Chapter 14

Competition in the payments system

14.1 There are many aspects of the payments system about which concerns have been raised concerning competition. The Committee heard that the payments system may be a significant barrier to entry, due to the dominant role of the major banks:

> …some non-ADIs have approached us and said they have found significant obstacles—for example, in accessing the payments clearance system…[1]

> APCA [Australian Payments Clearing Association] is governed by the big four banks and the big two credit card companies, that they set the rules of the game and that in a sense there is really a disincentive for them to set rules that would make it easy for new entrants to come into the market.[2]

> If you think about the financial sector, it is a bit like a triangle, with the Reserve Bank at the top, then the banks and then everybody else—and everybody else in the financial sector is dependent upon the banks for access to ultimate liquidity, which does put the banks in a very powerful position in that area.[3]

Background

14.2 The main supervisor of the payments system, and catalyst for improved competition within it, is the Payments System Board of the Reserve Board. This is an additional board to the more familiar board with responsibility for monetary policy decisions. It is chaired by the Governor of the Reserve Bank and includes the Chair of the Australian Prudential Regulation Authority (APRA) and some independent experts.

14.3 Another key role in the payments system is played by the Australian Payments Clearing Association (APCA), a private self-regulatory body, owned by organisations active in one or more of the five payments clearing systems that it administers. APCA told the Committee that it:

> …believes that promoting competition is the best means to ensure the payment services deliver what Australian citizens and businesses need over the long term.[4]

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1 Mr Richard Lloyd, International Policy Adviser, Choice, *Committee Hansard*, 14 December 2010, p 29.

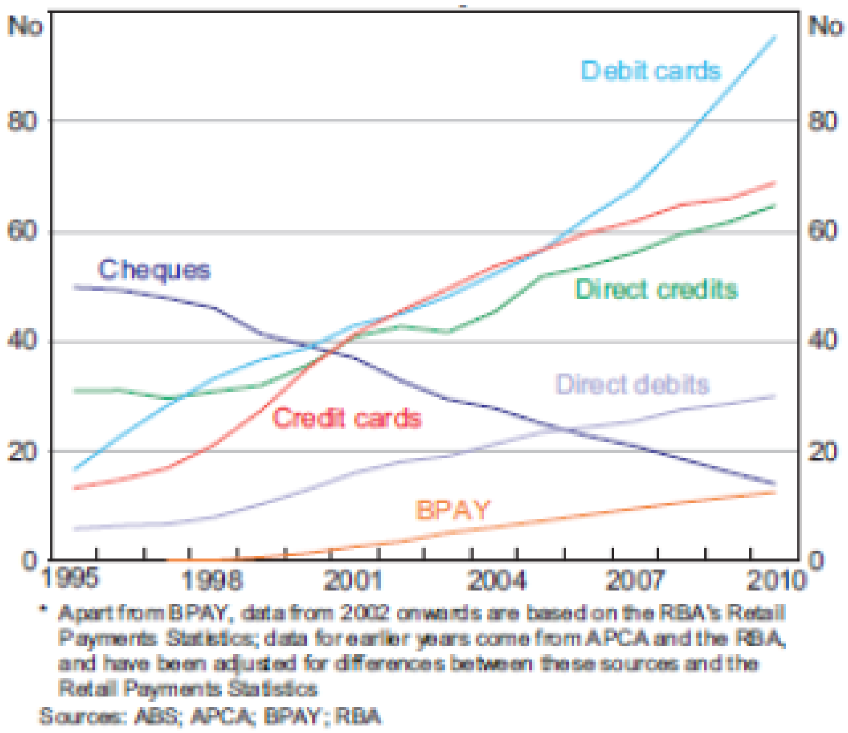
2 Mr Nick Stace, Chief Executive Officer, Choice, *Committee Hansard*, 14 December 2010, p 29.

3 Professor Tom Valentine, *Committee Hansard*, 25 January 2011, p 74.

4 Mr Christopher Hamilton, Australian Payments Clearing Association, *Committee Hansard*, 21 January 2011, p 30.

14.4 From being dominated by cash and cheques there are now a number of different electronic systems that enable payments to be made (Chart 14.1).

Chart 14.1: Non-cash payments per capita

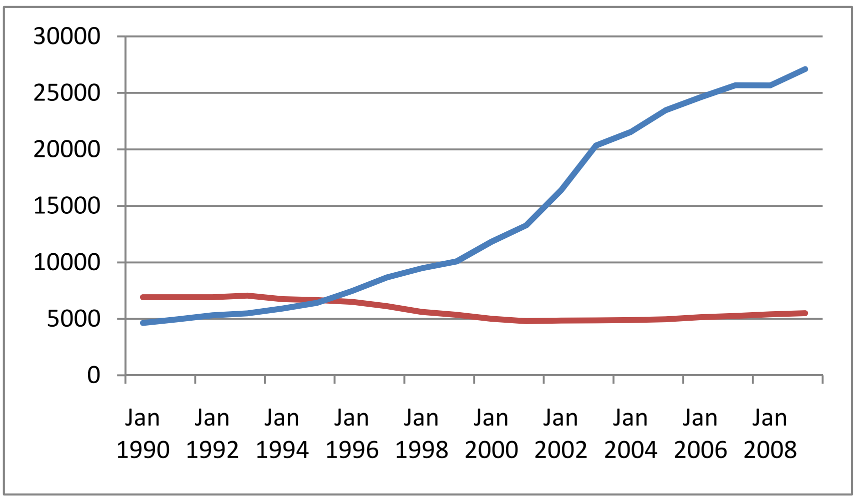


Source: Australian Payments Clearing Association, *Submission 49*, p 3.

