

# Retail Payments Policy and Research

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## Review of Card System Access Regimes

In May 2013, the Reserve Bank released a consultation paper reviewing the Access Regimes applying to the MasterCard credit, Visa credit and Visa Debit systems in Australia. The decision to consult was largely prompted by concerns that the Access Regimes were no longer as effective in fulfilling their original objective and instead may have been preventing some prospective scheme participants from entry. After consulting with interested parties, the Bank initiated a further round of consultation in December 2013 seeking feedback on draft variations to the Access Regimes, which would allow MasterCard and Visa greater discretion over membership of their respective systems, potentially widening eligibility.

The original access framework was implemented in 2004 and 2005 to expand access to the MasterCard and Visa systems while minimising any risks to the payments system as a whole. In addition to Access Regimes imposed by the Reserve Bank, the framework involved creating a new class of authorised deposit-taking institution, known as specialist credit card institutions (SCCIs), and supporting amendments to the *Banking Regulations 1966*. Since the framework was implemented, two entities have been authorised by the Australian Prudential Regulation Authority (APRA) as SCCIs. More recently, the Bank had become aware of a number of other entities with an interest in undertaking credit card issuing or acquiring activities (but not other banking business) in Australia. However, prospective participants may be discouraged from entry because the access framework imposes a regulatory burden that may be more onerous than necessary given the nature of their operations.

In March, the Board announced a decision in principle to vary the Access Regimes. This will also require the removal of the current SCCI framework, administered by APRA. The Bank's assessment is that the revised arrangements are in the public interest; they will promote competition and efficiency, while not materially increasing risk in those systems.

The revised Access Regimes will require each scheme to have in place transparent eligibility and assessment criteria and to certify annually to the Bank its compliance with the Regime. The certification will also include a list of entities that applied to participate in the Scheme in Australia over the reporting period, as well as a list of entities that ceased to participate in that Scheme.

The Board's decision to vary the Access Regimes is contingent on associated changes in other regulatory and self-regulatory frameworks. The proposed Access Regimes will be effective only if Regulation 4 of the Banking Regulations – which determines credit card issuing and acquiring in the MasterCard and Visa systems to be banking business – is repealed. The Bank has also indicated that the changes to the rules of the Bulk Electronic Clearing System would need to be amended to satisfactorily accommodate the effect of

the changed regulatory framework on its membership. The Bank expects that the variations should become effective around the end of 2014.<sup>8</sup>

## Operational Incidents in Retail Payments Systems

To strengthen its oversight of operational disruptions in retail payments and contribute to the ongoing integrity of retail payment systems, in 2012 the Bank implemented reporting arrangements for significant retail payment incidents. To supplement this, in late 2013 the Bank implemented a framework for routine statistical reporting on retail payments incidents. The Bank has also collected additional information on the system architecture supporting retail payments activities to assist in its review of participant incident reports.

The Board has been kept informed of this work, and preliminary analysis of the data has been presented to the Board. Over time, these data are expected to provide a clearer picture of retail operational incidents and inform the Bank as to whether further policy action is necessary, either by individual institutions or across the industry more broadly. The Bank has also engaged with the Australian Payments Clearing Association (APCA) on how aggregate data might be provided to payment system participants to allow them to benchmark their operational performance.

## Research: Cost and Consumer Use Studies

The Bank has been undertaking two significant studies to gather more information on the Australian payments system.

As discussed in the chapter 'Trends in Retail Payments', the Bank undertook its third survey of consumers' use and attitudes toward different payment methods in November 2013. As with the previous studies in 2007 and 2010, an important goal of the survey was to measure the use of cash in the economy, given that there is little other reliable information on this segment of the payments system. In addition, the survey provides a rich and valuable dataset for analysing payment choice by consumers. Two papers on this topic were published in June 2014: a Research Discussion Paper on trends in the use of retail payment methods by consumers<sup>9</sup> and a *Bulletin* article focusing on the use and holdings of cash.<sup>10</sup>

The fieldwork for the survey was undertaken by Colmar Brunton following a competitive tender process. The survey consisted of three elements: a pre-diary questionnaire capturing demographic characteristics; a seven-day diary recording individual transactions; and an end-of-survey questionnaire asking about payment preferences and attitudes. For the first time, the survey was available online and was answered by most participants via this channel (including an option to respond using a smartphone-optimised webpage). However, a paper-based survey was also used for a smaller number of respondents who did not have access to the internet.

