

**Submission to RBA re
Credit Card Interchange
and Other Issues**

8 April 2005

Contents

- 1. Introduction..... 3
- 2. Benchmark Credit Card Interchange Fee..... 3
- 3. Other Scheme Fees 4
- 4. Reporting..... 5
 - 4.1 Scheme Debit 5
 - 4.2 Fraud 6
 - 4.3 Cardholder Fees 7
 - 4.4 Credit Card Types..... 8

This document has been prepared with the assistance of
TransAction Resources Pty Ltd

1. Introduction

The Reserve Bank of Australia (RBA) introduced a series of credit card reforms which were progressively introduced during 2003 and 2004. One of the key reforms was the introduction of a cost-based interchange fee for each of the credit card schemes (Visa, MasterCard and Bankcard). These new interchange fees took effect from 1 November 2003.

Because each of the credit card schemes have different cost structures, this has resulted in each of them having different benchmark rates. This means that the scheme with the highest cost base has the highest interchange fees. As higher interchange fees result in higher income to issuers, this provides an incentive for issuers to issue those cards over lower cost alternatives.

The RBA has requested submissions on whether the standards for credit card interchange fees should be amended so that the same benchmark interchange fee applies to all schemes. The RBA has suggested there are two main alternatives. These are to set a benchmark based on average eligible costs measured across all three credit card schemes, or alternatively to set a benchmark based on the costs of the lowest-cost scheme.

In this paper, the Australian Merchant Payments Forum (AMPF) outlines its response to this issue. The AMPF also believes that all fees that card schemes use to move funds from acquirers to issuers, such as scheme fees and marketing incentives, should be addressed at the same time, to ensure that these methods are not used to bypass the intent of the RBA reforms.

The RBA has also announced that it is considering regularly publishing additional data in the Reserve Bank Bulletin regarding provision of market share data for the credit card schemes plus American Express and Diners Club. The AMPF also expresses its view on this and other data which could be made available in the Bulletin to provide interested parties with a sounder basis for analysis and decision making.

The AMPF represents a number of merchants, both large and small, and merchant associations on payments related matters.

2. Benchmark Credit Card Interchange Fee

At present the benchmark interchange fee varies for each scheme according to its current cost profile at the point in time when the data is collected and provided to the industry expert for that scheme. This benchmark rate is not published and is confidential between each of the card schemes and the RBA. In the current situation there appears to be a variation of around 3 to 4 basis points between the benchmark rates for the three schemes.

As the RBA has pointed out, it is possible that the scheme with the higher costs could have an advantage in recruiting issuers, by virtue of the higher income level available as a result. This could potentially have the undesirable effect of giving schemes an incentive to increase their costs over time.

Given that the intent of the reforms is to encourage and drive efficiencies within the payments system and to provide the best possible price to consumers, this result may be counter-productive. It therefore seems appropriate to consider ways to remove this difficulty from the present arrangements.

The AMPF view is that the benchmark rate for all schemes should be equal to the rate of the lowest cost scheme. By this approach, the higher cost schemes would be penalised by under-recovery and would have a direct incentive to lower their costs in order to remain competitive.

If a weighted average between the schemes is employed instead, then a single high cost scheme could disproportionately affect the outcome and create the potential for other schemes to over-recover, effectively removing their incentive to become more efficient.

The AMPF believes that adopting the “lowest cost” approach for credit cards will create the best incentives to reduce costs within the payment system over time. It is also important to remember that credit card interchange fees are multilateral and are not negotiated bilaterally in the manner of EFTPOS interchange fees. Therefore credit card interchange fees are not subject to normal competitive processes.

3. Other Scheme Fees

While the focus of wholesale pricing reform has been on interchange fees, the card schemes have other ways of transferring funds from acquirers to issuers.

It has been common practice for some time in various countries (eg. USA) for both Visa and MasterCard to offer “marketing incentives” to issuers in order to persuade them to issue a particular product. This money is paid to the issuer by the card scheme itself.

