COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON ECONOMICS, FINANCE AND PUBLIC ADMINISTRATION

Reference: Review of the Reserve Bank and Payments System Board annual reports 2005

TUESDAY, 16 MAY 2006

SYDNEY

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HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON ECONOMICS, FINANCE AND PUBLIC ADMINISTRATION

Tuesday, 16 May 2006

Members: Mr Baird *(Chair)*, Dr Emerson *(Deputy Chair)*, Mr Ciobo, Mr Fitzgibbon, Ms Grierson, Mr Keenan, Mr McArthur, Mr Secker, Mr Somlyay and Mr Tanner

Members in attendance: Mr Bruce Baird, Mr Steven Ciobo, Dr Craig Emerson, Mr Michael Keenan, Mr Stewart McArthur, Mr Alex Somlyay

Terms of reference for the inquiry:

To inquire into and report on:

The 2005 annual reports of the Reserve Bank of Australia and the Payments System Board

WITNESSES

Committee met at 9.01 am

MAIR, Mr Peter, Private capacity

CHAIR (Mr Baird)—Welcome. Do you have any comments to make on the capacity in which you appear?

Mr Mair—I appear before the committee as someone who takes an interest in public policy issues associated with retail banking payment systems and some other things.

CHAIR—We are very much aware of that. Although the committee does not require you to give evidence under oath, you know that this hearing has the same standing as proceedings before the parliament. We have received your written submission to this inquiry. Do you wish to make an opening statement?

Mr Mair—I would like to say a few words, and I appreciate the opportunity to do so. The way I see things, Australia still has no prospect of getting the efficient retail payment system which, in the wake of the Wallis inquiry, the Reserve Bank of Australia was given responsibility and authority to deliver. Put bluntly: none of the major players running the retail payment system wants change. I listened yesterday, as you did, to evidence from major players and I see no reason to soften that assessment. Indeed, if the parliament is serious about its committees being given evidence in good faith, some things said yesterday would not pass muster.

The dominance of Australia's major banks in the retail payment system largely reflects exclusive access to the proceeds of objectionable deals done with regulators and to other offensive trade practices widely considered contrary to the public interest. One cannot expect major players or their front organisations to come before a committee with their hands up, ready to surrender to the spirit of the law. Nonetheless, it is unedifying to hear bland defences of current schemes and unfairly protected monopoly positions that are clearly contrary to the public interest. On the other hand, one cannot excuse the clear and continuing ineffectiveness of the Reserve Bank in this matter—and, in passing, I note the Governor's absence from these hearings.

Regulatory responsibility for unwinding the deals and the offensive trade practices that corrupt the efficiency of the retail payment system was given to the Reserve Bank. It was not a wise decision. After a decade of running around in circles on credit card schemes, the bank is now proposing to regulate EFTPOS fees and related arrangements. No-one believes this policy package will work, not even the bank. The bank is again asking for another chance, proffering another review next year, with vague promises of doing things better in 2009. The community can have no confidence in a process akin to waiting for Godot. Frankly, the form guide for the bank in this race suggests a dead horse.

Australia does need an efficient retail payment system, and the committee has questions to consider about the proper regulation of it in the future. As suggested in my submission, it is time for the government to saddle a fresh horse and give riding instructions that will ensure it runs truly. Yesterday, the suggestion was made that that fresh horse may be the Productivity Commission and that Gary Banks might be the rider. Gary Banks is an outstanding public servant, as I am sure you gentlemen know, and I have no doubt that he would sort this lot out good and proper. Banks on banks—back it!

I want to mention how pleased I am with the generous offer that I think the retailers made yesterday. They did not have to do that. The proposal that all interchange fees be set to zero was right in the ballpark of where things should be headed. There are different ways of getting either to zero or close to zero. The United Kingdom have taken the option of declaring certain costs in interchange fees to be extraneous and, therefore, fairly excluded. I might take a slightly different tack and say that basically a lot of the alleged costs are illusions. In addition to arguments about costs and whether they are extraneous or illusory, I make the point that the idea that an allowance for fraud would be included in those interchange fees no longer has any credibility.

Before I close, I just make mention of the possibility that the Australian Taxation Office could make a very useful contribution to the way the market works in the retail payment system. There is scope to administer the income tax law to reduce the attractiveness of various tax avoiding barter schemes that are entrenched in the banking industry. These barter schemes are simply contrivances underpinning a range of inappropriate practices. The banks and some others have made an art form of converting tax deductible business expenses into tax-free income in kind in the hands of their customers. That artwork, while clever enough, corrupts the efficiency of Australia's retail payment system, and the ATO could fairly put a stop to a lot of the nonsense that is going on. Thank you.

CHAIR—Thank you very much, Mr Mair. That was a provocative and interesting introduction to your paper. Thank you also for your emails, which you send through regularly. We do appreciate them. Obviously, having an objective mind on these issues is very much welcome. You have mentioned whether responsibility for the retail payment system should have gone to the Reserve Bank. People on this committee also question whether it should have gone to the Productivity Commission or the ACCC et cetera. Do you have a view on a more appropriate body for it to go to—the Productivity Commission or the ACCC?

Mr Mair—In the normal course of events, the Productivity Commission would be one agency that could do what I have suggested, which is, in a sense, to lift this bit out of the bank, where it is now, and coordinate a proper inquiry. That would, as I have said, put the evidence on the table and explain to the community, in a way that has not been done before, just what is going on. The government would receive a report from the Productivity Commission and it would then be a matter for the government to make a decision on the regulatory agency. The ACCC has a lot of things to do, and I am not sure I would want this added to a list of things it may eventually get around to doing. In the United Kingdom, when they took the Bank of England out of the game, they gave the Office of Fair Trading additional resources to deal with the banking industry. The idea that there needs to be an agency putting in a major effort for a long time on this is, I think, incorrect. Once this matter is sorted out, you would get to a position—and people talked about it yesterday—where there would not be much need for further ongoing regulation and you would leave it to the market.

CHAIR—It sounds as though you agree that there should have been a reduction in the interchange fees.

Mr Mair—The fundamental problem with the Australian retail payments system at the moment is credit card interchange fees.

CHAIR—They did move to reduce them.

Mr Mair—Yes, but coming down from 0.95 per cent to 0.55 per cent has left so much slack in the system. That policy has not worked; everybody can see it has not worked.

CHAIR—The drop in interchange fees has left the consumer wondering whether they are better off. There is no evidence that there has been a reduction in prices as a result. Card charges have gone up, in many cases by 100 per cent, and the benefits have been substantially reduced. If it were to go down to zero, wouldn't that further exacerbate the problem of the cost of the cards and the further reductions in benefits? Would the consumer be better off?

Mr Mair—With respect, this is pea and thimble stuff on a scale which, I think, you people have not had to come to grips with before. The so-called rewards are only payable because the interchange fee is excessive to start with. That is where they get the money from to pay the rewards. I do not know where the idea came from that people should be given a reward for using a payment instrument. I will not elaborate on it too much here, but it is basically a form of predatory pricing by the major banks who can afford to run loyalty schemes and so on. It is not good for the small players. There is no way a small credit union can tie up with Qantas to offer a reward scheme.

The other idea is that the community should not be paying for the transactions that they make. With respect, I do not think that is a sensible idea either. It is very important in this market, as in every other market, that the community, the customers, face clear price signals about what they are doing. In this pea-and-thimble arrangement, the banks use a form of pricing which I call 'all-you-can-eat pricing'. Once you have paid your annual fee for your credit card or you have paid your five bucks a month for your transaction account, you can do what you like; every transaction after that costs you nothing. The price system which economists rely on to keep the system working properly and efficiently is not allowed to run in this industry.

CHAIR—There are costs involved in running card systems.

Mr Mair—There are substantial costs.

CHAIR—Why should the banks who operate them, or the card issuers, not be paid something?

Mr Mair—They must be paid. They have got to recover the costs. In the normal way that they would recover the costs, they would charge the customers for using their cards or for writing a cheque. As I said a minute ago, to the extent they have charges in place, they are those sorts of funny charges which are sort of all-you-can-eat prices, which means the next cheque you write or the next withdrawal you make will cost you nothing. In the background of all this is the insidious barter arrangement whereby hundreds of billions of dollars are kept in bank accounts and no interest is paid on them. The banks earn interest on the investment of that money. It is not given to me or you in a form where we are required to pay tax; it is used to cross-subsidise these all-you-can-eat schemes plus some other arrangements that you guys find attractive, whereby basic banking services are free of charge and all that nonsense. There are plenty of ways to help poor people other than by wrecking the whole system.

CHAIR—That is very much the free market answer.

Dr EMERSON—On the free market: you mentioned monopoly in your opening statement. If there were not barriers to entry, then we would have a free market.

Mr Mair—I have been in this game for over 40 years and I have listened constantly to regulators and governments and whatever talk about how they will be bringing competition to the banking industry. You and I have sat around and watched it get tighter and tighter.

Dr EMERSON—Well—

Mr Mair—There is no new entry and—

Dr EMERSON—That is not right.

CHAIR—There is one new one, I understand.

Dr EMERSON—In the credit card business, but in the banking industry there are plenty of new entries.

Mr Mair—That is MoneySwitch, I think, who are going to be an acquirer of transaction services. They are not taking deposits, I don't think.

CHAIR—We will ask them.

Dr EMERSON—My question is: what are the barriers to entry? How do they keep them out?

Mr Mair—The barrier to entry is the one I just mentioned, which is that arrangement that allows the four major banks who monopolise, dominate, the retail payment system to have hundreds of billions of dollars in transaction accounts on which they pay no interest. That generates a tax-free income for them of, in ballpark figures, $10 billion to $15 billion a year, which they then use partly to subsidise the free services and other things. Nobody else can get into that game. When the foreign banks came and when the building societies and credit unions tried to get into this game, if they had put ads in the paper saying, 'Bring your money to us; we'll pay you nothing,' they would have got nothing. They had to offer to pay interest on their deposit accounts, whereas the banks had this inertia running for them. They had all the money there and they did not offer competitive interest rates on their deposits, whereas the building societies and credit unions and the foreign banks had to.

When the foreign banks first tried to come in here, as you know, they went home quickly with their tails between their legs because they could not make any impression on the market because of that. The same applies in England and America where their banks have the same privileged access. It is called the endowment. The major banks are endowed with this windfall income that comes from not paying interest on current account balances. In their jargon, it is called CANBIs—current accounts not bearing interest. They know it is a river of gold.

CHAIR—But those foreign banks are pretty big. They are much much bigger than the Australian banks.

Mr Mair—Not in retail banking in Australia.

Dr EMERSON—No, but if a foreign bank said it wanted to get into this market—and it would have plenty of surplus, too, to cross-subsidise—it could use its very big profits to say, 'We will get into this market and we will charge an interchange fee of 30c or 20c.'

Mr Mair—You saw what happened back in the late eighties when that war was on. They were trying to get in using various ammunition supplies in the form of subsidy from their offshore operations. We nearly broke this banking system. Four of the state banks went under, basically.

Dr EMERSON—That was from very imprudent lending practices.

Mr Mair—The whole thing was connected. What we know is that there have not been any new entries—the smaller banks, the building society banks, the credit unions and the building societies that are still building societies. To the extent that they have a role in the payment system, it is basically by the grace and favour of the major banks. The major banks can take them out any time they want, and they may well go.

Dr EMERSON—My last question is: if the problem is, as you identify it, the interchange fee, has it not been almost half solved? Would it not be completely solved if the Reserve Bank issued another bit of paper which said 'It is not going to be 55c any more; it is going to be much less'—just to cover costs?

Mr Mair—Just for fun, I think we need to be getting close to zero. If you took out what the United Kingdom regulators are calling extraneous costs, which is the whole illusion of that interest-free period—that is smoke and mirrors like you wouldn't believe—and you took out the fraud, the fraud that continues to exist in the credit card game is entirely discretionary because they do not use PINs. You heard yesterday that there is no fraud, apart from a little bit of sophisticated technical stuff lately duplicating magnetic stripes. By and large, there is no transaction fraud with EFTPOS cards. Fraud continues to be an issue with credit cards only because of the reliance on the signature.

Mr SOMLYAY—Were you here for the evidence given by the Australian Consumers Association?

Mr Mair—I was.

Mr SOMLYAY—What did you think of that?

Mr Mair—I was pleased to see that they had stepped away from the support they used to give to the credit unions and Visa Debit. The important point made by the consumers association yesterday is a point I make also in my papers. The functionalities that attach to credit cards—over the phone, on the internet, the line of credit and this new little wrinkle they have put on it, this tap and go nonsense—only apply to credit cards. They apply to Visa Debit, which is a credit card masquerading as a debit card. Those functionalities need to be attached to your EFTPOS card. The idea that our banks allowed those additional functionalities to only attach to the product which was so—I will use the words of the Europeans—outrageously profitable meant Australia was let down.

I think we need those functionalities. We need to be able to make payments over the phone, over the internet. We need a stored value card so that if you want to buy a Coke at a vending machine you just wave a card near it, it knocks off a dollar and that is great. We need those, but we do not need them attached to credit cards, which come with an expensive merchant service fee coupled with an interchange fee. We need those functions attached to a debit card, for which the charges and the costs to merchants are very low.

Mr SOMLYAY—Do you have a view on what the credit union has said to us? Were you here for that?

Mr Mair—I was. Twenty-five years ago, working with the Campbell committee, we gave the credit unions a big leg up. They were very much mutual organisations looking after their customers and so on. They still do that to some extent. They got waylaid into this game with the major banks where, uniquely in Australia, the major banks said, ‘If these credit unions and building societies come in, they are not coming into our system for free, we will charge them.’ So they put that interchange fee on the EFTPOS so that the credit unions had to pay the acquirer. Australia is unique in the world in this regard. That was one way they got them: the banks put a fee on the business that the credit unions and building societies did that had to go through a major bank acquirer.

As an offset to that, the major banks using the Visa scheme then said to these little guys, ‘Look, you can offer this debit card, but if you tell your customers to use it as a credit card, you will pick up 1.2 or one per cent’—or whatever it was—‘as the interchange fee paid to the card issuer.’ So all of these little guys played the game. They told their customers: ‘When you are buying things, always press the credit button. You are not allowed to overdraw the account; it is not a credit card. You must never overdraw the account.’ But if the customers pressed the credit button, they would be given 1.2 or 1 per cent of the value of whatever their customers bought. So they then got this revenue stream which helped them to pay the fees they were giving to the majors for letting them have their ATMs and EFTPOS cards. I want that Visa debit to come to an end. Over 10 years ago, I pointed out clearly how this should never have been allowed to start. It is unfortunate that it has taken 10 years to even get close to putting a stop to it.

Mr McARTHUR—What would you suggest is the best way to establish the interchange fee on its own for the cost of the operation of the system?

Mr Mair—The short answer is the simple answer that I think the retailers gave yesterday, which was basically to set them at zero. Everybody else that came yesterday said they were interested in setting the fees in relation to costs. That is sort of the track that the Reserve Bank went down. In 2001, in the middle of December, it got very close. As far as I was concerned, it promised the community the right answer. They said, ‘We will not allow the banks to include an allowance for the cost of the interest-free period.’ They still allowed the fraud and a bit of other processing stuff but, had they held their line then, we would not be meeting here today—this problem would have been dealt with then. It is a question of defining costs that are eligible and measuring them properly.

Just as a matter of interest, many people came here yesterday and talked about a cost basis for setting interchange fees. An academic came here and he used a sophisticated concept in economics that looks only at the resource social costs and does not count any transfers associated with it. So, from a strictly academic point of view, if you are just looking at the social costs, this guy could say openly, as he did, ‘Credit card or debit card—it doesn’t matter. It’s the same bit of plastic, the same system, it costs the same.’ It is not the same for the merchants. The transfer payment that the merchants make, the interchange fee, is a transfer of income in a social sense. It is not a cost, but it still distorts the way the world works.

