

SUBMISSION TO THE RESERVE BANK OF AUSTRALIA

- LUFTHANSA AIRPLUS SERVICEKARTEN GMBH –

BACKGROUND

- 1 Lufthansa AirPlus Servicekarten GmbH (**AirPlus**) is a global provider of business travel management solutions for corporations.
- 2 Unlike other payment providers whose products are based on a credit card network, AirPlus uses the Universal Air Travel Plan (**UATP**) as platform for its core product “AirPlus Company Account”.
- 3 UATP is a payment network for corporate customers to purchase airline tickets and related services.
- 4 During the payment process, AirPlus collects data on behalf of the customers, processes it and issues a periodical consolidated statement. This is payable to AirPlus. Settlement happens via UATP.

THE A.I.D.A. MODEL

- 5 Not all merchants or airlines are actually merchants of the UATP network (**non-aligned merchants**). To address the needs of customers wishing to book travel with non-aligned merchants, AirPlus developed a model (called **A.I.D.A.**) which allows customers to effect a payment for travel services other than through the UATP network. This payment model is available in various countries worldwide.
- 6 AirPlus markets A.I.D.A. not as a separate product but as means of acceptance enhancements for the AirPlus Company Account.
- 7 A.I.D.A. enables AirPlus customers to pay for travel and related services with non-aligned merchants that accept MasterCard.
- 8 The A.I.D.A. model operates as follows:
 - 8.1 Customers log on to the AirPlus customer portal or use the downloaded software client to request a voucher for travel services from non-aligned merchants.
 - 8.2 The A.I.D.A. software, in conjunction with the Orbiscom technology platform licensed from MasterCard, automatically generates a transaction unique number for the voucher request, following the rules and requirements for a virtual MasterCard Commercial Card Payment Product, based on a MasterCard BIN and a 16 digit card number, and corresponding expiry date and card validation value (CVV) is issued.

- 8.3 The number generated is a unique MasterCard number limited to a one time use for a single transaction with a specific merchant. In other words, each transaction has a unique MasterCard card number.
- 8.4 The non-aligned merchant accepts the MasterCard card number as payment for the travel services.
- 8.5 The MasterCard based transaction is aggregated internally by AirPlus onto the customer's AirPlus Company Account and delivered periodically to the customer; there is no separate MasterCard number based transaction statement.
- 9 Under the A.I.D.A. model, the customer has one contractual relationship for the AirPlus Company Account.
- 10 The corporate customer is invoiced by AirPlus periodically and AirPlus requires payment in full at the end of each billing cycle and there is no ability to transfer the amount outstanding to the next payment period.
- 11 Under the A.I.D.A. model the non-aligned merchant receives its money from its MasterCard acquiring bank. The acquiring bank in turn recovers the funds from AirPlus via the MasterCard settlement network.
- 12 Despite the A.I.D.A model being restricted (as the issue of transaction specific electronic numbers to be used once and with a single merchant), the A.I.D.A model is regarded in Australia as the equivalent of credit card issuing and requires a specialist credit card issuer (**SSCI**) authorisation in the same way that MasterCard and Visa require an authorisation.
- 13 This is despite the fact that both of these entities issue credit cards that are used for multiple transactions with multiple vendors and despite the fact the American Express and Diner's Club issue cards which are assumed by most consumers to be credit cards but which are not prudentially supervised because they are regarded as charge cards not credit cards.

REGULATORY ISSUES

Issue of cards by ADI

- 14 Credit card issuing and acquiring activities in a 'four party' credit scheme were designated on 11 April 2001 by the Reserve Bank as '**banking business**' as defined in Section 5 of the Banking Act and Regulation 4 of the Banking Regulations.
- 15 In the traditional 'four party' scheme there is:
- a cardholder;
 - an issuer of the card;
 - an acquirer being a financial institution serving the merchant; and
 - the merchant.

- 16 There is no definition of a 'credit card' in either the Banking Act or the Banking Regulations.
- 17 In the Standard issued under Section 18 of the Payment Systems (Regulation) Act 1998 (Cth) deeming MasterCard to be a designated payment system, the term '**credit card**' was defined as a 'card issued under the rules of a scheme than can be used for purchasing goods or services on credit or any other article issued under the rules of the scheme and commonly known as a credit card.'
- 18 '**Credit card issuing**' is defined in regulation 2(2) of the Banking Regulations as follows:
- 'if the person issues a credit card to another person (a customer) and:
- (i) receives payments from the customer for amounts owed by the customer, under the terms governing the credit card, for credit card transactions; or
 - (ii) pays, or accepts liability to pay, a credit card acquirer (either directly or through another person) for amounts paid or payable by the acquirer to a merchant for the customer's credit card transactions.'
- 19 A '**credit card issuer**', by definition in the Banking Regulations, is a person who undertakes the liability to pay a credit card acquirer for its customer's credit card. There is no distinction made in relation to volume or usage.
- 20 Implied in this regulation is the concept that there is a physical card issued to a client that is then used to purchase any number of goods or services from a number of merchants that honour that card. The one card is used for multiple transactions with multiple merchants and often for unlimited amounts.
- 21 This is the premise on which the access system is based and it requires the issuer of the card to be an entity authorised as a SCCI.

