

Review of Card System Access Regimes: A Consultation Document

MAY 2013

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Reserve Bank

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1. Introduction

As part of its payments system reforms, the Reserve Bank introduced access regimes for the MasterCard and Visa credit card systems in 2004 and for the Visa Debit system in 2005.¹ These access regimes were largely designed to expand access to the card schemes in Australia and stemmed from the concern that the schemes' restrictions on entry had not struck the right balance between competition in the payments system and the financial safety of the schemes, and were therefore not in the public interest.

The access regimes have allowed new entrants that would otherwise have been ineligible for scheme membership to participate in the card schemes without compromising the financial safety of the schemes. The reforms have promoted efficiency and competition in the provision of credit and debit card payment services to merchants and cardholders by facilitating the participation of institutions that specialise in card issuing, acquiring, or both, but that do not conduct other banking business.

It has become clear from recent developments, however, that the access regimes in their current form may no longer be fulfilling their original objective. Indeed, they may now be preventing prospective scheme participants from entry. The Reserve Bank is now considering whether changes to these regimes may be appropriate. Section 2 of this consultation document sets out the background to the access regimes and potential issues that have arisen. Section 3 outlines some preliminary policy options and Section 4 provides further discussion on those options. Section 5 looks at issues for consultation and Section 6 provides details of the next steps.

¹ An access regime was also imposed on the Bankcard system, which ceased operation in 2006.

2. Background and Potential Issues

Background

Conditions of access to card schemes have the potential to affect payments system competition and efficiency. High barriers to entry are likely to entrench the market power of incumbents, while if there are low barriers to entry, competition can be effective even where the market is quite concentrated. This was highlighted in the Final Report of the Financial System Inquiry (the Wallis Committee).² Among other things, the Inquiry noted that the rules of the MasterCard and Visa credit card systems were not transparent and might limit membership to the then existing range of financial institutions. A particular concern was that card scheme rules might be used to restrict the ability of non-deposit-taking institutions to compete in new payment technologies.

The issue of access was examined further in a study ('the Joint Study') conducted in 2000 by the Bank and the Australian Competition and Consumer Commission (ACCC).³ 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.

The Joint Study recognised that there may be good reasons why card issuers should be required to be of sound financial standing. The card networks are built around arrangements that ensure the merchant will be paid even if the institution that issued the card cannot meet its obligations, which may have implications for other members of MasterCard and Visa. This means that there is a need to provide some confidence that new participants do not impose significant settlement risks on the system – a concern that the schemes addressed by restricting issuing (and therefore also acquiring) to supervised financial institutions. The Joint Study therefore concluded that restrictions on issuing could be justified if their aim was to ensure that issuers were able to meet their obligations and would not disrupt the credit card system; the Study also recognised that the ADI requirement had been an effective screening device for the schemes.

However, the Joint Study found that participation criteria based on institutional status may have created higher barriers to entry than those necessary to ensure the security and integrity of the card schemes.⁴ Issuers did not need to be deposit takers, for example, and cards could be issued by non-financial institutions that

2 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>>.

3 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>>.

4 In addition to the criteria for participation, the Joint Study also examined the price of entry to the credit card schemes. It found that MasterCard and Visa membership fees were relatively low and did not appear to act as a deterrent to entry.

were financially sound without adding settlement risks to the system. The Study saw no justification for the requirement that acquirers also had to be issuers – as net receivers of funds from card issuers (which are passed on to merchants), acquirers do not generally introduce significant settlement risk to the system. While the Joint Study noted that there were other attributes that a card scheme may find desirable in an acquirer (e.g. the ability to process transactions in an efficient and reliable manner, to bear the risk of merchant fraud, and to bear the chargeback costs if a merchant failed without having delivered goods already paid for by cardholders), none of these attributes required the acquirer to be an ADI.⁵

To address these concerns, the 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 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 expanding 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.⁶ 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. The Bank subsequently imposed access regimes on the MasterCard and Visa credit card systems following extensive consultation; the regimes took effect in February 2004.⁷ The access regimes, aimed at improving competition and efficiency in the provision of credit card payment services, require that any ADI be eligible to apply to participate in the MasterCard and Visa credit card systems in Australia.⁸ They require the schemes to not discriminate between types of ADIs, including SCCIs, 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 scheme member, subject to the requirements of the access regimes.

In 2005, Visa advised the Bank that its international rules may have operated to prevent SCCIs from joining the Visa Debit system and that an SCCI intending to acquire both Visa credit and debit card transactions might not be able to join the scheme. The Payments System Board (the Board) decided, after consultation, to impose an access regime on the Visa Debit system to ensure that SCCIs are eligible to join the Visa scheme to provide services to merchants accepting both Visa credit and debit cards.⁹ The Access Regime for the Visa Debit System is largely the same as that imposed on the Visa credit card system.

