Developments in Retail Payment Systems

The Board closely monitors trends and developments in the Australian retail payments system. 2009/10 saw a continuation of the broad trends of recent years, with the use of non-cash payments rising at a steady pace and ongoing substitution of electronic methods of payment for more traditional methods. The recent strong growth in debit card payments relative to credit cards also continued, although growth in the use of credit cards picked up modestly from the low rates experienced during the global financial crisis. Patterns for accessing cash shifted in 2009/10 as consumers adjusted their behaviour to the new charging arrangements at ATMs; the use of ATMs declined while EFTPOS cash-outs experienced relatively strong growth.

Other developments during the year included a sharp rise in the rate of debit card fraud and a further increase in the proportion of merchants applying a surcharge to credit and charge card transactions.

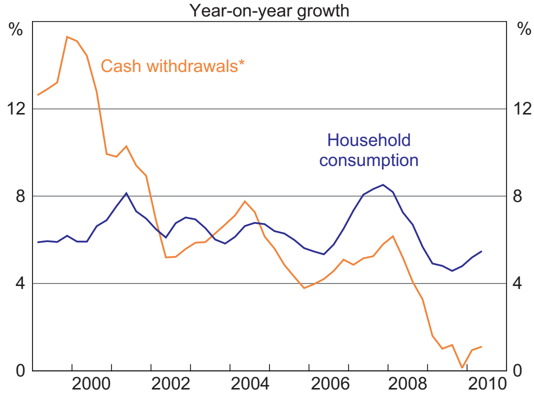
Trends in Retail Payments Use

Cash payments

Because cash transactions occur directly between merchants and consumers without the involvement of financial institutions, they are difficult to measure. The best available data come from a consumer survey conducted by the Reserve Bank in 2007 and due to be updated in 2010/11. These data indicate that cash payments account for around 70 per cent of the number of consumer payments made in Australia. But since cash is used predominantly for small transactions at particular business types, it accounts for only 38 per cent of the value of transactions.

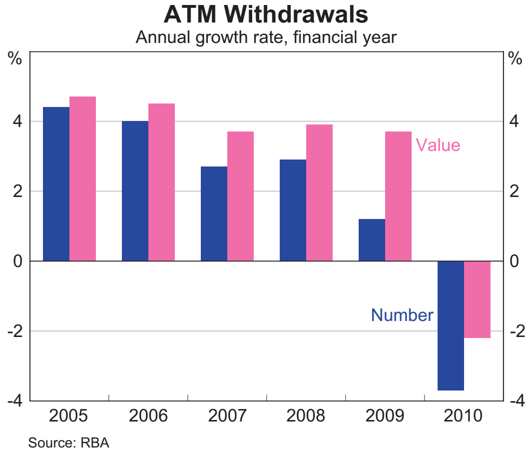
More recent trends in cash payments can be inferred from data on cash withdrawals, which are reported by financial institutions. In 2009/10, the value of cash withdrawals increased by 1.1 per cent, substantially slower than the 5.5 per cent increase in nominal household consumption over the same period (Graph 1). The rate of growth of cash withdrawals has been less than growth in consumption for a number of years. So while growth in cash withdrawals over the past year may have been distorted to a degree by the introduction of ATM direct charging in 2008/09, the trend is suggestive of a longer-term shift away from cash payments.

Graph 1
Value of Cash Withdrawals and Household Consumption
Year-on-year growth



* Data from September 2004 onwards include ATM, over-the-counter, EFTPOS cash-outs and credit card cash advance withdrawals; prior to September 2004, the data only include ATM withdrawals
Sources: ABS; RBA

Graph 2



Over 2009/10, there were also some significant changes in the way consumers access cash. In particular, cash withdrawals from ATMs declined and those using EFTPOS rose. ATMs have been the main means of accessing cash for some time, comprising nearly two-thirds of the value and three-quarters of the number of total cash withdrawals. Nonetheless, the number of ATM withdrawals decreased by 3.7 per cent in 2009/10; the value of withdrawals fell by only 2.2 per cent, suggesting an increase in size of the average withdrawal (Graph 2). This likely reflects the effect of the introduction of ATM direct charging during the previous financial year, which encouraged cardholders to reduce the frequency of visits to ATMs where they pay a charge. This is more clearly seen with the 14 per cent decrease in the number of 'foreign ATM' withdrawals during the year.[1] Another factor that may have contributed to the reported decrease in ATM withdrawals is the boost in the number and value of withdrawals made in the previous year as a result of the Government's stimulus payments.

After ATM withdrawals, EFTPOS cash-outs are the next most frequent means of accessing cash, accounting for 22 per cent of the number of cash withdrawals. However, because cash-outs are typically only around a third of the size of a typical ATM withdrawal, they account for a much smaller proportion of the value of withdrawals. The number of EFTPOS cash-outs increased by 7 per cent in 2009/10, most likely reflecting some substitution away from ATM withdrawals as a result of ATM direct charging; EFTPOS cash-outs are typically free to the customer.

Over-the-counter (OTC) withdrawals make up only 2 per cent of the number of cash withdrawals, but nearly 30 per cent of the value. The number of OTC withdrawals declined slightly during the year, while the value increased. Credit card cash advances make up around 3 per cent of withdrawals, but have been declining for a number of years. The trend accelerated in 2009/10, with the number of advances falling by 11 per cent.

