RESERVE BANK OF AUSTRALIA

Review of Card Payments Regulation

Consultation Paper

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Contents

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1. Introduction and Background

Introduction

This paper is the second key document in the Reserve Bank's review of card payments regulation. It presents some preliminary conclusions on the future of card payments regulation in Australia, reached following the public consultation process undertaken in the months after the release in March of the *Review of Card Payments Regulation: Issues Paper* (the Issues Paper). It also presents some draft standards that would implement a proposed approach. The Bank is now seeking comments on these draft standards with the expectation that the Payments System Board (the Board) will decide on any changes to the regulatory framework in mid 2016.

The regulatory framework for card payments was introduced in the early 2000s and reviewed by the Board in 2007–08. The retail payments market has evolved considerably since then: card payments have continued to grow in importance; new products and channels have been developed; and current and would-be participants have continued to innovate. Part of this evolution has reflected the actions of payment systems, participants and end users in response to the regulatory framework. It is therefore important to ensure that reforms that were intended to promote competition and efficiency in the payments system, by improving price signals and encouraging efficient payment choices, continue to do so.

The review has, in part, been informed by two additional factors. First, the 2007–08 review left open the prospect of either a removal of interchange regulation or tighter interchange regulation, contingent on how competition in the payments system evolved. A formal and final conclusion was not reached at that time. The current review is therefore an opportunity to provide greater regulatory certainty. Second, the recent Financial System Inquiry (FSI) endorsed the Bank's approach to card regulation, but made a number of recommendations and suggestions, while accepting that these were ultimately decisions for the Board. The current review has incorporated the FSI recommendations amongst the various options that have been consulted on. More recently, the Government has released its response to the FSI, in which it noted that it looked forward to the Board completing its review and announced that it would legislate a ban on excessive surcharging and give enforcement powers to the Australian Competition and Consumer Commission (ACCC) in relation to excessive surcharges.

Most of the key policy decisions in the Review relate to three areas – interchange fees, surcharging and 'competitive neutrality' between card products. Issues of transparency also provide an important backdrop to these areas and are reflected in elements of the Bank's proposed approach. This paper is therefore structured along the following lines: Chapter 2 briefly summarises the issues and the consultation undertaken thus far; Chapter 3 considers a range of options for each issue and provides the Board's preliminary assessment that informs the draft standards summarised in Chapter 4;

Chapter 5 then sets out the next steps and invites submissions on the paper and the draft standards that are set out in the Annex.

The March 2015 Issues Paper and the Bank's submission to the FSI cover the Bank's earlier reforms and recent developments in card payments in some detail.[1] The current paper does not repeat that material; therefore it should be read in conjunction with those earlier papers. Based on the Board's preliminary assessment of the issues, the paper includes draft standards for consultation, consistent with the requirements of the *Payment Systems (Regulation) Act 1998* (PSRA). This paper also serves as the early-stage Regulation Impact Statement, in line with criteria established by the Office of Best Practice Regulation.

Background to the Review

Following the recommendations of the Wallis Inquiry in 1997, the regulatory structure for the payments system was updated with the aim of improving competition and efficiency, while ensuring that stability and confidence in the system were not compromised.[2] The Bank was assigned a number of powers and responsibilities in respect of payment systems and the Board was established to oversee this mandate. The Bank's broad approach to payments system regulation has sought to encourage industry to undertake reform, using its powers only when it judges this to be necessary for managing risk and promoting efficiency, competition and stability.

In 2013, the first major review of the Australian financial system since the Wallis Inquiry was announced. The Bank's submission to the FSI noted that the reforms to the payments system since the early 2000s have, in the Bank's view, been in the public interest and have contributed to a more efficient and competitive payments system, which has benefited the Australian economy. However, the Bank's submission also indicated that there was scope to review certain aspects of the regulatory arrangements, to ensure that regulation continues to promote good outcomes in an evolving payments system. In particular, the Bank indicated that it would be reviewing aspects of the operation of the credit and debit interchange systems, the regulatory treatment of American Express companion cards issued by financial institutions and whether action by the Bank, ACCC or ASIC might be appropriate to deal with concerns over excessive surcharging in some industries.

The Final Report of the FSI was released in December 2014. It acknowledged the critical role that payment systems play in the broader financial system, and emphasised the need for efficiency, transparency and innovation in this area. While the report endorsed reforms undertaken by the Board since it was established, it recommended that the Bank consider a range of measures related to card payments regulation, particularly in relation to interchange fees and surcharging.

In March 2015, the Bank commenced a review of the framework for the regulation of card payments with the publication of the Issues Paper. The Issues Paper sought the views of industry and other stakeholders and interested parties on the regulation of card payments. The Board indicated that it would also be considering any submissions on card payments regulation made in response to the Government consultation on the FSI recommendations. The Bank received over 40 submissions in response to the Issues Paper, and consulted with a wide range of interested parties, both individually and collectively when it hosted a roundtable discussion bringing together a range of stakeholders, including card schemes, consumer representatives, merchants, financial institutions and government.

1 See RBA (Reserve Bank of Australia) (2014) and RBA (2015).
2 See Financial System Inquiry (FSI) (1997).

In August 2015, as part of the ongoing review, the PSB asked Bank staff to liaise with industry participants on the possible designation of the bank-issued American Express companion card system, the Debit MasterCard system and the eftpos, MasterCard and Visa prepaid card systems. The Bank has the power under the PSRA to designate a payment system if it considers that doing so is in the public interest. The decision to designate a system is the first of a number of steps the Bank must take to exercise any of its powers, such as imposing an access regime on a system or setting standards for the safety and efficiency of that system. Following a resolution of the Board, the Bank designated these systems on 15 October. Designation of these systems will allow a more holistic consideration of the issues – including those relating to the regulatory treatment of companion cards and prepaid cards – as the Bank continues with the review.

Government response to the Financial System Inquiry

On 20 October, the Government released its response to the FSI.[3] It noted that it looked forward to the Board completing its work on interchange fees and customer surcharging, and stated that the Government would phase in a legislated ban on excessive card surcharges, with the ACCC responsible for enforcing these rules. The Government confirmed its expectation that the Board would provide clarity around what constitutes excessive customer surcharges on card payments.

The Bank has been working closely with Treasury and the ACCC over recent weeks and will continue to do so over the coming period to ensure that regulatory arrangements dealing with surcharging are as clear as possible, with the goal of reducing instances of excessive surcharging and dealing with them effectively if they occur.

3 See Australian Government (2015).

2. Issues and Consultation

The Issues Paper noted some developments in the operation of card payment systems that have caused concern for various stakeholders and also for the Bank. The Bank invited views from a wide range of interested parties, including both industry participants and end users, on possible policy responses. In total, more than 40 submissions were received from financial institutions, merchants, card schemes, consumer groups and individuals; 33 of these have been published on the Bank's website, with the remaining submissions received in confidence.[4] Around 30 parties took up the invitation to have discussions with the Bank, with some major stakeholders having follow-up meetings.

As part of the consultation process, the Bank also convened a Payments Roundtable on 23 June, moderated by the Deputy Chair of the Board. Thirty-three organisations were represented at the Roundtable, including schemes, card issuers and acquirers, merchants, government and regulatory agencies, and ministerial staff. The Roundtable provided a forum to discuss views on the direction of regulation, focusing particularly on issues relating to interchange fee regulation, surcharging, companion cards and merchant routing of card transactions.

The remainder of this chapter provides a brief summary of the main issues under review and an outline of views expressed during the consultation process.

Issues in the Transparency of Card Payments

Summary of issues

The Bank has, for some time, held concerns about the lack of transparency available to merchants at the time of a card transaction. The Issues Paper cited two examples, both of which result in price signals about the underlying costs of payments instruments being diluted. The first is the inability of many merchants to distinguish between debit and credit cards in card-not-present (e.g. online) environments. The second is the uncertainty over the cost of individual cards for merchants that do not benefit from merchant-specific interchange rates, such as 'strategic merchant' rates. While all of the transactions accepted by merchants on the latter rates ('qualifying merchants') are subject to the same relatively low rate, other (mainly smaller) merchants may face interchange rates that vary significantly according to the type of card presented and have no visibility over this at the time of the transaction. Strategic rates have fallen over the past decade or so, while interchange rates on premium and other higher-cost cards have risen as interchange fee schedules have become increasingly complicated.

4 The Bank also received around 250 emails from individuals regarding surcharging, in most cases focused on the practices of airlines.

In both of these examples, a lack of transparency means that a merchant will not necessarily know either the particular type of card they are accepting at the time of the transaction or the associated cost of accepting that card. A consequence is that a merchant would be unable to consider surcharging to reflect the underlying cost of that transaction.

The Bank outlined several regulatory options that could be considered to enhance the transparency of payment costs to merchants and cardholders. These included: ensuring that debit cards and credit cards are clearly distinguishable visually and electronically; more general requirements to ensure that card types with different costs are readily identifiable; and the possibility of further modifying 'honour-all-cards' rules so that merchants could make separate acceptance decisions for cards within a particular scheme.

Summary of consultation

There was fairly general support for the proposition that greater transparency about the cost of payments for end users would be desirable. Many parties acknowledged that the increasing complexity of interchange schedules, particularly the widening of the range of rates paid by non-preferred merchants, was a source of concern. To address this, a number of submissions noted that introducing a cap on the maximum interchange rate, or combining a cap with a floor, could be considered (see below). There was also general in-principle support for measures that would facilitate merchants being able to determine their costs for accepting a particular transaction, such as via improvements to the information that merchants receive from acquirers. However, many respondents noted that regulation that required the provision of real-time cost information would likely be difficult and expensive to implement. Some submissions, including those from the international card schemes, argued that existing honour-all-cards arrangements give customers certainty as to whether their card will be accepted at a merchant and that therefore those rules should not be altered.

Interchange fees and payments system efficiency

Summary of issues

The Bank's assessment is that the caps on card interchange fees that were introduced in the early 2000s have constrained the potential for those fees to distort efficient payment choices – for example, to provide incentives for consumers to use high-resource-cost payment methods – and have contributed in a significant way to the fall in the overall resource cost of payments. However, the Issues Paper highlighted a number of aspects of the current system that give rise to efficiency and competition concerns, and raised some potential policy responses. The issues fall into four broad categories.

The first relates to the coverage of interchange caps. The main issues here are whether interchange (and related) regulation is being applied appropriately and consistently across payment systems; and the types of transactions that should be covered by the caps. As discussed in further detail below, the issue that has attracted most commentary is whether American Express, and particularly companion card arrangements, should be subject to interchange regulation.

On the types of transactions covered by interchange caps, the Issues Paper noted that there was a degree of ambiguity on interchange arrangements for prepaid cards (which are not explicitly regulated), and that it would be useful to clarify this as part of the Review. Separately, although it was

not canvassed in the Issues Paper, a number of submissions argued that commercial cards should be excluded from the application of interchange fee caps. These submissions argued, among other things, that commercial cards delivered significant benefits to both cardholders and merchants, but relatively high interchange fees were necessary to make them commercially viable for issuers.

Another issue that was not discussed in the Issues Paper but has recently come to the fore is the treatment of foreign-issued cards in the Bank's regulation. The Bank's standards have generally been taken to apply to transactions on Australian-issued cards acquired domestically. In contrast, there is currently consideration in the European Union of having European regulation of interchange fees also applying to transactions on foreign-issued cards acquired in Europe. The Bank considers that this Review presents a timely opportunity to consider whether a similar approach might be adopted in Australia, particularly given the possibility of circumvention of Australian regulation by foreign issuance.

The second general issue is whether interchange fee caps should be broadened to capture non-interchange payments between schemes and issuers that are economically equivalent to interchange fees. Such payments can potentially be used to circumvent interchange regulation. There are a range of payments – such as marketing fees, incentive fees and rebates – that could be used to mimic an interchange payment; for example, a four-party scheme might increase fees charged to acquirers and use these funds to pay rebates to issuers. The FSI Final Report suggested that extending the current interchange fee caps to apply on a broader functional basis would help prevent circumvention of interchange caps and enhance competitive neutrality in the case of companion card arrangements.

A third set of issues concerns the level and nature of interchange fee caps. The current standards provide for caps of 0.50 per cent for credit and 12 cents for debit, specified as a weighted average of interchange rates within a system. The Issues Paper and the FSI Final Report raised the possibility that the existing interchange caps might, however, be inefficiently high. While it is often argued that interchange fees play an important role in encouraging the uptake of card payments in emerging payment systems, the extent to which this rationale applies to well-established systems such as Australia's is arguable. Indeed, card payments have grown strongly over recent decades and now account for a very large share of retail transactions. The Bank has also noted that differentials in interchange fees provide the incentive for payment choices to be based on the size of the interchange payments rather than the underlying attributes and resource costs of different payment methods. The FSI Final Report suggested that payments system efficiency could be enhanced by lowering interchange fee caps, with the benefits including lower product prices for all consumers as a result of lower merchant service fees, and less cross-subsidisation in the payments system.

The Issues Paper also invited views on whether the weighted-average interchange fee caps should be replaced by hard caps. This reflected concerns that: schemes have used the flexibility provided by the weighted-average system to set their interchange fee schedules in a way that results in relatively high costs for smaller merchants; the widening of the range of interchange rates has reduced the transparency of costs for merchants (see above); and, the adoption by schemes of some relatively high interchange rates (combined with the current compliance methodology – see below) has resulted in average interchange rates in the Visa and MasterCard systems that are typically above the caps. If the weighted-average method were retained, an option would be to supplement it with a hard cap, or ceiling, on individual interchange rates to address the dispersion of rates within the international four-party schemes' interchange schedules.

Finally, the Issues Paper raised some compliance-related matters, including the possibility of amending the way in which compliance with interchange benchmarks is assessed, so as to address the tendency for actual (average) interchange fees to be higher than the regulatory benchmark. Currently, compliance with the benchmark is assessed every three years, on the basis of a scheme's newly set interchange schedule and a backward-looking set of transactions (the most recent financial year's data). The behaviour of schemes and issuers within this framework has meant that average interchange fees tend to drift well above the benchmark level between the three-yearly compliance points. A potential response is to shift to more frequent compliance.

Summary of consultation

While there was broad consensus on some aspects of interchange policy, views diverged markedly on others. The international four-party schemes, for example, reiterated their long-held view that interchange regulation has been ineffective; and, along with a number of other respondents (which included a number of financial institutions), argued against a lowering of interchange caps. Many other submissions, including the majority of those from merchants and consumer groups, argued that the interchange caps should be lowered. These respondents were almost universally of the view that the spread of interchange rates between small and large merchants should be reduced. There were a few submissions arguing for the complete elimination of interchange fees.

There were also somewhat mixed views on broadening the scope of interchange fee caps to include other payments between schemes and issuers. Many respondents viewed this issue through the lens of competitive neutrality, arguing that interchange-like flows in three-party schemes should be regulated consistently with interchange fees in four-party schemes. A couple of stakeholders argued that interchange fee caps should be made as broad as possible. However, some respondents were of the view that incentive payments and other rebates paid to issuers by four-party schemes were sufficiently different in nature from interchange fees (and interchange-like payments in three party schemes) to warrant ongoing exclusion from interchange caps.

As noted above, a number of submissions addressed coverage-related issues that were not raised in the Issues Paper. In particular, several parties argued that commercial cards should be excluded from interchange caps. It was suggested that these cards conferred substantial benefits for participants on both sides of the transaction, and that if interchange caps were lowered (including if a cap on individual rates was introduced) it would have an adverse impact on the viability of commercial cards issued by four-party schemes. Some views to the contrary were received during consultation. There was a range of views – but limited strongly held opposition – on the question of whether prepaid cards should be explicitly included within the debit card interchange cap. The possible inclusion of domestically acquired transactions on foreign-issued cards was not commented on; the Bank will seek stakeholder views as part of this consultation.

Views were more closely aligned on some other issues, mainly related to compliance, though this was perhaps more evident at the level of broad principles than on details of any potential changes in policy. In general terms, most stakeholders accepted the concerns raised in the Issues Paper about the lack of transparency in the cost of interchange payments and the widening of interchange rates; many indicated that some form of a cap on the highest interchange rate could be considered. Some suggested that a cap could be combined with a floor on the lowest interchange rate which, they argued, would ensure some degree of flexibility for schemes to set competitive interchange fees, while potentially narrowing the spread between interchange fees faced by small and large merchants. While there was some support from end users for moving to a hard cap, mainly on the basis that it

would be a simpler and more transparent system, submissions from schemes and financial institutions were in favour of retaining the weighted-average approach because it provides more flexibility in the setting of interchange rates. Most respondents were open to a move to more frequent observance of the weighted-average interchange benchmarks from the current three-yearly compliance cycle.

Excessive surcharging

Summary of issues

The ability of merchants to levy surcharges on different types of payment instruments is an important mechanism for promoting the efficient allocation of resources in the payments system. It allows merchants to signal the costs of different payment choices and to pass on these costs to users, aligning end users' private costs more closely to social costs and thereby contributing to a more efficient payments system. The outcome is that merchants are able to set prices for goods and services lower than would be the case if surcharging was prohibited, and the extent to which users of lower-cost payment methods subsidise users of higher-cost methods is reduced. The ability to surcharge also potentially improves merchants' bargaining position in relation to widely held ('must take') payment methods, which can help keep downward pressure on merchant service fees and interchange fees.

However, the Issues Paper noted that the Bank and other stakeholders have been concerned that, in a small number of cases in particular industries, surcharge levels on some transactions appear to be well in excess of the merchants' likely acceptance costs. This is particularly evident for certain lower-value transactions on which fixed-rate surcharges are levied, as in the airline industry. A related concern is that enforcement of the current standards – under which scheme rules limit surcharges to the reasonable cost of card acceptance – has been inadequate. The FSI Final Report cited the complexity of calculating merchants' reasonable cost of acceptance and the associated lack of transparency as factors that have contributed to the limited enforcement of the current regime by schemes and acquirers.

In addition to excessive surcharging in certain industries, the Bank has been concerned about a more general tendency of merchants to 'blend' surcharges for high- and lower-cost schemes and card types (that is, applying the same surcharge regardless of different acceptance costs). This practice reduces the effectiveness of surcharging in helping to promote efficient allocation of resources. While blended surcharging can reflect merchants' preference for simplicity, the fact that some merchants do not have a clear view of their average acceptance costs for different types of cards can also be a contributing factor.

The Issues Paper sought feedback on potential options to improve the accuracy of price signals and to address perceptions of excessive surcharging in some industries. Among the options was a three-tiered surcharging system as originally proposed in the FSI Final Report. The Bank also invited views on whether cases of excessive surcharging could be addressed via targeted changes to regulation or through measures that improve the enforceability of current reasonable-cost rules.

On 20 October, the Government released its response to the FSI, indicating its expectations that the Board – through this Review – would provide clarity around what constitutes excessive customer surcharges on card payments. It also indicated that it would phase in a legislated ban on excessive surcharges, with enforcement to be undertaken by the ACCC.