The intent of these reforms was to widen the eligibility criteria for scheme membership and thereby open up access to these systems, and at the same time minimise any risks to the payments system as a whole. Of the 15 to 20 direct issuers and acquirers in the MasterCard and Visa systems in Australia, two are SCCIs that gained access under the regime introduced in the early 2000s.

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

6 See regulation 4 of the Banking Regulations 1966.

7 The Access Regime for the MasterCard Credit Card System is available at <<http://www.rba.gov.au/media-releases/2004/pdf/mr-04-02-gazette-notice-mastercard.pdf>>, and the Access Regime for the Visa Credit Card System is available at <<http://www.rba.gov.au/media-releases/2004/pdf/mr-04-02-gazette-notice-visa.pdf>>.

8 The same requirements were placed on the Bankcard system.

9 The Access Regime for the Visa Debit System is available at <<http://www.rba.gov.au/media-releases/2005/pdf/mr-05-10-gazette-notice-access-regime.pdf>>. Differences in the rules of MasterCard and Visa meant that such an access regime was not necessary for the Debit MasterCard system.

Potential Issues

In the Bank's assessment, the access regimes represented a balance between competition and financial safety. However, a number of issues have arisen in more recent years such that the reforms may no longer be fulfilling their original objectives. These issues are discussed in the sections that follow.

Before proceeding, it should be noted that aside from the Bank's access regimes, other regulations may also affect prospective participants' eligibility to participate in the card schemes. In particular, the *Banking Act 1959* stipulates that the only entities that may carry on 'banking business' are ADIs, the Reserve Bank of Australia, and entities that are granted an exemption from the requirement. 'Banking business' is defined in the Banking Regulations 1966 to include credit card acquiring and credit card issuing, if undertaken by a participant in a credit card scheme designated as a payment system under section 11 of the *Payment Systems (Regulation) Act 1998* on 11 April 2001 (i.e. the MasterCard and Visa credit card systems).¹⁰ Therefore, even without the Bank's access regimes in place, a prospective credit card acquirer or issuer can only participate in those systems if they have been authorised as an ADI by APRA or have been granted an exemption from the requirement.

Access regimes as a barrier to entry

The access regimes were originally designed to lower barriers to entry and, as noted above, have allowed more participants into the MasterCard and Visa systems while minimising risks to the payments system. More recently, however, the access regimes appear to have had the potential to prevent some entities from participating in the schemes when they might otherwise have been able to do so. Accordingly, they may no longer represent an appropriate balance between competition and financial safety.

Prospective participants may be discouraged from entry because the access regimes impose a regulatory burden – that of prudential supervision by APRA – that may be more onerous than necessary given the nature of their operations and financial standing. For instance, the combination of the Bank's access regimes and regulatory requirements administered by APRA currently require an entity wishing to become a MasterCard or Visa acquirer to go through the same ADI authorisation process and ongoing prudential supervision as a prospective issuer, despite posing arguably less risk to the payments system. Equally, financially sound merchants wishing to acquire their own transactions may also be discouraged from doing so by the combined regulatory requirements of the Bank's access regime and banking legislation.

The Bank is aware of an increasing number of entities – often foreign corporations focusing on non-traditional products such as 'virtual cards' – with an interest in undertaking credit card issuing or acquiring activities, and not other banking business, in Australia. At the same time, both MasterCard and Visa have expressed an inclination to accept a wider range of participants into their systems. This may reflect, in part, the change in the corporate structure of the schemes, with the shift from member-owned associations to public companies. It may also reflect the nature of the new products offered by the prospective entrants and the fact these entities may already be subject to prudential supervision overseas. Yet these prospective participants would not be eligible to participate under the Bank's access regimes unless authorised by APRA as ADIs. It is therefore possible that the regimes are now contributing to a higher barrier to entry than would be the case in their absence.

¹⁰ 'Designation' is the first of a number of steps the Bank must take to exercise its powers over a payment system under the *Payment Systems (Regulation) Act 1998*, 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.

