



TAILORED FINANCIAL SOLUTIONS

National Australia Bank Limited  
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**5 April 2001**

**Mr. I. J. Macfarlane  
Governor  
Reserve Bank of Australia  
65 Martin Place  
SYDNEY NSW 2000**

Dear Ian

### **THE AUSTRALIAN RETAIL PAYMENTS SYSTEM**

In my letter to you of 26<sup>th</sup> March 2001 I noted that we were pleased to have been invited to consult with you prior to the Reserve Bank of Australia (*RBA*) deciding whether or not to “designate” the Australian credit card system. My colleagues Ross Pinney, Peter Thomas and Geoff Bennett have had a constructive meeting with Dr. Laker, Dr. Veale and Ms. Bullock on 28 March 2001. We thought it might be helpful if we summarised our views on the matters discussed at that meeting, as well as raising some additional matters for the RBA’s consideration.

If the RBA decides to designate the Australian credit card system, the National is keen to work closely with the RBA to achieve the most favourable outcome from that process for all stakeholders. However, the ongoing litigation brought against the National by the Australian Competition and Consumer Commission (*ACCC*) is a substantial hindrance to a successful, efficient and co-operative outcome.

#### **The litigation**

The National rejects the *ACCC*’s allegation that it has engaged in price fixing in respect of credit card interchange rates in breach of the *Trade Practices Act*. If required to do so, it will continue to vigorously defend the litigation. As a result of the allegations made in the litigation, the National has had no alternative other than to join 30 other parties to this litigation, including the major banks, CUSCAL, VISA International, MasterCard and a number of smaller institutions. The litigation will constrain the National and these other parties to the litigation in exchanging information with the RBA as part of developing a co-operative resolution of the RBA’s concerns. Suffice it to say that dropping the case will make the task of the RBA, the National and the other respondents to the action, a great deal simpler.

#### **Guiding principles in relation to designation**

Should the RBA decide to designate, the National believes that its decision to do so and the scope of the designation, should be based on a number of broad principles, including the following:

1. **The Australian retail payments system should be considered as a whole.**
2. **Competition between the various participants in the Australian retail payments system should be on a “level playing field”, consequently:**
  - (a) **the closed credit card schemes; and**
  - (b) **Australian dollar denominated credit cards issued by foreign institutions for use in Australia,****should fall within the scope of any RBA designation of the open credit card schemes.**
3. **Participation in the open credit card schemes should be open to all subject to appropriate prudential, technical and regulatory criteria.**
4. **Pricing should be transparent to consumers and based on user pays principles.**
5. **Cross-subsidisation should be minimised.**
6. **Consumers should be the beneficiaries of reform.**

**We set out our comments on each of these principles below.**

1. **The Australian retail payments system should be considered as a whole.**

**The efficiency, profitability and benefits to the Australian community of open credit card schemes should be reviewed in the context of the entire Australian retail payments system, including cash, cheques, the closed credit card schemes, direct debit and credit, and eftpos.**

2. **Competition between the various participants in the Australian retail payments system should be on a “level playing field”**

**In the National’s view, if the RBA designates the open credit card schemes, it should also designate similar systems within the Australian retail payments system. This will ensure that participants in the Australian retail payments system do not enjoy an advantage or suffer a detriment by reason of uneven regulation.**

- (a) **The closed credit card schemes should fall within the scope of any RBA designation of the open credit card schemes**

**The National considers that any designation which applies to the open credit card schemes should also apply to closed card schemes. In this regard, we note that, for the purposes of designation, there seems to be no valid distinction between the open and closed credit card schemes. For example, VISA card “transactors” use their cards in the same way as American Express charge cardholders. Both schemes allow deferred payment without interest cost (provided the monthly repayment is made on the due date), both provide a monthly**

**statement detailing usage and both may provide benefits such as loyalty programs.**

**The fact that American Express has an implicit interchange rate and VISA an explicit one, and that American Express is a closed scheme with no members (although we note the multiplicity of agency issuing agreements that American Express has entered into with local institutions) and VISA is an open scheme with membership rules, does not justify regulating one scheme but not the other.**

**Further, there is strong anecdotal evidence that the average merchant service fee charged by the closed schemes is higher than that charged by the open schemes' members.**

**Failure to include the closed schemes within the ambit of the designation will lead to the perverse result that the more expensive closed schemes will continue to thrive at the expense of the cheaper open schemes, through their ability to continue providing attractive benefits, such as loyalty schemes, to their cardholders.**



- (b) Australian dollar denominated credit cards issued by foreign institutions for use in Australia should fall within the scope of any RBA designation of the open credit card schemes**

**The National also considers that any designation which applies to the open credit card schemes should apply to Australian dollar denominated credit cards issued by foreign institutions for use in Australia.**

