Response to the Reserve Bank of Australia Consultation Document

Reform Of Credit Card Schemes in Australia
December 2001

By

The Australian Retailers Association

March 2002

PUBLIC VERSION

Prepared with the assistance of

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Contents

Executive Summary

The Australian Retailers Association (ARA) in making this submission to the Reserve Bank of Australia (RBA), wishes to re-emphasise its continuing firm belief that credit card interchange needs to be abolished completely. We have detailed the problems and inequity of such a charge in earlier submissions and we will again point out our views on this matter. Further, we believe that the RBA's draft rulings highlight the problems of implementing and effectively monitoring any interchange regime. The appointment of an independent expert, the powers vested with such a body, the establishment of an appeal process and the framework within which they can operate is a very difficult outcome to achieve.

In dealing with the specific draft rulings as proposed by the RBA consultation document, we will highlight the issues we see arising with each ruling, were the RBA to implement these unaltered.

The ARA is keen to see the RBA's stated aims of promotion of greater efficiency, transparency and competition in the Australian payments system, to the benefit of the community as whole. We would point out that the retailing community has been, and continues to bear, a large part of the costs associated with the operation of an inefficient payments system in Australia.

We commend the RBA for its' actions to date, but we would encourage a review of the intended course of action - the non-abolition of interchange fees.

1. Introduction

The ARA submitted a number of papers to the RBA over the course of 2001, on the subject of credit card interchange fees. The ARA's major submission on this matter, in July 2001, proposed a specific set of reforms to the Australian credit card industry, including the complete abolition of credit card interchange. The RBA in its consultation document 'Reform Of Credit Card Schemes in Australia', December 2001 has acknowledged the reforms as proposed by the ARA but has proposed an alternate package of measures to achieve a more transparent and equitable credit card industry in Australia, the 'Draft Standard for Designated Credit Card Schemes – Standards 1 and 2' and the 'Draft Standard for Designated Credit Card Schemes – Draft Access Regime for Designated Credit Card Schemes'.

This paper is in response to the RBA's consultation document and draft standards, and will highlight a number of areas the ARA believes require specific attention prior to any final decision on the Australian credit card industry.

1.1 Confidentiality

The ARA "PUBLIC VERSION" of the report is made available for release into the public domain.

Some of the contents of the full report are confidential. Data relating to the business of the Australian Retailers Association (ARA) or its members and contained within that submission is confidential and is not to be released into the public domain.

1.2 The Australian Retailers Association

The ARA is the nationwide voice of the Australian retail industry. In December 1998 the ARA was registered as an organisation under the Federal Workplace Relations Act 1996 with coverage of the retail industry across Australia. The ARA has state Divisions in New South Wales, Victoria, South Australia and Tasmania and affiliations with the Retailers Association of Queensland, The Retail Traders Association of Western Australia, the Northern Territory Retailers Council and the ACT Chamber of Commerce.

The ARA's membership comprises approximately 11,000 retail businesses, which transact an estimated 75% of the nation's retail sales and employ around three quarters of the retail workforce.

ARA members operate around 40,000 retail outlets across the nation. Approximately 10,000 or 95% of the Association's members are small businesses (i.e. employing less than 20 staff) operating in only one state.

Larger ARA members are also responsible for significant investments in Australian payments infrastructure. Such retailers have invested tens of millions of dollars in providing consumers with the ability to reliably utilise multiple payment methods.

2. Objectives

The ARA has three key objectives in making this submission:

1. to restate its' firm belief that interchange should be abolished completely, as argued in the ARA submission of July 2001; and
2. to address each of the specific recommendations as made in the draft standards and draft access regime and to state its' views in relation to each; and
3. to provide an alternate perspective and additional comment to proposed changes, where warranted.

The ARA also wishes to highlight its concerns relating to the practicalities of implementation of the proposed new standards.

3. Reforms As Proposed By The ARA

The ARA in its' earlier submission to the RBA (July 2001) had proposed four key reforms to the Australian credit card market[1]:

1. that interchange between card issuers and card acquirers should be completely abolished and replaced with activity based fees or fees for service;

2. that ad valorem merchant service fees (MSF) should be completely abolished and replaced with market negotiated activity based fees;

3. that the current credit card scheme no surcharging or 'non-discrimination rule' be abolished across all card types, and that merchants and the market not be restricted (subject to competition law) from setting their own pricing policies, and;

4. that the removal of scheme restrictions on access to credit card issuing and acquiring be mandated by the RBA.[2]

The ARA acknowledges that the RBA does not favour ARA proposals 1 and 2[3], for reasons of possible lack of transparency and rigidity of fee setting. ARA proposals 3 and 4 have been accepted[4], allowing Australian retailers to optionally reflect the true cost of credit card acceptance and allowing for controlled access to credit card issuing and acquiring. The RBA's intention to implement proposals 3 and 4 will contribute to a more efficient payments system in Australia.

