Variation to the MasterCard and Visa Access Regimes: Details-stage Regulation Impact Statement

March 2014

CONTENTS

1. Background ... 1
2. The Problem ... 4
3. The Objective of Reform ... 8
4. Options ... 9
5. Impact Analysis ... 12
6. Consultation ... 21
7. Conclusion ... 27
8. Implementation and Review ... 29

© Reserve Bank of Australia 2014. All rights reserved. The contents of this publication shall not be reproduced, sold or distributed without the prior consent of the Reserve Bank of Australia.

1. Background

Participants in a card scheme (e.g. MasterCard and Visa) can be issuers or acquirers, or in most cases, both.[1] When a cardholder purchases goods from a merchant, the issuer undertakes to make payment for those goods (to the acquirer) and recoups the funds from the cardholder according to the terms of their agreement. Any entity that wishes to undertake card issuing and/or acquiring under the rules of a scheme is obliged to be a participant in that scheme. Conditions of access to card schemes therefore have the potential to affect competition and efficiency in the provision of card payment services.

Access to the MasterCard and Visa credit card systems in Australia was examined by regulators in the late 1990s and early 2000s.[2] At the time, scheme rules stipulated that only card issuers that were prudentially supervised or organised under local banking legislation were eligible to participate. In Australia, this meant that card issuers and acquirers had to be authorised deposit-taking institutions (ADIs) supervised by the Australian Prudential Regulation Authority (APRA). Card acquirers were also required to be issuers to be eligible, and penalties were imposed on institutions that were significant net acquirers (i.e. businesses that wished to focus on acquiring would be at a considerable disadvantage to those that both issued and acquired transactions).

It was recognised by the regulators that it was appropriate for card issuers to be of sound financial standing in order to ensure that issuers were able to meet their obligations and would not disrupt the credit card systems. It was also recognised that the ADI requirement had been an effective screening device for the schemes. However, it was found that participation criteria based on institutional status might have created higher barriers to entry than necessary. For instance, there did not appear to be good reasons to require that issuers be deposit takers; cards could be issued by non-financial institutions that were financially sound without adding settlement risks to the system. Likewise, there was no justification for the requirement that acquirers also had to be issuers. Furthermore, while there were desirable attributes of acquirers (e.g. processing capacity and the ability to bear chargeback costs), these did not require the acquirer to be an ADI.[3]

To address these concerns, the Reserve Bank worked closely with APRA to formulate a new class of ADIs – specialist credit card institutions (SCCIs) – to allow entities that are not deposit-takers to undertake issuing or acquiring activities in the MasterCard and Visa credit card systems. These

---

1 Card issuers provide individuals or businesses cards to make payments, maintain accounts associated with those cards and undertake other activities that enable payments to be made (e.g. authorising payments, and clearing and settling payment obligations with acquirers arising from the use of those cards). Card acquirers provide merchants with facilities to accept card payments and also undertake similar activities (e.g. clearing and settling the resulting obligations with card issuers). See Box A for a description of the basic concepts in a credit card transaction.

2 See Financial System Inquiry (Wallis Committee) (1997), *Financial System Inquiry Final Report*, Australian Government Publishing Service, Canberra, pp 399–400, available at <http://fsi.treasury.gov.au/content/FinalReport.asp> and Reserve Bank of Australia and Australian Competition and Consumer Commission (2000), *Debit and Credit Card Schemes in Australia: A Study of Interchange Fees and Access*, October, available at <http://www.rba.gov.au/payments-system/resources/publications/payments-au/interchg-fees-study.pdf>.

3 While merchants would have to hold their deposits with an ADI, this need not be their acquirer.

entities would be subject to prudential supervision by APRA in a manner consistent with the risks they incur. The reform was put in place by extending the definition of 'banking business' under the *Banking Act 1959* to include credit card issuing and acquiring in Australia in the designated MasterCard and Visa systems.[4] This allowed a wider range of prospective participants to be authorised by APRA as ADIs and to become eligible to participate in the card schemes.

As part of the same reforms, the Reserve Bank introduced access regimes for the MasterCard and Visa credit card systems in 2004 and for the Visa Debit system in 2005.[5] The intent of the Access Regimes was to strike an appropriate balance between controlling risk in the payments system and the increased competition and efficiency that would come from wider eligibility criteria for access to payment card issuing/acquiring. In particular, the effect of the Access Regimes is that any ADI (including an SCCI) is eligible to apply to participate in the MasterCard, Visa and Visa Debit systems in Australia, and that the schemes must not discriminate between types of ADIs when assessing applications for participation. The schemes are also prohibited from preventing a participant from being an issuer only, an acquirer only, or both an issuer and an acquirer. It is nonetheless up to the schemes to assess whether to admit an entity as a participant, subject to the requirements of the Access Regimes.

Since the introduction of these arrangements, only two entities have gained SCCI status; a third entity has recently indicated that it has received in-principle approval to become an SCCI. Developments since the original access reforms suggest the need for considering whether the current access arrangements continue to strike an appropriate balance between new entry and risk in those systems.

---

4 See Regulation 4 of the Banking Regulations 1966.

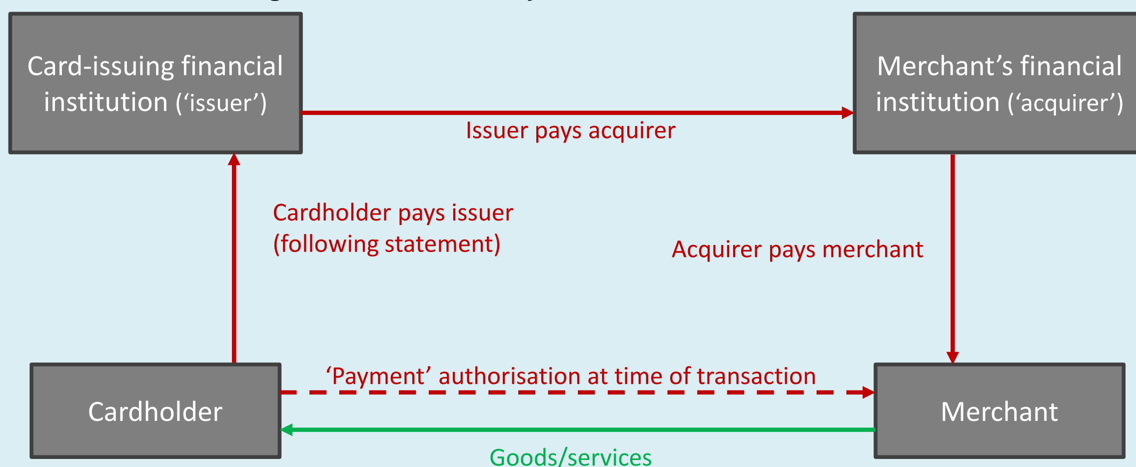
5 The *Access Regime for the Visa Debit System* was introduced at the request of Visa, which advised the Reserve Bank that the scheme's international rules might be preventing SCCIs from joining the system and that an SCCI intending to acquire both Visa credit and debit card transactions might not be able to join the scheme. An access regime was also imposed on the Bankcard system; however, Bankcard ceased operation in 2006. The Access Regimes for the MasterCard, Visa and Visa Debit systems are available at: <http://www.rba.gov.au/payments-system/legal-framework/current-regulations.html#access>.