The banks also say they want this cost base. The credit card schemes offer the illusion of benefits: this so-called free credit period. That is basically an illusion. Most people who pay off their card on time already have the money in an account on which they are not being paid interest. The bank lends them money for nothing; they lend the bank money for nothing. Every month they ring up and square it off. The banks like to include as a cost a benefit which the customers could take if they wanted to—that is, if you really wanted to put in all the effort and manage your affairs so that you only had money in your account every 55 days.

Visa and MasterCard had a concept of cost which was quite amusing to me. They were basically saying that interchange fees were a way of sharing the costs. But one of the costs they wanted shared was what it would have cost the merchants if the merchants had to provide their own card system and credit system. As far as I am concerned, that is not a cost at all. That is saying to merchants, ‘If you had to do this yourself, you’d have to run a cost. So when I am setting what I call my costs, I am including what you would have had to spend.’ Only a cartel could put that deal to someone and get away with it. I am happy to run with a cost base format for setting interchange fees. I will not bore you with the detail today, but I would be more than happy to help anyone get a fix on the costs that should be included.

Mr McARTHUR—So it can be done—you can estimate the costs of the interchange?

Mr Mair—All these things require an element of judgment, of course. It certainly can be done sensibly. I do commend to you the general idea that a zero fee would fix credit cards and it would fix Visa Debit. Whether you do it the UK way—calling it extraneous costs—or whether you take out fraud, because it is a discretionary thing that should not be in there anyway, the closer you get to zero.

CHAIR—What is the UK way?

Mr Mair—The Cruickshank report came out in the UK in March 2000. Cruickshank basically said what I have just told you; that is, the banks were running a bit of a racket. He said he wanted these so-called free credit expenses out, which is what I want and what the Reserve Bank said a few years ago it also wanted. Any allowance for this interest-free credit is an illusion; it should be taken out.

Regulators sometimes get caught up in semantic games in which they have freedom to do this, not to do that and so on. In the UK, the Office of Fair Trading has come down with a decision which avoids having to measure the cost. It just says: ‘This is an extraneous cost which doesn’t necessarily have anything to do with offering this product. If you want to give free credit, go and do that, but do not ask us to let you charge someone else—the merchant—because you decided to give free credit to someone else.’ The Office of Fair Trading has said that it is an extraneous cost, and that is a sensible way to deal with it. As I said, there are a few ways you can deal with that, and all of them will bring it down close to zero.

CHAIR—So there is no interchange fee per se in the UK?

Mr Mair—At the moment, there still is. The Office of Fair Trading has announced this decision and communicated it to Visa and MasterCard. Other important developments are occurring at the European competition commission, and I have sent the secretariat a copy of that report. They are calling for submissions by the middle of June. They have picked up on what is happening in the UK and they are bringing to the European Union the idea that they are going to put a stop to this racket. They have told them clearly that they are going to stop it.

Mr McARTHUR—Could you comment on how the banks arrived at the 55-day interest-free period, the 16 per cent interest they charge and, with the recent competitive pressures, the figure of 8.5 per cent they are now suggesting? Why is there a major discrepancy and how did they get away with 16 per cent in the first place?

Mr Mair—It used to be 18 per cent and I think it got up as high as 21 per cent. I was involved in all of this stuff over the years. When credit cards first came to Australia, the interest rate was 18 per cent. It was not called ‘18 per cent’; it was called ‘1½ per cent per month’; but those who had a calculator could get 18 per cent out of that. With compounding and so on, it was probably a bit more than 18 per cent. Basically, the 18 per cent or the 16 per cent is an instruction to the customer. The banks are telling the customers, ‘We don’t want you to borrow.’ Even though it is called a credit card, even though people are silly enough to pay 18 per cent and it is profitable, the reason the interest rate is set so high is that the banks are basically saying: ‘We only want you to use this as a transaction device. We don’t want you to borrow.’ Of course, a lot of people do borrow—they are called ‘outstandings’; you can read about them in the banks’ financial statements—and, to the extent that that money is owed by people who can pay it back, that is fine. I have no sympathy for people who are paying 18 per cent. If somebody is silly enough to pay 18 per cent, 16 per cent or whatever, they get no sympathy from me, because they do not have to do that. I think this committee should just focus on credit cards as a transaction device and keep that separate. The fact that there may be a loan attached to it, with a higher or lower interest rate, is a separate matter; it is a credit decision and, by and large, does not have any bearing on the use of credit cards for transactions, which is the focus of this inquiry and the focus of my concern.

Mr McARTHUR—I take your point of view that credit is used as a stopper now. Some operators are suggesting 8.5 per cent. How could there be that sudden change of mind-set?

Mr Mair—This becomes part of the pea and thimble trick they play. If you go down to Wynyard—I will not give an advertisement for the bank—you will see that they are handing out brochures about eight per cent or whatever. By and large, it is only for six months. In America it has gone crazy. I think someone mentioned yesterday that everybody in America gets four mail-outs a year. It is all pea and thimble stuff. They want you to move and, having got you to move, they rely on inertia that you will not move again.

Do not underestimate inertia. The reason the major banks run this game the way they do is that people like me—I will not say you—are silly enough to put money with them and they pay me no interest when it is put in a transaction account. That is the way it works. It is the inertia. There are only four of them to go to. There is no point going to a different one every week. At the end of the day they are all the same anyway. It is like Visa and MasterCard. You think they are two different organisations, but the rules are identical. It is the same with the four majors. You get little wrinkles one way or the other but, by and large, it is the same deal.

Mr SOMLYAY—If my bank does not want me to borrow on my credit card, why do I get a letter every three months offering to extend my credit limit?

Mr Mair—In the case of a good customer like you, Alex, they would want you to borrow.

Mr SOMLYAY—But I do not.

Mr Mair—It is an intelligence test whether you choose to pay them the 18 per cent. I am sure you pass that one as well. Back on that credit union thing, it is quite likely that the credit unions, if they do not issue the Visa Debit nonsense, will start to issue credit cards. There is nothing stopping them saying to their customers, ‘We are going to give you a credit card and the rules are that you are never to borrow more in the way of credit than you have on deposit with us at any time.’ It is within the gift of these credit unions and the current silly rules that they could structure a product that would be exactly the same as Visa Debit. It would not be called that. There would be a little more risk at the fringes. It is the same now. If somebody has got one of these cards and they decide to go on a shopping spree, they can run up a big debt. I have overworn the analogy, but it is pea and thimble. Keep your eye on it. That is how this game is played.

Mr KEENAN—If it were to be a zero interchange fee, who would bear the cost? There is obviously a cost in running the system.

Mr Mair—Certainly. The merchants have costs and they have to recover those costs, probably in the prices they charge for their products, in the same way as they already cover the costs of dealing in cash and whatever. It is an overhead if you are running a shop. You have got to have money for payment. Then there are the banks. It is true that these systems are expensive to develop and operate. The payments system has to work and, by and large, as you know, it does work very reliably. That costs. Those costs have to be recovered. While it might sound a bit silly to say this to a group of parliamentarians who take great comfort in all this free banking and basic banking for nothing business, the fact is that this community would be far better off if there were an explicit price when we used a payment instrument—not an ‘all you can eat’ price, but an explicit price that reflected the cost of the different services—so that we could choose which one we wanted on the basis of how much we were prepared to pay for the service we were getting back. At the minute there is no price system working in the payments system.

CHAIR—Hasn’t the Reserve Bank gone about halfway to your preferred position?

Mr Mair—This is the 95c to 55c?

CHAIR—Yes.

Mr Mair—No.

CHAIR—And also some of the new rules about surcharging and accepting all cards stuff.

Mr Mair—All that disappears the minute you get those interchange fees down to zero. There may be a case for having an interchange fee in the early stages of setting up a payments network but, for a mature payments network like credit cards, BPay or EFTPOS, there is no longer any need for that. There is an infant industry argument, but it no longer applies to these grown adults who are quite capable of gross misbehaviour.

The banks need to charge their customers. There are some customers—and you know who they are; they write to you often—who cannot afford to pay bank fees. They need to be provided for. There are various ways of doing that. My own preference would be that certain people who are eligible for social security benefits would also be eligible to conduct a basic bank account for which they would not be charged fees by the bank and the banks would then be reimbursed from government revenue. They would tender for that business. You would get a damned good deal.

CHAIR—Thank you for that. It was a very interesting and provocative session.

Mr Mair—I must say how pleased I am that after many years this committee has had a hearing that ranged more widely than just the Reserve Bank. Thank you.

[9.46 am]

McDONALD, Mr Moray, Managing Director, Diners Club Australia

CHAIR—I now welcome Mr McDonald of Diners Club. Although the committee does not require you to give evidence under oath, this hearing still has the same standing as proceedings before parliament. Do you wish to make an opening statement?

Mr McDonald—If you like, I could describe the scope of Diners Club in Australia. Is that a benefit or are you well aware of that?

CHAIR—Briefly, please.

Mr McDonald—I can be as brief as you like.

CHAIR—I was thinking more in terms of the issues we are considering rather than the scope of Diners per se.

Mr McDonald—In that case I will just take your questions.

CHAIR—All right. Obviously you are one of the cards that is seen as being a beneficiary of the changes that were made by the Reserve Bank in terms of restrictions on interchange fees by designated schemes. Diners Club and American Express were outside of those provisions. As such, we see a growth in the market of these schemes. Have you experienced significant growth since the changes have occurred.

Mr McDonald—We had a growth trajectory prior to the reforms and we have had growth since. Essentially, as you note, the Reserve Bank correctly chose not to regulate Diners Club. None of the bases for regulation applies to Diners Club. That is why I say they correctly decided not to. The model of our business remains unchanged pre and post. We were quite successful before. We have continued to be successful after. We are essentially unaffected by the letter of the reform, but we have continued to grow after the reforms.

CHAIR—What percentage have you grown since that time?

Mr McDonald—That is commercial information.

CHAIR—Is it—or not? These are figures provided by the Reserve Bank.

Mr McDonald—Those figures are correct.

CHAIR—You do not want to assist us in this?

Mr McDonald—The figures that we provide to the Reserve Bank are correct.

CHAIR—Thank you for your cooperation. Can we go through the benefits that you offer. If we take your card in terms of the four-party scheme and in relation to your arrangement with Qantas and the ANZ Bank, where customers faced changes because of the restrictions that were placed on the Visa card, people were enticed to go to the new card with Diners. The result was an increase in card costs from what they previously experienced—is that right? There was a liquidated damages charge—

Mr McDonald—Sorry—an increase in what?

CHAIR—In the card charge, over what they would have experienced before?

Mr McDonald—No.

CHAIR—It cost the same as a Visa card—is that right?

Mr McDonald—That is about four questions. Are you asking me specifically about our relationship with ANZ?

CHAIR—Yes, in terms of the previous arrangement, where Qantas had a card with ANZ, an ANZ Visa card—

Mr McDonald—Yes.

CHAIR—and then people were encouraged to trade up because of the restrictions on the benefits, a $1,500 limit, and they went down to half a point—

Mr McDonald—Would you like me to describe how our product works and what was offered to customers?

CHAIR—I would like to ask a question first.

Mr SOMLYAY—I would like to hear it.

Mr McDonald—What is the question? I was not sure which product you were asking me about.

CHAIR—We have a change in the system. Because of the designated card arrangements, the ANZ shifted, where they were encouraging people to join your card.

Mr McDonald—That is correct.

CHAIR—As a result, they did not have the restriction on the points when they reached $1,500, but there were certain downsides, as I understand it. Your card is more expensive than the Visa card.

Mr McDonald—Let me explain what the product does. I think I have to do that in order to answer your questions.

CHAIR—I have other parts to the question because, as I understand it, there is a liquidated damages clause. I am just talking about the difference between the designation of the other cards and your being the beneficiary. There was a liquidated damages clause, whereby interest was charged at about three per cent if it was not paid within, I think, a month, and customers lost their frequent flyer points at the same time.

Mr McDonald—Are you aware that our card is not a replacement for the ANZ card? You say that it costs more. The idea is that it is a companion card.

CHAIR—What I am trying to say is that there were charges in the market to the ANZ-Qantas card and then people were encouraged to transfer to your card. I am just trying to point out that there were certain differences in the way it operated. We are trying to work out where the consumer is worse off.

Mr McDonald—If you would permit me to describe the differences, then perhaps we could discuss what the customers' motives were for making the changes they made.

CHAIR—Okay.

Mr McDonald—Obviously I have to be careful in talking on behalf of ANZ. This is what I understand ANZ to have decided. As a result of the RBA changes, they decided that it made sense for them—not for us—to make some changes in their product.

CHAIR—I understand that—it is a free market.

Mr McDonald—That included their Qantas Visa card. Having decided to make those changes, in which we were clearly not involved, they then decided that it would be of benefit to their customers to offer them a Diners Club card, so ANZ invited us to offer a Diners Club card. That card was separately priced. It was a completely separate product. It was not an offshoot of their ANZ Visa card. It was a card such as we might offer directly in the market—namely, it had its own fee; it had our, not ANZ's, terms and conditions, a part of which is the fee that you refer to in terms of late payment, which we call LDC. So there was absolutely no coercion or compulsion; there was simply the offer of that to their customers. A proportion of those customers chose to take that separate product and, of course, they were then bound by its terms and conditions, as they would be if they voluntarily took any product in the market. It was a product that was intended to be held alongside their ANZ Visa card and the great majority of the customers who took it have maintained both cards. This was in a free market: customers chose to act in their own best interests and took a completely separate product.

CHAIR—It was not exactly a free market, because the Reserve Bank intervened by designating that some cards would be subject to the interchange fee requirement. Others escaped that net and therefore were able to offer packages which the other cards could not offer—for example, Visa could not offer the benefits that you were able to offer.

Mr McDonald—At all times and under any regulation we will seek to offer the best products we can.

CHAIR—Would you like to see the existing arrangements continue or would you prefer that we move to the zero interchange fees and arrangements on all cards that some of our witnesses have spoken about?

Mr McDonald—It is a difficult question to answer because you are talking about my response to an outcome. This comes back to the role of the Reserve Bank. I think the Reserve Bank has to set out some goals in terms of market workings and then frame regulations to encourage what it sees as those goals. You can argue till the cows come home whether it has been successful or not—and maybe you will ask me that.

CHAIR—Maybe we will. What is your view? Has it been successful?

Mr McDonald—The point I was going to make was that if there are ways in which Diners Club operates which are not transparent and which restrict competition—for instance, if we acted collusively—I would expect that would be a reasonable pretext to be regulated. Since we do none of those things, I am unaware of any reason the RBA would have to bring us within any net of regulation.

Dr EMERSON—Does that imply that the ones who are being regulated do behave in that way?

Mr McDonald—They belong to some clubs or associations which have a common set of rules. Unlike Diners Club, which issues every single Diners Club card in the market and which acquires every Diners Club transaction in the market, credit cards act according to some common rules. If you interpret that in any sense as being collusive, that the prices set within the different parties within that system are not transparent and open to competitive forces, then you should regulate. I think that is what the RBA believed and therefore they did. It is hard to see how that possibly relates to an organisation which operates in a completely free market, such as Diners Club.

Dr EMERSON—If we were talking about petrol or concrete, the ACCC would be doing that job. In your view, is there a role for the ACCC to be looking at any evidence—I am not asserting from where I am sitting whether or not there is such evidence—of collusive or non-competitive behaviour? Is that the domain of the ACCC?

Mr McDonald—That is what I understand it to be. I understand that anticompetitive market practices, the abuse of market power and collusive behaviour is the role of the ACCC.

Dr EMERSON—I am not suggesting that you should be an expert on this at all.

Mr McDonald—I am not and I would not put myself up as one, but I understand that is their role.