In addition to the study of consumers' use of payments, the Bank has also sought to improve its understanding of other aspects of the payments landscape. In particular, over the course of 2014 the Bank has been undertaking a large-scale review of the costs of different payment instruments for financial institutions and merchants. This study will update and extend the analysis undertaken as part of the 2007/08 review of the Bank's payment system reforms – when the costs associated with a variety of commonly used payment methods were last

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8 See RBA (2014), *Payment Card Access Regimes: Conclusions*, March, available at <<http://www.rba.gov.au/payments-system/reforms/cc-schemes/201403-impact-stmt/conclusions/index.html>>.

9 See Ossolinski C, T Lam and D Emery (2014), 'The Changing Way We Pay: Trends in Consumer Payments', RBA Research Discussion Paper No 2014-05.

10 See Meredith J, R Kenney and E Hatzvi (2014), 'Cash Use in Australia', *RBA Bulletin*, June, pp 43–54.

considered. It will provide estimates of the costs to financial institutions of processing various payments and of the costs to merchants and other participants in the payments system. It will shed light on how changes in technology, payment functionality, issuing arrangements, pricing and patterns of payment use have altered the costs of different payment methods since 2007. The current study also involves a survey of small- and medium-sized merchants to provide information about how the costs borne by smaller merchants differ from those borne by larger merchants. Together, this information will enhance the Bank's understanding and analysis of retail payments issues, provide benchmarks against which financial institutions and merchants can compare their own cost structures, and help promote the public's understanding of the costs associated with different payment instruments.

The Bank is currently analysing the data received to date, seeking further information where necessary, and preparing a report that will be published towards the end of the year. It is grateful for the close cooperation of the financial institutions, merchants and business associations participating in this important project.

## **International Developments**

Regulatory reform abroad continues to focus on improving competition and efficiency in card payment systems. Regulators in a number of jurisdictions have also undertaken a variety of consultations and reviews aimed at improving governance and examining the efficacy of existing payment systems. In this context, moves towards real-time retail payments and the introduction of new payment technologies have both received significant attention.

### **Regulatory frameworks, governance and innovation**

In November 2013, the Reserve Bank of New Zealand (RBNZ) announced that it would review the payment and settlement systems that it owns and operates – the Exchange Settlement Account System and the NZClear Securities Settlement System. A consultation paper was released in May 2014 focusing on the likely future needs of both the RBNZ and the industry, with a view to significant upgrades necessary in the near term. The paper refers to the New Payments Platform project underway in Australia to provide real-time retail payments and seeks feedback from users as to their needs in relation to payment speed, innovation and system capabilities. Submissions were sought by July 2014.

In September 2013, the Financial Services Policy Committee of the US Federal Reserve System released a consultation paper on strategic initiatives to address impediments to innovation and efficiency in the US retail payments system. The paper emphasised the 'end-to-end' efficiency of payments rather than interbank issues. Similar to the approach taken by the Board in its Strategic Review of Innovation, the Federal Reserve sought views on some identified 'gaps' in the US payments system, the proposed outcomes that would address these gaps and the Federal Reserve's role in this process.

To address the gaps identified, the Federal Reserve proposed five outcomes to be achieved within ten years, one of which was 'ubiquitous electronic solution(s)' that would allow near-real-time retail payments to be made without knowing the bank account number of the recipient. The submission window closed in December 2013 and a new discussion paper is expected to be released in the second half of 2014. However, some progress has already been made with NACHA – the Electronic Payments Association (formerly the National Automated Clearing House Association) – announcing in March 2014 that it was reviving efforts to introduce same-day Automated Clearing House settlement capability.