The requirement that participants must be ADIs also means that the Reserve Bank, in its capacity as a provider of banking services, is not eligible to apply to become a participant in the MasterCard and Visa systems because the Bank is not an ADI.¹¹ The Bank is a banker to various government departments and agencies, and in this capacity provides card acceptance services indirectly to some customers (using the services of other financial institutions); in the future, it may wish to acquire card transactions directly for those customers. To do so, the Bank would need to seek membership of the relevant schemes. While it would currently be able to do so for the eftpos scheme, the access regimes for the MasterCard and Visa schemes would prevent the Bank from participating in those systems because it is not an ADI.¹²

The merits of the Reserve Bank participating in schemes in its role as banker to a range of government agencies are not considered in this consultation.¹³ However, it is appropriate for the Board to consider whether the access regimes should continue to prevent Reserve Bank participation. In doing so, there are a number of issues that may be taken into account.

First, it may be undesirable for regulatory arrangements to allow the Bank – in its banking business activities – to participate in one card scheme (eftpos) and not in other competing schemes. Such a position would not place the schemes on an equal competitive footing. Second, participation by the Reserve Bank does not bring additional risks to those systems, given the lack of credit risk posed by the Bank. Third, to the extent that there are any conflicts of interest between the Bank’s regulatory function and its participation in the schemes at an operational level, these would need to be properly managed. In particular, the Board would need to ascertain that the Bank’s policy on managing potential conflicts of interest arising from the Bank’s commercial activities was being observed.¹⁴

Transfer of costs to the prudential regulator

To an extent, the current regulatory framework transfers the cost of screening the soundness of current and prospective members of the card schemes to APRA. This reflects the arguments made at the time – and acknowledged by the Board – that there was merit in using APRA’s prudential oversight as a screening device, which was more objective than scheme-set criteria and which reduced the risk that the schemes would apply variable standards or that existing members might use their position inappropriately. However, the question now arises as to whether these arguments remain appropriate in light of the change in the schemes’ corporate structure and the nature of some prospective participants’ activities. In particular, risks to the system may be small if a prospective participant has only limited business in Australia, concentrating on niche market segments (e.g. issuing virtual cards to travel agents). In such a case, it may be more appropriate for the schemes to bear the cost of screening and ongoing monitoring of these entities. The cost of assessment is likely to rise for APRA with the number of enquiries from prospective participants. A broader issue to consider is whether prudential regulation of all participants is appropriate.

11 The Bank is empowered under section 8 of the *Banking Act 1959* to conduct banking business as the Reserve Bank without ADI status.

12 The scheme rules for the eftpos system do not limit eligibility for participation to supervised financial institutions only, but instead allow an applicant with ‘sufficient financial resources to fulfil its obligations as a Member’ to be eligible. In addition, debit card acquiring is not defined as ‘banking business’ under the *Banking Act 1959* or the *Banking Regulations 1966*. Hence, entities undertaking this activity in the eftpos system need not be ADIs.

13 These are not matters for the Payments System Board, but are rather for consideration by the relevant department and the management of the Bank on commercial grounds.

14 The policy, *Managing Potential Conflicts of Interest Arising from the Bank’s Commercial Activities*, is available at <<http://www.rba.gov.au/payments-system/policy-framework/conflict-of-interest.html>>.

3. Policy Options

In light of the issues discussed above, the Bank has identified three broad policy options – varying the access regimes to expand eligibility to a larger range of entities; revoking the access regimes; and maintaining the status quo. It should be noted that regardless of the option chosen, the Banking Regulations 1966 would also have implications for whether entities that are not ADIs could participate in credit card systems as card issuers or acquirers.

Option 1: Vary the Access Regimes to Widen Eligibility for Participation

Under this option, the access regimes would be retained but varied to widen the range of entities eligible to participate in the MasterCard and Visa schemes. This option thus recognises both the continuing relevance of the original rationale for imposing the access regimes and the desirability of expanding access in light of recent developments.

Several approaches are possible under this option. The access regimes could be modified in a prescriptive way to provide access for a specified class of entities that is broader than ADIs. For example, they could either include all entities conducting banking business in Australia, or those with an Australian credit licence (ACL). The first would allow the Reserve Bank (which is permitted to conduct banking business under legislation but is not an ADI) to participate in the schemes, but would not extend eligibility to any other prospective entrant that is not currently eligible. By contrast, using holders of an ACL as a threshold could allow a wider set of participants to become eligible. However, given the fact that the ACL regime relates to ‘consumer credit’, this approach may not be a means of expanding access to prospective participants focused on business-to-business payments or solely on acquiring. In addition, in the absence of other criteria, merely being an ACL holder may not be sufficient in terms of the management of potential risks arising from participation.

The class of eligible entities could also be expanded by specifying the nature of activities undertaken (beyond ‘banking business’) rather than by the institutional status of these entities. New eligibility thresholds could be created to cater for different classes of prospective participants, targeted to risks they may bring to the system.