Dr EMERSON—Logically, you wonder then why in this particular industry the Reserve Bank is the champion of competition and in other industries such as concrete, cardboard, petrol and a few others it is the ACCC.

Mr McDonald—I have an imperfect understanding of this area. My understanding is that parliament has delegated powers to designate and then regulate to the Reserve Bank. I am afraid I am not expert on the interplay between the Reserve Bank and the ACCC.

Mr SOMLYAY—You operate in many countries—I do not know how many—across the world. How does our regulatory system compare with comparable countries?

Mr McDonald—Comparable in the sense of what you would ordinarily call developed or Western countries?

Mr SOMLYAY—Yes.

Mr McDonald—I understand it to be a little bit of a patchwork. Are you asking specifically about interchange regulations?

Mr SOMLYAY—Yes, the way your industry operates.

Mr McDonald—Regulation of the payment system is widespread, so I think every developed country has laws and regulations on the way the payment system can or cannot operate and limits on the behaviour of the parties in the system, such as consumers, merchants, and credit card and charge card companies. As I understand international comparisons, Australia has been at the forefront of pursuing interchange regulation. If you are talking particularly about the level of issuer interchange, Australia is very much at the lower end of the developed economies. To put that more directly: the income derived from the value of every transaction from an Australian credit card is lower than that value would be in other developed countries because of the level of issuer interchange. However that arrived where it is tends to be higher in other developed countries, such as the United Kingdom and the United States of America, than it is here. Again, I am far from being an expert in regulation of payment systems internationally.

Mr SOMLYAY—No, but you run a business.

Mr McDonald—I run a business in Australia.

Mr SOMLYAY—And I presume run the business in other countries. I am saying in Australia—

Mr McDonald—I do not actually, but I am a member of the Diners Club International Global Board, so I have some exposure to other countries.

Mr SOMLYAY—Do you have problems with regulation in Australia that you might not have in other countries?

Mr McDonald—No, no problems. I have no problems with the regulation of charge cards by the Reserve Bank in Australia. The element of the changes in October 2003 which had most effect on Diners Club was surcharging. We have never sought to discourage our merchants from asking for whatever payment method they prefer, so the regulation of surcharging was not an issue for us. We regard surcharging as an issue between the retailer and the customer, not between the retailer and us. If the retailer believes that it is positive for their relationship with their customer to negate and refuse their payment choice, then that is what the retailer should do. Retailers in more competitive situations have chosen not to do that. Our observation is that retailers who feel they are subject to less competitive pressure have tended to surcharge.

Mr CIOBO—Do you concede that there is now an uneven regulatory playing field between three-party schemes and four-party schemes?

Mr McDonald—There literally is because there is a whole set of regulations—

Mr CIOBO—Just with respect to interchange fees.

Mr McDonald—There are no interchange fees for charge cards.

Mr CIOBO—Do you concede that there is now less attractiveness flowing to issuers of four-party card schemes than there is to three-party card schemes as a result of the regulation of interchange fees?

Mr McDonald—The attractiveness for whom—the issuer?

Mr CIOBO—For the issuer, and then obviously that flows on to the customer.

Mr McDonald—That depends. The regulation clearly had some effects, and it was literally to regulate one bunch of people in one system and to leave others unscathed. To that extent I completely agree.

Mr CIOBO—They are competitive products, aren't they?

Mr McDonald—Yes. There is a level of competitive crossover—though not completely. A very large part of my business is providing payments for corporates, which is an area of commercial cards where most of the banks are not very successful. So there is some competitive crossover; it is not a 100 per cent match.

Mr CIOBO—But, as a customer, if I am interested in pursuing rewards—which I think many customers are, especially transactors—do you concede that I am going to be more drawn to your product or Amex's product over a traditional four-party scheme product?

Mr McDonald—I think it depends how you balance out rewards against other things you want from the card. Do you like paying fees? Are you willing to pay a fee? Do you want a card that is accepted by every single merchant in Australia or are you willing to have a card that is only accepted in some places? Even customers who are very rewards motivated set that off against benefits that they might receive from a credit card. Credit cards are much more likely to offer you a fee-free card just because of their economics. If you occasionally wish to borrow and or not to repay your bill, I feel I cannot offer that to you. I am a charge card. I have to ask you to pay at the end of the month. So I think the picture is not one that is completely black and white, frankly.

I offer a superior rewards program to that offered by most credit cards—although not all, by the way, as there are still credit cards that provide one point per dollar spent and either do not cap or provide extraordinarily high caps to earnings—but you have to offset that against the fact that mine is a product for which a fee is charged and the fact that not every merchant in Australia accepts Diners Club, although we try our best to persuade them to do so. I agree with you that there is a tendency for customers to come to products that offer the highest rewards benefits, but there are offsetting advantages and disadvantages to every payment product. I do not want to sound evasive

Mr CIOBO—Is Diners Club looking at any cobranded cards?

Mr McDonald—We have cobranded cards at the moment with ANZ, Qantas and quite a large number of professional associations. Yes, we would always consider cobrands. The structure of our agreement with ANZ is a simple cobrand.

Mr CIOBO—Is the market share for the cobranded card with ANZ reflected as Diners Club market share or ANZ market share?

Mr McDonald—Diners Club, because it comes through our system.

Mr CIOBO—So the increase in market share that Diners Club has experienced would in part be from the roll out through ANZ banks.

Mr McDonald—Yes—as well as from Qantas and from the fact that we dominate government payments in terms of our corporate business. We have had a number of sources of growth which have been valuable.

Mr CIOBO—A submission yesterday from Visa spoke about a principles based approach to the setting of interchange fees. Obviously, under a three-party scheme that is not possible, because you do not have interchange fees as such.

Mr McDonald—No.

Mr CIOBO—But if there was a principles based approach that sought to apply something uniformly across the various card systems, what would be your reaction and response to that.

Mr McDonald—I am not clear about how it would work.

Mr CIOBO—So you could not see any way in which it could operate with regard to—

Mr McDonald—I literally mean that I do not know what it is that they are proposing, not that I think it would not work. I just do not know what they are proposing.

Mr CIOBO—I am going out on a limb here, but I would speculate that, between you and Amex, it would look at some way of analysing costs with respect to the commission paid back in marketing. I think you pay marketing commissions and things like that to some of your issuers, such as ANZ, for example.

Mr McDonald—No—nothing; not a cent. I am aware that arrangements like that exist in the market. We do not pay a cent. What has to be recognised here is the delegated powers that I understand the RBA holds to designate and regulate require them to have a reason to intervene. If it can be shown in any way that the way in which my business operates fails adequately to provide transparency, distorts the market in some way, is unfair or collusive et cetera, then we would be very happy to be caught within the net of further regulation.

Mr CIOBO—Otherwise, you would rather be left alone.

Mr McDonald—I would imagine that good public policy does not require you to set superfluous regulation where there is no distortion to markets. If you look at the way we operate, we individually negotiate every merchant rate with every merchant. We are quite transparent in what our product costs, and it is paid for by the customer. Any merchant who does not wish to take us does not. Any merchant who wishes to pass on the charge of our merchant fee to customers does. It seems to me very difficult to imagine what the principles might be for the RBA to want to regulate Diners Club Australia. But if some reason can be shown then obviously it would be appropriate to regulate us.

Mr CIOBO—In a previous answer you indicated you were comfortable with the abolition of the ‘no surcharge’ rule. Do you have a view on the ‘honour all cards’ rule and the ‘no steering’ rule?

Mr McDonald—If by ‘no steering’ you mean that no payment provider should be allowed to prevent any merchant from discouraging any payment mechanism, I completely agree with that. A merchant who wishes to ask for a different payment mechanism when a Diners Club is offered is quite at liberty to do that. If the Diners Club member subsequently chooses to put the goods back or to buy but not to go back there again, that is the outcome of the merchant’s free actions. That is absolutely fine. I have no problem with getting rid of the ‘no surcharging’ and ‘no steering’ rules. I cannot see the benefit in restricting the merchant’s ability to act as he wishes.

Mr McARTHUR—What is your main competition?

Mr McDonald—It differs between corporate customers and personal customers. In our personal card business, we are in competition with pretty much every credit card in the market, more particularly with those credit cards that provide reward schemes. So those cards that have rewards or loyalty points associated with them tend to be our competitors. In the corporate market, customers are looking for the richness of data we can provide them about how their employees are spending the company’s money. We and Amex are the two specialists in that particular market, so we most often rub up against Amex competitively where the customer is a corporate or government client.

Mr McARTHUR—And your fees—what you charge the customers—are quite transparent?

Mr McDonald—We have a main card fee of $95. We have not changed that card fee since prior to the regulations. We have not moved that fee.

Mr McARTHUR—What is your comment on Mr Mair’s observation about the rewards being taxable? That might change the whole context of the marketplace.

Mr McDonald—I did not hear him make the comment, so it is very hard for me to say.

Mr McARTHUR—If the rewards were part of the of taxation regime, it might change the whole competitive environment.

Mr McDonald—I am not sure how it would. If there were a change in the taxation of reward points and that occurred across the market, we would continue to operate as best we could.

Mr McARTHUR—What if it were incorporated in the fringe benefits tax as a taxable item?

Mr McDonald—I do not have an opinion as to whether or not that should occur. If it occurred, we would respond in the same way that other market participants would and continue to compete as best we could. I do not really have a comment on whether the ATO should take that action.

Mr SOMLYAY—How do you charge your corporates? You have told us how you charge your private card holders, but what about the corporates?

Mr McDonald—How do corporates pay? In the same way. They pay a card fee, a fee for the card that they issue to their employees. That is how they pay.

Mr KEENAN—Can you inform the committee of the transaction costs that you charge merchants? Say I have to put $5,000 worth of travel on my Diners Club card. What are the costs associated with that and who is bearing them?

Mr McDonald—Do you mean what are the costs that I bear or what is the fee that I charge the merchants?

Mr KEENAN—Start with the fee that you charge the merchant.

Mr McDonald—It varies tremendously. Basically, the drivers are the size and the risk of the merchant.

Mr KEENAN—So larger retailers charge a smaller fee?

Mr McDonald—They pay a smaller fee to us. That is really quite easy to understand, because small merchants or merchants that are recently established represent a much more significant product risk to us. Essentially we are paying the merchant well before we get reimbursed by the card member. So there is much more risk associated with smaller or more recently established businesses, to whom we are essentially extending credit on behalf of our card members. So that tends to make those fees higher. You are correct that, in the case of larger merchants where the volume is higher, where they are much more established, our costs tend to be lower. We tend to have a lower incidence of loss and fraud because we are able to take antifraud measures in cooperation with those merchants. Also, competitively, those are the toughest—and this again is a demonstration of the fact that we live in a completely commercial world. Those merchants are able to drive our costs lower because of competitive negotiation.

Mr KEENAN—So it is a risk of fraud which leads you to set your fees for different merchants?

Mr McDonald—No, it is volume, because volume tends to drive down our costs per merchant. It is volume, risk—one of those risks is fraud—and, finally, the negotiating leverage of those merchants whereby very large merchants have very large buying power. If you take the large supermarkets, anybody who is a supplier to those organisations would tell you that they are among the toughest customers in terms of pricing to deal with.

CHAIR—Nevertheless, the evidence before us from the majors—you were not here yesterday—indicated that the fees they were paying to Amex and Diners have gone up by 15 per cent during the last 12 months.

Mr McDonald—I do not think that is correct. When you say the 'majors', are you talking about large retail organisations?

CHAIR—Woolworths, Coles.

Mr McDonald—No, I do not think that is correct. I cannot speak for American Express. Specifically on Woolworths and Coles, we have not raised our merchant service fee for those two organisations.

CHAIR—No, but if your market share goes up then obviously—

Mr McDonald—Sorry, I misunderstood your question. If volume goes up at the same rate, the total dollars of merchant service fee they pay would rise. Clearly that would occur, yes.

Mr CIOBO—Is that occurring?

Mr McDonald—The information we supply to the RBA is correct.

Mr KEENAN—What is the range, on a percentage basis, of what you might charge for your business—from the smallest and, say, the most risky merchant, if you like, through to the largest and the least risky?

Mr McDonald—For the most risky merchants it is very similar to the rates charged by Visa and MasterCard. Their rates for those very small, high-risk and new start merchants are overwhelmingly driven by the same risks that we have. So whenever you see rates above, say, three per cent, that represents relatively small merchants or those new in business that represent a higher risk. The rates that those acquiring banks would charge for those same merchants are very similar to Visa and MasterCard rates. Our rates go very much lower than that and in many segments are quite similar to Visa and MasterCard.

Mr KEENAN—So what would be your range?

Mr McDonald—I am afraid I am not going to describe our highest and lowest rates in the market. That is commercially quite sensitive.

Mr CIOBO—Evidence and PIN based systems are a lot less subject to fraud than signature based systems. Is Diners Club looking at introducing a PIN based system? What would be the drivers that would encourage you to or prevent you from introducing such a system?

Mr McDonald—Australia, as part of the wider global organisation, has obviously looked at chip and PIN based systems. The drivers of that are economic and a little bit political. The economics are the point at which your share of the cost to change the terminal fleet is roughly equal to the fraud that you are incurring or avoiding. That is the point at which you start to get interested in bearing, as I say, your share of replacing the terminal fleet. The challenge is who should bear the cost of replacing the terminal fleet, if that is required.

Mr CIOBO—In Australia how would that work? Would that be likely to be borne by merchants and organisations such as Diners Club, Amex, MasterCard and Visa? Is it solely borne by merchants?

Mr McDonald—There is no answer to that, because that consensus has not been reached.

Mr CIOBO—It would require consensus, though?

Mr McDonald—Absolutely. The point I was going to make—and that is why I am choosing my words carefully—is that it depends on whatever our proportion was of the cost of the infrastructure replacement, because it is not obvious. The nature of networks is that they benefit all participants. That is why connectivity is such a great thing—we all win. The more volume there is going through any network, the more we all win because the average cost lowers. So what would be required would be consensus. This is if infrastructure has to change. You would imagine it would be to the benefit of card members, merchants, terminal owners and network users. We have to remember that every bank and issuing institution uses every other institution's terminal network. It is not simple.

Mr CIOBO—Do you think that with the lower interchange fee now there is more or less incentive for the banks to invest in the roll-out of new tactical platforms, such as chip and PIN based systems, or do you think it has no bearing?

Mr McDonald—I do not know the main credit card issuer's economics, but I can imagine what they might be. I believe the lowering of issuer interchange, despite the way those issuers have change their products, has reduced their income from credit cards.

Mr CIOBO—So implicit in that is that there is less incentive now.

Mr McDonald—I am talking about third parties here, because we were unaffected. But I believe the economics are that the total income from transactions has reduced. The reason I say 'income from transactions' is there may have been compensating income from fees, lending and other sources. I do not know whether the banks have completely compensated through reduction in benefits, higher fees and greater lending initiatives and whether they have covered the impact of reduced issuer interchange. If they had done so, they would be just as motivated to invest in that as a business. I do not know whether they have.

CHAIR—Thank you very much for participating in today's inquiry. We appreciate your coming today. We may get back to you with some other questions as the inquiry proceeds.

[10.22 am]

BECKERT, Mr Pierric, Managing Director, Australia, American Express Australia Ltd

LORIGAN, Mr Colm, Group Counsel, American Express Australia Ltd

MEGALE, Ms Luisa, Head of Public Affairs and Communications, American Express Australia Ltd

CHAIR—Welcome. Although the committee does not require you to give evidence under oath, this inquiry has the same standing as proceedings before the parliament. We have received a written submission from you. I invite you to make an opening statement to the committee. I was pleased to see you sitting through the hearing. Now is your chance to hit back at your critics—some people have seen you as the bete noire of the new changes.

Mr Beckert—Thank you for using some French words, I appreciate that.