Summary of consultation

A number of submissions opposed the principle that merchants should have the right to surcharge for more expensive payment instruments. International card schemes, for example, advocated removing the standards, which would enable them to reimpose 'no-surcharge' rules. In contrast, many others, including consumer groups and merchants, noted the potentially useful role of surcharging in providing effective price signals about payment costs and in holding down the overall prices of goods and services.

Most submissions expressed concern over excessive surcharging in some industries. There was a fairly general view that the FSI's proposed three-tier approach was overly complicated. Many submissions argued that it was important that a low-cost, non-surchargable, payment option be available and that the 'reasonable cost' rule on surcharges should be more enforceable, potentially by a public agency. A number of merchants argued for greater transparency of payment costs of different schemes in merchant statements and acquirers generally indicated that they would be willing to work with the Bank to enhance the transparency of merchants' payment costs. A few submissions from merchants in industries where surcharges are common argued that surcharging practices should be allowed to reflect special factors in those industries. Views were mixed on the merits of a targeted approach to excessive surcharging focused on particular industries; while some respondents suggested that the limited incidence of excessive surcharging justified such an approach, others emphasised the importance of applying regulation on a consistent basis.

Competitive neutrality and companion cards

Summary of issues

Some stakeholders have argued that the Bank's regulation may not be 'competitively neutral' because it applies to some card systems but not to others. In this regard, most attention has focused on the fact that payments from American Express to banks issuing companion cards are not regulated, in contrast to the interchange fees paid in the four-party schemes.[5] The two types of payments are, in many respects, economically equivalent, and both are aimed at encouraging banks to issue cards and supporting rewards programs and other benefits that promote use by consumers. The different regulatory treatment of three- and four-party cards is argued to have contributed to the issuance of American Express companion cards and an increase in the market share of three-party schemes over the past decade.

Summary of consultation

While the Bank received representations both for and against extending the regulatory net in general, most respondents focused on the possibility of regulating American Express companion cards. The international four-party schemes argued that if four-party card systems continue to be regulated, then all the payments in bank-issued companion cards from three-party schemes should be subject to interchange regulation. One scheme went further, arguing that proprietary three-party cards (i.e. those issued by the scheme) should also be brought within equivalent regulation. Most merchants supported bringing companion cards under Bank regulation.

5 Bank-issued American Express cards were initially offered as stand-alone products. They are now issued as part of a companion arrangement where customers are provided an American Express card as part of a package with a MasterCard or Visa credit card, with both cards accessing the same line of credit.

In contrast, American Express and most submissions from companion card issuers argued that fee arrangements for companion cards were negotiated bilaterally and therefore were of a different nature to multilateral interchange fees, so should remain outside the regulatory framework. More generally, it was argued that concerns about 'competitive neutrality' had been overstated because American Express had a much smaller share of the cards market than the two largest four-party card schemes; and because American Express cards are not considered 'must take' cards by many merchants, and/or are more often subject to a surcharge.

Merchant routing

This issue relates to situations – most notably, for dual-network debit cards – where a single card or device contains more than one payment option and the question of whether merchants should have the ability to choose the network through which transactions are routed. If acquirers were required to provide merchants with this ability, this could help address upward pressure on interchange fees. The Bank notes that this type of requirement has been introduced in the United States for debit cards. The Bank received mixed views on this issue, with submissions arguing both sides of the case for formalising merchants' control over routing decisions. Most merchants argued that once a cardholder had chosen between a debit and credit transaction, the merchant should have the ability to determine the network through which the transaction is processed. International card schemes, and some financial institutions, argued that cardholders and/or issuers should have control over how a transaction is routed. Consumer groups noted that merchant routing could give rise to consumer protection issues if it led to a different consumer experience than had been intended and/or resulted in a transaction being processed from a different account than the cardholder had intended.

The Board remains of the view that issuance of dual-network cards promotes competition between networks, and that these cards provide convenience for consumers. Facilitating merchant choice is likely to be in the interests of payments system efficiency and can help to hold down payment costs because it can offset the tendency for competition in card payment systems to put upward pressure on interchange fees. However, consultations have highlighted that there are some consumer protection issues that need to be considered, particularly in cases where a consumer has separate accounts associated with the different networks on their card. Accordingly, the Board is not proposing to consult on any regulatory changes in this area at present but restates the Bank's previous position that, where a device provides access via two different networks to the same account, schemes or payments providers should not prevent merchants from exercising choice in how they route transactions, providing there is appropriate disclosure to customers.

Competing applications on mobile devices

An important change underway in the payments industry is the advent of electronic wallets, which potentially allow a consumer to access a wider range of different cards (or other means of payment) for a given transaction than in the past. This gives rise to a number of regulatory issues, including the possibility that technology, telecommunications or payment providers could seek to restrict the choice of options available to end users and financial institutions. Innovations in the payment process such as tokenisation might also be used in ways that restrict competition, for example, where a network requires that a transaction be processed via a particular tokenisation service. The Issues Paper noted that there were a number of regulatory options that could potentially be considered, some of which had been proposed in other jurisdictions. Regulation could, for example, include measures to ensure that different payment applications or brands cannot be excluded from a

particular device such as a mobile phone. In consultations, some respondents noted that there may be benefit in considering a code of conduct around new technologies, including mobile wallets, rather than taking a regulatory approach, with the Australian Payments Clearing Association recently commencing some work in this area. Others noted the challenges involved in considering regulatory interventions in circumstances where technology is changing rapidly. The Bank will continue to take an interest in developments and will consider the appropriate response if particular issues arise.

3. Reform Options

This chapter sets out some options for reform, drawing on the material in the Issues Paper and the consultation undertaken to date. For the various options, relevant efficiency and competition considerations are discussed, along with potential costs and benefits, followed by the Board's preliminary assessment.

Companion Cards

It has been a decade since the Bank first considered the case for regulating interchange-like payments made by American Express to its partner banks in a similar fashion to interchange fees in the four-party schemes.[6] Since then, issuance of companion cards has grown faster than that of four-party schemes' cards (and of traditional three-party cards), suggesting that differences in regulatory treatment are influencing the development of the market.

Reform options

There are three broad options that might be considered in relation to companion card arrangements, the fee flows embedded in them and issues of 'competitive neutrality'.

Option 1: Retain the current arrangements

This option would retain the status quo. On the assumption that standards remained in place for four-party schemes, interchange fee arrangements in the latter would continue to be formally regulated, while companion card issuer fees and other payments to issuers would not.

Option 2: Remove regulation of interchange fees for four-party schemes

Under this option, consistency in regulation would be achieved by removing existing interchange fee regulation for the four-party schemes. The four-party schemes would be free to set interchange fees at their preferred levels to directly compete with American Express' companion cards.

Option 3: Regulate issuer fees and other payments to issuers

Under this option, payments to issuers of American Express companion credit cards would be subject to regulation. Interchange-like issuer fees would be subject to the same interchange fee cap as the four-party schemes. Other payments to issuers – such as marketing fees, sign-on fees, incentive fees and rebates – would be subject to rules on 'other net payments' to prevent circumvention of regulation. Competitive neutrality would require that the latter restrictions also be applied to four-party schemes (see 'Scheme payments to issuers' below).

6 See RBA (2005) and RBA (2008b, p 20).

Considerations

Differentials in interchange fees and other payments to issuers significantly influence the behaviour of card issuers and the payment choices by cardholders. In the Bank's view, an efficient payments system is promoted where the relative prices of different payment methods faced by cardholders reflect the relative resource costs of those payment methods. However, it is likely that companion card arrangements are encouraging cardholders to use those cards more than they otherwise would because they receive more generous rewards on these cards. In turn, those rewards are made possible by relatively high payments from American Express to issuing banks.

As noted in Chapter 2, some submissions argued that the bilateral nature of negotiations in companion card arrangements and the fact that American Express has a smaller market share than the international four-party schemes justified companion cards remaining outside of the regulatory perimeter. A counter to the first of these arguments is that, irrespective of how they are negotiated, interchange-like fees and other payments to issuers influence behaviour in much the same way as credit card interchange payments; encouraging the issuance of payment methods that are more resource intensive, and providing incentives to cardholders to use these cards. The four-party schemes have also suggested that the more generous cardholder benefits offered on companion cards have been a driver for the establishment of 'super premium' four-party cards because higher interchange fees are their only means of competing with American Express in some segments of the market.[7]

The combined share of credit and charge card transactions accounted for by American Express and Diners Club has increased from around 15 per cent in the early 2000s to about 19 per cent. This change largely occurred in two steps around 2004 and 2009 that coincided with the introduction of bank-issued companion American Express rewards cards by the major Australian banks. The combined market share has been relatively flat for the past few years. Notwithstanding this, household survey evidence indicates that bank-issued American Express cards have steadily increased their market share since their introduction, with American Express companion cards now more widely held than American Express' scheme-issued, or 'proprietary', cards.[8] Some merchants have indicated that an increased cardholder base as a result of companion card arrangements, combined with acceptance of American Express by the large retailers, has resulted in increased pressure for them to also accept American Express cards.

Option 1 would retain the current regulatory arrangements, with payments in the American Express companion card system remaining unregulated by the Bank. This approach would take into account the fact that American Express cards are not as widely accepted as MasterCard or Visa cards. However, American Express has a strong presence in specific sectors, such as the corporate card market. It is therefore likely to be considered a must-take card in industries where there is significant corporate card expenditure, such as travel and entertainment. This is also likely to be the case for some retailers that cater to higher-income individuals or international visitors. As noted above, some smaller and mid-sized supermarkets also argue that they have to accept American Express cards (and

7 This may have contributed to the widening in the range of interchange fees noted below. This widening and the emergence of super premium cards has, however, also been observed in other (unregulated) markets, which suggests that there are also other factors at play.

8 In the RBA's 2013 Consumer Use Survey (Ossolinski, Lam and Emery 2014), nearly half of those consumers that had a credit card held an American Express card, with the vast majority of these cardholders having the bank-issued version of the card (sometimes in addition to the proprietary card).

not surcharge) because the largest supermarket chains accept them. Moreover, growth in companion card issuance has been relatively strong over the past decade, suggesting that the current regulatory arrangements are facilitating the promotion of a higher-resource-cost payments method.

Options 2 and 3 would place the four-party schemes and American Express companion cards on a more consistent regulatory footing. However, under Option 2 (removal of interchange regulation for four-party schemes), unconstrained interchange fees (as discussed elsewhere in this paper) would be likely to result in rising payment costs, distorted price signals to cardholders and an inefficient allocation of resources in the payments system.

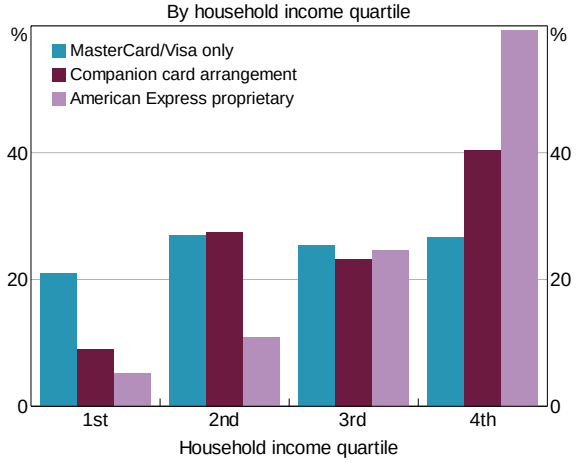
Option 3 (regulation of all payments to issuers) would represent a significant change from the status quo for the current companion card issuance model. The growth of companion cards in large part reflects the significant payments from American Express to issuing banks. These payments comprise not only transaction-based 'issuer fees' (the most direct equivalent to interchange fees) but also other payments to issuers. To place schemes on an equivalent footing in terms of the relative incentives that can be provided to issuers and cardholders would require both the application of 'interchange fee' regulation to all schemes and a broadening of the type of payments that are captured in that regulation. Regulation of these fees would imply a reduction in the payments from American Express to its bank partners and could alter the relative appeal of companion cards to issuers and cardholders, probably implying a decrease in rewards and other benefits offered. It is possible that some banks would cease to see a commercial advantage in issuing companion cards, while for American Express, promotion of proprietary cards might become relatively more attractive. Under this option, for competitive neutrality and to prevent possible circumvention of the interchange regulations, there would also need to be limits on payments from four-party schemes to issuers (see 'Scheme payments to issuers').

While Option 3 would likely result in a reduction in benefits to holders of companion cards, price signals and resource allocation in the payments system would improve and lower card acceptance costs to merchants would result in downward pressure on the prices of goods and services to consumers. In addition to these benefits in terms of the efficiency of the payments system, Option 3 would also entail an equity benefit. American Express companion cards are more common among higher-income individuals (Graph 1). As a result, people on lower incomes are often effectively subsidising those on higher incomes. To the extent that this effect is reduced, equity will be enhanced in the payments system.

Graph 1

Proportion of Schemes' Cardholders*

By household income quartile



* Primary credit card

Sources: Colmar Brunton; RBA

In terms of compliance costs, Option 3 would involve some one-off costs for American Express and for companion card issuers, as they would need to ensure that their bilateral arrangements complied with relevant standards. There would also be ongoing costs related to monitoring compliance and meeting reporting obligations under the regulations. However, based on experience with the existing regulatory framework, these costs are likely to be modest. Removing interchange fee regulation (Option 2) would have no direct effect of compliance costs for companion card arrangements, which are currently unregulated, and would remove the modest current compliance costs for four-party systems. Both Options 2 and 3 would be likely to lead to changes in commercial strategy among schemes and issuers which would themselves generate costs ranging from the renegotiation of contracts to systems changes and communication with cardholders.

Preliminary assessment

If Option 1 were adopted, leaving companion cards unregulated, the existing issues of competitive neutrality would persist. These issues could be amplified in the event of other regulatory changes to interchange fee arrangements for four-party schemes, such as a reduction in interchange fee benchmarks or caps on the maximum permissible level of individual interchange rates. American Express companion card issuance would be likely to continue to expand. This in turn could increase payment costs overall, initially borne by merchants that accept American Express cards, since its merchant service fees are higher than those of most other payment methods. In the event that merchants surcharge American Express these costs would be passed on to the relevant cardholders; however, to the extent that surcharging did not occur, the costs would be passed on to consumers more generally.

Option 2 could level the playing field by removing existing regulation on interchange fees on four-party schemes; however, as is discussed below, this would come at the cost of much higher interchange fees. Higher interchange fees involve significant efficiency costs including greater use of higher-cost credit cards, higher retail prices for consumers and subsidisation of credit card users by users of other payment methods such debit cards and cash.

Regulation under Option 3 addresses competitive neutrality between four-party and companion card arrangements, while building on the efficiency benefits of existing interchange regulation. More

generally, this option is consistent with the view taken by the FSI that regulating payments to companion card issuers would enhance competitive neutrality in the payments system:

> 'Incentive payments used in most systems and service fees used in companion cards systems can achieve the same outcomes as interchange fees; however, they are not currently captured by interchange fee caps. Applying interchange fee caps on a broader functional basis would help prevent alternative payments from avoiding caps and provide competitive neutrality for four-party and companion card payments system providers.'[9]

The Board favours Option 3 as the basis for the next round of public consultation.

Interchange Fees

This section outlines a range of possible options for addressing some of the issues raised in the previous chapter around the current interchange framework. There are a number of interrelated issues that are considered in turn. First, the coverage of the regulatory framework is discussed, with a focus on whether various types of transactions should be included or excluded from the framework. Second, there are some possible changes to the compliance process that the Bank proposes to consult upon. Third, some potential changes to the benchmarks and possible ceilings on individual interchange fees are discussed. Finally, consistent with options to include companion card arrangements within the framework for interchange fee regulation, options for regulation of other payments to issuers are addressed.

Coverage of interchange standards

In addition to the proposed inclusion of companion cards for the purposes of interchange regulation (see discussion above), three other aspects of the coverage of interchange standards warrant consideration. One of these aspects (prepaid cards) was raised in the Issues Paper; a second (commercial cards) was raised by a number of submissions to the Review; the third (foreign-issued cards) is relevant due the possibility of circumvention and some recent developments in the European Union.

Commercial cards

Currently, commercial cards are included within the scope of the Bank's interchange standards, and are included for the purposes of compliance with the weighted-average benchmarks. Interchange rates on commercial credit cards tend to be well above the average levels; ranging from 0.68 per cent to 1.8 per cent; while commercial debit card interchange rates for MasterCard and Visa are set at 0.91 per cent and 1.05 per cent, respectively.

Option 1 (the status quo): Commercial cards to be retained in coverage of interchange standards

Under this approach, commercial cards would continue to be covered by the Bank's standards. Schemes would need to ensure that the interchange rates for these products were consistent with the weighted-average benchmarks set by the Bank.

9 Financial System Inquiry (2014), p 173.

Option 2: Commercial cards to be exempted from interchange regulation

Under this option, commercial cards would not form part of the interchange benchmark calculations and could be set by schemes without regulatory constraints. If commercial cards were to be exempted, there could be a case for introducing measures similar to those developed in Europe, such as modifying regulation covering 'honour-all-cards' rules, as well as provisions to ensure unbundling of pricing and greater transparency, both visually and electronically.

Considerations

The issue of the regulatory treatment of four-party commercial cards was raised by a number of parties – mainly schemes and issuers of these cards – who argued that such cards should be exempted from interchange regulation, especially in the event that interchange caps were lowered. These parties characterised commercial cards as providing benefits, for both payers and merchants, relative to more traditional ways of settling business transactions. It was argued, for example, that commercial cards afforded corporate purchasing departments more control over spending and better reconciliation of transactions. For merchants, it was suggested that card payments led to improved cash flows for the business. Exempting commercial cards would, at least at face value, be consistent with the approach taken by the European Union.

However, based on consultations and given the arguments regarding the significant benefits to parties on both sides of the transaction, it is not clear that large interchange payments are required to induce the provision of commercial card programs. Indeed, most issuers noted – notwithstanding the fact that interest earnings on commercial cards are relatively small – that rebates to corporates were common in this sector, implying that effective pricing arrangements for commercial cards may in fact not be that dissimilar to those for personal credit cards.

Another consideration is that, other things being equal, exempting commercial cards from interchange regulation would represent a de facto relaxation of the cap; that is, because commercial interchange rates are significantly higher than the benchmark, excluding them would allow other interchange rates to rise. It would also raise issues of possible circumvention through issuance of commercial cards to individuals. While the probability and possible costs of any circumvention are difficult to estimate, the Bank notes that EU regulation exempting commercial cards was accompanied by strict definitions of commercial cards and expects that a similar approach would need to be taken in Australia.[10]

Accordingly, the Board's preliminary view is that it remains appropriate to include transactions on commercial cards in the regulatory framework for interchange payments.

Foreign-issued cards acquired in Australia

Currently, the Bank's standards for card systems apply to cards issued under the rules of a scheme as applied in Australia, and so have generally been taken only to apply to transactions on Australian-issued cards acquired domestically. As noted, the approach proposed recently in Europe would apply

10 The exclusion of commercial cards from EU hard caps was accompanied by various measures to improve transparency and empower merchants with the ability to decline commercial cards – for example, honour-all-cards and no steering rules were removed for commercial cards.

interchange regulation to 'inter-regional' transactions – specifically, interchange caps would also apply to transactions in Europe using foreign-issued cards.[11]

Option 1: Retain the current approach

Under this option, the definition of transactions in the Bank's standards would not include foreign-issued cards acquired in Australia, and transactions on these cards would not need to be included in the weighted-average calculation for interchange benchmarks.

