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Payments Policy Department  
(Dr Tony Richards)  
Reserve Bank of Australia  
BOX 3947  
**SYDNEY NSW 2001**

**20 April 2012**

Dear Dr Richards

## **RE: Review of the Regulatory Framework for the eftpos System**

The Payment Systems Board (PSB) has sought comments from interested parties on the designation of the eftpos system going forward. National Billing Group (NBG) has set out what we believe to be the key issues that the PSB needs to address at the outset of its review process. These go to the form as well as the substance of the regulatory frameworks that are to govern electronic payment systems and will underpin future governance, arrangements and innovation within the system.

### **Setting the Scene: - The Regulatory Framework**

The Banking Sector argued post Wallis that it required an industry specific regulator and not be left to the economic regulation of the ACCC particularly in relation to the operations of the Payment System and eftpos. The Government's response was legislation that created within the Reserve Bank the Payment Systems Board (PSB). Further the legislative base was designed to apply economic regulation to the Payment System including access arrangements and designation of payment systems that is set out in the Payment Systems (Regulation) Act 1998.

Government left the wider issues of economic regulation of the Payment System to the ACCC as they related to Competition. With two economic regulators responsible for the conduct of the Payment System the division of policy responsibilities between the two regulatory bodies was detailed in the 1998 Memorandum of Understanding (MOU) between the PSB and the ACCC.

Economic Regulators<sup>1</sup> seek to achieve efficient market outcomes balanced with consumer protection. Of particular interest to Economic Regulators is the performance of network industry assets. Such assets are often difficult to replicate, subject to bottlenecks that give rise to the imposition of excessive rents by the owner, and inhibit effective competition with resultant loss of community welfare at the consumer level. Governments see regulating the terms of access to these assets as essential to promoting economic efficiency and productivity. It is thus a matter of national interest for the operation of efficient markets.

### *The Payment System's Board and Regulation of eftpos*

Government vested the PSB with the responsibility of delivering open access arrangements for the payment system as a key element of the Payment Systems (Regulation) Act 1998. Central to the access arrangements was the concept of "designation" of a payment system. This is similar in form to the designation of an infrastructure asset under Part IIIA of the Competition and Consumer Act 2010 (CCA). The "tests" for declaration (coverage)<sup>2</sup> of such assets are more complex in the CCA than the "public interest" test contained in the Payment Systems (Regulation) Act. With a simpler test for Payment Systems "designating" access should be easier for Payment Systems from the perspective of both the regulator and Market participants.

Comparable regulatory frameworks to the payment systems arrangements are also evident in the industry-specific competition and access regulation found in Parts XIB and XIC of the Competition and Consumer Act 2010 with respect to Telecommunications

Both the Telecommunications and Infrastructure asset regulatory frameworks provide some guidance as to the nature and form of access and the regulatory arrangements that could be pursued by the PSB in its approach to the Payment Systems and eftpos going forward.

Ideally Regulators seek to attain these outcomes in a light handed but strongly independent fashion so as to create an environment that unlocks potential bottleneck assets and stimulates competition, innovation and consumer welfare benefit.

The PSB's regulatory approach to date to the Payment System, and eftpos in particular, is instructive in that:

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<sup>1</sup> Economic Regulators operate within an analytic framework underpinned by a rigor and discipline founded in the theory associated with industrial organisation, and the economics of the firm. To this is added an overlay of a legal framework to facilitate enforcement and compliance with the determinations of the regulator or the operation of the market. This may be contrasted to "process regulation" which characterises much of the regulation of the Australian financial services sector as found in the regulatory models of ASIC and APRA. These are "compliance" models with a legalistic and administrative law underpinning. It is the former frameworks that need to govern the focus of the PSB rather than the latter in its approach to the Payment System and eftpos.

<sup>2</sup> A process with the functional outcome similar to designation under the Payment Systems (Regulation) Act.

1. It has been light handed in the extreme in its approach to regulation;
2. It has sought consensus outcomes;
3. It has vested responsibility for reforms of the Payment System Sought in “industry” bodies by facilitating their creation (e.g. APCA and ePAL).

