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Proposed Reform of Credit Card Schemes in Australia

NARGA Position Paper
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Introduction

The National Association of Retail Grocers of Australia (NARGA) represents more than 4000 independent grocery stores and supermarkets, employing more than 50,000 people throughout Australia. NARGA member's stores compete on a day-to-day basis with the two major grocery chains, which dominate close to 80 percent of the Australian grocery market. NARGA and its membership play a critically important role in maintaining competition in the retail grocery sector, for the benefit of all Australian consumers.

The major supermarket chains have numerous competitive advantages arising from their size, visibility, cash flow and human resources. NARGA is currently campaigning for reforms to the *Trade Practices Act* to help ensure that the chains' dominant market position is not abused and so there is a more level playing field for small businesses competing with the major retailers..

We remain concerned that as unintended consequences of the proposed credit card reforms, the major supermarket chains may achieve additional significant advantages over their independent competitors, unrelated to the products or service offered to retail customers.

NARGA's aim is to ensure that independent grocers are able to be a competitive third force to counter the significant market power of the two major supermarket chains. Indeed, the very existence of a viable and competitive independent retail grocery sector will help protect consumers from exposure to the dominant duopoly. If the independent sector was weakened, the major chains could refrain from competing on price or service; and there would be a lack of genuine innovation. Where independents are able to compete fairly, consumers benefit from more choice, better prices and better services.

In rural and regional Australia, independent grocery retailers play a key role in the survival of many communities, underpinning the social and commercial infrastructure, particularly in small towns where the chains have no presence.

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Reserve Bank Credit Card Reform Objectives

The Reserve Bank of Australia (RBA) is proposing to regulate the bank credit card industry by addressing three core areas of the industry, access to the schemes, interchange fees and surcharging.

Access To Four Party Schemes

The RBA wishes to increase competition in the four party credit card system issuing and acquiring business. The RBA claims this will be achieved by broadening eligibility for membership of the schemes, by amending Australia's banking laws. The RBA proposals will require the Australian Prudential Regulation Authority (APRA) to consider applications from non-Authorised Deposit-Taking Institutions for licenses to join the credit cards system. It is hoped by the RBA that a greater range of institutions will participate in the credit card industry, thereby applying competitive pressure on the industry for the benefit of end consumers, merchants and cardholders.

Interchange Fees

The RBA hopes that by implementing a clear and transparent process, and a cost based formula for the determination and review of the four party system interchange fees, it will eliminate what it perceives to be a cross subsidisation of credit card users by non-credit card users through inflated retail prices.

The proposed interchange formula restricts the interchange costs that can be considered to fraud and processing costs incurred by credit card issuing institutions, and excludes the costs of credit risk, the interest free period, marketing and loyalty program costs, distribution, capital costs, and any other costs incurred by credit card issuers. The proposed reforms are intended to encourage consumers to utilise more efficient forms of payment, such as debit cards.

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NARGA believes the proposed restriction of the interchange fee formula is not a valid one. Many of the costs which have been excluded from the RBA's proposed formula are genuine, and at a minimum would be borne by retailers offering their own credit program. NARGA does not support this proposal, for the reasons provided below.

Surcharging

The RBA seeks to lift the restrictions on card accepting merchants from imposing a surcharge on credit card using consumers. The RBA believes retailers should be free to surcharge customers so as to give the appropriate price signals, that is, merchants should be free to pass on the cost of accepting cards to their consumers, without restriction.

NARGA Position

NARGA supports in principle the RBA's proposals to enhance transparency in the setting of interchange fees and that the Australian Prudential Regulation Authority be involved in approving new entrants to the credit card system.

NARGA believes that the proposed abolition of the prohibition on surcharging is commercially unrealistic, other than in sectors where there is little effective competition.