In the United Kingdom, legislative changes have been made following the conclusion of the Government's 2013 consultation on improving the governance of the payments system. A new regulator – the Payments System Regulator (PSR) – has been established as a separate body under the Financial Conduct Authority. Similar to the Board's role and responsibilities, the new regulator will have a mandate to promote 'competition, innovation and the interests of end-users', while having regard to the stability of the UK financial system. To address the latter, the Bank of England (which retains responsibility for oversight and regulation of key financial market infrastructure, including recognised payment systems) and the Prudential Regulation Authority will have powers of veto over the PSR's decisions.

The PSR's powers will come into effect in 2015 and extend to any payment system operating in the UK that has been brought into scope by being designated by HM Treasury. Similar to the regime in Australia, once a payment system is designated the PSR will have a range of powers over its participants (operators, infrastructure providers and payment service providers).

The European Central Bank announced in December 2013 that the Single Euro Payments Area (SEPA) Council would be replaced by the Euro Retail Payments Board (ERPB); an entity with a broader membership and mandate. The ERPB is composed of seven representatives from the demand side (e.g. consumers, retailers and corporations) and seven from the supply side (e.g. banks and payment and e-money institutions), compared with five each on the SEPA Council. There are also five representatives from the euro area national central banks and one from the non-euro area European Union (EU) national central banks, all on a rotating basis.

The mandate of the ERPB is to 'help foster the development of an integrated, innovative and competitive market for retail payments' in the EU, but it has no power to impose binding measures. Instead, the ERPB is responsible for formulating common positions and issue guidance and statements on the direction of the development of the EU retail payments market while taking into account the views of end-users. It is expected to pay particular attention to cross-border integration of the payments card market and address aspects of the retail payments market (including business practices, requirements and standards) it deems necessary to achieving its objectives.

## Card regulation

In December 2013, a US federal court judge granted final approval to a settlement negotiated in the long-running litigation between 17 merchants and merchant associations, and MasterCard, Visa and a number of card-issuing banks. The merchants and their associations had alleged that the respondents had colluded in setting credit card interchange fees and placed undue restrictions on merchants. The final settlement of US\$5.7 billion was reduced from US\$7.3 billion after 8 000 merchants opted out of the agreement. Most of the merchants opting out cited the settlement condition that would have prevented them from bringing similar action against the schemes in the future. A group of large merchants who opted out subsequently filed an appeal against the settlement agreement.

Separately, merchants in California, Florida and Texas filed challenges in March 2014 to respective state laws prohibiting merchants from imposing surcharges on credit card payments. Specifically, the merchants are contesting the prohibition on calling the price differential between a cash and credit purchase a 'surcharge', even though the economically equivalent concept of a cash 'discount' is permitted to be communicated. This follows a ruling by a New York federal court judge in October 2013 striking down the state's prohibition on surcharging and filing a preliminary injunction against its enforcement on the grounds that it violated the First Amendment right to free speech.

The challenges to state 'no-surcharge' laws are motivated by settlements reached with Visa, MasterCard and American Express last year, which permit merchants to impose surcharges under certain conditions, provided this is not prohibited by state law. No-surcharge laws are currently in effect across nine states, including California, Florida and Texas; the results of these challenges may have implications for the remaining six states with surcharging bans.

The European Parliament approved an amended package of reforms to retail payment regulations in April, but postponed voting on a draft legislative resolution until after the European Parliament elections. The reform package proposed by the European Commission has two components: a Regulation applying to card-based transactions and an update to the Payment Services Directive. The package is aimed at harmonising regulations across the European Economic Area, recognising new types of services available, and addressing competition concerns in the cards market. If approved, the package would significantly affect European retail payments, with proposed reforms including:

- a cap on interchange fees for domestic and cross-border debit and credit card transactions
- the separation of card schemes and processing entities
- non-discriminatory access for third party payment service providers to payment systems and account information.