Option 2: Clarify the definitions in the Bank's standards to include transactions in Australia with foreign-issued cards

This option would bring transactions with foreign-issued cards acquired in Australia under the coverage of the interchange standards and require that they be included in the weighted-average calculation.

Considerations

The Bank's consideration of the treatment of foreign-issued cards is mostly a reflection of an increased possibility of circumvention of the interchange standards through the use of such cards. This is most apparent with the advent of 'virtual' cards, which are card numbers – often single-use numbers – that are not associated with any physical card. The virtual card model has so far been used predominantly in the travel industry and by niche issuers, though it could potentially be used in the broader corporate purchasing card market. These cards could well lend themselves to offshore issuers marketing to Australian corporates, taking advantage of higher interchange rates on international transactions. More broadly, any significant differences in standard domestic interchange rates and the rates set on transactions in Australia using foreign-issued cards raises the possibility of circumvention of the Bank's interchange standards. This suggests that the Bank should consider consulting on changes to the Bank's interchange standards that would treat transactions at Australian merchants using foreign-issued cards in the same way as transactions on Australian-issued cards, and include them in the calculation of weighted-average interchange fees.

The effect of Option 2 would be to lower average interchange fees paid by Australian acquirers – either as a result of the interchange fees on foreign-issued cards being lowered directly, or else through lower interchange fees in other categories so as to comply with the benchmark. These lower fees for acquirers would be expected to flow through to lower merchant service fees and more broadly to lower prices for consumers. The international schemes typically do not publish their 'inter-regional' or international interchange rates, but they appear to be mostly in the 1½ - 2 per cent range. Based on an estimate that transactions on foreign-issued cards comprise 3 per cent of domestically acquired transactions, the implied reduction in average interchange fees (relative to current benchmarks) is around 4 basis points for credit and 2 cents for debit. Forgone interchange revenue under Option 2 would be borne at least initially by issuers – mostly foreign-based banks if compliance was achieved by schemes lowering the interchange rates applying to foreign-issued cards acquired in Australia.

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11 In particular, the European Commission has proceedings open against both MasterCard and Visa for the interchange fees that apply to transactions on non-EU cards at EU merchants. It appears that the Commission may be seeking to have foreign cards subject to the same interchange fees as European cards (i.e. 20 or 30 basis points), when used within the EU.

Overall, given the potential for circumvention of interchange regulation, the Board's preliminary view is that foreign-issued cards should be treated similarly to domestically issued cards when used in Australia. Costs to schemes from any such change to the Bank's standards would be small since transactions on foreign-issued cards are already separately identified for the purposes of interchange payments and fees on these transactions.

Prepaid cards

The Board's earlier approach to the emergence of prepaid cards reflected their considerable similarity to debit cards. While prepaid cards are not regulated, the Board has noted that it expects these cards to be treated in broad conformity with the Bank's standard on debit cards. As noted above, this has given rise to a degree of ambiguity, and the Issues Paper raised the option of formalising the approach to prepaid cards to clarify their regulatory treatment and ensure that schemes can be confident of a level playing field.

Option 1: Retain the current approach

Under this option, the current 'quasi-regulation' of prepaid cards would continue, with schemes expected to ensure that interchange arrangements are broadly in conformity with the requirements of the Visa Debit standard.

Option 2: Remove prepaid cards from regulation

An alternative – that would address the ambiguity of 'broadly in conformity with' – would be to rescind the Board's expectation around prepaid card arrangements. Prepaid interchange rates would be able to be set without reference to regulatory benchmarks.

Option 3: Formalise regulation for prepaid cards consistent with debit standards

Under this option, the Board's current 'expectation' would be formalised into a standard, fully consistent with the treatment of debit card interchange fees.

Considerations

In most respects, prepaid card interchange rates have, to date, been set consistent with the debit card standard, with similar decisions about categories being made by the schemes: both MasterCard and Visa have 'strategic merchant' rates that apply to prepaid transactions at particular merchants and both have introduced 'premium prepaid' categories in recent years with relatively high percentage interchange rates. However, with significant growth in premium prepaid transactions, average prepaid interchange fees for the international schemes have recently been above the 12 cents benchmark applying to debit cards.

The current approach (Option 1) was adopted partly because of the relatively low values and volumes of prepaid card transactions a decade ago. However, growth in the use of prepaid cards has meant that the ambiguity associated with the current approach is potentially more problematic than it was in the past, and it would be undesirable if the two international schemes were to interpret 'broadly in conformity with' in quite different ways. Accordingly, the Board sees merit in addressing this ambiguity – a position broadly supported in consultation to date. While Option 2 would remove the ambiguity, if prepaid interchange rates were unregulated it would be very likely that there would be a significant increase in these rates, with adverse implications for payments system efficiency. Indeed,

the recent experience with the setting of prepaid rates, in particular the recent increases in rates applying to 'premium' prepaid cards, suggests these incentives are already at work.

The Board's preliminary view is that Option 3 would best address the ambiguity in policy settings. Making the regulatory framework consistent between prepaid and debit cards recognises that they are close substitutes. In terms of compliance costs, schemes would need to ensure that average interchange rates on their prepaid transactions (when combined with debit) were consistent with the benchmark. These costs should be little different to the current approach where prepaid rates are set 'broadly in conformity with' debit card interchange benchmarks.

Benchmark compliance

The current compliance mechanism in the interchange standards has seen average interchange fees in the MasterCard and Visa systems typically remain above the benchmarks and also drift higher over the course of the three-year compliance cycle; this has not, however, been the case for ePAL, where average interchange rates in the eftpos system have remained well below the debit benchmark. Accordingly, a consideration in the current review is whether the compliance process should be changed to ensure that average interchange fees do not exceed the benchmarks on a consistent basis.

Option 1: Retain the three-year compliance cycle

Current interchange regulation for both credit and debit cards requires that every three years, or at the time of any other voluntary reset of interchange fees, the weighted average of a scheme's new schedule of interchange fees does not exceed the benchmark set by the Bank. The weights ascribed to individual interchange fee categories are based on the transactions of the most recent financial year.

Option 2: Quarterly compliance

Under this option, schemes would be required to comply with the benchmarks on a quarterly basis, rather than every three years. Schemes' weighted-average interchange fees would be reported to the Reserve Bank on a quarterly basis (as is currently the case). If a scheme's average interchange fee – calculated using current-period transaction weights – in a given quarter, *t*, exceeded the benchmark, the scheme would be obliged to reset its interchange schedule to, or below, the benchmark within 45 days of the end of the quarter. In this case the compliance calculation would use the new interchange schedule as set by the scheme, and transaction weights from quarter *t*. Schemes would only be obliged to reset interchange rates if a quarterly check indicated that their weighted-average interchange fee exceeded the benchmark. Schemes would be free to make voluntary changes to their interchange schedules but would be required to ensure that their new schedule complied with the benchmark, based on transaction weights from the previous quarter.

Considerations

A benefit of the current three-yearly backward-looking approach (Option 1) is that it imposes a low compliance burden. For example, in the event of unexpected changes in transaction flows, schemes are not required to reset their schedules to bring the weighted-average interchange rate back to the benchmark.

However, a result of the current approach is that schemes are also not required to reset their schedules in the event that their average interchange rates rise above the benchmark due to deliberate strategic decisions. In particular, the downside of infrequent and backward-looking

compliance has been that it has allowed the international schemes' actual weighted-average interchange fees to drift well above the benchmarks over time. When the schemes reset their interchange schedules they have tended to introduce new, higher interchange fee categories. These new categories initially have a zero transaction weight for benchmark compliance purposes. Issuers have an incentive to increase their interchange revenue by issuing and promoting these new, high-interchange cards – for instance, by replacing standard cards with 'premium' cards, 'super-premium' cards, etc. After three years of upwards drift in average interchange fees in a compliance period, the schemes must then lower some interchange rates to ensure compliance with the benchmark, at which time they have tended to reset their schedules in ways that will again cause their average interchange fees to rise during the next three-year period. As a result, schemes' weighted-average interchange fees – especially for credit cards – have followed a 'sawtooth' pattern since the imposition of the benchmarks, with the benchmark level not representing a cap on average interchange fees. This pattern is likely to continue under the status quo.

The Board is concerned that the flexibility of the current system has had adverse effects on payments system efficiency. Indeed, the strategic interchange rate setting observed is an example of the tendency for competition between must-take card schemes to lead to higher interchange rates and payment costs as schemes compete to incentivise issuers to issue their cards. The cost of these high interchange fees has tended to fall on medium-sized and smaller merchants and other merchants that do not benefit from low strategic interchange rates.

The Board notes that it would be possible to retain the flexibility of a three-yearly compliance period and still ensure average interchange rates are set below, or close to, a desired level, by setting the regulatory benchmark below the desired level by an amount based on the expected degree of overshooting that is likely to result from strategic behaviour by schemes. Similarly, it would be possible to shift to annual compliance and take the same approach. However, the Board is not attracted to this option.

Instead, the Bank is consulting on an option of quarterly compliance with the benchmarks (Option 2).[12] By requiring observance of the benchmark on a quarterly basis, the upward drift in average interchange fees would be reduced and average interchange fees would be at levels intended under the benchmarks. Compared with the status quo, this option would impose some additional compliance costs on the MasterCard and Visa schemes; there would currently be no effect on the eftpos system. In particular, depending on how closely they choose to set their average rates to the benchmark, the international schemes may have to reset their interchange schedules more regularly than is required under the current three-yearly compliance cycle.

Under the current system, before each three-yearly compliance date, schemes put significant effort into determining a new interchange fee structure that will achieve compliance while best meeting their commercial objectives. These resets often result in significant changes to interchange fee schedules and result in costs to issuers who may have to reprice and potentially restructure their product offerings as a consequence. Under a quarterly compliance system, interchange resets might be more frequent but would be much more incremental in nature than the resets currently occurring every three years.

12 Most stakeholders supported more frequent benchmark compliance during consultation, typically favouring an annual reset cycle. The Bank expects that shifting to annual compliance would be an improvement, but there would still be significant incentives to set interchange schedules to bring about drift over the benchmark.

There are reasons to suggest that the costs of incremental resets to meet the benchmarks may be relatively modest. While the schemes have been required to reset their Australian interchange schedules to the benchmark only once every three years, in practice they have tended to make changes more frequently. For instance, following resets that have been required each three years on 1 November, the schemes have typically undertaken a subsequent, voluntary, reset on the following 30 June. Schemes have also made voluntary annual changes to their debit card interchange schedules since 2012. In addition, they have implemented voluntary resets at short notice when deemed appropriate. For instance, following an unanticipated voluntary reset by MasterCard of its debit card interchange schedule in November 2013, Visa implemented similar changes to its schedule eight days later. Taken together, this suggests that the schemes do not see the cost of incremental resets of interchange fees as prohibitive. Given that the schemes will have a significant degree of control over when a reset will be required, the costs of the proposed quarterly compliance methodology appear to be moderate.

Preliminary assessment

In the Board's view, shifting to quarterly compliance would be the most effective approach for ensuring that schemes' average interchange fees remain close to the benchmark levels. As noted above, the current three-yearly compliance framework has significant shortcomings in that it allows average interchange fees to drift well above the benchmarks over time and encourages the expenditure of resources on maximising interchange fee flows. The cost of the upward drift falls on medium-sized and smaller merchants and other merchants that do not benefit from low strategic interchange rates.

The Board recognises that quarterly compliance may require schemes to reset their interchange schedules more frequently than is currently the case. However, as noted above, there are reasons to suggest that the cost to schemes of such resets is modest. Alternatively, it would be open to the schemes to set their interchange schedules so as to maintain their average interchange fees sufficiently below the benchmarks to avoid the need for frequent resets. In this case, compliance costs would be very low and would involve only quarterly reporting of their average interchange fees.

Interchange benchmarks and ceilings

The interchange benchmarks set by the Board are the primary instrument for the Bank to anchor credit and debit card interchange fees at a desired level. The current benchmarks of 0.50 per cent of the value of a credit card transaction and 12 cents per debit card transaction have been in place since 2006.[13] When the Board last reviewed these caps in the 2007–08 Review it considered the possibility of lowering the caps to 0.30 per cent for credit and 5 cents or even zero for debit, but decided against doing so at that time.

As noted above, average credit and debit interchange fees in the MasterCard and Visa systems have typically been above the benchmarks and have drifted higher between compliance periods. Schemes have used the flexibility afforded by the weighted-average benchmark framework to set increasingly complex interchange schedules, with new, higher-fee categories and a wider range between the lowest and highest rates. The Issues Paper noted that the higher rates tend to be borne

13 EFTPOS interchange fees were originally constrained between four and five cents, flowing to the acquirer. They were brought fully into line with scheme debit interchange fees and subject to the 12 cent cap in 2013.

disproportionately by smaller and medium-sized businesses, most of which do not benefit from the 'strategic' and other preferential rates that are available to some larger merchants.

Options for consultation

The Bank is consulting on four broad options with regard to the interchange fee benchmark system. It has decided at this time to not consider the implementation of hard caps in place of a weighted average on all interchange fees, nor of caps that are the minimum of a percentage amount and a fixed amount. The options for consideration are:

Option 1: No change to the current standards

This option retains the current benchmark for the weighted-average interchange fee at 0.50 per cent of transaction value for credit cards, and 12 cents per transaction for debit systems, with no constraints on the levels of individual interchange categories.

Option 2: Retain a weighted-average framework for the benchmarks, supplemented by a ceiling on individual interchange rates

The second option is to retain the weighted-average benchmarks but to introduce ceilings on individual interchange fees within the schedules. No credit card interchange fee could be more than 0.80 per cent while no debit card interchange category could be set at more than 15 cents or more than 0.20 per cent of transaction value.

Option 3: Reduce the weighted-average interchange fee benchmarks

This option is to reduce the weighted-average benchmarks to:

a. 0.30 per cent for credit;

b. 8 cents for debit.

Option 4: Remove interchange regulation but introduce measures to increase transparency of interchange fees to merchants and strengthen the ability of merchants to respond to high interchange cards

This option would remove all existing regulation of credit and debit card interchange fees. However, given the concerns held by the Bank and many end users regarding the dominant market position of the large schemes and the likelihood that schemes would seek to increase interchange rates, this option would be accompanied by requirements that schemes and acquirers provide greater real-time information about the interchange costs of individual transactions and greater flexibility to merchants to respond in their acceptance decisions.

Considerations

The main argument for leaving the benchmark system unchanged (Option 1) is that the industry has adjusted to the current framework and would no doubt welcome a period of continued stability in the regulatory framework.

However, preserving the status quo would not address the Board's concerns about the widening in the range of interchange rates and the resulting lack of transparency in payment costs for non-preferred merchants. The highest credit card interchange fee is currently 2.00 per cent of transaction value, which is almost double the highest rate when the Bank's reforms were first introduced. In the

case of debit cards, both international schemes have introduced *ad valorem* or percentage-based interchange categories which can be particularly costly for large-value transactions. Due to the hierarchy of interchange fees, the cost of these high-rate categories falls on merchants that do not qualify for 'strategic' and other preferential interchange fees – typically small and medium-sized retailers. In the September quarter 2015, the average credit card interchange fee faced by non-preferred merchants was around 55 basis points higher than the rate face by preferred merchants; for debit cards the spread was around 13 cents.

The option of supplementing the weighted-average benchmarks with a ceiling on individual interchange categories (Option 2) would potentially go a long way towards dealing with these issues. Stakeholders generally acknowledged the Board's concerns about the growing dispersion of interchange rates and many indicated that a cap on the highest interchange rates could be an acceptable solution. The caps proposed under this option would result in a reduction in interchange fees on premium consumer cards and on commercial cards (with implications for the generosity of rewards packages and rebates on such cards).[14] The option would be likely to result in a meaningful reduction in the interchange disadvantage of non-preferred merchants. However, Option 2 would also increase the importance of addressing the issue of competitive neutrality and companion cards. In particular, without action to make companion cards subject to regulation of fees paid to issuers, caps that limited the interchange fees that four-party schemes could pay on premium and commercial cards would place them at a disadvantage relative to companion cards from three-party systems.

The option of reducing the weighted-average benchmarks (Option 3) would address the Board's concern that interchange benchmarks may still be higher in Australia than is desirable for the overall efficiency of the payments system. In particular, it would be consistent with the view that interchange fees tend to distort price signals and can inefficiently skew usage towards higher-resource-cost payment methods. As the Bank has frequently observed, competition between mature 'must-take' card networks can result in networks increasing their interchange rates as they compete to persuade banks to issue their cards, with issuers then using these fees to pay rewards to individuals to take and use the cards. As a result, competition can have the perverse result of increasing the price of payment services to merchants, thereby resulting in higher retail prices of goods and services for all consumers, including those who do not use cards.

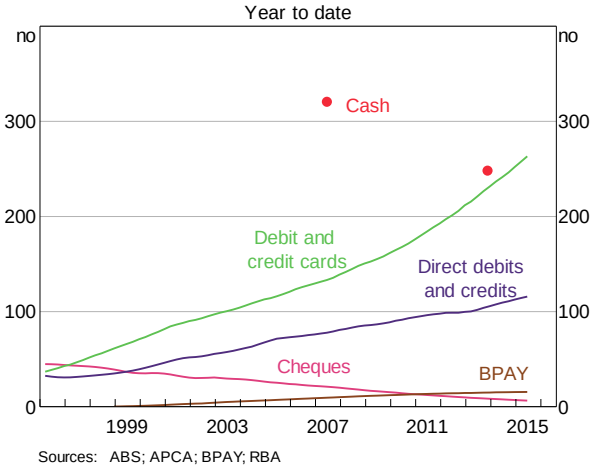
As a result of these dynamics, payment decisions by end users may be based on the size of the interchange payments rather than based on the underlying attributes and resource costs of different payment methods. Systems with relatively low interchange fees will often be at a disadvantage in attracting cardholders from competing payment systems with higher fees. Indeed, looking ahead, the prospect for new payment methods to emerge and be widely adopted may be significantly affected by the interchange policies of the dominant existing schemes.

As noted in Chapter 2, while there may be a role for interchange fees in emerging payment systems in encouraging the use of a system by one side of the market or the other, the case for such fees is much weaker as the system becomes well established. The latter conditions clearly apply in Australia; payment cards are now the dominant means of making retail payments, with the relative use of cash

14 In the case of credit, the majority of transactions in these affected categories are at interchange rates that are not that far above 0.80 per cent, so – other things held equal – the imposition of a ceiling would imply only a modest reduction in weighted-average interchange rates. In the case of debit, interchange fees that are above the proposed 0.20 per cent ceiling are significantly above, implying a more significant reduction in weighted-average interchange rates.

declining rapidly (Graph 2). Visa and MasterCard are the two largest schemes and jointly account for around 65 per cent of all card payments (debit, credit and charge). This market share has grown over the past few years, but there has been no tendency for interchange rates in these systems to fall as system volumes have risen and average costs have fallen.