CHAIR—Oui, n'est-ce pas!

Mr Beckert—Merci. I will take the opportunity to make a very short opening address. I want to thank you for the opportunity to address the committee on the issue of the RBA reforms and their impact on the Australian payment system. At the risk of sounding self-interested, my opening address will focus on the persistent question of whether American Express got an advantage. It is a wonderful question that has the benefit of obscuring the underlying issues that kicked the reform process off. The basic facts are that American Express was not regulated as we did not engage in anticompetitive practices and we have no collectively-set interchange fee. There was no American Express problem, simply said.

However, while the RBA did not regulate American Express directly, they have applied a consistent regulatory policy to American Express. It has had the intent and effect of driving our merchant fees down. Since the reforms were introduced, American Express merchant pricing has fallen from an average of 2.57 per cent to 2.26 per cent, a drop of 31 basis points for market participants who are not engaged in any unlawful practice. I hope you will agree that this is hardly an advantage. It is like being fined for being near a speeding car even though you are not speeding yourself. As well as pricing pressure, we have certainly faced more regulatory pressure than the dominant schemes through surcharging. Merchants have actually been encouraged by the Reserve Bank governor to surcharge our products. He has said that, by surcharging American Express, merchants are helping the community and acting in the national interest.

Merchants have been encouraged by the Reserve Bank to use the threat of surcharging to secure pricing reductions. Once again, that is hardly an advantage that we gain as a result of the RBA process. We have numerous cases of merchants that are still charging more than we charge them, with limited controls or consumer protection to our benefit. American Express have spent the past 2½ years, since the reforms were introduced, doing what we have always done: competing aggressively on our own resources and innovating in the marketplace. The dominant schemes have pointed to a pricing premium and business strategy as being a direct result of the reform process. This is simply not true. American Express prices are defined and driven by the value that we provide, both for the consumer and the merchant. We have always priced this way and likely always will. This is what we as a company and as a brand stand for.

The market share figures also do not support the advantage myth. Market share of American Express and Diners moved within the 14 to 16 per cent range before the reforms and now move largely between the 15 and 17 per cent range. We are grateful to MasterCard for providing the chart that makes these figures very clear. It is on page 4 of their submission. You will see also that there is clear volatility in the market share of American Express and Diners. American Express have not stood still since the reforms were introduced. We have launched premium products. We have refreshed older portfolios. We have used our knowledge of our customer and the benefit of the closed loop of data to offer better products to our base, to enhance the loyalty of our customer and therefore shift more of that spend onto our product. Is this not the very essence of competition? You may be aware that we are very much a growth stock and an innovative company, and we will continue to compete in the Australian market and do our best to secure a place as the payment product for the premium end of the consumer market and for successful businesses.

CHAIR—Thanks very much. Considering that your merchant charge has gone down, will we say that the reforms that Dr Lowe instituted are working?

Mr Beckert—I would say that our price has gone down. And we continue as we did before the reform: we price for the value that we provide to the merchants. We negotiate the price on a one-on-one basis with the merchants. If we demonstrate value to the merchants, which can take different forms—access to our card member, marketing services we provide to them—then that is how we sign a deal with the merchant for the price that is linked in the contract.

CHAIR—I know from discussions before that you are not quite as shy as Diners are in talking about your market share. It is outlined. Do you want to say what has happened to your market share since the changes by the Reserve Bank?

Mr Beckert—As you can see, the only published data is the combined market share between Amex and Diners. Diners were not willing to provide figures on their own market share. The combined share moved between 14 and 16 per cent before the reform and between 15 and 17 per cent afterwards. That is the movement. They stated that Diners were growing. We were growing before the reform and we have been growing after the reform.

CHAIR—So those figures that were mentioned yesterday, which you would have heard, from Coles and from Woolworths are in line with that statement about the 15 per cent. Is that in line with—

Ms Megale—There is no way of substantiating that because we do not know what their share of till is. We know what our volumes are doing with them, and they have not doubled. I think the comment was that we were, prior to the reforms, three per cent of their till and we are now six per cent of their till. We looked at our data last night. That figure is not supported. But, on the question of whether we are 15 per cent of their merchant service fee, we do not know because I do not know what the volumes are from the other players.

CHAIR—Fair enough.

Mr CIOBO—What is it then? You say it is not six and you are saying it has not doubled.

Ms Megale—Would you mind if we provided that confidentially?

CHAIR—Yes, that is fine. You can provide it in camera and then it will not be published. It would be interesting. We appreciate your cooperation on that.

Ms Megale—Great.

CHAIR—You have heard various proposals. What is your view on the zero interchange fee?

Mr Beckert—Looking at the impact of the reform at hand, I think it would be fair to say that it is unclear if it would have any positive impact for the different players, particularly for the consumer. I am not sure what kind of impact a further reduction in the interchange fee would have, as it is difficult to demonstrate the positive benefits that it has created—

CHAIR—It would probably increase your market share, would it not?

Mr Beckert—There has been a very small increase in the combined market share between American Express and Diners.

Mr KEENAN—What would you say to the allegation that, because American Express and Diners are charging higher merchant fees, it is making the whole system more expensive for consumers and merchants?

Mr Beckert—We are only 15 per cent of the overall market. I think it is giving us a lot of credit to say that 15 per cent can actually move and shake an entire industry.

Mr KEENAN—I do not know whether you heard Mr Mair's evidence this morning, but he thinks we should go to a transaction based system where the costs are borne by the people who are making the transaction—presumably the consumers. That would obviously have a marked effect on your business model.

Mr Beckert—We actually have a series of fees that we charge our customers. A lot of our card products have a card fee attached to the product and our reward services also have a fee attached to them. We believe that we already charge the consumer for the service that we provide to them.

Mr KEENAN—What if it were to be done in a more direct way, as in specific transactions have a specific cost? What would your response be to a suggestion that the government might move in that direction?

Mr Beckert—I am not aware of any other examples or any other market going that way, so I could not comment on any potential impact of that kind of change.

Mr KEENAN—American Express is obviously a big global business. How does the regulatory system in Australia compare to that in other developed countries?

Mr Beckert—I would say that it has been an economy you can follow on. It has been fairly unique. Our broader regulation has been in Australia. I am aware of markets where there has been regulation on the interchange, but the combination of the different actions that the RBA has taken is, I believe, unique to Australia.

Mr Lorigan—The regulation of financial services in Australia is very competent and professional and has a high level of independence and integrity. One could have an interesting discussion about whether there is enough regulation or too much regulation, but generally the regulatory burden American Express faces in Australia is comparable to other countries where the economy is developed.

CHAIR—I have a process question. You labelled your submission to us commercial-in-confidence. We asked whether you had a problem with us publishing it.

Ms Megale—I am sorry. Everything gets labelled. It is like a template. I did call the secretariat and say that it was fine for publication.

CHAIR—It was a concern in terms of our asking questions from it.

Ms Megale—It is fine. I think it is on the web site. So if it is not fine, I am in trouble.

Dr EMERSON—If I recall what has happened, the Reserve Bank has cut the interchange fee from 95c to 55c. We just learned or confirmed that your fees to merchants have fallen and your market share has risen. Doesn’t that constitute evidence of greater competition in the industry?

Mr Beckert—I am not sure. We are trying to provide better service and better value to our customers, or card holders, and all merchants. When a merchant decides to take American Express they see value and they have options in front of them to take or not to take the card and to surcharge or not to surcharge. The fact that we acquire a customer or retain a merchant is a direct result of the kind of value that we provide to them. It was the case before the regulation and it continues to be the case.

Dr EMERSON—I am looking for a chain of causality. I am not in the slightest bit being critical. Otherwise, it seems to be a very happy coincidence that the Reserve Bank has stepped in and behaved in what it believes to be a way that promotes competition in the industry and, lo and behold, your operation has reduced the fees to merchants and increased its market share. I am not saying that is a bad thing at all, but it would be an incredible coincidence, it seems to me, if there were no causality.

Mr Beckert—In terms of market share, Australia has been a market in which American Express has invested for quite some time. If you look at the growth that we have in the market and the number of employees that we have in Australia, I believe it is largely correlated to the amount of investment that we put into the Australian market. In terms of the reduction in the merchant service fee that we provide, we have clearly been under more pressure from the merchants in demonstrating the value that we provide to them as a result of the reform.

Dr EMERSON—So do you think there would be some relationship, some causality, there?

Mr Beckert—We have to demonstrate a lot of value to the merchants.

Dr EMERSON—All I am seeking to establish is that they are related; they are not two completely unrelated events. This does seem to constitute, as I have said, evidence of greater competition in the marketplace. In your submission you say:

... dominant schemes have obtained an advantage from many years of operating unlawful interchange agreements ...

Can you elaborate on what is unlawful about the interchange agreements?

Mr Lorigan—The four-party interchange agreement is an unlawful price-fixing agreement. It has actually been found to be so in a number of countries, not least of all here in Australia. A press release from the ACCC on 4 September 2000 basically announced that they were starting an action against an institution here on the basis of that. There has been a very similar result in a number of other jurisdictions. So they have looked at it, the EU have looked at it in the Visa case in 2002 and the OFT, the Office of Fair Trading, in the UK have looked at it. Very notably, at the beginning of 2005 the Spanish Competition Tribunal, in the ServiRed, Sistema and Euro cases—all published on the same day—found that the four-party interchange fee was an unlawful price-fixing agreement. When the agreements have been examined, the law in any country with a developed competition law, as we have here in Australia, has found that they are in fact unlawful.

Dr EMERSON—Consequently, would the ACCC be the best agency or authority to regulate this, rather than the Reserve Bank? Based on your assertion—which I do not have the expertise to challenge, so I am not commenting on that—it seems a bit bizarre that there is an interchange fee, which you have described as unlawful in evidence, and the intervention has been to reduce the amount of this unlawful fee. It seems to be a strange policy response. If it is unlawful, it should go, shouldn't it?

Mr Lorigan—You might say that those schemes have been given a very soft landing by being allowed to reduce, in an orderly manner, what is basically an unlawful charge, which is what we have here. We clearly have a very experienced competition regulator and a very developed system of competition law in Australia. That would certainly be a channel by which these matters could be resolved, as has been the case in the European Union, the UK, Spain and the majority of other countries that have looked at this. It has been resolved through the competition law, the antitrust channel.

Dr EMERSON—So they did not have a separate authority, a central bank, stepping in to say, 'This is an unlawful scheme, we will just make it half as unlawful by cutting it from 95c to 55c'?

Mr Lorigan—That is absolutely right. Australia is somewhat unique in having a payment system regulation which allows an intervention of the magnitude that the RBA has been able to conduct. That is partly a unique regulatory feature here in Australia. In other countries they had to rely on the more traditional competition law structure.

Dr EMERSON—I am new to this committee and therefore new to these hearings. You say that in 2000 the ACCC identified the interchange fee as unlawful?

Mr Lorigan—They did.

Dr EMERSON—What then happened? Did they proceed to take action?

Mr Lorigan—They did. I do not want to get too legalistic here, but they started an action under section 45 of the Trade Practices Act against one of the largest banks. They issued a series of press releases. As I said, all the documentation for what I have said is referenced in our submission. The ACCC started these proceedings and it was only after that had got under way that the matter was passed to the Reserve Bank for a resolution under the Payment Systems (Regulation) Act. It clearly could have taken its course under the Trade Practices Act as an enforcement proceeding like any other.

Dr EMERSON—That helps answer a question I was asking yesterday as to why if there is anticompetitive behaviour the ACCC is not doing that work.

CHAIR—Because they transferred it to the Reserve Bank.

Dr EMERSON—They did or the government did?

CHAIR—The government did.

Dr EMERSON—I could ask our chair this question, but he is on the same side of the table.

CHAIR—Not the same side of the parliament.

Dr EMERSON—Was there a suggestion that the ACCC was not going to succeed and that therefore the Reserve Bank should step in?

Mr Lorigan—You are asking a question that is bigger than us.

Dr EMERSON—I know that, but you sound like you have a lot of expertise.

Mr Lorigan—There may have been policy considerations behind that that we could not comment on.

CHAIR—Perhaps it is a question we could pursue later.

Mr CIOBO—Just on that point, is the interchange fee illegal or is the way in which it is set illegal?

Mr Lorigan—It is the way that it is set. It is a collective pricing agreement between institutions who are supposed to be competing with each other.

Mr CIOBO—So the interchange fee is acceptable; it is just that there were allegations about price fixing in the way in which it was set.

Mr Lorigan—Yes. There is nothing unlawful about a fee as such. It is the process by which that fee is arrived at that is unlawful.

Mr CIOBO—You talked about having a very small increase in your market share. Is American Express seeking to increase its market share significantly?

Mr Beckert—Like most growth companies, yes, there is an expectation that we will increase our market share. The way we are doing it is by providing more value to our customers and investing in the market.

Mr CIOBO—Value being driven by rewards?

Mr Beckert—By a wide range of services and products that we provide to our customers. The rewards system is one of them. The quality of the service that we provide to our customers is also a significant driver of the market share we are able to maintain and grow.

Mr CIOBO—Quality of service in what way?

Mr Beckert—Being an advocate for the customer. Just as an example—

Mr CIOBO—Disputed transactions and things like that?

Mr Beckert—In disputed transactions we give the benefit of the doubt to the customer. We are pretty unique in that approach.

Mr CIOBO—You heard me ask this question of Diners Club. Do you concede that there is a benefit provided to Amex as a consequence of the fact that you are now able to be more competitive than other four-party scheme cards in your up-front fee for the card and your unlimited ability to provide points—with Qantas I think you provide 2.5 points or three points per dollar spend—given the reduction in interchange fee revenue?

Mr Beckert—Just on rewards, something that is important to note is that we have actually increased the fee on our rewards product. The airline rewards scheme that we have has just had its fee increased from $59 to $80 with very limited negative impact on the customer. There has not been an increase in attrition as a result of that. There has been an increase in participation from—

Mr CIOBO—I will let you go on, but how does that sit with regard to four-party scheme annual fees? Does that put it in the middle, at the top or at the bottom?

Mr Beckert—I believe that we provide more value in these programs and we charge the customer more for these programs.

Mr CIOBO—So you are saying that the $80 fee is at the higher end?

Mr Beckert—I am not sure they actually charge separately for their rewards scheme. Most of their products are bundled, I believe.

Ms Megale—I have that detail in front of me. Eighty dollars would be considered the high end for stand-alone fees, but most of the premium end products now are bundled, so you will pay a $250 fee, for example, but the rewards fee is bundled in. In those instances where they are bundled out, $80 would be a significant fee.

Mr Beckert—The other thing that I think is important to note from a rewards standpoint is that we get customers to pay a fee for that, either a bundled or an unbundled fee. We also provide value to the merchants through our rewards program. We give them access to what we call our membership rewards catalogue, where we give an opportunity to merchants to sell, for points, their products and services. That is something that is increasingly valuable for card holders and for merchants. Lastly, we also provide the opportunity for merchants to use our points to create their own loyalty schemes for their customers and actually buy points and provide points to reward behaviour of their customers when they show loyalty to the merchants' products and services.

CHAIR—Diners Club conceded earlier on that there was less revenue flowing as a result of interchange fees—I think the Reserve Bank has made this point is well—and the money has had to be recouped directly from card holders. Is that also your observation of the four-party schemes and the issuing banks—that they are recouping that lost revenue directly from card holders?

Mr Beckert—I think we have read the same submission as you have, which I think stated that, yes, there was less money flowing through the interchange fee and there has been at the same time an increase in some fees that are being charged to customers. Is it purely timing? I do not know.

