



## **Payment Systems Board 2007/08 Review of the Credit and Debit Card Regulatory Regimes**

Announcing the final credit card reform measures under the *Payment Systems (Regulation) Act 1998*, the Reserve Bank of Australia indicated that the Payment Systems Board would “undertake a major review of credit and debit card schemes in Australia after five years, updating the findings of the Joint Study [by the Reserve Bank and the Australian Competition and Consumer Commission]”<sup>1</sup>. On 13 September 2006 the Reserve Bank sought comments on the content and process of the review.

Comments by Visa International Service Association are set out below.

### **Best practice evidence-based review**

The Payment Systems Board should follow best practice in regulatory review and be consistent with National Competition Policy and the duties of the Payment Systems Board<sup>2</sup>. Clause 5(9) of the Competition Principles Agreement gives general guidance to the content of the review.

“Without limiting the terms of reference of a review, a review should:

- (a) clarify the objectives of the legislation<sup>3</sup>;
- (b) identify the nature of the restriction of competition;
- (c) analyse the likely effect of the restriction on competition and on the economy generally;
- (d) assess and balance the costs and benefits of the restriction; and

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<sup>1</sup> Reserve Bank of Australia, *Reform of Credit Card Schemes in Australia: IV – Final Reforms and Regulation Impact Statement*, (August 2002), p.40.

<sup>2</sup> *Reserve Bank Act 1959*, s.10B. The guiding “public interest” principle in s.8 of the *Payment Systems (Regulation) Act 1998* is consistent with this duty.

<sup>3</sup> A reference to “legislation” in this clause expressly includes regulations: clause 5(1).

- (e) consider alternative means for achieving the same result including non-legislative approaches.”

These legal principles require an *evidence-based review* that has the *overall objective* of compliance with the “guiding principle” in clause 5(1) of the Competition Principles Agreement, namely, that regulations should not restrict competition unless the benefits outweigh the costs and that the objectives of the legislation can only be achieved by restricting competition. This is consistent with Government policy in relation to regulatory burden and practice in relation to regulatory review<sup>4</sup>.

### **Four step process**

In order to comply with its legal obligations the Payment Systems Board should follow a four step process for the review.

#### **Step 1 – Identify objective standards by which the review will assess the regulation**

A review must specify objective *ex ante standards* against which the effectiveness of the regulatory regime are to be assessed.

The Payment Systems Board should clarify what it regards as the objectives of the regulatory regime, in particular, distinguishing between macroeconomic (for example, management of economy-wide debt levels) and microeconomic (competition and efficiency) objectives.

#### **Step 2 – Obtain the facts**

A detailed and comprehensive factual analysis must be undertaken. There are three distinct but interrelated elements of this exercise.

#### ***The three elements of the analysis***

##### **1. A competition analysis must be undertaken**

This analysis will help avoid unintended competitive distortions arising from the regulatory regime, either between payment instruments or providers of payment services. The OECD has recently emphasised the importance of substitute services on the analysis of regulation, and in particular, the problem of “regulatory asymmetry”. It concludes that, in general, it is not

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<sup>4</sup> Commonwealth of Australia, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business* (January 2006); and the *Government Response*, Commonwealth Treasurer Media Release (15 August 2006); Office of Regulation Review, *A Guide to Regulation* (2nd ed, 1998) (to be updated following the Taskforce report).

good public policy to allow asymmetries to persist and that, once eliminated, other policy objectives are more likely to be achieved<sup>5</sup>.

A competition analysis will also assist in identifying the effects of regulations. If for no other reason, the importance of the role played by interchange and other aspects of the operation of payment cards depends on the level of competition among different payment instruments, as the European Commission has recently noted<sup>6</sup>.

The Payment Systems Board should therefore identify, from both the supply and demand side, the substitutes for credit and debit cards and the effect of the regulations on barriers to entry and other aspects of the competitive process. Further elements of a review have been set out by the Bank for International Settlements, Committee on Payment and Settlement Systems in their discussion of a “stocktaking exercise”<sup>7</sup>. Further guidance on the scope of such a fact-finding exercise is found in the sector inquiry recently held by the European Commission on payment cards.<sup>8</sup>

The outcome of this exercise might be the identification of “markets”, although the precise identification of markets is merely a tool to identify the other payment instruments and their providers relevant to the assessment of the regulatory regime. The Joint Study did not undertake such an exercise. It is clear, given the work by the Department of Communications, Information Technology and the Arts (DCITA)<sup>9</sup>, that alternatives to payment cards and the likely effect of the regulatory regime is now, if not then, a critical element in assessing the competition and efficiency effects of the regulatory regime.