Non-cash payments

Trends in the use of non-cash retail payment instruments have been reasonably stable over the past five years (Table 2). The total number of non-cash payments made in Australia increased by 7.9 per cent in 2009/10, slightly above the recent average. Australians made an average of 286 non-cash payments each during the year. The most common payment method was by card, with credit and debit card payments accounting for just over half the number of transactions. Direct entry payments were also popular, accounting for a third of transactions. Per head of population, there were 96 debit card, 69 credit card and 95 direct entry (direct debit and direct credit) transactions during the year (Graph 3).

While credit and debit cards were the most commonly used payment methods, they accounted for less than 3 per cent of the value of transactions. Direct entry transactions accounted for 85 per cent of the value of non-cash payments and cheques accounted for 11 per cent, reflecting the larger average transaction sizes of these payment methods. Continuing the long-run trend, the number of cheque payments fell by

1 A 'foreign ATM' refers to a domestic ATM that is not owned by the cardholder's bank.

Table 2: Australian Non-cash Retail Payments

	2009/10			Average growth, 2004/05–2009/10	
	Per cent of total		Average value	Per cent	
	Number	Value	$	Number	Value
Cheques	4.9	11.3	4 814	-9.3	-2.3
Direct debits	10.5	37.5	7 462	7.0	8.4
Direct credits[(a)]	22.7	47.0	4 333	6.5	6.8
Debit cards	33.4	1.1	67	13.1	12.8
Credit cards[(b)]	24.1	1.7	145	5.9	8.1
BPAY	4.4	1.4	697	13.8	16.2
Total	**100.0**	**100.0**	**2 090**	**7.2**	**6.2**

(a) Excludes BPAY transactions; a reporting change by a bank caused a break in the series, increasing the number and decreasing the value of direct credits
(b) Excludes BPAY transactions
Sources: BPAY; RBA

11.6 per cent over the year. There were around 14 cheques per person written in 2009/10, down from 50 cheques in 1995.

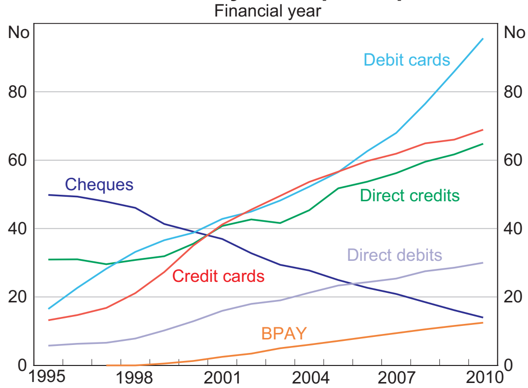
The trends in Australia are consistent with those overseas. Electronic payment instruments, in particular payment cards, continue to increase in importance while cheque use is in decline throughout the world. In 2008 (the latest period for which comparable international data are available), payment cards made up almost half of all retail non-cash payments internationally compared with less than one-third at the end of the 1990s.

Card-based payments

There were around 3.7 billion card-based transactions in Australia in 2009/10, for a value of $365 billion. This represents an increase in the number of card-based payments of around 10 per cent from the previous year, while the value of those transactions increased by around 8 per cent. The average value of both debit card and credit and charge card transactions remained broadly steady at $67 and $145, respectively.

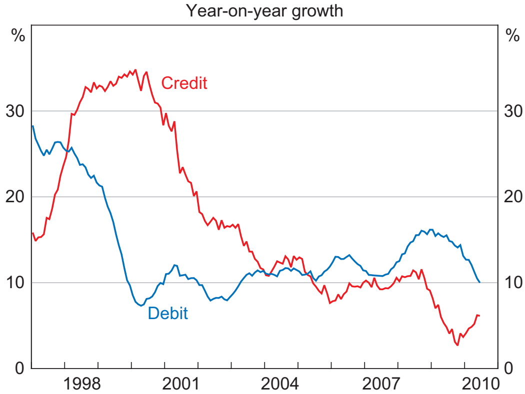
Growth in credit and charge card usage picked up moderately in 2009/10 after falling to historically low levels in 2008/09 (Graph 4). The earlier slow-down may have been partly attributable to households seeking to reduce indebtedness during the global financial crisis. The recent pick-up suggests that this factor may have since declined in importance, with both the

Graph 3
Non-cash Payments per Capita*
Financial year



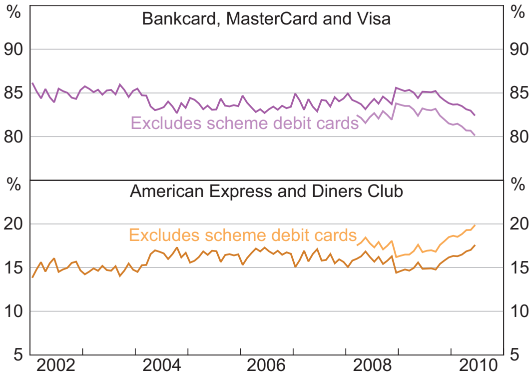
* Apart from BPAY, data from 2002 onwards are based on the RBA's Retail Payments Statistics; data for earlier years come from APCA and the RBA, and have been adjusted for differences between these sources and the Retail Payments Statistics
Sources: ABS; APCA; BPAY; RBA