While acknowledging that the complete abolition of interchange and ad valorem merchant service fees (MSF) has not been supported by the RBA, the ARA would nevertheless encourage the RBA to revisit this matter as the arguments in favour of such an action remain compelling.

[1] ARA – Submission to the Reserve Bank Of Australia – July 2001 p. 4
[2] ibid. p. 18
[3] RBA – Reform Of Credit Card Schemes In Australia p. 53
[4] ibid. p. 81

Were interchange to be completely abolished then a number of the implementation issues identified in this paper, such as establishment of a calculation and monitoring regime, would become less onerous.

The ARA believes that elements of the draft standards as currently structured, may lead to a similar set of problems as those currently experienced, specifically:

1. retailers and therefore the community bearing higher than necessary MSF charges as a result of unrelated costs being attributed under the guise of necessary interchange (and therefore MSF) components; and
2. the continuation of less than optimal payments practices in the Australian market.

It is the ARA's view that such problems can be overcome once further details of the RBA's intended actions are published. The comments below, in relation to each of the Draft Standards and the Draft Access Regime will hopefully assist the RBA to deliver a fair and efficient set of final outcomes in the event the RBA implements the standards as currently proposed.

4. Setting Of Wholesale Fees – Standard No. 1

The format for comment on the RBA's Draft Standards and Draft Access Regime, adopted in this paper, is the identification of each of the RBA's intended rule changes followed by agreement or disagreement and comment by the ARA.

The concept of ad valorem credit card interchange between credit card issuers and credit card acquirers is purported as necessary by the credit card schemes, as a compensatory tool for costs incurred by the card issuer.

We would contend, as we have previously, that there is still no relevance for such a charge, in any form including that proposed under the RBA's draft rulings (as a percentage based charge). While we do not object to issuers and acquirers being paid a fair and reasonable flat fee for their services, this must be from the respective beneficiaries of those services. That is, cardholders in the case of issuers and merchants in the case of acquirers.

We would again put an alternative perspective on the concept of interchange, namely that issuers should pay an interchange fee to merchants who agree to accept cards for payment, as without these merchants the issuers would not have a business. There is no greater case for issuers to pass on their costs to merchants than for issuers to meet retailers' costs.

While we do not support the interchange concept as proposed in the draft rulings, we will nevertheless provide our perspective of the issues and problems with implementation if it were to proceed as proposed.

The RBA has proposed in its draft methodology for setting interchange fees, the inclusion of three cost categories:[5]

[5] RBA – Reform Of Credit Card Schemes In Australia p. 58

1. [issuer cost one] - *issuers' costs incurred in processing credit card transactions received from an acquirer that would not be incurred if the issuer was also the acquirer in those transactions. This category includes the costs of receiving, verifying, reconciling and settling such transactions*;
2. [issuer cost two] – *issuers' costs incurred in respect of fraud and fraud prevention*; and
3. [issuer cost three] - *issuers' costs incurred in providing authorisation of credit card transactions*.

In addition the RBA proposes that separate Scheme interchange fees must apply to:[6]

1. [interchange inclusion one] - *electronic transactions that are the subject of a payment guarantee*;
2. [interchange inclusion two] - *transactions (other than electronic transactions) that are the subject of a payment guarantee*;
3. [interchange inclusion three] - *transactions (other than electronic transactions) that are not the subject of a payment guarantee*; and
4. [interchange inclusion four] - *electronic transactions that are not the subject of a payment guarantee*.

