

Discussion

1. Tom Pockett¹

Alternatives to Direct Regulation

Good morning everyone. For those of you who don't know me, my name is Tom Pockett and my role at Woolworths Limited is Finance Director. Since the commencement of the Reserve Bank's reforms to the payments system I have been a keenly interested observer.

Dr Frankel, in his paper and speech, has presented a very compelling argument as to why interchange fees are unnecessary in Australia's cards market, and recommended that the Reserve Bank 'continue moving forward' with its reforms. I commend Dr Frankel's comments, and I would like to add to these by providing a comparison of the merits of alternative cards market governance models.

This session has been titled 'Alternatives to Direct Regulation'. In practice, this means alternatives to the Reserve Bank, or a similar government body, regulating the Australian cards market.

The complex network structure of our cards market requires well-considered rules to ensure that it functions as a reliable system of payment. And the setting of rules to govern a market amounts to regulation – regardless of whether the rules are set by a card scheme, a collection of large financial institutions, or a government body.

Prior to the Reserve Bank's market intervention, the role of regulating the credit card market was undertaken by the card schemes, acting on behalf of their members. The cards market at this time could be best classified as self-regulated.

Since the Reserve Bank first intervened in this market, it has shared the role of market regulator with the card schemes. The card schemes still maintain their scheme rules; however, the Reserve Bank has assumed control of rules related to interchange, card acceptance and network access. All decisions made by the Reserve Bank are taken in close consultation with all market participants and users. Thus, the current state of our cards market is best described as co-regulated by the Reserve Bank and the card schemes.

I will restrict my comments today to the regulation of interchange fees, network access and card acceptance within the cards market. Regulation of these matters will always attract feverish levels of interest because of the commercial implications of these decisions. Consequently, it is vital that the market regulator is independent, and is not influenced by its own commercial interests.

I will now discuss the three main regulatory models proposed for Australia's cards market: self-regulation, industry co-regulation and government co-regulation.

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Self-regulation

Let's begin with self-regulation.

Self-regulation involves market participants acting collectively to set the rules governing the market.

Self-regulation is an apt description of Australia's cards market prior to the Reserve Bank's intervention. Those parties that are presently pushing for a self-regulatory solution are effectively promoting a return to a pre-Reserve Bank market landscape.

The key failing of self-regulated cards markets is that the interests of the parties that collectively set interchange rates are very closely aligned. The interests of card scheme members, as issuers, are closely aligned because they are the beneficiaries of income generated by interchange fees. This interest is not affected by a member's position as an acquirer, because acquirers pass on the full cost of interchange to their merchant customers.

Close alignment of the interests of cards market participants is not unique to Australia. In fact, interchange fees around the world have been set at levels far in excess of cost in many other self-regulated markets. While high rates of credit card interchange may serve to benefit card issuers, they are detrimental to the interests of merchants and consumers.

I won't repeat the logic here, but Dr Frankel's paper details how banks have exercised their collective market power in setting interchange fees to exploit inelastic merchant demand for card acceptance.

Proponents of self-regulation have argued that competition will deliver an efficient and equitable level of interchange. But how can interchange fees be subject to competition if their price is centrally fixed? Furthermore, how were interchange fees subject to competition prior to the Reserve Bank's intervention, given that they remained constant for long periods of time?

Also, let's not forget that the card schemes introduced the anti-competitive 'honour all cards' rule and no-surcharge rule under a self-regulated market. More recently, card schemes have stipulated that they require acceptance of their prepaid and gift cards because the Reserve Bank's Standard does not explicitly recognise prepaid and gift cards. We should expect further restrictions placed on competition if we return to a self-regulated market.

One final point before I move on. Merchants have always paid a higher rate of interchange for scheme debit card transactions compared to EFTPOS transactions, even though both categories of debit cards offer identical functionality at the point of sale. It is high time that both categories of debit cards were treated equally. New Zealand's solution for scheme debit transactions is worth mimicking; all debit card transactions made at the point of sale, regardless of whether the card is a scheme debit or proprietary debit card, are processed via the EFTPOS network and incur identical interchange fee treatment.