ATM fees and access

14.5 ATM fees have become more important as banks close physical branches and ATM networks expand (lower and upper lines respectively in Chart 14.2).

Chart 14.2: Bank branches and total ATMs



Source: Secretariat, based on data from Reserve Bank of Australia.

14.6 A significant, albeit declining, proportion of ATM transactions may incur a fee. A relatively high estimate made last year was:

> …almost half of all ATM cash withdrawals are made outside of a bank or credit union's own ATM network.[5]

14.7 A survey in late 2010 showed that less than a quarter of ATM withdrawals incurred a direct fee.[6] Younger people and those outside major cities are more likely to pay, although those in remote areas appear to make more use of EFTPOS cash-outs to avoid ATM fees.[7]

14.8 Some submissions are critical of ATM fees:

> A $2.00 charge for a $50.00 withdrawal contains an explicit finance charge of 4% daily (the Annual Percentage Rate is harsh and unconscionable). A fair warning disclosing the implied finance rate would be more responsible rather than the small dollar value. The majority of clients incurring such fees do not have the financial skills to calculate the finance rate.[8]

14.9 ATM fees have a disproportionate effect on poorer people as it is harder for them to use ATMs from their own bank, they are more likely to withdraw smaller sums and a fixed charge is a larger proportion of their income. The Redfern Legal Centre refers to:

> …the elderly and people with disabilities, who in our experience are more likely to experience difficulty in travelling in order to access fee-free ATMs. They are also often less able to afford the fees. Consumers living in areas that are under-serviced by banks (often due to branch closures in rural, regional and remote areas) have little choice between banks or ability to travel in order to avoid ATM fees. Accordingly, the imposition of ATM fees has a greater impact on people living in non-urban areas. Given that there are generally higher levels of unemployment and lower average incomes in such areas, ATM fees are hardest to avoid by the people who are least able to afford them.[9]

14.10 Similarly, the Brotherhood of St Laurence commented:

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5 Care Financial Counselling Service, Senate Economics Legislation Committee inquiry into the Banking Amendment (Delivering Essential Financial Services for the Community) Bill 2010, *Submission 3*, p 6.

6 Flood, Hancock and Smith (2011, p 44). The authors point out that 'it is possible that the survey respondents may have modified their behaviour during the course of the survey as a result of making a record of the direct charges incurred'.

7 Flood, Hancock and Smith (2011, p 45).

8 John O'Brien, *Submission 117*, p 5.

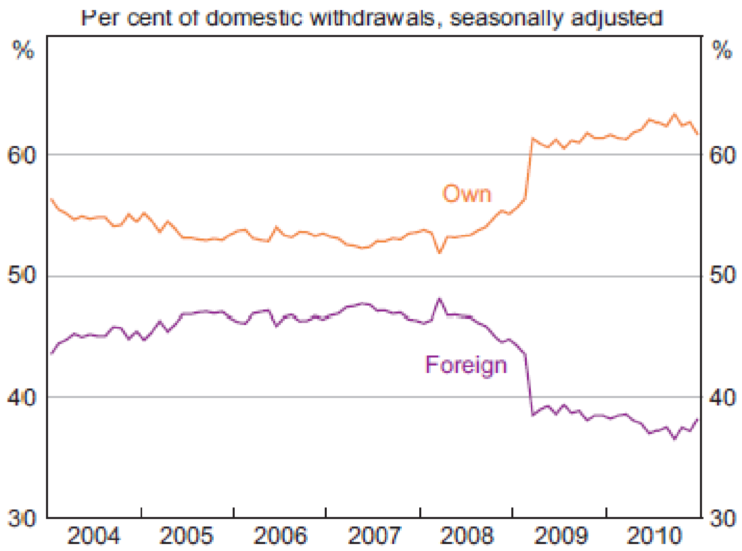
9 Redfern Legal Centre, Senate Economics Legislation Committee inquiry into the Banking Amendment (Delivering Essential Financial Services for the Community) Bill 2010, *Submission 2*, p 2.

> While some banks offer free ATM transactions, if you are constrained or disabled then the cheapest ATM may not be convenient.[10]

14.11 ATM fees were reformed by the Reserve Bank in March 2009. The most visible element was abolishing fees charged by banks to their customers for use of other banks' ATMs and their replacement by direct charges. Under the previous system the owner of an ATM charged the bank of the customer using the ATM an 'interchange fee'. The bank then passed on this fee, or sometimes more than passed it on, to the customer as a 'foreign fee', which the customer would only become aware of when they received their next bank statement. Now the ATM owner directly charges the customer at the time of the transaction but has to display the charge before the transaction is completed. The customer must be given the opportunity to cancel the transaction without cost if they do not wish to proceed.

14.12 These reforms saw a shift in transactions towards use of ATMs owned by cardholders' own banks away from those owned by other banks (Chart 14.3), an increase in average withdrawal size when using other banks' ATMs, and increased use of (typically free) EFTPOS cash-outs, all of which reduce the amount of transaction fees.[11] The Reserve Bank estimates that this has saved bank customers around $120 million a year in cash withdrawal fees.[12]

Chart 14.3: Composition of ATM withdrawals



Source: Flood, Hancock and Smith (2011, p 44); update of Reserve Bank of Australia, *Submission 41*, p 23.

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10 Mr Gerard Brody, Senior Manager, Financial Inclusion, Brotherhood of St Laurence, *Committee Hansard*, 25 January 2011, p 3.

