



29 April 2015

Dr Tony Richards
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Reserve Bank of Australia
65 Martin Place
Sydney NSW 2000

Dear Dr Richards, *Tony*

Review of Card Payments Regulation - Issues Paper

The Qantas Group (Qantas) welcomes the opportunity to comment on the Reserve Bank of Australia's (RBA) Review of Card Payments Regulation Issues Paper (RBA Issues Paper), released in March 2015.

As well as being a large merchant, Qantas is also a key participant in the issuing side of card payments – both through Qantas Cash and the issuance of Qantas Frequent Flyer points – providing us a broad perspective on the impact of changes to the payments system. Qantas supports efforts to deliver efficiency and economic reform in the public interest and is broadly supportive of a number of the proposed changes to the current payments system regime. However, we believe that both the basis for, and impacts of, some issues under consultation require further careful consideration prior to additional regulatory intervention.

Summary Perspective

The current payments system regulatory regime has delivered significant results to date.

- By the RBA's own measures, regulatory changes have had a substantial impact towards achieving its objectives; these positive impacts are likely to continue.
- A number of proposed changes, which refine the current regulatory regime to adapt to the evolving market, are likely to have merit.
- However, there are a number of proposed changes that we consider lack a sound basis, do not have a clear net public benefit, are excessively complex and do not support payments system efficiency.

The basis of any additional regulatory changes, and their likely short- and long-term impacts, should be clear and explicit, and based on practicable analysis of payment network economics as it applies in the Australian market.



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- There is no clear evidence that further changes to the regulatory framework would result in significant reductions in resource costs or additional public benefit, or that the payments market efficiency has reached a point of diminishing returns within the current regulatory framework.
- Interchange fees: Qantas does not consider there to be a clear basis for: changing the existing framework; assuming that interchange fees fund reward programs; suggesting that economic benefits outweigh consumer impacts; or referencing offshore experiences.
- Surcharging: Qantas does not consider there to be a clear basis for: claiming Qantas imposes excessive surcharges; or introducing a complex tiered surcharging program which is likely to have detrimental customer outcomes. Jetstar does not charge a credit card surcharge. Jetstar's Booking and Service Fee is a market based fee not correlated to costs associated with card acceptance.

Changes to payments system regulation that add undue regulatory burden and complexity are unnecessary. In particular, those that are overly complex to implement and administer:

- may result in detrimental merchant outcomes, and diminish merchants' ability or willingness to maintain an effective and transparent surcharging program; which
- would be a backward step and undermine the efficiency of the payments system.

Any changes to the existing interchange and surcharging standards should be made simultaneously, but not without appropriate consultation due to the significance of potential impacts on businesses and consumers.

Further commentary is provided in the attachment to this letter. Qantas would welcome the opportunity to further engage with the RBA on the issues raised, and work with the objective of ensuring any efforts to improve the efficiency of the payment system are practicable, effective and support the public best interest in the near and long-term.

Yours sincerely,



Andrew Parker
Group Executive, Government and International Affairs

The current payments system regulatory regime has delivered significant results to date.

The Payment Systems Board (PSB) has conducted extensive and robust reviews of interchange and customer surcharging over the last 15 years, resulting in substantial reforms, such as:

- a) meeting key PSB objectives, including reduced overall payments system resource costs (e.g. payments services are now 0.54% of GDP compared to 0.80% in 2006),
- b) greater proportional use of lower resource cost debit cards; and
- c) improved price signalling, through surcharging, to direct consumer payment choice.

Given these trends appear likely to continue under the current regulatory framework, Qantas considers that minimal further intervention of the regulatory framework is warranted.

Qantas appreciates that the payments system landscape is evolving, and adapting the current regulatory framework in line with a changing market appears to be appropriate. Against this context, Qantas supports a number of the following potential changes, which enable the existing regulatory regime to adapt to this evolving landscape:

- *Making changes to the interchange benchmark system to reduce the upward 'drift' in average interchange rates inherent in the current three-year reset cycle*

Qantas supports increasing the frequency of review through shortening the current three-year cycle of calculating average interchange rates, to reduce the upward 'drift' of these averages.