Graph 2
Transactions per Capita



Sources: ABS; APCA; BPAY; RBA

In the case of debit cards, a reduction in the benchmark to 8 cents would unwind the effective increase in percentage terms in the benchmark that has resulted from the fall in average transaction size since 2006. It is likely that such a change would serve to bring interchange fees on the international scheme debit products and the domestic eftpos system closer together. It would also be expected to bring down payment costs for merchants who do not benefit from strategic interchange rates and might result in greater acceptance of debit cards for low-value transactions; currently some merchants do not accept cards for low-value transactions because they consider the transaction costs to be too high.

In the case of credit cards, a benchmark of 0.30 per cent would be consistent with the cap to be implemented for all intra-European transactions in the new EU regulations. Unlike the hard cap being implemented in Europe, Option 3 would retain the current weighted-average framework, where schemes have the flexibility in setting individual interchange fees above and below the benchmark. The ability for schemes to set higher and lower interchange fee categories may be appropriate in certain situations, for example, where they are seeking to encourage actions such as fraud prevention by issuers, acquirers or merchants.

Significant reductions in the interchange benchmarks would, however, require some adjustments to industry business models. In the case of credit cards, a reduction in the benchmark would presumably be associated with some change in the generosity of rewards programs. As with the previous option, it would require some action with respect to companion cards to avoid a significant effect on the competitive balance between these and four-party schemes.

One benefit of Option 4, if it were feasible, would be that it would avoid the need for interchange regulation. While it seems highly likely that the removal of any interchange benchmarks would lead to very strong pressures for higher interchange rates, these might be contained if the power of merchants to respond to high interchange rates in their acceptance decisions could be strengthened sufficiently. However, the downside of this option, as indicated in Chapter 2, is that industry participants indicated that empowering merchants in this way would involve significant costs to

industry. In addition, the relatively limited adoption of surcharging in some sectors suggests that the discipline provided by Option 4 may be somewhat uneven.

Preliminary assessment

The FSI endorsed the Bank's overall approach to interchange regulation, and the Board remains of the view that interchange reforms have contributed to a more efficient and competitive payments system. One example is the fall in merchant costs, with average merchant service fees having fallen by more than 60 basis points for MasterCard and Visa transactions since interchange regulation was introduced. The Bank's most recent Payment Costs Study (Stewart *et al* 2014) estimated that the costs involved in providing payment services to households have fallen from 0.80 per cent of GDP in 2006 to 0.54 per cent of GDP in 2013. At the same time, the use of cards has continued to grow strongly.

The Board is not attracted to Option 4, which would involve the Bank stepping back from interchange regulation and relying instead on strengthened merchants' rights to respond to upward pressures on payment costs. The payments industry has indicated that significant systems changes would have to occur if it was required to provide merchants with real-time information on payments costs and greater ability to respond when high-interchange, high-cost cards were presented by cardholders – which would likely be necessary for a no-interchange regime to be effective. In addition, merchants in a range of sectors have indicated that the principle of merchant surcharging for higher-cost means of payment is still not fully accepted, so that they find it very difficult to surcharge to offset the higher cost of particular 'must-take' payment methods. Further, the experience of the 2007–08 Review suggests that an approach of stepping back from interchange regulation and relying on voluntary undertakings is unlikely to be a feasible way of achieving the Bank's policy objectives.

In considering the case for retaining the current standards (Option 1), the Board has weighed the identified drawbacks of the current system against the potential costs to industry of adjusting to a change in regulation. The main benefit of maintaining the current interchange benchmark system would be that it is well understood by the industry, and some of the shortcomings of the current approach could be dealt with if the coverage of interchange fee standards is broadened. However, the Board's preliminary view is that Option 1 would not be in the public interest because it would not adequately address the lack of transparency of payment costs and higher and rising average interchange fees faced by merchants that do not qualify for preferential interchange rates.

Of the remaining options, the Board has seriously considered the case for lowering both the debit and credit card benchmarks (Option 3). The current review has not altered the Board's long-held view that there appears to be little justification for significant interchange fee payments in mature card systems. It notes that lower interchange rates would have a number of benefits including: a reduction in payment costs of merchants; downward pressure on retail prices of goods and services for consumers; reduced need for merchants to consider surcharging of more expensive cards; reduced focus on rewards programs and reduced incentives for the use of payment methods with higher resource costs; a reduction in barriers to entry for potential new methods of payment; and a reduction in the extent to which current arrangements in the card payment systems favour large retailers and higher-income consumers. The main counter to this is that Option 3 may be more disruptive for existing participants in the payments industry than Option 2, at a time when there are a number of other initiatives underway (notably the New Payments Platform and the new ePAL hub). The Board also notes that Option 2 would still achieve some reduction in average interchange rates due to tighter compliance requirements, as well as the inclusion of transactions on foreign-issued

cards acquired in Australia. It would also entail less risk of unexpected effects on the competitive balance between three- and four-party schemes or of a significant increase in circumvention efforts.

On balance, the Board considers that different options are appropriate for credit and debit systems. It is of the preliminary view that Option 2 is appropriate at present for credit card interchange fees. A ceiling of 0.80 per cent would bring a meaningful reduction in premium and commercial card interchange fees, and would still allow four-party schemes to compete effectively with three-party products, especially given the existing higher acceptance of the former. However, the Board is of the view that a reduction in the debit card benchmark (Option 3b) would be appropriate, especially in light of the growth in transaction volumes and the reduction in average payment values in the debit systems. It would also bring interchange fees in the international scheme debit systems and the eftpos system closer together.

Scheme payments to issuers

In addition to interchange payments from acquirers to issuers, four-party card scheme arrangements are typically also characterised by payments from card schemes to issuers. These marketing and incentive payments are bilaterally negotiated and can be quite material in value. The flexibility of such payments means that they can potentially be structured in ways to circumvent interchange regulation. For example, a scheme could mimic an interchange payment by altering the incidence of scheme fees on the issuing and acquiring sides on the market, in particular by increasing the level of scheme fees on acquirers and making an equivalent payment to issuers (or reducing issuer scheme fees accordingly).

Internationally, regulators have moved to limit the extent to which non-interchange payments can be paid to scheme participants. For example, the US regulatory framework for debit cards contains a general provision prohibiting the circumvention of interchange fee regulation and specific provisions which limit net payments by card schemes to issuers to zero. Under the European regulation, other payments are treated as if they were interchange payments.

The Bank is consulting on two options for other payments to issuers:

Option 1: No regulation of scheme payments to issuers

Under this option (the status quo), payments and rebates by schemes to issuers would not be directly regulated. Interchange and issuer fees would be subject to the Bank's benchmarks, but other fee flows to issuers would not be regulated.

Option 2: Limits on payments by schemes to issuers

Option 2 introduces a general and objective anti-avoidance provision to minimise the possible circumvention of the Bank's Standards. In addition 'other net payments' would be defined as all payments from schemes to issuers (including via third parties) excluding any payments captured in the interchange benchmark calculation, less any payments from issuers to schemes. The standard would deal with payments that are related to multi-year agreements and multi-product agreements and would avoid capturing payments that were genuinely unrelated to incentivising issuance decisions. Under this option, other net payments to issuers may not be positive. Schemes would calculate net payments at the level of each individual issuer and would have to attest to the Bank annually that they had not made positive net payments to any issuer.

Preliminary assessment

Card schemes and large issuers argued against the regulation of scheme payments in their submissions to the Bank's Issues Paper. However, regulation cannot be effective if it can be easily circumvented. The Board is of the view that measures to monitor and prevent circumvention are required, especially if the application of the benchmark is to be broadened to cover issuer fees in companion card schemes or if the benchmarks were lowered (or effectively tightened due to the inclusion of additional types of transactions). However, there is a trade-off between the strength of the anti-avoidance provisions and the overall compliance cost for the industry. The Board's preliminary view is that Option 2 would not involve significant compliance costs and would result in a net benefit to the effectiveness of the regulatory framework. More broadly, the Board expects payment systems participants to observe and comply with the Bank's regulatory framework in good faith and not attempt to circumvent the policy.

Surcharging

Options for consultation

The Bank has determined its preferred consultation option on surcharging with reference both to the views expressed by stakeholders in consultation and the Government's proposed framework for enforcing limits on surcharges in its response to the FSI Report. The Government's response included a number of elements:

- the continuation of the right of merchants to surcharge on expensive payment methods
- a desire to ensure that merchants do not surcharge at excessive levels that are unfair for consumers or payment schemes
- a desire for greater clarity in the definition of what constitutes excessive surcharging
- roles for both the ACCC (in enforcement) and the Bank (in terms of the policy framework) in the regulatory framework for surcharging.

The Bank has had discussions with the Treasury and the ACCC about possible policy approaches. The agencies have worked towards a coordinated approach along the following lines: [15]

- the Bank's standard continues to specify that card schemes may not have no-surcharge rules
- the Bank's standard defines the cost of card acceptance
- the Bank's standard requires that acquirers (or payment facilitators) in designated card systems must provide information to merchants about the cost of acceptance of different card types
- Government legislation will ban excessive surcharging, with the threshold for excessive surcharging relying on the definition of merchants' acceptance costs in the Bank's standard
- the ACCC will have enforcement powers in cases where merchants are surcharging in excess of the cost of acceptance.

15 This framework applies to card schemes that are designated. In principle, if there were concerns about excessive surcharging on other payment methods (e.g. cash, cheques, BPAY, etc.) the framework could be extended to those methods. The Bank could define a cost of acceptance for these methods and the ACCC could also be given enforcement power over excessive surcharges on these payment methods.

The Bank is consulting on three options:

Option 1: No change to the existing definition of reasonable cost of card acceptance

Under this option, merchants would retain the ability to surcharge up to the reasonable cost of accepting card payments based on a broad definition of eligible costs as in the Bank's current guidance note. This option, with its broad definition, would add complexity to the ACCC's enforcement of a Government ban on excessive surcharges.

Option 2: Remove regulation

Under this option, merchants may be prevented from surcharging at all, with schemes able to reintroduce the type of 'no-surcharge' rules that were in place prior to the Bank mandating the removal of such rules in 2003. This would not be consistent with the Government's response to the FSI.

Option 3: Modifications to the cost of acceptance framework

This option is intended to preserve the right of merchants to surcharge for high-cost payment methods while ensuring that merchants do not abuse this right by surcharging in excess of their acceptance costs. It would retain the cost of acceptance as the ceiling for surcharges, but would define acceptance costs explicitly and more narrowly.

The option includes a number of elements:

- Card schemes could not have no-surcharge rules.
- Merchants could surcharge up to the cost of acceptance for a payment method, where the cost of acceptance is defined as the average cost of that payment method in terms of fees paid by the merchant to the acquirer (or payment facilitator) for payment services.[16]
- Surcharges would be explicitly defined in a functional way, to ensure that merchants could not attempt to evade limits on surcharges by describing their fees as something else, for example, a 'booking and service fee' on credit card payments.
- Acquirers (or payment service providers) would be required to provide merchants with information on their cost of acceptance for each payment method (e.g. for eftpos debit cards, Debit MasterCard, Visa Debit, MasterCard credit, and Visa credit).[17] The cost of acceptance would have to be expressed in percentage terms, unless the acquirer charged a fee for a particular payment method that was fixed across transaction values.
- There would be strengthened requirements on schemes and acquirers to make debit and credit cards identifiable to merchants, including in the card-not-present environment, to ensure that merchants have the ability to surcharge debit and credit cards differentially if desired.

Based on discussions with stakeholders, the policy options that the Bank is consulting on do not include a framework along the lines of the FSI's proposed three-tier model. The Bank is not attracted to setting a single maximum surcharge rate for the second tier ('medium-cost' systems) of the FSI framework, because any single rate would be a poor reflection of the acceptance costs of many

16 References to acquirers in this option should be taken to apply to other parties (including payment facilitators, payment service providers, aggregators etc.) that provide card acceptance services to merchants.

17 Prepaid cards would be included within the debit categories.

merchants. It is also not attracted to the proposed first tier of the FSI model, whereby schemes could reimpose no-surcharge rules for 'low-cost'/'low-interchange' payment methods such as debit cards, for several reasons.

- Interchange fees are only one component of the cost of payments. Acquirer fees and scheme fees may be more significant than interchange fees in some circumstances and may transform a low-interchange product into a relatively high-cost payment.
- Whether a payment method is low-cost will often depend on the nature of the transaction. A debit card may well be the lowest-cost payment method available in some types of transactions (e.g. in an online environment where real-time authorisation is important). However, cash, BPAY or Electronic Funds Transfer may be lower-cost means of payment in many other environments, and one type of debit card may be lower-cost than other types (for example, eftpos is often significantly cheaper for merchants than MasterCard or Visa).
- The relative cost of different payment instruments can change over time. This applies to cash and cheques as well as payment cards, and it may be unwise to 'hard-wire' into a surcharging standard the assumption that a particular means of payment is low-cost and cannot be surcharged.

Considerations

The main argument for retaining the 'reasonable cost' definition set out in the Bank's guidance note as the cost of acceptance (Option 1) is that it would continue to provide merchants with significant flexibility to consider their individual circumstances when calculating the cost basis for any surcharge. In principle, this flexibility promotes efficiency by allowing a relatively accurate matching of price signals to merchants' costs.

However, the conceptual attractiveness of the current framework must be balanced against the ability to enforce limits in cases where surcharges may be excessive. Acquirers and schemes have limited visibility over some of the payment costs included in the definition of reasonable costs in the Bank's guidance note. Accordingly, it may be difficult for schemes to ascertain whether merchants are surcharging excessively, so they may be unable to enforce their rules. A second drawback with the current system is that it allows merchants to set their surcharges to recover their overall payment costs, but does not prevent them from recovering more than their acceptance costs on individual transactions. This is an issue in the airline industry, where the current system of fixed-dollar surcharges would appear to be resulting in airlines significantly over-recovering their payment costs on low-value tickets (while possibly under-recovering costs on high-value fares).

The main argument for the option of removing regulation and allowing schemes to reintroduce no-surcharge rules (Option 2) is that it would eliminate any instances of excessive surcharging by particular merchants. However, at the same time it would take away the right to surcharge of those merchants that are currently surcharging at or below their cost of acceptance. It would also significantly reduce pressure on schemes to reduce payment costs and would result in the loss of the benefits in terms of competition and efficiency in the payments system that have resulted from the Board's 2003 decision to allow surcharging.[18]

18 For example, the removal of the no-surcharge rule in the American Express system is likely to have contributed to the decline of merchant service fees in that system.

The available data indicate that the removal of the no-surcharge rules in 2003 appears to have had many of the expected effects:

- Observed surcharging behaviour is generally linked to the cost of card payments, with merchants more likely to surcharge more expensive cards. For example, survey data from the Bank and the NSW Business Chamber for over 700 small and medium-sized businesses indicate that 30 per cent of merchants accepting American Express applied a surcharge, compared with 12 per cent for MasterCard and Visa credit cards, 5 per cent for MasterCard and Visa debit cards and 3 per cent for eftpos.[19]
- In addition, surcharges tend to be higher for more expensive cards. The Bank's 2013 Consumer Use Survey indicated that the median surcharge paid for transactions involving American Express cards was 2.0 per cent compared with 1.5 per cent for surcharged MasterCard and Visa transactions.[20]
- While many merchants may surcharge one or more card type, consumers are typically able to use lower-cost alternative payment methods in order to avoid paying a card surcharge. The Bank's Consumer Use Survey indicates that surcharges were paid on only around 4 per cent of card transactions overall.[21]
- At an economy-wide level, there is no evidence to suggest that merchants have taken advantage of the ability to surcharge to recoup an amount in excess of their cost of accepting card payments. The Bank estimates that in 2013 merchants in aggregate recouped approximately one-quarter of the merchant service fees they paid when accepting card transactions; this estimate is significantly lower than implied by some estimates reported from industry participants.[22]

The case for allowing the schemes to reintroduce no-surcharge rules has been considered in a number of contexts in addition to the Bank's 2007–08 Review of the Reform of Australia's Payment System and its 2012 Review (RBA 2008a, RBA 2008b and RBA 2012). For example:

- The 2013 report by the Commonwealth Consumer Affairs Advisory Council (CCAAC 2013, p iii) concluded that: 'Credit card surcharges that reflect the reasonable costs of card acceptance are generally beneficial to consumers as they support wider acceptance of payment options that are convenient for Australian consumers while facilitating efficient outcomes within the payments system. CCAAC notes that since the removal of the "no-surcharging" rules in 2003, there has been a significant reduction in the service fees applied to merchants upon a consumer's use of their credit card.'

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19 See Stewart *et al* (2014), pp 44–45.

20 See Ossolinski, Lam and Emery (2014), p 36.

21 Ibid.

22 This estimate is based primarily on the Bank's 2013 Consumer Use Survey where 1 167 consumers filled in online or paper payments diaries for every transaction undertaken over a week. This resulted in detailed data (including on surcharges paid) on more than 15 500 transactions by households. The estimate of total surcharges paid also includes an estimate of surcharges paid on commercial cards which assumes that transactions on these cards were more likely to be surcharged and were surcharged at higher rates than consumer transactions. This methodology yields an estimate of surcharges paid of around $800 million in 2013, compared with merchant service fees paid of around $3 billion. By contrast, MasterCard's July 2014 submission to the FSI reported a higher estimate from a survey, which it had commissioned, which did not involve a diary and simply asked consumers to estimate how much they paid in surcharges on average per month; see MasterCard (2014).

- The view that the right to surcharge is an important mechanism for promoting payments system efficiency was supported by many submissions in response to the issues paper. Most notably, leading consumer organisations have supported cost-based surcharging, while stressing the importance of proper disclosure of surcharging and the provision of other widely available non-surcharged means of payment. For example, CHOICE's submission noted that 'CHOICE supports fair surcharging. Any return to a "no surcharge" regime would shift the costs from consumers who choose a specific payment type to all consumers, as costs are absorbed into the overall price of goods and services. Such a change would disadvantage consumers using lower cost payment methods like eftpos or cash while subsidising users of higher cost credit cards.'

Option 3 would deal with some of the shortcomings identified with the current standards and better deal with instances of excessive surcharging. This option defines the cost of card acceptance for each card system in terms of the merchant service fee for that type of card plus any other card-related fees paid to the merchant's acquirer (or payment facilitator). These other costs may include items such as fees for the rental and maintenance of payment card terminals and scheme fees incurred in processing card payments and passed on by the acquirer – costs that are specified in item 2a of the Bank's current guidance note. This should be a simple, observable definition that could improve price signals by facilitating enforcement and reducing the scope for merchants to surcharge excessively.

