CSR LIMITED
Triniti 3 39 Delhi Road North Ryde
NSW 2113 Australia
Locked Bag 1345 North Ryde BC
NSW 1670 Australia
www.csr.com.au
ABN 90 000 001 276

31 May 2014

Competition Policy Review Secretariat
The Treasury
By on-line submission

Submission Concerning Competition in Credit Card Payment Systems in Australia

Thank you for considering this submission concerning the impact of Australian regulation of credit card payments and systems on our business. Credit card payments play an important and growing role in Australian payments, including in the Business-to-Business sector, from a small base around 40 years ago. In 2013, purchase transactions with credit cards exceeded $262 billion (RBA website[1]).

The credit card market has rapidly evolved in recent years with the introduction of a range of premium cards which has encouraged small business to use credit card purchases on a B2B basis to take advantage of benefits such as frequent flyer programs, interest free credit periods and other benefits. Regulation has not kept pace with these developments.

Economically efficient payment systems are critical infrastructure to the health of the Australian economy, requiring (among other things) a regulatory framework that:

- Deters inbuilt economic cross subsidisation between system participants within a payment mechanism
- Impedes anti-competitive business structures and structural barriers to system competition
- Incentivises competitive market structures, encourages innovation, and entry of new card schemes, card issuers and acceptors
- Delivers competitive and transparent transaction costs in a timely way
- Provides open and non-discriminatory access to new system participants, and
- Permits the use of existing infrastructure by others, as seen in other areas of infrastructure.

The regulatory framework that governs this critical payment infrastructure and its industry structure is out-dated and does not reflect its mainstream role in commerce today. There are virtually only two major card Schemes (Visa and MasterCard hold an 85% market share of credit card transaction volume: RBA website[1]), and almost insurmountable obstacles to the entry of new schemes at both a local and international level. The current industry structure and its regulatory framework entrenches anti-competitive market structures, cross-subsidisation from merchants to other system participants, and inhibits economic efficiency.

With only two widely accepted card schemes, there is no evident competition, or evident mechanism to drive competition between Schemes, and evidence that current regulations entrench the status quo.

- There are 5 key participants in each Scheme's arrangements and transactions (being the scheme, the card issuer, card acquirer, cardholder, and merchant). Although neither the merchant nor cardholder user have a contract with the card scheme, each Scheme effectively determines the access arrangements to the infrastructure through its terms & conditions to card issuers and acquirers, including pricing (via fixed price interchange fees), and terms of merchants' access.
- Interchange fees charged by each Scheme and paid by commercial merchants other than Woolworths and Coles (which are deemed and categorised as "strategic") are fixed according to card category. Both major schemes charge the same or very similar fee levels for aligned card categories.

The present regulatory arrangements & system structure facilitates and supports an ad valorem fee structure through which merchants economically underwrite the card payment systems and system participants:

- The majority of merchants (ie except those deemed "strategic" such as Woolworths and Coles, charities, & schools) can only access card payments systems at the very high ad valorem interchange fees fixed by each scheme[2] and yet processing costs per transaction are fixed, low, and unrelated to transaction size.
- There is no economic justification to charge interchange fees as a percentage of the transaction given transaction costs are fixed and low.

  There is no requirement or mechanism for the Schemes to advise merchants of the fees applying to a transaction using a particular card in advance of the transaction occurring, although technically and economically feasible. It is difficult to nominate another private infrastructure, business or industry which requires the purchaser of a service, in this case the merchant, to buy without advising the transaction price in advance.

  Real time fee information would allow the merchant to accurately pass on the cost of the transaction to the cardholder according to card type, rather than as a general average across historical transactions. This is fundamental to transparency and minimising cross subsidisation; it is noteworthy that Schemes (through card acquirers) decline to make this information available. Accordingly, merchants have no alternative but to charge an estimate of average cost of accepting cards.

- The difference between the extremely high charges to accept more expensive cards when compared to a standard card clearly demonstrates the substantial levels of cross subsidisation underwritten by merchants. The range of interchange fees posted on Visa's Australian website[2], quote fees of 'Standard' card at 0.33%, while there are five categories of card with fees exceeding 1.65%, the highest being the 'High Net Worth, Qualified' rate of 2.20%; MasterCard's charges are similar[2].

  Higher interchange fee cards are growing as a percentage of card presentations due to the increasing proportion of these cards on issue, and active marketing of these card categories by system participants who are incentivised by the system structure to do so.

- Regulation that imposes caps on system-wide interchange fee averages, when combined with the favourable pricing provided to strategic merchants (Coles & Woolworths), incentivises the issue of more expensive cards and the imposition of charges to merchants not categorised as strategic. Although Visa and MasterCard are reported as saying their average transaction fee is 0.82%, this is a system wide average, and the majority of commercial merchants would pay average transaction fees well in excess of this amount. Increasingly higher interchange fees, in combination with the increasing proliferation of more expensive cards in the cardholder base, have resulted in growing average costs well above the system average.

The regulatory structure therefore entrenches cross subsidisation from the merchant to other system participants, between merchant categories, and potentially between categories of consumers. Merchant fees cross subsidise product features unrelated to the provision of a payments mechanism, notably award/loyalty products, and a period of credit. This is not a market based outcome, but occurs because regulations entrench high barriers to entry by new schemes, discrimination between merchants, and fixed price interchange fees to non-strategic merchants.

Structural distinctions between strategic (Coles and Woolworths) and other commercial merchants in interchange fee pricing are anti-competitive, have no place in vital economic infrastructure, and should be removed. However they are highly material, impacting merchants' pricing capacity and potential competitiveness. This applies to the competitiveness of one business relative to another in the same industry category.

The principles advocated above should apply equally to other incumbent payment schemes and mechanisms, such as American Express, and all new payment mechanisms.

There may be a case for a larger role for the ACCC in regard to the supervision of open access and more competitive and transparent arrangements in the payment systems and associated mechanisms. Consideration should be given to having the RBA focus on its statutory mandate of economic efficiency.

In summary, we would ask the review to investigate this matter further so that the necessary steps can be taken to ensure the card payments systems become economically efficient and competitive through the following:

- Remove obstacles to a competitive payments system environment, by eliminating regulations which support and enforce cross subsidisation
- Apply the same standards to economic infrastructure as other forms of infrastructure; force unbundling of costs, and correct economic allocation by capping the level of interchange fees at no higher than 0.33%, with a maximum charge of less than $10, more reflective of transaction costs
- Remove distinctions between strategic and other merchants to remove anti-competitive structures
- Require real time card specific interchange fee data to be made available to the merchant at the time of a transaction
- Implement all necessary steps to facilitate automated differential fee recharging by merchants directly to the cardholder at the time of the transaction
- Roll out principles of open transparent pricing in real time, a level playing field for system users, remove regulation and system ‘rules’ which protect anti-competitive structures, and apply these principles to all payment systems and mechanisms
- Open and transparent publication and availability to the public of transaction data (including by merchant category, by Scheme, detailed fee data by merchant category, interchange fees paid to card issuers & retained by card acquirers).

We would welcome the opportunity to discuss our submission and would be pleased to provide more detailed information on the problem and suggested solutions.

Yours sincerely

Marion Johnstone
Group Treasurer

Note 1 : http://www.rba.gov.au/payments-system/resources/statistics/index.html
Note 2 : http://www.visa.com.au/aboutvisa/interchange/interchange.shtml; http://www.mastercard.com.au/merchant/getting_started/interchange_rates.html

CSR LIMITED ABN 90 000 001 276
Triniti 3 39 Delhi Road North Ryde
NSW 2113 Australia