Graph 4
Value of Card Payments*
Year-on-year growth



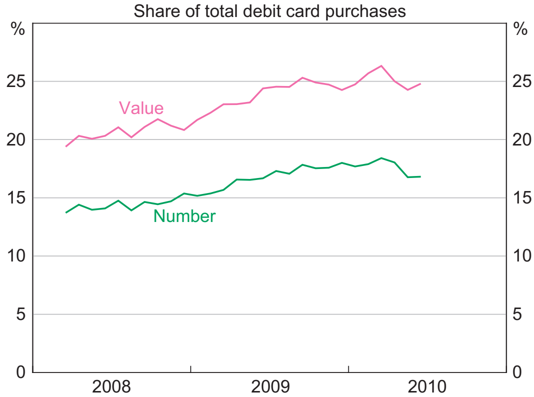
* RBA credit card data prior to March 2008 adjusted to remove BPAY transactions
Sources: BPAY; RBA

Graph 5
Market Shares of Card Schemes
By value of purchases



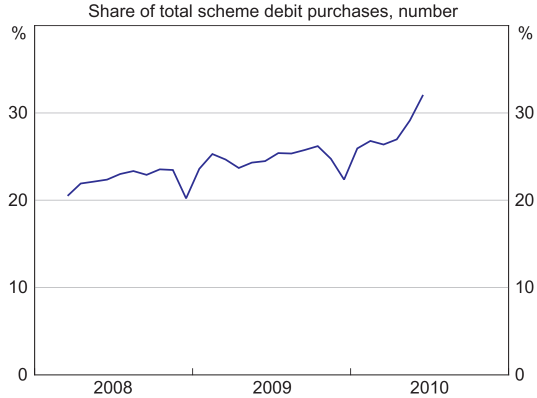
Source: RBA

Graph 6
Scheme Debit Cards
Share of total debit card purchases



Source: RBA

Graph 7
Remote Scheme Debit Purchases
Share of total scheme debit purchases, number



Source: RBA

number and value of credit card payments increasing by around 6 per cent in 2009/10.

Within the credit and charge card category, trends in the use of individual products have been affected by the introduction of 'companion' American Express credit cards by two major banks. Under this arrangement, existing MasterCard or Visa cardholders are issued with an American Express credit card on the same account and earn more rewards points on the American Express card. Cardholders appeared to respond to these incentives; the market share by value of the three-party schemes (American Express and Diners Club) increased from 16.8 per cent in June 2009 to 19.9 per cent in June 2010 (Graph 5). All four major banks now issue co-branded American Express cards.

Growth in the number and value of debit card purchases slowed in 2009/10, but, consistent with the trend over the past five years, remained higher than for credit cards. The value of debit card purchases rose by around 11 per cent during the year, down from 17 per cent in the previous year. Growth was underpinned by a further strong increase in the use of scheme debit cards, with the value of purchases using these cards increasing by around 25 per cent over the year, compared with an increase of around 6 per cent for EFTPOS purchases. This took scheme debit's share of the value of debit card purchases to 25 per cent on average during 2009/10, a rise of 3 percentage points from the previous year (Graph 6).

Despite strong growth over 2009/10, use of scheme debit cards appears to have slowed significantly towards the end of the year, most likely reflecting the decision by a major retailer to route all transactions on dual-function debit cards (which can access both EFTPOS and scheme debit) through the EFTPOS network from April 2010 (see discussion in 'Competition and Co-operation in Retail Payments'). This is also likely to have reinforced the existing trend towards a greater proportion of scheme debit transactions taking place remotely (that is, via mail order, telephone order or the internet). The share of scheme debit transactions that were undertaken remotely averaged around 26 per cent in 2009/10, up by close to 3 percentage points from the previous year (Graph 7).

Other electronic payments

The number of direct entry payments grew in line with longer-term trends in 2009/10. The number of both direct debits and direct credits increased by around 7 per cent, a little stronger than the previous year. However, the value of direct entry payments was much more subdued, with average transaction sizes declining. After adjusting for a significant series break, the total value of direct credits appears to have risen by around 3 per cent in the year, while the value of direct debits was little changed.

BPAY continued to grow strongly in 2009/10, with the number of transactions increasing by around 10 per cent and the value by around 8 per cent.

Cheques

The number of cheques written continued to decline in 2009/10, falling by 12 per cent, in line with their longer-term trend. However, the value of cheque payments remained broadly steady. The average value of a cheque transaction increased by 13 per cent, to $4 814, suggesting that cheque use is mainly declining for lower-value payments. The use of cheques for transactions such as housing settlements remains widespread, reflecting the lack of an electronic substitute for those transactions at the present time. Cheques accounted for 5 per cent of the number of non-cash transactions in 2009/10, down from 6 per cent in 2008/09.

Other Retail Payments Developments

Interchange fees

The Reserve Bank regulates interchange fees in the MasterCard and Visa credit card systems and the Visa and EFTPOS debit card systems.[2] Standards imposed by the Bank cap the weighted average of multilateral interchange fees in each system on specified compliance dates – 1 November of every third year after 2006 and the date that any interchange fee is introduced, varied or removed. This approach allows for significant flexibility in the setting of individual fees, provided that the weighted-average cap is met. MasterCard and Visa have established a variety of different fee categories, distinguished by factors such as: the type of card account (for example, consumer, premium, commercial); the type of merchant (for example, petrol station, government/utility); and the type of transaction (for example, card present/not present).

The interchange fee caps for Visa and MasterCard were unchanged in 2009/10, at 0.50 per cent of the value of transactions for credit card purchases and 12 cents per transaction for scheme debit card transactions (excluding GST). Compliance with the caps was required on 1 November 2009, resulting in both MasterCard and Visa altering their interchange fee schedules to meet the benchmark. Both schemes made further changes to fees on 30 June 2010 – the last day on which weights based on transactions in 2008/09 could be used (Tables 3 and 4).