A downside of the option is that it may omit some significant elements of the cost of acceptance for some industries.[23] For example, consultations have pointed to issues in industries where the 'merchant' is not the ultimate supplier, and the good or service is purchased significantly in advance. Notably, this is the case for travel agents. In these cases, card scheme rules may require that agents provide cardholders with chargeback rights if the ultimate supplier of the good or service – for example, an airline or hotel – becomes insolvent before the good or service is supplied. The agent would not have the same exposure if payment was made by another means – for example, eftpos, BPAY or cash – so the cost of chargeback rights is one that varies by payment method. Given that the cost of chargebacks (or insuring for chargebacks) falls on the merchant, it is not included in the cost of payment services provided by the acquirer. The cost of chargebacks in this case would not be considered a cost of acceptance under Option 3 and therefore would not be included in the permissible surcharge. The Bank is interested in views on possible alternative approaches – ones that would not excessively complicate the 'cost of acceptance' measure – in cases similar to this.[24]

A further consideration in determining a suitable approach to surcharging is the fact that, conceptually, the appropriate surcharge on a higher-cost payment method is the incremental cost of that method over alternative low-cost (non-surcharged) means of payment accepted by the merchant. This reflects the fact that all payment methods have costs, including those that are not surcharged. If merchants instead surcharge at the full cost of the more expensive payment method, they are likely to be surcharging more than is appropriate. In practice, however, it would be difficult to include the idea of the incremental cost in a standard that was both simple and enforceable, so the

23 In addition, by proposing that surcharging be limited to the average cost of all cards from a scheme, this option would mean that merchants would no longer be able to surcharge differentially within a card type, for example, to surcharge premium cards at higher levels than standard cards. However, few merchants currently appear to be interested in taking up such an option. In addition, if the proposed cap on individual interchange fee categories were adopted, there would be less need for differential surcharging of cards within the same scheme.

24 Possible solutions might include: introducing a carve-out from chargeback obligations in the case of insolvency of a supplier; acquirers providing explicit insurance for insolvency, which would then become part of the cost of acceptance; or travel agents making their payments to suppliers with cards that also carry chargeback rights.

Bank is not proposing to do so. By defining the cost of acceptance in a narrow way as fees paid to an acquirer – which excludes any costs internal to the merchant or paid to other providers – it is likely that it better approximates the incremental cost for many merchants.

Overall, Option 3 represents an attempt to determine a definition of acceptance costs that strikes a balance between the aims of promoting efficient price signals and avoiding excessive complexity. While a comprehensive definition that encompasses the wide range of costs faced by diverse merchants may be conceptually appealing, experience with the current regime suggests that erring on the side of simplicity is likely to lead to an approach to surcharging that is more efficient and enforceable in practice. In particular, costs that are internal to the merchant are not readily observable to a third party and are likely to be difficult to verify in an enforcement context.

Under this option, the Bank's standard would also require acquirers (or payment facilitator) to provide merchant statements with separate information on the average cost of accepting each card type – in most cases this would imply providing average costs of acceptance for Visa credit, Visa Debit, MasterCard credit, Debit MasterCard and eftpos.[25] Merchants would be provided with this information both in each monthly (or quarterly) statement and also in an annual statement at the end of each financial year. This information should facilitate greater understanding by merchants of the cost of accepting different card schemes and would be the basis for determining the appropriate surcharge for those merchants considering surcharging.[26]

The greater transparency of acceptance costs under this option would allow a third party, including the ACCC, to easily verify whether a merchant was surcharging excessively. Preliminary discussions with acquirers suggest that modifying merchant statements as proposed in Option 3 would be feasible and not excessively costly, provided an adequate transition period was allowed for.

This option would also restate existing obligations for schemes and issuers to make debit and credit cards identifiable visually and electronically, and for schemes and acquirers to make lists of credit and debit Bank Identification Numbers (BINs) available to merchants on request.[27] However, the Bank is not proposing that acquirers would be required to provide merchants with real-time data on the interchange category and payment cost applying to different cards. This reflects both the implementation costs of such a change and the likelihood that such functionality might not be widely used by merchants, especially given that the changes proposed above to the interchange standard would imply less dispersion in the costs of different types of credit cards.

Option 3 could also deal with the issue of fixed-dollar surcharging in the airline industry, which has been the subject of significant public concern. It would require that the information provided to merchants on their cost of acceptance for different payment methods be expressed in percentage terms, with an exception only if the cost for a particular payment method was genuinely fixed for all

25 In the case of American Express and Diners Club, merchants are billed directly by the scheme, and pricing is typically a straightforward single percentage rate on all transactions. In the case of UnionPay, which (as discussed below) will not initially be subject to regulation, the Bank will encourage acquirers to provide merchants with information on average costs that is similar to the data provided for the more commonly used cards.

26 Merchants would, in principle, be able to set different surcharges for different schemes, though it is likely that a desire for simplicity will limit the number of different rates. In the event that a merchant chose to surcharge different types of cards at the same rate, the surcharge could not be above the average cost for the lowest-cost scheme.

27 This obligation is established in the standard, *The 'Honour All Cards' Rule in the Visa Debit and Visa Credit Card Systems and the 'No Surcharge' Rule in the Visa Debit System*.

transaction values. This should eliminate the practice – currently common in the airline industry – of charging the same dollar surcharge on transactions with very different costs to the merchant.

However, the issue of surcharging may remain challenging in the case of the taxi industry. Taxi drivers are mostly unable to arrange their own terminal and payments arrangements from acquirers, typically because of risk factors. Instead, payment services are usually provided by firms which specialise in providing terminals and arranging card payment services from an acquirer. The fee for paying by card in a taxi therefore encompasses the acquirer's fees, the terminal provider's costs and a margin for the terminal provider. Until recently, card surcharges of 10 per cent were typical and were clearly excessive, given that terminal providers competed for drivers by sharing part of that 10 per cent with drivers. However, authorities in Victoria, New South Wales, Western Australia and the Australian Capital Territory have taken decisions to cap surcharges to 5 per cent, which may be much closer to the actual cost of providing payments services in taxis given that rebates to drivers are reportedly much reduced or have been eliminated. The Bank understands that regulators in some of the other states and territories are considering similar actions.

In principle, the general framework of Option 3 is also applicable to the taxi industry. If taxi drivers are viewed as applying the surcharge, Option 3 suggests that any surcharge should not exceed the amount that drivers pay to their payment providers. However, it may still be the case that fees charged by payment providers are excessive, especially in the states and territories that have not taken action to reduce surcharges from 10 per cent. Given the greater complexity of the card payments process in the taxi industry and the fact that most aspects of the industry – including taxi fares – are heavily regulated, it may be appropriate for the time being to leave regulation of surcharging in that industry mostly to state regulators, who may be best placed to assess issues such as the actual cost of providing payment services in taxis and the appropriate rate of return for taxi payment providers. The Bank seeks feedback on this approach and on whether there are other industries operating on a non-standard payment model that warrant further consideration.

Preliminary assessment

The Board remains of the view that surcharging has improved price signals in the payments system and has contributed to the downward pressure on merchant service fees seen since 2003. Accordingly, it sees no case for the Bank stepping back from regulation of surcharging arrangements and allowing schemes to reintroduce no-surcharge rules (Option 2). If that option was adopted, merchants would be unable to signal to consumers that different payment methods entail different costs, resulting in less efficient payment choices by users and a reduction in downward pressure on payment costs. This would likely be associated with higher retail prices for goods and services generally.

At the same time, it has become apparent that the current surcharging standards have not been entirely successful in preventing some surcharging behaviour that undermines price signals in the payments system. While an approach to surcharging that allows merchants to recover their costs of card acceptance remains appropriate, the current framework (Option 1) is viewed by many stakeholders as complicated and inadequately enforced. A particular problem that has been identified is the lack of transparency surrounding the calculation of merchants' 'reasonable cost of acceptance' under the current relatively wide set of eligible acceptance costs.

The Board's preliminary view is that changes along the lines of Option 3 will represent a significant improvement to the framework. The central element of this option is a clearer and narrower

definition of acceptance costs, which would be accompanied by various other measures to enhance transparency and facilitate improved price signals about payment costs. This transparency should reduce the likelihood that merchants seek to surcharge in excess of their cost of acceptance and should ensure that any cases of excessive surcharging can be readily addressed by the ACCC following changes to legislation to give it powers in this regard. Bank staff will continue to work with staff from Treasury and the ACCC with a view to coordinating prospective changes to the legislative and regulatory frameworks. Bank staff will also commence work shortly with acquirers and other payment facilitators with a view to ensuring that merchants are provided with statements that provide more useful information on the cost of accepting cards from different payment systems.

Issues Concerning Other Payment Systems

The Board's decision to designate some additional systems in October and the current consultation on changes to the regulatory framework raise the question of whether designation and regulation should be considered for any other systems. One possibility would be for the Board to publish thresholds for when payment system providers will be automatically subject to interchange or related regulation. The FSI Final Report suggested that such thresholds, which could be based on market share, would provide industry participants and potential new entrants with greater certainty and transparency about how regulation would be applied. There was a range of views on this issue in consultations. Some respondents argued that setting objective thresholds, potentially at a low market share, would foster a level playing field, while others suggested that such an approach could act as a barrier to entry for newer participants in the payments system.

The Board recognises that there could be benefits to providing greater clarity to market participants as to when systems will be subject to regulation. On the other hand, fixed thresholds might not be entirely consistent with the public interest requirements of the PSRA – judgements about competition and efficiency are likely to involve more considerations than just market share. Accordingly, at this stage, the Board is not publishing explicit numerical thresholds for when systems will be designated but will be giving further consideration to the issue.[28] More broadly, the Board considers the most important priority for the current review to be its consideration of what changes are appropriate for the broad regulatory framework to apply to all designated systems issuing various types of cards. Questions of whether some additional (typically smaller) systems should also be subject to particular parts of the regulatory framework can be dealt with subsequently (and probably relatively quickly).

Nevertheless, it may be helpful to stakeholders for the Bank to provide some preliminary thinking on factors influencing the regulatory treatment of particular payment systems. Four systems are particularly relevant here.

The Board's current expectation is that issues concerning surcharging and proprietary American Express cards can be dealt with via a continuation of the current voluntary undertaking. As a system that has not been designated, the American Express proprietary system would not technically fall within the proposed ACCC enforcement regime. However, in practice, the combination of a voluntary undertaking on surcharging, the proposed formal regulation of the American Express companion card system and the Government's ban on excessive surcharging should result in equivalent treatment to other schemes, given that merchants do not distinguish between proprietary and companion

28 The Bank will also be working with Treasury, APRA and ASIC on the question of appropriate arrangements for purchased payment facilities, consistent with Recommendation 17 of the FSI Report.

American Express cards. In the event that this was not yielding appropriate outcomes, the Board would consider designating the American Express proprietary cards system and then making it subject to formal regulation on surcharging.

Diners Club's market share is currently far smaller than the larger schemes in the credit and charge card market. As a three-party scheme, the Bank's interchange standards are not relevant for Diners Club. Diners Club provided a voluntary undertaking on surcharging in 2002, has removed its no-surcharge rule and has indicated that it would be willing to provide an updated undertaking based on any new surcharging standard. Accordingly, the Bank does not currently see any case for designating Diners Club. This again implies that the ACCC enforcement regime for excessive surcharging would not apply for Diners Club cards. However, in the event that excessive surcharging of these cards was found to be a problem or if Diners Club were to enter into companion card arrangements with issuers that were inconsistent with the interchange standards, the Bank would consider the case for designation.[29]

UnionPay's activities in Australia are currently focused on working with the four major banks to increase acceptance of its overseas-issued cards. UnionPay does not currently issue cards in Australia focused on domestic use; its two small domestic issuance programs, one of debit cards and the other of prepaid cards, are both targeted at use in China. It does not have a 'no-surcharge' rule. Accordingly, there does not currently appear to be any case for interchange regulation or to make UnionPay subject to the Bank's surcharging standard. However, if there is significant domestic issuance and use of UnionPay cards in the future, the Bank will consider making UnionPay subject to the requirements of the relevant standards applying to other four-party schemes.

PayPal does not issue cards in Australia. The principal issue with PayPal is its application of a no-surcharge rule. When the Board considered the issue in 2008–09, PayPal was a relatively small player and the Board was not convinced that the benefits of imposing regulation to remove the no-surcharge rule would outweigh the costs. Since then PayPal has seen significant growth in the number of user accounts and merchant accounts. While PayPal's share of the overall retail payments market in Australia is still small compared with the major card schemes, it has a significant market share in the online sphere. The Bank intends to initiate discussions with PayPal regarding its no-surcharge rule, with a view to reconsidering the decisions taken in 2008–09.

29 In addition, in the event that Diners Club (or any other undesignated system) was concerned about excessive surcharging on its cards it would be open to it to include the terms of the Bank's surcharging standard in its scheme rules, along with a requirement that merchants warrant to consumers that any surcharge does not exceed the cost of acceptance. Any excessive surcharge would be a misrepresentation on the part of the merchant.

4. Summary and Next Steps

The preceding chapter identified a number of areas where a case can be made for changes to existing standards for payment card regulation. In contemplating changes to the regulatory system, the Bank has closely considered the interactions between the different parts of the regulatory framework and the likely effect of the proposed reform package on the payments system and broader economy (see Box). It is the preliminary view of the Board that competition and efficiency in the payments system could be enhanced by the following:

- extending interchange fee regulation to the American Express companion card system, the Debit MasterCard system and the prepaid card systems operated by ePAL, MasterCard and Visa
- lowering the level of the weighted-average interchange fee cap for debit cards to 8 cents per transaction and applying it jointly across the debit and prepaid cards of each scheme
- altering the methodology for capping interchange fees to:
  - supplement the weighted-average benchmarks with caps on any individual interchange fee within a scheme's schedule
  - include interchange fees on foreign-issued cards presented in Australia in the interchange fee cap
  - require quarterly compliance with weighted-average interchange fee benchmarks, with interchange fee rates 'reset' whenever average interchange fees exceed the regulated benchmark in a quarter
  - prevent circumvention of interchange fee caps – including by making other net payments to issuers
- moving away from a limit on surcharges based on 'the reasonable cost of acceptance' to one based on fees paid by a merchant to its acquirer (or payment facilitator), and obliging the provision to merchants of information on average acceptance costs for each system. This will be accompanied by the Government's amendments to the *Competition and Consumer Act 2010*, which will ban excessive surcharging and provide enforcement powers to the ACCC.

Section 18(4) of the PSRA requires the Bank to consult prior to determining or varying a standard. The Bank is therefore seeking comments on the Annex to this document, which sets out draft standards incorporating the above elements. These draft standards are described below.

Box: Likely Implications of Regulatory Reforms

In forming its preliminary views on a potential set of reforms to card payments regulation, the Board has considered the implications for participants in, and end users of, the payments system. This Box summarises the likely effects of the Board's preferred options, considered as a package of measures, on various stakeholders. It includes a focus on consumers and small businesses, consistent with the requirements of an early-stage Regulation Impact Statement (RIS).

Industry participants

- A change in the nature of competition between three- and four-party card schemes would be expected. For example, with issuer fees in companion cards subject to the credit card interchange benchmark, there may be a reduction in companion card issuance.
- Reductions in the overall level of interchange payments for debit and credit transactions would be expected to flow through into falls in four-party merchant service fees. Changes to the debit interchange cap could result in higher card acceptance for low-value transactions.
- A fall in merchant service fees for the four-party schemes is likely to result – as in the Bank's initial reforms – in downward pressure on three-party merchant service fees.
- Changes to the interchange fee benchmark frameworks and a reduction in merchant service fees would result in less cross-subsidisation/price discrimination between different types of cardholders and consumers, as well as between preferred and non-preferred merchants.
- The caps on maximum interchange rates would bring down interchange fees on some commercial cards issued under four-party schemes which may result in some reduction in rebates on these cards.
- Smaller card issuers (e.g. credit unions and building societies) do not generally issue high-interchange, high-rewards cards, and so are likely to be much less affected by caps on the highest interchange rates than the large banks.
- Reductions in interchange fees (and, as noted below, the generosity of rewards packages) would reduce the obstacles facing new payment methods in the future.

Consumers

- Lower merchant service fees would be expected to lead over time to a slightly lower overall level of prices of final goods and services to consumers.
- There would be fewer instances of excessive surcharging, owing to simpler, more transparent surcharging arrangements and enhanced enforceability (including by the ACCC). The changes to interchange regulation to bring down payment costs and the narrower definition of the cost of acceptance may also result in some reduction in the frequency of surcharging on some cards.
- The reduction in interchange fees, especially the cap on the highest *credit card* rates, is likely to result in some reduction in the generosity of rewards programs on premium cards. It is likely, however, that there would be only limited changes to other elements of the credit card package (e.g. interest rates, interest-free periods). Similarly, the reduction in the high percentage *debit/prepaid* interchange categories may be likely to result in some reduction in rewards generosity for some of the new debit/prepaid rewards cards. There are unlikely to be other material changes to arrangements for transaction accounts.

Businesses

- As noted above, it is likely that merchant service fees would fall due to a reduction in interchange payments. There may be additional downward pressure on payment costs to the extent that there is some substitution away from companion cards to lower-cost payment methods.
- The difference between interchange fees on transactions at preferred and non-preferred (mainly smaller) merchants would be expected to narrow significantly. Caps on maximum interchange fees would likely benefit small businesses that currently bear most of the cost of 'super-premium' cards. For example, if the interchange fee category on super-premium transactions was reduced from 2.00 per cent to 0.80 per cent, small merchants on 'interchange-plus' pricing arrangements would see a $1.20 reduction in merchant service fees on a $100 transaction using such a card.
- Transparency of payment costs for merchants would be enhanced by changes to surcharging standards and associated disclosure requirements. The improved disclosure of costs would result in greater merchant awareness of the cost of different payments, and surcharging practices that more accurately reflected the cost of different schemes.

Draft Standards

Reflecting the Board's preliminary view, draft standards have been prepared that would give effect to a set of reforms with the above elements. In drafting new standards, the Bank has sought to provide as simple a regulatory framework as possible. While designations apply to a number of systems, the Bank's intention is to adopt standards that can be applied across several systems. Equally, it has attempted to remove complexity where possible, for instance, by removing the complicated and costly cost-based methodologies for calculating interchange fee benchmarks.

Three draft standards are presented in the Annex – *The Setting of Interchange Fees in the Designated Credit Card Schemes and Net Payments to Issuers*; *The Setting of Interchange Fees in the Designated Debit and Prepaid Card Schemes and Net Payments to Issuers*; and *Merchant Pricing for Credit, Debit and Prepaid Card Transactions*. Each is described below.

Draft Standard No.1: The Setting of Interchange Fees in the Designated Credit Card Schemes and Net Payments to Issuers

This standard would apply to the American Express Companion Card System, the MasterCard Credit Card System and the Visa Credit Card System. It would establish a benchmark of 0.500 per cent that would apply to the weighted average of interchange fees in the designated systems (including issuer fees for companion cards), along with a maximum interchange fee of 0.800 per cent, which could not be exceeded at any time by any interchange fee in those systems. The Draft Standard replaces the previous methodology for calculating the benchmark (based on a survey of issuers' costs) with a benchmark determined by the Bank. The restrictions would apply to all transactions acquired under these schemes in Australia, including transactions in Australia using foreign-issued credit cards.

