# Payments System Regulation

## Response by MasterCard Worldwide to the Issues for the 2007/08 Review

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Contact persons regarding this response:

**MasterCard Asia/Pacific (Australia) Pty Ltd**
146 Arthur Street
North Sydney NSW 2060
Australia
Contact: Leigh Clapham
Ph: +61 2 9466 3700
e-mail: leigh_clapham@mastercard.com

# Executive Summary

**"Australian consumers are now saddled with higher costs"**

Five years after the regulatory intervention by the Reserve Bank of Australia (**Bank**), which aimed to enhance competition, improve efficiency, and benefit consumers, available evidence suggests that the Bank's objectives have been largely unachieved. Overall, the payments market has not been made more efficient and Australian consumers are now saddled with higher costs as issuers increased annual fees and reduced loyalty rewards to compensate for the Bank-mandated reduction in interchange fees.

This submission describes the impacts of the regulations as supported by evidence in the Australian marketplace. Some of the intended and unintended ramifications of the regulations have included:

- higher cardholder fees and interest rates, with reduced features and benefits;
- a reduction in average merchant fees of more than 0.60% since the introduction of the regulations equating to approximately A$1 billion per annum;
- no evidence of reduced consumer prices to reflect the reduced merchant cost;
- a widening in the gap between the average merchant fees of the regulated and unregulated schemes;
- a competitive advantage derived by the unregulated three-party schemes, as evidenced by growth in the collective market shares of American Express and Diners Club;
- the interchange regulations have disadvantaged one regulated scheme against the other regulated scheme, simply due to the differential make-up of each scheme's portfolio;
- the surcharging of credit card transactions by merchants across all retail and non-retail segments (with some examples of price-gouging); and
- there have been no significant new entrants into the Australian market since the introduction of the regulations in 2003.

The experience of the past five years has merely served to reinforce the general presumption that competition is the superior to direct regulation in achieving efficient outcomes. MasterCard considers that the Bank should therefore focus on facilitating workable competition between payments systems rather than directly regulating interchange fees.

Such an approach by the Bank would be entirely consistent with the evidence from Australia and Europe that a merchant's ability to discourage card usage through such means as offering cash discounts and surcharging means that the merchant community has the ability to effectively constrain interchange fees .

MasterCard's view is that the four-party schemes have been able to deliver significant value to consumers and merchants in ways that the Bank has failed to take into account. For example, the value to merchants of accepting credit cards is particularly important to them in terms of sales promotion and competitive success. Two types of shopping behaviours are targeted by merchants in their marketing and sales efforts: (a) impulse spending (defined as spending decisions made on the spot and not part of the planned purchases); and (b) optimistic spending (defined as spending above planned purchases). A 2007 survey undertaken by MasterCard, of shoppers' impulse and optimistic spending behaviours in five cities (Sydney, Hong Kong, Singapore, Manila and Taipei) shows that both types of spending

is positively correlated with credit card usage. In other words, credit card acceptance is critical to helping merchants increase sales incrementally as part of their competitive efforts, thereby contributing added value to merchants over and above simply being a payment instrument.

**"All payments vehicles should be put on the same footing"**

Finally, MasterCard wishes to point out that if the Bank is genuinely serious about promoting competition in the payments market in Australia, then all payments vehicles should be put on the same footing for consideration; which would include not only four-party schemes, but three-party schemes; two-party payment cards, and cash and cheques as well.

From this perspective, the key consideration should not be the price at which each of these vehicles available to the market; but the values delivered to the end users, the consumers, by these competing payment vehicles. Only consumers and merchants, moreover, are in a position to decide what value is being delivered to them. More often than not consumers' perceptions of such value is highly sensitive to where and when they need to make a payment, and for what purposes. No regulatory authority can hope to understand what the needs of millions of consumers may be at any given time; and how their needs may change over time. Only the consumers themselves know, and hence only they are in a position to decide what values are being delivered to them by which product or service.

This is no different from the pricing of two similar personal fashion accessories, one with a designer brand and the other without. Their costs of production may be similar; and yet consumers perceive vastly different values between them; and consequently are willing to pay a much higher price for the former than for the latter.

Focusing exclusively on interchange is equivalent to a hypothetical government regulatory authority aiming to regulate the pricing of personal fashion accessories and deciding that the branded goods should be priced the same as the unbranded if their production costs are similar - an absurd conclusion. Such a stance is also against the broader interests of consumers and an effective market economy.

# 1. Introduction

In May 2007 the Bank published its Reform of Australia's Payments System – Issues for the 2007/08 Review (**Issues Paper**).

The Issues Paper provided a summary of the Bank's regulation of payments systems to date and in it the Bank sought the views of interested parties on the effects of the regulations to date and possible changes to those regulations.

MasterCard is pleased to provide its response to the Bank on the Issues Paper.

Section 2 of this response provides a description of the main points MasterCard wishes to make concerning the Bank's 2007/08 Review (**Review**). Section 3 provides MasterCard's responses to specific issues noted by the Bank in its issues Paper.

# 2. The Regulatory Landscape

Paragraph 27 of the Issues Paper[1] states that the Bank's regulations have addressed four principal areas designed to enhance competition and the efficiency of the Australian payments system:

i. the effects of interchange fees on price signals, particularly to cardholders;

ii. the effects of restrictions placed on participants (most notably merchants) in payment systems;

iii. access arrangements for the credit and debit card systems; and

iv. the availability of comprehensive information about the payments system.

The last three of the regulatory measures set out above are based on the premise that the Bank should seek to ensure that the market's competitive forces are working effectively. The Bank's objectives were to provide merchants with greater freedom to set prices based on payment method, limit restrictions on acquiring and make further information available to merchants, cardholders, issuers and acquirers to assist understanding of the competitive dynamics of payment systems. In contrast, the direct regulation of interchange fees is based on the premise that competition among debit and credit card systems works to the detriment of consumers, and that the prices that result from this competition need to be controlled by direct regulation.

Before drafting this submission to the Review, MasterCard has undertaken a careful analysis of the effects of the Bank's regulations to date. This review has concluded that:

i. merchants are aware of the removal of the 'no surcharge' rule and a significant number of merchants have responded by introducing surcharges. This plus other cards usage discouragement methods at a merchant's disposal, such as offering cash discounts and simply asking for another form of payment, means that the willingness of merchants to pay for credit card services must be taken into account in the setting of interchange fees;

ii. regulations that sought to 'open up' the payments system through the access regime and also to make it more transparent have had little effect; and

[1] Issues Paper at p. 17

iii. the reduction in interchange fees has resulted in higher cardholder fees for four-party credit cards, and a reduction in merchant service fees. Three-party card schemes, which were not subject to the same fee regulations, have benefited at the expense of four-party credit card schemes. Further, no evidence exists to show that consumers have experienced a fall in prices at the cash register as a result of the reduction in merchant service fees. Indeed shifting cost from merchants to consumers (cardholders) is antithetical to the purpose of competition law, which exists to protect consumer welfare and maximise consumer choice.

# 3. Approaches to Regulation

**"MasterCard urges the Bank to use the opportunity provided by the Review to clarify its objectives with respect to the regulation of payments systems."**

MasterCard's review indicates that while there may be arguments to support the Bank's 'pro-competitive' interventions having regard to the characteristics of the Australian market, the regulation of interchange fees has been both unnecessary and, indeed, anti-competitive.

MasterCard urges the Bank to use the opportunity provided by the Review to clarify its objectives with respect to the regulation of payments systems. The Bank needs to decide whether it is merely seeking to determine consumer and merchant behaviour by regulating what it regards as 'obvious abuses' by the providers in the market.

The contrast between these alternative approaches to microeconomic policy was expounded by Maureen Brunt in a paper that criticised the 1965 Trade Practices Bill and provided a rationale for the introduction of broad-based antitrust legislation in 1974.[2] Professor Brunt contrasted what she referred to as the 'cops and robbers' approach to microeconomic policy and the 'workable competition' approach. She favoured the workable competition approach:

> *"Broadly speaking there are two alternative types of policy available, (i) the "cops and robbers" approach and (ii) the "workable competition" approach. The first aims to proscribe "obvious abuses" such as destructive price cutting, collusive tendering or "exhorbitant pricing." The second aims to foster effective competition over a wide area of the economy. Effective or workable competition may be defined as a situation in which there is sufficient market rivalry to compel firms to produce with internal efficiency, to price in accordance with costs, to meet the consumers' demand for variety, and to strive for product and process improvement. Thus a workably competitive industry has two characteristics: first, the industry is reasonably efficient and progressive and, second, the efficiency and progressiveness have been achieved through impersonal market pressures. In effect, in making the choice between the abuse approach and the workable competition approach we ask ourseleves the question: are we interested solely in morals? Or are we interested also in hygiene?"*[3]

MasterCard supports the 'workable competition' approach favoured by Professor Brunt. It urges the Bank to take the opportunity of the Review to make a similar commitment. A 'workable competition' approach would imply that the Bank would only intervene to remove impediments to competition or to proscribe behaviour that lessens competition (such as anti-

[2] Maureen Brunt, *Legislation in search of an objective*, (1965) 41 Economic Record, pp 357-386.

[3] At p 363.

competitive agreements or mergers) [4] – not to correct what it regards as abusive or perverse prices and thereby referee the choices of end users.

Analysing the working and effects of competition among providers of payment systems requires some sophistication. In particular, it requires some understanding of the literature that has developed over the last decade on the workings of multi-sided platforms. Some industries with multi-sided platforms are characterised by such strong network effects that competition may be affected.[5] However, other well-known examples of multi-sided platforms seem to be quite consistent with competition between alternative platforms.[6] The Bank should continue to encourage competition among alternative payment platforms.

On the other hand, the Bank's direct regulation of interchange fees has been based on the premise that competition among alternative payment platforms results in perverse prices:

> *"The Bank also concluded that interchange fees were not subject to the normal forces of competition. In the case of credit card and scheme debit systems, these fees were set collectively by the members of the scheme, and overseas evidence suggested that competition between schemes is more likely to put upward, rather than downward, pressure on fees. In particular, by increasing its interchange fees, a card scheme may be able to increase usage of its cards by providing issuers with additional revenue to support more attractive pricing to cardholders, most notably through reward points. This is more likely to be so if merchants' decisions to accept particular payment methods are not very sensitive to the costs involved."*[7]

The reference to 'upward' and 'downward' pressure in this passage must be a reference to levels of fees as distinct from changes to these fees over time. There is nothing in economics that would lead one to predict that competition should cause prices to increase or decrease over time. The reasoning by the Bank amounts to the proposition that competition among alternative payment platforms causes interchange fees to be too high. In the language of Professor Brunt, the proposition is that competition among alternative payment platforms leads to an 'obvious abuse.'

This is a proposition that MasterCard rejects - for reasons explained in further detail below. The dangers associated with government regulators attempting to identify and correct what it may regard as 'obvious abuses' in pricing are well canvassed in the literature of microeconomics.[8] These dangers are also well-illustrated by an analysis of the effects of the Bank's regulations. The Bank's pricing interventions have focused on one aspect or dimension of competition between two different methods of payment – between debit and credit cards – without a clear and comprehensive program in place to develop a competitive payments system free of ongoing regulation.[9] As our detailed response below shows, the primary effect of the direct regulation of interchange fees has been a significant increase in the amount paid by consumers for credit cards and the handing of a substantial benefit to merchants - which has not been offset by any demonstrable reduction in retail prices enjoyed by consumers.

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4 Noting that this, of course, is properly the function of the ACCC.

5 Common examples in the literature are fixed-line telecommunications networks and organised securities exchanges.

6 Credit cards, newspapers and dating services are common examples in the literature.

7 Issues Paper, para 30.

8 A watershed in this literature was the famous debate in the 1930s between socialists favouring state setting of prices and the free-marketeers who were sceptical. The literature from the planning side is summarised in N Ruggles, *The Welfare Basis of the Marginal Cost Pricing Principle*, (1949) 17 *Review of Economic Studies*. The literature on the free-market side is surveyed in F A von Hayek (ed), *Collectivist Economic Planning: critical studies on the possibilities of socialism,* George Routledge, 1935.

9 Indeed, the Bank has only considered the effect on one side of these businesses, the merchant side.

Further, the direct regulation of interchange fees has not had any demonstrable effect on the use of debit and credit cards, but rather has resulted in discrimination in favour of three-party credit card schemes over their four-party competitors.

**"The Bank should now allow competitive forces, rather than direct regulation of prices, to determine the structure and progress of an efficient payments system."**

For these reasons, the Bank should abandon the direct regulation of interchange fees.

The Bank believes it has introduced regulations to improve competitive processes in the payments system. The Bank should now allow those competitive forces, rather than direct regulation of prices, to determine the structure and progress of an efficient payments system.

# 4. MasterCard's Response to Specific Questions Raised in May 2007 Issues Paper

In Section VI of the Issues Paper the Bank sought views from interested parties on a number of key issues:

i.) what have been the effects of the reforms to date?

ii.) what is the case for ongoing regulation of interchange fees, access arrangements and scheme rules, and what are the practical alternatives to the current regulatory approach? and

iii.) if the current regulatory approach is retained, what changes, if any, should be made to standards and access regimes?

Section VI then set out these questions in more detail and raised a number of specific issues on which interested parties might wish to respond.

MasterCard's responses to a number of those issues are as follows (adopting the question numbers and paragraph numbering in the Issues Paper):

**Q 1: What have been the effects of the reforms to date**

***The effect of the interchange "reforms" on cardholders and merchants***

107. (i) The extent to which the pricing of credit cards (including annual fees, interest rates and reward programs) to cardholders has changed as a result of the reforms, and the effect of any changes on cardholder behaviour.

**MasterCard's Response**

That the Bank's regulations would result in increased prices to cardholders was clear:

> *"The reforms will have a direct impact on credit cardholders and are likely to result in some re-pricing of credit card payment services, but*

*such a move toward 'user pays' is the means by which the price mechanism directs users of the payment system toward the most efficient choice of payment instruments."*[10]

It has generally been the case that the annual fees charged by financial institutions for certain credit cards have increased in the period since the introduction of the Bank's regulations. In Annexure B there is a table provided, based on data collected by Cannex, of the comparison in the pricing of certain three-party and four-party scheme cards as at the end of June 2002 and as at the end of June 2005, which indicates the increase in annual fees, interest rates, and the introduction or increase of other fees.