Box A Credit card transactions – key concepts

A typical credit card transaction (Figure 1) involves four parties – the cardholder, the cardholder's financial institution (the issuer), the merchant, and the merchant's financial institution (the acquirer).[6]

When the cardholder presents a card to the merchant, and authorises the transaction (for example, by the use of signature or a PIN), the merchant provides the relevant goods or services to the cardholder. The merchant has not at this time received funds from the cardholder; rather, the authorisation of the transaction implies a series of flows of funds that will occur later. The issuing institution makes payment to the acquirer, and the latter provides funds to the merchant – usually this occurs after settlement of the issuer's obligations to the acquirer, but there is nothing to prevent an acquirer providing value to the merchant earlier in the transaction. Finally, the issuer will provide a statement to the cardholder, reflecting this transaction and any others during the statement period, and require payment from the cardholder. Where the cardholder makes payment to the issuer of the full amount owing within a specified period, the transaction may be 'interest-free' for the cardholder. If the full amount is not paid off, or where no interest-free period is offered, interest on the balance will be charged.

Figure 1: Flows in a Stylised Credit Card Transaction



The credit card scheme operators, MasterCard and Visa, are not parties to the transactions, but: establish the rules under which the payments are exchanged; provide the network that allows payment messages to be transmitted between issuers and acquirers; and licence card numbers to issuers. Issuers and acquirers must be members of a scheme in order to directly provide the branded payment services of that scheme.

6 This description abstracts from fees associated with the provision of payment services, including interchange fees.

2. The Problem

The 2004/05 reforms sought to balance competition and financial safety in the MasterCard and Visa systems, including by creating a new class of ADI (SCCIs) and requiring that they be eligible to participate in the schemes and not be discriminated against.[7] Nonetheless, the Access Regimes imposed by the Reserve Bank established that *only* ADIs were eligible to participate in the systems. It is the Bank's view that this regulatory framework no longer strikes an appropriate balance and may now be unnecessarily restricting competition. In particular, it is too restrictive for the following reasons:

- limiting membership to ADIs is preventing potential participants that the schemes might be willing to accept as members from participating
- APRA's supervisory framework for SCCIs necessarily mirrors the requirements for banks and as a result is more onerous than necessary for participants in credit card systems. This both discourages entry and imposes unnecessarily high costs on those that seek SCCI status.

The consequence is that competition in card issuing and acquiring markets is reduced relative to what might otherwise be the case.

As an illustration, a company that wishes to issue credit cards in Australia and have them widely accepted would need to be able to access an acceptance network (e.g. point of sale terminals) and arrangements for clearing those transactions and settling the amounts owing to merchants. In accessing a credit card scheme, the potential issuer could either become a member of the scheme or they could do so indirectly (i.e. by relying on an existing direct member, such as one of the banks). In the latter case they would be charged a fee for this and would be at a competitive disadvantage to direct members as a result. The same is true of potential acquirers, who would need to be able to provide merchants with the ability to process transactions from many issuers and would in effect need to gain access to both the MasterCard and Visa systems to provide a viable service. Constraints on membership therefore have a direct effect on competition in both issuing and acquiring.

This problem has recently been most apparent in the case of issuers of virtual credit card transactions; that is, card transactions that utilise only the card number, rather than the physical card – often for a single, specific-purpose transaction. A number of entities provide these services overseas, particularly in the travel industry, but may be ineligible to do so in the MasterCard and Visa systems in Australia because they are not ADIs. In some cases these entities might not be eligible to become ADIs, for instance due to ownership restrictions in the *Banking Act*. In addition, given the very narrow focus of their business, the costs of APRA authorisation as an ADI (e.g. fees, reporting costs and the cost of holding capital) are likely to be large relative to the

7 In particular, the issues identified by the Bank relating to access arrangements in card systems centred on such aspects as the high membership fees for the Bankcard system, as well as scheme rules in the MasterCard and Visa systems restricting competition in issuing and acquiring activities. See Reserve Bank of Australia and Australian Competition and Consumer Commission (2000), *Debit and Credit Card Schemes in Australia: A Study of Interchange Fees and Access*, October, p 58, available at <http://www.rba.gov.au/payments-system/resources/publications/payments-au/interchg-fees-study.pdf>.

potential size of the business proposed. As a result, entry into the Australian market is likely to be discouraged, and availability of this type of product may be reduced, as may competition for the provision of similar services.

An indication of the relatively restrictive nature of the existing arrangements is that only two of the 15 to 20 direct issuers and acquirers in the MasterCard and Visa systems in Australia are SCCIs. As discussed below, the Bank is aware of at least 11 entities that have expressed an interest in issuing or acquiring credit card transactions in Australia but are not ADIs. This suggests a considerable potential for new entry and that card markets may be less efficient, costs higher and services more limited for users of the payments system (consumers, business and government) than they would be if access was less restricted.

Measures to enhance competition and efficiency in the credit cards market are desirable given the extensive use of cards in the economy. There are 5.1 million credit card transactions in Australia (amounting to $720 million) per day, with almost 60 per cent of Australians over the age of 18 holding a credit or charge card.[8] The benefits of any reforms are likely to increase over time as the number of payments made with credit cards continues to grow, having experienced an average annual growth of 5.8 per cent between 2007/08 and 2012/13.[9]

The Bank's view is that the schemes are much better placed to make judgements about access to their respective systems than in 2004, but a reduction in the current regulatory constraints is necessary for the schemes to exercise this judgment.

Limiting Access to ADIs is Preventing New Entry

As noted, only two entities have gained SCCI status in Australia since the current access framework was implemented. While this modest take-up might simply indicate that relatively few non-traditional parties have seen a business case for joining the schemes, the Reserve Bank is aware that a number of parties have, in the past, considered gaining SCCI status but decided against it.

More recently, the Reserve Bank has become aware of at least nine entities focused on new or niche business models, as well as several current indirect participants in the schemes, that have indicated an interest in issuing or acquiring credit card transactions in Australia. Most have indicated in consultation that they consider the requirements to become an SCCI to be significantly more onerous than warranted for the business they plan to undertake.[10] In the absence of changes to access arrangements, some of these players will most likely not enter the Australian market directly, while others may nonetheless decide to pursue SCCI authorisation and as a consequence bear significant costs. Those that choose to enter indirectly (by relying on the services of a scheme member) will also bear additional costs.

In contrast to the case in 2004, MasterCard and Visa have indicated that they would be prepared to admit a wider range of entities than those who currently hold ADI/SCCI status in Australia (and a wider range than they would have been prepared to admit prior to the reforms), although Visa

8 Estimates of credit card transactions based on data from the 2012/13 financial year.

9 See 'Trends in Retail Payments' in Reserve Bank of Australia (2013), *Payments System Board Annual Report 2013*, available at <http://www.rba.gov.au/publications/annual-reports/psb/2013/html/index.html>.

10 The business undertaken might for instance include issuing cards only to corporate customers or acquiring only for post-paid services, where there is no chargeback risk from the default of a merchant that has yet to deliver its services.

has expressed a preference for participants to be regulated entities in some form. Both schemes have changed their corporate structure since the initial access reforms, moving away from member associations of banks to publicly listed companies. This could be expected to alter the schemes' incentives in favour of allowing wider participation.

The current requirements for participation may be preventing users of the payments system from gaining the benefits that new entrants might bring. For instance, the virtual card products proposed by several prospective entrants have the potential to significantly improve the efficiency of payments and reconciliation for businesses operating in the travel industry. Other potential entrants offer improvements in efficiency for other types of payments system users. More generally, any additional entry has the potential to apply competitive pressure to the prices and service levels of incumbent payments system participants.

A second element suggesting that the existing access arrangements might be too restrictive is that the Access Regimes in their present form prevent the Reserve Bank from participating in the international card schemes. This arises because the Access Regimes restrict eligibility for participation in the schemes to ADIs. The Reserve Bank is not an ADI but it is nonetheless able to undertake banking business under the *Reserve Bank Act 1959*. This appears to be an artificial constraint which prevents the Reserve Bank from delivering services to the Commonwealth Government in the most efficient way possible. It also results in an inconsistent treatment of card schemes in Australia, with the Reserve Bank able to become a member of the eftpos payment system but not of the MasterCard and Visa systems. This may be detrimental to competition between the schemes.