The methodology for compliance with the cap for weighted-average interchange fees would change from the current compliance points each third year to one that is closer to continual compliance. Under the proposed methodology, if actual interchange fees payable in a quarter exceeded the benchmark in that quarter, the scheme would be required to reset its interchange rates within

45 days of the end of the quarter such that no breach of the benchmark would have occurred had those new rates been in place in the previous quarter. If a scheme chose to change any interchange rates at any other time, its rates must also be set such that its average interchange fee in the preceding quarter would not have exceeded the benchmark had those new rates applied.

The Draft Standard incorporates 'no circumvention' provisions, which prevent means of bypassing interchange restrictions. These provisions include a restriction on other 'net payments to issuers' which would require that direct or indirect payments from schemes to issuers (other than interchange or issuer fees) could not exceed scheme and other fees paid by issuers to schemes.

The administrator of a scheme or a representative of participants would be required to certify to the Bank each year that the interchange fees and net payments to issuers had been in compliance with the Standards. The schemes would also be required to report information on interchange fees and transactions to the Bank each quarter.

Draft Standard No.2: The Setting of Interchange Fees in the Designated Debit and Prepaid Card Schemes and Net Payments to Issuers

This standard would apply to the eftpos, MasterCard and Visa debit card and prepaid card systems.

This standard would operate in a similar fashion to the credit card standard described above, to cap interchange fees in the debit and prepaid card systems. In this case, the benchmark for weighted-average interchange fees would be 8.0 cents per transaction and fees for individual interchange categories could not exceed 15.0 cents (if levied as a fixed amount) or 0.200 per cent (if levied in percentage terms). The caps on weighted-average interchange fees would apply jointly across debit and prepaid cards (referred to in the Draft Standard as Scheme Pairs). In this case if the average interchange fee for a scheme pair in a quarter, expressed in cents, exceeded the 8.0 cents benchmark, a reduction in interchange rates would be required within 45 days of the end of the quarter. This methodology implies that weighted-average prepaid interchange fees could exceed the benchmark, provided that weighted-average debit card interchange fees were sufficiently below the benchmark, and vice versa.

The other provisions of the Draft Standard are similar to those described above for credit cards, including 'no circumvention' provisions.

Draft Standard No. 3: Scheme Rules Relating to Merchant Pricing for Credit, Debit and Prepaid Card Transactions

This standard applies to the MasterCard and Visa credit card systems, the American Express companion card system and the eftpos, MasterCard and Visa debit card and prepaid card systems. It prevents the card schemes from imposing 'no surcharge' rules, but allows them to cap merchant surcharges to acceptance costs. The Bank expects that other schemes – including the American Express proprietary card system, Diners Club and potentially others – will make voluntary undertakings to make themselves subject to this standard.

The Draft Standard differs in two main ways from the existing standards relating to surcharging. First, rather than allowing the schemes to cap surcharges at the 'reasonable cost of acceptance', with the latter explained further in a guidance note, the Draft Standard relies on the 'cost of acceptance' which is defined in the Draft Standard and is narrower than the 'reasonable cost of acceptance'. It is defined

to include only fees paid to the merchant's acquirer (or payment facilitator), including the merchant service fee, terminal rental and maintenance fees and other fees paid to the acquirer.

Merchants would be able to surcharge up to the average of their costs over a recent 12-month period (or their average cost over a shorter period if they have not received an annual statement). They could surcharge each card scheme separately, or if they chose to apply the same surcharge to more than one scheme, their surcharge could reflect the cost of the lowest cost scheme. Surcharges would be percentage-based unless the merchant's costs were constant regardless of the transaction size.

Second, to facilitate greater transparency of permissible surcharges, acquirers (and payment facilitators) would be required to provide to merchants in their regular statements details of the average cost to the merchant of accepting each of:

- eftpos debit/prepaid
- MasterCard debit/prepaid
- Visa debit/prepaid
- MasterCard credit
- Visa credit.

The final statement for a financial year would provide the average for each system over the preceding year, so that the merchant could rely solely on those figures to determine its maximum permissible surcharge. This information would be available to the ACCC, which will be given responsibility for enforcing new legislation prohibiting excessive surcharging.

The Bank is keen to ensure that new surcharging arrangements take effect as soon as practicable. While the Board cannot determine changes to the Bank's standards until after it has undertaken consultation consistent with the requirements of the PSRA, the proposed improvements in transparency of acquirer statements could be worked on by industry without formal changes to standards (indeed, some financial institutions have indicated that such improvements would be relatively straightforward). Accordingly, Bank staff expect to shortly commence work with acquirers to encourage them to make expedited changes to their merchant statements consistent with this improved transparency.

Issues for Consultation and Next Steps

The Bank is seeking submissions on the options in Chapter 3 and, in particular, the reform package embodied in the draft standards. Submissions are requested by 3 February 2016. The Bank will then hold meetings with interested stakeholders. Given the complexity of issues involved with respect to interchange fees and companion cards, it is unlikely that the Board will take any formal decision on changes to the interchange standards before its May 2016 meeting. In the case of surcharging, depending on consultation responses, it is possible that the Board may be in a position to make an earlier decision on changes to its standards.

Stakeholders are encouraged to focus not only on the broad approach, but also on the detailed drafting of standards. In preparing submissions, stakeholders should consider the following questions:

i. Is the proposed approach appropriate? Does it meet the public interest?

ii. Is the proposed approach enforceable?

iii. Do the draft standards achieve what is intended?

iv. Are there factors that have not been properly addressed or considered, either in the general approach or the specific drafting?

v. How long should be allowed between the time that any final decisions are made on the regulatory framework and the effective date of any new or revised standards? What factors are relevant to the length of this implementation period?

vi. Would transitional arrangements be necessary for any of the changes embodied in the draft standards?

In addition, the Bank is seeking views on two related issues touched on in this paper:

vii. Possible approaches where merchants wish to surcharge to cover the potential cost of chargebacks arising from the insolvency of a third party (page 32)

viii. The approach to the taxi industry and whether there are other industries operating on a non-standard payment model that warrant further consideration (page 34).

5. Consultation

The Board is seeking views from interested parties on this Consultation Paper. Formal written submissions on the options discussed in Chapter 3 and on the draft standards in the Annex, or on any other aspect of the Bank's card payments reforms, should be provided by no later than 3 February 2016, and should be sent to:

Head of Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001

or

pysubmissions@rba.gov.au.

Submissions provided by email should be in a separate document, in Word or equivalent format. Submissions in PDF format must be accompanied by a version in an accessible format such as .rtf or .doc.

Submissions will be published on the Bank's website, unless the Bank determines that there are reasons not to do so. Where some elements of a submission are considered confidential, respondents are requested to provide two versions of the submission – one for consideration by the Bank and one, with confidential information removed, for publication. In the normal course of events, those making submissions will be provided with an opportunity to discuss their submission with the Bank.

Reserve Bank of Australia
December 2015

Privacy

Unless requested otherwise, published submissions will include contact details and any other personal information contained in those documents. For information about the Bank's collection of personal information and approach to privacy, please refer to the Personal Information Collection Notice for Website Visitors and the Bank's Privacy Policy, which are both available at http://www.rba.gov.au/privacy.

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Annex: Draft Standards

DRAFT STANDARD NO. 1 OF [ ]

THE SETTING OF INTERCHANGE FEES IN THE DESIGNATED CREDIT CARD SCHEMES AND NET PAYMENTS TO ISSUERS

1. Objective

The objective of this Standard is to ensure that the setting of interchange fees and payments and other transfers of valuable consideration having an equivalent object or effect to interchange fees in each designated credit card scheme is transparent and promotes:

- *efficiency; and*
- *competition*

in the Australian payments system.

2. Application

2.1 This Standard is determined under Section 18 of the *Payment Systems (Regulation) Act 1998* (the **Act**).

2.2 This Standard applies to:

(a) the payment system operated within Australia known as the MasterCard system which was designated under the Act as a payment system on 12 April 2001 and which is referred to in this Standard as the **MasterCard System**;

(b) the payment system operated within Australia known as the VISA system, which was designated under the Act as a payment system on 12 April 2001 and which is referred to in this Standard as the **VISA System**;

(c) the American Express Companion Card payment system operated within Australia, which was designated under the Act as a payment system on 15 October 2015 and which is referred to in this Standard as the **American Express Companion Card Scheme**,

each of which is referred to in this Standard as a **Scheme**.

2.3 In this Standard:

Above Benchmark Quarter has the meaning given to it in clause 4.2 of this Standard;

Acquired includes accepted;

Acquirer means a participant in a Scheme in Australia that:

(a) provides services, directly or indirectly, to a Merchant to allow that Merchant to accept a Credit Card of that Scheme; or

(b) is a Merchant that accepts, or is a Related Body Corporate of a Merchant that accepts, a Credit Card of that Scheme and bears the risk as principal in relation to

the payment obligations of the Issuer of that Credit Card in relation to that acceptance;

Credit Card of a Scheme or **Credit Card of that Scheme** means, in relation to a Scheme, a Device that can, under the Rules of the Scheme, be used in Australia for purchasing goods or services on credit (irrespective of whether the Device is issued in or outside Australia);

Credit Card Transaction means, in relation to a Scheme, a transaction in that Scheme between a holder of a Credit Card of that Scheme and a Merchant involving the purchase of goods or services using a Credit Card of that Scheme that is Acquired by an Acquirer (but does not include any transaction to reverse such a transaction or provide a credit or make a chargeback in relation to such a transaction);

Device means any card, plate or other payment code or device, including a code or device where no physical card is issued and a code or device used or to be used for only one transaction;

Interchange Fee Category has the meaning given to it in clause 4.1(b) of this Standard.

Interchange Fees means:

(a) for each of the VISA System and the MasterCard System, wholesale fees, known as interchange fees, which are payable by an Acquirer, directly or indirectly, to an Issuer in relation to Credit Card Transactions in the Scheme; and

(b) for the American Express Companion Card Scheme, Credit Card Transaction based payments which are payable, directly or indirectly, to Issuers which are participants in the Scheme in Australia by the Acquirer or the administrator of the Scheme in Australia, or any Related Body Corporate of either of them, which are functionally equivalent to the fees described in paragraph (a) above, including issuer fees;

Issuer means an entity that issues Credit Cards of a Scheme to its customers;

Merchant means, in relation to a Scheme, a merchant in Australia that accepts a Credit Card of that Scheme for payment for goods or services;

Quarter means a 3 month period ending on 30 June, 30 September, 31 December or 31 March;

Related Body Corporate has the meaning given in the *Corporations Act 2001*;

Reporting Period means a 12 month period ending 30 September;

Rules of a Scheme or **Rules of the Scheme** means the constitution, rules, by-laws, procedures and instruments of the relevant Scheme, and any other arrangement relating to the Scheme by which participants in that Scheme consider themselves bound;

include or **including** or **such as** when introducing an example do not limit the meaning of the words to which the example relates to that example or examples of a similar kind; and

terms defined in the Act have the same meaning in this Standard.

2.4 For the purposes of this Standard:

(a) a provision of a plan, arrangement or agreement shall be deemed to have a particular purpose if the provision was included in the plan, arrangement or agreement by a party or parties for purposes that include that purpose and that purpose was a substantial purpose; and

(b) conduct including the payment or receipt of a fee or other valuable consideration shall be deemed to have been made for a particular purpose if the person undertaking the conduct, payment or receipt did so for purposes that include that purpose and that purpose was a substantial purpose.

2.5 Each participant in a Scheme must do all things necessary on its part to ensure compliance with this Standard.

2.6 If any part of this Standard is invalid, it is ineffective only to the extent of such part without invalidating the remaining parts of this Standard.

2.7 This Standard is to be interpreted:

(a) in accordance with its objective; and

(b) by looking beyond form to substance.

2.8 This Standard comes into force on [ ] (the **Commencement Date**).

2.9 On the Commencement Date this Standard replaces Standard No. 1, *The Setting of Wholesale (Interchange) Fees in the Designated Credit Card Schemes* which applied to each of the VISA System and MasterCard System.

3. Transition Provision

3.1 If, after the Commencement Date and prior to [ ], any Interchange Fee is introduced, varied, or removed in the MasterCard System or the VISA System, the average of Interchange Fees implemented in the relevant Scheme in Australia on the date of that change, calculated in accordance with paragraph 20 of Standard No. 1, *The Setting of Wholesale (Interchange) Fees in the Designated Credit Card Schemes* in place as at the day before the Commencement Date, must not exceed the common cost-based benchmark for that Scheme calculated in accordance with paragraphs 13–17 of that standard.

4. Interchange Fees

4.1 From [ ]:

(a) an Interchange Fee (exclusive of goods and services tax) in relation to a Credit Card Transaction must not exceed 0.800 per cent of the value of the Credit Card Transaction to which it relates; and

(b) if an Interchange Fee applies in relation to a category of Credit Card Transactions (whether that category is determined by reference to the nature of the holder, or type, of the Credit Card of the Scheme, the identity or nature of the Merchant, the means of effecting the transaction, the security or authentication that applies or any other matter, or is a residual category covering transactions not in any other category) (**Interchange Fee Category**), that Interchange Fee must be a percentage rate applying to all Credit Card Transactions in the category or a fixed amount applying to all Credit Card Transactions in the category, and cannot be expressed as a range of rates or amounts.

4.2 From [ ], if the total value of Interchange Fees (exclusive of goods and services tax) payable in relation to Credit Card Transactions undertaken in a Scheme during a Quarter exceeds 0.500 per cent of the total value of those Credit Card Transactions:

(a) that Quarter will be an **Above Benchmark Quarter**; and

(b) the participants in that Scheme must take all necessary steps to vary the rates or amounts of Interchange Fees applicable under that Scheme, with effect no later than [45] days after the end of the Above Benchmark Quarter, to rates or amounts such that, had those varied rates or amounts applied under the Scheme during that Above Benchmark Quarter, that Quarter would not have been an Above Benchmark Quarter.

4.3 From [ ], if at any time any Interchange Fee applicable under a Scheme is introduced or removed, or the rate or amount of any Interchange Fee under a Scheme is varied, the Interchange Fees applicable under that Scheme following that change must be such that, had they applied for the whole of the most recent Quarter prior to the date of the change, that Quarter would not have been an Above Benchmark Quarter. Nothing in this clause 4.3 limits clause 4.2.

5. Net Payments to Issuers

5.1 From [ ];

(a) no Issuer which is a participant in a Scheme in Australia may receive, directly or indirectly, Net Compensation in relation to Credit Card Transactions undertaken in that Scheme. **Net Compensation** is received by such an Issuer if the Issuer Receipts of the Issuer over a Reporting Period exceed the Issuer Payments of the Issuer over that Reporting Period; and

(b) the administrator of a Scheme in Australia must not pay or facilitate payment or enter into an agreement or arrangement that provides for payment or facilitates payment, directly or indirectly, of Net Scheme Compensation to an Issuer which is a participant in a Scheme in Australia. **Net Scheme Compensation** is paid, or payment of it is facilitated, if, for one or more such Issuers, the Issuer Receipts of the Issuer that are paid, given or allowed, directly or indirectly, by the administrator of the Scheme in Australia to the Issuer over a Reporting Period exceed the Issuer Payments of the Issuer that are paid, given or allowed, directly or indirectly, by that Issuer to that administrator of the Scheme in Australia over that Reporting Period.

5.2 For the purpose of clause 5.1:

(a) subject to paragraphs (c), (d) and (e), **Issuer Receipts** of the Issuer is the total of the payments or rebates received, directly or indirectly, by the Issuer in relation to Credit Cards of the Scheme or Credit Card Transactions undertaken in the Scheme that have a purpose or likely effect of promoting or incentivising the issuance or use of Credit Cards of the Scheme or of providing or funding incentives to holders of Credit Cards of the Scheme to use those cards (but excluding Interchange Fees and payments made by or on behalf of holders of Credit Cards of the Scheme to discharge a liability to the Issuer as a result of holding or using such a card). These payments and rebates include volume based and transaction specific payments, incentives, fees or rebates such as:

(i) marketing incentives;

(ii) payments or rebates for meeting or exceeding a specific transaction volume, percentage share or dollar amount of transactions processed; and

(iii) signing bonuses;

(b) subject to paragraphs (c), (d) and (e), **Issuer Payments** of the Issuer is the total amount of all amounts paid or rebates paid, given or allowed, directly or indirectly, by the Issuer to the administrator of the Scheme in Australia or an Acquirer in relation to Credit Cards of the Scheme or Credit Card Transactions undertaken in the Scheme (excluding the amount of the Credit Card Transactions paid by the Issuer to the Acquirer to settle obligations arising from the clearing of Credit Card Transactions). These payments include:

(i) Scheme branding fees;

(ii) processing fees; and

(iii) assessment fees;

(c) if an amount referred to in paragraph (a) or (b) paid to or by, or a rebate referred to in paragraph (a) or (b) given, allowed or received, directly or indirectly, by an Issuer does not relate solely to Credit Cards of the Scheme or Credit Card Transactions undertaken in the Scheme and also relates to other Devices or other transactions, the amount or rebate must be apportioned between the Credit Cards of the Scheme and Credit Card Transactions on the one hand (the **Relevant Portion**) and the other Devices and other transactions on the other fairly and reasonably, having regard to, where relevant, the transaction history on Devices used in the payments systems to which the amount or rebate relates and the proportion of the Devices to which the amount or rebate relates that are Credit Cards of the Scheme issued by the Issuer, and the Relevant Portion included in the determination of Issuer Receipts or Issuer Payments, as applicable;

(d) one method of apportionment that will be fair and reasonable for the purpose of clause 5.2(c) is an apportionment on a pro-rata basis, based on the value of Credit Card Transactions undertaken in the Scheme using Credit Cards of the Scheme issued by that Issuer over the Reporting Period as a proportion of the total value of the transactions undertaken in any payment system to which the amount or rebate relates over the Reporting Period using Devices issued by that Issuer. This does not preclude an apportionment in another way that meets the requirements of clause 5.2(c);

(e) where a payment or rebate referred to in paragraph (a), (b) or (c) relates to a period that spans more than one Reporting Period, the payment or rebate or, in the case of a payment or rebate referred to in paragraph (c), the proportion calculated in accordance with paragraph (c), may be allocated among Reporting Periods on a pro-rata basis based on the number of months in each relevant Reporting Period to which the payment or rebate relates provided that:

(i) no part of it is allocated to any Reporting Period the whole of which occurs before the term of the contract or arrangement to which the payment or rebate applies has commenced;

(ii) no part of it is allocated to any Reporting Period the whole of which occurs after the term of the contract or arrangement to which the payment or rebate applies has ended; and

(iii) it may not be allocated among more than 5 consecutive Reporting Periods.

6. Reporting and Transparency

6.1 The administrator of a Scheme or a representative of the participants in the Scheme in Australia must publish the Interchange Fee rates or amounts (whichever is applicable) of the Scheme in Australia on the Scheme's website, including the rates or amounts for each Interchange Fee Category.

6.2 The administrator of a Scheme or a representative of the participants in the Scheme in Australia must on or before 31 October each year certify in writing to the Reserve Bank of Australia in respect of the most recent Reporting Period, that Interchange Fees of the Scheme in Australia were over that Reporting Period in compliance with this Standard.