Another approach is to vary the access regimes to specify that ADIs are the narrowest class of participants that must be eligible for participation, but that entities that are not ADIs may also participate. This would have the advantage of maintaining an obligation on card schemes to allow at least the entities currently eligible for participation to continue being eligible, while allowing the schemes themselves to expand eligibility beyond this minimum.

While Option 1 has a number of benefits, it raises the possibility that ADIs would be competing in the same business activities as non-ADIs that are subject to less onerous regulatory requirements. This may result in an uneven playing field or encourage regulatory arbitrage. The scope for such arbitrage would, however, be limited to the narrow range of activities that such non-ADIs may be able to undertake.

Option 2: Revoke the Access Regimes

Enabling the schemes themselves to determine eligibility for access may be appropriate if there are minimal risks to the payments system as a whole and no adverse competition or efficiency issues from doing so. This would represent the most straightforward approach to widen access.

Two general approaches are possible if the access regimes were to be revoked. Voluntary undertakings on access – including some specific criteria for eligibility – could be obtained from MasterCard and Visa, or the schemes could be allowed to determine their own participation criteria without influence from the Bank. Both approaches could offer greater flexibility than the more prescriptive approaches under Option 1. It should be noted that greater flexibility is currently built into the scheme rules, extending eligibility in some jurisdictions.¹⁵

With either of the approaches under Option 2, the Board would need to be satisfied that any additional flexibility provided by removing the access regimes would be in the public interest. In particular, the Board would need to be confident that barriers to entry similar to those that existed prior to regulatory action by the Bank and APRA would not re-emerge; the Bank notes that at least one current participant in the MasterCard and Visa systems would not have gained entry without the access regimes. However, both schemes have indicated a willingness to admit a wider range of members than previously, subject to certain criteria. The Board would also have to be mindful of a risk at the other extreme – namely that the schemes, in competing for business, may weaken eligibility criteria too far and potentially compromise the financial safety of the systems.

One possible way to address these concerns would be for the Board to make an in-principle decision to remove the access regime for each card scheme only when the scheme has put in place, and published, a satisfactory set of access criteria. Alternatively, the Bank may choose to seek a greater level of assurance that the schemes will adopt a satisfactory approach to access on an ongoing basis through voluntary undertakings.

A relevant consideration under Option 2 would be that – even if suitable undertakings were provided to the Bank – the private remedies currently provided by sections 16 and 17 of the *Payment Systems (Regulation) Act 1998* would cease to be available. Specifically, a person denied access would no longer have a statutory entitlement to ask the Bank to give a direction, and no longer have the right to apply to the Federal Court for an order for compliance and/or compensation.

Option 3: Maintain the Status Quo

A third option, which is required to be considered under the Commonwealth's regulatory guidelines, is to maintain the access regimes in their current form. This would be appropriate if it were decided that the existing access regimes continue to strike a suitable balance between the capacity for scheme operators and participants to manage risks and the ability for prospective participants to join.

One benefit of the status quo is that the criteria for eligibility are clear, objective and non-discriminatory. As discussed in Section 2, however, the access regimes in their current form may no longer be fulfilling their original objectives. In particular, new narrow business models are emerging which might not warrant prudential supervision as an ADI, which would nonetheless be required under the current regime. At the same time, the card schemes appear to be willing to consider admitting the entities operating with these models without ADI status. In combination, this suggests that the access regimes may no longer be lowering the barriers to entry.

¹⁵ For instance, in some circumstances non-prudentially supervised entities may be admitted.

There are also costs for APRA relating to processing enquiries and applications from potential entrants wishing to become ADIs and the ongoing supervision of these entities if authorised. These costs have the potential to increase with the number of prospective scheme participants. Depending on the nature of risks to the financial system raised by these entities, it is possible that the benefits of the current level of prudential supervision required by the access regimes (in conjunction with banking legislation) may no longer outweigh the costs.

Moreover, this option has implications for the competitive position of the MasterCard and Visa schemes. Option 3 would mean that – should it decide to become a direct acquirer of card payments in order to offer improved services to its customers – the Bank could seek to become a member of the eftpos scheme but would not be in a position to do so for the competing MasterCard and Visa schemes.

4. Discussion

Under sections 14 and 15 of the *Payment Systems (Regulation) Act 1998*, the Bank may vary or revoke an access regime if the Bank considers it appropriate, having regard to:

- (a) whether varying or revoking the access regime would be in the public interest; and
- (b) the interests of the current participants in the system; and
- (c) the interests of people who, in the future, may want access to the system; and
- (d) any other matters the Reserve Bank considers relevant.

