Are you being served?

Major reforms to Australia's credit card sector by the Reserve Bank has had profound implications for Australian retailers – a 'windfall' on one hand, the removal of a useful income stream on the other. On balance, however, they've come out ahead, reports *Steve Worthington*.

In 2002, the Reserve Bank of Australia (RBA) announced major reforms to Australia's credit card sector and started by halving the Merchant Service Charge (MSC), the fee payable by merchants on each transaction. By July 2004 the average MasterCard and Visa interchange fee had fallen to an average of 0.55 per cent, saving Australian retailers more than $700 million per annum. The reduction in the interchange/MSCs has not, however, translated into any discernable price reduction for consumers.

In response to these changes MasterCard and Visa issuers sought to migrate cardholders to existing or new co-branded American Express and Diners Club cards to preserve their MSC income stream. For example, ANZ co-branded with Diners Club and American Express teamed up with Westpac and NAB. This loss of interchange income to issuers also means an increased reliance on interest, additional fees (over credit limit/late payment etc.) and, where applicable, overseas transaction foreign currency fees.

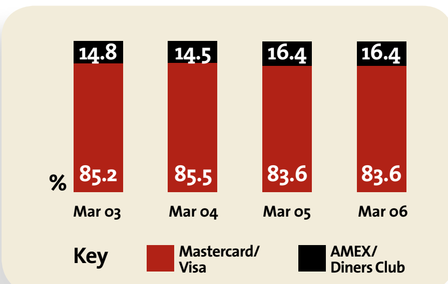
The second change the RBA instigated was allowing merchants to add a surcharge for payment made by credit and charge cards, to offset the MSCs. Ironically this has hindered more than helped consumers with companies like Qantas, Virgin Blue and Telstra now adding a surcharge to all credit and charge cards payments.

The third of the RBA reforms was to open up the Australian market to new issuers and acquirers by expanding the criteria to include a new class of Authorised Deposit-taking Institution (ADI), known as a Specialist Credit Card Institution (SCCI). So far four companies have taken this up, three of which (including GE Money) already issued credit cards in Australia through an overseas affiliate. The fourth company wants to provide credit card services to merchants.

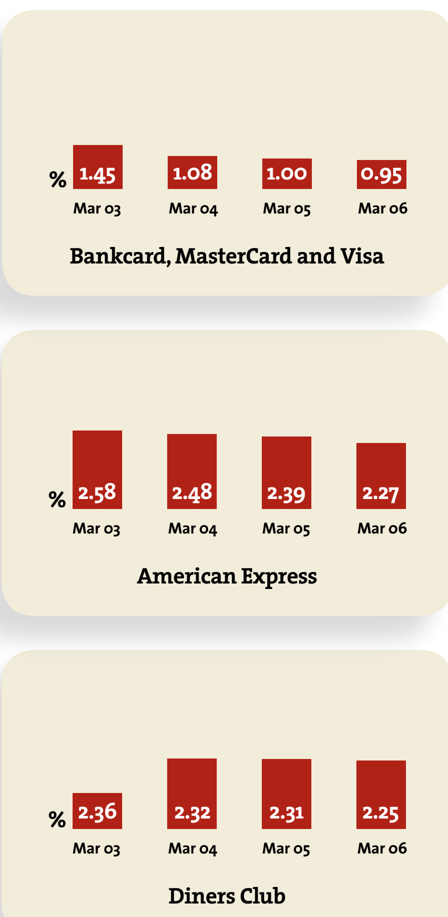
The debit (EFTPOS) card

The RBA has also intervened in the interchange arrangements and fees of debit cards. These fees had until then produced a substantial income to retailers like Coles Myer. At its 2004 AGM, Coles Myer revealed it provided $3.8 billion in cash out/cash back to its customers that year. Macquarie Equities Research analysts speculate that this alone equates to some $90 million in acquirer fees. Needless to say, major

Breakdown of purchases between card companies



How merchant fees have fallen since the reforms



Source: RBA

Australian retailers questioned the legality of the RBA's 'designation' of the debit card payment system, but this proved to be unsuccessful and achieved little more than to delay the regulatory impacts.

There are three major reforms. The first is the adoption of both a cap and a floor on interchange fees paid by financial institutions issuing EFTPOS cards. This has seen a fall of around 4 to 5 cents per transaction from an average of 20 cents. The second reform is the adoption of a cap on the weighted-average interchange fee in the Visa Debit system, reducing interchange fees in the Visa Debit system (and any equivalent MasterCard Debit system) to an average of 15 cents per transaction, from around 40 cents. Finally, Visa has been required to remove restrictions on merchants to accept its debit cards if they accept its credit cards.

The RBA's reforms also addressed the EFTPOS access regime by adopting a cap on the price that existing participants can charge others for establishing a connection. As well it gives new and existing participants the right to establish direct connections with EFTPOS participants and sets a timeframe for establishing a connection.

With the changes to the economics of both the credit card and the EFTPOS systems in Australia, some of the larger merchants are becoming self-acquirers. Coles Myer, for example, has links with all of the major Australian banks, American Express, Diners Club and agencies. All payments through Coles terminals are 'acquired' by Coles and switched directly to the issuers, thereby largely dis-intermediating MasterCard and Visa.

These RBA reforms have given Australian retailers a 'windfall' via the reduction in credit card interchange rates but have also taken from them a useful income stream by reducing debit card interchange rates. On balance, however, retailers have come out ahead and now have the choice to surcharge any credit or charge card payments they take.

Steve Worthington, Professor of Marketing at Monash University in the Faculty of Business and Economics, specialises in issues surrounding the distribution of financial services particularly via plastic cards. He has authored *Branding and Relationships in Plastic Cards* (Financial Times) and *The China Cards Market 2005–2006* (VRL Publishing).