11 Filipovski and Flood (2010, pp 40-41) and Flood, Hancock and Smith (2011). Similar responses were observed in the US: see McAndrews (1998, p 3).

12 Dr Christopher Kent, Head, Payments Policy Department, Reserve Bank of Australia, *Proof Committee Hansard*, 4 March 2011, pp 35-36.

14.13 The reforms have been hailed in some quarters:

> …the reforms introduced in 2009 by the Reserve Bank of Australia, which aimed to make fees transparent, improve consumer choice and increase competition and the supply of ATMs in Australia, have been successful.[13]

> We were very supportive of moving to the direct charging regime….[14]

14.14 One smaller bank witness was less enthusiastic:

> …if we looked at what the consumer is paying in a quantum, whether it is in a transaction fee or a direct charge, my thought would be that it has not changed much over the last 10 years. Whilst there is more visibility, I am not sure whether the consumers are better off…… in America, when they brought in the [direct charging] regime that there are short-term changes of behaviour but it does not persist.[15]

14.15 Fortunately, the Australian experience has not followed this pattern. As shown in Chart 14.3, Australian bank customers have increasingly avoided incurring foreign ATM fees. Banks can choose to increase the number of ATMs their customers can use without charge by reciprocal agreements or by agreeing to make payments to owners of other ATM networks. Many banks have done so.[16]

14.16 Most banks charged 'foreign fees' of $2, and so far this is also the most common direct charge for use of an ATM (Chart 14.4).

14.17 An exception is National Australia Bank:

> Since the introduction of direct charge our pricing has been $1.50 per withdrawal and $0.50 per balance enquiry. This pricing is consistent across our entire network and no differentiation is applied for either location or time of day, selected locations apply no direct charge on any withdrawal or balance enquiries.[17]

14.18 The Reserve Bank told the Committee that:

> A small number of ATMs owned by independent deployers apply even lower charges, including some for which no direct charge is levied at all, with the cost of the transaction being met by the site owner.[18]

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13 ATM Industry Reference Group, *Submission 79*, p 2.

14 Ms Nicole Rich, Director, Policy and Campaigns, Consumer Action Law Centre, *Committee Hansard*, 25 January 2011, p 19. See also Brotherhood of St Laurence, Senate Economics Legislation Committee inquiry into the Banking Amendment (Delivering Essential Financial Services for the Community) Bill 2010, *Submission 5*, p 4.

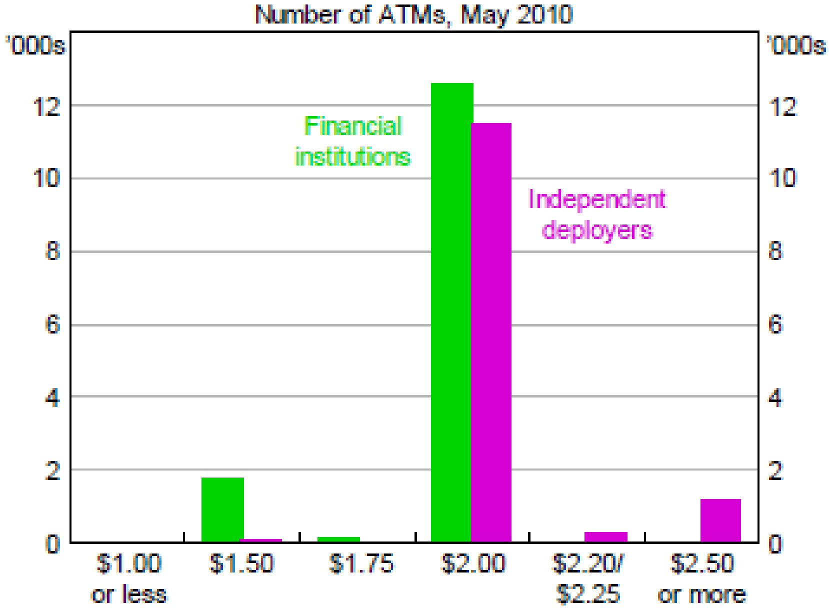
15 Mr John Minz, Chief Executive Officer, Heritage Building Society, *Proof Committee Hansard*, 4 March 2011, pp 16-17.

16 Filipovski and Flood (2010, p 42).

17 National Australia Bank, *Submission 91*, p 9.

18 Reserve Bank of Australia, *Responses to questions on notice*, no 6, 18 January 2011, p 1.

Chart 14.4: Direct charges for withdrawals



Source: Reserve Bank of Australia, *Submission 41*, p 23.

14.19 It is disappointing that so far the greater price transparency has not led to competitive pressures driving down the price of ATM transactions. Two Reserve Bank officials surmise that:

> It is possible that this reflects the fact that cardholders typically need to proceed some way through the transaction process at the ATM before the direct charge is displayed. This may make it difficult to compare prices, particularly where cardholders are unfamiliar with the ATMs in a particular location. While cardholders might avoid an ATM if they see that it applies a direct charge higher than they think is reasonable, there is little incentive for ATM owners to lower fees if it is not obvious to potential customers that they have done so. As a consequence, relatively little price competition among ATM owners appears to have developed to date. An obvious response is for ATM owners with a low direct charge to advertise the charge prominently so as to attract additional throughput and higher fee revenue. There is nothing to prevent owners from doing this, although the strategy requires the general public to understand pricing sufficiently to react accordingly. To date, advertising of prices has occurred only in isolated cases…[19]

19 Filipovski and Flood (2010, p 43). A similar tale is told by Choice, *Response to questions on notice*, no 5, 17 January 2011.