- *Including prepaid cards within the caps for debit cards*

Prepaid cards are an increasingly prevalent product in the payment system environment. In addition, virtual single use cards that are similar in form and function are becoming increasingly popular. Qantas believes that these payment types which typically ride on scheme infrastructure and therefore they should be included within the existing regulatory framework. There should not be regulatory ambiguity in regard to payment types that operate within scheme infrastructure.

- *Publishing thresholds for which payment system providers will be subject to interchange or related regulation (e.g. surcharging)*

Qantas supports the innovation and introduction of new payment products, and considers that publishing thresholds will provide certainty for new entrants and foster innovation.

However, a framework that addresses both interchange *and* related regulation (e.g. surcharging) simultaneously is necessary to prevent any competitive distortion.

In addition, Qantas also believes the following suggested changes may have merit, given the evolution of the payments system:

- *Allowing for 'buying groups' for smaller merchants to group together (subject to any competition law restrictions) to negotiate to receive the lower interchange rates that are accessible to larger merchants*
- *Ensuring that merchants have the ability to choose to route their transactions via lower-cost networks or processors*
- *Clarifying arrangements for competing payment options within a single device or application*

The basis of any additional regulatory changes, and their likely short- and long-term impacts, should be clear and explicit, and based on practicable analysis of payment network economics as it applies in the Australian market.

As acknowledged above, the scale of change to date in the payments system regulatory framework has resulted in substantial reform outcomes. There is no clear evidence that additional changes would result in significant further reductions in resource costs or public benefit, or that the payments market efficiency has reached a point of diminishing returns within the current regulatory framework.

There is no clear basis that regulatory changes to simply lower payment acceptance costs are in the public benefit. Qantas agrees with the RBA that:

“Both [resource costs and benefits] need to be considered when drawing policy implications from these numbers; increased use of the lowest-cost payment system or less use of the higher-cost systems does not necessarily imply better outcomes.”

The Evolution of Payment Costs in Australia, RBA, 2014

Interchange Fees

Qantas believes that there is no basis for the changes to interchange fees proposed in the following consultation issues considered below.

Working within the existing regulatory framework, updating the interchange benchmarks using the current calculation methodology, and reducing the review cycle (as discussed above), present the most prudent and appropriate way forward.

- *Lowering interchange caps*
- *Replacing weighted-average interchange caps with hard caps*
- *Applying caps as the lesser of a fixed amount and a fixed percentage of transaction values*
- *Broadening interchange fee caps to include other payments between schemes and issuers*

No clear basis for changing the existing benchmark calculation framework

The interchange fee benchmark is based on providing issuers with a source for recovering certain costs incurred on behalf of merchants (processing costs; fraud losses; immediate funding). This approach, determined after extensive consultation and studies, has been an important element in achieving the RBA’s objectives to date. Therefore, the rationale to change this approach, either conceptually or in application, is not clear.

Qantas believes there is a case for updating the cost benchmark calculations, which has not been done for a number of years, to reflect current market dynamics.

Incorrect assumption that interchange fees fund reward programs

The interchange fee benchmark does not include reward program costs. Therefore, lowering the benchmark to reduce the potential for cross-subsidisation of rewards programs has no basis.

A further lowering of interchange fees, in the hope of indirectly influencing / reducing reward program costs could impact an issuer’s ability to recover other costs related to its card issuing business. Therefore, this basis for payment regulation would be of concern to Qantas.

No clear demonstration of economic benefits that outweigh consumer impacts

There is still considerable debate surrounding reductions in payment acceptance costs and whether these flow through to consumers, meaning the economic benefits of further lowering interchange fees are unclear.

Conversely, it has been demonstrated that reductions to issuers' revenues streams result in an increase in cost for cardholders, for example in the form of higher annual fees and interest rates. Given that, in Australia, most consumers are cardholders, impacts to the consumer are clear.

Further, reward programs have an attractive multiplier effect for the economy, especially in tourism and related industries, by both stimulating consumer spending and increasing the immediacy of that spend. Significant impacts on rewards programs as a result of issuers' reduced revenue (because of changes to interchange) would also have a disruptive effect on these key industries and public benefit.

Inappropriate to reference offshore experiences

The offshore experience should not serve as a basis for change in Australia. Relying on relatively recent offshore developments (e.g. the Tourist Test) would be inappropriate. Given their recent implementation, the outcomes and possible unintended consequences in offshore markets are not clear, nor is their applicability to Australian market dynamics. Qantas believes it would not be prudent to follow this approach at this time¹.