It also has been the case that loyalty schemes offered by financial institutions in respect of four-party scheme credit cards have been made less generous.[11] The restructuring of the loyalty programs offered has taken various forms:

**"Loyalty schemes offered by financial institutions in respect of four-party scheme credit cards have been made less generous."**

- the offering of cards with and without loyalty programs attached. Those with loyalty programs attached may attract an additional fee payable by the cardholder;
- capping the number of points that may be earned by a cardholder[12]; and
- introducing less generous frequent flyer conversion rates[13]

**In comparison, the loyalty schemes offered by the three-party schemes have not been subject to any winding back in the period since the introduction of the Bank's regulations. On the contrary, the Bank's regulations have given a "free-kick" to the three-party schemes.**

As indicated in the response to paragraph 111(i) below, the market share of the three-party schemes has increased since the introduction of the Bank's regulations. This has been assisted by financial institutions such as ANZ Bank, National Australia Bank and Westpac issuing three-party scheme cards that, unaffected by the regulations, are able to fill market demand that the four-party schemes find it difficult to match as a result of the regulations.

In this respect, at least, the Bank's regulations have had the (intended) effect of generally increasing the price of four-party credit card payment services for consumers. As indicated in the response in paragraph 107(iii) below, while the Bank had expected that the *quid pro quo* for consumers that would flow from the regulations would be a reduction in prices by merchant for goods and services, there is no evidence of any such price reductions.

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10 Reserve Bank of Australia, *Reform of Credit Card Schemes in Australia – IV – Final Reforms and Regulation Impact Statement*, August 2002 at p.34

11 While the value of loyalty programs on the unregulated three-party schemes has either increased or been maintained at pre-regulation levels.

12 As is the case with some cards offered by Commonwealth Bank and ANZ. Datamonitor, *Interchange in Australia – Global Implications*, March 2005 at pp 34-88

13 As is the case with some cards offered by Commonwealth Bank, Westpac, NAB and ANZ. Datamonitor, *ibid* at pp 34-38.

(ii) The extent to which the pricing of transaction accounts and per transaction charges for EFTPOS and scheme debit have changed as a result of the reforms, and the effect of any changes on the use of debit cards.

**MasterCard's Response**

MasterCard does not have any data to be able to respond to this question.

(iii) The effect of the changes to interchange fees on merchants' costs of accepting credit and debit cards, and consequently, on the prices charged by merchants for goods and services.

**MasterCard's Response**

As indicated in the response in paragraph 111(i) below, the changes to interchange fees brought about by the Bank's regulations have resulted in a significant reduction in merchant service fees for four-party scheme cards and a smaller reduction for three-party scheme cards. In the period between July 2003 and March 2007 there has been a 40% reduction in merchant service fees for four-party scheme cards and an 8% reduction in merchant service fees for three-party scheme cards.

**"While merchants have clearly benefited from a reduction in merchant service fees, there is no evidence that these reductions have been passed on to consumers in the form of lower prices."**

It is not possible to evaluate what impact the reduction in interchange fees in respect of scheme debit has had. The only relevant scheme debit card in this respect is Visa Debit as MasterCard did not introduce a debit card until after the Bank had introduced regulations relating to the interchange fee for Visa debit[14]. However, as the interchange fee for Visa Debit was reduced from that which applied to credit cards (before the taking effect of the credit card interchange standard)[15] to 12 cents per transaction, this has clearly reduced merchants' costs.

While merchants have clearly benefited from a reduction in merchant service fees, there is no evidence that these reductions have been passed on to consumers in the form of lower prices.

The Bank, in introducing its regulations for the four-party schemes stated that those regulations were "consistent with the broad objectives of the Government's competition policy" and would "allow normal market mechanisms to work more effectively in the Australian payments system and reduce its overall costs to the community."[16] This was being seen by the Bank as being achieved through, amongst other things:

> *"lower merchant service fees as a direct consequence of reduced interchange fees, which will pass through to consumers in the general level of prices"*[17]

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[14] MasterCard provided the Bank with a written undertaking to voluntarily comply with the Visa debit interchange standard.

[15] The average interchange fee being in the order of 0.95%.

[16] Reserve Bank of Australia, *Reform of Credit Card Schemes in Australia – IV – Final Reforms and Regulation Impact Statement*, August 2002 at p.33

[17] *Ibid* at p.34.

The Bank's view that the regulations would be reflected in lower prices being enjoyed by consumers was repeated several times after their introduction:

> *"…merchants have gained significant savings in merchant service fees as a result of the lower interchange fees. Given the competitive environment in which most merchants operate, these lower fees are likely to eventually find their way into lower prices of goods and services than would have otherwise have been the case. When fully passed through, the reduction in fees would be expected to reduce the Consumer Price Index (CPI) by between 0.1 and 0.2 percentage points. While important, this change is difficult to observe in the overall CPI, which is increasing, on average, by around 2.5 per cent per year."* [18]

The Bank indicated that, in the 12 months to June 2005, the fall in merchant service fees in both the four-party and three-party schemes meant that merchant costs were around $580 million lower than they otherwise would have been.[19] While the expectation was that merchants would pass this benefit on to consumers, the difficulty was in determining whether this actually occurred:

> *"It is, however not possible to monitor the speed and extent to which this is occurring, as the effect is relatively small compared to changes in the overall price level in the economy. … there are no statistical techniques with fine enough calibration to separately identify this change against a background where the overall CPI increase is about 2.5 per cent. But the fact that it cannot be separately identified does not mean that it has not happened."*[20]

In the 12 months to June 2006 the Bank reported that merchants' costs of accepting credit and charge cards were around $730 million lower than they would otherwise have been.[21] Again, the Bank reported:

> "*These cost savings are flowing into lower prices for goods and services although the flow-through is difficult to measure given the much larger changes in other costs that are occurring on our ongoing costs."* [22]

It is clear that the Bank's regulation of interchange fees has resulted in an enormous benefit to merchants which, since the introduction of the regulations, can be measured in the billions of dollars. In the Issues Paper it was stated that:

> *"The reduction in merchant service fees represents a significant cost saving to merchants. At current levels of spending, a 0.56 percentage point reduction in fees in the MasterCard and Visa schemes is worth around $870 million per year, while the reduction in fees in American Express and Diners Club represents a further saving of $80 million per year."*[23]

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18 Payments System Board Annual Report 2004 at p.12.
19 Payments System Board Annual Report 2005 at p.11.
20 *Ibid* at p.11.
21 Payments System Board Annual Report 2006 at p.12.
22 *Ibid.*
23 Issues Paper at para 93.

That there is uncertainty to whether this benefit is flowing through to consumers is unsatisfactory. As indicated in the response to paragraph 107(i) above, it is clear that consumers holding credit cards have suffered under the Bank's regulations – paying more for credit cards which have fewer benefits. However, what is not so clear is whether these consumers – as well as those that do not hold credit cards – have benefited from any reduction in prices at the cash register.

The suspicion is that merchants, rather than consumers, have been the significant beneficiaries of the Bank's regulations:

> *"The fact that retailers soaked up the saving is further supported by research conducted in 2004 by Cannex, who surveyed merchants in Australia regarding the impact of the interchange fee regulation on their regular business. Of those merchants who noticed change, less than five per cent revealed that they had reduced prices to consumers and more than 20 per cent of those merchants reported that their profits had increased."*[24]

In research commissioned by MasterCard in the period from November 2003 to July 2005, Roy Morgan Research found that "the majority of merchants (62%) were not aware of the recent Reserve Bank of Australia (RBA) changes to the interchange fee …."[25] If merchants are not aware of the Bank's regulations affecting interchange fees, it would seem likely that there would not be a conscious decision on the part of the merchants to reduce prices to consumers.

Furthermore, a cursory glance of the publicly available financial statements of many of Australia's merchants would reveal a consistent growth in the profit margins irrespective of changes to that merchant's cost base. Indeed the Australian retail and airline sectors are rather concentrated by global standard, the first being dominated by two conglomerates and the latter by a single carrier. This may explain the ability of merchants to widen margins when merchant fees decline, as opposed to passing on the windfall to their customers.

**"MasterCard believes that more work is required to be done by the Bank in order to confirm that the enormous savings in merchant service fees brought about by the Bank's regulations are being passed on by merchants to consumers."**

In view of the significant benefit provided to merchants by the Bank's regulations, MasterCard believes that more work is required to be done by the Bank in order to confirm that the enormous savings in merchant service fees brought about by the Bank's regulations are being passed on by merchants to consumers. If it is not, it further calls into question the reasoning behind the introduction of the regulations.

[24] Datamonitor, *Payment Cards in Australia 2007*, June 2007 at p.34.

[25] Roy Morgan Research, *Tracking Study on Credit Card Surcharging and the Interchange Fee*, August 2005 at p.29.

(iv) The extent to which changes in interchange fees have affected the payment methods accepted by various merchants.

**MasterCard's Response**
MasterCard is not aware of any data which suggests that changes in interchange fees have affected the payment methods accepted by merchants.

(v) The effect of excluding EFTPOS transactions involving a cash-out component from the EFTPOS interchange Standard.

**MasterCard's Response**
As this issue does not concern MasterCard, no comment is made concerning it.

***The effect of the interchange fee reforms on financial institutions***

108. (i) The effect of the reforms on the net revenue of financial institutions. (In many analyses of interchange fees it is assumed that these fees are a way of redistributing revenue from acquiring banks to issuing banks in a way that affects the prices facing cardholders and merchants, but not necessarily the net revenue of banks.)

**MasterCard's Response**

The financial institutions are better placed to comment on this question than MasterCard and no comment is made concerning it.

(ii) The extent to which the reforms have affected the type of payment methods promoted by financial institutions.

**MasterCard's Response**

It has been previously stated by the Bank[26] that the regulations are the reason for the growth of the low rate credit card segment. Such a belief, however, ignores the natural evolution of the personal lending market and the credit card product in particular. The surge in promotion of low rate programs in Australia is simply a reflection of what has happened in unregulated markets such as the United States and United Kingdom several years ago, MasterCard together with a number of issuers pioneered low rate credit cards in Australia prior to the implementation of the regulations.

Credit card issuers in Australia have developed and promoted low rate credit card programs in order to attract customers that may have otherwise taken up a personal loan, or some form of store finance. The low rate credit card offers the flexibility of the credit card, which cannot be matched by a personal loan or other form of unsecured lending. Reflecting on the global experience, one would conclude that it was simply a matter of time before low rate programs were promoted in Australia. Indeed, as dealt with in our response to paragraph 107(i) above and the information contained in Annex B, but for the Bank's regulations, it is very possible that the interest rates applied to the low rate credit card programs would have been lower still.

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[26] Payments System Board Annual Report 2005 at p.14

While it cannot be concluded that low rate credit card programs have not been spawned by the Banks' regulations, three-party system "companion cards" certainly have been. The regulations have lead to a number of credit card issuers providing their MasterCard and Visa cardholders with an American Express or Diners Club branded "companion card." The companion card is linked to the same account that the pre-existing MasterCard or Visa card is linked to, and gives the cardholder the option of using either card with the transaction being applied to the same account. The cardholder is clearly encouraged to use the three-party system brand card through the provision of higher rewards points being awarded. Typically the reward is double or triple to that applicable for a regulated scheme card transaction.[27] The issuer is also rewarded by sharing in the merchant fee charged by the three-party schemes, which is almost two and a half times more than that charged for the regulated schemes.[28]

**" it cannot be concluded that low rate credit card programs have not been spawned by the Banks' regulations, three-party system 'companion cards' certainly have been."**

The impact of the companion card phenomenon on merchant pricing is clear, and is a further demonstration of the gulf in the competitive playing fields between the regulated and unregulated schemes.

(iii) The effect of the reforms on product innovation.

**MasterCard's Response**

Payment product innovation is a complex area that involves many factors. These factors include considerations such as:

- demonstrated demand for the product/service and a clear value proposition;
- adequate and credible business cases that provide:
  - potential for scale (growth and profits), and
  - a reasonable risk/return profile;
- demonstrate safety and security because of the financial and brand risk involved in payment products;
- a set of clear, stable commercial rules (tax policy, regulatory policies, and so forth) to minimise risk;
- access to sufficient capital to fund the often long lead-times before achieving critical mass and commercial success;
- an entrepreneurial marketplace with sufficient capital to support multiple initiatives (because there are more innovation "failures" than successes); and

27 For an example of such programs, refer Westpac Altitude program, including Westpac Altitude Platinum, and Westpac earth.

28 See paragraph 111(i) below.

- the ability to evaluate a multitude of possibilities during the process of deciding on which innovation to "take to market". This is an internal process that is not significantly different from a venture capitalist screening a vast number of ideas before committing substantial sums to each sequential stage of commercialisation. Typically payment product innovation is not a "bet the farm" approach to innovation.

Because payment systems are complex, product innovation covers a broad array of initiatives that are targeted at, amongst other things, enhancing value for end users, reducing costs and providing payment services to new retail channels. Examples include:

- innovation within existing payment types/channels (e.g. key fob form factor for credit cards; new technologies such as biometrics for authentication);
- derivatives of existing payment types/channels (e.g. MasterCard PayPass that uses contactless technology at the point of sale; Moneysend that uses a different network infrastructure to support merchant acquiring); and
- substantially "new" methods to make a payment using different access devices and networks (e.g. mobile payments in which the consumer's mobile handset is the access device and the telecommunications network is an integral component element of the end-to-end transaction).

There are numerous payment product innovations occurring globally, driven by growth in the global economy, integration of the global economy, advances in technology, competition, entrepreneurship, and evolution of retail and business-to-business (B2B) channels. The following table provides illustrations of the range of payment product innovation currently underway.

| Area | Comment |
|---|---|
| Contactless payments | Application of contactless technology with existing payment cards. MasterCard's product is PayPass and is being rolled out in the US with a pilot project in Australia.<br>NFC is a contactless technology being deployed that allows the mobile handsets to act as the access device for a contactless transaction. |
| Mobile ATM services | Mobile phone based banking (e.g. balance transfers, enquiries) using a mobile handset. Service providers include ClairMail, Firethorn, network service providers, financial institutions and telecommunications companies. |
| Mobile payments - P2P | Person to person payments using the mobile phone as the network access device. Participants in the value chain include the international schemes, financial institutions, telcos and service providers such as PayPal, Obopay, BillMonk and TextPayMe. |
| Remittances (mobile and other) | Increasing number of service providers and methods to transfer funds between parties. Participants in the value chain include the international schemes, banks, telcos and companies such as Western Union, MoneyGram, Travelex, G-Cash, Wizzit, GFG and M-Pesa. |

| Prepaid cards | Payment cards for which value is loaded before the card is used. Participants in the value chain include the international schemes, banks and companies such as NetSpend. |
|---|---|
| Chip cards | Use of cards with embedded IC chips for specific market segments. Examples include micro banking services for the under-banked population in India and healthcare payments for LifeNexus in the US. |
| Rebate cards | Product rebate value is loaded on a payment card. Participants in the value chain include the international schemes, banks and companies such as Parago. |
| Decoupled debit cards | Banks can issue debit cards tied to bank accounts at financial institutions other than the Issuing bank. Participants in the value chain include financial institutions, network service providers and companies such as Tempo. |
| Affinity cards | Continual innovation to develop affinity cards to appeal to particular market segments (eg. Barclay Breathe credit card focused on environmental issues). |
| ATM networks | ATM networks that allow surcharge free transactions for all cards. An example would include Allpoint, which does not require member Issuers to also acquire. |
| Acquiring networks | Use of new technology such as IP and GPRS that allows lower cost ATMs and merchant terminals. |
| Variations of current products | Continual innovation use existing core products/networks to provide enhanced value/lower costs to consumers.<br>Examples include:<br>• use of remittance services for shopping on the Internet (Western Union);<br>• ability to switch loyalty programs e.g. air miles to cashback to air miles (Chase Freedom card);<br>• one-off credit card numbers for on-line transactions (e-carte bleu);<br>• co-brand debit cards (Capital One);<br>• anonymous credit card (GratisCard);<br>• personalised commercial terms for cards (Accucard);<br>• alternative card form factors (Discover2GO card); and<br>• payment cards combined with mortgages/ transaction accounts/savings accounts (e.g. Bank of America “Keep the Change” program |

The Australian profile in respect to payment product innovation can be characterised as a “slow adapter” in the sense of applying proven technology to satisfy market opportunities. Examples include:

- banks issuing credit cards in the 1970s (whether an international brand or Bankcard);
- EFTPOS following the deployment of ATM networks in the 1980s; and
- BPAY following the deployment of telephone banking in the 1990s and Internet banking shortly thereafter.