Industry co-regulation

Moving on to industry co-regulation now.

Industry co-regulation involves a variation from self-regulation. Industry co-regulation entails a governing body working with the market participants to set the market rules.

Both the Australian Payments Clearing Association (APCA) and the Australian Bankers' Association (ABA) have proposed a model where APCA would engage with the market participants to set the market rules. However, is APCA the right organisation to fill this co-regulatory role?

APCA was conceived as an organisation to manage the clearing arrangements for various payment instruments within Australia. APCA's membership overwhelmingly comprises financial institutions, and its Board of Directors comprises even less diversity than its membership base. APCA's Board currently consists of 7 bank representatives, 1 retired bank executive, 1 credit union and 1 building society representative, and APCA's CEO. This lack of diversity is enforced by a requirement that board members must have membership of at least 3 of APCA's clearing streams.

The parties that would be involved in APCA's co-regulatory model are largely identical to the self-regulatory participants. Thus, in its current guise, APCA is not suitable to administer and oversee the setting of card market rules and card interchange rates in Australia.

Government co-regulation

Finally, I'll discuss government co-regulation.

As Reserve Bank data demonstrate, the Bank's reforms so far have not resulted in a decline in the market for credit cards. Credit card accounts and transactions continue to grow, and each year a new record is set for these measures. Consumers still view credit cards as a desirable proposition in a market co-regulated by the Reserve Bank. In fact, the Reserve Bank has successfully met its policy objectives, whilst maintaining a healthy market for credit cards.

Significantly, the famously predicted credit card market 'death spiral' never eventuated. Dr Frankel's paper eloquently explains that cardholders have not abandoned their cards, as predicted by the 'death spiral' argument, because they still receive significant benefits today from using their card. So any other such dire predictions should be handled with a touch of scepticism.

More and more government and competition bodies around the world are taking a closer inspection of their own domestic cards market. As a result, the instances of government intervention in cards markets overseas are increasing. While the Reserve Bank's reforms at first might have been considered an 'experiment' by some, they are now increasingly being perceived as pioneering.

While it is true that the Reserve Bank is the co-regulator of the Australian cards market, it is not necessarily true that the Bank has increased the *amount* of regulation governing this market. In fact, many of the Reserve Bank's reforms so far have *deregulated* an aspect of the market that previously had been regulated by the card schemes. For instance, the Bank's reforms to remove rules restricting *surcharging*, *product steering*, *access and card acceptance* are all examples of *deregulation*. Hence, any reduction in the Reserve Bank's regulatory role does not necessarily equate to deregulation of the cards market.

The Reserve Bank's reforms to date have not consistently benefited the same parties. Take for instance, the reforms to credit card and EFTPOS interchange. The Credit Card Interchange

Standard benefited merchants and their customers at the expense of card issuers and cardholders, while the EFTPOS Interchange Standard benefited card issuers and cardholders at the expense of merchants and their customers. However, Australia's payments system is now more competitive and equitable, with improved price signals and lower system costs than prior to the Reserve Bank's reforms. On this basis, the Reserve Bank's regulation of Australia's cards market can be considered very successful. It also reflects the need for an independent body to perform the role of co-regulator.

The key advantage of the Reserve Bank co-regulating the cards market, as opposed to a self-regulated market or an industry co-regulated market, is that it does not have a business interest in the cards market. Just as importantly, it does not have a membership base with business interests tied to the cards market.

Consequently the Reserve Bank is unbiased in its decision making, and considers *all* stakeholders involved in the payments market, including merchants and consumers.

Therefore, any organisation proposing to replace the Reserve Bank in its role as co-regulator of the Australian cards market must first demonstrate that they are better suited to this role than the Bank. At present there are no such candidates.

Conclusion

To conclude; yes, there are alternatives to the Reserve Bank's co-regulation of the Australian cards market.

However, none of these alternatives promise to yield a fairer or more efficient outcome to both the cards market, and the overall payments market, than that currently delivered by the Reserve Bank in conjunction with the market.

Thank you.