To summarise, the aim of the access arrangements is to encourage competition and efficiency in the payments system by striking an appropriate balance between new entry and risk control. There is some evidence that the correct balance is not currently being achieved.

Prudential Framework

APRA's prudential framework for ADIs (including SCCIs) requires an authorisation process and ongoing compliance with a range of prudential requirements, together with the payment of application and ongoing fees (see Section 5 for details). While SCCIs do not take deposits like other ADIs (at least not to any material extent), they must by and large meet the same standards as other ADIs. This reflects an important principle that all ADIs should be supervised to the same standard. Applying a lower level of supervision for some ADIs would create confusion about what ADI status and prudential supervision means and could cause reputational damage if an entity supervised to a lower standard were to fail, potentially reducing confidence in more systemically important institutions.

APRA supervision is directed to ensuring that ADIs manage risk prudently so as to minimise the likelihood of financial losses to depositors. However, the nature of risks in a credit card system is quite different to those being addressed by APRA for other ADIs. Holders of credit cards do not in the normal course of events have an exposure to credit card issuers as they are receiving credit rather than providing deposits. Therefore APRA's depositor protection mandate is not relevant. Merchants may have a financial exposure to card acquirers, as merchants require settlement of the funds owed to them for credit card purchases. Risk to merchants is reduced to an extent by the fact that acquirers are largely passing through funds from issuers and the schemes have mechanisms in place to provide confidence that settlement between issuers and acquirers will occur.

In effect, the largest exposures are managed within the card schemes, while participants must cover losses arising from the credit provided to their cardholders (for issuers) and non-performance by a merchant (for acquirers). Some merchants may have exposures with respect to funds passed through by their own acquirer.

This suggests that, although not intended, APRA supervision of SCCIs largely operates to protect the MasterCard and Visa systems rather than the users of those systems. This might be justified if these exposures were of a scale that presented some risk to financial stability, but the daily value of transactions in all credit card systems in Australia averaged only $720 million per day in 2012/13, compared with Real Time Gross Settlement (RTGS) payments of $158 billion and Direct Entry payments of $40 billion.[11]

APRA believes that supervising credit card system participants is no longer an appropriate use of its resources and is not consistent with its core mandate. In APRA's view, responsibility for determining access to the card schemes rests with the schemes themselves, not a prudential regulator charged with the protection of depositors.

The above factors mean that prudential supervision by APRA is imposing higher costs than necessary on SCCIs and potentially preventing direct participation in the MasterCard and Visa systems by some prospective entrants. The current regulatory regime is estimated to cost an additional $1.6 million per year, on average, for a participant than would be the case in the absence of the SCCI regime.[12]

11 Credit card transaction figures include American Express and Diners Club. All debit card transactions (including eftpos) averaged around $540 million per day.

12 One-off costs are amortised over 10 years.

3. The Objective of Reform

In line with the requirements of the *Payment Systems (Regulation) Act 1998*, the objective of reforming current access arrangements is to foster greater competition and efficiency in the payments system by achieving a balance that is in the public interest between new entry to the MasterCard and Visa systems and risk in those systems.

This objective might be achieved by:

- providing greater scope for the entry of new participants in the MasterCard and Visa systems, including by entities that are not currently eligible because they are not ADIs
- providing a suitable mechanism for the risk to the MasterCard and Visa systems from new entrants to be assessed and managed
- ensuring that regulatory imposts on participants are not higher than warranted.

A subsidiary objective is to ensure that regulatory resources (including those of APRA) are directed to the greatest public benefit and not to functions more appropriately performed by the private sector.

A constraint on these objectives is that other regulations may also have to be altered to complement any changes to the Access Regimes. In particular, the *Banking Act* stipulates that only entities that are ADIs, the Reserve Bank or those with exemptions can carry on 'banking business' in Australia. Under the Banking Regulations 1966, banking business includes both credit card issuing and acquiring in a payment system designated under section 11 of the *Payment Systems (Regulation) Act* on 11 April 2001 (i.e. the MasterCard and Visa credit card systems).[13] Therefore, even if the Access Regimes were removed, any entity wishing to issue or acquire MasterCard or Visa credit cards in Australia would still be required to become an ADI unless the Banking Regulations were amended.

The Reserve Bank has authority only in relation to the Access Regimes and not the Banking Regulations. If the amendment of the Banking Regulations is required to achieve the preferred policy option, the Reserve Bank will work with APRA and the Treasury with the aim of achieving this.

---

13 'Designation' is the first of a number of steps the Reserve Bank must take to exercise its powers over a payment system under the *Payment Systems (Regulation) Act*, and has no other effect. The MasterCard designation is available at <http://www.rba.gov.au/media-releases/2001/pdf/mr-01-09-gazette-mastercard.pdf>, and the Visa designation at <http://www.rba.gov.au/media-releases/2001/pdf/mr-01-09-gazette-visa.pdf>. The Bankcard scheme was also designated at the same time but the designation was revoked in April 2006 following the scheme's closure.

4. Options

Three options have been identified to meet the objectives described above:

- maintain the status quo
- remove the APRA SCCI regime while retaining some controls via the Access Regimes
- remove all access regulation.

Through consultation, the Reserve Bank is satisfied that these options explore a range of feasible approaches in addressing the problem and meeting the objectives stated in Section 3. As discussed above, evidence suggests that the status quo may be imposing higher barriers to entry and ongoing costs for participants than those necessary to control for risk in the card payments system. The Reserve Bank has focused on exploring whether a relaxation in part or in full of the current regulations would better meet the objectives of regulation.

Submissions and views put forward in response to the Reserve Bank's consultation processes have been taken into consideration in further developing these options.

Option 1: Maintain the Status Quo

This option would retain the current MasterCard and Visa Access Regimes and continue to rely on ADI status to determine eligibility to participate in the schemes. Potential new entrants that are not already ADIs would need to satisfy APRA's prudential framework for SCCIs, including an authorisation process and ongoing compliance with a range of prudential requirements, together with application and ongoing fees.

Option 2: Remove the APRA SCCI Regime, but Retain Some Controls via the Access Regimes

Option 2 aims to provide the schemes with greater freedom to grant membership to new types of participants, while continuing to place some obligations on the schemes through the Access Regimes. Under this option, the Access Regimes would be varied to widen the range of entities eligible to participate in the MasterCard and Visa systems. Rather than the current approach where only ADIs are eligible, the proposed approach would make ADIs and entities that were SCCIs at a specified date eligible, but also provide the schemes with the discretion to allow additional types of entities to participate. The schemes would be required to make public their risk-based criteria for determining which additional entities would be eligible and for determining which eligible entities would be admitted as participants. Further confidence in the objectivity of the schemes' processes would be provided by requiring the schemes to report annually to the Reserve Bank on how they had used this discretion and on their compliance with the Access Regimes.

This option would only be effective if Banking Regulation 4 (which defines credit card issuing and acquiring to be banking business) were removed, meaning that the SCCI category of ADIs would no longer exist. So as not to lose the benefits of the earlier reforms, as noted above the amended Access Regimes would ensure that existing SCCIs remain eligible to participate in the schemes once the new arrangements come into place. However, it should be noted that this would not guarantee any individual entity ongoing membership; like any participant a former SCCI's membership could be withdrawn if over time it fell short of the scheme's requirements. These requirements, and the rights and obligations of participants more generally, would be prohibited from being discriminatory towards former SCCIs (or any other entity) other than on the basis of risk.

Option 3: Remove All Access Regulation

The third option is the complete removal of the Access Regimes, leaving access entirely in the hands of the schemes. Once again, this option would only be effective if Banking Regulation 4 was removed so that issuers and acquirers of credit cards were no longer required to be ADIs. In other words, access arrangements would be the same as prior to the reforms in 2004; the ability of current SCCIs or new entrants to participate would be determined solely by the schemes' willingness to admit them. As discussed earlier, there are some indications that the schemes are now more willing to admit new types of participants.