This perspective is confirmed by the Department for Communications, Information Technology and the Arts' (DCITA) report on the future of electronic payments in Australia[29], which focused on electronic payments because "by reducing the costs of a transaction electronic payment mechanisms would generate productivity and efficiency gains, leading to economic growth and increased levels of national prosperity"[30].

The report observed that electronic payment innovation:

- has occurred in Australia "over many years";
- involved both domestically developed (BPAY) and offshore developed (PayPal) payment products; and
- focuses on using technology to improve current products (for example, the use of smart cards or microchips to reduce fraud) as opposed to developing new electronic payments products and channels. The major exception to this is Internet-based payments.[31]

The report noted that regulation can influence the pace of change and the rate at which electronic payment products enter the market, and the basis on which they compete and that it is "rarely a straightforward matter to identify the single factor at play, or learn which of many factors was critical to the outcome."[32]

The DCITA report identified seven broad areas where appropriate action would help the realisation of the potential gains from greater use of electronic payments.

- "closing information gaps;
- accelerating adoption of electronic payment methods and channels by consumers and businesses;
- increasing transparency in the pricing of payment products;
- increasing competition and access to new entrants in the payment market;
- promoting appropriate and judicious regulation;
- increasing the capacity for innovation; and
- government continuing to lead by example."[33]

It is interesting to note that this extensive study (that included participants both from the financial services and merchant sectors) identified areas in which the

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29 Department for Communications, Information Technology, and the Arts, *Exploration of the Future Electronic Payments Market,* June 2006.

30 *Ibid* at p.1.

31 *Ibid* at p.2

32 *Ibid* at p.6

33 *Ibid* at p.7

Bank has introduced regulations (information gaps; pricing transparency; increased competition and access) but did not identify that regulatory intervention in intermediate (i.e. interchange) pricing was required. In addition, the report concluded that "stakeholders in the workshops suggested that laws and regulations related to payments are viewed as complex, confusing, and adding some uncertainty to their operations".[34]

On balance, it is MasterCard's view that the Bank's regulations have reduced innovation. During this period the industry has seen the emergence of new payment product/service providers such as MoneySwitch and Bill Express while also seeing the demise of Bankcard and Internet based POSTbillpay. While the regulations may have facilitated the entry of participants such as MoneySwitch to the payments market[35]:

- the financial services industry has lost over $3 billion in revenue from credit card interchange fees since the credit card regulations were implemented. This has been slightly offset by a decrease of $100 million in reduced interchange fees paid for EFTPOS transactions. Looked at another way, the financial services industry currently has about $50 million less per month in revenue. That has significantly lessened the incentives for card issuers to introduce cardholder innovations, and there is little evidence that the beneficiaries of this net reduction in interchange fees (merchants) have supported innovations by acquirers;
- there has been some "innovation" in the area of existing payment products such as low-rate cards, special offers for balance transfers, new feature sets for existing products (e.g. reduced or revised loyalty programs) and so forth. While the Bank may view this as an example of intended innovation, it has taken management time away from the type of innovation to fill payment gaps identified in the DCITA report that would result in "efficiency gains, leading to economic growth and increased levels of national prosperity"; and
- by the Bank's own admission it has pursued "an evolutionary rather than revolutionary regulation" in respect to interchange fees. The result is that the Bank has not provided a platform for regulation based on economic theory and commercial reality. To date the Bank's approach has been *ad hoc* and partial, and has failed to provide a longer-term vision of a deregulated payments system.

There is ample evidence that four-party payment networks lead to greater efficiency, broader usage, and faster take-up than three-party schemes. A characteristic of four-party networks is that the incidence of costs and revenues can be mismatched, justifying the payment of a fee between parties (an inter-party or interchange fee). In an environment of uncertain and arbitrary regulation of inter-party fees, there is less certainty for any business case for new and innovative products and services. This uncertainty and risk dampens the effort and resources deployed to innovation.

MasterCard is not privy to all payment product innovation initiatives in Australia (under way or under consideration), but it is likely that many of them involve in one way or another four-party payment networks. In turn

[34] *Ibid* at p.129

[35] It is too early to determine if MoneySwitch will be a commercial success in their innovative approach to payments acquiring.

the viability of these types of innovation initiatives may depend on properly matching the revenues and costs amongst the participants by means of an interchange fee. As noted above, successful payment product innovation requires market demand, a well-articulated value proposition to all participants and an adequate and credible business case. With the fragmented and uncertain approach the Bank has taken to interchange fees, payment product innovation in Australia has been delayed pending some resolution of the uncertainty.

An example of where Australia's payments system regulations have delayed product innovation is the introduction of chip cards. Australia was very active in chip card projects and trials in the late 1990's (e.g. Mondex). Chip cards lower the cost of current payment options (e.g. reduced fraud) and provide a platform to better meet the needs of consumers and merchants (e.g. micro payments). During the past 5 years the introduction of chip cards in Australia has fallen well behind other global markets such as the United Kingdom, and mainland Europe as well as Asian markets such as Singapore, Malaysia, Taiwan and Japan. Whilst the specific cause and effect between the regulations and delay in EMV migration in Australia may be subject to different views, there is no doubt the lost revenue to financial institutions, significant management time redirected to mitigate the negative financial impact of the regulations, and uncertainty about uniform and equitable industry economics in the future all have contributed. There is little doubt that Australia will at some stage have EMV compliant chip cards but it may be a case in point of Australia moving from a Tier 1 market in terms of payment innovation to a Tier 2 market.

**"The Bank needs to review its regulations with an eye to ensuring it is not promoting evolution towards the equivalent of a low cost Model T on the global payment highway."**

With no apparent positive impact of the Bank's regulations on payment innovation in Australia and the massive transfer for value from the financial services industry (that typically is an important stimulus for innovation) to the merchant sector (that typically does not stimulate payment innovation), the Bank needs to review its regulations with an eye to ensuring it is not promoting evolution toward the equivalent of a low cost Model T on the global payment highway.

(iv) The compliance costs associated with the reforms.

**MasterCard's Response**

MasterCard believes that the financial institutions are better placed to respond to this point.

***The effect of the removal of the no-surcharge rule***

109. (i) The extent of surcharging, the size of any surcharges relative to merchant service fees, and the extent to which merchants set different surcharges for different payment methods.

(ii) The extent to which the ability to surcharge has led merchants who previously did not accept credit cards to now accept these cards.

(iii) The effect of surcharging on cardholder behaviour.

**MasterCard's Response**

This response deals with the issues raised in each of sub-paragraphs (i), (ii) and (iii).

The removal of the 'no surcharge' rule in the merchant-pricing Standard, implemented in January 2003, provides merchants with greater pricing flexibility. They have yet another option to charge more to customers who use credit cards than they charge customers who use other payment instruments.

MasterCard maintains the view that a 'no surcharge' rule can provide important branding benefits for MasterCard and consumers. Consumers are able to rely on the MasterCard brand as delivering a particular level of service, namely, acceptance at merchants on no-less favourable payment terms. The 'no surcharge' rule provides for consistency of cardholder treatment, as consumers dislike being surcharged at some stores but not others. It also protects consumers from price gouging by merchants that have market power. Even without surcharging, merchants would retain pricing flexibility as they would still be able to offer discounts for other payment methods. Nonetheless, MasterCard also recognises the possible benefits in the Australian context of increasing merchants' pricing flexibility, and that surcharging provides four-party schemes with yet another basis to ensure that the level of interchange fees does not exceed merchant willingness to pay. The costs and benefits of a 'no surcharge' rule are therefore need to be balanced. For that reason, MasterCard ordinarily considers the question of whether to maintain the 'no surcharge' rule on a country-by-country basis.

***Difficulty of Dis-entangling the Data***

There is a particular problem associated with assessing the effects of the abolition of the no-surcharge rule. This is that it was introduced at the same time as regulation of interchange fees. The effects of the two regulations are impossible to disentangle.

The removal of the no-surcharge rule gives merchants an extra option when they are negotiating merchant fees with their banks: if those fees are too high, they can impose a surcharge. The Bank's time series data on merchant fees demonstrates that these have been reduced as a result of the regulations. It is impossible to tell the extent to which this reduction has been caused by: (a) the regulation of interchange fees; or (b) the removal of the no-surcharge rules. It is impossible to disentangle the effect of each cause.

The simultaneous introduction of these two regulations means that it is also impossible to measure the effect of the abolition of the no-surcharge rule on the extent and level of surcharging. Merchants will have a higher incentive to surcharge the higher merchant fees are. However, the no-surcharge rule was abolished at the same time as the regulation of interchange. Thus, at the same time as merchants were given more freedom to surcharge, their incentive to surcharge was reduced.

MasterCard considers that the ability of merchants to discourage card use, by such means as cash discounts and surcharging, should be more than sufficient to avoid excessive interchange fees. Credit card schemes have an interest in avoiding discouragement by merchants, because it lessens card

use. It should not, therefore, be surprising that schemes will set interchange fees to dissuade widespread discouragement practices by merchants. A low level of discouragement might therefore simply reflect that merchants are not unhappy with their current merchant fees relative to the benefits they obtain from accepting cards. That is simply the nature of bargaining - one does not need to exercise an option for it to have value to the merchant.

The threat of discouragement has value to the merchant (in restraining merchant fees) as long as it is credible[36], even if it is not exercised.

It has also been argued by some parties that merchant discouragement is unlikely to provide an effective constraint on merchant service fees because merchants fear losing business to competitors that do not engage in similar practices. This reasoning is, however, deficient, for two reasons:

The first reason is that a decision to surcharge card sales (as an example of merchant discouragement behaviour) would be accompanied by the scope for reducing prices for non-credit card sales. For a given merchant service fee, firms will therefore balance the (competitive) gains from surcharging (more non-credit-card sales) with the costs (lower credit card sales). An increase in merchant service fees will clearly raise the gains from surcharging relative to the costs, and hence make it more likely that surcharging will occur.

The second reason is that surcharging would not necessarily result in lost sales, as customers may simply use a different means of payment within the same store. There is surely every reason to expect that merchants will structure prices in order not to lose sales to competitors. Consultants to MasterCard in the UK in fact found in consumer survey work that consumers were much more likely to substitute payment method rather than spend at a different retailer that did not surcharge.[37]

In summary, MasterCard cautions against a simplistic interpretation of the actual level of, or growth in, surcharging, and whether this is 'good' or 'bad'.

## *Data on merchant surcharging*

In order to better understand merchant and consumer reaction to the removal of the 'no surcharge' rule in Australia, MasterCard commissioned research from Roy Morgan Research on the behaviour of both consumers and merchants. This

**"The merchant community has the ability to ensure that the normal forces of market competition operate effectively to set interchange fees at the optimum level."**

36 For that threat to be credible, the merchant must be better off from surcharging compared to not surcharging if the acquirer refuses to reduce merchant fees. As indicated above, the threat will probably not be credible for certain types of merchants (for whom the cost of surcharging is relatively high because of frequent transactions, etc.). But the Bank has adduced no evidence to suggest that there will be very few merchants for whom the increases in revenue from surcharging will outweigh its costs (implementation costs and potential loss of custom).

37 See Dotecon, *Discouragement of credit card use A study of merchants' ability to affect customers' choices of payment method*, February 2005, p. 35. Dotecon notes that: "These results provide strong evidence of different forms of payment being closer substitutes for each other than different retail outlets, i.e. other things equal, credit card holders are more likely to switch to another payment method in a given shop than they would be to use the same payment method in another shop if faced by actions by merchants that reduced the utility of using a particular payment method (such as surcharging credit card sales)."

research consisted of a series of consumer and merchants interviews at various stages between the introduction of the regulations and July 2005. Four surveys ('waves') were conducted - November 2003, May 2004, January 2005, and July 2005.

The key results from this work are as follows:

- there is evidence that a significant number of **merchants** have responded to the removal of the no surcharge rule by introducing surcharges. A further significant proportion of merchants offer cash discounts;
- there is evidence to suggest that **consumers** are observing and reacting to the use of surcharging by merchants; and
- **taken together**, this evidence suggests that a merchant's ability to discourage card usage through such means as offering cash discounts or surcharging means that the merchant community has the ability to effectively constrain interchange fees.

This said, given the extent of surcharging in the face of very significant reductions in the cost of accepting credit cards, and the concentrated nature of some important Australian merchant sectors, MasterCard has some concerns that the balance mentioned above may have tipped in favor of merchants and against consumers. Therefore, MasterCard would not support any further steps to encourage surcharging and suggests that credit card system operators be given the ability to require that merchants limit the amount of surcharges to the cost of credit card acceptance (today, only acquirers, acting individually, may require this). This would bring the Australian practice in line with that in Europe, where MasterCard requires that merchant surcharges bear a 'reasonable relationship' to the cost of acceptance.

[Confidential]

### *Effects of the abolition of the no surcharge rule*

The Bank's objective in introducing the Standard was to "ensure that a merchant accepting a credit card of a designated credit card scheme is free to recover from the cardholder the cost of accepting that card."[38] While the Bank did not provide an explicit expectation or benchmark for measuring the success of the pricing Standard, it did note that interchange fee regulation was justified in the absence of strong competition in the acquiring market and without "the establishment of merchant freedom to charge according to the means of payment as an effective discipline on merchant service fees."[39]

As we noted earlier, while MasterCard considers that the 'no surcharge' rule can generate net benefits under some conditions, both as another means by which merchants can discourage card usage and as a facilitator of enhanced

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[38] Reserve Bank of Australia, *Reform of Credit Card Schemes in Australia – I – A Consultation Document,* December 2001, p.78

[39] Reserve Bank of Australia, *Reform of Credit Card Schemes in Australia – IV – Final Reforms and Regulation Impact Statement*, August 2002 at p.33.

price competition between merchants, it must be recognised that this comes at a cost to consumers.