**The use of such cards in Australia would attract the international default interchange rate, which is higher than the current domestic interchange rate (and would presumably be higher than any interchange rate which resulted from the designation process). If this was the case, the foreign institutions that issue these cards would have a distinct advantage over the issuers of cards in designated schemes because they would be able to use their higher interchange rates to offer cardholders better loyalty programs.**

- 3. Participation in the open credit card schemes should be open to all subject to appropriate prudential, technical and regulatory criteria**

**Participation in the open credit card systems should be open to all, provided that all participants are required to meet the same degree of technical competence, financial soundness and regulatory oversight. This broad principle should apply equally to the open credit card schemes as to other parts of the Australian retail payments system. Changes to the membership rules of the open credit card schemes should be carefully structured so as not to introduce unwarranted risk into the Australian retail payments system.**

**4. Pricing should be transparent to consumers and based on user pays principles.**

**Adoption of user pays and fully transparent pricing will ensure that the correct price signals are sent to consumers and this should in turn contribute to the economic efficiency of the system.**

**5. Cross-subsidisation should be minimised**

**Cross subsidisation between different types of payment instruments and other financial services products should be minimised to the extent practicable. In particular, we note that for many years the open credit card schemes in Australia have subsidised the eftpos network.**

**6. Consumers should be the beneficiaries of reform**

**Any cost savings which result from the proposed reforms to the Australian credit card system should flow through to the end consumers and should not be allowed to bolster merchants' profit margins. In this regard we shall be formally requesting the ACCC to monitor retail prices to ensure that cost savings are passed on to consumers in full.**

**Potential consequences of designation and other relevant issues**

**As the RBA considers the desirability of designating the credit card schemes there are a number of other issues which the RBA may wish to consider.**

**These issues flow from the RBA's stated reform objectives, namely:**

- to broaden the membership of the international card schemes beyond regulated deposit taking institutions;**
- to reduce interchange fees to a level that reflects only costs related to network considerations; and**
- to eliminate the "no surcharge " rule.**

**We have briefly set out a non-exhaustive summary of the potential consequences of designation and other relevant issues below:**

**1. Foreign investment**

**If an overly prescriptive regime is introduced as a result of the designation process, this may act as a deterrent to foreign investment in Australia.**

**2. Future investment in payment systems**

**Considerable time and a great deal of money has been invested in order to develop the Australian credit card business. An outcome that substantially reduces the profitability of the credit card business will act as a strong disincentive to make further investments in payment systems. In addition some investment is driven by prudential and regulatory requirements. For example, Triple DES in**

**the credit card business and Continuous Linked Settlement in foreign exchange settlement.**

**3. Smaller financial institutions**

The National believes that a significantly lower interchange rate will have a far more serious impact on the smaller issuers of credit cards than the larger issuers. We have in mind particularly the credit unions and building societies which use credit cards as a means of providing low cost transaction accounts. The smaller organisations are also the principal issuers of VISA and MasterCard debit cards, a service to their customers that we believe provides them with significant income.

**4. Repricing of other services**

A significant reduction in the interchange fees and an adherence to the principles of “user pays” and no cross subsidies, may lead to a repricing of credit card services and the elimination of some cardholder benefits. The same principles will also probably lead to a restructuring of the pricing for eftpos, particularly as regards merchants.

**5. Smaller merchants**

The open credit card schemes provide the smaller merchants with the ability to provide delayed payment or extended terms to their customers. This service can be viewed as an outsourcing of the smaller merchants’ credit ledgers. If as a result of the proposed reforms there is a significant shift away from credit card usage to eftpos this will have the possible consequences of:

- (a) reducing consumer spending with a consequent impact on the economy generally, and
- (b) providing the major retailers, which issue their own store cards, with a distinct advantage over smaller retailers.

**6. No-surcharge rule**

Although there are some sound arguments for the “no surcharge” rule in some business sectors, the National as a practical matter does not oppose its abolition. However, if the rule is abolished it should follow that merchants are also allowed to impose a surcharge for other payment mechanisms, including cheques and cash, both of which have high handling costs. This may introduce an element of confusion to consumers at the check out counter.

**Conclusion – other matters**

If a designation process is to occur, the National is keen to ensure that there is no risk that in giving effect to any regulation introduced by the RBA the National (and other participants) in any way contravene the *Trade Practices*

**Act. At the appropriate time, we would be very pleased to co-operate with the RBA to ensure that the designation process is not affected by this uncertainty.**

**In closing let me reiterate that the National is very willing to work with the RBA toward reform of the credit card system.**

**Yours sincerely,**

**(Signed)**

**F J CICUTTO**