14.20 The Reserve Bank remains optimistic that greater price competition is 'the next stage that may well be in prospect'.[20]

14.21 The Commonwealth Bank stated:

> Currently, almost all of our ATMs do not cover their costs through the ATM direct charge… The cost of any ATM is a complex mix of rent and transaction mix (which drives servicing costs, cash replenishment costs etc). One main driver of difference is whether the ATM is in a branch or in a non-branch location. Non-branch sites are more expensive (by an additional 50%) due to the floor space rental costs.[21]

14.22 A 2007 Reserve Bank study estimated the average cost of an ATM transaction to a bank at around 75 cents, well below the current predominant charge of $2.[22] With fees charged on only about a third or less of withdrawals, the average direct charge across all withdrawals is a little below the average cost.[23]

14.23 The 2007 study suggested that the solely cash-related costs were around 25 cents, so the cost for a balance enquiry was around 50 cents.[24] In around a third of cases the charge for a balance enquiry is lower than for a cash withdrawal, being typically 50 cents to $1.25, but in other cases it is the same.[25]

14.24 Treasury commented:

> There are a number of alternatives to ATM balance enquiries, including internet and phone banking. A customer is also informed of their account balance in the course of making a withdrawal. If a transaction is declined because the customer has insufficient funds, ATM providers are prohibited by industry rules from making a direct charge. As a consequence, relatively few customers make balance enquiries for which they are charged. Data collected by Edgar Dunn & Company indicate that for bank ATMs (where many transactions are made charge-free by the bank's own customers) around 23 per cent of transactions are balance enquiries. However for

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20 Dr Christopher Kent, Head, Payments Policy Department, Reserve Bank of Australia, *Proof Committee Hansard*, 4 March 2011, p 36.

21 Commonwealth Bank, *Responses to questions on notice*, no 8, 15 December 2010, p 2.

22 Schwartz et al (2007, pp 100-101). The main components of the cost are the ATM equipment (18 cents), cash handling and storage (14 cents), ATM owner centre management (9 cents) and rental (12 cents). The cost is now likely to be significantly higher, at least for some ATMs as site rents have increased and ATMs are now deployed in sites where servicing costs are higher or transactions volumes lower; Reserve Bank of Australia, *Responses to questions on notice*, no 6, 18 January 2011, p 10. Cash restocking costs may vary significantly from site to site, depending on whether the ATM is stocked by the site owner with recirculated cash, or externally by the ATM provider.

23 Reserve Bank of Australia, *Responses to questions on notice*, no 6, 18 January 2011, p 9.

24 Reserve Bank of Australia, *Responses to questions on notice*, no 6, 18 January 2011, p 10.

25 Treasury, *Responses to questions on notice, no 14*, 4 February 2011, p 8.

> independently owned ATMs (where nearly all transactions are charged), only 6 per cent of transactions are balance enquiries.[26]

14.25 There have been proposals to limit ATM charges to the cost of providing the service in the United States, where the typical direct charge for using an ATM is US$1-2, but there are also interchange fees which are passed onto customers.[27] There was a varied response in the US to the introduction of direct charging, with the states of Connecticut and Iowa banning them while fifteen states passed laws outlawing agreements *not* to impose them. At a national level, in 1997 a Republican Senator sought unsuccessfully to have direct charges banned while in 2010 a Democrat senator sought to limit the charge to 50 cents and ensure that ATM fees bear a 'reasonable relation to the cost of processing the transaction', which he estimated at 36 cents.[28]

14.26 The Salvation Army supports regulation of ATM fees:

> The regulation of ATM fees provides a fairer service when a customers ‘own-branded’ ATM is not available, which will particularly benefit rural / remote, elderly and disabled customers who depend on ATM use.[29]

14.27 Unsurprisingly, the Australian Bankers' Association oppose such regulation. Their then chief executive argued:

> Senator Brown's anti-competitive proposal against bank customers could result in fees being paid by customers to use their own-bank ATMs because non-customers of the bank would be able to use the ATM service for free.[30]

14.28 The Committee is aware of reports of people in remote indigenous communities paying up to $10 per ATM transaction. This is especially a problem for people do not like to carry large amounts of cash with them so make frequent withdrawals and to avoid overdrawn account fees need to check account balances before making withdrawals. This means that they can pay large amounts of ATM fees relative to their account balances.

14.29 The Reserve Bank has been investigating these reports, including by travelling to the Alice Springs region to check the veracity of reports of ATMs charging $10 fees. They described how:

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26 Treasury, *Responses to questions on notice, no 14*, 4 February 2011, p 8.

27 McAndrews (1998, p 2).

28 Senator Tom Harkin's amendment no 3812, co-sponsored by Senator Charles Schumer, to S. 3712, the *Restoring American Financial Stability Act*. The 1997 initiative was by Senator Alfonse D'Amato, then chair of the Senate Banking Committee.

29 Salvation Army, Senate Economics Legislation Committee inquiry into the Banking Amendment (Delivering Essential Financial Services for the Community) Bill 2010, *Submission 6*, p 2.