While merchants now have the ability to surcharge, it is obvious that not all merchants will elect to do so. That might simply be because the costs of doing so (e.g. explaining the surcharge to the customer, possible adverse customer reaction) are larger than the benefits (the additional revenue obtainable from the consumer, or cost savings from diverting the consumer to a lower-cost payment method for the merchant).

The Bank appears to have a view that surcharging is *per se* desirable, and should be widespread:

- "we think [merchants] are acting in the national interest when they [surcharge]."[40]

- "Submissions on this issue might therefore wish to outline under what conditions surcharging could be considered sufficiently widespread…"[41]

- "A related question is under what conditions might the current regulations – particularly those surrounding interchange fees – be removed or relaxed….Another might be a continuing rise in the number of merchants that are prepared to impose surcharges for relatively expensive payment instruments."[42]

These views seem to reflect thinking within the Bank that surcharging is 'good' and should be increasing. It reflects a view that regulators can determine which prices are good and which prices are bad. In short, it appears to reflect a 'cops and robbers' approach to policy that is inferior to the 'workable competition' approach – a view which many Australian consumers would struggle to agree with when incurring surcharges for the provision of services over the internet, which have only ever been purchasable with a credit card.

MasterCard rejects the view that it is possible to determine the 'appropriate' level of surcharging. The removal of the rule was designed to lead to greater flexibility for merchants to reflect the cost of different payment instruments and to provide a further channel to offset any increased costs of doing business.

**"MasterCard rejects the view that it is possible to determine the 'appropriate' level of surcharging."**

One might also expect that the efficiency of surcharging would differ by the type of retailer and the type of transaction. Retailers who specialise in smaller value transactions are less likely to surcharge, as the *ad valorem* nature of merchant fees means that they are likely to be small in absolute terms relative to the costs of explaining to consumers that a surcharge applies, and/or encouraging the customer to use a lower cost payment type. Against that force, larger retailers

[40] Mr I Macfarlane, Reserve Bank of Australia, *Transcript,* 17 February 2006, p. 37

[41] Reserve Bank of Australia, *Reform of Credit Card Schemes in Australia – I – A Consultation Document,* December 2001, pp. 27-28.

[42] Dr P Lowe, Reserve Bank of Australia, *Reform of the Payments System – The 2007-08 Review*, June 2007 available at http://www.rba.gov.au/Speeches/2007/sp_ag_270607.html

undertaking high volumes of smaller value transactions (such as supermarkets) have shown that they are able to negotiate relatively low merchant fees. That effectively reduces the benefits to them of surcharging. In neither case should a lack of surcharging be seen as 'inefficient' – rather, it reflects that different merchants have different costs and benefits of surcharging, and, therefore, different critical thresholds for surcharging. A further possible factor determining willingness-to-surcharge is the price-cost margin. *A priori*, the lower the margin, the less one can afford to bear additional costs and the more willing firms will be to surcharge. One would therefore expect retailers with very low margins (e.g. travel or ticket agents) to surcharge, and in fact that is the case.

As credit card schemes have an interest in avoiding surcharging by merchants (because it discourages card use), it should not be surprising that schemes set interchange fees to avoid widespread surcharging and other forms of card usage discouragement behaviour.

### *Honour-all-cards and surcharging*

In the Issues Paper, the Bank refers to the honour-all-cards rule as a further source of restriction on merchants that might lessen competition and efficiency.[43]

In particular, the Bank comments that it is interested in views as to whether the honour-all-cards Standard should be modified to allow merchants to accept some, but not all types of credit cards. The Bank then suggests one possible modification would be to allow merchants to accept standard cards, but to decline acceptance of premium cards or pre-paid cards.

**"It should not be surprising that schemes set interchange fees to discourage widespread surcharging."**

MasterCard submits that further regulations, along the lines of those suggested, are neither desirable nor necessary.

We understand that the Bank supports the honour-all-cards rule as it relates to issuers. One of the essential requirements of a four-party scheme is that it must ensure that a card issued by any issuer can be used at a merchant acquired by any acquirer. This requirement goes to the core of the scheme as it guarantees issuers equality of access and assures consumers of the ubiquity of the card. The Bank's earlier regulations differentiated between branded debit and credit cards, so that these are now not subject to the honour-all-cards rule.

The question is whether honour-all-cards rule should extend to all MasterCard branded credit cards, rather than just 'standard' cards. The concern seems to be that the honour-all-cards rule may be used by

**"Should certain credit cards be refused, MasterCard's view is that it would lead to cardholder confusion and (possibly) merchant embarrassment, and ultimately damage MasterCard's brand."**

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43 Issues Paper at para 45.

MasterCard to force acquirers and merchants into accepting cards that carry relatively high interchange fees. These concerns are misplaced. There are several (pro-competitive) reasons why a payment scheme such as MasterCard includes different types of credit cards under the same acceptance mark:

- First, it allows MasterCard to use the brand value already created to introduce new products into the market. This is a very common strategy (e.g. Diet Coke).

- Second, it allows MasterCard to compete effectively with other payment systems, since MasterCard must compete with the full line of its competitors' products, including consumer and commercial cards.

- Third, it reflects in part the fact that MasterCard does not dictate to its issuers (consistent with intra-brand competition) the exact nature of cards they will issue or how they will market them. Should certain credit cards be refused, MasterCard's view is that it would lead to cardholder confusion and (possibly) merchant embarrassment, and ultimately damage MasterCard's brand. For example, a cardholder sees the MasterCard logo on a shop window, but realises only at the moment of the payment that the merchant only accepts MasterCard consumer credit cards, as opposed to MasterCard commercial credit cards — or vice versa. This would undeniably damage the value of the MasterCard brand from the cardholder's and merchant's perspective.

Additionally, further modifications to the Honour All Cards Rules could allow certain merchants to effectively refuse the acceptance of cards issued by particular issuers, by for example choosing to avoid the type of card that certain issuers tend to be heavily represented in – therefore effectively doing away with the sacrosanct "Honour All Issuers" component of the Honour All Cards Rule - a result that all commentators generally agree should be avoided.

***The effect of the modification of the honour-all-cards rule***

110. (i) The extent to which the modification of the honour-all-cards rule has led merchants to decline acceptance of scheme debit (or credit) cards, and the effect of the modification of the rule on negotiations over merchant service fees or the setting of interchange fees.

(ii) The effect on merchants of the expansion in the number of interchange categories, in particular the introduction of the premium interchange fee under the umbrella of the honour-all-cards rule.

(iii) Any effects on product development.

**MasterCard's Response**

This response serves as an answer to all three sub-paragraphs of this paragraph.

The modifications to the honour-all-cards rule brought about by the regulations have transferred significant power into the hands of Australia's largest merchant groups. This power has been exercised to the detriment of the propagation of innovation, to other merchants and to Australian consumers.

[Confidential] To allow issuers to realise an average interchange fee of A$0.12 per transaction as allowed for under the regulations, interchange fees for smaller merchants have been increased substantially to make up the difference.

**"The modifications to the honour-all-cards rule brought by the regulations have transferred significant power into the hands of Australia's largest merchant groups."**

[Confidential] . It is MasterCard's understanding from the Bank's statement on prepaid cards[44] that prepaid cards are to be classified as debit cards for the purposes of the application of the regulations. As such, the schemes can enforce acceptance of prepaid cards for merchants choosing to accept debit cards[Confidential]
[Confidential]
Clearly the result of the changes to the honour-all-cards rule have transferred significant power to Australia's largest merchants, resulting in higher interchange fees for smaller merchants, and a diminution in the attractiveness of innovative and beneficial products such as scheme branded prepaid programs.

***The effect of the reforms on the competitive position of different payments***

111. (i) The extent to which the reforms have affected the competitive positions of MasterCard and Visa, relative to American Express and Diners Club.

**MasterCard's Response**

In MasterCard's March 2002 Submission[45] it was stated:

*"The Bank's selective and arbitrary intervention in focusing exclusively on the four-party schemes will result in a reduction in the efficiency of the payments market in Australia as the three-party schemes, which have higher overall fees and lower network benefits, will reap a competitive windfall against the four-party schemes."*[46]

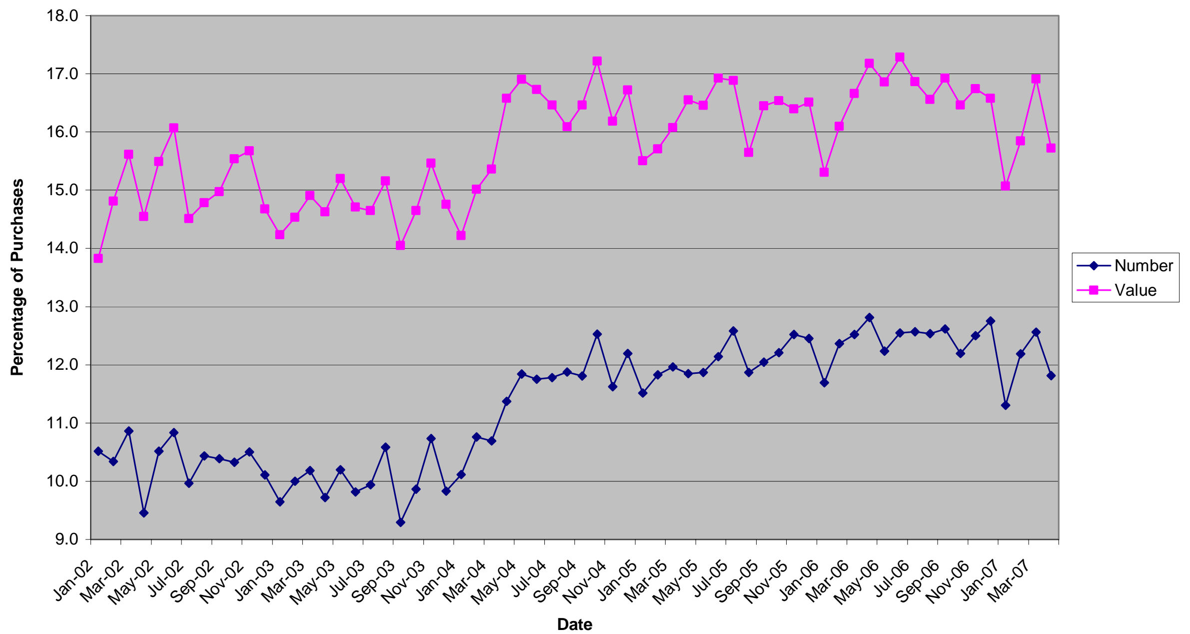
This prediction has come to fruition. The Bank's statistics show that since the introduction of the regulations, the market share of the three-party schemes has increased at the expense of that of the four-party schemes. This is illustrated in the following charts:

**"Since the introduction of the regulations, the market share of the three-party schemes has increased at the expense of that of the four-party schemes."**

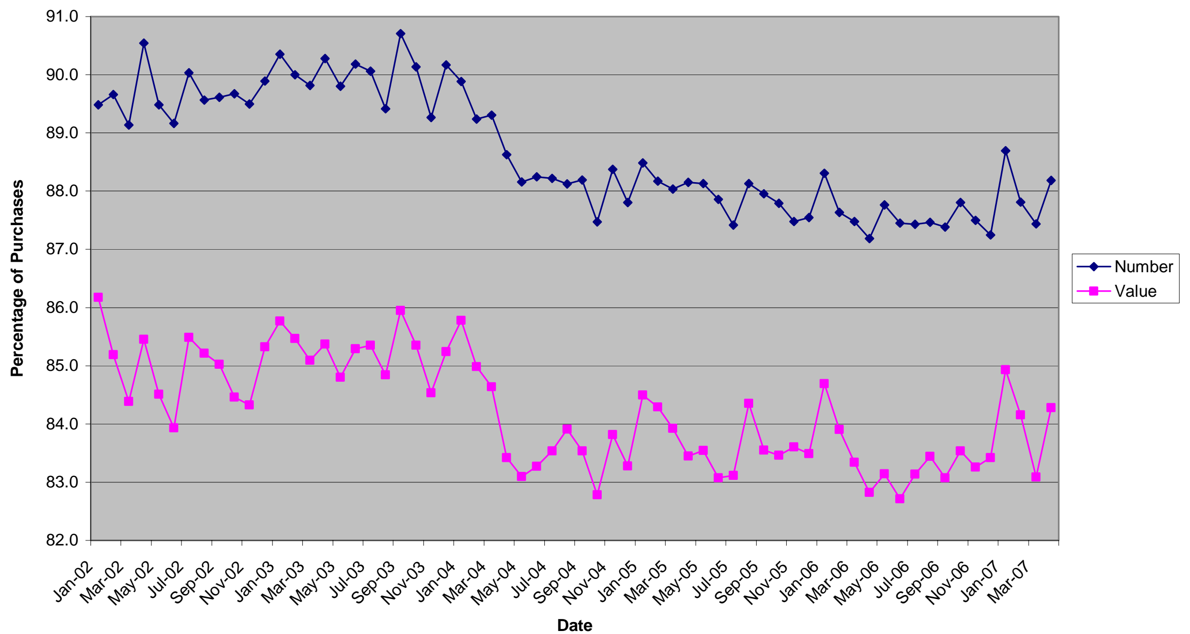
44 Reserve Bank of Australia, Media Release, 13 September 2006

45 *Reform of Credit Card Schemes in Australia, Response to the December 2001 Consultation Document to the Reserve Bank of Australia*, March 2002

46 *Ibid*, at Part A, para. 2.6




Source: Reserve Bank of Australia, Bulletin Table C2_Market Shares of Credit Card and Charge Card Schemes.




Source: Reserve Bank of Australia, Bulletin Table C2_Market Shares of Credit Card and Charge Card Schemes.

The interchange standard came into force in July 2003. Since that date the share of purchases has increased for American Express and Diners Club from 9.9% by number and 14.6% by value to as high as 12.8%[47] and 17.3%[48]

47 In April and December 2006 - Reserve Bank of Australia, Bulletin Table C2 - Market Shares of Credit Card and Charge Card Schemes.

respectively. The share of purchases for the regulated four-party schemes since that date has declined from 90.1% by number and 85.4% by value to as low as 87.2% by number[49] and 82.7% by value[50].