Finally, the RBA provides seven criteria for determination of interchange fees:[7]

1. [determination one] – *data on eligible costs of each nominated Scheme participant for each type of specified transaction must be provided by that participant to an independent expert agreed to by the Reserve Bank of Australia. The data must be drawn from accounting records of the nominated Scheme participant for the previous financial year prepared in accordance with generally accepted accounting standards*; and
2. [determination two] – *the expert must review the data to determine if the costs are eligible costs and use the data on eligible costs to calculate an interchange fee for each type of specified transaction. The interchange fee for each type of specified transaction must be calculated as a weighted average of the nominated Scheme participants' eligible costs for that specified transaction. The weights to be used are the shares of each nominated Scheme participant in the total value of the transactions undertaken on credit cards issued by all the nominated Scheme participants in the financial year to which the data relates*; and
3. [determination three] – *the Scheme Administrator or, if none, the nominated Scheme participants, must provide the Reserve Bank of Australia the data on eligible costs used by the independent expert and the interchange fees calculated by the expert*; and
4. [determination four] – *the Scheme Administrator, or if none, participants in the Scheme must publish in a national newspaper and permanently publish on the Scheme Administrators website, or, if none, on another relevant website:*

[6] ibid p. 59
[7] ibid p. 59

a. *the aggregate data used by the expert to calculate interchange fees; and*

b. *the interchange fees calculated by the expert in accordance with paragraph 10 of [the] standard*.

5. [determination five] – *any interchange fees charged or paid by a participant in respect of a specified transaction in a Scheme must not exceed the interchange fee calculated by the expert for that specified transaction in accordance with [the] standard*; and
6. [determination six] – *the interchange fees of a Scheme must be calculated and published in accordance with [the] Standard within [three] months after this Standard comes into force*; and
7. [determination seven] – *the interchange fees must be recalculated and published in accordance with this Standard every three years from the date this Standard comes into force. If the Reserve Bank of Australia considers that changes in costs warrant an earlier recalculation of interchange fees, it can so advise the Administrator of the Scheme or, if none, each of the participants in the Scheme. A recalculation of interchange fees in accordance with [the] Standard must be carried out and completed and any new interchange fee published in accordance with [the] Standard within [three] months of that advice.*

Each of the above points will be addressed below.

4.1 Issuer Cost One

The ARA would point out that retailers also incur costs in processing credit card transactions, yet these costs are not reflected in the reforms proposed by the RBA. For example, retailers are faced with:

- card processing equipment costs, both capital and recurring;
- telecommunications charges for processing card transactions;
- consumables costs;
- dispute management costs;
- staff costs for training and acceptance of cards;
- the costs of ongoing updates to software and systems as issuers release new card products and services.

These costs are not reflected in the draft rulings, as proposed.

We would argue that the abolition of interchange fees would remove the inequitable requirement for retailers to meet their various card acceptance costs as well as those incurred by issuers.

Should the RBA proceed with the proposed issuer cost inclusion, then a clear definition of such costs needs to be published by the RBA. We would also suggest in relation to this item, that the proposed industry expert (or another body such as the ACCC or the Payments System Board, after referral from the expert), be authorised to seek justification for proposed inclusions to issuer costs.

4.2 Issuer Cost Two

Were interchange fees to be retained, the inclusion of fraud and fraud prevention costs in their calculation will pose a significant problem in seeking to have interchange and MSF fees reduced to realistic levels. The ARA would encourage the RBA to fully clarify the nature of fraud prevention costs that may be included in the calculation of interchange.

A number of points should also be noted on the matter of fraud prevention and associated costs:

1. from the inception of credit cards, it has been the issuers and acquirers who have been in control of fraud prevention measures, merchants have been the recipients of card acceptance and fraud prevention rules and have not been consulted on the appropriateness or otherwise of such measures ;
2. issuers have had the ability to PIN enable all credit cards from the mid 1980's yet have chosen not do so, most likely due to cost considerations and possible reductions in credit card usage as a result. This has contributed significantly to the current levels of fraud, the costs of which issuers will no doubt seek to have incorporated in future interchange levels; and
3. as a result of the fraud prevention policies pursued by both issuers and acquirers, interchange and MSF levels have been kept at levels higher than may otherwise have been the case.

Under the proposed regime, these practices could continue and may in fact worsen, as will be discussed.

The ARA would draw to the attention of the RBA, the significant issues which arose between the British Association for Payment Clearing Services (APACS) and the British Retail Consortium (BRC) in relation to costs for fraud reduction measures.

Card fraud in the UK has been growing strongly and it is a major focus of the UK banks to contain this growth. While the major increases in fraud have been in the area of counterfeit cards and card not present (CNP) transactions, the major source of fraud is still lost and stolen cards (including card not received by cardholder). In the UK this accounts for ½ of all card fraud.