In Australia, MasterCard has traditionally charged higher scheme fees than Visa to acquirers for processing acquired MasterCard transactions through their Area Processing Centre (APC). Recently however, Visa decided to increase the fees levied on their acquiring members, effective 1 April 2005. Information available to AMPF members suggests that these fees may be tiered. If this is the case, low volume acquirers will be the hardest hit.

One result of this increase may be seen on page 19 of the *Australian Financial Review* on Friday 1 April. Westpac placed an advertisement to notify all its merchants that their credit card merchant fees would be increased by 0.038%, effective immediately. Many AMPF members have also been approached by their acquirers wanting to increase Merchant Service Fees as a result of the higher Visa fee.

The AMPF has four concerns regarding this situation. Firstly, the increase in scheme fees is targeted at acquirers only. For any scheme member which is an issuer or both an issuer and an acquirer, the net result may not be so bad, as these marketing incentives will presumably become available to all issuer members. For new specialist acquirers, or self-acquirers, this additional cost could have a major impact on their economics, particularly at start-up when the volumes are small.

The second issue is that scheme fees could be used to take funds from acquirers and pass them to issuers in a manner that effectively bypasses the RBA reforms to interchange through substituting an alternative mechanism to achieve the same objective.

Thirdly, it would appear that the acquirers intend to fully recover the increase in scheme fees by raising prices to merchants, effective immediately. If these acquirers are also issuers, and therefore receive additional incentive income, this income will be fully incremental after recovering all their cost increase from Australian merchants.

Finally, unlike interchange fees, these other scheme fees are secret and under scheme rules are not allowed to be divulged to merchants or the public. This is against the spirit of the RBA's reforms in that there is no transparency and merchants are unable to gain insight into the cost components of their Merchant Service Fee.

The AMPF wishes the RBA to be fully aware of this situation and its potential to undermine both the interchange reform and the access regime reform.

4. Reporting

The AMPF supports the RBA's desire to provide more comprehensive data on the Australian card market to aid in sounder analysis and better decision making. In particular, the AMPF agrees with the RBA's initiative to request Bankcard, Visa, MasterCard, American Express and Diners Club to allow publication of market share data. The AMPF's view is that individual data for each of the above schemes should be published in at least the following categories:

- number of accounts
- number of cards on issue
- \$ spend
- transaction numbers

The above data should be reported for credit and charge card transactions only and should not include data for any scheme debit transactions as this would distort the credit card data.

In addition to the credit and charge card market share data above, the AMPF believes there should be additional reporting provided in other areas, such as scheme debit cards, fraud, cardholder fees and corporate cards.

4.1 Scheme Debit

At present, there is no separate reporting on scheme debit cards, and in particular for Visa Debit. Accordingly, there is no ability to compare or separately analyse scheme debit and EFTPOS debit cards.

Based on guidelines published on the RBA's web site, it has been our understanding to date that Visa Debit figures are not included in the debit card data. The RBA instructions for those organisations providing data to the RBA specifically stated that only those debit transactions conducted with a PIN should be included in the debit reporting. This therefore excludes Visa Debit transactions processed with a signature. The RBA has recently advised that this is not actually the case and that they have advised organisations providing data to include all debit transactions, whether conducted with a PIN or signature, in the debit category. There appears to be some confusion at present as to exactly what data is included in these tables. This would be eliminated if there was separate reporting of EFTPOS and scheme debit cards.

The AMPF has previously recommended such separation for scheme debit cards, and in particular Visa Debit, in submissions to the RBA in January 2004¹ and April 2004². We believe that separate reporting on scheme debit would provide a sounder base for analysis of debit card usage and would also allow comparison of usage and trends for these different forms of debit cards. This would uncouple usage trends for Visa Debit from other credit cards and EFTPOS.