6.3 Each of the administrator of a Scheme in Australia and each Issuer who is a participant in the Scheme in Australia must on or before 31 October each year certify in writing to the Reserve Bank of Australia that it was, over the most recent Reporting Period, in compliance with clause 5 of this Standard.

6.4 The administrator of a Scheme or a representative of the participants of the Scheme in Australia must, not later than 30 days after the end of each Quarter, certify in writing to the Reserve Bank of Australia each of the following for that Quarter for the Scheme:

(a) the total value of Credit Card Transactions undertaken in the Scheme in that Quarter;

(b) the number of Credit Card Transactions undertaken in the Scheme in that Quarter;

(c) the total value of all Interchange Fees (exclusive of goods and services tax) payable in respect of the Credit Card Transactions undertaken in the Scheme during that Quarter;

(d) the total value of Interchange Fees (exclusive of goods and services tax) payable in respect of Credit Card Transactions undertaken in the Scheme during the Quarter divided by the total value of the Credit Card Transactions undertaken in the Scheme during the Quarter;

(e) each Interchange Fee Category that applied for some or all of the Quarter and, for each of those categories:

(i) the Interchange Fee rates or amounts that applied during the Quarter (expressed as a percentage or an amount, not as a range); and

(ii) the total value of Interchange Fees (exclusive of goods and services tax) payable in respect of that Quarter that are referrable to Credit Card Transactions undertaken in the Scheme in that Quarter in that category.

7. Anti-Avoidance

7.1 A participant in a Scheme must not, either alone or together with one or more other persons, enter into, begin to carry out or carry out a plan or arrangement or otherwise be knowingly involved in a plan or arrangement if it would be concluded that the person did so for a purpose of avoiding the application of this Standard, and the plan or arrangement or part of the plan or arrangement has achieved or could reasonably be considered to have achieved that purpose.

DRAFT STANDARD NO.2 OF [ ]

THE SETTING OF INTERCHANGE FEES IN THE DESIGNATED DEBIT AND PREPAID CARD SCHEMES AND NET PAYMENTS TO ISSUERS

1. Objective

The objective of this Standard is to ensure that the setting of interchange fees and payments and other transfers of valuable consideration having an equivalent object or effect to interchange fees in each designated debit card scheme and prepaid card scheme is transparent and promotes:

- *efficiency; and*
- *competition*

in the Australian payments system.

2. Application

2.1 This Standard is determined under Section 18 of the *Payment Systems (Regulation) Act 1998* (the **Act**).

2.2 This Standard applies to:

(a) the payment system operated within Australia known as Visa Debit, which was designated under the Act as a payment system on 23 February 2004 and which is referred to in this Standard as **Visa Debit**;

(b) the payment system operated within Australia known as Visa Prepaid, which was designated under the Act as a payment system on 15 October 2015 and which is referred to in this Standard as **Visa Prepaid**;

(c) the payment system operated within Australia known as Debit MasterCard, which was designated under the Act as a payment system on 15 October 2015 and which is referred to in this Standard as **Debit MasterCard**;

(d) the payment system operated within Australia known as MasterCard Prepaid, which was designated under the Act as a payment system on 15 October 2015 and which is referred to in this Standard as **MasterCard Prepaid**;

(e) the debit card payment system operated within Australia known as the EFTPOS payment system, which was designated under the Act as a payment system on 12 June 2012 and which is referred to in this Standard as the **EFTPOS System**; and

(f) the prepaid card payment system operated within Australia under the EFTPOS Scheme Rules, which was designated under the Act as a payment system on 15 October 2015 and which is referred to in this Standard as **EFTPOS Prepaid**,

each of which is referred to in this Standard as a **Scheme**.

2.3 In this Standard:

Above Benchmark Quarter has the meaning given to it in clause 4.3 of this Standard;

Acquired includes accepted;

Acquirer means a participant in a Scheme in Australia that:

(a) provides services, directly or indirectly, to a Merchant to allow that Merchant to accept a Card of that Scheme; or

(b) is a Merchant that accepts, or is a Related Body Corporate of a Merchant that accepts, a Card of that Scheme and bears the risk as principal in relation to the payment obligations of the Issuer of that Card in relation to that acceptance;

Card of a Scheme or **Card of that Scheme** means a Debit Card of a Scheme or a Prepaid Card of a Scheme;

Card of a Scheme Pair means a Card of a Scheme that is part of a Scheme Pair;

Card Transaction means a Debit Card Transaction or a Prepaid Card Transaction;

Debit Card of a Scheme or **Debit Card of that Scheme** means, in relation to a Scheme, a Device that can, under the Rules of the Scheme, be used in Australia to make payments for goods or services by accessing a deposit account held at an authorised deposit-taking institution or a bank or other financial institution (irrespective of whether the Device is issued in or outside Australia);

Debit Card Transaction means, in relation to a Scheme, a transaction in that Scheme between a holder of a Debit Card of that Scheme and a Merchant involving the purchase of goods or services (whether or not it also involves the obtaining of cash) using a Debit Card of that Scheme that is Acquired by an Acquirer (but does not include any transaction to reverse such a transaction or provide a credit or make a chargeback in relation to such a transaction);

Device means any card, plate or other payment code or device, including a code or device where no physical card is issued and a code or device used or to be used for only one transaction;

EFTPOS Scheme Rules are the rules promulgated under the constitution of the EFTPOS Payments Australia Limited (ABN 37 136 180 366) and any schedule, document, specification or rule published by EFTPOS Payments Australia Limited pursuant to those rules;

Interchange Fee Category has the meaning given to it in clause 4.2 of this Standard;

Interchange Fees means in relation to a Scheme, wholesale fees, known as interchange fees which are payable between an Issuer and an Acquirer, directly or indirectly, in relation to Card Transactions in the Scheme but excluding any such fees to the extent that they are referable only to the obtaining of cash by the Card holder;

Issuer means an entity that issues Debit Cards or Prepaid Cards of a Scheme (as the case may be) to its customers;

Merchant means in relation to a Scheme a merchant in Australia that accepts a Card of that Scheme for payment for goods or services;

Prepaid Card of a Scheme or **Prepaid Card of that Scheme** means, in relation to a Scheme, a Device that can be used in Australia, under the Rules of the Scheme, to make payments for goods or services using a store of value that has been prepaid or pre-funded and is accessible to make payments for goods or services only through the use of that, or a linked or related, Device (irrespective of whether the Device is issued in or outside Australia);

Prepaid Card Transaction means, in relation to a Scheme, a transaction in that Scheme between a holder of a Prepaid Card of that Scheme and a Merchant involving the purchase

of goods or services (whether or not it also involves the obtaining of cash) using a Prepaid Card of that Scheme that is Acquired by an Acquirer (but does not include any transaction to reverse such a transaction or provide a credit or make a chargeback in relation to such a transaction);

Quarter means a 3 month period ending on 30 June, 30 September, 31 December or 31 March;

Related Body Corporate has the meaning given in the *Corporations Act 2001*;

Reporting Period means a 12 month period ending 30 September;

Rules of a Scheme or **Rules of the Scheme** means the constitution, rules, by-laws, procedures and instruments of the relevant Scheme, and any other arrangement relating to the Scheme by which participants in that Scheme consider themselves bound;

Scheme Benchmark is 8.0 cents;

Scheme Pair means:

(a) VISA Debit and VISA Prepaid;

(b) Debit MasterCard and MasterCard Prepaid; or

(c) EFTPOS System and EFTPOS Prepaid.

include or **including** or **such as** when introducing an example do not limit the meaning of the words to which the example relates to that example or examples of a similar kind; and

terms defined in the Act have the same meaning in this Standard.

2.4 For the purposes of this Standard:

(a) a provision of a plan, arrangement or agreement shall be deemed to have a particular purpose if the provision was included in the plan, arrangement or agreement by a party or parties for purposes that include that purpose and that purpose was a substantial purpose; and

(b) conduct including the payment or receipt of a fee or other valuable consideration shall be deemed to have been made for a particular purpose if the person undertaking the conduct, payment or receipt did so for purposes that include that purpose and that purpose was a substantial purpose.

2.5 For the purposes of this Standard, an Interchange Fee paid from an Acquirer to an Issuer is to be expressed as a positive number and an Interchange Fee paid from an Issuer to an Acquirer is to be expressed as a negative number.

2.6 Each participant in a Scheme must do all things necessary on its part to ensure compliance with this Standard.

2.7 If any part of this Standard is invalid, the Standard is ineffective only to the extent of such part without invalidating the remaining parts of this Standard.

2.8 This Standard is to be interpreted:

(a) in accordance with its objective; and

(b) by looking beyond form to substance.

2.9 This Standard comes into force on [*effective date consistent with new credit card standard*] (the **Commencement Date**).

2.10 On the Commencement Date this Standard replaces each of the following Standards:

(a) *The Setting of Interchange Fees in the Visa Debit Payment System*, which is referred to in this Standard as the **Visa Debit Standard**; and

(b) *Interchange Fees in the EFTPOS System*, which is referred to in this Standard as the **EFTPOS Standard**.

3. Transition Provision

3.1 If, after the Commencement Date and prior to [ ], any Interchange Fee is introduced, varied, or removed in Visa Debit or the EFTPOS System, the weighted average of Interchange Fees implemented in each of the relevant Schemes in Australia on the date of that change, calculated in accordance with paragraph 12 of the Visa Debit Standard and paragraph 14 of the EFTPOS Standard in place as at the day before the Commencement Date, must not exceed the benchmark calculated in accordance with paragraphs 13 and 14 of the Visa Debit Standard.

4. Interchange Fees

4.1 From [ ] an Interchange Fee (exclusive of goods and services tax) in relation to a Card Transaction must:

(a) where the Interchange Fee is a fixed amount per transaction, not exceed 15.0 cents; or

(b) where the Interchange Fee is calculated by reference to the value or amount of the transaction, not exceed 0.200 per cent of that amount or value.

4.2 From [ ], if an Interchange Fee applies in relation to a category of Card Transactions (whether that category is determined by reference to the nature of the holder, or type of the Card of the Scheme, the identity or nature of the Merchant, the means of effecting the transaction, the security or authentication that applies or any other matter, or is a residual category covering transactions not in any other category) (**Interchange Fee Category**), that Interchange Fee must be a percentage rate applying to all Card Transactions in the category or a fixed amount applying to all Card Transactions in the category, and cannot be expressed as a range of rates or amounts.

4.3 From [ ], if:

(a) the total value of Interchange Fees (exclusive of goods and services tax) payable in relation to Card Transactions undertaken in a Scheme during a Quarter divided by the number of those Card Transactions exceeds the Scheme Benchmark; and

(b) for the Scheme Pair of which the Scheme referred to in sub-paragraph (a) forms part, the total value of Interchange Fees (exclusive of goods and services tax) payable in relation to Card Transactions undertaken in each of the Schemes in the Scheme Pair during the Quarter divided by the number of those Card Transactions exceeds the Scheme Benchmark;

that Quarter will be an **Above Benchmark Quarter** for that Scheme and the participants in the Scheme referred to in sub-paragraph (a) above must take all necessary steps to vary

the rates or amounts of Interchange Fees applicable under that Scheme, with effect no later than [45] days after the end of the Above Benchmark Quarter, to the rates or amounts that, had those varied rates or amounts applied under the Scheme during the Above Benchmark Quarter, that Quarter would not have been an Above Benchmark Quarter for that Scheme unless:

(c) prior to the end of that 45 day period, a variation to the rates or amounts of Interchange Fees applicable under the other Scheme in the Scheme Pair takes effect; and

(d) the varied Interchange Fees referred to in paragraph (c) are such that, had they applied under that other Scheme during the Above Benchmark Quarter, the Quarter would not have been an Above Benchmark Quarter.

4.4 From [ ], if at any time any Interchange Fee applicable under a Scheme is introduced or removed, or the rate or amount of any Interchange Fee under a Scheme is varied, the Interchange Fees applicable under that Scheme following that change must be such that, had they applied for the whole of the most recent Quarter prior to the date of the change, that Quarter would not have been an Above Benchmark Quarter. Nothing in this clause 4.4 limits clause 4.3.

5. Net Payments to Issuers

5.1 From [ ]:

(a) no Issuer which is a participant in a Scheme in Australia may receive, directly or indirectly, Net Compensation in relation to Card Transactions undertaken in any of the Schemes in the Scheme Pair of which that Scheme forms part (**Scheme Pair Transactions**). **Net Compensation** is received by such an Issuer if the Issuer Receipts of the Issuer over a Reporting Period exceed the Issuer Payments of the Issuer over that Reporting Period; and

(b) the administrator of a Scheme in Australia must not pay or facilitate payment or enter into an agreement or arrangement that provides for payment or facilitates payment, directly or indirectly, of Net Scheme Compensation to an Issuer which is a participant in a Scheme in Australia. **Net Scheme Compensation** is paid, or payment of it is facilitated, if, for one or more such Issuers, the Issuer Receipts of the Issuer that are paid, given or allowed, directly or indirectly, by the administrator of the Scheme in Australia to the Issuer over a Reporting Period exceed the Issuer Payments of the Issuer that are paid, given or allowed, directly or indirectly, by that Issuer to that administrator of the Scheme in Australia over that Reporting Period.

5.2 For the purpose of clause 5.1:

(a) subject to paragraphs (c), (d) and (e), **Issuer Receipts** of the Issuer is the total of the payments or rebates received, directly or indirectly, by the Issuer in relation to any of the Cards of the Schemes in the Scheme Pair or Card Transactions undertaken in any Scheme in the Scheme Pair that have a purpose, or likely effect of promoting or incentivising the issuance or use of Cards of any Scheme in the Scheme Pair or of providing or funding incentives to holders to use Cards of the Scheme or Scheme Pair (but excluding Interchange Fees and payments made by or on behalf of holders of Cards of the Scheme to discharge a liability to the Issuer as a result of holding or

using such a card). These payments and rebates include volume based and transaction specific payments, incentives, fees or rebates such as:

(i) marketing incentives;

(ii) payments or rebates for meeting or exceeding a specific transaction volume, percentage share or dollar amount of transactions processed; and

(iii) signing bonuses;

(b) subject to paragraphs (c), (d)and (e), **Issuer Payments** of the Issuer is the total amount of all amounts paid or rebates paid, given or allowed, directly or indirectly, by the Issuer to the administrator of a Scheme in the Scheme Pair in Australia or an Acquirer in relation to any of the Cards of the Schemes in the Scheme Pair or Card Transactions undertaken in any Scheme in the Scheme Pair (excluding Interchange Fees and the amount of the relevant Card Transactions paid by the Issuer to the Acquirer to settle obligations arising from the clearing of Card Transactions). These payments and rebates include:

(i) Scheme branding fees;

(ii) processing fees; and

(iii) assessment fees;

(c) if an amount referred to in paragraph 5.2(a) or 5.2(b) paid to or by, or a rebate referred to in paragraph 5.2(a) or 5.2(b) given, allowed or received, directly or indirectly, by an Issuer does not relate solely to Cards of any Scheme in the Scheme Pair or Card Transactions undertaken in any Scheme in the Scheme Pair and also relates to other Devices or other transactions, the amount or rebate must be apportioned between the Cards of any Scheme in the Scheme Pair and Card Transactions undertaken in any Scheme in the Scheme Pair on the one hand (the **Relevant Portion**) and the other Devices and other transactions on the other fairly and reasonably, having regard to, where relevant, the transaction history on Devices used in the payments systems to which the amount or rebate relates and the proportion of the Devices to which the amount or rebate relates that are Cards of a Scheme in the Scheme Pair issued by the Issuer, and the Relevant Portion included in the determination of Issuer Receipts or Issuer Payments, as applicable;

(d) one method of apportionment that will be fair and reasonable for the purpose of clause 5.2(c) is an apportionment on a pro-rata basis, based on the value of Card Transactions undertaken in any Scheme that forms part of the Scheme Pair using Cards of any such Scheme issued by that Issuer over the Reporting Period as a proportion of the total value of the transactions undertaken in any payment system to which the amount or rebate relates over the Reporting Period using Devices issued by that Issuer. This does not preclude an apportionment in another way that meets the requirements of clause 5.2(c);

(e) where a payment or rebate referred to in paragraph (a), (b) or (c) relates to a period that spans more than one Reporting Period, the payment or rebate or, in the case of a payment or rebate referred to in paragraph (c), the proportion calculated in accordance with paragraph (c), may be allocated among Reporting Periods on a pro-rata basis based on the number of months in each relevant Reporting Period to which the payment or rebate relates provided that:

(i) no part of it is allocated to any Reporting Period the whole of which occurs before the term of the contract or arrangement to which the payment or rebate applies has commenced;

(ii) no part of it is allocated to any Reporting Period the whole of which occurs after the term of the contract or arrangement to which the payment or rebate applies has ended; and

(iii) it may not be allocated among more than 5 consecutive Reporting Periods.

6. Reporting and Transparency

6.1 The administrator of a Scheme or a representative of the participants in the Scheme in Australia must publish the Interchange Fee rates and amounts of the Scheme in Australia on the Scheme's website, including the rates or amounts for each Interchange Fee Category.

6.2 The administrator of a Scheme or a representative of the participants in the Scheme in Australia must on or before 31 October each year certify in writing to the Reserve Bank of Australia in respect of the most recent Reporting Period, that Interchange Fees of the Scheme in Australia were over that Reporting Period in compliance with this Standard.

6.3 Each of the administrator of a Scheme in Australia and each Issuer who is a participant in the Scheme in Australia must on or before 31 October each year certify in writing to the Reserve Bank of Australia that it was, over the most recent Reporting Period, in compliance with clause 5 of this Standard.

6.4 The administrator of a Scheme or representative of the participants of the Scheme in Australia must, not later than 30 days after the end of each Quarter, certify in writing to the Reserve Bank of Australia each of the following for that Quarter for the Scheme (and in the case of paragraph (e), the relevant Scheme Pair):

(a) the total value of Card Transactions undertaken in the Scheme in that Quarter;

(b) the number of Card Transactions undertaken in the Scheme in that Quarter;

(c) the total value of all Interchange Fees (exclusive of goods and services tax) payable in respect of the Card Transactions undertaken in the Scheme made during that Quarter;

(d) the total value of Interchange Fees (exclusive of goods and services tax) payable in respect of Card Transactions undertaken in the Scheme made during the Quarter divided by the total number of the Card Transactions made during the Quarter;

(e) the total value of Interchange Fees (exclusive of goods and services tax) payable in respect of Card Transactions undertaken in the Scheme made during the Quarter across the Scheme Pair of which the Scheme forms part divided by the total number of the Card Transactions undertaken in the Scheme made during the Quarter across the Scheme Pair of which the Scheme forms part;

(f) each Interchange Fee Category that applied for some or all of the Quarter and, for each of those categories:

(i) the Interchange Fee rates or amounts that applied during the Quarter (expressed as a percentage or an amount, not as a range); and

(ii) the total value of Interchange Fees (exclusive of goods and services tax) payable in respect of that Quarter that are referrable to Card Transactions undertaken in the Scheme in that Quarter in that category.