The Bank's own statistics demonstrate that its regulations have been a windfall for the three-party schemes. Indeed an analysis of American Express' share of credit card outstandings by MasterCard shows an even more dramatic shift in its market share. Although these numbers are not published, MasterCard's calculations from other publicly available information suggest that outstanding balances on American Express issued cards grew from 11% in 2004 to more than 13.6% in 2006. It is from outstanding balances that issuers earn their greatest revenues.

**"The Bank's own statistics demonstrate that its regulations have been a windfall for the three-party schemes."**

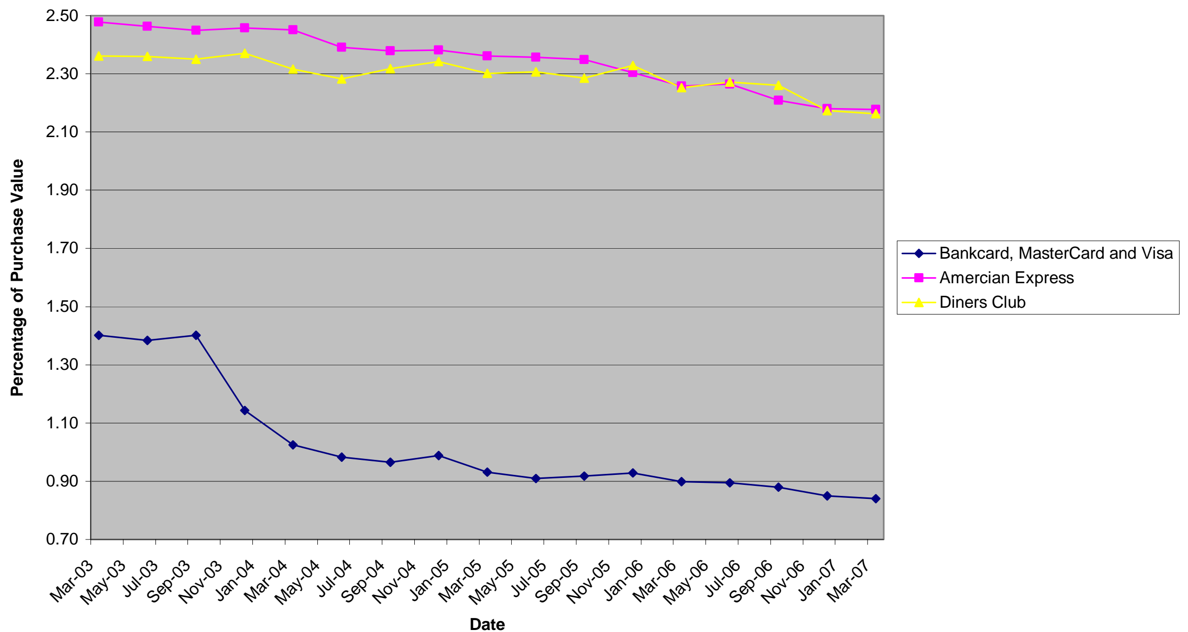
MasterCard believes that, were it not for the abolition of the no-surcharge rule, the share of purchases for the three-party schemes would have been greater. The ability of merchants to impose a surcharge in respect of purchases using credit cards has acted as a constraint on the growth of the three-party scheme.

The charts below illustrate that merchant service fees dramatically decreased for the four-party schemes from 1.4% of purchase value before the interchange standard came into effect in July 2003 to 0.84% in March 2007. A 40% reduction in merchant service fees. In comparison, while there has been a reduction in merchant service fees for the three-party schemes, this has been at a much reduced pace. In the case of American Express the fees have reduced from 2.46% before July 2003 to 2.18% in March 2007 – an 11% reduction. In the case of Diners Club the fees have reduced from 2.36% before July 2003 to 2.16% in March 2007 – an 8% reduction.

48 In June 2006 – *ibid.*

49 In April and December 2006 – *ibid.*

50 In June 2006 – *ibid.*




Source: Reserve Bank of Australia, Bulletin Table C3-Merchant Fees for Credit and Charge Cards[51]

Accordingly, in assessing the effect of regulations on the competitive positions of MasterCard and Visa, relative to American Express and Diners Club, the effect of the regulations on the merchant service fees charged by the three-party schemes needs to be taken into account as well the effect on the share of purchase transactions using three-party scheme charge cards as compared to the share of purchase transactions using four-party scheme credit cards. In the Consultation Document the Bank was of the view that:

> *"If a standard for interchange fees resulted in lower merchant service fees in the designated credit card schemes, normal competitive processes would ensure that competitors would have to react. Merchants would have an even stronger preference than at present for cards of the four party schemes. They would be likely to seek to renegotiate merchant service fees changed by American Express and Diners Club … . These schemes would therefore be under strong competitive pressure to respond by lowering their merchant service fees to protect their merchant base."*[52]

While it is a fact that there has been a reduction in the merchant service fees charged by the three-party schemes, and this has no doubt been caused by the substantial reductions in the merchants service fees charged by the four-party schemes, it is clear also that the level in reduction of the fees charged by the three-party schemes has been somewhat modest.

51 The Bank's statistics also include 'Other' fees which are not included in this chart. 'Other' fees include annual fees, terminal fees, terminal rentals, monthly fees, joining fees and other fees or associated costs charged to merchants.

52 Reserve Bank of Australia, *Reform of Credit Card Schemes in Australia – I – A Consultation Document,* December 2001 at p.119

The merchant service fees charged by the three-party schemes has always been a multiple of those charged by the four party schemes. This has increased from a multiple of 1.7 in July 2003 to a multiple of 2.5 in March 2007. The increase in relative revenue which the three-party schemes have been able to generate as a result of the Bank's regulations have enabled those schemes to offer significantly more attractive card programs than the regulated schemes and, in turn, is a factor that contributes to the increased share of three-party scheme cards as compared to regulated scheme cards. As indicated above, the ability of merchants to impose a surcharge in respect of purchases using credit cards has acted as a constraint on the growth of the three-party scheme. If merchants were not allowed to impose surcharges and steer American Express and Diners Club cardholders to alternative payment methods, the share of the three-party schemes would have been far greater.

In the absence of the Bank's regulation, and ensuing increased gap between the merchant service fees charged by the regulated schemes and the three-party unregulated schemes, it is unlikely that the three-party schemes would have been entering into arrangements with Australian banks to enable the distribution of three-party scheme cards. National Australia Bank and Westpac now issue American Express Cards and this has undoubtedly contributed to the increased share of purchases using three-party scheme cards.

The Bank stated in its Consultation Document:

> *"Objections to reform of the designated credit card schemes – that it would give a 'free kick' to the relatively small, higher cost three party schemes … are, at heart, a vote of no confidence in the competitive process in Australia. This is a view that the Reserve Bank does not share."*[53]

**"The three-party schemes have indeed been given a 'free-kick' through the Bank's regulatory shackling of the four-party schemes."**

The conclusion one draws from the Bank's own data is that the three-party schemes have indeed been given a "free-kick" through the Bank's regulatory shackling of the four-party schemes. MasterCard believes that the desirable outcome of the Bank's review of its regulations is the unshackling of the four-party schemes so that they may compete on a more even footing with the three-party schemes.

(ii) The extent to which the specific details of the interchange Standards have affected the competitive positions of MasterCard and Visa against one another.

**MasterCard's Response**

This issue is more fully addressed in MasterCard's response to paragraph 132 below.

(iii) The extent to which the competitive positions of EFTPOS and scheme debit have been affected by the reforms.

**MasterCard's Response**

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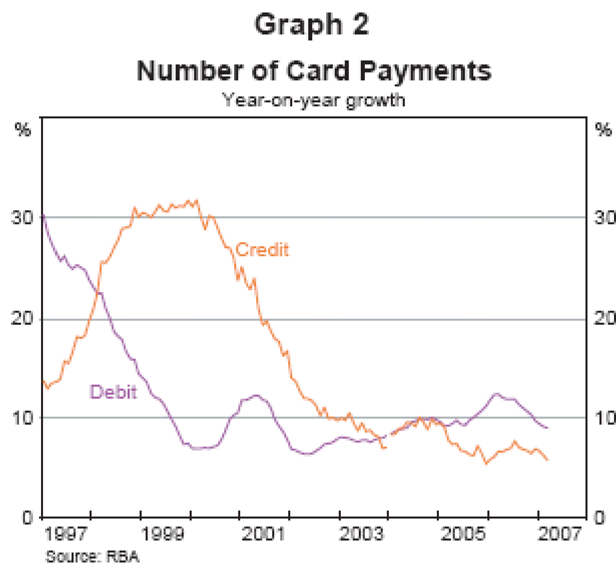
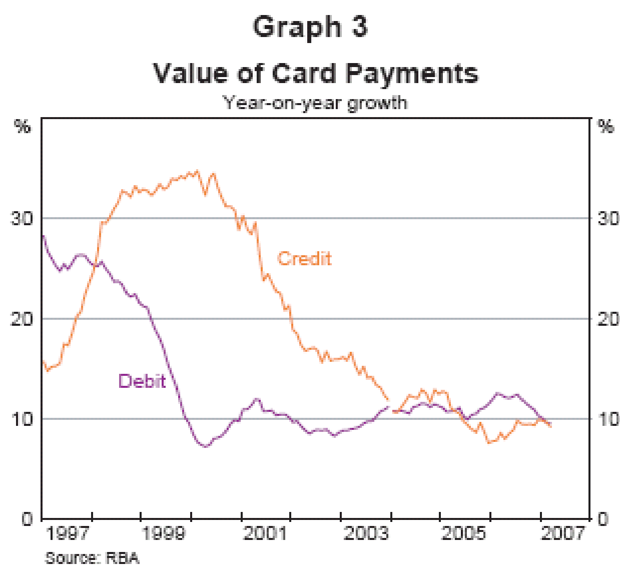
[53] *Ibid* at p.ix.

The Bank refers to Graphs in its Issues Paper in asserting that "[O]ver the past couple of years, both the number and value of debit card payments have grown more quickly than for credit cards (Graphs 2 and 3)."[54]




Source: Reserve Bank of Australia, Reform of Australia's Payment System, Issues for the 2007/08 Review, May 2007 at p17.

The interpretation of the Graphs may be a somewhat optimistic assessment of the growth in debit cards relative to credit cards. The Bank's policy objectives in seeking to promote debit, and in particular EFTPOS, over credit card transactions has been made clear:

> *"In the Bank's view, the combination of the previous reduction in credit card interchange fees and the proposed reduction in EFTOS interchange fees would promote more soundly based competition in the payments system and likely lead to greater use of EFTPOS than would otherwise be the case. … this is not viewed as an objective in*

[54] Issues Paper at p.17

> *itself, but rather a reflection of the more appropriate price signals facing cardholders."*[55]

While the point may involve a fine use of semantics, it is clear that the Bank's regulation of interchange fees of the four-party scheme and of EFTPOS were directed at encouraging the use of EFTPOS over the use credit cards. The data presented by the Bank in the above charts is misleading in some respects. In the Issues Paper it is stated that:

> *"Over the past couple of years, both the number and value of debit card payments have grown more quickly than for credit cards (Graphs 2 and 3)."*[56]

MasterCard understands from enquiries made of the Bank that the data used to compile Graphs 2 and 3 does not include all debit and credit card operations. The data used to plot the number and value of credit card payments only includes purchases and not cash advances. The data used to plot the number and value of debit payments includes only EFTPOS and scheme debit and not ATM withdrawals or cash out.

The Bank's statement is to some extent correct so far as Graph 2 is concerned over the last two years although it is not so clear when the value of payments is considered – as reflected in Graph 3. The data indicates that the rates of growth of credit and debit payments have begun to converge since the start of this year.

Another way to look at the rates of growth of credit and debit would be to use the total credit transactions recorded in the Bank's Credit and Charge Card Statistics[57] (purchases plus cash advances) and to compare this with the total debit transactions recorded in the Bank's Debit Card Statistics (which would include EFTPOS purchases, scheme debit, cash out and ATM withdrawals). This would provide insight into the relative change in the use of credit, debit and cash and gives a very different result. Graph A shows that the rates of growth of the total number of credit and the total number of debit transactions over the last two years are very similar. Graph B shows that the rate of growth of the value of credit transactions has exceeded the rate of growth of debit transactions throughout the last two years.

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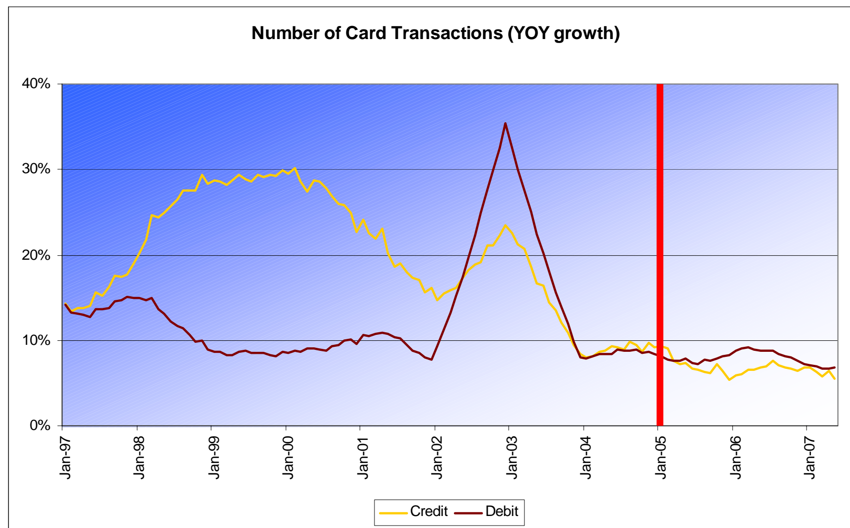
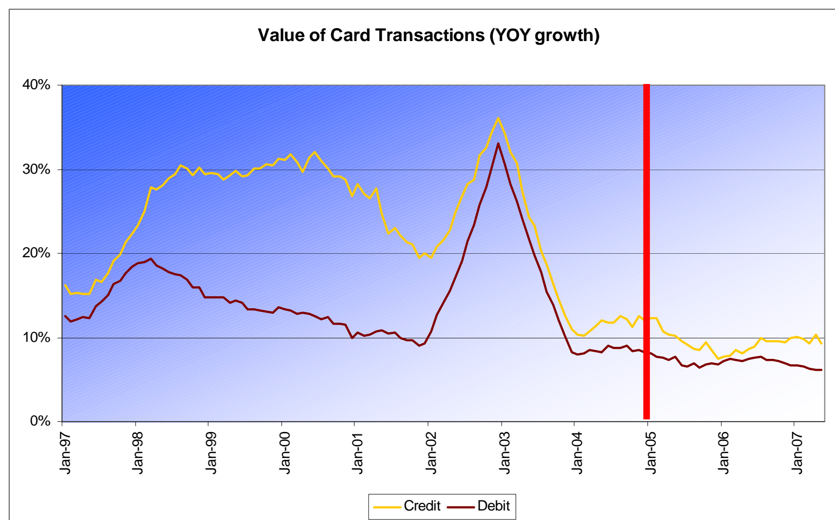
55 Reserve Bank of Australia, *Reform of the EFTPOS and Visa Debit Systems in Australia – Final Reforms and Regulation Impact Statement*, April 2006 at p. 24.