During consultation, the Reserve Bank considered the use of voluntary undertakings from the schemes under this option. However, some stakeholders were concerned with transparency of this approach, arguing that if regulation of network access were to continue, it should occur via a public, transparent process.

Options Not Considered to be Feasible

Alternative options that were frequently discussed in consultation were either to reduce the regulatory requirements for SCCIs or create a new category of regulated entities that would be subject to less onerous requirements. Neither is within the control of the Reserve Bank. APRA does not consider it possible to reduce supervisory imposts on SCCIs and an alternative supervisory framework would most likely require legislative change. This is discussed further in Section 6.

Note: Visa Debit Access Regime

The Access Regime for the Visa Debit system was put in place in 2005. At the time that the Visa credit card Access Regime was being developed, the Reserve Bank expected that an SCCI joining the Visa credit card system with the intention of acquiring credit card transactions would also be able to acquire Visa Debit transactions. However, Visa indicated that this may not have been the case since its own scheme rules may have precluded an SCCI from acquiring debit card transactions. The Reserve Bank considered two options: first, to request that Visa review and modify its rules; second, to impose an access regime on the Visa Debit system, mirroring that imposed on the Visa credit card system. While the first option would have avoided the need for further regulation, Visa's decision-making structure meant that rule changes were likely to involve not just its Australian operations but also its Asia-Pacific and international boards, and thus could take an extended period of time and would have an uncertain outcome. The second

option was therefore more likely to promote competition in card acquiring, and would do so in a timely fashion. The same complication did not arise with respect to MasterCard, as it had different rules regarding eligibility to join the MasterCard system.

5. Impact Analysis

This section discusses the likely impact of each option. The directly affected private parties are likely to be MasterCard, Visa and current and prospective scheme participants. Businesses and consumers that use card payment systems are likely to be indirectly affected by the degree of competition in the delivery of card payment services that each option is able to provide. APRA will also be affected by the cost of applying the SCCI regime in each option.

It should be noted that because the proposed options involve considerable uncertainty around the likely number of new entrants under each option, the way in which each scheme will respond and the precise effects of increased competition, the ability for likely impacts to be quantified is limited. The regulatory burden and cost offset estimates have been calculated using the Business Cost Calculator on an annual basis.

Option 1: Maintain the Status Quo

This option would retain the current MasterCard and Visa Access Regimes and continue to rely on ADI/SCCI status to determine eligibility to participate in the schemes. It has been used as the benchmark for considering the costs and benefits of the other options.

Benefits

Maintaining the status quo provides clear and objective entry criteria that are set by a regulator. Because the criteria for entry are relatively high and ongoing prudential supervision is applied by APRA, this option is likely to result in the least risk from system participants to the card systems among the options considered.

This option also means that assessment of participant risks is centralised with APRA, potentially reducing the need for assessment processes to be conducted in parallel by both MasterCard and Visa for some entities (although MasterCard and Visa have noted that they already undertake their own assessment of individual participants under the existing framework – for example to impose collateral requirements).

The above benefits primarily accrue to the card schemes and incumbent participants, which benefit from this option where they bear some of the cost and reputational risk arising from a participant default. Incumbents also benefit from reduced competition relative to the other options.

By maintaining the Access Regimes, Option 1 provides a mechanism for a person denied access to ask the Reserve Bank to give a direction, and the right to apply to the Federal Court for an order for compliance and/or compensation. This benefits potential entrants.

Costs

The costs of Option 1 are the direct regulatory costs to SCCIs and reduced competition in the card issuing and acquiring markets. The former largely affects SCCIs, while the latter ultimately affects the users of the payments system – consumers, businesses and government.

Regulatory costs

SCCIs will face higher costs than otherwise. Those applying for SCCI status will face application fees and the cost of undergoing assessment by APRA, along with the cost of changes to governance and operations that might be in excess of what would otherwise be required to undertake the business. If granted authorisation, SCCIs face ongoing fees and administrative costs of compliance with the SCCI regime, along with the costs of meeting regulatory requirements such as minimum capital requirements on an ongoing basis. Many responses to consultation have expressed a view that these costs are higher than warranted for the nature of the business undertaken.

Reduced participation and competition

Because the costs of entry are likely to be higher under Option 1 than otherwise, fewer entities will join the systems as participants, reducing competition among card issuers and acquirers. Further, some entities may be ineligible to participate regardless of costs, for instance because of ownership restrictions imposed by the *Banking Act* on ADIs. The limited new entry of SCCIs that has occurred since the Access Regimes were introduced is *prima facie* evidence that the current regime is in practice quite restrictive. The Bank is aware of several entities that have considered applying for SCCI status but have considered the costs too high.

Limiting participation in the MasterCard and Visa systems will deny users of those systems – consumers, business and government – the benefits of stronger competition. The price of card payments is therefore likely to be higher than otherwise. It is not possible to quantify the magnitude of this effect; average acquirer margins (estimated by the mark-up of merchant service fees over interchange fees) for MasterCard and Visa credit card transactions have fallen from 59 basis points to 27 basis points over the period that RBA access regulation of card systems has been in place. Reduced participation also means that competition via improved services or innovation is likely to be reduced. For instance, the virtual card products proposed by several prospective entrants have the potential to significantly improve the efficiency of payments and reconciliation for businesses operating in the travel industry. Other potential entrants may offer improvements in efficiency for other types of payments system users.

Public sector costs

The current arrangements also result in costs for APRA and the Reserve Bank in its provision of services to the Commonwealth Government.

Authorisation and supervision of SCCIs places demands on APRA's supervisory resources. This occurs even though SCCI risks do not fit within APRA's core mandate; cardholders generally do not face risks from the MasterCard and Visa systems and risks within those systems are not of a magnitude to generate systemic risk.

The Access Regimes also prevent the Reserve Bank itself from participating in the MasterCard and Visa systems, since it conducts banking business under the *Reserve Bank Act* rather than as an ADI. This may prevent it from delivering payment services (e.g. acquiring) to the Commonwealth Government in the most efficient way possible. As noted above, there is no similar constraint on Reserve Bank participation in the eftpos system. This raises the prospect of inconsistent treatment of card schemes in Australia and potential detriment to inter-scheme competition.

Option 2: Remove the APRA SCCI Regime, but Retain Some Controls via the Access Regimes

Under this option, the Access Regimes would be varied to widen the range of entities eligible to participate in the MasterCard and Visa systems. As noted, Banking Regulation 4 would need to be removed, meaning that the SCCI category of ADIs would no longer exist. ADIs and entities that were SCCIs at a specified date ('former SCCIs') would remain eligible to participate and the schemes would have the discretion to also allow additional types of entities to participate. Schemes would be required to make public their risk-based criteria for determining which additional entities would be eligible and which eligible entities would be admitted, and to report annually to the Reserve Bank on how they had used this discretion and on their compliance with the Access Regimes.

There are two possible ways in which MasterCard and Visa could respond under Option 2. They could decide only to allow participation by ADIs and former SCCIs, meaning that entry is not expanded (scenario 1) or they could decide to admit additional types of participants, which would bring with it an obligation to publish risk-based criteria for entry (scenario 2).

Benefits

Scenario 1

Under scenario 1, the benefits relative to Option 1 largely flow to existing SCCIs, who would no longer be subject to the ongoing costs associated with APRA regulation, including fees, administration and reporting costs and the need to hold higher capital than might otherwise be necessary.

Scenario 2

The benefits under scenario 2, where the schemes choose to admit additional participants, are more significant, affecting current SCCIs and prospective entrants, as well as users of the card systems (consumers, businesses and government).