7. Anti-avoidance

7.1 A participant in a Scheme must not, either alone or together with one or more other persons, enter into, begin to carry out or carry out a plan or arrangement or otherwise be knowingly involved in a plan or arrangement if it would be concluded that the person did so for a purpose of avoiding the application of this Standard, and the plan or arrangement or part of the plan or arrangement has achieved or would have achieved or could reasonably be considered to have achieved that purpose.

DRAFT STANDARD NO. 3 OF [ ]

SCHEME RULES RELATING TO MERCHANT PRICING FOR CREDIT, DEBIT AND PREPAID CARD TRANSACTIONS

1. Objective

The objective of this Standard is to promote:

- *efficiency; and*
- *competition*

in the Australian payments system by providing for scheme rules that require participants to give merchants the freedom to make a charge for accepting payment of a particular type that reflects the cost to the merchant of accepting that payment type.

2. Application

2.1 This Standard is determined under Section 18 of the *Payment Systems (Regulation) Act 1998* (the **Act**).

2.2 This Standard applies to:

(a) the payment system operated within Australia known as the MasterCard system, which was designated under the Act as a payment system on 12 April 2001 and which is referred to in this Standard as the **MasterCard System**;

(b) the payment system operated within Australia known as the VISA system, which was designated under the Act as a payment system on 12 April 2001 and which is referred to in this Standard as the **VISA System**;

(c) the American Express Companion Card payment system operated within Australia, which was designated under the Act as a payment system on 15 October 2015 and which is referred to in this Standard as the **American Express Companion Card Scheme**;

(d) the payment system operated within Australia known as VISA Debit, which was designated under the Act as a payment system on 23 February 2004 and which is referred to in this Standard as **VISA Debit**;

(e) the payment system operated within Australia known as Debit MasterCard, which was designated under the Act as a payment system on 15 October 2015 and which is referred to in this Standard as **Debit MasterCard**;

(f) the debit card payment system operated within Australia known as the EFTPOS payment system, which was designated under the Act as a payment system on 12 June 2012 and which is referred to in this Standard as the **EFTPOS System**;

(g) the prepaid card payment system operated within Australia under the EFTPOS Scheme Rules, which was designated under the Act as a payment system on 15 October 2015 and which is referred to in this Standard as **EFTPOS Prepaid**;

(h) the payment system operated within Australia known as MasterCard Prepaid, which was designated under the Act as a payment system on 15 October 2015 and which is referred to in this Standard as **MasterCard Prepaid**; and

(i) the payment system operated within Australia known as VISA Prepaid, which was designated under the Act as a payment system on 15 October 2015 and which is referred to in this Standard as **VISA Prepaid**,

each of which is referred to in this Standard as a **Scheme**.

2.3 In this Standard:

Acquired or **Acquiring** includes accepted or accepting;

Acquirer means a participant in a Scheme in Australia that:

(a) provides services, directly or indirectly, to a Merchant to allow the Merchant to accept a Card of that Scheme; or

(b) is a Merchant that accepts, or is a Related Body Corporate of a Merchant that accepts, a Card of that Scheme and bears the risk as principal in relation to the payment obligations of the Issuer of that Card in relation to that acceptance;

BIN means a Bank Identification Number or an Issuer Identification Number;

Card, **Card of a Scheme** or **Card of that Scheme** means a Credit Card of a Scheme, Debit Card of a Scheme or Prepaid Card of a Scheme;

Card Transaction means a Credit Card Transaction, Debit Card Transaction or Prepaid Card Transaction;

Commencement Date has the meaning given in clause 2.7;

Cost of Acceptance has the meaning given in clause 3.2;

Credit Card, **Credit Card of a Scheme** or **Credit Card of that Scheme** means, in relation to a Scheme, a Device that can, under the Rules of the Scheme be used in Australia for purchasing goods or services on credit (irrespective of whether the Device is issued in or outside Australia);

Credit Card Scheme means the American Express Companion Card Scheme, the MasterCard System or the VISA System;

Credit Card Transaction means, in relation to a Credit Card Scheme, a transaction in that Scheme between a holder of a Credit Card of that Scheme and a Merchant involving the purchase of goods or services using a Credit Card of that Scheme that is Acquired by an Acquirer and includes any transaction to reverse such a transaction or provide a credit or make a chargeback in relation to such a transaction;

Debit Card, **Debit Card of a Scheme** or **Debit Card of that Scheme** means, in relation to a Scheme, a Device that can, under the Rules of the Scheme, be used in Australia to make payments to Merchants for goods or services by accessing a deposit account held at an authorised deposit-taking institution or a bank or other financial institution (irrespective of whether the Device is issued in or outside Australia);

Debit Card Scheme means Debit MasterCard, the EFTPOS System or VISA Debit;

Debit Card Transaction means, in relation to a Debit Card Scheme, a transaction in that Scheme between a holder of a Debit Card of that Scheme and a Merchant involving the purchase of goods or services (whether or not it also involves the obtaining of cash) using a

Debit Card of that Scheme that is Acquired by an Acquirer and includes any transaction to reverse such a transaction or provide a credit or make a chargeback in relation to such a transaction;

Device means any card, plate or other payment code or device, including a code or device where no physical card is issued and a code or device used or to be used for only one transaction;

EFTPOS Scheme Rules means the rules promulgated under the constitution of EFTPOS Payments Australia Limited (ABN 37 136 180 366) and any schedule, document, specification or rule published by EFTPOS Payments Australia Limited pursuant to those rules;

Financial Year means a period from 1 July to the following 30 June;

Issuer means an entity that issues Cards of a Scheme to its customers;

Merchant means in relation to a Scheme a merchant in Australia that accepts a Card of that Scheme for payment for goods or services;

Merchant Service Fee means a transaction-based fee charged to a Merchant by an Acquirer for Acquiring, or by a Payment Facilitator for arranging the Acquisition of, one or more types of Card Transaction from that Merchant whether collected on an ad valorem or flat-fee basis, or charged as a blended rate across more than one type of Card Transaction or on an interchange plus acquirer margin basis or any other basis;

Payment Facilitator means an entity with an arrangement with an Acquirer, and arrangements with one or more Merchants, through which the entity arranges or procures for the Merchant(s) Acquiring services from the Acquirer;

Prepaid Card, **Prepaid Card of a Scheme** or **Prepaid Card of that Scheme** means, in relation to a Scheme, a Device that can be used in Australia, under the Rules of the Scheme, to make payments for goods or services using a store of value that has been prepaid or pre-funded and is accessible to make payments for goods or services only through the use of that, or a linked or related, Device (irrespective of whether the Device is issued in or outside Australia);

Prepaid Card Scheme means EFTPOS Prepaid, MasterCard Prepaid or VISA Prepaid;

Prepaid Card Transaction means in relation to a Prepaid Card Scheme a transaction in that Scheme between a holder of a Prepaid Card and a Merchant involving the purchase of goods or services (whether or not it also involves the obtaining of cash) using a Prepaid Card relating to that Scheme and includes any transaction to reverse such a transaction or provide a credit or make a chargeback in relation to such a transaction;

Related Body Corporate has the meaning given in the *Corporations Act 2001*;

Rules of a Scheme or **Rules of the Scheme** means the constitution, rules, by-laws, procedures and instruments of the relevant Scheme, and any other arrangement relating to the Scheme by which participants in that Scheme consider themselves bound;

Scheme Pair means:

(a) VISA Debit and VISA Prepaid;

(c) Debit MasterCard and MasterCard Prepaid; or

(d) EFTPOS System and EFTPOS Prepaid.

Statement Period has the meaning given to it in clause 5.1(b) of this Standard;

Surcharge means, in respect of any Card Transaction, any of the following, however named or described:

(a) any amount levied, charged or imposed in addition to the price of the goods or services purchased by means of the Card Transaction; or

(b) an increase to the price of the goods or services purchased by means of the Card Transaction that is levied, charged or imposed,

by a Merchant on or to the holder of the relevant Card (or the holder of the account on which the relevant Card was issued) because the purchase of the relevant goods or services was effected using the relevant Card or that would not be levied, charged or imposed by that Merchant if the purchase of the relevant goods or services was effected otherwise than by using a Card;

include or **including** or **such as** when introducing an example do not limit the meaning of the words to which the example relates to that example or examples of a similar kind; and

terms defined in the Act have the same meaning in this Standard.

2.4 Each participant in a Scheme must do all things necessary on its part to ensure compliance with this Standard.

2.5 If any part of this Standard is invalid, it is ineffective only to the extent of such part without invalidating the remaining parts of this Standard.

2.6 This Standard is to be interpreted:

(a) in accordance with its objective; and

(b) by looking beyond form to substance.

2.7 This Standard comes into force on [ ] (the **Commencement Date**).

2.8 On the date 4 calendar months after the Commencement Date this Standard replaces each of the following Standards or parts of Standards:

(a) each of Standard No. 2 *Merchant Pricing for Credit Card Purchases* which applied to the MasterCard System and Standard No. 2 *Merchant Pricing for Credit Card Purchases* which applied to the VISA System; and

(b) paragraphs 9 and 10 and sub-paragraphs 12 (i), (ii) and (iii) of The Honour All Cards Rule in the Visa Debit and Visa Credit Card Systems and the No Surcharge Rule in the Visa Debit System Standard.

3. Merchant Pricing

3.1 From the date 4 calendar months after the Commencement Date neither the Rules of a Scheme nor any participant in a Scheme shall prohibit:

(a) a Merchant from recovering, by charging a Surcharge to a holder of a Card of a Scheme at any time, an amount that does not exceed the Permitted Surcharge for that Merchant and that Scheme at that time; or

(b) a Merchant, in recovering part or all of the Cost of Acceptance of Cards of the Scheme, from applying different Surcharges to the holders of Cards of different Schemes (except that, in relation to a Scheme Pair, the Rules of a Scheme may

require that if a Surcharge is applied to the holders of Cards of one Scheme in the Scheme Pair, any Surcharge applied to the holders of Cards of the other Scheme in the Scheme Pair must be the same).

3.2 The Permitted Surcharge for a Merchant and a Scheme at any time is:

(a) if the contract in effect between the Merchant and its Acquirer or Payment Facilitator at that time for Acquiring services in relation to Cards of that Scheme provides that the Merchant will be charged for each Card Transaction at that time using a Card of that Scheme a single fee or charge that covers some or all of the elements in sub-paragraphs (i) to (iv) inclusive of paragraph (b) or (c) (as applicable) of clause 3.3 (**Permitted Cost of Acceptance Elements**) and no other fees, costs or expenses (an **All Inclusive Charge**), an amount equal to that All Inclusive Charge; or

(b) if the contract in effect between the Merchant and its Acquirer or Payment Facilitator at that time for Acquiring services in relation to Cards of that Scheme does not provide for an All Inclusive Charge, then the average of the Cost of Acceptance of Cards of the Scheme during the Statement Periods in a 12 month period that begins on the first day of a Statement Period and ends on the last day of a Statement Period, where that last day is not more than 13 months before that time; or

(c) if the contract in effect between the Merchant and its Acquirer or Payment Facilitator at that time for Acquiring services in relation to Cards of that Scheme does not provide for an All Inclusive Charge, and the Merchant does not at that time have the Cost of Acceptance of Cards of the Scheme for the Statement Periods in a 12 month period preceding that time, then:

(i) if at that time the Merchant has the Cost of Acceptance of Cards of the Scheme for one or more Statement Periods that ended not more than 11 months before that time, the Cost of Acceptance of Cards of the Scheme over any such Statement Period; or

(ii) if at that time the Merchant does not have the Cost of Acceptance of Cards of the Scheme for one or more Statement Periods that ended not more than 11 months before that time, an estimate of the average cost of acceptance of a Card of the Scheme calculated by the Merchant in good faith, for a period determined by the Merchant that does not exceed 3 months, using only known or estimated Permitted Cost of Acceptance Elements and card transaction volumes for Cards of the Scheme.

3.3 For the purposes of clauses 3.1, 3.2 and 5.1(b):

(a) a Merchant's Permitted Surcharge to holders of Cards of a Scheme must be determined by reference to either:

(i) where the Merchant applies the same Surcharge to Cards of more than one Scheme, the Permitted Surcharge of the Scheme with the lowest Permitted Surcharge as amongst the Cards of the Schemes to which that Surcharge relates; or

(ii) otherwise, the Permitted Surcharge of the Cards of the Scheme;

(b) **Cost of Acceptance** means for a Statement Period, in relation to a Merchant's acceptance of a Credit Card of a Scheme, the average cost per Credit Card

Transaction calculated for the Statement Period using only the following amounts payable by the Merchant in respect of that Credit Card Scheme to the entity that was its Acquirer or Payment Facilitator, as the case may be, during the Statement Period:

(i) the applicable Merchant Service Fee or fees in respect of the Credit Card Scheme;

(ii) fees for the rental and maintenance of payment card terminals that process Cards issued under that Credit Card Scheme;

(iii) fees incurred in processing Credit Card Transactions undertaken in that Credit Card Scheme and levied by the Acquirer or Payment Facilitator including international service assessments or cross-border transaction fees; and

(iv) other fixed fees for providing payment acquiring equipment and services referable to that Credit Card Scheme (whether alone or with other Schemes), being other fees that are included on the Merchant's card processing statement;

(c) **Cost of Acceptance** means for a Statement Period, in relation to a Merchant's acceptance of a Card of a Scheme that is part of a Scheme Pair, the average cost per Card Transaction across the Scheme Pair calculated for the Statement Period using only the following amounts payable by the Merchant in respect of the Schemes in the Scheme Pair to the entity that was its Acquirer or Payment Facilitator, as the case may be, during the Statement Period:

(i) the applicable Merchant Service Fee or fees in respect of those Schemes;

(ii) fees for the rental and maintenance of payment card terminals that process Cards issued under those Schemes;

(iii) fees incurred in processing Card Transactions undertaken in those Schemes and levied by the Acquirer or Payment Facilitator including international service assessments or cross-border transaction fees; and

(iv) other fixed fees for providing payment acquiring equipment and services referable to those Schemes (whether alone or with other Schemes that are not in the Scheme Pair), being other fees that are included on the Merchant's card processing statement; and

(d) where a cost referred to in paragraph (b) or (c) above is not levied or charged on a per transaction basis and is not referable to Card Transactions undertaken in a single Scheme (in the case of paragraph (b)) or Scheme Pair (in the case of paragraph (c)) (for example, a fixed monthly terminal rental cost that allows Card Transactions under more than one Scheme to be made), that cost is to be apportioned among the relevant Schemes and Scheme Pairs (as the case may be) for the purpose of determining Cost of Acceptance under paragraph (b) or (c), as applicable, on a pro-rata basis based on the value of the Card Transactions under the relevant Schemes or Scheme Pairs (as applicable) over the period to which the cost relates as a proportion of the total value of Card Transactions to which the cost relates over that period (in each case, the value of the Card Transactions excludes the amount of any cash obtained by the holder of the Card of the Scheme as part of the Card Transactions).

4. Card Identification

4.1 All Debit Cards issued after [date] in Australia by a participant in a Debit Card Scheme that are capable of being visually identified as Debit Cards must be so identified. All Prepaid Cards issued after [date] in Australia by a participant in a Prepaid Card Scheme that are capable of being visually identified as Prepaid Cards must be so identified.

4.2 All Debit Cards issued in Australia by a participant in a Debit Card Scheme must be issued with a BIN that allows them to be electronically identified as Debit Cards. All Prepaid Cards issued after [date] in Australia by a participant in a Prepaid Card Scheme in Australia must be issued with a BIN that allows them to be electronically identified as Prepaid Cards.

4.3 Without limiting clause 4.2:

(a) on request by a Merchant (whether made directly or through a Payment Facilitator), an administrator of a Scheme in Australia or an Acquirer that Acquires both Credit Card Transactions and Debit Card Transactions for that Merchant, must provide to the Merchant, BINs that permit the Merchant to separately identify Credit Card Transactions and Debit Card Transactions electronically; and

(b) from [date], on request by a Merchant (whether made directly or through a Payment Facilitator), an administrator of a Scheme in Australia or an Acquirer that Acquires Card Transactions of more than one Scheme for that Merchant must provide to the Merchant BINs that permit the Merchant to separately identify Card Transactions of each applicable Scheme electronically.

5. Transparency

5.1 Subject to clause 5.2:

(a) each Acquirer must before, or as soon as practicable after, the Commencement Date notify in writing each Merchant for which the Acquirer directly or indirectly provides Acquiring services of the provisions of this Standard and of the frequency of the provision of statements referred to in paragraph (b) below (which must be not more than 3 months); and

(b) from the Commencement Date each Acquirer must issue statements to each Merchant for which the Acquirer provides Acquiring services, directly or indirectly, no less frequently than every 3 months. Each such statement must set out:

(i) the dates on which the period covered by the statement begins and ends (**Statement Period**). For that purpose, for all statements except the first, the date a statement period begins must be the day after the day the immediately previous statement period ends;

(ii) for the relevant Statement Period:

(A) the Cost of Acceptance for the Merchant of:

(1) Credit Cards of each applicable Credit Card Scheme; and

(2) Debit Cards and Prepaid Cards of each applicable Scheme Pair,

over the Statement Period;

(B) each Cost of Acceptance described in paragraph (A) above must be expressed as a percentage of the value of Card Transactions undertaken

in each applicable Scheme or Scheme Pair in the Statement Period, unless the Merchant's Cost of Acceptance of Cards of the relevant Scheme or Scheme Pair is a fixed amount with no variable or ad valorem component; and

(iii) if it is the statement for the last full Statement Period within a Financial Year, the average of the Cost of Acceptance for the Merchant over the 12 month period ending on the last day of that Statement Period (an **Annual Period**) of:

(A) Credit Cards of each applicable Credit Card Scheme; and

(B) Debit Cards and Prepaid Cards of each applicable Scheme Pair,

and each such average Cost of Acceptance for the Annual Period must be expressed as a percentage of the value of Card Transactions undertaken in each applicable Scheme or Scheme Pair in the Annual Period, unless the Merchant's Cost of Acceptance of Cards of the relevant Scheme or Scheme Pair for each Statement Period during the Annual Period was a fixed amount with no variable or ad valorem component.

5.2 An Acquirer will not contravene clause 5.1 of this Standard if:

(a) the Acquirer provided Acquiring services to the Merchant indirectly via a Payment Facilitator;

(b) prior to the time the Acquirer was required to notify or give a statement under clause 5.1 of this Standard, it entered into a written agreement with the Payment Facilitator which obliged the Payment Facilitator to provide the notice and statements described in clauses 5.1(a) and 5.1(b) at the times described in those clauses;

(c) after conducting due inquiries of the Payment Facilitator before that agreement was entered into, the Acquirer was satisfied that the Payment Facilitator had sufficient processes in place to provide those notices and statements at the times described in clauses 5.1(a) or 5.1(b) (as applicable); and

(d) after entering into that agreement and prior to the time the notice or statement (as the case may be) was required to be sent, the Acquirer had not had cause to suspect that the notice or statement would not be sent to the Merchant by the Payment Facilitator in accordance with clauses 5.1(a) or 5.1(b) (as applicable).