Ms Megale—Probably the only other point I would add to that is that none of the banks run their card business, as I understand it, as discrete entities, in the way we and Diners Club do it. So, if you have a relationship with a card holder, they may be bundled in with a mortgage account or a whole bunch of other accounts and, if you lose on one hand, there are many other levers you potentially can pull to recoup those costs. They will take a whole-of-customer view. At this point I cannot tell you what has happened to the fees on that score.

Mr CIOBO—Is it fair to say, as a general observation, that we have seen card holders bearing an increased portion of costs? The Reserve Bank says this is part of their aim—an increased portion of costs directly as a result of the lessening of the interchange fee.

Mr Beckert—There has been an increase of some fees. If you look at the competitive activity over the last three or six months from an acquisition standpoint, you will see that four-party schemes have never been as aggressive as they are in providing incentives for customers to take their products. A lot of points are being offered by four-party schemes to join these kinds of products. I do not know. That is also something to keep in mind when you look at the overall fees that are asked of the customer or at offers and incentives that are provided.

Mr CIOBO—Has American Express looked at the introduction of PIN based or chip based cards rather than signature based cards? You heard me ask the question earlier. How would that operate, from your perspective?

Mr Beckert—I am not aware of us having looked at that in Australia. One thing that came through my mind when you were talking about that earlier was that, when we look at our fraud data in the Australian market, by all standards it is actually quite low compared to all the developed economies in the world. There is not a major fraud issue. We do not see fraud increasing in the market. If we look at effectiveness that could be driven by a PIN based system, from our data, from the behaviour that we see in our system, we do not see a lot of effectiveness that could be driven by changing to a PIN based system.

CHAIR—What percentage of your cost would be fraud?

Ms Megale—I do not know. We can—

Mr Beckert—We can provide that.

CHAIR—That would be interesting. One of the earlier presentations said it was wrong to be including fraud, because it could easily be avoided by using PINs. It is a question of, if it is very small anyway—

Mr Beckert—We are happy to provide that data.

Ms Megale—If it would help the committee, we are happy to speak to our overseas colleagues. Only having heard the evidence yesterday, we have not had a chance to collect data on it, but there are other jurisdictions. We can gather that information for you.

Mr CIOBO—That would be interesting. There have been calls from other witnesses about possibly limiting the surcharge to the merchant service fee that is imposed on the merchant. What are your thoughts on that?

Mr Beckert—I would say either limiting it to what is being charged or giving us a recourse to cancel the agreement with the merchant. I believe that the merchant gets an advantage by putting our brand on their store and I feel that, if at the same time they are also charging an amount that could be two, three or four times what we charge them, it has a negative impact on our brand and I would like to have the ability to say, 'This is not the way we would like to do business.'

CHAIR—Would you like it legislated so that there was a cap on the quantum of surcharging that is available?

Mr Lorigan—We would like that very much.

Mr SOMLYAY—I am just a bit confused. I bank with Westpac and I have a Westpac MasterCard. After the reforms, they offered me a Westpac Altitude MasterCard and that entitled me to an American Express Altitude card. So I have the relationship between the bank, MasterCard and American Express. Who is in competition there?

Mr Beckert—I will give you some context on that. I have direct ownership and responsibility for what we call the proprietary business of American Express, where we, American Express, issue the card. The card that you are talking about with Westpac is actually issued by Westpac on the American Express network. As you can imagine, there are firewalls between Westpac and American Express, and I am not privy to the kind of relationship that may exist, but with the issuance in the case you are talking about the balance sheet is Westpac's, not American Express's. The network is American Express.

Mr CIOBO—Is it their market share, your market share or the bank's market share?

Mr Beckert—The acquiring market share would be factored into the American Express market share.

Mr SOMLYAY—If I use the MasterCard to make a purchase, I get one point. If I use American Express, I get two points. What is in it for the bank to encourage me to use American Express?

Mr Beckert—I am not privy to the agreement that exists between the network side of the business and the bank, as a result of the firewall.

Mr SOMLYAY—Maybe I should have asked that question of MasterCard.

Mr Beckert—Or Westpac.

CHAIR—I am glad to see MasterCard at the back.

Mr SOMLYAY—Nodding.

CHAIR—Perhaps in the break you could ask them the question. As there are no further questions, I thank you for your open and cooperative approach. Information that you provide to us on a confidential basis will be kept confidential, and we may come back to you. Thanks very much for your participation today.

Proceedings suspended from 10.53 am to 11.12 am

CLAPHAM, Mr Leigh Brian, Senior Vice President and General Manager, Australasia, MasterCard International

NAFFAH, Mr Albert, Business Leader, Business Planning And Corporate Affairs, MasterCard International

CHAIR—Welcome. Thank you for coming back today. We are glad to see you here today. You have heard the question that was asked before the break, but maybe Mr Somlyay will restate it for the record.

Mr SOMLYAY—Basically, I want to know the relationship between the three players with regard to my two cards.

Mr Clapham—That relates to the ability of Westpac to issue an American Express card and a MasterCard on the same account to give you two points for your Amex transaction and one point for your MasterCard transaction.

Mr SOMLYAY—That has come about as a result of these reforms.

Mr Clapham—Correct. I will start with the way the market looks overseas, where, for a MasterCard, a bank would charge a merchant about 30 per cent less than American Express for a transaction with basically the same functionality on each card. In Australia, the difference is 57 per cent. So it is around 98 or 99 basis points for a merchant, on average, to accept a MasterCard transaction issued by a bank which equates to the American Express figure that the previous gentlemen mentioned, which was 226 basis points. So, in the four-party environment, that figure of 98 basis points has dropped 35 per cent since the reforms were introduced and American Express's figure has dropped 12 per cent to 226.

Consequently, with their 226 versus the average interchange that a bank earns on a MasterCard transaction of 55 basis points, if 55 basis points helps the bank fund one basis point on a MasterCard transaction, one would hypothesise that 110 basis points would help them fund two. So if it is 110 basis points—and I, like the previous gentleman, do not work for that side of the American Express business—that leaves them 116 basis points to still run their business, whereas the bank only gets the interchange. So it is 55 versus 226. That is effectively the equation at hand.

Mr SOMLYAY—Does the bank make more money out of MasterCard or American Express?

Mr Clapham—I do not know the commercial relationship, so I cannot say. They may be getting more than 110 points; they may be getting less. I am purely hypothesising what it might cost to fund what they are offering the consumer.

Mr Naffah—The difference really is what they get for the transaction conducted with the merchant. In our system, it is clear that there is an interchange fee that is set according to the formula in the recommendations. This is capped at 55 basis points. Only Westpac and Amex would know what they get when you use your American Express card but, as Leigh has just described, we are assuming it is at least double, given that they fund double the points because there is a richer pot with the significantly higher merchant fee that Amex get for that same transaction.

Mr SOMLYAY—But, through the same bank, you are in competition with Amex, are you not?

Mr Clapham—Indeed.

Mr SOMLYAY—And they do not pay a fee to you?

Mr Clapham—They do not have an interchange figure that they disclose, but I am sure that internally it would be certain that the revenues will flow from the acquiring side of their business to the issuing side of their business, just like it does in a four-party environment.

CHAIR—Having sat through quite a bit of the evidence, is there any response you want to give to any of the other witnesses? You gave a fairly comprehensive response earlier, but is there anything additional you have heard that you want to correct?

Mr Clapham—No, I think it was purely around the cost to the merchant. It is very difficult to determine in the Australian market what difference there is between MasterCard and a bank providing a payment methodology to a merchant and what American Express provides. It costs a merchant in Australia 98 basis points for a MasterCard transaction and 226 basis points for an American Express transaction.

Mr Naffah—I will add one point to that. Amex did contend that interchange fees were illegal. Our advice at the time the ACCC made the allegation—and it is the same today in Australia and throughout the world—is that interchange fees are not illegal. There are significant differences under the Trade Practices Act, but interchange fees were never found to be illegal in this country.

CHAIR—We want to pursue that with the Reserve Bank. Please note there is a chance that we might have some of that evidence in camera.

Mr SOMLYAY—What is the difference in operation between MasterCard and Bankcard?

Mr Naffah—We are a global scheme whereas Bankcard was very much a local scheme which was owned by the banks that established it in Australia 30 years ago. Obviously, there are some differences in the international functionality that our brand offers.

Mr Clapham—MasterCard is accepted by 24 million merchants and Bankcard is accepted by about 400,000 to 500,000 merchants. That is the big difference.

CHAIR—Thank you for appearing before the committee again today.

[11.18 am]

FAGG, Dr Jennifer Anne, Managing Director, Consumer Finance, Australia and New Zealand Banking Group Ltd

NASH, Ms Jane, Head of Government and Regulatory Affairs, Australia and New Zealand Banking Group Ltd

WILSON, Ms Carlene, Senior Manager, Government and Regulatory Affairs, Australia and New Zealand Banking Group Ltd

CHAIR—Welcome. ANZ is the only bank to front this inquiry, and it deserves plaudits for doing so. Although the committee does not require you to give evidence under oath, these proceedings have the same standing as proceedings of the parliament. We have received your written submission and we now invite you to make an opening statement.

Ms Nash—ANZ is pleased to be here to assist the committee with its inquiry. Payments system reform in Australia does have some history. It began with the Wallis inquiry recommending back in 1997 the establishment of the PSB within the RBA to promote efficiency of the payments system. The inquiry also recommended that interchange arrangements be reviewed by the PSB and the ACCC. It is a matter of history now that the RBA and the ACCC did that. They released a joint study of interchange fees and access in debit card and credit card schemes in October 2000. That study set out the RBA's case for reform in debit cards, credit cards and ATMs.

Since then, the RBA has designated or regulated the credit card and EFTPOS payment systems. The reforms to credit cards took effect in October 2003. Reforms to debit cards will take effect later on this year. ATM reforms have yet to be finalised. We provided a submission to you yesterday that focuses on the impacts of the reforms on our business, particularly credit cards, and makes some forward looking considerations for the committee's consideration.

A key change in credit cards was the cut in interchange fees from 95 basis points down to 54 basis points as costs of running the system, including statement production and distribution, operating risk capital, risk assessment, payment processing, card plastic, except for lost or stolen cards, core operating system costs and a return on the cost of capital invested in providing the system and regulatory and compliance costs were no longer eligible to be recovered from merchants. The result is that these costs are now recovered from card holders, rather than merchants.

The reforms required product changes from ANZ that were not popular with the customers who were affected by them. These changes included increasing annual fees for credit cards and reducing benefits of loyalty schemes. So in response, in order to minimise the impact on rewards programs for most ANZ credit card customers, ANZ adjusted its credit card offerings and entered into a commercial arrangement with the unregulated Diners scheme for customers who are seeking high rewards programs. The ANZ Diners card offers an uncapped one point per $1 spent, including frequent flyer points. The closed schemes offer more favourable loyalty programs than we do. Three-party schemes have leveraged the fact that they are outside of the reforms to grow their business. Examples of that are the Amex Rewards Maximiser, which offers 1.5 points per one dollar spent, and the Qantas Amex card, which offers up to 2.25 points per $1 spent. ANZ's frequent flyer Visa offers one point for every dollar spent up to $1,500 and then one point for every $2 spent above $1,500, and that is capped at $5,000.

Looking to the future, we think a number of issues have arisen as a result of the reform program that need to be addressed. One issue is that are that there is currently no merits review in the RBA's decision making or periodic independent review of the reforms. We think it has to some extent distorted the market by excluding Amex and Diners closed schemes and that this has created an unlevel playing field. In the case of ATMs, we do not think that there are demonstrated tangible benefits to consumers of direct charging. Out of that, we suggest for the committee's consideration that they recommend a merits review mechanism for the RBA decisions made under the Payments Systems (Regulation) Act, that the planned 2007 ABA review of the reforms be done by an independent body or reviewer, and that consideration be given to how the reforms could be made competitively neutral between open and closed card schemes. We would like the RBA to take a second look, if you like, at ATM reform with regard to the direct charging aspect.

CHAIR—Thanks very much, and thank you for appearing today. Is it the wish of the committee that the submission by the ANZ, dated 16 May, 2006, be accepted as evidence and authorised for publication? It is so decided. Do you support the decision made by the RBA? Or, because of the concerns that you have about distorting the market and there currently being no merits review, do I take it that you therefore are opposed to the reforms that the RBA made?

Ms Nash—I do not think it would be fair to extrapolate from the fact that we would like to see a merits review that we think the reform process has been misplaced or unfounded. The RBA did a study—that is, the joint study—back in 2000. That formed the basis for the decisions that they made afterwards. What we are asking for here with the merits review is that there be some appeal mechanism in a way that is similar to the ACCC's Competition Tribunal. This we see as being consistent with the Bank task force finding that, where you have a merits review mechanism, it does tend to make for more accountability and better quality decision making over time. Also, it tends to increase business confidence. One thing I think we could probably agree on is that the Reserve Bank reforms have not been without controversy. There is a range of views around them, which is why we think it would be good to have a merits review mechanism.

CHAIR—Certainly we have heard evidence of that over the last two years.

Ms Nash—Yes.

CHAIR—It has been good to see that the RBA have been here during the entire process—as they were at the forum down in Melbourne put on by the Melbourne Business School—and have listened to all of the comments. They have certainly been exposed to all of the criticism. They have not stayed in their ivory tower.

Ms Nash—No. We have found them quite accessible and fairly transparent through the whole process.

CHAIR—What about the recommendation that was made by the Merchant Payments Forum group to reduce all the interchange fees to zero? If they were heading in the right direction last time in terms of reform, how far should they take it?

Dr Fagg—It is an interesting idea, I guess. We are part of an international payment system. If you compare the way our interchange works with those of the rest of the world, we are at the low end now—that is, the very low end—of the credit card interchange. In fact, as you would be aware, we are the reverse in terms of debit interchange. If we were isolated from the rest of the world, you could look at it and look at different arguments. Benchmarking us against the rest of the world, we are already way at the low end of the interchange fee structure.

CHAIR—What about the use of PINs to reduce the level of fraud? Is that something you would support?

Dr Fagg—Over time. I think there needs to be a series of innovations within the market. If you look around the world, we are lagging behind many of the markets in our innovations. We are ahead of other markets as well, of course. Over time PIN at POS is something that we would expect to move to. I think it is just a matter of timing, as well as just how much capital can be invested over each year. We also have to obviously look at chip cards, EMV. Then it would become a matter of prioritisation.

Dr EMERSON—I would like to follow up on that question and use an analogy. Australia happens to have some of the lowest tariff rates in the world, compared with just about every other country, but that of itself is not an argument that Australia should not reduce tariffs further until the rest of the world does. In fact, there is not such an argument. On the fact that Australia has interchange fees at the low end of the market, can you, beyond just saying they are lower than those anywhere else, explain why that is a bad thing? What costs are being incurred? What adverse consequences are flowing from the interchange fee being 55c here and higher in other countries? If it were cut further, what further consequences would flow that would be bad for society? I understand what is bad for individual cards. MasterCard and Visa would say, ‘Oh, that’s terrible,’ and American Express and Diners would say, ‘Oh, that’s great.’ We know that, but our job is to not favour or disfavour any particular business or bank but to work out what is in the national interest, the public interest. What public interest argument is there against further reducing the interchange fee?

Ms Nash—We do not argue with a reduction in the interchange fee. It would be reasonable to say that we have had a debate around which costs should be in and which costs should be out. I think the Reserve Bank’s objective was that consumers should be exposed to the correct price signals so that they see the true underlying costs. Of course, if it were to go down lower, given that interchange is a balancing mechanism for distributing costs between the merchants and the consumers, we would say that we would expect that consumers would face even higher prices.

Dr EMERSON—The argument is that consumers are facing lower prices because of the reduction in the interchange fee. Why would they suddenly go up by further reducing it?

Ms Nash—When I talked about a higher price, I meant the price they pay to the bank for having the credit card.

Dr EMERSON—Okay, so not for the merchant's goods or services?

Mr CIOBO—Card holders rather than consumers.