30 Mr David Bell, *ABA Media Release*, 3 March 2010.

> We asked for those who were reporting them to come to us. We tracked them down. They may have been charging $10 in the past. We did not find any current evidence anywhere in Australia of a store in a remote community charging $10 on an ATM.[31]

14.30 Consumer groups were also cognisant of the need to retain incentives for ATM owners to provide machines in remote areas:

> We do not want to see a situation where there are no ATMs available in certain communities because there is regulation that prevents operators from making a sufficient return on the machines to actually run them.[32]

14.31 Professor Sathye suggests a possible compromise of restricting the availability of accounts with no ATM fees to socio-economically vulnerable consumers.[33]

14.32 The Brotherhood of St Laurence want to distinguish between use of ATMs to check balances and (the more costly) use to withdraw cash:

> …many of our clients wish to use an ATM to check their account balance so that they do not overdraw the account. Many of these clients do not have access to internet banking or some other system to check balances. For some accounts, even checking the account balance via the ATM incurs a fee, making it difficult for consumers to then use their account in a way that minimises fees.[34]

14.33 This concern was shared by a parliamentary committee which recommended that consideration be given:

> …to ensuring that the price of obtaining an account balance is kept to and at the very least is in alignment with the costs associated with delivering the service.[35]

14.34 The Brotherhood of St Laurence recommends that:

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31 Dr Christopher Kent, Head, Payments Policy Department, Reserve Bank of Australia, *Proof Committee Hansard*, 4 March 2011, p 42. Flood, Hancock and Smith (2011, p 47) report that 'the highest direct charge that the Bank is aware of in any location is $5.00 for a cash withdrawal at a specialised venue'.

32 Ms Nicole Rich, Director, Policy and Campaigns, Consumer Action Law Centre, *Committee Hansard*, 25 January 2011, p 19.

33 Professor Milind Sathye, Senate Economics Legislation Committee inquiry into the Banking Amendment (Delivering Essential Financial Services for the Community) Bill 2010, *Submission 1* p 6.

34 Brotherhood of St Laurence, Senate Economics Legislation Committee inquiry into the Banking Amendment (Delivering Essential Financial Services for the Community) Bill 2010, *Submission 5*, p 4.

35 Joint Committee on Corporations and Financial Services, *Report on the ATM Fee Structure*, January 2004, p 24.

> …appropriate regulators be tasked with monitoring the level of ATM fees to ensure that they are not excessive, and empowered to regulate such fees should this be necessary.[36]

14.35 Another suggestion is that:

> …the RBA require the industry to amend its payment system clearing rules, to require a real-time warning to be given to consumers on ATM screens where a penalty fee will be imposed if a particular transaction goes ahead.[37]

Impact on ATM availability

14.36 Liaison by the Reserve Bank suggests that the move to direct charging has meant that:

> …some of these ATMs have been deployed in locations that might otherwise have not been viable – including in rural, regional and remote areas. It is also becoming more common to see ATMs in relatively low-usage locations and temporary ATMs at public events. Such ATMs tend to apply above-average direct charges, but would most likely not have been available under the previous regime.[38]

14.37 Professor Sathye warns that in the UK the number of ATMs provided has stagnated, while it has increased in Canada and the US where charging is allowed, and therefore 'removal of direct charging may have adverse consequences for consumer welfare in terms of higher transaction costs'.[39]

14.38 A US study of direct charging for ATM use concluded that the charges:

> …encourage the deployment of ATMs to areas that are too expensive for interchange fees alone to support, such as airports, casinos, football stadiums, and ski resorts.[40]

14.39 Two French academics argue:

> Nowadays, the USA and Canada have many more ATMs per inhabitant than countries in which surcharging [ie direct charges] is not applied.[41]

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36 Brotherhood of St Laurence, Senate Economics Legislation Committee inquiry into the Banking Amendment (Delivering Essential Financial Services for the Community) Bill 2010, *Submission 5* p 4.

37 Consumer Action Law Centre, *Submission 87*, p 23.

38 Filipovski and Flood (2010, p 44).

39 Professor Milind Sathye, Senate Economics Legislation Committee inquiry into the Banking Amendment (Delivering Essential Financial Services for the Community) Bill 2010, *Submission 1*, pp 4-5.

40 McAndrews (1998, p 2).

41 Donze and Dubec (2009, p 584).

14.40 The ATM Industry Reference Group, which represents three companies who together provide almost half the ATMs operating across Australia,[42] warn that they rely on direct charges. They warn:

> …any externally imposed control on the level of the current free market of ATM direct charges, even if this only related to one sector of the industry, could artificially distort the level of competition in the setting of ATM direct charges with potential unintended consequences that could ultimately lead to a lower level of ATM service across the nation.[43]

14.41 A similar view is put by the international ATM Industry Association:

> Direct Charging fees have allowed ATMs to be economically viable in both urban and rural areas, providing universal access to cash where there may be no or little alternative. The removal or capping of ATM fees may restrict the ability to deploy in rural or other low volume locations reducing both the growth and potentially the number of ATM locations in rural areas…[44]

14.42 The Government has foreshadowed further reforms, announcing:

> The joint Treasury/Reserve Bank Taskforce will report to the Government in June 2011 on the need for further action…[45]

Socially responsible location of ATMs

14.43 The National Australia Bank explained:

> There has been a growing concern over the supply of the availability of ATMs in gaming venues as this is believed to exacerbate problem gambling. NAB does not locate any ATMs in gaming venues, nor does our affiliated rediATM network – we were quite explicit about this when we negotiated our agreement.[46]

Committee comment

14.44 The Committee commends the Reserve Bank for requiring ATMs to display fees before the customer completes the transaction. The Committee hopes this will in time lead to greater competition and ATM providers will advertise machines with lower fees. Measures to cap ATM fees would be counterproductive as they would lead to ATMs being removed from some remote locations. NAB are to be commended for

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42 Banktech, Customers Ltd and First Data International (Cashcard Australia).