Virtual card scenarios

- 22 The present access regime does not recognise that there can be situations, such as the A.I.D.A. system, where no physical card is issued but a transaction unique number is generated that can only be used in a specific transaction and honoured by a limited number of merchants (namely the travel services providers and airlines).
- 23 This means that it is possible to provide a non-cash payment facility for customers while being regarded under the Banking Act as a 'credit card issuer' merely because a designated payment facility provider (MasterCard) has agreed to issue a unique transaction number to give to the client for a specific purchase made with a single merchant.

Public interest issues

- 24 The requirement that an SCCI requires an APRA authorisation to carry out a limited range of banking activities was intended to open up competition in Australia by allowing non-financial institutions to engage in credit card issuing and/or acquiring activities.
- 25 Neither American Express nor Diners Club is regulated in Australia as an SCCI, despite the size of their operations and the value of the purchasing transactions which are facilitated by their usage. They are considered to be issuers of charge cards as opposed to credit cards. This distinction is not well known with many Australians referring to these cards as credit cards.
- 26 While not as onerous as the requirements for authorisation as an ADI, the authorisation requirements and the prudential standards applicable to SCCI's are still significant and require ongoing capital and solvency requirements, risk management systems including credit underwriting policies, large exposure policies, merchant screening and three year business plans including current and targeted cardholder demographic composition.
- 27 The cost of applying for authorisation as a SCCI and the subsequent cost of APRA's supervision is grossly disproportionate to any potential public interest merit in requiring the company only using transaction specific computer generated number to seek an SCCI authorisation.
- 28 Entities such as AirPlus are not in the business of issuing credit cards. It is in the business of providing services to corporate customers in the purchase of corporate travel services and a centralised billing and itemisation of those service costs and arrangements.

Anomalies

- 29 Several forms of non cash payment facilities have had declarations under section 9(3) of the Banking Act making them exempt purchased payment facilities.
- 30 Currently exempted are gift card facilities, loyalty schemes, and limited value facilities even though in each of these cases the stored value permitted on the card can be far in excess of the amount of money a customer with an electronically generated unique number can spend on a single transaction under the A.I.D.A. system.
- 31 The A.I.D.A. system shares similar characteristics to these exempt facilities:
- 31.1 The gift card can be redeemed at only a single store or related chain of stores;
 - 31.2 The redemption must take place within a limited time period
 - 31.3 There is a maximum amount which can be spent
 - 31.4 There can be no additional amounts added to the value that can be spent.
- 32 However in terms of regulation ,the gift card and related other stored value cards are in most instances exempt from APRA authorisation requirements or APRA supervision as well as exempt from AFS licensing by virtue of the exemption given by the section 9(3)

declaration.

- 33 From a public interest perspective this is an inconsistent position. It is possible to be the issuer of stored value cards for significant amounts of retail customer usage and be unregulated but if you facilitate the issue of a single transaction specific number for use by a corporate customer with a specific merchant you require both an AFS licence for non cash payment facilities and an APRA authorisation as an SSCI.

Consumer credit providers

- 34 A similar inconsistency exists with the application of the NCCPA. Credit providers require an Australian Credit licensee (ACL) if loans are made to consumers for loans for personal or domestic use.
- 35 ACLs are issued by ASIC not APRA and there are no specific solvency requirements for such credit provider merely the requirement that licensees have adequate financial resources as required by s47(1)(l) of the NCCPA. ACL are responsible for deciding how to comply with their financial resource requirements. There is no prudential supervision and the aggregate amount of monies on loan to consumers is unlimited.
- 36 The regulatory regime for a credit provider is significantly less onerous both in terms of licensing and ongoing supervision than compared to that applying to an entity wishing to issue a transaction specific transaction number under A.I.D.A that may incur a financial liability on average of no more than \$5,000 - \$6,000 and the client is a corporate entity and the merchant is obviously not a consumer within the meaning of the NCCPA .