56 Issues Paper at para 76.

57 Bank's Credit and Charge Card Statistics under database CO2.




Graph A




Graph B

**"The regulations have had the unintended consequence of benefiting the three-party schemes and the use of cash rather than the intended result of encouraging the use of debit. This may seem contrary to policy objectives designed to encourage more efficient payment systems."**

Graphs A and B would therefore indicate that regulation in itself will not always result in the outcome that is sought by the regulators. The regulations have had the unintended consequence of benefiting the three-party schemes and the use of cash rather than the intended result of encouraging the use of debit. This may seem contrary to policy objectives designed to encourage more efficient payment systems.

(iv) Any effects of the reforms on product innovation.

**MasterCard's Response**

This is dealt with in paragraph 108(iii) above.

***The effect of the reforms on the competitive position of different payments***

112. (i) The extent of competition between acquirers and whether this has changed as a result of the reforms.

**MasterCard's Response**

In its June 2001 Submission to the Bank[58] in response to the Joint Study[59] and questions put to MasterCard by the Bank, MasterCard stated in relation to the restrictions on eligibility for membership of MasterCard in MasterCard's rules:

> *"MasterCard can report to the Reserve Bank that it has not had many, if at all, significant enquiries for membership of MasterCard by institutions that would not otherwise qualify for membership under MasterCard's existing rules. There may be a question as to whether the Joint Study in advocating an easing of the restriction on membership may be seeking a solution to perceived rather than a real problem."*[60]

**"The access regime for the designated credit card schemes has not, in MasterCard's view given rise to any increased competition between acquirers."**

The Bank's access regime for the designated credit card schemes has not, in MasterCard's view given rise to any increased competition between acquirers. Those financial institutions currently acquiring MasterCard credit card transactions are the same as those financial institutions that were acquiring such transactions prior to the introduction of the access regime. All the access regime has done is to introduce rules not that dissimilar to MasterCard's long-standing policy of permitting regulated and supervised non-deposit taking institutions to participate in its system.

Since the access regime was introduced there have been two entities that have obtained authorisation from the Australian Prudential Regulation Authority (APRA) as specialist credit card institutions: GE Money and MoneySwitch. GE was already a member of MasterCard due to its prudential regulation in the United States. [Confidential]

(ii) Any remaining obstacles to access.

**MasterCard's Response**

Consistent with the maintaining of various prudential safeguards which MasterCard (as well as APRA) considers is important to the question of what entities should be allowed to issue MasterCard cards or acquire MasterCard credit or debit transactions, MasterCard does not believe that there are any remaining obstacles to access.

MasterCard's rules, before the introduction of the Access Regime, had permitted regulated and supervised financial institutions to participate in the

58 Submission to the Reserve Bank of Australia, June 8, 2001 (as revised July 20, 2001)

59 Australian Competition and Consumer Commission and Reserve Bank of Australia, *Debit and Credit Card Schemes in Australia: A Study of Interchange Fees and Access*, October 2000.

60 *Ibid* at Part B, para. 1.1.

MasterCard system. MasterCard supports the prudential requirements that must be satisfied under the Access Regime in order for entities to be able to obtain access to the four-party schemes.

It is noted in this regard that, while various prudential requirements have been considered necessary in order for an entity to be authorised by APRA as a "specialist credit card institution" (SCCI), there is no such restriction in relation to cards issued by three-party schemes. An entity which might not otherwise qualify as an SCCI and therefore not qualify as an issuer or acquirer of regulated four-party scheme cards, could nevertheless enter into an arrangement with the three-party schemes in relation to three-party scheme cards.[61] This is a further example of the Bank's regulations allowing three-party schemes the freedom to run their payment systems as they see fit while the more efficient four-party schemes are subject to an array of restrictions.

**Q2: What is the case for ongoing regulation of interchange fees, access arrangements and scheme rules, and what are the practical alternatives to the current regulatory approach?**

113. The public policy case for ongoing regulation of interchange fees, access arrangements and scheme rules. Possible alternatives to the current regulatory framework.

**MasterCard's Response**

The changes to the access arrangements have had very little effect. The only clear effect of the regulation of interchange on the allocation of resources has been the diversion of credit card business from the four-party schemes to the three-party schemes. This is a distortion brought about by a policy of direct regulation of interchange. This should be dropped.

**"The Bank has failed to develop a coherent 'market failure' framework for its interventions."**

In MasterCard's view, the Bank has failed to develop a coherent "market failure" framework for its interventions. The Bank has justified its interventions by suggesting that the "normal forces" of competition were not working. The Bank appears not to mean that competition is deficient, in the sense of firms using their market power, but rather seems to mean that competition has led to relatively high cost payments systems displacing lower cost systems.[62] As has been pointed out to the Bank before, this substitution by itself says nothing about efficiency. High cost schemes produce greater benefits to consumers than lower cost schemes. The Bank has also tried to cast the perceived problem as one of 'adverse selection', in that the 'bad' or high cost payment system is driving out the 'good' or low cost payment system.[63] We do not dispute that informational problems can lead to market failure, but the Bank's characterisation misconstrues the nature of an adverse selection market failure. Markets subject to adverse selection are prone to failure because of hidden information, not because of incorrect price signals, as the Bank seems to suggest.[64] A "bad" quality product will only drive out the good if purchasers

61 It is noted that there does not appear to be an example of this actually happening.

62 See I. J. Macfarlane, *Gresham's Law of Payments: Talk to ABIF Industry Forum*, March 2005.

63 *Ibid*.

64 Note that in Kreps, *A Course in Microeconomic Theory*, Chapter 17, p. 625, Gresham's Law is identified as an information problem: "Imagine that some of the coins have been shaved in this fashion, while others have not. Then someone taking a coin in trade for goods will assess positive probability that the coin being given her has been shaved, and thus less will be given

are unable to differentiate between qualities. For example, an insurer may not be able to determine whether a consumer undertakes high risk activities, or a used car buyer may not be able to determine whether he is buying a 'lemon'. We are not aware of any suggestion here that consumers are unable to differentiate between different 'quality' payments systems. Even if such a problem existed (if the market could not solve the problems of its own accord), standard government interventions to correct these types of market failures relate to the filling of the information gap, **not** price regulation. For example, the Government may implement consumer protection legislation such as Part V of the *Trade Practices Act 1974* (which forces merchants to certify items they sell as "fit for purpose"), or may provide more information to consumers about product quality.

MasterCard encourages the Bank to further consider the rich literature on two-sided markets that has emerged since the Bank's 2002 regulations.[65] MasterCard considers that the key insight of this literature is that end-user prices are not set in two-sided markets purely on the basis of 'cost' or 'user pays' on each side. Rather, prices are set so as to 'bring both sides on board' – to maximise the benefits to cardholders of having a large merchant network, and to merchants from having a large cardholder base. Optimal prices therefore must be set with reference to demand elasticity on either side, to capture externalities/network effects *and* costs.

**"The Bank should trust in the forces of competition to deliver efficient outcomes."**

Of course, it is not possible to claim that MasterCard's prices optimise across all of these variables at all points in time. But that is a normal phenomenon in competitive markets (how many firms would know exactly what their marginal costs are?), and it is the role of competition to ensure that firms do not markedly deviate from efficient pricing rules. MasterCard submits that a competition analysis of the payments system reveals a number of rival competing payment systems. The Bank should therefore trust in the forces of competition to deliver efficient outcomes, and, if it does not, it should focus its interventions on improving competition.

MasterCard is confident that the Bank will find a number of examples where prices are not set to reflect 'user pays', and that a diversity of pricing structures are possible even where firms compete within the same market. An obvious example is newspapers. The Bank's current intervention is akin to penalising one type of newspaper that is 'free' to consumers, but relatively expensive for advertisers, in favour of newspapers that charge consumers a positive price and offers lower rates to advertisers. There is no public policy case in favour of price regulation in either case.

As indicated in our response at paragraphs 129-131 below, MasterCard's approach to interchange fees has resulted in fees that respond to upward and downward movements in costs and competitive market forces. These forces provide adequate self-regulation parameters and constraints. We would expect the same result in Australia going forward without the need for regulation.

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for it than if it was certain not to be shaved. The holder of an unshaved coin will therefore withhold the coin from trade; only shaved coins will circulated." In other words, a market failure will only arise if the trader cannot determine which coins have been shaved and which have not. Other versions of Gresham's Law, which apply even when traders *can* determine which are the bad coins, usually rely on a further government-imposed rule that traders *must accept* all coins. This failure is an example of government failure, not market failure.

[65] A useful starting point is by Wright, *One Sided Logic in Two-Sided Markets,* AEI Working Paper, September 2003.

***What are the characteristics of payment systems that have given rise to public policy concerns, particularly over interchange fees?***

116. Comments on lessons from recent experience and insights from theoretical research about the influence of the market structure, conduct and performance of payment systems for the efficiency of the payments system as a whole.

**MasterCard's Response**

Reference is made to the response in paragraph 113 above.

117. Comments on whether, given the current structure of the main payment systems, competition between, and within, these systems is likely to deliver a configuration of interchange fees that promotes the overall efficiency of the payments system.

**MasterCard's Response**

Reference is made to the response in paragraph 113 above.

118. Potential public policy concerns regarding access arrangements and scheme rules in payment systems.

**MasterCard's Response**

Reference is made to the response in paragraph 113 above.

***The conditions under which current regulations could be removed or relaxed***

119. The conditions under which one might have reasonable confidence that the normal forces of competition would deliver a payments system that is competitive, efficient and innovative.

**MasterCard's Response**

Reference is made to the response in paragraph 113 above.

120. Whether there have been sufficient changes in market structure or conditions since the reforms were introduced to allow a relaxation or removal of some, or all, of the regulations. Future changes that would allow a relaxation or removal of the regulations. Alternatives to the current regulations that might address any public policy concerns.

**MasterCard's Response**

Reference is made to the response in paragraph 113 above.

***The extent to which the bank's public policy concerns could be addressed through self-regulation***

121. Comments on whether and why self-regulatory solutions are now feasible in a number of areas where, to date, regulation has been required. Roadblocks to self-regulation and the nature of possible self-regulatory solutions.

**MasterCard's Response**

Reference is made to the response in paragraph 113 above.

***The extent to which the non-surcharge rule alone could address the Bank's concerns over interchange fees***

122. The conditions under which surcharging could be considered sufficiently widespread to allow interchange fees to be set by the card schemes, rather than through regulation. The likely effect of removing interchange regulation, while leaving the no-surcharge rule in place.

**MasterCard's Response**

Reference is made to the response to paragraph 109 above.

123. Whether further modifications to the honour-all-cards rule, to allow merchants to make independent acceptance decisions about a broader range of cards, would strengthen any case for removing the regulation of interchange fees.

**MasterCard's Response**

Reference is made to the response in paragraphs 109 and 110(ii) above.

***The extent to which the structure and rules of payment schemes affect competition by limiting the ability of merchants to influence which payment method is used***

124. Whether there remain restrictions, or other structural constraints, on merchants that weaken competition.

**MasterCard's Response**

It is MasterCard's view there are no restrictions on merchants imposed by the regulated payment systems schemes that have the potential to reduce competition or to lessen the efficiency of the payments system.

125. The honour-all-cards rule and the merits of a potential model in which merchants were able to choose how to send a credit card transaction to the issuer. The feasibility and desirability of allowing merchants to send credit card transactions directly to the issuer of a card, rather than using the scheme to direct the transaction. Does providing merchants with greater control over how payments are processed strengthen any case for removing the regulation of interchange fees?

**MasterCard's Response**

At present merchants can send MasterCard branded credit and debit card transactions to the issuer without the intermediation of an acquirer or the infrastructure operated by MasterCard. Coles has done this and can send credit card transactions directly to issuers. Woolworths has announced that it will do the same. The regulated payment schemes do not prohibit this and, accordingly, there is no need to implement any changes to allow the practice.

**"MasterCard is of the belief that use of a central switch such as that operated by MasterCard in Australia is more efficient than the operation of a multitude of bilateral or direct arrangements."**

While there is nothing in the MasterCard rules of participation requiring issuers, acquirers or merchants to utilise MasterCard's processing technology, it should be

noted that MasterCard is of the belief that use of a central switch such as that operated by MasterCard in Australia is more efficient than the operation of a multitude of bilateral or direct arrangements, particularly for smaller merchants.

***The regulation of other payment systems, including American Express, Diners Club and BPAY***

126. Should American Express and Diners Club, or the BPAY system be formally regulated. Is there any public policy case for regulation of these schemes and what aspects of the schemes' activities might be subject to regulation and how they should be regulated?

**MasterCard's Response**

It is MasterCard's view that the four-party schemes should be put on an equal competitive footing with the three-party schemes. As indicated in the response to paragraph 111(i) above, the Bank's selective regulation of the four-party schemes has handed the three-party schemes a competitive windfall and been directly responsible for the ability of the three-party scheme to increase their share of purchases relative to the four-party schemes since the date of effect of the interchange standard. However, MasterCard does not believe that this is a reason for the Bank to increase its regulatory purview of payments systems. Rather, MasterCard considers that the Bank should wind-back its regulation of the four-party schemes so as to place them on a more competitive footing with the less efficient and more costly three-party schemes.

**"The Bank should wind-back its regulation of the four-party schemes so as to place them on a more competitive footing with the less efficient and more costly three-party schemes."**

***The effectiveness of existing access arrangements***

127. Whether any of the access reforms have achieved their objective of making access to Australia's payment systems more generally practicable. The extent to which the reforms have made the market more contestable even if there has been limited entry. What improvements that could be implemented the address any identified short comings in access arrangements.

**MasterCard's Response**

This issue is addressed in MasterCard's response to paragraph 112 above.

**Q3: If the current regulatory approach is retained, what changes, if any, should be made to standards and access regimes?**

***A further reduction in credit card interchange fees and/or the adoption of a uniform approach to the setting of all regulated interchange fees***

129. Whether it is appropriate for credit card interchange fees now to be lowered further. Analysis of the appropriate level of interchange fees in the credit card system.

### MasterCard's Response

The Bank has stated on a number of occasions its view that "interchange fees were not subject to the normal forces of competition" and "competition between schemes is more likely to put upward, rather than downward, pressure on fees".[66] This conclusion appears to be a basis for the Bank's decision to impose standards on interchange fees, in addition to regulations (access and surcharging) that focus on the processes of competition in payments systems.