The reporting format for scheme debit cards should be similar to that already contained in the C2 Table for Debit cards. It should include:

- number of accounts
- number of cards / cardholders (this should also be included for EFTPOS in the future)
- transaction and spend data by channel
 - ATM
 - card present (at merchant premises)
 - card not present (MOTO, Internet, etc.)

The AMPF has also previously requested that Visa Debit transaction data (volumes and values) be reported to merchants by their acquirers on the same basis as currently occurs for credit card and EFTPOS data.

We believe the absence of separate reporting on scheme debit cards diminishes the degree of transparency sought by the RBA for the payments systems, does not provide for sound analysis of debit card usage and trends and does not allow any comparison of the different types of debit cards in the market.

4.2 Fraud

The AMPF believes it is imperative that comprehensive fraud data is available to permit proper analysis and identification of the major areas of concern for all parties concerned (issuers, acquirers, merchants and cardholders). The AMPF has previously requested that reporting on fraud be introduced, and suggested this be included as part of the RBA's regular Payment System statistics (C Tables)³.

Access to statistics on fraud is even more important now that fraud is an eligible cost in the determination of the credit card interchange fee. The AMPF strongly believes that only those elements of fraud for which the acquirer or merchant is responsible should be allowed as a component of the eligible cost. Fraud costs which have resulted from scheme rules or poor practices by issuers should not have to be borne by acquirers or, in turn, merchants. In order to be able to assess this, reporting by type of fraud and location is essential.

The AMPF has suggested that the statistics reported by the Association for Payment Clearing Services (APACS) in the UK could act as a basis for Australian reporting. The APACS data contains a break-up of the fraud data by card type, fraud type and location of where fraud occurs (eg ATMs, POS, overseas, etc.). As previously discussed, the AMPF

¹ *Submission to RBA re Scheme Debit Cards*, AMPF, 27 January 2004

² *Submission to the Reserve Bank of Australia - Designation of Visa Debit*, AMPF, 2 April 2004

³ *Submission to RBA re Scheme Debit Cards*, AMPF, 27 January 2004

would be happy to participate in any group set up to monitor card fraud, collect and collate fraud data and develop fraud reduction measures.

Recommended reporting on fraud should include the following categories:

- by card type (transaction numbers and \$ value)
 - credit
 - charge cards (Amex, Diners)
 - scheme debit
 - EFTPOS
- by type of fraud (transaction numbers and \$ value)
 - lost / stolen card
 - non-receipt of card
 - fraudulent possession of card details
 - counterfeit card
 - third party fraud (eg merchant fraud)
- by location of fraud (transaction numbers and \$ value)
 - ATM
 - branch withdrawals
 - merchant POS
 - card not present (CNP) transactions (MOTO and Internet)
 - BPay
 - international

Fraud statistics should be reported on a regular basis, and at least quarterly is recommended.

4.3 Cardholder Fees

There has been much discussion in recent times about cardholder fee levels, particularly for EFTPOS, but there is no public data available on the weighted average for these fees. It is recommended that cardholder fee data be collected and published on a regular basis. These statistics should include both per transaction fees and annual/monthly fees which are directly related to cards, but not those which apply to a more general account. Fees for all card types should be reported in terms of actual dollar income, including:

- EFTPOS
- scheme debit cards
- credit cards (Visa, MasterCard, Bankcard)
- charge cards (American Express and Diners Club)

It is also recommended that the average Annual Percentage Rate (APR) across all credit cards be calculated and published on a regular basis.

4.4 Credit Card Types

The AMPF believes it would be useful to have the credit card statistics broken out for consumer cards separately to business cards such as corporate cards and purchasing cards. Business cards have a far higher interchange fee than consumer cards and it is important to monitor trends with these cards.

It would also be valuable to have the credit card and charge card figures reported by card type. For example, American Express' revolving credit product should be reported separately from their charge card product. This would allow more accurate analysis of trends between credit and charge cards.