Fraud in the UK as in Australia, particularly for lost and stolen cards, is not helped by the current method of signature verification of the cardholder. This is highly prone to fraud as every lost and stolen card has the cardholder's signature conveniently located on the back for the thief to copy. Signature verification does very little to control fraudulent card use, it simply seems to provide a mechanism to allow banks to chargeback many of these transactions to the merchant.

The emphasis in the fraud area by the UK banks has been focused on reducing counterfeit fraud. Although this accounts for just over ¼ of fraud, it is growing rapidly. This has lead to the introduction of the UKIS chip which will be rolled out on all credit and debit cards (at an estimated cost of around £300 million to date!). Phase 1 of UKIS simply transfers the magnetic stripe data onto a chip on the basis that having the card number on a chip is more secure, and harder to copy, than just having it on a magnetic stripe. It also allows for a card to be authorised on-line every n-transactions. If the card is lost or stolen, the chip can be invalidated on-line. UK retailers have been sceptical of the introduction of chips by the UK banks as they are being asked to invest a considerable amount of money in chip infrastructure for a programme that benefits the banks but does nothing for their own revenues, and increases costs.

The ARA is concerned that a similar outcome may eventuate in Australia, with retailers being asked to shoulder higher interchange and MSF levels, as Australian issuers 'chip enable' their card bases in the name of card fraud prevention. The chip would be used for a range of revenue generating activities with a significant part, if not all, of the cost being ascribed to 'fraud reduction'.

The ARA therefore strongly recommends that the RBA remove fraud from any interchange fee. If however, the RBA is to leave fraud and fraud prevention as a component of interchange, that it be mandated that any proposed fraud control measures by the issuers, affecting retailer costs, be agreed to in advance by the ARA.

Such a measure would ensure that any proposed fraud control initiatives were beneficial to both issuers and retailers, while also ensuring that implementation costs were managed as efficiently as possible.

4.3 Issuer Cost Three

The ARA would again point out that retailers also incur costs in the process of authorising credit card transactions. These have been detailed in 4.1, yet they fail to be reflected in the reforms proposed by the RBA. As also noted in 4.1, the abolition of interchange fees would remove the requirement for retailers to meet their card processing costs as well as those incurred by issuers.

The ARA would suggest that should the RBA proceed with this proposed issuer cost, that a clear definition of eligible inclusions be published by the RBA. We would again suggest in relation to this item, that an independent party be authorised to seek justification for proposed inclusions to issuer costs.

The ARA would, in relation to all issuer costs, suggest establishment of an adjudication process whereby retailers may dispute the magnitude of costs being included in the interchange fee setting process. Issuers, acting in their own self-interest, will have little or no incentive to reduce any of the eligible costs. Indeed some of these costs may increase over time if they can be recovered through the interchange fee.

4.4 Interchange Determinations One Through Four

The ARA firmly believes that interchange fees should be removed. However, were this to not eventuate then the RBA's intention to have separate interchange fees posted for electronic and non-electronic transactions with and without payment guarantees, would be an improvement over the current system. We would however draw a number of points to the attention of the RBA in structuring the final wording of the draft standard:

1. As noted by the RBA the differential interchanges proposed for guaranteed and non-guaranteed transactions must reflect the difference in costs incurred by the issuer;[8]
2. there must be a clear choice for the retailer to select a payment guaranteed or non-guaranteed service for both electronic and non-electronic transactions from their acquirer. Retailers must be free to choose whether they will receive guaranteed payment or whether to insure transactions with other parties, where such insurance services are available, or indeed to have no payment guarantees whatsoever. This is important for two reasons;
    a. to allow retailers to make a clear choice on the level of payment risk they are willing to accept;
    b. to allow retailers to purchase payment insurance services from the lowest cost providers – which may not be the acquirers.
3. where a retailer accepts a payment guaranteed service (for electronic or non-electronic transactions), there must be complete clarity within the final standard as to what such an acquirer guarantee would involve. The ARA would suggest the following features of a payment guarantee;
    a. guaranteed settlement of the full value of a transaction at days end, where a relevant electronic or non-electronic authorisation has been obtained;
    b. guaranteed settlement of the full value of a transaction at days end, where a transaction has been performed within agreed floor limits; and
    c. in relation to previous point, we would strongly suggest that acquirers be prevented from removing the existing off-line floor limit system as a cost reduction measure. Off-line floor limits serve a very valuable purpose for customers and retailers, where retailers are unable to obtain an online authorisation from their acquirer for reasons outside their control.