Ms Nash—That is right—card holders. I meant our customers. On the issue of the price level and whether the prices have been passed through, which I think is part of what you are asking me about, you have to believe that in a competitive market the merchants will pass those price reductions through. If you believe that the market works then you would believe that there is reasonable ground for believing that it would be passed through.

Dr EMERSON—I am just not sure, on the basis of your answer—and I am really not trying to be difficult—about what the national interest or public interest argument is against further reducing the interchange fee? Your answer has been that the sorts of things that could happen are that reward systems could become even less generous, there could be no interest-free period or a shorter interest-free period, or interest rates on credit cards could go up. Are any of those things really bad if, on the other hand, a competitive market does work, the merchants' costs go down and those savings are passed on to consumers? Doesn't this present price signals that will have consumers understanding and responding to the true costs being reflected in prices?

Ms Nash—I hear what you are saying. I am not clear that it would need to go down further for consumers to get those clearer price signals. After all, you have a range of payments mechanisms for consumers to choose between. To say that it should go down further suggests that you think you can have more of a good thing, so to speak.

Dr EMERSON—But I do not know whether there is a crossover. Going from 95c to 90c to 85c and so on makes sense—and you are not arguing about a 5c increment—but, wow, we have hit 55c and that is it; we have found the magic number. Why is that a magic number?

Ms Nash—You should probably ask the Reserve Bank about why that is the magic number. As I understand it, they went through all of the costs in the system, allocated them between merchants and customers and said, 'The merchants derive benefits to this extent and customers to this extent. Therefore we allocate the costs that benefit the merchants to them and the costs that benefit customers to them.' As I understand it, that is how they arrived at their set of eligible costs. So, if you are after reflecting the true costs of a system, there must be a point that you reach on the eligible costs—something that says to you, 'We've reached that point.'

Dr Fagg—I agree. I am not sure what the absolute number is, but it seems to me that there is a benefit to customers, merchants and banks in having a credit card issuing system. It is hard to say what the exact number is, to respond to your point, but merchants certainly derive benefit from the use of credit cards and their customers using credit cards, so I am not sure how there being no cost attribution to merchants is consistent with allocating a benefit across society.

Dr EMERSON—You have identified a benefit to society, if you like, of a credit card issuing activity. If the interchange fee went to zero, are you saying there would be no more credit cards, or would credit cards contain fewer rewards, shorter holidays and perhaps higher interest rates that reflect the actual costs?

Dr Fagg—Who knows? That is the real answer. It is hard to believe there would be no more credit cards; I am not expecting that, but the form that that would take would be vastly different.

Dr EMERSON—There might be less coverage of credit cards amongst merchants. That is possible.

Dr Fagg—I do not know.

Mr SOMLYAY—Interest rates on some products associated with credit cards have come down—have virtually halved. Why is that?

Dr Fagg—I think there are a couple of reasons for that, and I think a good thing for the industry overall is that we are actually much clearer now than we were several years ago at explaining to customers what the products are and what their benefits are. A few years ago it was more amorphous; people just took a card. Now it is quite clear that there are low-rate cards and you take them because you want a low rate. Typically, they are used by people who revolve, so they pay interest and use the credit feature. The reason is partly that we follow overseas markets in Australia. We tend to be at least five years behind other markets. For example, the UK went before us and we tend to follow. But, as I said, I think we have got much better at communicating with customers which type of credit card they should be using for their particular needs.

Mr CIOBO—I want to clarify this. Is ANZ unable to enunciate the way in which interchange revenue is of benefit to the bank or to the credit card system?

Ms Nash—I do not think we are unable to enunciate it; we have said that it is a mechanism for distributing the costs.

Mr CIOBO—But you do not know what that price should be?

Ms Nash—Yes, we do. I said that there is a set of costs which have been itemised and allocated—some to merchants under the interchange standard that the Reserve Bank set and we recover the rest from our customers.

Mr CIOBO—The Reserve Bank has made a decision about what costs should be incorporated and what costs should not be. I am trying to ascertain whether you agree or disagree with what the Reserve Bank has said?

Dr Fagg—It is very judgmental.

Mr CIOBO—You are a stakeholder in the industry; I am asking for your perspective.

Dr Fagg—The costs are as the RBA has set out. There are some that we believe should be included that are not included. If you went through at a line-by-line level, for example, operating risk capital is not an eligible cost. To us, that is clearly a regulatory cost and should be included. But overall I think the high-level cost structure has been set, and we are tending to argue around specific items within that overall cost structure.

Mr CIOBO—With respect to merits review, do you have an opinion as to whether or not this committee, which functions in an oversight role for the RBA, is able to meet your needs? Do you believe that there does need to be a merits based review by some other body?

Ms Nash—We would not have put it in if we did not think that there should be another body. We are not in any way trying to devalue the role of the committee.

Mr CIOBO—Sure. Do you see that as being the ACCC, the Productivity Commission or another body?

Ms Nash—I do not think we have a very firm view about who it should be. We are not trying to forum shop or to pick a regulator. The point is that we feel that there should be a mechanism there.

Mr CIOBO—With respect to the rollout of new platforms—and you were talking about chip based technology or PIN based platforms—has that been impacted at all by the regulation of interchange fees, or is it unrelated?

Dr Fagg—There is a kind of reality about how much capital is available to allocate towards investments, so it is hard to get a direct link between any of the number of things that are going on in the system at any point in time. In terms of why Australia has not rolled out chip technology when a number of countries around the world have, I would not say that that is directly related to interchange fees. At the same time, we would say that the Visa and MasterCard based schemes have certainly had other challenges to focus on in the last few years. In terms of ANZ’s position on chip technology, we support rolling it out.

Mr CIOBO—If the interchange fee were set at zero, I take it from your evidence that you would simply recoup your costs from card holders.

Dr Fagg—I do not know exactly what our position would be. We have not worked through scenarios on that. It was mentioned as a possibility for the first time that I am aware of in the last 24 hours or so.

CHAIR—Thanks very much for coming. We appreciate your brave stand in appearing on behalf of all the banks, particularly ANZ. It was good to get your perspective.

[11.42 am]

BULLOCK, Ms Michele Louise, Chief Manager, Payments Policy Department, Reserve Bank of Australia

LOWE, Dr Philip William, Assistant Governor, Financial System Group, Reserve Bank of Australia

VEALE, Dr John Michael, Head of Payments Policy Department, Reserve Bank of Australia

CHAIR—I welcome back representatives of the Reserve Bank of Australia to today's hearing. You are aware of all the normal advice to you, so perhaps we will invite you to respond to all the various comments that have been made so far.

Mr SOMLYAY—In five minutes!

Dr Lowe—From our perspective, the past day and a half has been very useful, so I would like to thank the committee once again for providing the opportunity to have these hearings and for allowing each of the stakeholders to present their views. As you will no doubt have observed, many views have been put to the RBA and many of these views directly contradict one another.

CHAIR—Absolutely. I have counted them all.

Dr Lowe—As was observed yesterday, almost without exception, the views reflect the commercial interests of those expressing them. In this environment, the RBA's job has been to try to sort through these competing views, drawing on evidence and analysis, and to pursue reforms that are in the interest of the community at large rather than just one section of the community.

I would like to repeat a point that I made yesterday and one that is not always remembered: 45 per cent of adult Australians do not have a credit card—55 per cent do, but 45 per cent do not. It is also important to recognise that much of the payments system work has been devoted to ensuring that the system remains stable, although that typically does not receive much attention and has not received any attention in these hearings.

In the interest of time I thought I would address three issues that have reoccurred through the hearings. The first is why we felt the need to go further than just removing the restrictions on merchants—the no-steering provisions, the honour-all cards rule and the no-surcharge rule—and essentially why we felt we needed to regulate interchange fees, the second is how the RBA's actions have affected the incentive to invest in the system, and the third is why we have adopted different interchange standards in the various systems. People have noted the lack of consistency in the various standards. I would also be happy to answer any other questions, including the relative roles of the ACCC and the RBA.

The first issue is why we need to regulate interchange fees. Essentially, there are three planks to this argument. The first is that interchange fees are not subject to normal competition, the second is that the EFTPOS system is a lower cost system—yet the configuration of interchange fees discourages the use of EFTPOS—and the third is that surcharging was unlikely to become sufficiently commonplace to send the appropriate price signals to card holders. I would like to say a few words about each of these planks.

The RBA has long argued that interchange fees are not set in a competitive market, and I do not think we have heard anything in the past day and a half which has contradicted this view. We have heard interchange fees variously described as a balancing device and a cost allocation mechanism—because that is what they are. They are not a fee for service. Historically, these fees have been set collectively by the banks, and in Australia they have essentially been the same as in the MasterCard and Visa schemes. Yesterday we also heard how the ABA explained these fees could be constant for many years—decades—despite changes in costs and demand conditions over that period.

In 2000 the ACCC wrote to the banks saying that, in its view, interchange arrangements in Australia breached the Trade Practices Act. Around the same time, the ACCC instituted legal proceedings against the National Australia Bank. Given this background, it is difficult to escape the conclusion that the interchange fees and the competitive dynamics that surround them are unlike most other prices in the economy and are not subject to normal competitive pressures. Just because something is not subject to the normal competitive discipline of the market is not a case for regulation.

That brings me to my second plank, and that is distortions in the system caused by interchange fees. We had a system whereby these fees created a strong disincentive to use the EFTPOS system relative to the credit card system. This has been a concern of the bank, because the EFTPOS system has lower operating costs. Yesterday Dr Simes suggested the differences between the operating costs of the EFTPOS and credit card systems were not large, and his paper presented some evidence of that. We have a number of problems with the measurements that Dr Simes undertakes in the paper, but the paper does not dispute the basic proposition that processing a payment through the credit card system involves higher resource costs than processing a payment through the EFTPOS system.

At first glance this might seem strange, because both the EFTPOS and the credit card systems are electronic systems, but there are at least four reasons that the credit card system has higher resource costs. These include: first, the higher costs of fraud in the credit card system; second, the additional costs associated with international acceptance of the cards; third, the costs of processing disputed transactions in the credit card system, which often involves a lot of manual processing; and, fourth, the costs of processing chargebacks. So there are a number of reasons that the credit card system has higher resource costs than the EFTPOS system. Some of these additional costs arise because of the signature based nature of the credit card system, while others arise because of the greater functionality of credit cards.

In most other markets, though, a product that offers more services and is more costly to produce attracts a higher price at the consumer level. The situation we face here is the reverse. The product that was more costly to produce was offered to consumers at a lower price, and the main reason for that was the configuration of interchange fees, which again were not subject to normal competitive pressures.

Many of the submissions that you have heard have argued why an interchange fee in one system should be higher or lower than it currently is. I think relatively few or perhaps none of the submissions asked the question: how should interchange fees be configured across the various systems—in particular, should they be configured so that they encourage one form of electronic payment, namely, credit cards, at the expense of another form of electronic payment, PIN based debit? That is a question we have asked ourselves a lot and one that we encourage the industry to think about more than they have currently done to date.

This brings me to my third plank of the argument—that is, surcharging. As Professor Gans said yesterday, the issue of price signals to consumers could be fixed if there were widespread surcharging. In principle we agree with this. The problem is that surcharging remains relatively uncommon and, given overseas experience and what we heard from the merchants yesterday, this is likely to remain the case. Given this, we are realistic enough to know that if all we did was to remove the no-surcharge rule it would have relatively little effect. So in the end, given the fact that interchange fees are not subject to normal competitive pressures, that they were distorting payment patterns in Australia and that the price signals for card holders could not be corrected quickly or even over the medium term through the removal of the no-surcharge rule, we have elected to regulate the interchange fees.

The second issue is the incentive to invest. An argument that has been heard repeatedly over the last day and a half is that the RBA's intervention has reduced the incentive to invest and that is why we are starting to slip behind on the technology front. In our view this argument does not stand up to scrutiny. The example that is most commonly cited is the lack of PIN and chip functionality on credit cards. In our view this has nothing to do with interchange fees. I note here that this chip and PIN functionality does not exist in the United States, where interchange fees are over three times higher than they are in Australia. In some other countries chip and PIN exist on debit cards where there are no interchange fees at all. I think the relationship between interchange fees and the decision to invest in chip and PIN is very weak. Ultimately, innovation is financed through revenue earned from fees charged to card holders and merchants. The RBA has not regulated these fees at all.

Until recently, when we talked to the banks about why the upgrade to chip and PIN had not occurred in Australia, the answer has been that there is not a business case to do so. The argument has been that Australia already has very low levels of credit card fraud—we heard that again this morning—and there are few cost savings to be gained, at least at the moment, from the introduction of PIN on credit cards. As a result, in terms of fraud reduction, the investment simply did not pass the cost-benefit tests. We have been told, however, that the calculations would change if fraud increased or was expected to increase. The decision focuses on whether the introduction of chip and PIN would reduce fraud by more than the cost of introducing chip and PIN. To date, the Australian banks' assessment has been that it did not pass that cost-benefit test.

I might note that, notwithstanding comments we heard yesterday from Visa, the submissions received by the RBA over a long period have stated that around 80 per cent of the costs of upgrading to chip and PIN fall on the acquiring side of the market and not on the card-issuing side. This is because most of the main costs in moving to chip and PIN involve the updating of merchants' terminals rather than the reissue of cards. Given the costs fall mainly on the acquiring side, I find it puzzling that people have argued that reducing interchange fees paid by the acquirer to the issuer has in fact reduced the incentive for acquirers to upgrade their systems.

Another point made was that investment had generally suffered because the bank had raised the whole technology issue. It was suggested that the investment climate was clouded by fears that the RBA would require the establishment of a central switch or some other technology. Frankly, I was surprised to hear this argument repeated again yesterday, as it was made clear at the Melbourne Business School conference, at which the chairman was in attendance, that the RBA had no such intentions. We have said nothing to suggest otherwise. For the industry, I would like to repeat the point I made at the Melbourne Business School: the RBA has no plans of appropriating investment or of requiring a central switch to be established in the industry.

The third issue was that the bank has not used a consistent approach to the setting of interchange fees. Different methodologies exist in the three systems that we have regulated: Visa Debit, credit cards and the EFTPOS system. People have criticised the bank for the lack of a consistent approach and said that that is poor regulatory policy. The central issue we faced is that the starting points had been grossly inconsistent with one another. We have had interchange fees in this country flow in opposite directions in the different systems and they have been quite far apart. What we have done is to push these interchange fees in the right direction rather than to seek the perfect solution, whatever that might be. This has involved a degree of pragmatism on the part of the bank. Ultimately we have had to use our judgment about how far the movement should be. We felt we had no other choice because, if we were to move interchange fees all in the same direction, it would involve very large changes for at least one payment system. We thought that the case was not strong enough to do that.

In time we would look to have a more consistent approach, but it is easier said than done. Yesterday the merchants did propose one consistent approach, and we have talked a bit about that—zero interchange fees everywhere. It is an interesting idea and worth further exploration. Of course, we already have zero interchange fees in a number of our payment systems in Australia. In the cheque system there is no interchange fee, in the direct debiting system there is no interchange fee and in the direct crediting system there is no interchange fee. Zero interchange fees exist in some very successful debit card systems around the world. So I think it is an interesting idea to explore.

Having said that, there are solid theoretical arguments as to why non-zero interchange fees might promote the efficiency of the system. There is a large and growing volume of academic literature exploring the rationale for non-zero interchange fees. Many of the points in that literature have merit. I think the more difficult issue for us, but probably at least as important, is whether there is a case for completely different interchange fees in the various systems—in particular, what is the rationale for a set of interchange fees that result in card holders being encouraged to use credit cards over EFTPOS, particularly when the EFTPOS system has lower resource costs? This question will continue to be a challenge to all those involved in these debates over the coming years.