As under scenario 1, **current SCCIs** will benefit from reduced regulatory costs arising from APRA regulation outlined above. **New entrants that would have achieved SCCI status** in the future under Option 1 will also gain those benefits, and would no longer face the one-off costs of the initial APRA assessment and authorisation process. These cost reductions are estimated to be approximately $1.6 million per year, on average, for a participant that would otherwise have

been required to become an SCCI.[14] There may be some offsets to the extent that MasterCard and Visa impose more rigorous standards and compliance processes than under the status quo. These are nonetheless likely to be more flexible and tailored for different types of card payment businesses than APRA's requirements on ADIs, resulting in a lower net cost to participants than under Option 1. Many submissions, including from the schemes, argued that the APRA SCCI regime is more onerous and restrictive than warranted by credit card business.

Other potential participants will benefit by being able to directly undertake MasterCard and Visa acquiring and issuing business where they could not currently. In part this benefit could be approximated by the fees charged by an existing participant to provide issuing and acquiring services to a third party. However, in consultation, a number of parties indicated that the principal costs of not being able to participate are the constraints imposed on that party's activities if they are forced to operate via a direct participant, such as constraints on the volume of business or the card schemes that it may deal with. It is not possible to estimate this cost (and hence the benefit provided by Option 2 in allowing these parties direct access).

As well as benefiting SCCIs and potential participants, scenario 2 would additionally provide increased competition in issuing and acquiring and therefore greater efficiency in the payments system. This would benefit users of the payments system, including **businesses, consumers and government**. These parties are likely to face lower card payment costs as a result, along with benefits from improved services (e.g. acquirers offering more features to merchants) and innovation (e.g. the introduction of niche products such as 'virtual' credit cards). It is not possible to quantify these benefits.

This option would also allow MasterCard and Visa to choose to admit the Reserve Bank as a participant, resulting in a more consistent treatment of card schemes in Australia, given that the eftpos system is already able to accept the Reserve Bank as a member. This would potentially allow the Reserve Bank to provide payment services more efficiently to the Commonwealth Government.

APRA would no longer bear the cost of authorising and supervising SCCIs, allowing it to better direct supervisory resources to its core mandate. Note that these cost reductions are not considered by the OBPR to be compliance costs for the purposes of the regulatory burden and cost offset estimates in the table below.

In light of the Reserve Bank's objective of appropriately balancing the benefits and risks of greater participation in the MasterCard and Visa systems, an important benefit of Option 2 is that it increases accountability of schemes' access policies and practices through the transparency of eligibility and assessment criteria and through reporting to the Reserve Bank. This reduces the potential for the schemes to impose and apply arbitrary criteria or discriminatory practices, or to excessively relax risk standards.

Like Option 1, both scenarios under Option 2 provide a mechanism for a person denied access to ask the Reserve Bank to give a direction, and provide the right to apply to the Federal Court for an order for compliance and/or compensation.

14 One-off costs are amortised over 10 years.

Costs

Scenario 1

Scenario 1 would result in few costs if the schemes chose not to admit participants beyond ADIs and existing SCCIs. Given that the two existing SCCIs will no longer be subject to APRA supervision, the schemes might choose to conduct more intensive ongoing monitoring of their financial position than currently. This implies some additional cost to MasterCard and Visa in relation to those two entities, though it can be assumed that the cost for the SCCIs would be more than offset by the removal of APRA compliance costs (reflecting the fact that APRA regulation is considered to be more onerous than necessary for credit card business). Other incumbent participants and users of the systems would be little affected by this scenario.

Scenario 2

The costs of Option 2 under scenario 2 (i.e. MasterCard and Visa admit new types of participants) fall largely on MasterCard, Visa and potentially existing participants.

Because under this option former SCCIs and any new non-ADI members (or potential members) will no longer be supervised by APRA, a greater onus will be placed on the schemes to assess and manage participant risk. While the schemes have stressed that they already perform this function, there may be some increase in costs for incremental activities to be undertaken in the absence of APRA supervision. These costs are likely to depend on the types of members admitted; for instance costs may be lower where the only additional members admitted are those subject to prudential regulation in another jurisdiction. Given that these costs will depend upon the approaches taken by the schemes, they cannot be estimated at this time.

If the schemes choose to admit participants beyond ADIs and former SCCIs, they will be required by amended Access Regimes to publish eligibility criteria and report to the Reserve Bank each year on how they have applied those criteria. This will result in administrative costs for the schemes.

The nature of Option 2 is that MasterCard and Visa will only admit additional entities if the benefit to the schemes outweighs the costs of doing so. Nonetheless, MasterCard and Visa have expressed different opinions on the materiality of potential additional costs.

A further cost is the potential for greater risk to be introduced to the systems by admitting members that are not prudentially supervised. The failure of a participant to meet its settlement obligations within the system has the potential to affect the scheme and other participants. The net of the failed participant's obligations would need to be absorbed in the system; how this occurs would depend on the arrangements in each system. Both MasterCard and Visa argue that they have strong member assessment and risk management systems in place. The use of collateral requirements, tailored to the profile of the participant, is an important element of this.

The incentives faced by the schemes are important when considering the risks that might be introduced by relaxing new entry. The schemes' primary interest is in generating transaction flows, which generate fee revenue. Transaction flows in turn rely on the size of the network; that is, the number of cardholders and merchants, which is supported by the number of issuers and acquirers. Allowing additional participants is likely to increase transaction flows. However, if existing participants become concerned about facing additional risk as a result, or reputational

damage from a participant failure affects adoption by end-users, this might ultimately be detrimental to the network.

Regulatory burden and cost offset estimate

Average Annual Compliance Costs (from business as usual)*				
Costs ($m)	**Business**	**Community Organisations**	**Individuals**	**Total Cost**
Administrative costs	-0.04	0	0	-0.04
Substantive compliance costs	0	0	0	0
Delay costs	0	0	0	0
Total by Sector	**-0.04**	**0**	**0**	**-0.04**

Cost offset ($m)	**Business**	**Community Organisations**	**Individuals**	**Total by Source**
Agency	0	0	0	0
Within portfolio	0	0	0	0
Outside portfolio	0	0	0	0
Total by Sector	**0**	**0**	**0**	**0**

Proposal is cost neutral?	☐ yes	☑ no		
Proposal is deregulatory	☑ yes	☐ no		
Balance of cost offsets	**N/A**			

* As required by the OBPR, costs include compliance costs associated with financial costs but do not include the financial costs (e.g. levies paid to APRA) themselves.

Net benefits and costs under Option 2

The Bank's objective is to enhance competition and efficiency in the card payment systems by encouraging broader participation. This will be achieved under Option 2 by the schemes choosing to admit new types of members beyond ADIs and former SCCIs. While the schemes bear additional costs in admitting new types of members, by doing so they would indicate that the benefits to them outweigh the costs. Competition benefits will not be achieved if the schemes opt not to extend membership beyond ADIs and former SCCIs. Nonetheless there will be a reduction in regulatory costs for former SCCIs and APRA, with limited additional costs for the schemes in relation to the two former SCCIs.

There are a number of factors that suggest that a material increase in risk from reducing access restrictions is unlikely:

- the schemes have an incentive to ensure that their respective systems remain attractive to participants, including by controlling risk

- this option does not compel the schemes to expand membership from the current arrangements; if they consider that the admission of entities not subject to prudential supervision gives rise to unacceptable risks, they will not admit them
- the schemes argue that they have robust participant screening and risk management mechanisms in place, including the use of collateral.

The Bank's assessment is that Option 2 offers net benefits relative to Option 1 regardless of which scenario plays out.

Option 3: Remove all Access Regulation

The third option is the complete removal of the Access Regimes, leaving access entirely in the hands of the schemes. Once again, this option would only be effective if Banking Regulation 4 was removed so that issuers and acquirers of credit cards were no longer required to be ADIs.