In line with the discussion in the preceding sections, the Bank is seeking views on whether the access regimes in their current form are appropriate. These regimes may no longer be in the public interest as they may be impeding competition and efficiency in the payments system. Prospective participants in the MasterCard and Visa systems that are otherwise financially sound may be discouraged from entry by the requirement to be prudentially supervised in Australia. There is little justification to exclude such prospective participants if they do not introduce additional risks to the payments system; indeed, allowing the current access regimes to remain may limit competition from new entrants, ultimately resulting in less innovation, higher prices and less choice for end users.

However, it is not clear whether the access regimes should be varied or revoked. Any reform should strike a balance between increasing competition in the provision of card services (and thereby increase the efficiency of the payments system) and maintaining the safety of the payments system. Before making any decision, the Board will need to obtain more information on the rules and procedures that the schemes have in place to address the risks arising from participation. It will also need information on any criteria proposed by MasterCard and Visa to assess whether an entity is eligible to apply for access should the Bank's access regimes be revoked.

Notwithstanding the absence of this detailed information, it would appear that specifying ADIs as the narrowest class of entities eligible for participation under amended access regimes (Option 1) or removing the access regimes, with undertakings in their place (Option 2), would address some of the issues outlined in Section 2 while allowing for flexibility to keep pace with potential changes to the nature of participation (e.g. technological change).

These approaches have the advantage of maintaining a degree of objectivity in determining whether an entity is eligible to participate, such that a scheme (or its members) is largely prevented from using entry criteria to discriminate against some prospective participants. At the same time, both approaches would allow the schemes themselves more freedom in forming the criteria for participation (beyond any minimum required by regulation or undertaking) that are best suited to that scheme.

Both approaches would also address the issues of regulatory neutrality outlined in Section 2, should the Bank consider participating in the MasterCard and Visa systems in its capacity as a provider of banking services. This would not pose additional risks to the schemes – indeed, the aggregate risk of any scheme in which the Bank became a participant would likely decline somewhat.

In making a decision on the access regimes, the Board is also mindful of a number of issues. First, a requirement for MasterCard and Visa to publish their criteria for assessing applications for participation should be retained in any varied access regime or undertaking. This would ensure that there is a widely known and objective set of criteria for assessment and discourage arbitrary discrimination among prospective entrants.

Second, any modification to participation in Australia will need to be consistent with the purpose and effect of interchange regulation established by the Bank. For example, ‘virtual cards’ issued for conducting transactions in Australia may need, as a minimum, to incorporate relevant domestic Bank Identification Numbers.

Third, as noted above, a change to the Bank’s access regimes will not allow a wider range of entities to participate in the MasterCard and Visa schemes unless there are also changes in the Banking Regulations 1966. As they were developed collaboratively between APRA and the Bank, consideration of the two regulatory regimes cannot be easily separated. While only APRA can decide on its prudential supervision policy, the Bank will work closely with the prudential regulator during the consultation process to ensure that both regulators’ aims could be achieved. This may mean a relatively long period between consultation and implementation of the outcome, depending on the nature of the regulatory changes needed.

5. Issues for Consultation

The Bank is seeking views on the issues discussed in this paper. Those issues include the following:

1. What is the nature of the risks faced by the card schemes and their members if a participant were to fail?
2. What is the most appropriate way to address those risks? What rules and procedures do the schemes currently have in place?
3. To what extent should the means of addressing risk be left in the hands of the scheme: that is, is there any role for regulatory oversight of these practices?
4. Is it appropriate to retain the access regimes in their current form?
5. How should the access regimes be varied if change is appropriate?
6. What criteria should be used to determine eligibility in the absence of the regulatory requirements on access?
7. What would be the potential effect on incumbent participants of extending eligibility for participation?
8. Do scheme participants need to be authorised and subject to prudential oversight by APRA and what is the purpose of APRA oversight should it continue?
9. Are there alternative approaches that would allow a wider range of prospective entrants into the card schemes?

6. Next Steps

The Bank expects to form a clearer view on the approach to the access regimes following consultation. This process will necessarily involve additional consultation with APRA given the related nature of the regulatory regimes in this area. Should the Bank decide to vary the access regimes, a further consultation on the proposed wording of the regimes will be required.

Formal written submissions regarding the general issues outlined above should be provided by no later than Monday, 8 July 2013, and should be sent to:

Head of Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001

or

pysubmissions@rba.gov.au.

Submissions provided by email should be in a separate document, in Word or equivalent format. Submissions in PDF format must be accompanied by a version in an accessible format such as .rtf or .doc.

In the normal course of events, submissions will be posted on the Reserve Bank's website and those making submissions will be provided with an opportunity to discuss their submission with the Bank.