43 ATM Industry Reference Group, *Submission 79*, p 1.

44 ATM Industry Association, *Submission 71*, p 2.

45 Australian Government, *Competitive and Sustainable Banking System*, December 2010, p 15. The Taskforce has provided an interim report to the Government on the impact of ATM charges on indigenous communities; Mr John Lonsdale, General Manager, Financial System Division, *Proof Committee Hansard*, 9 March 2011, p 12.

46 National Australia Bank, *Submission 91*, p 9.

not locating ATMs in gaming venues and the Committee would like to see other ATM providers follow their lead.

Recommendation 31

14.45 The Committee recommends that the Australian Payments Clearing Association and the Australian Bankers' Association encourage their members to have their ATMs screens display a real-time warning to consumers where a penalty fee will be imposed if a particular transaction goes ahead.

Recommendation 32

14.46 The Committee recommends that the government deal with the problem of excessive ATM fees in remote indigenous communities by tendering for an ATM provider to install a network of ATMs in these areas which make specified minimal charges for balance enquiries and low charges for cash withdrawals.

Competition in credit card markets

14.47 Interest rates on credit cards in Australia can exceed 21 per cent. The average rate is 16 per cent. These represent very large margins above the cost of funds and rates charged on other types of loans.

14.48 A concern for social welfare organisations is bank customers being pushed into credit cards:

> …small-amount consumer credit, which is required by households to smooth expenditure, particularly related to things like education costs, whitegoods or vehicles. Over the past years, the banks have shied away from providing small amount personal loans, instead pushing many onto credit cards or simply refusing to offer service. For many on low incomes, credit cards can be a debt trap designed to induce immediate spending without an affordable, planned repayment schedule…Things like the lowest value personal loan have increased. Some years it was a smaller amount, maybe only $1,000 or $2,000. Generally the large banks lend $5,000 or $7,000 for the lowest-value personal loan.[47]

14.49 There are some pilot programmes catering for low income households:

> Some banks, such as ANZ and the National Australia Bank, are offering small-amount affordable loans in partnership with community agencies. This is very welcome. These programs have demonstrated that, when

47 Mr Gerard Brody, Senior Manager, Financial Inclusion, Brotherhood of St Laurence, *Committee Hansard*, 25 January 2011, pp 2 and 5.

provided with opportunity and support, low-income earners can pay back debt.[48]

14.50 A former Reserve Bank officer is very critical of the structure of the credit card market:

> A moment's reflection reveals the 'credit card' to be simply a 'debit card' to which a line of credit is attached. The deception is about linking the illusion of free-credit (for 55 days on purchases) and 'flyer rewards' to the imposition of excessive charges on retailers, part of which – called an interchange fee – is paid to the bank issuing the credit card, supposedly to fund the 'free credit' and 'rewards'. There is no accounting for the actual cost to banks of either net 'free credit' given to bank customers or the 'rewards' actually redeemed. Deeming to be taxable income the gross value of these concessions would quickly expose the deception.[49]

14.51 Even an academic whose submission generally opposed interference in the banking market sees room for improvement in the credit card market:

> …the credit card issue. It appears to me that there are still restrictions on entry to that part of the payment system—that is, it is not entirely contestable, interest rates seem to be very high and there is an additional problem of credit card debt that many of the social services organisations are worried about.[50]
>
> Two possible reforms meriting attention are ensuring that the minimum monthly payment on credit cards at least covers the interest and other charges on it and creating a clearing house which looks at the total exposure of each borrower. Limits could be imposed based on the income, assets, etc. of the borrower.[51]

14.52 Another submitter was also critical of the lack of competition between card systems:

> MasterCard and Visa have a virtual monopoly…[there should be] investigation of the fees and charges imposed by credit card providers on both merchants and consumers.[52]

14.53 Visa responded that it:

> …requests internet acquirers to reach a minimum capital standard before they are permitted to become part of our network…Visa understands there has been suggestions made to the inquiry that regulation may be needed to

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48 Mr Gerard Brody, Senior Manager, Financial Inclusion, Brotherhood of St Laurence, *Committee Hansard*, 25 January 2011, p 2.

49 Mr Peter Mair, *Submission 2*, p 8.

50 Professor Tom Valentine, *Committee Hansard*, 25 January 2011, p 62.

51 Professor Tom Valentine, *Submission 14*, pp 7-8.

52 Ms Carolyn Currie, *Submission 114*, p 2.

> reduce these minimum collateral standards…Visa thinks it would be extraordinary in the immediate post-GFC environment to seek to put in place any form of regulatory intervention that would actually *reduce* the level of financial system security and stability.[53]

14.54 A possible reason for the apparent lack of competition and high interest rates on credit cards is that many customers intend to always pay off their balances in full each month and thereby not pay interest. While it is likely that many in fact do not exercise this much discipline, it nonetheless means that they do not shop around for low interest rates. This explanation was supported for the US market in a detailed study by Ausubel.[54] In Australia, only 15 per cent of credit card holders apply for a 'low rate' card and only around 40 per cent say they sometimes pay interest.[55]

14.55 There have been criticisms that the minimum monthly repayments set for credit cards are too low. Choice gave an example of how high interest rates, annual fees and low minimum repayments could mean an outstanding balance would not be paid off after fifty years.[56] Stating a minimum repayment may influence people not to pay off more than that amount.[57]

14.56 At one level, offers of initial low interest rates on credit card balances transferred from one bank to another are a welcome example of competition. There are, however, some aspects of these offers which are undesirable for customers not reading the fine print:

> Moving the balance is fine, as long as you’re not tempted to make a purchase on the new card. Any minimum monthly payment is taken from the low interest debt first (the balance transfer) while the high interest debt is left to compound. Not paying the full balance at the end of the month (which *includes* the balance transfer amount) leads to a loss of the interest free period (on new purchases) and further compounding of the high interest debt.[58]

14.57 As foreshadowed in its December 2010 announcement, on 24 March 2011 the Government introduced legislation[59] to force credit card lenders to allocate

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53 Visa, *Submission 127*, p 3.