Under this option, access arrangements would be the same as prior to the reforms in 2004. That is, the ability of current SCCIs or new entrants to participate would be determined solely by the schemes' willingness to admit them.

Because Option 3 places all discretion in the hands of the schemes, there is uncertainty about outcomes. The two scenarios outlined in Option 2 are possible, as is admission only of ADIs, thereby excluding former SCCIs.

Benefits

The benefits of this option are similar to those under Option 2, with the schemes having the ability to either retain current access arrangements or to admit additional types of participants.

If the schemes choose to allow participation by ADIs and current SCCIs only, benefits would flow largely to current SCCIs since they would no longer be subject to ongoing costs associated with ARPA supervision; the schemes would also benefit from having lower compliance costs than the status quo.

Should access be extended to entities that would not currently be eligible, benefits would flow to current SCCIs, prospective participants, as well as end-users of the card systems. Both SCCIs and new entrants that would have achieved SCCI status would no longer face regulatory costs associated with ongoing APRA supervision; the latter would also benefit from not having to pay the one-off costs associated with the SCCI assessment and authorisation process. Other potential participants will also benefit by being able to directly issue and/or acquire MasterCard and Visa transactions where they could not currently. Competition and innovation will be increased, promoting greater efficiency in the payments system. This would benefit the schemes and new entrants as well as consumers, business and government, who are likely to face lower prices, improved service and increased product choice.

In either case, this option would provide the benefits of reducing APRA's costs of authorisation and supervision, enabling it to better direct supervisory resources to its core mandate. Aggregate benefits may nonetheless be offset to the extent that the schemes choose to undertake any additional assessment and monitoring.

Finally, the removal of all access regulation may increase the schemes' ability to exercise judgment in granting membership relative to Option 2. While Option 2 allows the schemes to determine eligibility and assessment criteria, it may be difficult for those criteria to anticipate the full range of entities that may apply for membership in the future.

Costs

By removing all access regulation for the MasterCard and Visa systems, this option does not impose any costs directly on any party. However, to the extent that the schemes choose to utilise the freedom to admit additional members, a greater onus will be placed on them to assess and manage participant risk, potentially giving rise to costs for both new entrants and the schemes. The costs to the schemes of changing any eligibility and assessment procedures as a result would therefore be similar under Option 3 to Option 2 (these would not be classified as compliance costs). As noted, prospective participants will seek membership and the schemes will grant it only if each sees a net benefit in doing so.

Like Option 2, Option 3 has the potential to increase risk in the MasterCard and Visa systems by allowing entry of entities that are not prudentially supervised. The failure of a participant to meet its settlement obligations would mean that the net shortfall would need to be absorbed by the scheme or its participants. As discussed under Option 2, this risk is mitigated by the fact that the schemes have an incentive to maximise the size of their respective networks, including by maintaining the confidence of participants in the level of risk entailed. The schemes argue that they have robust participant screening and risk management mechanisms in place and should they have concerns about the risk implications of expanding membership, Option 3 (like Option 2) does not compel them to do so.

The principal drawback with Option 3 is greater uncertainty about the range of outcomes and therefore greater policy risk. In particular, whereas Option 2 guarantees the eligibility of current SCCIs and therefore that competition will not be reduced from current levels, this is not true of Option 3. For example, a scheme seeking to rely solely on ADI status for membership eligibility would not be required to extend eligibility to former SCCIs.

Also unlike Option 2, Option 3 offers no transparency and accountability on the part of the schemes in relation to their access policy. As a result, there is little to prevent the schemes from granting access in an inconsistent or arbitrary way. For instance, while the schemes may welcome new entry, they could be expected to focus on the potential entrants that offer the greatest commercial advantage or where membership in Australia is part of a broader relationship. Other parties might find access difficult simply because they are not a high priority for the schemes, rather than the schemes being opposed to their participation. A number of parties during consultation expressed concern about how the schemes might utilise any additional discretion provided to them. Compared with the other options, prospective participants are therefore more likely to face a greater level of uncertainty under Option 3. This is likely to have greater bearing for smaller prospective participants, given their limited capacity to generate large volumes of card transactions and therefore revenue for the schemes. Such an outcome would be detrimental to competition and limit product choice for consumers and merchants, particularly in non-traditional payment products.

Finally, Option 3 does not provide any recourse under the *Payment Systems (Regulation) Act* for a prospective participant unreasonably denied access. Because there is no Access Regime, a person

denied access cannot ask the Reserve Bank to give a direction, or apply to the Federal Court for an order for compliance and/or compensation.

Regulatory burden and cost offset estimate

Average Annual Compliance Costs (from business as usual)*				
Costs ($m)	**Business**	**Community Organisations**	**Individuals**	**Total Cost**
Administrative costs	-0.05	0	0	-0.05
Substantive compliance costs	0	0	0	0
Delay costs	0	0	0	0
Total by Sector	**-0.05**	**0**	**0**	**-0.05**

Cost offset ($m)	**Business**	**Community Organisations**	**Individuals**	**Total by Source**
Agency	0	0	0	0
Within portfolio	0	0	0	0
Outside portfolio	0	0	0	0
Total by Sector	**0**	**0**	**0**	**0**
Proposal is cost neutral?	☐ yes	☑ no		
Proposal is deregulatory	☑ yes	☐ no		
Balance of cost offsets	**N/A**			

* As required by the OBPR, costs include compliance costs associated with financial costs but do not include the financial costs (e.g. levies paid to APRA) themselves.

Net benefits and costs under Option 3

While increased access relative to Option 1 and lower regulatory costs than both Options 1 and 2 are possible under this option, there is greater uncertainty, including a possibility that access is reduced relative to the other two options. The absence of any recourse under the *Payment Systems (Regulation) Act* for parties that have been unreasonably denied access also weighs against this option. While indications from the schemes that they favour wider access suggests that this option would increase competition, this option also has a possible outcome of a reduction in competition; this uncertainty of outcomes means that it is not possible to conclude with confidence that this option is superior to either Option 1 or Option 2.

6. Consultation

The Consultation Process

The Reserve Bank released *Review of Card System Access Regimes: A Consultation Document,* in May 2013. The Reserve Bank sought the views of interested parties on three policy options: varying the Access Regimes to expand eligibility to a wider range of entities, revoking the Access Regimes and maintaining the status quo. The Reserve Bank also sought views on a number of questions related to the risks faced by card schemes and their members, how they should be addressed and the shape and potential effect of possible revised access arrangements. Taking into account views expressed by stakeholders, the Reserve Bank released *Proposed Variation to the MasterCard and Visa Access Regimes: Consultation Document* in December 2013 and began a second round of consultation. The December 2013 document refined the three options outlined in the May 2013 paper, with more detailed consideration of how each option could be implemented and included draft variations to the Access Regimes under Option 2. The paper expressed the Board's preliminary view that Option 2 would best serve the public interest. The objective of this consultation was to seek any further views on the options, given the more detailed proposal under Option 2, and to seek comments on the draft Access Regimes.

In total, the Reserve Bank received 16 submissions in the May 2013 consultation and 14 submissions in the December 2013 consultation, including from financial institutions, industry groups, potential members and the card schemes. Non-confidential submissions are published on the Reserve Bank's website. Participants' views remained largely consistent across the May and December consultations, with more parties favouring Option 2 in the December consultation. Most parties took up the invitation to discuss their submissions with the Reserve Bank.

The main points raised in these submissions are discussed below.

With regard to the options-stage RIS, the Reserve Bank has fully complied with the RIS requirements. Specifically, the options-stage RIS:

- includes a minimum of three elements (the problem, objective and options)
- includes at least three options, including a regulatory option, a non-regulatory or light-handed regulation option, and a do-nothing option
- has been certified at the secretary or deputy-secretary level and provided to the OBPR before consideration by the decision-maker
- has been published following the public announcement of an initial decision to regulate.

