to have ADI status.

The emergence of new entities in the acquirer market should be subject to adequate prudential and competition standards. Such an approach would result in a class of acquirer with no reliance on, or loyalty to, credit card issuing. Such entities would be aiming to capture market share by pricing transaction acquiring services in the most efficient manner. This would ensure delivery of acquiring services to merchants at the lowest possible fixed fee rate.

We would therefore view changes in credit card scheme rules that allow non-ADI entities and non-issuers to acquire credit card transactions as an essential prerequisite to an efficient merchant / acquirer fee regime.

Shell, as a large and financially stable organisation, would welcome the opportunity to consider operating on a 'self acquiring' model. Our proposals would encourage a number of organisations to enter the pure acquiring market. Such organisations may be larger transaction switching companies or other service providers wishing to enter the transaction acquiring and switching market.

It is our view that the model proposed would have positive outcomes in the market. We believe service and pricing levels would improve as a result of increased competition.

7.2 Issuing

7.2.1 Current Structure

The card scheme rules relating to membership have been outlined above. The conditions for scheme access are clearly focussed on card issuing. Once an organisation that has ADI status gains access it must demonstrate on an on-going basis an ability to be a net issuer of a scheme's cards.

There is therefore little ability for merchants such as Shell to directly participate in card issuing activities. Submissions to the RBA have suggested that co-branded cards provide retailers with an opportunity to 'participate' in card issuing. This is simply not true. The bank (or other scheme issuer), not the retailer decides who qualifies for one of these cards and the bank not the retailer, owns the customer details and relationship.

We would agree that there needs to be stringent guidelines for organisations to become credit card issuers, but not a requirement that they have ADI status.

7.2.2 Alternative Scenario

Credit card issuing with the marques of the major credit card schemes (MasterCard and Visa) should be allowed provided an organisation meets two key criteria:

- Prudential standards as determined by the an appropriate government supervised body and not as may be determined by the credit card schemes
- Access conditions regulated by an independent authority such as the RBA or the ACCC

As a large financially stable organisation with many years of experience in all elements of cards (acceptance, processing, issuing, co-branding partner), Shell believes it should have the option to issue "scheme cards" on its own account if it so desires. It appears quite illogical that organisations of the calibre of Shell Australia are prevented from issuing credit cards in their own right, yet extremely small financial organisations (community based credit unions for example) are able to gain access and issue credit cards in their own right.

Market forces will then determine the success or otherwise of a particular program. The organisation wishing to enter the card issuing market may then decide to perform all functions relating to card issuing itself or to outsource certain functions to existing issuers.