As an Economic Regulator the PSB’s approach to establishing the frameworks to give effect to “Access” and “Designation” as specified in the legislation does not appear to have been pursued in the same manner that the ACCC has in network industries and telecommunications over the same period. This is despite the Payment Systems (Regulation) Act 1998 offering a far simpler regulatory framework to undertake this activity than set out for the ACCC in developing Access arrangements under the Competition and Consumer Act 2010 for both infrastructure assets and telecommunications.

It is against this background that it is necessary to comment on the Board’s Discussion Paper.

### **Observations on The Board’s paper and its Options**

*Can ePAL membership and rules provide a basis to define an eftpos system?*

Without decrying from the valuable role ePAL plays in the promotion of Australian sourced eftpos solutions, its membership is slanted towards the established players and major retailers. It is difficult to see how the regulator can base or vest the carriage of reform of the system based on an industry body whose major members are conflicted not only with respect to the maintenance of the status quo but also as they are the principal “agents of the schemes” who are competitors of ePAL’s eftpos product.

“Industry regulators” can and do adopt such an approach but it has the potential to result in regulatory capture, protection of the vested interests of the members to the detriment of the wider community and loss of innovation.

*Reliance on bilateral arrangements as the sole basis of Access*

Using ePAL membership entrenches the concept of bilateral frameworks that are legacy arrangements and need to be rethought in the regulatory framework going forward. Going forward, Access arrangements with respect to eftpos and card based electronic payment systems need to be addressed via open access arrangements. Whilst these may be translated into bilateral arrangements, these can be concluded within a framework where the rules of engagement are clearly defined by participants, the appeal mechanisms are clear and the level of transparency in the system is enhanced for all market participants.

*Need for a strong regulator and an Open access arrangements to cover all Electronic Card Products.*

Only a strong independent economic regulator can oversee open access arrangements. This enables an active program of reform driven by a framework to achieve and maintain systems integrity via efficient and competitive outcomes; promote innovation; and offer safe transaction environment for all market participants via the implementation of common industry standards of security. That is the Board's "public interest" test as to whether to "designate" a payment system.

The Board's approach with respect to eftpos seems to have the potential to maintain a narrow product definition of what constitutes eftpos. This is implicit in the option of relying on ePAL membership and rules. The wider public does not make this distinction. They use it generically to describe all card based electronic transactions.

To keep pace with community expectations, the PSB needs to actively embrace an open access regime that covers all electronic payment systems offered not only by schemes, banks but other card providers (e.g. AMEX, Diners, Cabcharge).

The lessons from telecommunications and network industries that unless the economic regulator actively intervenes to specify the terms of access to the networks then the levels of competition, efficiency and innovation decline with a loss of community welfare. A key element of the lessons is that Open Access arrangements are necessary for effective competition NOT closed access arrangements. With Open Access the regulator can prescribe the terms and conditions for all market participants.

The operation of the Payment System to date has not embraced such an approach despite the capacity provided by the legislative framework providing for this outcome.

**In Summary:**

1. *NBG does not believe that it is possible for the PSB to rely on a body such as ePAL or ePAL membership as the foundation of reform of the eftpos system. We therefore do NOT support OPTION 1 but rather believe that the Board should adopt a wider definition as mooted in OPTION 2 in developing Designation and Access arrangements going forward.*
2. *NBG believes that the Board needs to pursue Open Access arrangements as an Independent Economic Regulator of the Payment System charged with the delivery*

*of competition in the Payment System. This may necessitate the reconsideration of the regulatory paradigm that has underpinned much of the Board's work to date and bring under its active regulation a wider range of electronic card based payment systems. There is much to be gained from the experience in the regulation of access and competition in telecommunications and infrastructure in Australia and this may assist and guide future arrangements for the PSB.*

- 3. Within the context of an Open Access arrangement the PSB is free to apply the "public Interest" test to determine the fees and standards to be adopted by market participants whether they are access seekers or granters.*
- 4. Within an Open Access regime the participants can then develop bilateral arrangements within a framework where the rules of engagement are clearly defined by participants, the appeal mechanisms are clear and the level of transparency in the system is enhanced for all market participants.*
- 5. In adopting a broad access paradigm the Board needs to be cognizant of the potential for asymmetry that can exist for new entrants and factor appropriate protections into access arrangements going forward.*

We are available to discuss aspects of this submission with the Board if required.

Yours sincerely



David Hamilton  
**General manager**  
**Strategy and Regulation**