2 For debit cards, MasterCard has undertaken to voluntarily comply with the interchange fee benchmark in the Visa Debit Standard. All interchange fees quoted in this section exclude GST.

Table 3: Credit Card Interchange Fees

Excluding GST, per cent unless otherwise specified

	MasterCard		Visa	
	30 June 2009	30 June 2010	30 June 2009	30 June 2010
Consumer electronic	0.43	0.35	0.40	0.40
Consumer standard	0.43	0.40[(a)]	0.55	0.45
Consumer chip	0.63	0.35	0.50	–
Premium/platinum	0.95	1.00[(b)]	0.90	1.00
Premium chip	1.15	1.00	1.00	–
Super premium	–	1.60[(c)]	–	1.70
Commercial	1.15	1.27	1.15	1.28
Commercial chip	1.35	1.27	–	–
Strategic merchant	–	0.25 or 0.34	–	0.25–0.35
Tiered merchant	0.34	–	–	–
VMAP[(d)]	–	–	0.30	–
Government/utility	0.30	0.30	–	0.30
– electronic	–	–	30.0 ¢	–
– standard	–	–	74.0 ¢	–
Charity	0.00	0.00	0.00	0.00
Petrol/service station	0.34	0.34	–	0.32
Education	–	0.30	–	0.40
Supermarket	–	–	–	0.32
Insurance	–	–	–	0.40
Transit	–	–	–	0.30
Recurring payment	0.30	0.30	0.40	0.30
Quick/express payments	0.30	0.40	0.40	–
Contactless payment	–	0.35	–	–
Micropayment	–	–	2.5 ¢	–
Large ticket[(e)]	–	–	–	$20 + 0.20
Benchmark	**0.50**	**0.50**	**0.50**	**0.50**

(a) May be 0.30% or 0.35% depending on use of MasterCard's SecureCode online authentication system
(b) May be 0.90% or 0.95% depending on use of MasterCard's SecureCode online authentication system
(c) May be 1.50% or 1.55% depending on use of MasterCard's SecureCode online authentication system
(d) Visa Merchant Alliance Program
(e) Transactions above $10 000 excluding travel/entertainment purchases
Sources: MasterCard website; RBA; Visa website

Table 4: Debit Card Interchange Fees

Excluding GST, cents unless otherwise specified

	MasterCard		Visa	
	30 June 2009	30 June 2010	30 June 2009	30 June 2010
Consumer electronic	9.1	6.0	8.0	8.0
Consumer standard	36.4	19.0	0.31%	0.30%
Consumer chip	13.6	12.0	–	–
Premium/platinum	–	0.50%	–	0.40%
Commercial	36.4	1.27%	–	1.00%
Commercial chip	40.9	1.48%	–	–
Strategic merchant	–	3.6	–	4.0–60.0
Tiered merchant	3.6	–	–	–
Electronic incentive	–	–	4.0	–
Government/utility	29.1	7.0	–	8.0
– electronic	–	–	8.0	–
– standard	–	–	37.0	–
Charity	0.00%	0.00%	0.00%	0.00%
Petrol/service station	9.1	4.0	–	6.0
Education	–	–	–	8.0
Supermarket	–	–	–	6.0
Insurance	–	–	–	8.0
Transit	–	–	–	6.0
Recurring payment	9.1	9.1	8.0	8.0
Quick/express payment	0.50%	4.0	8.0	–
Micropayment	0.50%	4.0	2.5	–
Large ticket[(a)]	–	–	–	$10 + 0.10%
Benchmark	**12.0**	**12.0**	**12.0**	**12.0**

(a) Transactions above $10 000 excluding travel/entertainment purchases
Sources: MasterCard website; RBA; Visa website

The changes implemented by the schemes included both adjustments to rates for existing interchange fee categories and the introduction of new categories. Significant changes for credit cards included the following:

- Both MasterCard and Visa introduced an interchange fee category for selected credit card products classified as 'super premium', with rates set at 1.6 per cent and 1.7 per cent, respectively. These fees are well above premium and platinum rates (1.0 per cent), which also increased.
- Both schemes increased their commercial rates by 12 or 13 basis points.
- Both schemes lowered their consumer standard fees, which apply for manually processed or card-not-present transactions, such as payments made over the telephone or internet, while MasterCard also reduced its rates for electronically processed card present consumer transactions.

- Both schemes introduced lower fees for 'strategic merchants' that meet performance requirements or thresholds determined by each scheme.
- Visa introduced a number of fee categories for specific industries, while MasterCard added an 'education and learning' category.
- Visa introduced new rates for certain 'large ticket' payments (above $10 000).
- MasterCard introduced lower rates for transactions that use MasterCard SecureCode, which provides an additional layer of security for online purchases.

Significant changes for scheme debit cards included:

- Following the pattern for credit cards, both MasterCard and Visa introduced an interchange fee category for premium and platinum debit card transactions, set at 0.5 per cent and 0.4 per cent, respectively. On an average-sized scheme debit transaction this would amount to a fee of 43 cents for a Debit MasterCard transaction and 35 cents for a Visa Debit transaction.
- Both schemes introduced 'strategic merchant' rates.
- MasterCard significantly reduced its fees for consumer electronic, consumer standard, government/utilities and petrol transactions.
- Visa introduced a new interchange fee category for commercial card transactions (1 per cent) and MasterCard replaced its existing flat-fee commercial rate with an *ad-valorem* fee (1.27 per cent).
- Visa introduced lower rates for specific merchant categories, such as service stations and supermarkets, along with a new rate for 'large ticket' payments.