2. Stuart E. Weiner²

Good morning. It is a pleasure to be here. I want to thank the organisers for giving me the opportunity to participate in this very important conference. I enjoyed reading Alan's paper very much. It is thoughtful, thorough, and not without a few choice controversial statements! In my comments this morning, I am going to do my best to steer away from potentially controversial statements and take what I hope is perceived to be an objective, neutral, central banker approach.

Specifically, I want to focus on the range of policy options available to policymakers in evaluating credit and debit card markets, where one of those options may be to do nothing and another may be to keep a watchful eye on industry efforts to self-regulate. Alan does an excellent job of addressing what I see as the more interventionist options. I would like to try to complement his discussion by addressing less interventionist options, without taking a position on what ultimately is to be preferred. In the final analysis that, of course, will depend on a given country's particular situation.

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At the outset, let me stress that the views I express today do not necessarily reflect the views of the Federal Reserve Bank of Kansas City or the Federal Reserve System. They do, however, reflect in part the views of my colleagues – Terri Bradford, Fumiko Hayashi, Rick Sullivan and Zhu Wang – with whom I have had discussions on Alan’s paper and related issues.

The table below, compiled by Fumiko Hayashi, shows public authority involvement in credit and debit card markets in various countries. It lists 26 countries or areas in which public authorities have taken some kind of action or initiated some kind of investigation, either on pricing issues – interchange and/or merchant service fees – or on surcharge rules. The table draws in part on the excellent summary in Reserve Bank of Australia (2007), as well as other sources listed at the back of the table.

I do not want to dwell on the table – time does not permit – but rather I offer the table as a reference and also to make an obvious but important point: while authorities in some countries have taken action, authorities in other countries have not. Why is this?

There are several possibilities. First, despite our best efforts, I am sure the table is incomplete and omits some countries where policymakers have been active. Second, in many countries, credit and/or debit card markets may simply not be sufficiently developed yet to register on policymakers’ radar screens. And third, in those countries where credit and debit card markets have developed, perhaps public authorities believe these markets are indeed operating effectively, or at least not ineffectively enough to warrant policy action. It is this third group of countries that largely motivates the remainder of my comments.

Policy action or inaction can be thought of as falling along a continuum. At the one end, authorities may elect to take no action. At the other end, authorities may elect to take significant action. And in between, there will be a range of escalating intervention.

In the case of credit and debit card markets, one can think of four distinct categories along this continuum. One is to do nothing – let the market work. The second is to do a little – let the market self-regulate, but keep a watchful eye, and be prepared to intervene if necessary. The third is to do more – remove obvious structural impediments (what Alan calls vertical restrictions) to ensure competitive conditions. And the fourth is to do a lot – establish specific prices or guidelines for prices. I would like to consider each of these in turn.

First, under what conditions might authorities elect to do nothing? This is a situation in which the market is judged to be performing well, and competitive forces are seen to be at work. Either: (i) existing firms are competing effectively; (ii) existing firms are facing potential competition from new entrants (that is, markets are contestable); or (iii) innovations from existing or potential competitors are helping to ensure a competitive environment.

With regard to innovation, in the United States, for example, we have been seeing a number of alternative payment arrangements and mechanisms designed to challenge traditional credit and debit card practices. How effective they have been in fostering competition remains an open question, in my view. A few years ago, First Data Corporation, in cases where it operated on both sides of the market, attempted to increase the number of Visa transactions that it conducted ‘on-us’. More recently, Tempo, HSBC, and Capital One have been attempting to build the so-called ‘decoupled debit’ market, whereby card transactions are routed over card networks but

settled via the Automated Clearing House. The prospects for innovation raise an interesting economic question. Does a market, or indeed a country, have to be a certain size – given the huge economies of scale in electronic payments – to give potential competitors and innovators a chance in achieving critical mass?