There is a strong suggestion in the wording that interchange fees are too high, and that the efficiency of the payments system would be improved if these fees were lowered further. MasterCard takes strong exception to this implication as, given the available evidence, there is simply no economic basis on which one could make such a claim.

As MasterCard has pointed out in its response to question 113 (and further addressed in its response to question 130), attempting to second-guess the efficient level of interchange is a fraught exercise that is beyond the scope of any regulator.

One cannot prove, as the Bank has attempted to do, that interchange fees are too high, and that competitive pressure forces fees upwards, by referring only to a small set of US data and examining only the merchant side of the business. Such a proposition seems based on a view that competition should force acceptance fees down over time, a statement that has no basis in economics as far as we are aware. The factors that change interchange fees will vary from market to market as they include considerations such as costs, competition and competitive responses, demand from merchants and consumers, the size of network effects and so forth. Moreover, lower prices to merchants implies higher prices to cardholders.

Aside from the considerations above, the Bank has not established a framework for dealing with the economics of substitute methods of payment beyond debit and credit, including such options as cash and cheques. While the Bank has stated it is not trying to promote one payment option over another, its interventions have clearly favoured the relative use of EFTPOS, rather than allowing relative use to be determined by the competitive advantages of each. The Bank has taken insufficient account of the terms of the use of all payment options, and the context of all factors that impact use – cost, convenience, coverage, confidentiality and so forth.[67]

One of the features of payments systems around the world is that interchange fees are often set at different levels and (sometimes) flow in different directions. Other than Australia, interchange fees globally for PIN debit are typically positive (flowing from acquirers to issuers) [68]. In some markets, interchange has moved from negative to positive (Italy and US regional debit several decades ago). MasterCard views such differences as reflecting country-specific factors that are perfectly consistent with efficient organisation of a two-sided market.

**"MasterCard therefore finds no basis for lower or zero interchange for debit card or credit card products."**

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66 Issues Paper at p.5.

67 See DCITA report page 38 for a description of 6 factors that drive the choice of payment option to use in any particular situation.

68 This issue of global practices was explored in detail at the Australian Tribunal undertaking in respect to EFTPOS interchange.

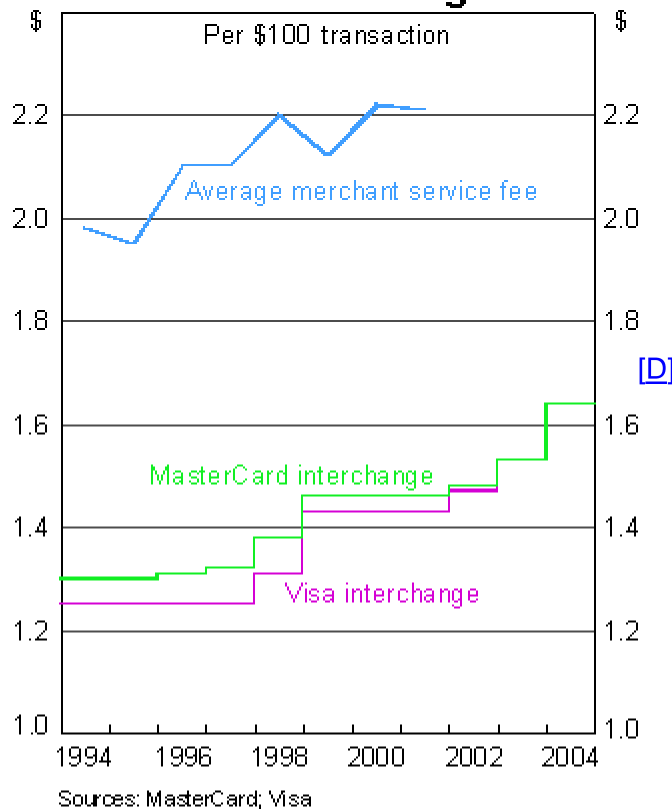
It should not be surprising that MasterCard therefore finds no basis for lower or zero interchange for debit card or credit card products – any more than there is any other preconceived “right” level for interchange fee values in the absence of proper analysis.

***Four-Party Schemes, Interchange, and Competition***

The Bank’s observation in regard to competition and interchange fees also appeared in a speech by the then Governor of the Bank, Mr I J Macfarlane to Australasian Institute of Banking and Finance Industry Forum 2005[69]:

> *“The first example relates to the interchange fees in the MasterCard and Visa credit card systems in the United States, where over the past decade there have been a series of competitive increases in these fees (Graph 1). There is an incentive for each scheme to raise its interchange fee in order to encourage banks to issue its cards because the higher fee provides the issuing bank with more revenue. The issuing banks in turn use the revenue to attract cardholders away from the scheme with the lower fee by offering cardholders more attractive pricing or more 'reward points'. Once one of the schemes raised interchange fees to give itself an advantage in attracting issuers and cardholders, the other responded in the same way. The result has been that competition amongst the schemes has seen fees increase from under 1.3 per cent in 1994 to 1.65 per cent today – a perverse outcome to anyone with an economics background who expects competition to lower prices. I might add that this is three times the average level of interchange fees in Australia following the Reserve Bank's reforms in 2003.*

**Graph 1**




[D]

69 Entitled “Gresham’s Law of Payments” , Sydney, 23 March 2005

*Of course the increase in US interchange fees has to be paid for by somebody. And, in the first instance, that somebody is the merchant, since interchange fees are built into the merchant service fee (what the merchant's bank charges it for processing credit card transactions). Not surprisingly, average merchant service fees have increased broadly in line with the increase in interchange fees since the mid 1990s.*

*The end result is that merchants have to bear the extra costs of the competition between the credit card schemes. But, of course, the story does not stop here. Ultimately, higher merchant costs flow through into higher prices for the customers of those merchants. This is a cost borne by all consumers whether they use a credit card or not."*

This seems to be another example of the Bank engaging in 'cops and robbers' style policy-making. It seems incongruous to observe competition on one hand and then, on the other, decry the results of that competition, even if the result is not entirely in line with what one might expect in a more simple market setting.

The dynamics of two-sided markets are clearly more complex than single-sided markets. One of the implications of the literature that has developed on two-sided markets is that one cannot make sensible judgements about what is going on on one side without reference to the other side. With regard to the US data, there are many valid business reasons to explain the US experience, which we will not set out here, but it is worthwhile exploring the experience in other markets.

MasterCard has gathered evidence in relation to the establishment of interchange fees in five markets over a long enough period of time to accurately assess the relationship between measured interchange costs (risk costs, funding costs and processing costs)and actual interchange fees. These markets are International (Inter Region), the United States, Japan, the United Kingdom, and Europe cross-border[70]. The relevant data is provided in the graphs below with commentary to describe local market factors.

***International (Inter Region)***

[Confidential]

***United States***

[Confidential]

***Japan***

[Confidential]

***United Kingdom and Europe Cross Border***

[Confidential]

***Conclusion – Four-Party Schemes, Competition and Interchange Fees***

[70] Until recently in other markets, domestic interchange fees have been established by domestic members and over which MasterCard has had no direct control.

The data produced here suggests that there is in fact a close relationship between the underlying measured costs of issuers and average interchange fees. Unfortunately, the Bank used too small a slice of data/time period that resulted in an incorrect conclusion on cause and effect. While MasterCard cannot speak in terms of what other four party schemes do in establishing interchange fees, for MasterCard the conceptual framework for establishing interchange fees results in fees that are practicable and work.

**"For MasterCard, the conceptual framework for establishing interchange fees results in fees that are practicable and work."**

130. Whether the various interchange Standards should be based on a common methodology, perhaps using the same set of cost categories. Whether a uniform approach to the setting of regulated interchange fees should now be adopted. How a uniform approach should be established and the consequence of establishing such an approach.

**MasterCard's Response**

The Bank has set standards related to establishing interchange fees for credit cards, scheme debit, and EFTPOS cards in Australia. The Bank states that these standards do not reflect a uniform approach to the establishing of interchange fees - "The Bank is interested in views as to whether a uniform approach to the establishing of regulated interchange fees should now be adopted".[71]

The Bank has "consistently emphasised a whole-of-system approach with, for example, regulations to interchange fees considered in the context of the impact of these fees on the *relative* prices for various payment services

As will be clear from MasterCard's responses in this submission, MasterCard does not support Bank intervention in the setting of interchange fees. That applies equally to all types of interchange. Having said that, MasterCard recognises that if fees are to be regulated, it would be preferable to do this on a whole-of-system basis. Interchange fees should be based on a uniform framework and the use of practicable, commercially realistic methods to determine those fees.

In the following paragraphs, we describe the development of MasterCard's interchange fee setting process.

During the 1970's and early 1980's there was significant growth in two notable four-party networks – general purpose credit cards and telecommunications (in the latter case this was created in the US with the break-up of the ATT/Bell system into essentially local service telephone service providers and "long distance service providers" (inter-exchange carriers)[72].

The growth of general purpose credit cards over that period was based to a large degree on the ability of the industry to be responsive to market changes which included:

[71] Issues Paper at para 130.

[72] It is not within the scope of this submission to review the equivalent of interchange fees in the telecommunication industry. Similar equivalent issues have arisen in terms of carrier access billing, reciprocal compensation, and bill & keep arrangements.

- the need to offer card services on a broad geographic basis where the issuer and acquirer of transactions were not the same organisation; and
- the fact that some organisations chose to specialise in "acquiring" functions (serving merchants) and others in "issuing" functions (serving cardholders).

By this concentration of effort[73] members could specialise in certain aspects of the credit card business (achieving efficiencies and scale economies) and not be required to have a direct relationship with both the cardholder and the merchant for a particular transaction. In order to do that, it was necessary to ensure that transactions at a merchant made on a card issued by one bank would be accepted by another bank that served as the acquirer of that merchant.

To accomplish that end, a set of commercial arrangements evolved. In the early years this was done on a bilateral basis, resulting in disparities among the various agreements and the perceived ability of large, stronger parties to impose pricing arrangements on smaller participants. It was clear that this process was cumbersome, inefficient and inequitable and thus would hinder the growth of the credit card schemes.

In the late 1970's MasterCard evaluated approaches to establishing commercial arrangements that would be equitable to issuer and acquirers because both sides of the transaction had to be considered if the scheme was to grow in a balanced manner. From this work evolved the MasterCard approach to interchange fees. The approach is objective and fair to issuers and acquirers and has the added advantage of being transparent and reasonably easy to apply. The approach was to establish interchange fees on the basis of costs that merchants would typically incur themselves if they issued their own store card or provided store credit. These costs were: risk costs (such as credit losses and fraud losses); funding the interest free period, and certain processing costs related to presenting the transaction for collection. The approach was founded both upon common sense in terms of how the competitive payments market actually operated and a desire to match the revenue collected (the merchant discount) with the costs incurred by the Issuer. The approach has underpinned the rapid growth of "interchanged" transaction volumes, allowing issuers and acquirers to grow more efficient as volumes increased and scale economies were realized. It allowed cardholders to more readily make payments outside of the areas in which they lived and allowed merchants to more readily and confidently accept payments from customers with whom they had no prior relationship.

Shortly thereafter (in 1983) William F. Baxter wrote his article "Bank Interchange of Transactional Paper: Legal and Economic Perspectives". As a lawyer who focused on law and economics, and specifically on the conceptual economic framework for four party payments and was less concerned with how his conclusions might be implemented. His article provided an economic related basis for a "side payment" in a four-party payment scheme[74] where a service is jointly provided and jointly consumed. Simply stated, the basis for a side payment was that the demand for the service between the two "consumers" (cardholder and merchants) might not match the incidence of cost between the providers of the service (issuers and acquirers). If there was a mismatch between revenue and cost between the issuer/cardholder and acquirer/merchant, a side payment would be warranted. The challenge with Baxter's

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[73] Banks originally typically were both the issuers and acquirers of transactions.

[74] The article also supports implicit interchange fees (account transfers) in three party payment schemes, particularly if performance measures are in place by functional activities / organizations within the scheme.

work is that it did not provide any particularly practicable ways to determine the side payment (interchange fee). This was left for the payments industry to determine. The result was a conceptual economic framework that is applicable to all four-party networks but one that provides no suggested approach for its practicable implementation to establish interchange fees in the commercial market, where data collection, costs, and competitive pressures varied across products and over time.

As additional payment products emerged from the four-party schemes, MasterCard developed practicable approaches to calculate related interchange fees consistent with the framework. There is an important semantic difference between an interchange framework or "methodology" and an "approach" for calculating interchange fees. MasterCard has various approaches (procedural mechanisms) for calculating interchange fees because of the realities and differences existing in each marketplace. These approaches fit within a conceptual framework or uniform methodology. The resulting fees are then subject to competitive forces (amongst the schemes and through the end users).

MasterCard's approach to credit card interchange calculations is a practicable approach to arriving at the results the Baxter framework would provide, if it could be applied in the commercial world. MasterCard's strong objections to the Bank's credit card standard on interchange fees is that it was not what some people would call a "modification to the methodology to fit the Australian circumstances" but rather the Standard provided a result that is not demonstrably a proxy for credit card interchange fees within the economic framework. As the Bank has stated, its approach aimed to "establish more appropriate price signals to cardholders".[75] The results have been to change relative end-user prices of credit cards, EFTPOS, and scheme debit - but there is no evidence that end-user pricing reflects an efficient level relative to other payment options such as cash.

While the detailed approach used by MasterCard to calculate relevant costs varies across products because of the factors mentioned above, each approach is consistent with the conceptual framework developed by Baxter. Competitive market forces require that methods to calculating interchange fees pass both a "common sense" and "commercial reality test". As described above, the approach for credit cards was developed before there was a conceptual framework. If the approach had not made common sense it is unlikely it would have either been successful or consistent with the conceptual framework that was later described by Baxter. The current mix of interchange fee calculation approaches contained in the regulations certainly don't appear to make "common sense" and as mentioned above, do not appear to conform to any uniform framework.

MasterCard's submits that its approach to establishing interchange fees make commercial common sense and is consistent within a uniform conceptual framework. The credit card approach of measuring risk, funding and processing costs has been compared with the results that would be obtained by using other procedural mechanics and the results confirm that the current MasterCard credit card approach (as used globally but not in Australia) is consistent with Baxter's conceptual framework. If the Bank is minded to continue interchange fee regulation, MasterCard believes that the Standard in regard to interchange fees should be removed or modified to include those costs indicated above (risk, funding and processing), to return the calculation to an approach that is consistent with commercial practices, common sense and economic theory.