Interchange fees in the EFTPOS system are also regulated by the Reserve Bank. As discussed in 'Competition and Co-operation in Retail Payments', the Payments System Board decided in November 2009 to amend the *Standard on the Setting of Interchange Fees in the EFTPOS System* to make the regulation of EFTPOS interchange fees more consistent with that for scheme debit. The amended Standard, which came into effect on 1 January 2010, caps the weighted average of multilateral interchange fees in the EFTPOS system at the same level as the benchmark for interchange fees in the MasterCard and Visa debit systems (12 cents per transaction paid to the card issuer). The regulated range for bilaterally negotiated EFTPOS interchange fees (which are paid by the card issuer to the transaction acquirer) was left unchanged at 4 to 5 cents for purchase transactions. The amendment to the Standard did not affect fees in the EFTPOS system in 2009/10 because no multilateral fees have been introduced to date.

Acquirers and self-acquirers with bilateral interchange agreements in the EFTPOS system are required to report information on the bilateral fees they receive each year. According to the data provided for 2008/09, acquirers received interchange fees for EFTPOS purchase-only transactions of between 4 and 5 cents per transaction, in line with the regulated range.

Merchant service fees

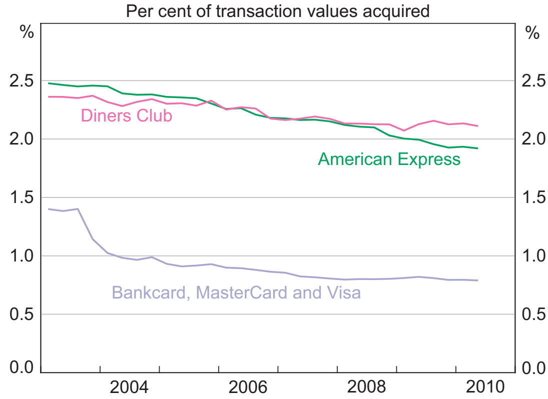
The average fee paid by merchants for transactions on MasterCard and Visa credit and scheme debit cards has changed little in recent years after significant declines following the implementation of the Board's reforms in 2003. The average merchant service fee for payments on these cards was 0.80 per cent in 2009/10, a slight fall of 1 basis point from 2008/09 and a fall of 60 basis points since the September quarter 2003, just prior to the reforms taking effect (Graph 8). The margin between merchant service fees and interchange fees on MasterCard and Visa transactions fell substantially in the first few years following the reforms, reflecting an increase in competition between acquirers for the business of merchants. In recent years, however, this margin has remained stable at around 30 basis points.

The average merchant service fee for payments on American Express cards has continued to decline steadily, while the fee for Diners Club transactions has remained more stable. In 2009/10, the average American Express merchant service fee fell by 10 basis points, to 1.93 per cent, and is 52 basis points lower than prior to the reforms – more than the regulated decline in interchange fees in the MasterCard and Visa systems. The average Diners Club fee was 2.13 per cent in 2009/10, little changed from the preceding year.

Since the introduction of the reforms, decreases in merchant service fees across all four schemes are estimated to have produced cumulative savings to merchants of around $6 billion, with merchant service fees in 2009/10 around $1.3 billion lower than they would have been if the merchant service fees prevailing prior to the reforms had been maintained.

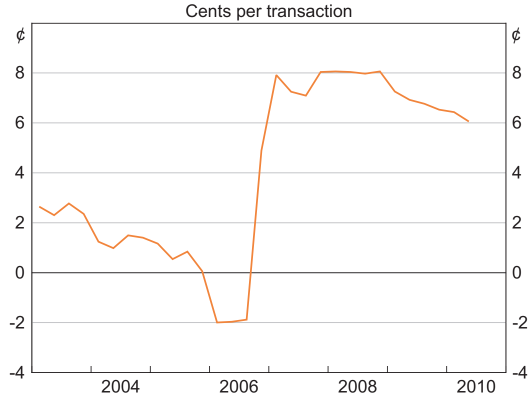
The average merchant service fee in the EFTPOS system fell by 1 cent in 2009/10 to 6.4 cents (Graph 9). Because interchange fees on EFTPOS transactions are paid by the card issuer to the transaction acquirer, the debit card reforms initially led to an increase in merchant service fees as acquirers sought to recover some of their lost fee revenue. But, as with credit cards, increased competition in acquiring has lowered the margin of merchant service fees over interchange fees in the EFTPOS system since the introduction of the reforms. In 2009/10, this margin was around 11 cents per transaction, a cent lower than in the preceding year.

Graph 8
Merchant Service Fees
Per cent of transaction values acquired



Source: RBA

Graph 9
EFTPOS Merchant Service Fees
Cents per transaction



Source: RBA

Pricing to cardholders

The structure of credit card pricing to cardholders has evolved significantly over recent years as new strategies have been adopted by issuers. In addition to price changes on existing products, new card products have emerged, such as low-rate cards and, more recently, new structures for rewards cards. As mentioned in last year's Annual Report some issuers provide complementary three-party scheme cards with some MasterCard/Visa credit card products and then offer more loyalty points to cardholders when the three-party scheme card is used than when the MasterCard/Visa card is used. Merchant co-branded cards that accrue points more quickly for purchases made at that merchant have also emerged, while other programs now cap rewards for spending above a certain amount.