What about the second category along the intervention continuum, industry self-regulation? Here I am referring to situations in which industry participants take actions internally which they fear might otherwise be taken by outside regulators. Or, stated somewhat differently, industry participants take pre-emptive action in light of a perceived ‘regulatory threat’. Some possibilities include: (i) making industry rules more transparent; (ii) relaxing industry rules by permitting more choices in acquiring, routing, and issuing arrangements; (iii) actively encouraging new entry by banks and non-banks alike; and (iv) holding prices (for example, interchange and merchant service fees) below profit-maximising levels to deflect charges of undue market power. Such industry self-regulation reportedly can be effective. Guillermo Ortiz, Governor of the Bank of Mexico, for example, in discussing reforms of the Mexican payments system, has stated that ‘[in] our case, this induced voluntary approach is producing a better reaction on the part of the industry’.³

The third category of intervention, policy-mandated removal of barriers to competition, contains a host of possible actions, many discussed by Alan. One set involves removing barriers to entry, for example: (i) eliminating restrictive rules, such as net issuer rules; (ii) encouraging non-bank participation; and (iii) encouraging innovation among existing and potential competitors by clarifying legal uncertainties. A second set involves eliminating industry practices that restrict consumer, merchant, and other choices, for example: (i) eliminating no-surcharge and honour all cards rules; and (ii) allowing merchants to steer consumers to preferred payment methods.

The fourth category of intervention, arguably the most interventionist of all, is for policy authorities to establish specific prices or guidelines for prices. Of course, this option has been much debated in recent years, is being debated during our program today, and undoubtedly will continue to be debated tomorrow!

I would like to close with an appeal for more research on ‘Alternatives to Direct Regulation’, both theoretical and applied. Evaluating such alternatives is fundamental to good policy, and devoting a section of today’s program to these topics explicitly recognises this.

Interchange issues, of course, have received considerable attention in recent years, and appropriately so. But in my view, it is important that we see more research conducted on these ‘alternative’ policy issues as well. For example, we need to learn more about merchant incentives and strategies in surcharging. We need to learn more about the impact of various industry rules on restricting competition. And we need to learn more about barriers to entry – both economic and artificial – in electronic payments.

At the end of the day – to come back to a point I made at the outset – the best policy or non-policy will, of course, depend on a country’s particular situation. But to get there, and to make that determination, policymakers will need solid research as well as effective industry dialogue. This conference is an outstanding example of how to go about this.

³ See Ortiz (2005), p. 292.

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PUBLIC AUTHORITY INVOLVEMENT IN CREDIT AND DEBIT CARD MARKETS: VARIOUS COUNTRIES

Table 1: Interchange and Merchant Service Fees

a. Actions taken by public authorities

Country	Credit	Debit
Argentina	1999: Law 25.065 for Credit Cards was enacted. The law established norms that regulate various aspects related to the credit, debit, and retail card systems, such as the relationship between the cardholder and the card issuer, and the relationship between the card issuer and the merchant. Among these norms was the setting of limits on the ability to implement price discrimination in merchant fees.	
Australia	2003: The Reserve Bank of Australia mandated Bankcard, MasterCard and Visa to set their interchange fees based on cost-based benchmarks.	2006: The Reserve Bank of Australia introduced interchange Standards for the EFTPOS and Visa Debit systems.
Austria	2006: Following the European Commission's interim reports on the retail banking industry, Austrian banks agreed to review arrangements for setting interchange fees and announced that a reduction can be expected.	
Canada		Mid 1990's: Through a consent order from the Competition Bureau of Canada, Interac set its interchange fee to zero.
Chile	2005: The Chilean Antitrust Court admitted a complaint filed by the National Economic Prosecutor alleging abuse of a dominant position by Transbank, the acquirer of all credit and debit cards issued in the country; the Court imposed a fine of approximately USD56 000. The National Economic Prosecutor requested, among other things, the modification of the Transbank price structure in such a way that it would be public, objective, and based on costs. The issue was finally solved with a partial understanding between the parties. According to this understanding, Transbank had to reduce merchant fee ceilings and present a self-regulating plan for setting prices.	
Colombia	2004(?): The Superintendent of Industry and Commerce (the Colombian competition authority) passed the new Inter-bank Exchange Tariff that allows merchants to negotiate fee rates with merchant acquirers.	2006: Credibanco (a Visa issuer) was required to exclude some costs included in its fee computation that were judged not to correspond exclusively to payment card services offered to merchants.
Denmark	1990: The Act on Certain Payment Instruments set a cap on merchant service charges (MSC) on internationally-branded credit/debit cards issued by Danish banks for domestic transactions at 0.75% of transaction value, or 1.25% of transaction value with a minimum of DKK 1.95 on the internet.	1990: The Act on Certain Payment Instruments set Dankort MSC to be zero. 2003: Amendment to the Act introduced a positive MSC to Dankort transactions and reduced the fees on Maestro and Visa Electron from 0.75% to 0.4%, with a maximum of DKK 4. 2005: Dankort MSC was replaced by an annual fee per retailer.