Surcharging

Qantas considers that there is no basis for the changes to surcharging suggested in the following consultation issues below.

- *Targeted changes to reduce particular cases of excessive surcharging*
- *A tiered surcharging system, perhaps along the lines of the FSI recommendations*
- *Any other changes to enforcement procedures and disclosure practices regarding surcharging*

Claims of excessive surcharging for all airlines are unfounded

Qantas calculates its reasonable cost of card acceptance in accordance with the RBA Guidance Note to the Surcharging Standards. In addition, Qantas complies with all applicable laws with respect to consumer disclosure. The current surcharge framework recognises that merchants have legitimate costs that sit outside the merchant service fee, and that these costs vary between merchants.

As a result of applying the current Standard, Qantas *significantly under-recovers* its total cost of card acceptance through its card payment fees.

The overall cost to Qantas of accepting cards is higher than average, due to:

- The mix and their payment choice;
- investment in technology, equipment and services for payment processing;
- the cost of establishing necessary infrastructure;
- costs payable to other parties, such as gateway or switching fees, fraud and fraud prevention costs; and
- other security and compliance costs.

Qantas' card payment fees already distinguish between low and high cost card types (debit and credit). Qantas sets the flat dollar fee levels to recover no more than the reasonable cost of the lowest cost card types in each of these categories.

Qantas card payment fees are transparent. They are disclosed to customers well in advance of purchase and can be avoided using popular and accessible fee-free payment options in all selling channels.

No basis for introducing a complex tiered surcharging system that may have detrimental customer outcomes

The eligible costs for recovery in the RBA's Guidance Note on Surcharging Standards remain relevant, and should not be further limited or differentiated between card schemes.

Along with introducing excessive cost and complexity, a tiered surcharging system may deny merchants the ability to transparently recover their costs. This would be detrimental to merchants, especially those:

- a) that have unique costs and have made significant investments in their payment infrastructure; and
- b) who compete in both domestic and international markets.

Surcharging in its current form remains an effective way to deliver efficient pricing outcomes within the payment system. Any additional complexity that resulted in the unintended consequence of merchants moving away from a legitimate and practicable surcharge regime would be detrimental to merchants and consumers, and run counter to the RBA's objectives.

Qantas believes the Surcharging Standards should balance consumers' needs of transparency and adequacy, with merchants' needs of efficiency and practicality.

Jetstar does not levy a credit card surcharge

Table 2 in the RBA Issues Paper suggests that Jetstar levies a credit card surcharge, and that this surcharge exceeds its costs of card acceptance.

Jetstar's Booking and Service Fee (BSF) is a market based fee; it is not a cost recovery mechanism for a type of card payment and is not correlated to costs associated with credit cards. The BSF is one of a variety of fees applicable in addition to Jetstar's basic ticket price that allow its customers to choose the level of comfort and convenience they desire. Like most prices, Jetstar's BSF is determined on the basis of several market driven factors. These include:

- customers' willingness to pay for different options, which is a reflection of their value and convenience to customers;
- competitive pricing dynamics; and
- costs arising from the need to maintain a multi-channel booking system, wide coverage of payment options, and associated customer services.

Jetstar's fees are transparent. They are disclosed to customers well in advance of purchase, and can be avoided.

Changes to payments system regulation that add undue regulatory burden and complexity are unnecessary. In particular, those that are overly complex to implement and administer may result in detrimental merchant outcomes, and diminish merchants' ability or willingness to maintain an effective and transparent surcharging program, which would be a backward step and undermine the efficiency of the payments system.

Regulatory refinements should be considered in terms of their cost and complexity for merchants and consumers, and potential unintended consequences, versus any incremental benefit to efficiency and the public interest.

Qantas believes that the changes suggested in the following consultation issues below add undue regulatory burden, complexity and cost to the payments system, without any clear evidence of benefits to the public interest.

