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19 May 2006

The Hon Bruce Baird MP
Chair
House of Representatives Standing Committee on
Economics, Finance and Public Administration
Parliament House
Canberra ACT 2600

Re: Committee review of RBA payments system reforms

Dear Mr Baird

Thank you for the opportunity for ANZ to appear before the Committee on May 16, 2006 to discuss the Reserve Bank of Australia's (RBA) payments system reforms.

During questioning, we were asked about the optimum level for credit card interchange fees and how zero interchange would affect the credit card market. This letter provides supplementary information to that provided at the hearing.

Interchange fees are wholesale fees paid between financial institutions when customers of one institution are provided with card services by another financial institution. Interchange fees are the mechanism used by financial institutions to allocate or share the costs of payment systems between the merchant and cardholder.

In the case of credit card networks, interchange fees are agreed between financial institutions that are members of the card schemes and are paid to the card issuer by the merchant's bank. The merchant's bank (the acquirer) then recovers its costs from the merchant via a merchant service fee. These fees are a way of merchants contributing to the issuer's costs in return for the benefits they derive from being able to accept credit card payments.

Credit cards provide benefits to cardholders and merchants. The RBA reforms have effectively reallocated the costs of the system to the parties on the basis of benefit. As such, the interchange fee should be set such that merchants pay their fair contribution to the system from which they derive significant benefit. Benefits to merchants include, for example:

- the ‘buy now, pay later’ benefit to the consumer and the ‘sell now, be paid now’ benefit for the merchant. The card issuer assumes the risk of settling the transaction – a major benefit to merchants. That is, the merchant receives immediate guaranteed settlement and does not have to pursue customers for payment; and
- merchants do not have the costs associated with cash management and operating lay-by schemes. This feature levels the playing field for small merchants who can also effectively offer short-term credit to customers - a feature only large retailers could afford to offer in the past. This enhances the competitiveness of the retailing sector.

In summary, credit cards offer big savings to merchants’ own business operations, for example in distribution, debt collection, inventory, and cash management, which represents a positive net benefit to merchants.

Operating the credit card payment system is not costless. The result of the RBA reforms, to date, is that some costs previously recovered from merchants are now recovered from cardholders. A zero interchange fee would in effect absolve the merchant from paying anything towards the costs of running the system and as a result all the merchant’s costs would be shifted to the cardholder. This would be contrary to the public policy outcome of the RBA’s reforms that price signals accurately reflect the underlying costs of credit cards and of each participant in the payment system paying their share of the costs.

Zero interchange would mean credit card holders would likely face increased annual fees, increased interest rates, reduced or no interest-free period (which delivers benefits to card holders and merchants) and curtailed or no loyalty programs.

If you require further information, please do not hesitate to contact me on (03) 9273 6323 or nashj@anz.com.

Yours sincerely

Jane Nash
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