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# **Proposed changes to credit card interchange**

Submission to the Reserve Bank of Australia

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## Executive Summary

This submission by ANZ responds to the Reserve Bank of Australia's proposal that interchange fees for credit cards be set as an average of eligible costs for the three credit card Schemes (Visa, MasterCard, Bankcard) or alternatively that the benchmark cost be that of the lowest cost Scheme, Bankcard.

ANZ submits that it is inappropriate to include Bankcard in any cost benchmark, either standing alone or as part of a Scheme wide average. ANZ supports a benchmark that is an average of Visa and MasterCard. However, it would be poor regulatory practice for the RBA to amend the interchange standards mid-way through the current regulatory period.

## Effects of the RBA's Proposed Changes

### Origins of this submission

In its media release of 24 February 2005, the Reserve Bank of Australia (RBA) made the following statement:

Under the existing credit card interchange standards the benchmark interchange fees differ amongst the Bankcard, MasterCard and Visa schemes. This reflects differences in average eligible costs across the schemes at the time the benchmarks were calculated. In part, these differences in costs are attributable to varying costs across issuers and varying representation of issuers across the three schemes.

One consequence of these arrangements is that the scheme with the highest interchange fee may be at a competitive advantage in encouraging institutions to issue its cards, particularly if the higher fee is not offset by the issuer facing higher costs when issuing cards belonging to that scheme. Accordingly, the Bank is seeking submissions on whether the standards should be amended so that the same benchmark interchange fee applies in all schemes. This is the approach being proposed for scheme-based debit cards. One possibility would be to set a benchmark based on average eligible costs measured across all three credit card schemes. An alternative would be to set a benchmark based on the costs of the lowest-cost scheme.

The RBA has suggested possible changes that credit card interchange standards could be amended so that the same benchmark interchange fee would apply to all three schemes, perhaps by taking an average of eligible costs for all three schemes, or perhaps by setting an interchange fee based on the eligible costs of the lowest cost scheme i.e. Bankcard.

### Bankcard as the benchmark

ANZ is strongly of the view that it would be **completely inappropriate** for Bankcard's eligible costs to serve as the benchmark for the determination of eligible costs. While it is true that the cost of Bankcard interchange is lower than for Visa and MasterCard, this is not because Bankcard is a more efficient scheme. Bankcard's costs are lower because it is a simple, domestic-only credit card whereas Visa and MasterCard are international schemes. The international nature of both Visa and MasterCard result in higher running costs of the schemes, including investments in marketing, technology and security, which are over and above the expenditure required by an essentially domestic provider.

This being the case, it would make no sense for Bankcard's eligible costs to serve as the benchmark for all three schemes. There would be no plausible incentive for Australian issuers of Visa and MasterCard credit cards to reduce their interchange costs to the level of Bankcard interchange costs, because they would have to remain in Visa and MasterCard's global interchange systems which, by their very nature, are more costly than the Bankcard interchange system. If the RBA were to impose Bankcard's eligible costs as the standard, it would simply be imposing large losses on issuers of Visa and MasterCard. Since Visa and MasterCard between them account for almost all of the spending on credit cards in Australia, and with Bankcard's market share steadily in decline, this change would mean the imposition of large losses on virtually the entire Australian credit card industry.

This would not be in the interests of either competition or efficiency in the payments system.

### **An average of Visa and MasterCard's eligible costs (excluding Bankcard) as the benchmark makes sense**

While not as bad as having Bankcard alone as the benchmark, an average of the three Schemes would still be flawed because it would still be influenced to some degree (depending on whether the average was a simple average, a weighted average, etc) by Bankcard's costs, which, as argued above, would be inappropriate.

However, ANZ does support having a single interchange fee for Visa and MasterCard transactions, based on an average of the two schemes' eligible costs. This may provide an appropriate incentive for each Scheme to lower its costs and potentially avoid issuers being attracted to the higher cost scheme.

### **Changing the rules now would be poor regulatory practice**

The interchange arrangements currently in place began in October 2003, following a very lengthy period of consultation and negotiation between the RBA and the industry that commenced with the publication of the RBA's and ACCC's *Joint Study* in October 2000. The arrangements are due to be revised in October 2006.

As the RBA is aware, ANZ has been supportive of both the objectives of payments system reform. However, ANZ would certainly oppose any revisiting of regulatory rules for credit card interchange mid-way through the regulatory period. Such an exercise in goal-post shifting would be poor regulatory practice.

ANZ draws to the attention of the RBA the publication by the Council of Australian Governments *Principles and Guidelines for National Standard Setting and Regulatory Action by Ministerial Councils and Standard-Setting Bodies*, as amended by COAG in June 2004 and in particular the paragraph entitled "Flexibility of standards and regulations". It states:

Specified outcomes of standards and regulatory measures should be capable of revision to enable them to be adjusted and updated as circumstances change. However, it is important to ensure that amendments to regulatory measures and instruments do not result in undue uncertainty in business operations and in so doing, impose excessive costs on that sector.

ANZ submits that, since October 2003, there has been no change in circumstances that would warrant a change to the credit card interchange standards mid-way through the regulatory period.