They are the three large issues that I wanted to respond to. You also asked yesterday at the beginning of these hearings about an article in the *Daily Telegraph*, so I thought I would come back briefly on that. We looked at the report last night looking at the relative costs in different countries of consumer and mortgage payments. Unfortunately, we are not really in a position to offer much help to the committee. International comparisons of these types are often very difficult. The devil is the detail. When we looked at the report we were challenged to even understand the data for Australia. It reported that the spread on mortgages was around 189 basis points, but in practice if today in the Australian market you are paying more than 120 basis points you should be going and talking to your lender or another lender. We have some trouble understanding the credit card margins reported in the table as well. So to do justice to that article the committee might talk to the authors of the report rather than me giving further comments on it.

At one general level, though, the Australian banks have been amongst the first to introduce user pays pricing for a large range of services. Perhaps it is only banks in some of the Scandinavian countries that have taken this practice further. Over recent years there has been a reassessment of this strategy, as consumers have reacted to the complicated pricing, particularly on transaction accounts. You have seen in the last year and a half the introduction of the $5 ‘all you can eat’ retail transaction account, whereas in previous years the banks have really gone for per transaction pricing. You also see the shift in attitude in the banks going cold on direct charging for ATMs. A couple of years ago at least a number of them thought it was an idea worth fully exploring. Today my understanding is that none of the major banks support the direct charging model. So we have seen a step back from the approach of marginal cost pricing for every transaction to some type of fixed pricing. I am not sure whether the same thing is going on in other countries. It might be an issue that is worthy of further exploration, particularly with the authors of that study. That is all I am in a position to offer.

Dr EMERSON—Could you give us the figure again? Is it 55 per cent of adult Australians that have a credit card or that do not have a credit card?

Dr Lowe—Fifty-five per cent have credit cards. That is from our survey.

Dr EMERSON—So 45 per cent do not?

Dr Lowe—Yes.

Dr EMERSON—Let us say for argument’s sake that merchants have passed on to consumers most or all of the $580 million in savings. That would be in the form of lower prices, wouldn’t it?

Dr Lowe—Yes.

Dr EMERSON—So 45 per cent have picked up a nice little gain from the Reserve Bank’s intervention?

Dr Lowe—That is a relatively accurate summary of what has gone on. We have a situation in which the price level was higher than it otherwise would have been because of the higher merchant service fees. The people who were benefiting from that were the credit card holders, through their reward points. But nothing in life is free. The people who were ultimately paying for this were the people who did not use their credit cards—that 45 per cent of the adult population who do not have a credit card.

Dr EMERSON—So the big winners from the Reserve Bank's reforms were those adults who do not have credit cards?

Dr Lowe—Those people are now paying lower prices for goods and services.

Dr EMERSON—Whether or not the $580 million, in total or in part, has been passed on?

Dr Lowe—Yes, they would have got their share of that. I think the number I quoted yesterday was $700 million.

Dr EMERSON—That is right. Where did we get the figure of $580 million?

Dr Lowe—The number is growing through time because the value of credit card transactions grows through time.

Dr EMERSON—So it could be $702 million by now?

Dr Lowe—If we come back in a week's time, we may have a slightly higher estimate.

Dr EMERSON—It seems that there are three consequences of moving from 55 to zero on the interchange fee—and we would not know the distribution of this: reward systems would become even less attractive, the interest-free period would be shortened or eliminated and/or interest rates on credit cards would rise. Is that right?

Dr Lowe—Yes, and annual fees.

Dr EMERSON—Annual fees would be introduced or increased?

Dr Lowe—Yes.

Dr EMERSON—All of that would make using credit cards less attractive than using EFTPOS, wouldn't it?

Dr Lowe—Yes, that is true.

Dr EMERSON—And if you add the reduction in the EFTPOS fee from 20c to 5c you get a fairly significant relative price difference that favours EFTPOS over credit, don't you?

Dr Lowe—Yes. I think that moving down from 55 basis points to zero would lead to a further significant adjustment in relative prices in the system.

Dr EMERSON—So more people would use debit cards—that is, EFTPOS—if you did that. Is that a necessarily a bad thing?

Dr Lowe—I think the issue here is whether an interchange fare is in the public interest. There are respectable arguments for why such a fee is in the public interest and promotes efficiency in the system. It helps develop the network. So I think it would be too early to conclude that zero is the right answer. The issue we have primarily focused on is: when you have interchange fees in different systems what is the rationale for them being completely different and what incentive effects are created by that?

Dr EMERSON—But, as you have said, EFTPOS is widely used and there is going to be a very low interchange fee—and, in other countries, no interchange fee. Presumably there is innovation and the spreading of that through the system—most retailers have an EFTPOS system—so why would it stand up logically that, if you got rid of the interchange fee, credit cards would not still be used widely throughout the system?

Dr Lowe—I think it is perfectly possible that they would be. No country has gone down to a zero interchange fee. As a number of people have said, we already have one of the lowest interchange fees. So I do not think we really know what would happen. But there would clearly be a readjustment in the price signals and you would see the EFTPOS system grow significantly as people move payments from credit cards to EFTPOS.

Dr EMERSON—Which would mean there would be less reliance on debt, but I do notice that in your opening statement you said that is not a policy objective of this exercise.

Dr Lowe—This is about payment system reform; it is not about debt or the balance sheet position of household debt.

Dr EMERSON—In terms of the incentive to develop the network—that is, make credit cards available in as many retail outlets as possible—isn't there still the incentive called the interest rate? Why wouldn't the issuers of credit cards still want to issue credit cards? The answer is that they get a 10, 12, 14 or 16 per cent interest rate. If you went from 55c to zero and they lost another $700 million or whatever, it seems to me that they would still say, 'We really like issuing these credit cards because you get a very high interest rate on them'. That itself provides plenty of incentive for innovation.

Dr Lowe—I think you are right. There would still be a credit card product with a zero interchange fee. It would most likely look different to what we have now. There may be no rewards points attached to it and the 55-day interest-free period that you get if you pay it off by the balance date may be cut significantly, but the product would still exist. The credit card is a very useful product. A lot of people like it. We should not lose sight of that. There is a clear consumer demand for it. I think there would still be a product but it would probably be different to the one we know today.

Dr EMERSON—To close the loop, would it not be the case that those who do not hold credit cards would be the big winners out of going to zero, just as they have been the big winners out of going from 95c to 55c?

Dr Lowe—You would certainly see a further reduction in the aggregate price level, and the people who do not use credit cards would be beneficiaries of that. There would likely be few adjustments on the cost of debit cards.

Dr EMERSON—I am not necessarily arguing that it should go to zero, but I think it would be useful to get the evidence as to what the impacts would be.

Dr Lowe—No-one has gone anywhere near there, so we are in the land of speculation here.

Dr EMERSON—But they have with EFTPOS. There is innovation in EFTPOS.

CHAIR—Counting who was on what side, the groups I have seen, in terms of evidence, who seem to have said that you have interfered unnecessarily include Visa and MasterCard, Professor Gans, Rick Simes and the ABA. The credit unions have mainly been concerned about your plans to change the accept-all-cards regime. The ANZ—it is a bit unfair to classify them separately because they are part of the ABA—said that they did not have any major problems with the reforms but certainly saw no reason to go further. Then we have the zero interchange from the merchants and Peter Mair.

So we have a range of views and all are motivated, as you have said, by self-interest, which we have no problems with. But you have to take a different view. Just on the other side from Dr Emerson is that if 55 per cent are card holders—and you cannot demonstrate that in terms of prices it is going to necessarily flow on—that 55 per cent of the community would be worse off under proposals to take it to zero, or are worse off under the changes that you have instituted. If the price of the cards has gone up and the benefits have lowered, it could be argued that the majority are worse off.

Dr Lowe—That could be argued, but to argue that you have to suspend the connection between prices and costs, and that is not something—as we have talked about before—that we think is an appropriate thing to do.

CHAIR—Difficult to prove.

Dr Lowe—Difficult to prove. We are asked to suspend a longstanding relationship. It is one that is argued for strongly by business and by banks in many other contexts, but we are asked to suspend it in this one.

CHAIR—For the average person who holds a card, I think the calculation—in terms of $500 million, or a bit more if it is $700 million—is about $1 a week or maybe $1.50 with your new figures, as opposed to significantly increased card holder fees. The average consumer may not necessarily feel that they have won in that exchange. I want to take you to the question of capping. There was the recommendation that there should be a cap on the level of surcharge that could be levied. What is your view on that?

Dr Lowe—The credit card standard says that the acquirer may come to an agreement that the surcharge is to be no greater than the merchant service fee. The standard specifically allows that possibility. The Reserve Bank, though, does not have the legislative power to say to the merchants of this country, ‘You may not charge more than X for accepting a payment instrument.’ That is beyond the scope of the power that the parliament has given the Reserve Bank. That is not something that the Payments System Board could do. It would have to be an initiative of government to pass relevant legislation.

CHAIR—Do you think that would be appropriate?

Dr Lowe—These costs are determined in a competitive marketplace. The merchants are operating, by and large, in competitive conditions. It seems to me that you would need a strong argument to say that we need to again suspend that competition and force an extra regulation of business. My assessment is that the argument has not been sufficiently made that we need to suspend that.

CHAIR—What about the credit unions' argument that they would be significantly disadvantaged by the accept-all-cards change?

Dr Lowe—I think this really comes to the whole package of reforms to the debit card system. We very much see that as a package. Our main concern here was that, if we left the current arrangements unchanged, there would be a very large incentive for issuers to migrate their card holders from the EFTPOS system to the Visa Debit system. Remember, under the current arrangements, whenever you use your EFTPOS card, your bank has to pay the merchant's bank 20c but, if you make exactly the same transaction from the same account, if you use the Visa debit card, your bank will get, on average, 40c a transaction. So there is a 60c turnaround on every transaction. Our position has been that, if that were to remain unchanged, there would be a very strong incentive for financial institutions to move to issuing Visa debit rather than EFTPOS, and that would not be in the public interest.

We started this by saying, 'One of the things we need to do is to narrow these interchange fees to, at least from the bank's perspective, not create this artificial incentive from interchange fees to encourage the use of Visa debit.' One consequence of that narrowing is that, at the margin, building societies and credit unions find it less attractive to issue Visa Debit. At the margin, a few more customers may use credit cards rather than Visa debit as a result of these reforms. But I think the entirety of the package is a set of reforms that will encourage the use of debit relative to credit and it will make sure that the EFTPOS and the Visa Debit systems compete on their merits rather than through interchange fees, which are longstanding and not subject to competitive pressures.

CHAIR—Are you concerned about the impact on credit unions, who are very much the minor players in the market?

Dr Lowe—It will have an effect on credit unions but, as they have said, they will restructure their pricing to build on the strong customer base that they have. They will have to look at their pricing—that is certainly true—but they have their strong customer relationships. I think that is the basis of their competitive advantage—it is not the structure of interchange fees. It surely cannot be the case that the whole competitive position of the credit union industry is built on something as obscure as interchange fees.

CHAIR—All right. Those are strong words. Thanks very much.

Mr SOMLYAY—Mr Mair suggested that the banks ought to cross-subsidise interchange fees from their windfall profits or endowments from the positive, non-interest-bearing accounts. Do you have a view on that?

Dr Lowe—I think he was making a number of points. One was that we should probably have zero interchange fees, and we have had a discussion about that. Another was that somehow there is no entry in Australian banking and that the banks get some great benefit out of this lack of competition in the marketplace. I would question that premise because we have seen a lot of new entry in the Australian financial system over the years and that is putting a lot of competitive discipline on the banking system. On mortgages, you saw all the mortgage originators come in and securitise, and as a result the banks now have an interest margin of—as I was talking about before—120 basis points, whereas in the early 1990s the number was closer to 400. On deposit accounts, all the major banks now offer internet based deposit accounts paying somewhere close to 5½ per cent. That was really driven by the foreign banks coming in and competing. The foreign banks came in with internet accounts and offered rates close to the Reserve Bank's cash rate. There is quite a lot of entry, and there is a lot of competition on the deposit side and on the mortgage side. So the claim that somehow there is a lack of competition and that that is the source of the problem does not stand up to close scrutiny.

Mr McARTHUR—I want to raise three issues. Does the Reserve Bank take responsibility for the integrity of the payments system, and is there a presumption amongst all the players that the system will work? Would you care to respond to that proposition?

Dr Lowe—Yes. The Payment Systems (Regulation) Act sets out the responsibilities of the Reserve Bank here, and it is the efficiency, competition and stability of the payments system. The Reserve Bank has spent quite a lot of time looking at the technical operation of the system and the regulations surrounding it to make sure that, if one institution was to experience problems in the payments system, those problems would not cascade through the entire system. We have done a lot of technical and non-glamorous work there, but it is very important work. It is typically work that the industry supports, because it improves the stability of the system. In making sure that the system works day to day, that a machine works when you put your card into it is the responsibility of the banking institutions themselves. The Reserve Bank is not responsible for making sure the system works every day and that institutions have the capability to do that. But institutions have a very strong incentive to do that. If your card does not work when you put it into a bank's ATM, you are not going to be very happy, so the institutions have a strong incentive to make sure that the system is reliable and works well, and they have done a very good job of that. I think the Australian payments system works very well for most users. It is highly reliable.

Mr McARTHUR—Have you got mechanisms in place to check that the system does have integrity? I come from Pyramid country, in Victoria, and we have found that that system did not work too well.

Dr Lowe—There are a couple of issues here. One is the prudential regulation of financial institutions, and that is really the job of APRA—to make sure that all deposit-taking institutions are meeting their prudential requirements. There is a subsidiary issue—whether we have fireproofed the payments system so that a problem that occurs in the payments system does not cascade through the whole system. The Reserve Bank is responsible for that, and we have done that, but the safety of deposits is really the job of APRA, not the Reserve Bank.

Mr McARTHUR—APRA had a bit of trouble in the insurance industry, so we might be more confident with you in that area. My second point is about this reward points issue. It is an issue which has been raised by a number of witnesses as well as you. One witness said today that there are rivers of gold in relation to the flow of these credit cards. How does the market really ascertain what the market signals are when you have these reward systems where it is almost impossible to gauge one against the other? What comment do you have on that.

Dr Lowe—This is a point that Dr Emerson raised yesterday as well—the complexity of the rewards schemes. Certainly they are complex. If you are like me and you have looked through those brochures that the banks send you every now and then, there is a tantalising array of different options. It can be quite difficult to work out what the actual value in these things is. One way that we have found useful, when comparing the different systems, is to look at how much you need to spend to get a $100 shopping voucher, because most systems, not all of them, offer that particular option. With most of the various cards you have to spend around $15,000 to get a $100 voucher. So that is one way that consumers can look at the various systems and compare them. It is much more difficult when you are comparing consumer electronics or something where there is a multitude of different products. I think the shopping voucher is one way of comparing them, cutting through some of the complexity.

Mr McARTHUR—If you remove the reward system totally, as a consumer, how would you judge one card versus another? If you are a sensible customer and you are trying to make an evaluation of whether you take Visa or MasterCard or whatever, how would you go about the process?

Dr Lowe—As a number of people have said already, I think you have to look at the various aspects of the card. You have to look at the annual fee, the interest-free period, the reward points and the interest rate if you borrow. For each person it is going to be different. Some people really value the reward points and are happy to pay a high annual fee because they spend a lot on the card. Some people are not going to spend very much on their card and so $15,000 on a credit card is a lot of spending. What those people want is a very low interest rate and probably a low annual fee. There is a multitude of cards in the marketplace and each person has to look at their own spending characteristics and compare the products on offer against their spending characteristics. It is complicated as there is an array of products out there. The complexity reflects the different nature of the demands from different people.

Mr McARTHUR—I want to raise a point about this interest rate argument, the 18 per cent and the 16 per cent, with some new players in the marketplace suggesting a rate of eight per cent. Could you give us the Reserve Bank’s assessment of the role of the interest rate component?