[8] RBA – Reform Of Credit Card Schemes In Australia p. 59

4.5 Determination One

The ARA agrees in principle to the appointment of an independent expert under the control and auspices of the RBA. We further agree that such an individual or organisation be charged with collating data on eligible costs to be used in setting of interchange fees, if they are judged relevant. It is highly likely however, that it will be extremely difficult for the proposed independent expert to obtain relevant issuer, acquirer and Scheme cost data. **In practice, it will also be extremely difficult to ensure that the cost data submitted by the issuers is realistic and reasonable, particularly when they have a financial incentive to keep published costs as high as possible**. We would raise a number of matters that must be dealt with in selecting such an independent expert and collating the relevant data for interchange fee setting:

1. the independent expert must have relevant qualifications and experience;
2. the experts' remuneration must be independent from parties with vested interests in deliberations and outcomes (possibly funded by the RBA or the Payments System Board);
3. the expert must be provided with the power to challenge the costs given as components of interchange by the issuers. The expert must have the ability to use international benchmark costs for calculation of interchange fees, where costs being provided are outside acceptable boundaries. We would further argue that such benchmark costs should be based on similar card processing services provided by organisations other than issuers and acquirers. **There are a range of third party organisations in Australia and globally which process card transactions (including retailers). Their costs for such processes should also be used as a yardstick for measurement of costs sought for inclusion in interchange.** Should the expert not be vested with such powers, then Australian retailers may continue to bear greater costs than would otherwise be necessary. A further outcome of the expert not being vested with the power to challenge costs along international benchmark lines would be the lack of incentive for issuers to move their cost bases to lower levels;
4. where issuers and the independent expert come into dispute on matters such as interchange cost inclusions, there must be the ability for referral of such disputes to an outside party, by the expert. Again, the ARA would suggest referral of such matters to bodies such as the ACCC or the Payments System Board.

In summary, the ARA would strongly recommend that the independent expert be vested with sufficient authority to effectively carry out all tasks required.

4.6 Determination Two

The ARA agrees with the proposed methodology for determination of eligible costs.

4.7 Determination Three

The ARA agrees with the proposed methodology for provision of eligible costs to the RBA provided that our arguments in 4.5 (3) are addressed. There must be, as noted in 4.5 (4) an appeal process where parties wish to object to inclusion of certain costs.

4.8 Determination Four

The ARA agrees with the proposed methodology for publishing eligible costs and interchange fee outcomes, as determined by the independent expert.

4.9 Determination Five

The ARA agrees with the proposed level of interchange fees paid by a Scheme participant, and their relativity to fees as set by the independent expert.

4.10 Determination Six

The ARA agrees with the proposed timeframes for calculation and publication of interchange fees, provided this timeframe does not include any test of reasonableness or independent auditing of issuers' costs.

4.11 Determination Seven

The ARA while disagreeing with the principal of interchange fees would, if such fees were to be retained, support the proposed recalculation methodology, provided eligible costs were based on international benchmarks and were derived by examination of card processing costs from a broad range of entities not just acquirers and issuers.

Further to 4.5 (3) above, the independent expert and the RBA must be able to perform interchange recalculations based on international benchmarks from time to time as they see fit, and at a maximum after each three year period. We would however highlight the following points:

The expert and the RBA must have the resources, ability and authority to;

1. determine international benchmarks vis-à-vis issuer processing and operating costs from a variety of sources (not just issuers). This must be on an on-going basis, with monitoring mechanisms put in place;
2. source interchange data from Schemes, for their operations globally. This would allow movements in overseas interchange levels by Schemes, to be reflected in the Australian market, in the context of international benchmarks for interchange cost inputs.

4.12 Other Items

The ARA would also draw to the attention of the RBA the following items relating to the independent expert and the interchange fee setting process:

1. further to 4.5 (2) there must be a clear funding source for the independent expert, with this source being free of potential conflict of interest; and
2. there must be a process for interested parties such as the ARA to comment on the inputs to and final levels of interchange, as determined by the independent expert; and
3. the independent expert must have an established process, were there to be a view formed that any costs provided by Scheme participants were unreasonable. Such a process, as noted in 5.5 (3) must involve comparison of provided costs with international benchmarks.