NARGA also believes that while the four-party system which developed in a free and competitive market has historically served consumers and small business well, reforms which potentially disrupt the balance between four-party, three-party and store card systems run the risk of handing competitive advantages to big business. Such disruption could not easily, quickly or cheaply be reversed and many small businesses might become victims of such change in the interim.

The large retail chains in Australia receive significant competitive advantages through the scale and market power they have amassed. Some large retailers have been able to offer a private label store card, for use exclusively within the retail group offering that facility. Other large retailers that do not at present issue a store card offer other forms of credit, but with essentially the same benefits as those attributable to a card.

The substantial costs of developing and maintaining a store card can be absorbed more easily by a large retailer that has the economies of scale to implement such a costly facility. Small businesses cannot afford to offer their own cards.

For this reason, when bank issued credit cards were introduced they were readily accepted by smaller retailers wishing to compete with large retailers that offered their own store-based credit. The bank issued credit card gave smaller retailers a relatively cost effective means of offering credit to their consumers, without the added burden of significant capital outlay to develop their own branded credit cards, and without the ongoing maintenance costs.

In effect the bank issued credit card was the way small and independent retailers outsourced the provision of credit to their customers, and regained the ability to compete with the retail conglomerates offering their own branded credit card. Additionally, bank credit cards afford additional benefits to retailers, such as credit fraud protection, easier bookkeeping via electronic records and other benefits that enable smaller retailers to compete on more equal footing with the major grocery and retail chains.

Negative Unintended Impacts of RBA Reforms

NARGA is philosophically committed to a pro-competition agenda and therefore supports reforms that will promote competition and transparency in payment services and the credit card industry. For this reason NARGA encourages the RBA to pursue reforms which will lead to such an outcome.

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NARGA does, however, caution the RBA to consider any unintended impacts on small business and in particular on competition in the grocery retail sector. As representatives of small business enterprises operating throughout Australia, we agree with the concerns raised by the Council of Small Business Organizations of Australia (COSBOA) and by the Credit Union Services Corporation (CUSCAL) in their public comments to the RBA.

Interchange Fee Reform

NARGA supports the implementation of a transparent cost based methodology for the establishment and review of credit card interchange fees.

An interchange fee in a four party credit card system is essential to ensure a fair sharing of the costs of running such a system. The philosophy of sharing costs, when there are joint benefits, needs to be observed in this context, as well as considering alternative payment methods, and their impact on the four party system.

In this respect, we feel that the Australian Retailers' Association (whose membership includes the major supermarket chains and major general retailers) position that interchange fees should be abolished is unreasonable and does not reflect commercial reality. We support the RBA's intention to keep an interchange fee in the cost calculation and urge the Bank to ensure all appropriate costs are factored into the formula, as detailed below.

NARGA understands the significant value small business derives from four party credit card systems, and the way such systems allow small business to compete on a level playing field with larger retailers in the provision of consumer credit.

For this reason NARGA calls on the RBA to ensure that the credit card reforms do not have the unintended consequence of giving either store cards issued by the large retailer or the more expensive three party systems a competitive advantage by shifting a disproportionate amount of the costs onto the cardholder, therefore making store cards or three party cards, or indeed cash, much more attractive.

NARGA members do not favour cash payment by their customers due to the increasing dangers associated with the storage of cash on premises. Unlike the larger retailers, small grocers are unable to afford the extra cost of a security guard on premises to protect against theft or robbery. Unfortunately armed hold ups have become more common, and the added security, and insurance costs arising from the need to accept cash have become excessive for small businesses. For this reason NARGA members call on the RBA to ensure their reforms do not lead to an inadvertent increase in the usage of cash for retail payments, with its attendant risks and costs for small business.

NARGA understands that the RBA's objectives are to promote the use of debit cards, and that as a consequence, there might be a migration from credit to debit, which is welcomed. The more likely result, however, in NARGA's opinion, is a significant migration to the more expensive three party credit cards, and to the restrictive store issued cards, leading customers away from small business to the large conglomerates.