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<sup>5</sup> OECD, *The Impact of Substitute Services on Regulation* (23 June 2006), pp.43-48.

<sup>6</sup> European Commission, *Interim Report I: Payment Cards: Sector Inquiry under Article 17 Regulation 1/2003 on retail banking* (12 April 2006), pp10-12 – “Competition among means of payment”.

<sup>7</sup> Committee on Payment and Settlement Systems, *General guidance for national payment system development* (January 2006), “Annex 3: Elements of a stocktaking exercise”.

<sup>8</sup> European Commission, *Interim Report I: Payment Cards: Sector Inquiry under Article 17 Regulation 1/2003 on retail banking* (12 April 2006).

<sup>9</sup> DCITA, *Exploration of Future Electronic Payments Markets* (June 2006).

**2. Data on the costs and efficiencies of alternative payment instruments must be collected**

The competition analysis will identify different payment instruments which are substitutes for payment cards. Considerable work has been done in respect of the costs of alternative payment instruments.<sup>10</sup> This work, as well as that in the Joint Study, should be updated.

**3. An *ex post* assessment of the effectiveness of the current regulatory regime**

This assessment should also identify the restrictions on competition imposed by the regulatory regime and any alternatives considered by the Payment Systems Board.

The assessment should specifically address the question of efficiency, including dynamic efficiency. Some of the relevant issues are set out in the DCITA report<sup>11</sup>. The assessment should also have the following.

- A discussion of alternative regulatory forms and options to could achieve the objectives, for example, self-regulation, co-regulation or alternative instruments.
- An analysis of the benefits and costs of the regulations, including those arising from restrictions on competition. Where possibly, quantitative analysis should be included. Rigorous cost-benefit analysis should be used to compare different regulatory options<sup>12</sup>.

There has been considerable econometric and other work undertaken to analyse the effect of the regulatory regime<sup>13</sup>

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<sup>10</sup> See the DCITA report and earlier work by David Humphrey, Magnus Willeson, Ted Lindblomand, and Goran Bergendahl, "What does it Cost to Make a Payment?" (2003) 2(2) *Review of Network Economics* 159.

<sup>11</sup> DCITA report, p1.

<sup>12</sup> Recommendations 7.2 and 7.8 in *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business* (2006). The Government has accepted these recommendations.

<sup>13</sup> For example, Howard Chang, David S Evans and Daniel D Garcia Swartz, "The Effect of Regulatory Intervention in Two-Sided Markets: An Assessment of Interchange-Fee Capping in Australia" (2005) 4(4) *Review of Network Economics* 328; Richard A Epstein, "The Regulation of Interchange Fees: Australian Fine-Tuning Gone Awry" (2005) (3) *Columbia Business Law Review* 551; Joseph Farrell, "Assessing Australian Interchange Regulation: Comments on Chang, Evans and Garcia Swartz" (2005) 4(4) *Review of Network Economics* 359; Fumiko Hayashi and Stuart E Weiner, "Interchange

which the Payment Systems Board should take into account and update. This should be published prior to closing of final submissions.

### ***Who should carry out this analysis?***

As the Reserve Bank is itself a player in the market a critical element of impartiality is potentially missing. The Reserve Bank can reduce the concerns about this lack of impartiality by obtaining the expert assistance of the Australian Competition and Consumer Commission and the Productivity Commission to undertake this stage of the review process.

### **Step 3 – Consultation and ongoing publication**

In addition to allowing a period for the public to make submissions, the review should adopt a business consultation website that notifies interested parties of consultation processes and ongoing publication of 'exposure drafts' for comment.<sup>14</sup>

### **Step 4 – Issue final report**

The final report must measure the effects and effectiveness of the current regulatory regime against the objectives and standards identified in step 1 of the review process.

The review outcome should be an objective assessment of the current regulatory regime. If the effects are not consistent with the objectives of the regulatory regime and National Competition Policy, a statement of the necessary amendments to the regulatory regime and a timeframe within and process by which the amendments will be effected.

## **Timing**

To give industry participants clarity regarding expectations and to enable them to plan appropriately, the Payment Systems Board should publish a clear and detailed timetable covering each step of the work preparatory to the review and to the review itself.

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Fees in Australia, the UK, and the United States: Matching Theory and Practice" *Federal Reserve Bank of Kansas City, Economic Review* (Third Quarter, 2006).

<sup>14</sup> Recommendations 7.6 and 7.7 in *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business* (2006).