5. Merchant Pricing – Standard No. 2

The RBA has proposed in its' draft standard for merchant pricing, five rules which a Scheme, issuers and acquirers must adhere to in advising interchange fees and setting merchant service fees for retailers:[9]

1. [merchant pricing rule 1] – *the rules of a scheme must not include any rule that requires a participant in the Scheme to prohibit, or that has the effect of prohibiting, a merchant in Australia from recovering from a credit cardholder the cost to the merchant of accepting a credit card issued by a participant in the Scheme*; and
2. [merchant pricing rule 2] – *the rules of a Scheme must include a rule that prohibits acquirers in the Scheme from imposing any term or condition in a contract, arrangement or understanding with a merchant in Australia which prevents, or has the effect of preventing, a merchant from recovering from a credit cardholder the cost to the merchant of accepting a credit card issued by a participant in the Scheme*; and
3. [merchant pricing rule 3] – *a participant in a Scheme must not prevent a merchant in Australia from recovering from a credit cardholder the cost to the merchant of accepting a credit card issued by a participant in the Scheme*; and
4. [transparency rule 1] – *the Scheme Administrator or, if none, each acquirer in the Scheme must ensure that each merchant in Australia that accepts a credit card issued by a participant in the Scheme is advised in writing of the provisions of this Standard*; and
5. [notification rule 1] – *the Scheme Administrator or, if none, each of the participants in the Scheme must notify the Reserve Bank of Australia of the changes made to the rules of the Scheme to give effect to this Standard*.

[9] RBA – Reform Of Credit Card Schemes In Australia p. 81 ~ 82

5.1 Merchant Pricing Rule 1

The ARA agrees with this proposed merchant pricing rule.

We would encourage the RBA, in its final deliberations, to publish a clear date from which Australian retailers will be allowed to surcharge credit card transactions, should they wish.

5.2 Merchant Pricing Rule 2

The ARA agrees with this proposed merchant pricing rule.

5.3 Merchant Pricing Rule 3

The ARA agrees with this proposed merchant pricing rule.

5.4 Transparency Rule 1

The ARA agrees with this proposed transparency measure for merchant pricing.

5.5 Notification Rule 1

The ARA agrees with this proposed notification measure for merchant pricing.

5.6 Other Items

There are three further items that the ARA wishes to draw to the attention of the RBA to ensure the full intention of the proposed merchant pricing rules, translate into practice within the Australian retailing community:

1. while the provisions within Draft Standard No. 2 will allow merchants to recover from cardholders the cost to the merchant of accepting a credit card issued by a participant in the Scheme, there is no such ability for merchants to recover such costs for Schemes falling outside the reform process, namely the three party charge card systems American Express and Diners Club.

   The ARA understands that these three party schemes were not part of the RBA designation process and are therefore not subject to the draft standards proposed. As noted in the ARA's earlier submission to the RBA[10], this may result in consumers seeking to switch from credit to charge cards in order to obtain various loyalty and other benefits offered by these cards. This may also result in merchants and consumers facing the same if not higher costs than those borne currently for acceptance of such card products.

[10] ARA – Submission to the Reserve Bank Of Australia – July 2001 p. 22

In addition, charge card take up may increase significantly and effectively dilute the intentions of the RBA reforms as they relate to a more efficient payments system.

Merchants will therefore be faced with an inability to recover card acceptance costs for what are the most expensive card products (in retail MSF terms) in the Australian market.

The ARA would recommend that the RBA allow cost recovery by Australian retailers on American Express and Diners Club cards, where retailers choose to do so. Without this ability, there is a high likelihood that Australian retail payments will continue to be skewed toward inefficient payment methods.

2. a related item to the cost of card acceptance is the practice of the Schemes to enforce the Honour All Cards Rule (HACR) via the merchant agreements in place with retailers. The HACR currently requires merchants to accept all card products under a particular Scheme regardless of the interchange and retail MSF levels such cards attract. This rule has been used to extract higher retail MSF levels from retailers for acceptance of certain corporate and purchasing card products. A further area where HACR has been used to unfairly extract higher ad valorem merchant service fees for essentially debit transactions, is via the use by certain issuers, of Visa debit products as Visa credit cards, in order to earn credit card interchange fees.

   The ARA is concerned that the Schemes may seek to introduce 'differentiated' products, carrying higher retailer costs, and force retailers to accept these products as part of an 'all or nothing' (HACR) acceptance policy. The ARA considers the likelihood of such an occurrence as quite high, given that issuing margins will come under pressure as a result of the RBA's proposed reforms.

   The ARA would recommend that the RBA provide a mechanism for retailers to appeal instances where HACR is used in an unfair or unscrupulous manner. Such an appeal body may be the ACCC or the Payments System Board.

   Such a process would reduce the possibility of higher cost cards being introduced by the Schemes and their acceptance being forced upon retailers.