May 2013 Consultation

Views on current access arrangements

The majority of submissions supported either varying or revoking access regulation, while incumbent scheme participants and industry associations expressed a preference for maintaining the status quo. Those supporting the status quo argued that maintaining APRA supervision was important in giving each participant some comfort on the financial condition of other participants and maintaining confidence in and stability of the system. They argued that APRA supervision provides clarity, transparency and objectivity, and obviates the need for 'overlapping screening' by the schemes; moreover, the regulatory approach should not be changed just because prospective participants wish to avoid what they perceive as onerous requirements by APRA. Most of the remaining submissions, however, agreed that the Access Regimes in their current form are not fulfilling their objectives and may be hindering competition by creating unnecessarily high barriers to entry – particularly for companies with business models that pose little risk to the system.

Options for reform

Among those favouring a change in the access framework, most preferred continued (but somewhat more flexible) regulation while a small number of submissions supported a complete removal of the Regimes. Those arguing for a complete removal of access regulation noted that the schemes are now more willing to accept a wider range of members than at the time when the existing arrangements were put in place. Nonetheless, even some of these submissions argued for the continued involvement of the Reserve Bank (e.g. through scrutiny of scheme rules or for voluntary undertakings to be given by the schemes).

Both incumbent and prospective participants questioned the schemes' ability, in the absence of regulation, to manage entry in a non-discriminatory way that appropriately managed risks. On one hand, some argued that entry would not be sufficiently restrictive because the schemes' commercial interests in increasing participation would override their interest in adequately managing risks. Others, however, suggested that entry might remain too restrictive, arguing that there remained a role for some form of regulatory oversight that was fair and non-discriminatory yet more flexible than current arrangements.

In line with this, a relatively common view (particularly among prospective participants) was that prudential supervision should continue to play a role while incorporating some additional flexibility. A common concern was that supervision of SCCIs did not sufficiently recognise differences in the risks presented by different business models. Some parties argued that requirements applicable to SCCIs – including those on capital, shareholder composition and reporting – are more onerous than warranted by the limited business they undertake. In addition, a number of players pointed to significant differences between the risk profiles of different types of SCCI business, which argued for more nuanced supervision. In this context, many parties referred to the differences in issuing and acquiring risk, arguing that they each warranted a different supervisory approach (e.g. a framework that allows for an 'acquirer-only' category that is supervised by either a regulator or an industry body but is not required to be an ADI). Some submissions also argued that entities already regulated in another jurisdiction should be subject to reduced regulation in Australia.

Views of the schemes

While both MasterCard and Visa were in favour of removing the Access Regimes, their views differed on whether participants should be prudentially supervised. MasterCard argued that since it was already proactive in ensuring the safety of the payment system and since stability and reliability of the system were in MasterCard's interest, the Access Regimes had created distortions that unnecessarily increased the costs to some entities wishing to join and prevented some others from joining entirely. By contrast, Visa believed that some form of minimum publicly set and overseen regulatory standard should remain by retaining the SCCI class of APRA-regulated institutions, albeit with less stringent requirements than presently the case. Visa argued that the approach would 'enhance competition while maintaining an appropriate screening and monitoring device for new entrants into card systems'. The schemes also diverged on whether undertakings on criteria for participation should be provided to the Bank if the Access Regimes were to be revoked, with Visa willing to do so and MasterCard arguing that it would be inappropriate as any regulation should occur via a public, transparent process.

Other issues

ADI sponsorship and partnerships

A number of incumbent participants suggested that prospective entrants that found regulatory requirements too onerous had the option of undertaking a partnership or a 'BIN sponsorship' arrangement with an existing participant.[15] However, some prospective participants argued that these arrangements could constrain the sponsored party's ability to compete and innovate.

A level playing field

Some parties noted concerns that allowing some entities to participate in the scheme with a lower standard of supervision (or no supervision) would provide those players with a competitive advantage. Others pointed out that a 'full service' bank generally has other competitive advantages over more specialised players, such as the capacity to bundle a number of services together in its customer relationship.

Reserve Bank participation

A small number of submissions addressed the merits of the Reserve Bank becoming a participant in the MasterCard and Visa systems. The main objection was that it would be inappropriate for the Reserve Bank to compete with private sector entities for provision of government banking services. A participant in the schemes noted in consultation that the ability of the Reserve Bank to participate in one card scheme (eftpos) but not others appeared to be an anomaly.

15 In a 'BIN sponsorship' arrangement, the incumbent would allow the new entrant to use scheme card or acquirer numbers allocated to the incumbent. As the member of the system, the incumbent would take responsibility for the performance of obligations related to those BINs.

December 2013 Consultation

Most parties that made a submission to the December 2013 consultation re-iterated their views from the May 2013 consultation. Most acknowledged that the current framework may be unduly inhibiting competition and were in favour of varying the Access Regimes; a minority – representing incumbents – preferred maintaining the status quo. Only one party, a scheme, continued to prefer the removal all access regulation, while the other scheme continued to advocate the removal of the Access Regimes but retention of prudential oversight at a lower level by APRA.

Preferred option

A majority of submissions supported the removal of the APRA SCCI regime while retaining some controls via the Access Regimes. These parties noted that current arrangements were more onerous than necessary for prospective participants and that Option 2 strikes the best balance between allowing new entrants into the schemes while managing any risks that these entrants might bring to the payments system.

Two submissions – one in support of Option 2 and one in favour of retaining some prudential oversight – advocated that the Bank set the minimum level of risk assessment required of the schemes, arguing that relying on transparency and *ex post* reporting would not be sufficient to ensure that the schemes strike an appropriate balance between competition and financial safety. One of these parties also proposed that the Reserve Bank set minimum capital requirements on a case-by-case basis to take into account the applicant's risk profile. Several parties sought opportunities for input to the setting of membership thresholds; one suggested that the schemes be required to publish their eligibility and assessment criteria before the Access Regimes are varied.

Two industry associations and one incumbent participant argued that the status quo should remain, as they did in the earlier round of consultation. These parties continued to argue that prudential regulation of scheme participants is efficient, non-discriminatory, and essential to maintain confidence in the payments system. It was also argued that current arrangements are flexible enough to allow new entrants into the schemes (such as through 'BIN sponsorship' arrangements) and are not an impediment to innovation.

Views of the schemes

The schemes largely restated the views they expressed during the May 2013 consultation, with one scheme expressing more support for Option 2 than in the previous consultation.

While noting its continued preference for the removal of all access regulation, MasterCard noted the benefits of Option 2 relative to the status quo and that it would welcome additional, risk-appropriate participants to its system. However, it expressed some reservations over specific wording of the draft Access Regimes. One concern related to the requirement to publish eligibility and assessment criteria, with MasterCard arguing that the criteria should remain confidential as publication could lead to some applicants 'gaming the system' to gain access. It also expressed some concerns over the distinction between 'eligibility' and 'assessment' criteria, and sought more clarity on timing requirements for decisions on applications from prospective participants.

By contrast, Visa continued to be in favour of revoking the Access Regimes while retaining 'some form of regulatory benchmark of approval' that would encompass a wider set of entities than the SCCI regime. This could be achieved by, for example, lowering the current SCCI benchmark. Visa noted that its next preferred option was to remove all access regulation and argued that the removal of the SCCI regime would lead to the schemes performing a 'quasi-regulatory role'. Like MasterCard, Visa also expressed concern over the requirement in the draft Access Regimes for the schemes to publish their risk-based eligibility and assessment criteria, noting the commercial-in-confidence nature of this information. Visa also objected to the requirement for the schemes to certify that successful applicants met at all times all risk-related criteria set by Visa.