Broadly, there are five main types of credit cards that cardholders can choose to hold (Table 5). 'Low rate' cards are generally most attractive to cardholders with outstanding balances accruing interest ('revolvers'), as the interest rate on these cards is on average around 6 percentage points per annum lower than the interest rate on a standard credit card. Low rate cards usually do not offer rewards points.

In contrast, cardholders who typically pay off their credit card in full each month ('transactors') are generally not as sensitive to prevailing credit card interest rates. Transactors who use their card infrequently may prefer to hold a 'low fee' card rather than paying a higher annual fee for a card that offers rewards. Transactors who use their card more regularly may be more attracted to standard, gold or platinum rewards cards. The main distinctions between these products are the level of annual fees, the generosity of rewards programs, and other 'premium' benefits. The average annual fee for platinum rewards cards ($299) is more than twice as much as for gold cards ($130), which is in turn almost twice that for standard rewards cards ($69) (Table 5). In return for higher annual fees, gold and platinum cards on average offer more generous rewards programs than standard cards. In June 2010, a platinum card holder could earn around 94 cents (in the form of a department store voucher) for every $100 spent, on average, compared with 71 cents for gold card holders and 67 cents on standard cards.

While product options have become more complicated, there is some evidence that fees have increased while rewards have become less valuable. Based on a sample of rewards cards issued by the major banks, annual fees for standard cards increased by around 12 per cent in the year to June 2010, while fees for the major banks' gold cards increased 3 per cent. In contrast, the rewards benefit to cardholders as a percentage of spending fell by around 7 per cent.[3]

Table 5: Typical Features of Personal Credit Cards, By Type[(a)]

As at end June 2010

	Average annual fee	Average interest rate	Average spending for $100 voucher[(b)]	Average rewards benefit	Range of rewards benefit
	$	Purchases, per cent per annum	$	Per cent of spending	Per cent of spending
No rewards					
Low rate	74	12.9	–	–	–
Standard ('low fee')	21	19.3	–	–	–
Rewards					
Standard	69	19.6	14 900	0.67	0.32–1.13
Gold	130	20.0	14 100	0.71	0.37–1.00
Platinum	299	20.0	10 700	0.94	0.56–1.11

(a) The total sample comprises around 80 credit card products offered by 11 issuers; reported averages are calculated as simple averages of relevant products' features; data are not directly comparable to figures reported in previous Annual Reports for major banks' average annual fees or rewards benefits

(b) The value of spending required to obtain a $100 department store voucher assumes cardholders with a credit card product containing a companion American Express card spend equal amounts on their MasterCard/Visa card and companion American Express card; figures do not factor in the ability to earn bonus points at certain merchants, caps on earning points or reduced point accrual rates for spending above certain thresholds

Sources: Credit card issuers' websites as at 30 June 2010

3 The sample of cards used for year-to-year comparisons is smaller than the sample used in Table 5. Based on this smaller sample, fees averaged $95 on standard cards and $145 on gold cards in June 2010. Rewards benefits averaged 0.55 per cent of spending.

As with other features of credit cards, there is considerable variation in interest rates. As at the end of June 2010, credit card interest rates ranged from 10.8 per cent per annum for some low rate products to in excess of 20 per cent per annum. In 2009/10 average interest rates increased by 1.55 percentage points for standard cards and 1.40 percentage points for low rate cards, to stand at 19.45 per cent and 13.35 per cent, respectively, at the end of June 2010. These increases were broadly in line with increases in the cash rate.

Given the close association with deposit accounts, pricing of debit cards to cardholders tends to be more closely linked to other account-keeping costs. The Bank's debit card reforms introduced in 2006 made it more cost effective for financial institutions to offer 'all you can eat' accounts whereby cardholders are charged a flat account-keeping fee, for which they can make an unlimited number of EFTPOS, 'own ATM' and internet/telephone banking transactions. Some of these accounts also include unlimited cheque and branch transactions, generally for a slightly higher monthly fee.

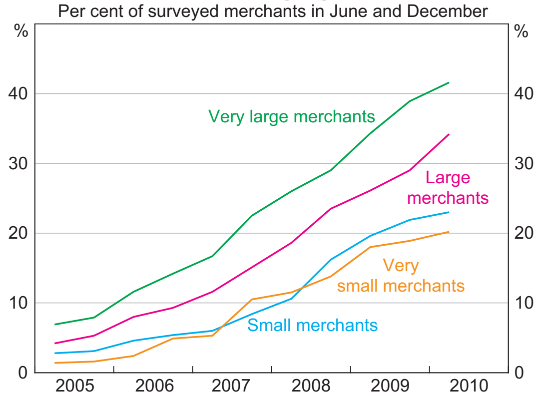
As noted in last year's Annual Report, pricing arrangements for debit cards have been largely unchanged in the past few years with average account-keeping fees remaining relatively constant at around $4 per month. There is, however, variation across institutions, with some limiting the number of fee-free transactions but charging a slightly lower monthly fee, while other institutions offer 'all you can eat' accounts for a zero monthly fee.[4]

Surcharging

The removal of 'no surcharge' rules that had been imposed on merchants by the international card schemes has played an important role in improving the price signals cardholders face when making payments. Although surcharging was slow to develop initially – owing to the strong expectation of cardholders that no surcharges would apply – data from East & Partners' semi-annual survey of the merchant acquiring business show that the rate of surcharging among merchants has grown strongly in recent years. In June 2010, 26 per cent of merchants surveyed imposed a surcharge on at least one of the credit cards they accepted (Graph 10). Surcharging remains most common among very large merchants (those with annual turnover greater than $340 million) at 42 per cent. The proportion of smaller merchants that surcharge is around 20 per cent.

