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Head of Payments Policy
Payments Policy Department
Reserve Bank of Australia
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Dear Michele,

Submission on proposed changes to the EFTPOS interchange fee standard

MasterCard Worldwide welcomes the opportunity to contribute to the consultation process for the proposed changes to the EFTPOS interchange fee standard.

The Reserve Bank of Australia has stated publicly on a number of occasions in recent times that it is a reluctant regulator of the Australian payments system. Indeed MasterCard welcomes the Bank's expressed desire to deregulate the payments system.

If anything has been unequivocally demonstrated in the six years since the Bank began directly regulating the Australian payments system, it is that adjusting one lever or condition results in a number of unanticipated and unintended consequences which then require further intervention to correct – and the cycle starts again. The market sees the effects of this daily.

The only solution that will not further distort the market and lead to new unintended consequences is deregulation of interchange fees and reliance on the two sided nature of the payments market to deliver the socially optimal outcomes. If the Bank has a concern that the current regulatory regimes are distorting competition – a view with which we agree – then we call upon it to either remove the regulations now, or at the very least wait until it is in a position to deregulate the system.

At its simplest, after six years of intervention the Bank is yet to demonstrate the case for regulation, and why the current state of the market is preferred to an unregulated alternative.

To argue that merchants have no choice but to accept the more popular card brands totally ignores what is happening in the Australian market place.

One of the clearest examples worth noting follows: American Express, (which has been gifted a remarkable competitive advantage by the Bank's regulation of the four party systems), now has issuing arrangements with all four major issuers in the Australian market and with David Jones, one

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of Australia's largest retailers. These issuers have helped American Express grow its Australian cardholder base considerably over the last six years by offering significantly more attractive benefits to users of the American Express card when compared to the equivalent MasterCard or Visa¹ card. Despite this fact, after an initial small surge, American Express has not increased its share of the payments market. This is widely acknowledged as being due to American Express' high merchant fees (which presumably reflect American Express' preference for maintaining margins over gaining share). According to the Bank's own statistics², the combined market share of credit card purchases for American Express and Diners Club currently sits at 14.9% compared to 15.5% in November 2003 when the regulations were implemented. So despite a massive increase in the number of Australians with an American Express plastic in their wallet, and strong incentives for them to use the card over and above the MasterCard or Visa card sitting alongside it, merchants have refused to accept the card, or have applied heavy surcharges to discourage usage – this example strongly demonstrates that merchants are extremely price sensitive and clearly do exercise choice over which payment cards they accept.

This is an excellent case study of regulated payment systems (MasterCard and Visa) operating side by side next to an unregulated payment system (American Express). With the regulated systems, the regulations have forced cardholders to pay almost \$1 billion per annum³ more in additional fees and interest, and in return receive less benefits, pay surcharges often not resembling the merchant fee, with no evidence that any of the savings enjoyed by the merchants are being passed back to consumers in the form of lower prices – indeed, the evidence is quite to the contrary. Yet with the unregulated system, despite card numbers growing considerably off the back of rich cardholder rewards funded by merchant fees more than two and a half times the level of those charged for MasterCard and Visa cards, the market has constricted the system's growth because of the excessive merchant fees.

The beauty of two-sided markets, like payment systems, is that the market punishes an imbalance in the pricing structure. Trying to correct any perceived distortion brought about by regulation through further regulation will fail. The market is the best regulator of payment systems. The evidence speaks for itself.

The Bank has suggested in the past that the problems with EFTPOS are not a result of interchange fee differentials but rather the lack of a coherent governance structure. This is being directly and actively addressed with the formation in May 2009 of EFTPOS Payments Australia, "owned and funded by its members [with] commercial responsibility for managing and promoting the Australian debt card system."⁴ The Bank should give this new organisation the opportunity to determine its own future, free of regulation, but responding to the unregulated competition of other payment systems like MasterCard and Visa.

¹ Most issuers offer double the number of airline miles for equivalent spend, while some offer up to four times the value for purchases undertaken on an American Express card

² <http://www.rba.gov.au/Statistics/Bulletin/C02hist.xls>

³ MasterCard's own calculation

⁴ [http://www.apca.com.au/Public/apca01_live.nsf/ResourceLookup/Media_Release_NewCompany_DebitCard_Website.pdf/\\$File/Media_Release_NewCompany_DebitCard_Website.pdf](http://www.apca.com.au/Public/apca01_live.nsf/ResourceLookup/Media_Release_NewCompany_DebitCard_Website.pdf/$File/Media_Release_NewCompany_DebitCard_Website.pdf)

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Moreover, as far as we are aware, the Bank has no particular basis for effectively setting the EFTFOS (or for that matter scheme debit) interchange fees at one level or another. Perhaps EFTPOS, MasterCard and Visa debit interchange fees should be the same level and perhaps they should not. Apart from a market driven result, there is no way to know, just as there is no way to know what this latest proposed regulatory intervention will mean for the Australian payments industry, merchants or consumers. It is not even clear why the Bank feels the need to intervene at this time, given that Payments Board has stated that very explicitly.

“...those individuals who use EFTPOS and cash are more likely to have been made better off [by the reforms] than those who use credit cards extensively and pay their balances off by the due date.”⁵”

As discussed above, additional regulation will result in the need to continually adjust the market but with no clear gain for consumers⁶. Numerous commentators and participants predicted it when the Bank first took a decision to regulate the international schemes and left the three party schemes essentially free to operate unhindered. We urge the Bank to heed the lessons of the last six years and maintain its focus on deregulation, rather than being distracted with tinkering with the existing arrangements.

Sincerely



Eddie Grobler
Executive Vice President
MasterCard Australasia

⁵ Reserve Bank of Australia, *Reform of Australia's Payment System Conclusion of the 2007/08 Review*

⁶ Refer recent article: Capping credit-card levies on retailers and other merchants could hurt consumers, *The Economist* 8 October 2009