Outcome of Consultation

Many of the views expressed in both rounds of consultation focused on central issues in determining whether current access regulation is striking a balance between new entry and risk that is in the public interest. In particular, they focused on: the extent to which current arrangements are constraining new entry and therefore competition; potential risks arising from new entry; and how the balance between these should best be managed. There was no consensus among submissions on these issues, but the views put have informed the Bank's assessment of the appropriate regulatory response.

A number of parties expressed concerns during the first consultation that, while the existing access framework was overly restrictive, there might be a temptation for the schemes to either give too little weight to risk or to also be overly restrictive or inconsistent in the granting of access. The Bank sought to address this in the design of Option 2 for the second consultation, by introducing transparency of the schemes' eligibility and assessment criteria and reporting to the Reserve Bank on how the access arrangements have been applied. This gave rise to subsequent concerns by the schemes about making access criteria publicly available. The Bank sees the proposed approach as a light-touch means of encouraging open and consistent access arrangements and is prepared to discuss with the schemes the appropriate level of detail in public disclosures.

Taking into account the views expressed by the schemes during consultation, the Bank made several minor or technical changes to its draft variations to the Access Regimes. These changes relate to clarifying the scope of reporting requirements, decision timelines and certification of compliance with the Access Regimes. In the view of the Bank and many parties making a submission, having transparent eligibility and assessment criteria is crucial to the objective, non-discriminatory application of these criteria by the schemes. The schemes' annual certification of compliance with the Access Regimes and transparency on the timing of decisions would serve a similar purpose. The Bank therefore proposes to retain these provisions under Option 2, with minor wording changes to address the schemes' concerns.

The Bank is not proposing to modify its approach as a result of other frequent themes in consultation:

- *'Light-touch' oversight* – a number of submissions supported a lighter-touch SCCI framework operated by APRA or another regulator. This would require legislative change and is outside the scope of the Board's consideration. In any event, the case for public supervision of public participants is not strong given the nature and magnitude of financial risks generated by the card systems, and an approach that may create ambiguity or confusion about the role of APRA's prudential supervision of ADIs is not supported by APRA.

- *Alternative avenues of participation* – some submissions suggested that potential entrants could access partnership or sponsorship arrangements if they could not meet the hurdles set by the SCCI framework. This does not appear to be a persuasive argument against considering regulatory change as the approach imposes higher-than-necessary costs and potentially other commercial constraints on new entrants, inhibiting their capacity to compete with existing players.
- *Level playing field* – some incumbent participants suggested that allowing entities that are not supervised by APRA to compete with those that are (i.e. ADIs) would constitute an uneven playing field. However, under Option 2 regulatory costs would only be imposed as a consequence of ADIs' broader banking activities rather than card issuing or acquiring. In any event, the ability of those conducting broader banking business to bundle card business with other banking products most likely confers ADIs an advantage over specialists in the card business.
- *Specifying minimum participation criteria* – some submissions argued for the inclusion of specific minimum participation criteria (e.g. on capital adequacy) in the Access Regimes. They argued that this would protect against the schemes excessively weakening entry criteria. While it was not proposed that the Bank supervise participants, this proposal implies the Bank, rather than the schemes, making judgements about the appropriate trade-off between new membership and risk. The Bank's view is that this is unnecessary and could even be counterproductive if it is accepted that the schemes have the appropriate incentives to balance these elements. An alternative approach suggested in one submission was for the Bank to 'pre-vet' the schemes' eligibility criteria before varying the Access Regimes.

7. Conclusion

The Bank's view is that Option 2 – varying the Access Regimes and seeking removal of Banking Regulation 4 – would best promote the public interest and balance the interests of current and prospective future participants in the MasterCard and Visa credit card systems and the Visa Debit system.

The status quo is not considered to be in the public interest because the current constraints on access are likely to result in lower levels of competition and efficiency in these systems relative to the other options. The status quo would be to the detriment of parties who may wish to participate in the systems because they will be prevented from entry if they are not ADIs and may be subject to more onerous regulatory requirements than warranted for their business if they seek to become ADIs. This option is likely to reduce competition relative to the other options, resulting in higher costs and reduced service for users of the payments system than might otherwise be the case. Some current participants (SCCIs) may also be subject to higher regulatory imposts than under the other options.

Removing all access regulation has some potential benefits over Option 1 in that, by placing greater discretion in the hands of the schemes to determine eligibility for membership, it provides the potential for expanded entry. This could benefit potential participants, while some existing participants may be subject to reduced regulatory imposts because they would no longer be required to be ADIs. However, the outcomes of this approach are quite uncertain; while there are indications that the schemes are willing to admit a wider range of members, it would be possible for them to deny access to the current SCCIs if they chose. Similarly, while the schemes would be expected to take account of risks to their systems in deciding which new entities to admit, there is no requirement for them to do so. Under this approach, parties denied access would also not have recourse to the provisions of the *Payment Systems (Regulation) Act*, including the right to ask the Bank to issue a direction or to apply to the Federal Court for a remedy. Overall, the Bank's view is that there are insufficient controls in this approach to be confident of outcomes that properly balance the efficiency and competition benefits of new entrants against the potential risks they bring to the system.

On balance, the Bank's view is that varying the Access Regimes (in conjunction with the removal of Banking Regulation 4) would strike the best balance between the interests of potential and existing participants in the system and would be in the public interest. The schemes would be able to admit new types of entrants, while existing participants that had gained entry under the previous reforms would remain eligible. In the Bank's view, this provides the best prospect of increasing participation in the systems and therefore enhancing competition and efficiency. Consultation identified the scope for at least 11 possible new entrants to scheme participation, with the potential for competition arising from new entry to in turn deliver benefits to consumers and merchants. At the same time, it requires the schemes to establish risk-based criteria for determining eligibility if they choose to expand access, along with criteria for assessing applications. This additional transparency and accountability should help to provide an appropriate balance between competition and risk, while allowing the schemes discretion to tailor membership arrangements to match the risk appetite of the system.

This approach will result in reduced costs of APRA regulation for non-ADIs, while some new costs will result for the schemes. There would be some cost in establishing and publishing eligibility and assessment criteria, along with a modest cost in reporting to the Reserve Bank each year. There are also likely to be costs involved in assessing potential entrants, both initially and on an ongoing basis if accepted, although the schemes argue that they already have robust systems of this type in place. Importantly, the schemes will only expand entry and incur these costs if they consider that they are outweighed by the benefits.

8. Implementation and Review

If the Payments System Board accepts the option identified in this paper as the preferred option, it is proposed that the amended MasterCard and Visa Access regimes become effective only when Banking Regulation 4 has been repealed. The Bank will work with APRA and the Treasury to seek removal of the Regulation but, because the legislative processes required to change the Banking Regulations are outside of the Bank's direct control, there is some uncertainly over the likely timeframe. Before final instruments are put in place, the Bank will also discuss with the Australian Payments Clearing Association (APCA) any implications for APCA clearing streams and confirm with Visa whether, as a technical matter, it considers that the Visa Debit Access Regime remains necessary.

It is anticipated that the Bank would nonetheless announce the Board's in-principle decision as soon as possible and begin discussions with MasterCard and Visa regarding reporting requirements and the disclosure of eligibility and assessment criteria, if required. This approach should provide the schemes, SCCIs and potential entrants with greater certainty about the direction of regulation and allow them time to begin any necessary preparations before changes to access regulation become effective. It is the Bank's intention that the effective date would take into account the time needed for industry to prepare for the new framework; accordingly, no transitional provisions are proposed.

The Reserve Bank will monitor developments through liaison with industry and the public disclosure and annual reporting requirements. It is anticipated that the Payments System Board will review the effects of the changes two years after their implementation. The Bank will also engage with the schemes to address any reports of actions that are contrary to the intent of the reforms.