The survey also suggests that surcharging is set to become increasingly commonplace in Australia, with only 17 per cent of merchants having no plans to surcharge in the near future, down from almost 65 per cent in June 2005. Less than 4 per cent of very large merchants and 26 per cent of very small merchants have no surcharging plans. The Bank is planning its own more comprehensive survey of merchant surcharging practices, the results of which will be available for publication in 2010/11.

Graph 10
Merchants Surcharging Credit Cards
Per cent of surveyed merchants in June and December



Source: East & Partners' Merchant Aquiring & Cards Market program

4 In addition, many financial institutions waive monthly account-keeping fees if the account holder maintains a balance above a certain amount or makes sufficient deposits each month.

Fraud

Although fraud rates in Australia have risen in recent years, they remain well below international levels. Overall, payments fraud rose by 13 per cent over the past year, to 9.4 cents per $1 000 of payments (Table 6). The weighted-average fraud rate on payment cards (credit, charge and debit cards combined) was 33 cents per $1 000 transacted in 2009, an increase of 1 per cent from the previous year. This is around half of the rate of fraud experienced on cards in the United Kingdom.

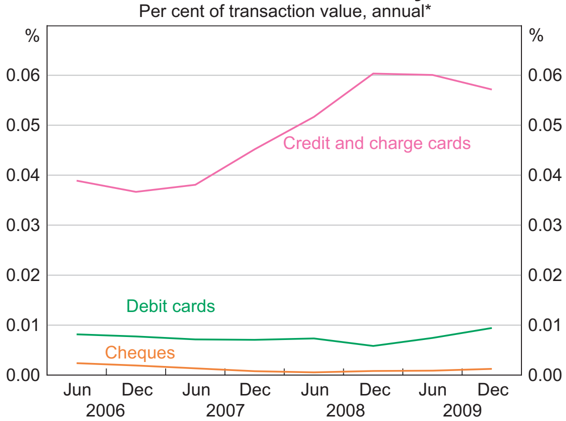
The largest component of payments fraud is credit and charge card fraud, accounting for over 75 per cent of the value of payments fraud in 2009. While the total value of credit and charge card fraud has been steadily increasing over recent years, the rate of fraud on those cards fell in 2009 to 57.1 cents per $1 000 from 60.3 cents in 2008 (Graph 11). Over the same period, debit card fraud rose from 5.8 cents to 9.4 cents per $1 000 transacted and cheque fraud also increased, from 0.8 cents to 1.2 cents per $1 000 transacted.

Table 6: Fraud on Australian-issued Payments
Per $1 000 transacted (cents)

	2008	2009
All instruments	8.3	9.4
All cards	32.7	33.1
Credit/charge card	60.3	57.1
Debit card	5.8	9.4
Cheque	0.8	1.2

Source: Australian Payments Clearing Association

Graph 11
Fraud Rates on Australian Payments
Per cent of transaction value, annual*



* From December 2008 onwards, rates of credit and charge card fraud have been revised upward and debit card fraud rates downward due to a change in reporting methodology by APCA
Source: APCA

One response to rising fraud rates on credit and charge cards has been the introduction of chip cards and personal identification number (PIN) authorisation at the point of sale. Chip cards are inherently more secure than the traditional magnetic stripe-based cards, as they are much more difficult to clone or copy. In countries where chip and PIN have been introduced, card fraud rates have fallen significantly. For example, in the United Kingdom, where the migration to chip and PIN is complete, a 28 per cent decline in card fraud losses was experienced between 2008 and 2009.

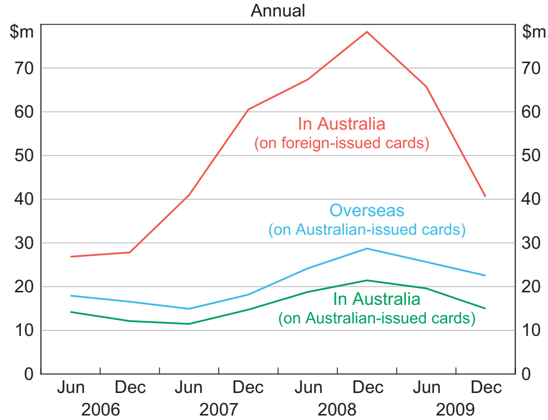
The migration to chip in Australia is still underway, with full chip rollout likely to take several more years to complete. Nevertheless, the effect of chip and PIN may be starting to have positive results. In 2009, skimming fraud on Australian-issued credit cards fell to $37.5 million from $50.2 million in 2008, while the value of skimming fraud on foreign-issued credit cards used in Australia declined by almost 50 per cent, from $78.3 million to $40.6 million (Graph 12). Nonetheless, continued reliance on magnetic stripe infrastructure during the transition to chip and PIN makes Australia vulnerable to counterfeit and skimming fraud. For example, Australia and the

United States – which also still relies on magnetic stripe infrastructure – have become among the most common countries for overseas fraud on UK-issued cards.