75 Issues Paper at para 34.

The MasterCard method to determine interchange fees meets common sense, commercial practices, and conceptual economic framework tests. MasterCard must respond to signals from merchants, cardholders and competing payments systems to establish the right balance of fees. Of course, MasterCard cannot prove that its interchange fees are 'optimal' at every point in time, but neither can the Bank establish that they are not. That is the nature of competition in two-sided markets, and is not unique to payments systems.[76] This merely emphasises again that it should be merchants and consumers, and not the Bank, that determines the success or otherwise of particular payment schemes.

**"The MasterCard method to determine interchange fees meets common sense, commercial practices, and conceptual economic framework tests."**

***Setting all interchange fees to zero***

131. The merits of setting all interchange fees to zero. The case for ongoing interchange fees as payment systems mature and use and acceptance becomes widespread.

**MasterCard's Response**

The comments in relation to paragraph 129 above also relate to this issue.

***Modification of the compliance aspects of the interchange standards***

132. The difficulties the interchange Standard may create for a scheme with a relatively high (and possibly increasing) share of premium cards, which now attract relatively high interchange fees.

**MasterCard's Response**

MasterCard, in its letter to the Bank of August 15, 2006 has previously advised the Bank that the revised standard gazetted on 25 November 2005 entitled *The Setting of Wholesale ("Interchange") Fees in the Designated Credit Card Schemes* (the "Standard") can provide a competitive advantage to one regulated scheme over another. In particular MasterCard is of the view that the Standard will lead to distortions in the marketplace due to the varying compositions of the credit card portfolios of the respective regulated credit card schemes.

Under the revised Standard the competing schemes are required to ensure that the weighted average of their respective credit card interchange fees does not exceed the common benchmark calculated in accordance with the Standard. The use of a common benchmark therefore means that the competing schemes must achieve the same weighted average of interchange fees despite differing costs, portfolio characteristics and importantly a differing mix of transaction or product types within such portfolios.

[76] By the same token, a newspaper could not say with any confidence that its structure of prices to readers and advertisers is optimal at every point in time. Calculating optimal prices would require a complex set of equations that accurately describe the interdependencies between the two demands. Where there is effective competition, we simply trust that firms that use efficient price structures will drive out firms that are using inefficient structures.

At present the two regulated four-party schemes have a variety of interchange fees for different transactions and card type. Some of the interchange fees for broadly comparable transactions and card types are as follows:

| **Interchange Category** | **MasterCard Rate**[77] | **Visa Rate**[78] |
|---|---|---|
| Charities | 0% | 0% |
| Governments/Utilities | 0.33% | 33 cents (electronic)<br>81.4 cents (standard) |
| Standard consumer cards | 0.473% | 0.6017% |
| Standard consumer cards -electronic | 0.473% | 0.4411% |
| Recurring payments | 0.33% | 0.4411% |
| Tiered merchants (MasterCard)/Visa merchant alliance program | 0.374% | 0.33% |
| Commercial cards | 1.265% | 1.265% |
| Premium consumer cards | 1.045% | 0.99% |

In a regulated environment such as the one we now have in Australia, the requirement for both regulated schemes to achieve the same weighted average interchange fees makes it mathematically impossible for one scheme to effectively compete with the other in certain transaction categories.

This argument is demonstrated by the following hypothetical example:

*At the time of setting interchange fees, total annual spend on Scheme A's cards equals A$10 billion. This is comprised of A$1 billion in spend on Scheme A's branded commercial/business cards, as well as another A$1 billion in spend on platinum cards. The remainder of the spend (A$8 billion) is on standard Scheme A branded cards. As such commercial/business card spend is 10% of total spend, as is the spend on platinum cards.*

*For the same period, the total annual spend on Scheme B's cards equals A$18 billion. This is also comprised of A$1 billion in spend on commercial/business card and another A$1 billion on platinum Scheme B cards. Therefore commercial/business spend is 5.6% of total Scheme B spend, as is the spend on platinum cards.*

Under the Standard, Scheme B may choose to set interchange fees for their premium and commercial card programs well above the cost based benchmark (while maintaining weighted average interchange fees at or below the benchmark cost). If Scheme B chooses to do this, Scheme A would need to match those interchange fees if it wanted to compete effectively in this part of the business. However, given the greater weighting Scheme A would have to apply to such rates (10% compared to

77 See: http://www.mastercard.com/au/rba/index.html
78 See: http://www.visa-asia.com/ap/au/mediacenter/factsheets/interchange.shtml

5.6%) because of its smaller base, Scheme A would need to significantly reduce the interchange fees (relative to Scheme B) that apply to standard cards, thereby making the majority of its credit cards less attractive to its issuers.

Following on from example above:

> *Assume the cost-based benchmark is 0.50%. Scheme B decides to set the interchange fee that applies to standard cards at 0.40%. It can then set platinum and commercial card interchange fees at 1.3% and remain within the cost-based benchmark.*
>
> *If Scheme A were to match those fees exactly, the weighted average interchange fee would be in the range of 0.58%. Scheme A would need to reduce, relative to Scheme B, either its platinum card or standard card interchange fee in order to be compliant with the Standard. For example, if Scheme A set the platinum and commercial card interchange fees at 1.3% to match Scheme B's interchange fees, it would need to set the interchange fee that applies to standard cards at 0.30% (compared to Scheme B's 0.40%) in order to remain within the cost-based benchmark.*

While this situation is of significant concern for MasterCard as the smaller of the regulated schemes, it is also of significant concern to Australian consumers if credit card issuers took advantage of this regulatory (and mathematical) anomaly and strongly preferred one scheme over the other due to the significant interchange fee differential. In the example above, it is highly likely that issuers of standard cards would strive to migrate their standard card portfolio from Scheme A to Scheme B.

Indeed the Bank itself by amending the Standard in November 2005 to allow for a common cost-benchmark has acknowledged the need for competitive neutrality with respect to the application of the interchange standard to the regulated schemes. MasterCard is of the view that if the Bank decides, following its review of its payments system regulations, that the Standard remain, it is necessary that amendments be made to it so as to ensure the competitive neutrality in the setting of interchange fees for which the Bank has previously expressed support. Such amendments should require the regulated schemes to apply combined scheme weightings to the different interchange fee categories.

MasterCard has previously provided the Bank with its suggested amendments to the Standard (in its letter to the Bank of August 15, 2006) to ensure that the Standard is consistent with ensuring competitive neutrality in the setting of interchange fees.

The above comments serve to illustrate the difficulties involved when the Bank seeks to regulate prices and why the preferred course of action is to remove altogether the regulation of interchange fees.

133. The merits of a number of possible changes to the operation of the existing interchange standards for the credit and scheme debit systems including: (i) more frequent compliance (perhaps yearly, rather than three-yearly as is the case currently); (ii) the use of industry-based, rather than scheme-specific weights; and (iii) requiring *all* interchange fees to be below the benchmark.

**MasterCard's Response**

As indicated in paragraph 113 above, MasterCard believes that the Bank should cease to regulate interchange fees.

*Modifications to the honour-all-cards rule to include premium and/or pre-paid cards*

134. Whether the honour-all-cards Standard should be modified to allow merchants to accept some, but not all types of credit cards. The possible scope of the honour-all-cards rule and how any modifications to the Standard would work in practice. Whether a revised standard should allow merchants to accept standard cards but to decline acceptance of premium cards if they judged that the merchant service fees applying to these cards were too high or should allow a merchant to decline acceptance of a scheme's pre-paid cards, while accepting its debit cards.

**MasterCard's Response**

This is dealt with in paragraph 110(ii) above.

*The regulation of interchange fees on EFTPOS cash-out transactions*

135. Whether it is appropriate to treat all EFTPOS transactions uniformly, or otherwise regulate EFTPOS transactions with a cash-out component. Whether interchange fees for EFTPOS cash-out transactions and ATM transactions should be treated in an equivalent manner.

**MasterCard's Response**

As this issue does not concern MasterCard, no comment is made concerning it.

*Possible changes to legislation to allow the Bank to set interchange fees directly*

136 The merits of the Bank being able to set interchange fees or an interchange benchmark directly.

**MasterCard's Response**

This is dealt with in the response in paragraph 113 above.

*The availability of information on Australian payment systems*

137. Whether there is a need for additional information to be available to market participants, and how best any additional information should be supplied.

**MasterCard's Response**

To date the additional level of information required by the Bank and made publicly available has been primarily:

(1) the requirement that four-party payment cards schemes and BPay publish their interchange/interbank fees, and

(2) the Bank publishing statistics on the average merchant service fee.

This only covers a small part of possible information disclosure of intermediate prices/costs:

- merchants do not publish their cost of accepting different payment options
- three-party schemes do not publish the fees they pay financial institutions to issue their cards or acquire their transactions; and
- nobody calculates and publishes the cost of using or accepting cash.

The transparency the Bank has sought for pricing has not been put in any overall framework of payment product pricing (end-user versus intermediate), and the Bank

has not yet provided a clear basis for determining why some prices should be published and others should not.[79]

The Australian payments market and retail market are competitive. Consumers can readily obtain information on the cost to use different payment products from banks and other service providers. Merchants can readily obtain information of the cost to accept various payment options. Merchants can provide different prices to customers based on the payment option used.

**"The Bank has not provided a logical explanation of why publishing average merchant service fees and interchange fees has enhanced competition and efficiency within the payments system"**

Disclosure of intermediate pricing is problematic in that there is no easy way to determine which intermediate fees should be made available from those that, if made available, might actually dampen competition. Disclosure of intermediate prices if the price is a standard price (in that all downstream participants are subject to the same pricing) is logical. However, providing pricing that is competitively determined acts to diminish the impact of the very competition that helps determine the prices.

The Bank has not provided a logical explanation of why publishing average merchant service fees and interchange fees has enhanced competition and efficiency within the payments system. Before consideration of any additional disclosure of intermediate fees that cannot be readily obtained elsewhere, the Bank needs to provide a more robust framework linking information disclosure, competition and efficiency.

[79] That is the cost of using cash, cheques or other non-scheme based payment cards is not calculated or published as is required for MasterCard, Visa, American Express and Diners Club

**Annex A:** [Confidential]

## Annex B: Pricing and Product Features – Three-Party and Four-Party Scheme Cards

### Three-Party Scheme Cards

| Card Type | Interest Rate (%) | | Application Fee ($) | | Annual Fee ($) | | Reward Program Annual Fee ($) | |
|---|---|---|---|---|---|---|---|---|
| | 6/02 | 6/05 | 6/02 | 6/05 | 6/02 | 6/05 | 6/02 | 6/05 |
| American Express Gold Credit | 14.49 | 15.49 | 0 | 0 | 70 | 70 | 33 | 59 |
| American Express Blue | 15.99 | 17.99 | 0 | 0 | 35 | 35 | 33 | 59 |
| American Express Green Charge | N/A | N/A | 30 | 0 | 65 | 65 | 27.5 | 59 |
| American Express Gold Charge | N/A | N/A | 30 | 0 | 95 | 95 | 27.5 | 59 |
| Suncorp Gold Amex | 14.49 | 15.74 | 0 | 0 | 70 | 70 | 33 | 59 |
| Suncorp Blue Amex | 15.29 | 16.54 | 0 | 0 | 25 | 25 | 33 | 59 |

Source: Cannex – Pricing and Product Features – as at 30 September

### Four-Party Scheme Cards

| Card Type | Interest Rate (%) | | Application Fee ($) | | Annual Fee ($) | | Reward Program Annual Fee ($) | |
|---|---|---|---|---|---|---|---|---|
| | 6/02 | 6/05 | 6/02 | 6/05 | 6/02 | 6/05 | 6/02 | 6/05 |
| ANZ Low Rate MasterCard | 13.25 | 11.75 | 0 | 0 | 26 | 58 | N/A | N/A |
| ANZ Gold | 16 | 16.99 | 0 | 0 | 87 | 87 | 11 | 55 |
| ANZ First Free Days Visa | 16.25 | 16.99 | 0 | 0 | 26 | 30 | N/A | 55 |
| Bank of Qld MasterCard | 14.50 | 15.75 | 0 | 0 | 0 | 0 | 0 | 0 |
| Bank of Qld Visa | 14.50 | 15.75 | 0 | 0 | 0 | 0 | 0 | 0 |
| Bank West Lite MasterCard | 9.99 | 10.99 | 0 | 0 | 36 | 36 | N/A | N/A |
| Citibank Gold MasterCard | 17.45 | 18.5 | 0 | 0 | 99 | 119 | 0 | 0 |
| Commonwealth Bank Gold MasterCard | 16.15 | 17.9 | 0 | 0 | 82 | 114 | 0 | 0 |
| CBA MasterCard Awards | 16.15 | 17.9 | 0 | 0 | 45 | 59 | 0 | 0 |

| Card Type | Interest Rate (%) | | Application Fee ($) | | Annual Fee ($) | | Reward Program Annual Fee ($) | |
|---|---|---|---|---|---|---|---|---|
| | 6/02 | 6/05 | 6/02 | 6/05 | 6/02 | 6/05 | 6/02 | 6/05 |
| CBA MasterCard | 16.15 | 16.9 | 0 | 0 | 24 | 30 | N/A | N/A |
| CBA Visa FeeFree | 14.5 | 15.25 | 0 | 0 | 0 | 0 | N/A | N/A |
| Heritage Build Soc – Visa Gold | 14.95 | 14.95 | 0 | 0 | 60 | 45 | 0 | N/A |
| NAB Gold MasterCard (Awards) | 15.75 | 16.65 | 0 | 0 | 88.3 | 88.3 | 33 | 33 |
| NAB Gold MasterCard (No Awards) | 15.75 | 16.65 | 0 | 0 | 88.3 | 88.3 | N/A | N/A |
| NAB Standard MasterCard (No Awards) | 15.75 | 16.65 | 0 | 0 | 26.4 | 26.4 | N/A | N/A |
| NAB Standard MasterCard (With Awards) | 15.75 | 16.65 | 0 | 0 | 26.4 | 26.4 | 0 | 0 |
| St George Bank Gold MasterCard | 15.99 | 16.50 | 0 | 0 | 59 | 59 | N/A | 0 |
| St George Bank Starts Low MasterCard | 10.99 | 11.25 | 0 | 0 | 39 | 59 | N/A | N/A |
| Suncorp Visa Extra | 13.75 | 11.90 | 0 | 0 | 30 | 29 | N/A | 39 |
| Westpac Altitude Gold | 17.15 | 17.90 | 0 | 0 | 90 | 150 | 0 | 0 |
| Westpac Altitude Standard | 17.15 | 17.90 | 0 | 0 | 49 | 100 | 0 | 0 |
| Westpac Gold MasterCard (No Rewards) | 15.9 | 16.65 | 0 | 0 | 65 | 90 | N/A | N/A |
| Westpac MasterCard (No Annual Fee) | 14.45 | 15.2 | 0 | 0 | 0 | 0 | N/A | N/A |

Source: Cannex – Pricing and Product Features – as at 30 September 2005