54 Ausubel (1991) examined the US credit card market, which also shows high and 'sticky' interest rates, and found that credit card lending earned a much higher rate of return that other banking activities, and this could not explained by the higher bad debts during recessions. His calculations suggest the interest rate was around 5 percentage points above the competitive rate.

55 Reserve Bank of Australia, *Responses to questions on notice*, no 6, 18 January 2011, p 7.

56 *Sydney Morning Herald*, 6 April 2011, p 6.

57 Study by the University of Warwick, cited in *Sydney Morning Herald*, 6 April 2011, p 6.

58 Accounts4Life, *Submission 128*, p 3.

59 National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011.

repayments to higher interest debts first,[60] prevent lenders from charging over-limit fees unless consumers specifically agree that their account can go over the limit, ban unsolicited credit extension offers unless pre-agreed to by the consumer and give consumers more say over their credit limits. The legislation would also introduce a requirement for lenders to provide a Key Facts Sheet for credit card contracts that provides a clear summary of the standard terms applicable, including minimum repayments required to be made, annual percentage rates and fees.

14.58 The Consumer Credit Legal Centre have criticised the bill for only applying to new rather than existing cards.[61]

Committee view

14.59 The Committee regards the reforms put forward by the Government as reasonable. It would not support bans on fees but measures to ensure customers are better informed about the implications of making only the minimum repayment are welcome.

Other aspects of the payments system

14.60 Some submitters drew attention to the payments system:

> …the real areas in which competition is low and super-profits earned by the banks are in payment systems, including credit card transaction processing. These areas, in which fees are by international standards very high, are the principal reason that the underlying profits of the Big Four banks represent almost 3% of Australia's GDP.[62]

14.61 A former Reserve Bank officer is very critical of what he terms:

> …the failure to deal with the institutionalized cartel arrangements and related price fixing for credit card, debit card and BPay transactions.[63]

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60 The Government gave the following example: 'the Johnson family may have a credit card balance of $5,000, consisting of a $2,500 balance transfer from a previous lender on which they are now paying interest at a special rate of 1.9% per annum, and another $2,500 which they have spent using a credit card from their new lender on which they are paying interest at 19.9% per annum. If the Johnson family were able to make a $2,000 payment towards their credit card balance, most lenders would seek to use this to pay off $2,000 of the debt which is only costing 1.9% per annum. The Government will legislate to ensure that the lender must instead use the $2,000 to pay down some of the debt on which interest is owed at the much higher rate of 19.9%, saving the Johnson family around $360 a year.' Australian Government, *Competitive and Sustainable Banking System*, December 2010, p 13.

61 Ms Karen Cox, Co-ordinator, Consumer Credit Legal Centre, *Sydney Morning Herald*, 6 April 2011, p 6.

62 Professor Ross Buckley, *Submission 32*, p 3.

63 Mr Peter Mair, *Submission 2*, p 7.

14.62 Other submitters also saw the payments system as key to competition:

> The biggest single regulatory mechanism used to hindering competition within the banking sector is the control by the four major banks of the payments system.[64]

14.63 The Reserve Bank acknowledges the challenge that:

> …the incumbents in a payment system will have a natural tendency to keep new entrants out and often might use risk as a justification for that.[65]

14.64 Direct access to the payments system is denied to most non-banks:

> …non-bank providers are effectively locked out of the electronic funds transmission system, and are unable to settle electronically, and have to deal with their competition being the banks when providing data for settlements.[66]

> APCA owns the BSB number range and will only release new numbers to Authorised Deposit-taking Institutions (ADIs). Accounts4Life has a business model that requires a BSB, yet does not constitute "banking business" and therefore does not need an ADI licence…the Big 4 can squash any attempt to allow a new entrant to operate independently and increase competition.[67]

14.65 Tyro Payments, a specialist banking institution supervised by APRA which provides EFTPOS and some other payment services but does not take deposits or make loans, comments:

> Due to its network nature, the payment industry requires a strong set of standards and rules to protect the integrity and stability of the system. However, the standards and rules must also enable innovation and competition.[68]

14.66 Tyro submits that it is the only non-bank acquirer to have applied for a specialised banking licence since the concept was introduced. Tyro is a tier one member of the Australian clearing and settlement system. It identifies a number of areas where it faced barriers to entry.[69]

14.67 A new entrant wanting to process credit card transactions is unlikely to have a rating from an agency and Visa and Mastercard then demand the entrant has

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64 Mr Mervin Reed, *Submission 5*, p 9.

65 Mr Darren Flood, Deputy Head, Payments Policy Department, Reserve Bank of Australia, *Proof Committee Hansard*, 4 March 2011, p 36.

66 Mr Mervin Reed, *Submission 5*, p 2.

67 Accounts4Life, *Submission 128*, p 2.

68 Tyro Payments. *Submission 36*, p 2.

69 The following paragraphs draw on Tyro Payments, *Submission 36*.

additional capital. Tyro argues that they should be satisfied if the entrant is licensed by the Reserve Bank and supervised by APRA.