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Table 1: Interchange and Merchant Service Fees

a. Actions taken by public authorities

Country	Credit	Debit
European Union	2002: The European Commission reached agreement with Visa to reduce its cross-border interchange fees by December 2007. The benchmark for its interchange fees was to be set at the level of the cost of supplying Visa payment services, and would not exceed the cost of the services which issuing banks provide, wholly or partly, to the benefit of merchants. An investigation into MasterCard's interchange fees is ongoing as of October 2007.	
France	1990: The Paris High Court ruled that the methods for determining interchange fees could be accepted in accordance with the Competition Council's statement of objections.	
Israel	2006: Agreement between the banks and the competition authority to reduce interchange fees from 1.25% to 0.875% by 2012.	
Mexico	2006: Interchange fee reductions agreed to between the Mexican Bankers Association and the Bank of Mexico.	
Norway	Zero interchange fee (Bank-Axept).	The general position of authorities regarding the introduction of new payment systems in Norway has been that payers should cover costs. This position can be seen as early as in the 1974 report from the Payment Systems Committee.
Panama	June 2003 - July 2004: Under the 1998 banking law, the Superintendent of Banks issued regulations for banks that issue and manage credit cards. It established procedures for approving a credit card and authorised the charges for commissions and other related items.	
Poland	2007: The Polish Office of Competition and Consumer Protection ordered banks to discontinue their multilateral interchange fee agreements.	
Portugal	2006: Following the European Commission's interim reports on the retail banking industry, Portuguese issuers and acquirers have met some of the Commission's concerns by reducing domestic interchange fees somewhat, and removing preferential bilateral domestic interchange fees.	

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PUBLIC AUTHORITY INVOLVEMENT IN CREDIT AND DEBIT CARD MARKETS: VARIOUS COUNTRIES

Table 1: Interchange and Merchant Service Fees

a. Actions taken by public authorities

Country	Credit	Debit
South Korea	The Korean Fair Trade Commission ruled that BC Card's (South Korea's four-party scheme credit card) joint pricing of merchant service charges was a cartel and imposed a fine of KRW 10.092 billion and corrective measures.	
Spain	2005: The Spanish Competition Tribunal denied authorisation of the interchange fee arrangements of the Spanish card schemes. In December, agreement reached between the Spanish card networks and merchants, coordinated by the Spanish Ministry of Industry, Tourism and Trade, for interchange fees to be reduced from a maximum of 2.32% to 1.1% by 2008.	
Switzerland	2005: Agreement between the Swiss Competition Commission and credit card issuers to reduce interchange fees from 1.65-1.70% to 1.30-1.35%.	
Turkey	2005: The Turkish Competition Authority made a decision on Interbank Card Centre's (BKM's) clearing commission rate by member banks. It is stated in the decision that, in order to grant exemption to the clearing commission formula proposed by the consultancy firm on behalf of BKM, certain cost items in the formula should be adjusted.	

b. Investigations initiated

Country	Credit	Debit
Brazil	May 2006: Banco Central do Brasil (the central bank of Brazil) issued Directive 1/2006. The directive's focus is on the payment cards industry (pricing – interchange fee, discounts, customer fee; concentration; profitability; governance; etc). It does not establish either obligations or prohibitions and does not mandate any sanctions. June 2006: Banco Central do Brasil's Economic Law Office and the Secretariat for Economic Monitoring agreed to cooperate with each other to collect payment card industry data and to coordinate public policy actions. September 2006: Payment card industry data collection.	