3. the final item which needs to be addressed in order to ensure the full intention of the proposed merchant pricing rules translate into practice within the Australian retailing community, is the matter of ensuring that the banks pass on reduced interchange fees to merchants in the form of lower merchant service fees so that retailers and other merchants can reduce their costs and pass the savings on to consumers.

   The ARA recommends that the RBA establish a process to assess whether merchants receive reduced Merchant Service Fees following any abolition or lowering of interchange fees.

6. Access For Designated Credit Card Schemes

The RBA has proposed a number of changes to the eligibility criteria for membership of the various Schemes in the Australian market:[11]

1. [eligibility rule 1] – *any person supervised by the Australian Prudential Regulation Authority (APRA) as an authorised deposit-taking institution or as a specialist credit card service provider must be eligible to participate in a Scheme in Australia*; and
2. [eligibility rule 2] – *the rules of a Scheme must not discriminate between authorised deposit taking institutions and specialist credit card service providers supervised by APRA in relation to the rights, obligations and entitlements of such participants in the Scheme*; and
3. [terms of participation rule 1] – *the rules of a scheme must not prevent a participant from being:*
   a. *an issuer; or*
   b. *an acquirer; or*
   c. *both an issuer and an acquirer;* and
4. [terms of participation rule 2] – *the rules of a scheme must not impose on a participant in a Scheme any fees, charges, loadings or any form of penalty as a consequence of, or which are related in any way to, a difference in the value or number of transactions in which that participant is the acquirer in comparison to the value or number of transactions that involve the use of credit cards issued by that participant*; and
5. [terms of participation rule 3] – *the rules of a scheme must not prohibit a participant from being a self acquirer if that participant can establish to the reasonable satisfaction of the Scheme Administrator or, if none, to a majority of the participants in the Scheme that it has the capacity to meet the obligations of an acquirer as a self acquirer. The rules of the Scheme may allow the decision on the capacity of a self acquirer to meet its obligations to be reviewed by the Scheme Administrator or, if none, by the participants in the Scheme upon the giving of reasonable notice to that self acquirer*; and

[11] RBA – Reform Of Credit Card Schemes In Australia p. 111 ~ 112

6. [transparency rule 1] – *the scheme administrator, or if none, participants in the Scheme must publish in the rules of the Scheme which govern the eligibility for participation, and the terms of participation, in the Scheme in Australia on the Scheme Administrators website or, if none, on another relevant website;* and
7. [transparency rule 2] – *the Scheme Administrator or, if none, each of the participants in the Scheme must give a person that has applied to participate in the Scheme, and who is eligible to participate under paragraph 6 of [the] Access Regime, reasons in writing if the application is rejected*; and
8. [notification rule 1] – *the Scheme Administrator or, if none, each of the participants in the Scheme must give the Reserve Bank of Australia prior notice in writing of any proposed changes to its rules governing the eligibility for participation, and the terms of participation, in Australia*.

Each of the above points will be addressed below.

6.1 Eligibility Rule 1

The ARA agrees with the proposed Scheme eligibility rule.

6.2 Eligibility Rule 2

The ARA agrees with the proposed Scheme eligibility rule.

6.3 Terms Of Participation Rule 1

The ARA agrees with the proposed Scheme participation rule.

6.4 Terms Of Participation Rule 2

The ARA agrees with the proposed Scheme participation rule.

6.5 Terms Of Participation Rule 3

The ARA, while agreeing in principle to the proposed Scheme participation rule, would highlight the following areas of concern with the current structure of the proposed rule, notwithstanding that the RBA has proposed two transparency rules (addressed below):

1. the ARA is concerned that a participant, wishing to act as a self acquirer will need to establish to the Scheme or to Scheme participants, their ability to meet the obligations of an acquirer as a self acquirer even though such an applicant may meet the APRA criteria as an authorised deposit taking institution or as a specialist credit card service provider. While the RBA, in its' transparency rulings, necessitates the publication of the Scheme rules for entry as an acquirer or self acquirer, it appears the Scheme or Scheme participants are exclusively responsible for interpreting a possible participants eligibility for entry.

   The ARA would recommend that a third party (the RBA or APRA or an independent expert) be assigned with the responsibility for arbitrating between the Schemes and / or Scheme participants and applicants, where a dispute arises on the applicants eligibility for entry.

2. following from 6.5 (1) above, while provision is made for the Scheme or Scheme participants to formally advise an applicant if their application is rejected, there is no course of appeal set down for applicants.