Skimming and counterfeit fraud is not confined to credit cards. Even though the fraud rate for debit cards in Australia remains below the rate for credit cards, it rose sharply in 2009. This rise is attributed to a significant increase in the incidence of skimming fraud at ATMs and point-of-sale terminals. Skimming fraud on debit cards rose from around $5.8 million in 2008 to $17.6 million in 2009 (Graph 13). EFTPOS Payments Australia Limited, the company that manages the EFTPOS system, has indicated that from 2011, all newly issued EFTPOS cards will incorporate chip technology, with the transition to full chip compliance to be completed by 2014.

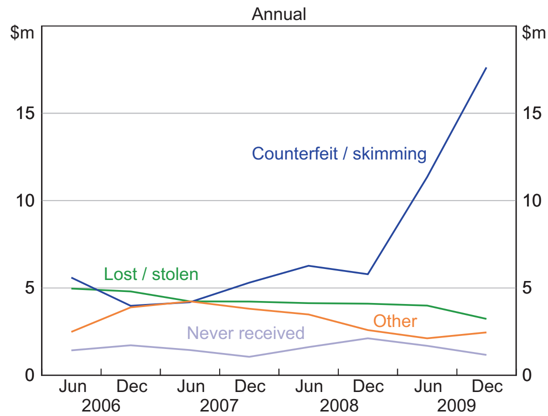
While the introduction of chip technology is aimed at addressing fraud committed at the point of sale, the rate of card-not-present (CNP) fraud continues to rise. CNP fraud involves the theft of genuine card details, which are then used remotely (over the internet, by phone or by mail order). In 2009, CNP fraud on Australian-issued credit cards rose from $72.8 million to $88.7 million. More than half of this fraud was perpetrated overseas, reflecting the increasingly borderless nature of payments fraud. The card schemes are continuing to work on developing ways of controlling CNP fraud.

Graph 12
Counterfeit / Skimming Fraud on Credit and Charge Cards



Source: APCA

Graph 13
Debit Card Fraud on Australian-issued Cards



Source: APCA

International regulatory developments in retail payments

With the decline of cheques and increase in the importance of card payments in retail payment systems around the world over recent years, these systems have faced increased regulatory scrutiny. Decisions are being made about the way to manage the decline in the use of cheques. And the level of competition and efficiency in the debit and credit card markets is under ever closer scrutiny from regulators, most notably in Europe and North America.

In response to the downward trend in cheque use in the United Kingdom, the UK Payments Council plans to phase out cheques, targeting an end date for cheques of 2018. In response to public disquiet about this move, however, this will only be enforced if a review of progress in 2016 shows that suitable alternative payment methods are available and a cost benefit analysis on the phase out is favourable.

Interchange fees on credit and debit cards have been intensively examined by regulators in Europe over a number of years. In December 2007, the European Commission (EC) ruled that MasterCard's cross-border interchange fees were illegal under European Union (EU) competition law. As a result, MasterCard was required to remove its interchange fees on cross-border card transactions with MasterCard and Maestro-branded debit and consumer credit cards in June 2008. Since then, MasterCard has been in discussions with the EC on an appropriate methodology to determine its cross-border multilateral interchange fees (MIFs).

MasterCard has now provided the EC with undertakings. In return, the EC has agreed not to pursue MasterCard further on its MIFs. The undertakings are that from July 2009:

- the cross-border MIF will be calculated based on the savings to merchants obtained from transactions being made using cards rather than cash. The resulting maximum weighted-average MIF will be 0.3 per cent per transaction for consumer credit cards (down from a range of 0.8 to 1.9 per cent in 2007) and 0.2 per cent per transaction for consumer debit cards (down from a range of 0.4 to 0.75 per cent in 2007);
- scheme fee increases announced in October 2008 will be repealed;[5] and
- there will be improvements to transparency, including merchants being offered and charged different rates for different cards (unblended rates).

The EC has also accepted commitments from Visa Europe to reduce its MIFs for debit transactions for the next few years. The reductions are for cross-border transactions, and national transactions in EU states where domestic interchange rates have not been set among local Visa participants. The reduction to 20 basis points is in line with the undertakings given to the EC by MasterCard in April 2009. Unlike MasterCard, however, Visa has given no commitments on MIFs applying to credit card transactions. Credit MIFs therefore remain under investigation by the EC, as does the honour-all-cards rule.

As well as taking action on interchange fees, European regulators have been concerned about the degree of competition in the debit card market. They have been encouraging the development of at least one new pan-European debit card scheme to compete with MasterCard's 'Maestro' and Visa's newly launched 'V Pay' scheme. Both these schemes offer Europe-wide payments as required by the European regulators, while domestic debit schemes, if unchanged, cannot.

In the United States in July 2010, Congress passed the *Dodd-Frank Wall Street Reform and Consumer Protection Act* and the President has signed it into law. The Act includes provisions to cap interchange fees on debit cards. The US Federal Reserve now has responsibility for ensuring that debit interchange rates are 'reasonable and proportional' to costs incurred (per transaction) by the issuers of the debit cards. As well, the legislation prohibits card schemes from requiring that transactions are processed only across their networks, allows merchants to discount for use of different payment instruments, and permits merchants to set minimums of up to US$10 for transactions using credit cards.

5 In September 2008, MasterCard Europe notified significant increases in its 'card scheme fees' from 1 October 2008. This drew complaints from merchants and the EC was considering whether the action represented an attempt to circumvent the ban on cross-border multilateral interchange fees.