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PUBLIC AUTHORITY INVOLVEMENT IN CREDIT AND DEBIT CARD MARKETS: VARIOUS COUNTRIES

Table 1: Interchange and Merchant Service Fees

<i>b. Investigations initiated</i>	
Country	Credit Debit
Hungary	2006: Gazdasági Versenyhivatal, the competition authority of Hungary, considered intervening in the payment card market. Interchange fees were regarded as too high compared to costs, especially in the case of debit cards. Price discrimination between 'on-us' (acquirer=issuer) and 'foreign' (acquirer=issuer) transactions was considered to have adverse effects on issuer competition.
New Zealand	2007: Proceedings initiated by the New Zealand Commerce Commission against Visa, MasterCard and member institutions of the two schemes, alleging price-fixing in the setting of interchange fees.
Norway	2004: On the initiative of the Ministry of Finance, Kredittilsynet (the financial supervisory authority) established a project group to report on competitive conditions in the Norwegian market for international payment and charge cards. 2005: 'The regulation of interchange fees is also being considered in Norway' – stated in the 2005 Norges Bank (the central bank of Norway) Annual Report.
South Africa	2004: The Task Group for the National Treasury and the South African Reserve Bank recommended that the Competition Commission should investigate the possibility of a complex monopoly in the governance and operation of the national payments system. 2006: Following the findings of the research report <i>The National Payment System and Competition in the Banking Sector</i> , the Commission began a public inquiry into bank charges and access to payment systems. 2007: The inquiry is at the final, report writing, stage.

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PUBLIC AUTHORITY INVOLVEMENT IN CREDIT AND DEBIT CARD MARKETS: VARIOUS COUNTRIES

Table 1: Interchange and Merchant Service Fees

b. Investigations initiated

Country	Credit	Debit
United Kingdom	2005: The Office of Fair Trading (OFT) found that MasterCard's interchange fee arrangements were illegal (September). The OFT issued a statement of objections on Visa's agreement (October). 2006: The MasterCard finding was appealed and, since MasterCard had changed its method of setting interchange fees, the OFT consented to its decision being set aside by the Competition Appeal Tribunal (June). The OFT launched a new MasterCard investigation in February.	

Annex. Zero interchange fee schemes

Country	Credit	Debit
Belgium		Zero interchange fee (Bancontact/Mister Cash)
Finland		Zero interchange fee (Pankkikortti)
Luxembourg		Zero interchange fee (Bancomat)
Netherlands		Zero interchange fee (PIN)

Note: Table prepared by Fumiko Hayashi, Federal Reserve Bank of Kansas City, November 2007.

PUBLIC AUTHORITY INVOLVEMENT IN CREDIT AND DEBIT CARD MARKETS: VARIOUS COUNTRIES

Table 2: Surcharges

<i>Actions taken by public authorities</i>	
Country	Debit
Australia	Credit 2003: Prohibition on surcharging lifted.
Canada	Debit 2006: Prohibition on surcharging for Visa and MasterCard signature debit card transactions lifted. 1996: Prohibition on surcharging for Interac transactions was removed through a consent order by the Competition Bureau of Canada.
Mexico	1993: The Mexican Competition Commission reached an agreement with a number of banks, under which the banks could not, in their acquiring contracts, forbid that merchants offer discounts for cash payments.
Netherlands	1997: Prohibition on surcharging lifted.
Sweden	1995: Prohibition on surcharging lifted.
Switzerland	2005: Prohibition on surcharging lifted.
United Kingdom	1989: Prohibition on surcharging lifted.

Note: Table prepared by Fumiko Hayashi, Federal Reserve Bank of Kansas City, November 2007.