Dr Lowe—I think the governor said at the last parliamentary hearing that the question he always used to get asked on credit cards was why the interest rates are so high and why the standard rate on credit cards is 18 per cent. I think his answer was that he was always perplexed about why that was the case, and I think that remains our position. One reason the banks had given was that there was quite a lot of credit risk associated with credit card lending—that when someone uses a credit card the merchant gets an immediate guarantee of payment and the bank takes the credit risk on the customer—so the default rate was sufficiently high to justify a very high interest rate. I think that argument did not stand up under close scrutiny because the default rates are not that high to justify the 18 per cent interest rate. We have seen that with new competitors that have come in offering credit card products at less than nine per cent.

Mr McARTHUR—How come all the banks were about the same for a long period of time? They were all about 18 per cent or 1½ per cent per month, which nobody quite understood.

Dr Lowe—It is a very good question, and I do not think I can give you a satisfactory answer to it. The credit card business was very profitable and the banks were focusing their competitive efforts on giving reward points to card holders. The idea that you would go and compete for credit card customers by lowering an interest rate seemed foreign to many financial institutions. What they wanted to do was attract people by offering a very generous reward scheme. That was where the competition in the credit card industry reflected itself, not on interest rates. But, since we have seen the lower interchange fees come into existence, we have seen the competitive dynamics realign themselves and people are now focusing on that segment of the market, whereas previously that was not the case.

Mr McARTHUR—On the 45 per cent of Australians who have taken out a credit card for extending credit or for their ability to transact business: do you think it is a bit of both, do you think they have a bit of extra credit up their sleeves or is it just convenience? What is your judgment on that issue?

Dr Lowe—I think it is both. There are some people who clearly find a credit card a very convenient way of making transactions, and there are good reasons for that. It is a very useful product for making transactions. But there are also people who are constrained in how many financial resources they have and are prepared to pay the high interest rates on credit cards. I think the survey data that we have available suggests that around two-thirds of people say they normally pay off their credit card by the due date and a third say they normally roll over some or all of the balance. There is clearly a variety of experience amongst the Australian population. Some people use it as a transaction device and others use it as a credit device.

Mr McARTHUR—What is the normal methodology of those 55 per cent of Australians, on your figures, who do not have a credit card for transacting business in 2006? Is it cash or cheque?

Dr Lowe—Forty-five per cent of people do not have a credit card and they would use a debit card, their EFTPOS card. There are as many EFTPOS transactions as there are credit card transactions in this country. Despite all the things that have been stacked against the EFTPOS system, people actually like using debit. A segment of the population actually like using debit. It offers them control. They know they are spending their own money. They know there is no risk of going into debt.

Mr McARTHUR—Can we just get that figure quite clear? The 45 per cent who have a credit card—

CHAIR—It is 55 per cent.

Dr Lowe—No, 55 per cent have a credit card; 45 per cent do not have a credit card.

Mr McARTHUR—What do they have? Just help us with that.

Dr Lowe—Most people have a standard bank account which has an EFTPOS card associated with it. You can take money out of the ATM or use it at the merchant to buy goods and services.

Mr McARTHUR—You are saying that most Australians have some form of card in their possession?

Dr Lowe—Most bank accounts now come with a card which you can use in the ATM and the EFTPOS system. I think there are more than 20 million such cards. In aggregate, there are as many transactions processed through the EFTPOS system—that is, through the debit card system—as there are through the credit card system.

Mr McARTHUR—That is underpinning the whole argument you have been putting to the committee, to get these two things more in alignment.

Dr Lowe—You pull your card out of your wallet and swipe it through the machine at the merchant and they ask you, ‘Would you like that to be on credit or savings?’ You make that decision. The prices that you face should broadly reflect the costs of the systems. The structure of the prices has been that you have an incentive to press ‘credit’ rather than to press ‘cheque’ or ‘savings’. It is largely a result of these interchange fees that you have that incentive, and we are questioning whether that is in the national interest.

Mr CIOBO—Dr Lowe, you have been here for all of the evidence. Most of the evidence we have heard from the four-party schemes is that, as a result of the RBA’s intervention, the three-party schemes have been unfairly advantaged from a regulatory point of view. The three-party schemes say that is not the case. They say, ‘Our market share has barely grown.’ The reason I say that as a preface to my question is to get your response to it, because I do not think you have touched on it thus far. Secondly, there is a line of argument that has been put to the committee about reducing interchange fees further. Some people say that that is in consumers’ interests, although card holders themselves bear more of the direct cost as a result of that. There is some merit in that argument, because I believe those cost savings are passed on. The question is: does that further exacerbate any market advantage that Amex or Diners may already have? That is why it is fairly fundamental as to whether or not the regulations provide a market advantage.

Dr Lowe—That is a very good question. The regulatory approaches to the four- and three-party schemes have clearly been different. The immediate impact on the four-party schemes has been more pronounced than the impact on the three-party schemes. The three-party schemes, though, are subject to much greater competitive discipline than had been the case in the past. We are seeing the average merchant service fee come down and we expect that the average merchant service fee of both American Express and Diners Club will come down further and that over time that will lead to a restructuring of their products and the generosity of their rewards. That is our expectation. It has taken a little longer than we thought it was going to take, but it is happening and we are seeing that competition work.

From our perspective, the issue is that we have seen a significant public advantage from these reforms. There are significant benefits to the community at large from the reforms. We have had different regulatory responses to the different schemes and that may at the margin have helped the three-party schemes rather than the four-party schemes, although the effect has been small. Our view is that we really need to view the reform process in its entirety and ask whether the benefits in net terms have been greater than the costs. Our view is that they have been and that any changes in market shares are not undermining those benefits.

CHAIR—At what point, Dr Lowe, would you decide that the distortion in the market is such that it outweighs the benefits to the consumers as you see them?

Dr Lowe—Another good question, and one that I cannot give a specific answer to. There is no magic point here. The observation that I would make would be that if the market shares of the three-party schemes were to increase significantly and at the same time—

CHAIR—What is ‘significantly’, though? They have already gone up—

Dr Lowe—Can I finish. If at the same time there was no reduction in the average merchant service fee of those schemes, then that would raise the issue of whether the competitive positions of the different schemes were starting to undermine the benefits of the reforms. But you would need to see both of those things, because there is nothing wrong with American Express increasing its market share. That may well be the outcome of a competitive marketplace. It would concern us more if we thought that that outcome was the result of the regulatory reforms, and one sign that that could be occurring is if the average merchant service fee that they charge did not fall any further. You would need to see the combination of those two things. I cannot give you any precise numbers. It would be—

CHAIR—I am sorry to interrupt Mr Ciobo’s question—he is becoming quite an expert in this area—but Visa are making the argument that they lack the ability to pursue the premium market that is particularly attracted by high frequent flier points and levels et cetera. One could assume that they could pursue it by putting up the price of their card sufficiently. As we have seen, the Amex-Qantas card costs about $400. In terms of your modelling, can Visa go for a platinum five-star card which could simulate the American Express card in a far different way?

Dr Lowe—It is up to each issuer to decide the structure of products that they are going to offer in the marketplace. Some of the issuers have introduced cards with quite high annual fees—$300 or $400 in the MasterCard and Visa schemes—and are offering a more comprehensive rewards package. That is really for the marketplace to determine.

CHAIR—There has been an argument that they were trying to compete with one arm tied behind their back. The interchange fee restrictions that applied to them certainly did not apply to Amex, Diners Club and so on, so that is interesting.

Mr CIOBO—As the RBA continues the trend of passing on consumer benefits through reduced interchange fees—and the RBA has been almost the strongest advocate of interchange fees to appear before the committee thus far—is there not a risk that, as the regulatory advantage of three-party schemes increases and as the direct costs borne by four-party schemes card holders increases, there is a bonanza for Amex and Diners? You could then sell a product to the market that is funded off the back of higher merchant service fees with broad acceptability and the lesser attractiveness of four-party schemes because of high up-front costs and lower rewards. Is that not a very real threat?

Dr Lowe—That is a risk if higher merchant service fees were to stay, if American Express charges were to stay as they are, if American Express were able to leverage that advantage to offer generous reward points and then we saw a large migration to American Express. We cannot rule that out as a risk.

Mr CIOBO—It is a pretty likely outcome.

Dr Lowe—I would question that. We have given merchants the tools to negotiate fee reductions with American Express and the merchant community is taking advantage of those tools. American Express said this morning that their average merchant service fee has fallen 30 basis points over the past couple of years. So merchants are taking advantage of those tools. Merchants are also imposing, in some cases, additional surcharges on American Express and they are declining acceptance of the card because they think the fee is too high. So people might have an American Express card in their wallet, but not all merchants are accepting that card. Our assessment to date—and people present the numbers differently—is that the movements in market share are relatively small. So, despite the more generous reward schemes being offered by some of the cards, there has not been a wholesale migration from the four-party schemes to the three-party schemes.

Mr CIOBO—So the cost benefit analysis for the RBA will effectively be to weigh up the broad consumer benefit that flows from lower interchange fees against not creating too much turbulence in terms of market share?

Dr Lowe—That is a reasonable summary. Regulatory neutrality is a very good principle, but we have schemes whose fundamental structures are so different. So if that is going to be the pre-eminent principle then we do not have any regulation of interchange fees.

Mr CIOBO—So you are Visa's and MasterCard's best friend now?

Dr Lowe—Our view is that the parliament has said we have to take the public interest into account, and that is really what we have tried to do.

Mr CIOBO—How would you respond to a merits review mechanism for your decisions?

Dr Lowe—This is an issue for the government. The current structure came out of the Wallis inquiry. There were very good reasons why the Wallis inquiry recommended that, and the government accepted those recommendations. If the government wanted to institute a merits review then the Reserve Bank would have to deal with that. But it is really an issue for the government. Having said that, I think there are some considerable benefits to the current process. If we have merits review then the whole process will end up in court more often because there are very strong interests on either side. The arguments will be made increasingly through lawyers in a court process at greater cost to the industry and with greater time delays. That can be the downside. I think the current arrangements have quite a lot of oversight. The Reserve Bank is subject to judicial review. If the court were to decide we had abused or extended our powers, or not exercised them appropriately, the decisions can be overturned.

CHAIR—Basically you are a regulator and a policy maker as well. Does that not put you in an unusual position?

Dr Lowe—We are the policy maker. The Payments System Board has responsibility for the policy for payment system policy. So the distinction between policy and regulation, I think, is not immediately clear. The act says that the board is responsible for the payments system policy of the bank. It is the policy, and the policy is reflected in the standards and access regime. So there is judicial review. There is certainly review by this parliamentary committee. Ultimately there are override provisions in the Reserve Bank Act that the government can exercise. I think it would be extremely unlikely to do that. But there are mechanisms of review already in place.

The benefit of the current arrangement is that it allows a lot of consultation, it allows industry based solutions to come forward where we can get them and it allows decisions to be taken by an expert board that is independent and advised by a highly competent staff outside the legal processes of courts and lawyers. Different people will come to different judgments about what the right process is, and ultimately it is a decision for the government, but from our perspective the current arrangements have worked well.

Mr CIOBO—Finally, with respect to PIN based and chip based systems, you indicated that that was not funded through the changed fees but more through MSFs and card holder fees. Again, I take it that this would be part of your calculations if there were a move away from four-party schemes. Presumably there would not be the revenue immediately available or even warranted to roll out some of this new technology again. Is that a risk? Is that something you just evaluate on an ongoing basis?

Dr Lowe—I think that is a very small risk. In the end, the calculation of whether to move to chip or PIN is really based around the incremental fraud savings that that would bring about relative to the costs of implementing chip and PIN. That is my understanding up until very recently. That was the calculation the banks were doing. They were saying, 'Fraud costs in Australia are very very low—probably less than 10c in $100. They are very, very low by international standards. That is the reason we have not moved to chip and PIN.' People in the industry have been questioning whether, as other countries do it, fraud will migrate to Australia and then we will find that it is not less than 10c in the dollar; it is much higher. That will force it. I really do not think this is an issue of interchange fees.

Mr CIOBO—Would you envisage a role for the RBA to play in coordinating the roll-out of that technology?

Dr Lowe—The RBA is supportive of the move to chip and PIN. We think that would be a very good thing to do. To date we have seen it as an issue for the industry because there is this cost/benefit analysis they have been doing and said that it hasn't passed the test. I think if we got to the point where we were very concerned about the potential for fraud to increase here, and we did not see the industry taking what we thought were appropriate steps, we would think about playing a more active coordinating role here. I would hope that we would not have to use our regulatory powers in this area. That is not something we would do lightly. I think the industry will get its act together and do something here.

CHAIR—Could you take us through the process of what happened in 1998 when the ACCC concluded that these fees were an unlawful price-fixing arrangement, in breach of section 45A of the Trade Practices Act, commenced proceedings and then were unable to reach agreement with the dominant schemes? Was it seen that, if they then proceeded and took them to court, your ability to regulate would be taken away? What was the motivation in passing it over to you?

Dr Lowe—Can I ask Dr Veale to answer that question because he was around at the time. I was not there.

Dr Veale—The background was this. During the course of 1999 and 2000 there were two pieces of work going on: the ACCC had received a complaint from a merchant that led them to investigate whether the setting of interchange fees was an infringement of the Trade Practices Act. At the same time, together with the ACCC, we were doing work on the economics of the credit card, debit card and ATM systems to figure out whether there was an economic rationale for the interchange fees that we have been discussing.

During the course of that period, the ACCC formed the view that the arrangements for setting the interchange fees in credit card schemes were an infringement of the Trade Practices Act—that was the infringement that Mr Lorigan described earlier. The ACCC then discussed with the banks whether there was a set of arrangements that the banks could come to or would propose, such that the setting of interchange fees might be authorised under the Trade Practices Act. The allegation that part of the act was being infringed was based on the sense that there was a collusive agreement to set prices that would have the effect of reducing competition. Those sorts of arrangements are per se illegal under the Trade Practices Act, but they can be authorised if the parties involved can demonstrate to the ACCC that there is an off-setting benefit from the lessening of competition—and that is a fairly common set of procedures called authorisation.

During that period—basically around Christmas 2000 into 2001—there was a series of discussions between the ACCC and the Australian banks about the possibility that such an arrangement might be authorised. Eventually, the ACCC formed the view that the proposals being put to them were not likely to lead, in their view, to an outcome that they would be able to authorise. Most of those discussions were quite informal and we, as the Reserve Bank, sat in on many of them; although the discussions were, I emphasise, between the ACCC and the banks, not directly with us. We were not in a position, naturally, to decide whether there was an infringement of the Trade Practices Act or to make any judgments about whether authorisation should be granted or not. That was clearly a matter for the ACCC.

Eventually, the chairman of the ACCC wrote to the governor saying, ‘We think it would be better to look at the question of interchange fees under the provisions of the Payment Systems (Regulation) Act, which the Reserve Bank administers.’ At that point, that question was put to the Payments System Board. The Payments System Board decided that it would be in the public interest to designate the credit card schemes with a view to looking at what would be an appropriate way of setting interchange fees in this country. That decision was taken in April 2001, and at that stage the ACCC withdrew the litigation that it had initially enacted against the National Australia Bank. And the rest is history.

CHAIR—As they say. Thank you very much. Having sat through this day and a half of hearings I think gives the committee some sympathy for your role in managing the various conflicting interests and self-interest—not that there is anything wrong with that—of the various players. Obviously there are pluses and minuses whichever way we go, and that does not provide an easy task for the committee. We thank you for appearing today.

Resolved (on motion by **Mr Somlyay**):

That the committee authorise publication, including publication on the parliamentary database, of the transcript of evidence given before it at the public hearing today.

Committee adjourned at 12.49 pm