   Again, the ARA would recommend that the RBA or APRA or an independent expert be vested with the authority to act as the final arbiter of an applicant's rejection for Scheme participation.

6.6 Transparency Rule 1

The ARA agrees with the proposed transparency rule.

6.7 Transparency Rule 2

The ARA agrees with the proposed transparency rule, but would again highlight the points made in 6.5 (1) and (2).

6.8 Notification Rule 1

The ARA agrees with the proposed notification rule.

7. General Comments And Other Items

The paper thus far has addressed the specific rule changes as proposed by the RBA. The ARA wishes to draw to the attention of the RBA a number of other items which should be considered prior to a final ruling on credit card reform in Australia.

7.1 Intra-Regional & International Cards

A large number of Australian retailers have a high component of international cards in their businesses (for example, hotel chains, airlines and car hire companies). While the ARA understands that the RBA does not have jurisdiction over international interchange, it is reasonable to assert that the RBA does have jurisdiction over the application of international interchanges in Australian retail MSF levels.

In order to avoid the possibility of Schemes and issuers raising international interchange levels and therefore retail MSF's for overseas cards, as a response to the basket of reforms proposed by the RBA, the ARA would propose that this issue be considered and dealt with in the RBA's final rulings.

The ARA believes that a possible means of protecting Australian retailers from such conduct, is a ruling by the RBA on the maximum percentage of an international or intra-regional interchange which may be factored into an Australian retail MSF, for acceptance of cards not issued domestically.

7.2 Card Scheme Fees

The matter of fees paid to the card schemes by issuers and acquirers has not been dealt with in the RBA's Consultation Document. These costs currently form part of interchange fees and retail MSF's. It is possible, again given the RBA's proposed reforms that issuers and Schemes may seek to increase such charges and thereby increase interchange levels.

Under the RBA's draft rulings, these costs could increase by many multiples and still be factored into the interchange fee and MSF levels. At present all interchanged credit card transactions are processed via the card schemes and therefore increased Scheme fees would form part of the issuers' eligible costs.

The ARA recommends that the proposed independent expert be vested with the power to monitor, seek justification and disallow where warranted, Scheme charges to issuing and acquiring members. As noted in 4.1, the ACCC or the Payments System Board could be used as arbiters where disputes arise.

7.3 Cross Border Transactions

The area of cross border transactions is another that has not been dealt with by the RBA, most likely for jurisdictional reasons. The ARA has an increasing number of members whose businesses operate along regional and global lines. Retailers in this area include fuel providers, car rental companies as well as hotel chains. These organisations are prevented from leveraging their global buying power through the lowest cost providers of credit card services, regardless of location. All but a handful of organisations (airlines) are unable to access lower cost card regimes in other parts of the world. As noted in our earlier submission[12], we are aware that in other credit card jurisdictions there are specific interchanges for certain industries, acknowledging for example, low transaction size. Scheme rules which disallow cross border acquiring, prevent retailers from accessing these types of pricing regimes.

It is the ARA's view that if the proposed independent expert, as recommended in 4.5 (3), is able to effectively monitor and use international benchmarks for interchange fee input calculation, then there would be no incentive for Australian retailers to seek agreements with foreign acquirers.

7.4 The Independent Expert

The ARA, subject to our comments in 4.5 (1), (2) and (3), is in broad agreement with the RBA on the appointment of an independent expert to oversee the proposed interchange regime.

We would however, request that Australian retailers and other relevant parties, be allowed input into the independent expert appointment process. There should also be a clear recourse path for any party wishing to dispute the suitability of a proposed independent expert.

[12] ARA – Submission to the Reserve Bank Of Australia – July 2001 p. 24

7.5 Possible Issuer / Acquirer Responses

It is the ARA's view that Schemes and Scheme members will seek to circumvent the rulings proposed by the RBA. It has come to the attention of the ARA that a large acquirer (and issuer) has already commenced the process of seeking unreasonable fees from small retailers. We would provide the following retail example:

Specific information has been removed.

The ARA would suggest that the type and level of these charges is positioned in anticipation of the RBA's rulings. Even a 50% reduction in this retailers current credit card MSF levels would still leave retail MSF of unreasonable proportions. The alarming debit transaction fee would also protect this acquirer's revenue.

We would encourage the RBA to structure its' final rulings in order to minimise (and preferably to eliminate) price exploitation, as illustrated above.