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Turkey

<http://www.oecd.org/dataoecd/0/30/39531653.pdf>

United Kingdom

http://www.offt.gov.uk/shared_offt/ca98_public_register/decisions/oft811.pdf

<http://www.offt.gov.uk/news/press/2006/97-06>

<http://www.offt.gov.uk/news/press/2006/20-06>

<http://www.offt.gov.uk/news/press/2005/195-05>

<http://www.kansascityfed.org/PUBLICAT/PSR/Proceedings/2005/Vickers.pdf>

Israel, New Zealand

http://www.rba.gov.au/PaymentsSystem/Reforms/RevCardPaySys/Pdf/issues_for_the_2007_2008_review.pdf

Belgium, Finland, Luxembourg, Netherlands

http://www.pseconsulting.com/pdf/articles/interchange/consequences_of_mif_mar05.pdf

http://ec.europa.eu/internal_market/finances-retail/docs/finfocus/finfocus3/finfocus3_en.pdf

Surcharges

Canada

<http://www.kansascityfed.org/PUBLICAT/PSR/Proceedings/2005/Weiner-Wright.pdf>

Mexico

http://www.iadb.org/europe/files/news_and_events/2006/LACF2006/SesII_Marta_Troya_Martinez_EN.pdf

Australia, Netherlands, Sweden, Switzerland, United Kingdom

http://www.rba.gov.au/PaymentsSystem/Reforms/RevCardPaySys/Pdf/issues_for_the_2007_2008_review.pdf

3. General Discussion

Discussion of Dr Frankel's paper was wide ranging with the main themes being: the legality of interchange fees; the case for regulating interchange fees; and surcharging.

Some questioned whether the legality of interchange fees in a card scheme depended upon the structuring of the scheme, as a commercial entity with management setting the fees or as a mutual association with member banks setting the fees. Dr Frankel indicated that, in his view, how interchange fees are set makes no difference to the analysis of their legality.

A second theme concerned whether interchange fees should be regulated. Some argued that, since the optimal interchange fee is unknown, it should be set by the market. In this context, industry self-regulation, and especially its practicality, received considerable attention. It was claimed that, while there is currently no industry body that could fulfil the self-regulatory role, the Australian Payments Clearing Association might develop into such a body. It was suggested

that self-regulation could work if the banks and the schemes could agree on how fees were set. With additional transparency, it was argued, the threat of direct regulation might be sufficient to ensure an outcome that meets public policy objectives. Doubt was expressed, however, about whether such agreement might be forthcoming.

There was some support for the Reserve Bank continuing to regulate card payment systems. One argument was that the Reserve Bank has in fact *de-regulated* the cards market by removing restrictions on merchants. It was also argued that, historically, interchange fees were regulated by the schemes – the Reserve Bank’s reforms have, therefore, only changed *who* regulates the fees. In a similar vein, it was suggested that it is in the public interest for the Reserve Bank to continue to regulate card payment systems, given their importance in day-to-day transactions.

The scope for international regulation of card payment systems was also raised. It was suggested that, in an ideal world, international card payment systems would be regulated on a consistent basis. The ensuing discussion noted that authorities are currently bound to work within their domestic jurisdictions, although it was recognised that improved knowledge about payment systems around the world has placed national authorities in a better position to make internationally consistent regulations.

A third main topic of discussion was surcharging by merchants. The main issue was whether interchange regulation is necessary when merchants have the freedom to surcharge. A number of financial institutions argued that surcharging has become increasingly common and that competitive pressure is now bearing on interchange fees, producing price signals that are more reflective of costs. It was also suggested that interchange regulation has reduced the need for merchants to surcharge since merchant fees have fallen accordingly. Furthermore, if interchange fees were to rise, surcharging would become more prevalent. On the other hand, a number of merchants noted the difficulty of surcharging when their competitors do not. It was argued that the decision to surcharge is a major step, particularly in retail environments. Some merchants felt it would be more appropriate for banks to charge their customers directly for using credit cards.

There was also discussion of the level of surcharges and whether they promote efficient outcomes. Concern was expressed, for example, about the lack of differential surcharging between scheme debit and credit cards. It was also suggested that, in some cases, surcharges are much higher than merchant service fees and that regulation may be needed to ensure that surcharges remain in line with merchants’ costs of card acceptance.