14.68 New entrants to the EFTPOS debit card network are required to connect to all members bilaterally which Tyro does not regard as commercially viable.

14.69 Tyro noted that the two major supermarket chains 'benefit from interchange fees that can be up to one half of what merchants in general are charged'.[70]

14.70 The domestic debit card (EFTPOS) system is governed by EFTPOS Payments Australia Limited (EPAL) which Tyro claims is dominated by card issuers and the major retailers. This leads to concerns that interchange fees charged to smaller retailers will be pushed up. The system is also lagging behind overseas schemes in its technical capacity, lacking features such as 'tap and go'.

14.71 Tyro has long aspired to gain access to the private health fund claiming market but this is dominated by a major bank.

14.72 The Electronic Funds Transfer Code of Conduct is a voluntary code that provides protection for consumers who use electronic means for making payments, including ATMs, EFTPOS, credit cards, online payments, internet banking and eBay. The code provides key consumer protections in the case of fraud and on unauthorised transactions.

14.73 Tyro is concerned about EFTPOS interchange fees:

> …we are focused on acquiring only so we do not have the conflict of interest that the major banks have to maximise their interchange revenue at the expense of the merchants. Thus, it does not come as a surprise that we are the only ADI that questions the looming reversal and increase of the EFTPOS interchange fee that threatens the small and medium enterprise community with an additional burden of up to $¼ billion.[71]

14.74 Tyro also called for real-time settlements to make payments systems more efficient and less risky:

> …the industry should move to real-time settlement; it is unnecessary risk. When we aspired to membership of BECS, some of the banks refused to accept us, claiming we were a risk to the system given our modest balance sheet. So we would argue: why don’t you use intelligent processes and information technology so that you can mitigate and eliminate the risk?[72]

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70 Tyro Payments. *Submission 36*, p 9.

71 Mr Jost Stollmann, Chief Executive Officer, Tyro Payments, *Committee Hansard*, 21 January 2011, p 34.

72 Mr Jost Stollmann, Tyro Payments, *Committee Hansard*, 21 January 2011, p 36.

14.75 A new entrant specialising in some aspect of the payments system may struggle against the major banks who cross-subsidise activities through bundling:

> …when a major bank settles its merchants a day earlier than our merchants, it means that it bundles the acquiring function with the transaction account. There is a bank that offers same-day settlement to its merchants if they have the transaction account and the acquiring relationship with them. They can do this because they do not go through your systems—the batch systems.[73]

14.76 Banks try to ensure merchants have all their banking relationships with the one bank, rather than just providing loans or just providing payment services:

> We certainly have customers who only utilise merchant facilities within our base. But, obviously, a key objective of ours is to deepen the relationships that we have with our customers and therefore provide broader services.[74]

14.77 A concern raised by small business as an example of banks colluding to maintain a poor service, concerns the payments system:

> …the behaviour by the major banks not to provide daily settlement of EFTPOS transactions by way of credits to merchants' accounts. It appears to be a concrete example of anticompetitive behaviour. The banks choose only to settle EFTPOS transactions on five days each week in a seven day commercial market. This unreasonably denies merchants access to their money.[75]

14.78 A specific shortcoming raised was the delay between when funds are debited from a customer's account and when the proceeds of the transaction are credited to the retailer's account. This generally takes a day, and for smaller retailers can take several days. This appears to be a result of the banks not agreeing to undertake the expense of installing better technology and agreeing protocols for its use:

> It is an historical thing and it needs further development to do that and there is the question of what is the cost of doing that and what is the best way of doing that…a problem that is common in this area, that what you often need to do to get the network to provide better functionality is to have everybody who is part of that network to move towards the same goal and often times you need a degree of coordination…[76]

14.79 There is an understandable suspicion that the bank is gaining from the delay, perhaps being able to earn interest on the short-term money market for the period the payment is in transit.

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73 Mr Jost Stollmann, Tyro Payments, *Committee Hansard*, 21 January 2011, p 45.

74 Mr David Foster, Chief Executive, Suncorp Bank, *Committee Hansard*, 9 February 2011, 9 February 2011, p 8.

75 Council of Small Business of Australia, *Submission 90*, p 5.

76 Dr Christopher Kent, Head, Payments Policy Department, Reserve Bank of Australia, *Proof Committee Hansard*, 4 March 2011, p 40.

14.80 The Reserve Bank assured the Committee that this is not the case:

> The funds are moved from one customer's account to another customer's account through this system and there might be some delay between when a payment instruction is sent and when that money is finally available at the other end for the receiving customer to take those funds out of their account if they so choose, but there is a point in time which is part of the arrangement where the exchange is deemed to have occurred and that is the point at which interest is calculated if any is being paid.[77]

Committee view

14.81 The Committee is concerned about claims that the payments system operates like a closed shop and would like to see more new entrants to it and greater competition in the provision of payments, clearing and settlement services. It believes this would accelerate the adoption of world class technology and real time settlement systems, to the benefit of bank customers.

Recommendation 33

14.82 The Committee recommends that the Government direct the Australian Competition and Consumer Commission to conduct an examination of barriers to competition in the Australian payments system and publicly report by the end of 2011 on any legislative or other reforms that would enhance competition and efficiency in the provision of payment, clearing and settlement systems.

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77 Dr Christopher Kent, RBA, *Proof Committee Hansard*, 4 March 2011, p 39.