- *A tiered surcharging system, perhaps along the lines of the FSI recommendations*
- *Targeted changes to reduce particular cases of excessive surcharging*
- *Broadening interchange fee caps to include other payments between schemes and issuers*
- *Strengthened transparency over the cost of payments to merchants and cardholders*

A complex tiered surcharging system is not only unnecessary, but may result in detrimental merchant and consumer outcomes

The practical applications of the proposed three-tiered surcharging system may result in detrimental outcomes for merchants, and uncompetitive market dynamics.

Acceptance costs for even 'low-cost' cards (which the RBA has linked to debit cards) are not immaterial. Prohibiting surcharging on these card types would deny merchants the ability to recover these costs. Further, within the debit card system, there are a range of card types and costs. Merchants with a higher mix of high cost debit cards (e.g. Platinum Debit cards, corporate pre-paid cards) would be further exposed and unfairly penalised, resulting in uncompetitive market dynamics.

Similarly, 'medium-cost' cards range in type and costs with the some rivalling costs of cards classified as 'high'. Capping surcharging of these cards by scheme, and to a market average, and potentially removing the ability to recover their full reasonable cost, would be unfair and uncompetitive for merchants with a mix that is higher than the market average.

Finally, the proposed three-tiered surcharging system proposed would be significantly difficult and complex to implement, administer, and monitor. This may diminish merchants' ability and willingness to maintain a surcharge program, which would remove the benefits of price-signalling to consumers and be a backwards step in promoting an efficient payments network.

Proposed targeted changes may result in detrimental merchant and consumer outcomes

The RBA has proposed ad valorem (percentage based) surcharging, or capped fixed dollar surcharges as methods of targeting excessive surcharging.

Ad valorem surcharges may not necessarily mean a consumer will pay a lower surcharge, for example, if the transaction is of a high value such as an international airfare. Alternatively, a merchant may have to cap their ad valorem amount to prevent 'surcharge shock', preventing them from recovering their costs. In addition, managing consumer price expectations through clear disclosures is more difficult if the consumer has to calculate a percentage. This may unfairly disadvantage merchants with a large volume of high value transactions, limit their ability to operate an effective surcharge regime in a competitive environment, and lead them to consider alternative methods to surcharging to recover their payment acceptance costs.

Capping fixed dollar value surcharges at an arbitrary low amount has significant implications for merchants. The basis for calculating the dollar value is not transparent; it does not allow

for differences between merchants to be considered; it disadvantages merchants with high value transactions; and is an arbitrary control that has no relationship to cost recovery.

As a result, Qantas believes the simpler a surcharge methodology a merchant can have in place the better. It allows for simpler administration processes; less changes to existing platforms and functionality (to be able to distinguish between multiple card types); and facilitates clearer disclosure to consumers well before the final price is displayed.

For these reasons, Qantas believes the RBA must carefully consider the impacts of proposed targeted changes prior to their implementation.

Any changes to the existing interchange and surcharging standards should be made simultaneously, but not without appropriate consultation due to the significance of potential impacts on businesses and consumers.

The RBA has suggested that changes to the surcharging standards “could be made relatively quickly”. Given that interchange and surcharging economic dynamics are inextricably linked, changing one aspect of the regulation and not the other could lead to distortions in the market, and may result in uncompetitive and unfair outcomes.

Further, even relatively minor changes to wording in the Surcharging Standards could result in merchants needing to respond with new methodologies. Such changes should be considered a major change for merchants and require the statutory period of time for consultation and implementation.

Qantas believes that any changes to the payments system regulation should be conducted simultaneously and consulted on accordingly.

¹ “When introducing these results, the Commission admitted that the process of collecting the data from merchants proved to be a very difficult and lengthy task. The Commission indicated that there are several caveats to the preliminary results and that a broader analysis is necessary” European Payments Council Newsletter, 31 October 2014, Andrea De Matteis

“Regulated IFs should not lie below the level set by the “tourist test,” which reflects the first benchmark; that is, the IF should be at least equal to the difference between the merchant’s benefit from card usage and the acquiring cost.

This level, however, probably is a conservative estimate of the socially desirable IF for two reasons:

- It does not reflect industry profit and its long-run impact on entry, innovation and end-user welfare.
- It does not reflect the negative social externalities exerted by alternative means of payment (tax evasion for cash, subsidized use for checks).”

Competition Policy International, “Payment Card Regulation and the Use of Economic Analysis in Antitrust”, Jean Tirole, Spring 2011