Public Interest Issues

- 37 It is difficult to reconcile how credit liabilities to the consumer market can be provided on an unlimited basis without prudential regulation regarded as a requirement (and for unlimited terms such as with home mortgages) but prudential supervision is required to issue an electronic number to a corporate client for a single relatively small value transaction.
- 38 The basis for this regulatory anomaly is the assumption that regulation of credit cards within an ADI based system requires a bank to be an issuer of physical cards with multi-merchant application, whereas this is not always the case as can be seen by the use of electronic platforms generating unique electronic transaction specific numbers in lieu of cards.
- 39 This premise lies beneath each of the three options raised in the RBA discussion paper. It overlooks how the generation of electronic payments models are shifting payment channels away from traditional ADI based systems to ones where the payment channels are dominated by new service providers. These providers such as telecoms and technology providers whose alternative payment regimes are providing the 'unbanked' with payment mechanisms using prepaid airtime.

- 40 This new form of payments system uses mobile phone infrastructure and mobile agents to bypass banks and other financial institutions from the customer level.
- 41 One such example is the Safaricom M.Pesa model where master agents buy and sell cash from Safaricom, make it available to subagents who use their own customer's mobile phone balances without the involvement of traditional financial institutions in the payment, delivery or clearing and settlement processes. In 2010, Safaricom reported that M-PESA transactions in Kenya alone included U.S. \$320 million per month in person to person mobile payments ¹
- 42 In places such as South Africa, Kenya and the Philippines mobile phone operators have already commoditised airtime to replace cash and barter transfer systems and surplus airtime can be bought and sold to third parties or agents of the network.²
- 43 Mobile enabled person-to-person payments and mobile money transfer systems are already well established throughout the world and their increasing popularity with consumers indicates that consumers regard these as valid alternatives to traditional financial institutions.
- 44 This is a clear example of technology enabling consumers to make their own choices and they appear to be choosing to go outside the traditional banking systems.
- 45 Creating barriers to entry or requiring prudential supervision of electronic platforms which issue electronic numbers as the equivalent of main stream issuers of credit cards is not in the public interest.
- 46 The existing access regimes protect the status quo by forcing some service providers to fit inside a regime that was designed for cards issued for multi transaction multi merchant use. This creates significant regulatory and cost disadvantages to these entities that are competing with other providers that are unregulated.
- 47 The increasing proliferation of person-to-person payments using mobile phone technology is cross border and instantaneous as well as rapidly gaining in popularity while the access regime is cumbersome and slow to respond.

¹ Ignacio Mas & Dan Radcliffe 'Mobile Payments go Viral: M-PESA in Kenya' 2010 (unpublished archived at The World Bank quoted in Promoting Responsible Financial Inclusion: A risk based approach to supporting mobile financial services expansion by Maria C. Stephens 330 Banking and Finance Law Review 27.B.F.L.R. at page 333

² ICT Regulation Toolkit 2010 Examples of Financing Services Using Mobile Phones <http://www.isctregulationtoolkit.org/en/practiceNote.3096.htm>

SUMMARY

- 48 In the ten years since Australia's payments access regime was developed there has been a proliferation of electronically generated payment mechanisms that challenge the traditional models requiring the involvement of a financial institution in the model.
- 49 The present access regime is cumbersome and has not kept pace with the advances in technology.
- 50 As a result of advances in technology it is possible to have electronic transactions using mobile phones that are not regulated by the payments regime. This results in significant amounts of money on circulating stored value cards which are exempted from APRA supervision despite being payment mechanisms,
- 51 Additionally, unlimited credit liabilities of consumer credit providers exist that are not prudentially supervised, while an APRA authorisation as an SSCI is required to allow for the issue of electronic transaction numbers for use with a specific merchant, a specific transaction (and for relatively modest amounts of money).
- 52 The access regime is not protecting the public nor is it opening Australia up to competition. At the same time, alternative payments systems that mimic financial functions are being developed and expanding rapidly and are unregulated.
- 53 AirPlus agrees with the statement of the RBA that the access regimes in their current form are no longer fulfilling their original objective and are preventing prospective scheme participants from entry and so reducing completion in the Australian market.
- 54 The existing concepts of issuing and acquiring activities within a credit card system do not reflect the use of technology in the processes and have only served to entrench the existing card issuers.
- 55 AirPlus submits that the present definition of 'credit card issuing' and the requirement that an entity that is merely passing on an electronically generated number applicable to a single transactions require authorised as an SSCI simply because the number is issued by MasterCard or Visa is creating a barrier to entry into Australia that is disadvantageous to the Australian market and is not protecting financial stability but rather stifling innovation.
- 56 When considered in the context of other areas of the Australian market that are not prudentially regulated, such as charge cards, credit and exempt payment systems, this anomaly is not serving the Australian public and is likely to accelerate the movement towards non- financial institutions offering alternative payment systems as is happening in the mobile phone person-to-person models.