Access to the Four Party Systems

NARGA applauds the RBA's initiative to provide a role for the APRA in its proposed Access Regime. NARGA members which may in the future utilise the services of non-bank providers of credit card facilities, are comforted by the fact that APRA sill have a role to play in authorising and supervising their activities, and ensuring funds payable to merchants are assured.

We understand also that the RBA would call upon the ACCC to ensure that any such providers associated with major retail chains who may enter the system are not able to exercise market power through the issuance and acceptance of credit cards to further their already strong position in the payments sector.

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Surcharging

The existence of strong competition in the grocery sector, coupled with the added complications generated by surcharging will ensure that it does not take hold in the retail grocery industry. For this reason NARGA does not support the proposed reforms.

In fact, the abolition of the schemes' no surcharge rule may expose consumers of other goods and services which do not face the same level of competition as the grocery industry to a non-cost reflective surcharge.

NARGA's Proposal For Interchange Fee Reform

NARGA supports the process proposed by the RBA for the implementation of a transparent process for the calculation of a cost based interchange fee, using an independent expert auditable by the RBA.

NARGA is aware of the European Commission (EC) proposals for the setting of interchange fees in that region. In contrast to the RBA's proposal, the EC model would include credit losses and the cost of the interest free period in the formula for calculating interchange fees.

NARGA's understanding is such a solution would ensure an immediate reduction in the prevailing interchange fee in Australia, without the counter productive migration of consumers from bank issued credit cards to cash (with its direct and indirect handling costs) or to store cards or three party systems, which impose significantly higher merchant fees on small retailers.

NARGA recommends that the RBA adopt the proposed EC solution, which would maintain a competitive playing field between the large and small grocers in Australia and prevent anti-competitive outcomes which would work to the detriment of Australian consumers.

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Unintended Consequences

A heavy reduction in interchange fees as proposed by the RBA, in our considered opinion will have the following unintended consequences.

1. Reduced Competition in the Australian Retail Sector

As four-party credit card systems are forced to raise their costs to cardholders, consumers will switch to the un-impacted store cards issued by the large retail conglomerates. These store cards, with their lucrative loyalty programs and strong branding, will effectively bind consumers to the stores that accept them. This will markedly reduce the competitiveness of independent retailers which do not have the necessary financial and staff resources, scale and market power required to issue a store card.

Such a reduction in retail competition would give the large retail conglomerates further market power and allow them arbitrarily to increase prices, without being exposed to robust competition from the independent sector.

2. Increased Cash Handling Expense

NARGA believes that the intended reforms are likely to see an increase in the number of consumers using cash as opposed to credit cards.

Such a phenomenon would increase the burden on small retailers, exposing them to direct and indirect cost increases relating to physical security and insurance and to additional risks of armed robbery and theft.

NARGA members do not support any regulatory reform which might lead to increased tax avoidance. The proposed interchange fee reduction will encourage consumers to switch to cash. Coupled with providing retailers with the power to impose a surcharge on a credit card, it will undoubtedly lead to a growth in cash usage in the retail sector, and an equivalent increase in the size of the Australian black economy.

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3. Increased Card Acceptance Costs

NARGA also fears that many card holders, and indeed card issuers will migrate to three-party systems in order to retain the benefits which will be eroded by a reduction in interchange fees. It is common knowledge among NARGA members that the three-party systems are significantly more expensive than the four-party system. Any reforms which lead to the growth of three-party systems are bad for small business and consumers, who will ultimately pay for any such increase in costs.

In Conclusion

NARGA's mission is to preserve an even playing field for its 4000 independent grocer members. As discussed above, the bank issued credit card has become a key tool for doing business for the small grocer. For this reason NARGA calls upon the RBA to ensure that its reforms are not to the detriment of the four party systems, not to the detriment of small business, and of course not to the detriment of the public interest, which is served by the ability of small business to compete with the larger retail conglomerates.

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