



Payment Systems (Regulation) Amendment Bill 2005

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Payment Systems (Regulation) Amendment Bill 2005

Date Introduced: 10 March 2005

House: House of Representatives

Portfolio: Treasury

Commencement: 1 July 2005

Purpose

The purpose of the Payment Systems (Regulation) Amendment Bill 2005 (the Bill) is to allow the Reserve Bank of Australia (RBA) to continue to control excessive bank charges on credit card transactions by exempting from the operation of Part IV of the Trade Practices Act, the setting or charging of interchange fees that accords with its interchange fees standards.

Background

Basis of policy commitment

The RBA has been active in trying to reform the payments system to make it more competitive and to encourage the take up of more efficient payment mechanisms. As the RBA points out:

Australia is among the first countries in the world to make efficiency of payment systems a statutory objective of the central bank. The RBA's initial work in this area has focused on cheque-clearing times, interchange fees associated with ATMs, credit cards and debit cards (undertaken in conjunction with the Australian Competition and Consumer Commission) and on encouraging the take-up of direct debits as a means of bill payment.¹

The RBA has concentrated recently on the interchange fees. These are fees that banks charge each other when someone uses a credit card. The interchange fee involves a payment that goes from the merchant's bank to the purchaser's bank and is paid at an agreed rate. In 2000 the Reserve Bank, together with the Australian Competition and Consumer Commission, published a study on [Debit and Credit Card Schemes in Australia](#) which dealt with credit card schemes, EFTPOS and 'foreign' ATM transactions. The RBA basically alleged that the card schemes acted against the public interest. High fees were charged to merchants and provided banks with high profits that funded loyalty schemes and often encouraged consumers into expensive debt. So long as the consumers paid off their credit cards on time they not only had a free payments mechanism but were rewarded through points schemes. Nevertheless, merchants paid very high fees to their own bank, some of which was then passed on to the customer's bank through interchange fees.

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However, to encourage the take-up of credit cards, banks prevented the merchants from recovering their costs from consumers.

The costs of credit card fees were probably passed on to *all* consumers. The whole system was tightly controlled through the main banks' influence over the three card schemes: Bankcard, Mastercard and Visa. All of the main banks were members of the three different schemes.

According to the RBA the schemes:

- did not have objective and transparent cost-based mechanisms for imposing fees on merchants
- prevented merchants from recovering their costs from customers, and
- prevented competition from potential new issuers of credit cards.

All of this was important in a wider context. Profits for the big four banks (ANZ, Commonwealth Bank, National Australia Bank and Westpac) were \$12.3 billion in the latest 12 months for which figures are available.² That means bank profits for the top four banks are around 1.5 per cent of Australia's GDP. Putting that differently, of every \$100 spent in Australia, \$1.50 ends up as profit for the big four banks.

In the past the RBA has presented evidence to the effect that bank margins are falling as a result of competition. However, bank profits have not been falling because the fall in margins has been compensated by the increase in fee income. For example, the fees charged to households were \$1.162 billion in 1997 and increased by 196 per cent to \$3.443 billion in 2004. Fees on business increased by 93 per cent, from \$2.880 billion to \$5.562 billion, over the same period.³ Banks seem to have been able to shift their profit sources away from the traditional markets that may have become more competitive and towards areas where they seem to have more market power. In this case the fees that have increased so rapidly have fallen particularly hard on transaction deposit accounts, credit cards and merchant fees. In effect the banks have put their own monopoly tax on important elements of the payments system. However, that then distorted the payments system and so attracted the interest of the RBA.

The RBA addressed the credit card interchange fee issue in three main ways. It permitted merchants to pass on any credit card fees to consumers and allowed new credit card issuers to access the market. However, for present purposes the important change was the introduction of a cost-based maximum interchange fee that could be charged. The standard interchange fee covers costs and a reasonable return to the bank. The RBA announced the new lower fees that were to apply from 31 October 2003.⁴ As a result banks' income from merchant service fees fell from \$1.837 billion in 2003 to \$1.522 billion in 2004.⁵

Initially, the new standard interchange fee imposed by the RBA took account of the different cost structures of the different card schemes. However, the RBA has since sought

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industry views on its new proposal to set a common interchange fee and asked for comment on two possible options:

- setting the fee based on the average costs of the three schemes, or
- setting the fees based on the lowest cost scheme.

Of those two options, the banks supported the former. However, the ANZ made the point that the average should exclude Bankcard. While Bankcard is the cheapest, it does not cover international transactions and other usage that drives up the Visa and Mastercard costs.⁶ The outcome of this consultation has not yet been finalised.

Position of significant interest groups and press commentary

Credit card schemes and their members, the main banks, originally opposed these reforms and Visa tried to hold them up with a legal challenge. However, the reforms have now been bedded down.

Main Provisions

To appreciate the operation of the proposed provision, it is necessary to understand that the compliance with the interchange fees standard determined by the RBA could amount to conduct which is prohibited by the operation of Part IV of the *Trade Practices Act 1974* (TPA). Justice Deane, then a Justice of the Australian Federal Court, has explained the aim and purpose of Part IV of the TPA, noting that:

Part IV of the Act is headed "RESTRICTIVE TRADE PRACTICES". The general purpose and scope of the Part can be described by saying that it contains provisions which proscribe and regulate agreements and conduct and which are aimed at procuring and maintaining competition in trade and commerce.⁷

Compliance with the interchange fees standard can be seen as restricting competition. However, the TPA accepts that some restrictive practices may be of some benefit and provides exemptions under certain circumstances. One of these exemptions can be created under paragraphs 51(1)(a)(i) or (ii) of the TPA whereby practices which are designated by law or subordinate legislation for the purposes of these paragraphs must be disregarded when deciding whether a particular practice may contravene Part IV of the TPA.

By implementing **proposed new section 18A**, the legislature will designate compliance with the RBA's interchange fees standard as exempt practice for the purpose of Part IV of the TPA and, as a result, compliance with the standards will not attract the legal consequences of a violation of this Part.

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Concluding Comments

A provision with the same effect has been operating as part of the Payment Systems (Regulation) Regulations 2003. However, this provision was due to sunset on 30 June 2005 because under section 51(1C)(c) of the TPA, the operation of provisions prescribed by regulations is limited to a maximum of two years.

The proposed amendment to the *Payment Systems (Regulation) Act 1998* (the Act) will incorporate the exemption into the Act to which, under the TPA, no time limit applies. As a result, the exemption will exist until it is repealed by Parliament.

Endnotes

- 1 Reserve Bank of Australia, Australian Payments System, available at: http://www.rba.gov.au/PaymentsSystem/australian_payments_system.html, accessed 5 August 2005.
- 2 For the Commonwealth Bank, that includes the half-years ending in June and December 2004. For the other banks, the figures include the half-years to September 2004 and March 2005. Figures from Annual Reports and half yearly Reports.
- 3 These figures are taken from the latest annual survey of bank fees published in “Banking fees in Australia”, the *Reserve Bank Bulletin*, May 2005, pp. 65–69.
- 4 Reserve Bank of Australia, Interchange fees for the Bankcard, Mastercard and Visa credit card schemes, *Media Release*, No. 2003-14, 31 October 2003.
- 5 RBA, 2005, op. cit.
- 6 Australia and New Zealand Banking Group Limited, *Proposed changes to credit card interchange: Submission to the Reserve Bank of Australia*, [Submission](#), 14 April 2005.
- 7 *Refrigerated Express Lines (A/Asia) Pty Limited v Australian Meat and Livestock Corporation* (1980) 44 FLR 455.

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