

1 February 2016

Dr Tony Richards
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By Email to: pysubmissions@rba.gov.au

Dear Dr Richards,

Submission in Response to “Review of Card Payments Regulation – Consultation Paper, December 2015”

Commonwealth Bank of Australia (the Bank) appreciates the opportunity to respond to the Reserve Bank of Australia (RBA) Consultation Paper on the Review of Card Payments Regulation dated December 2015. We understand that this submission will be published on the RBA’s web-site.

The Bank’s submission to the RBA dated 22 April 2015 remains our preferred position for addressing the concerns outlined by the RBA in its 4 March 2015 Issues Paper. The comments that follow are limited to the Bank’s views on the proposals contained in the RBA’s December 2015 Consultation Paper, as per the RBA’s request. Commentary is provided on an exceptions basis.

Companion Cards

The RBA’s preferred option with respect to Companion Cards (extending regulatory coverage to include American Express Companion Cards) is at odds with the preference expressed by the Bank in April.¹ The RBA’s option will, we believe, significantly change market structure and dynamics and result in a large upheaval to the Bank’s AMEX Companion Card products.

The Bank will require time to review this business in light of the proposed changes. Modifications to our relationship with AMEX may be required; adjustments to systems, processes and procedures will also eventuate. Product changes are inevitable as a consequence, and will need to be accompanied by an extensive communication process with our cardholders.

¹ In our submission of 22 April we indicated (page 3) that “we do not see a need for regulation of American Express cards or transactions. Further, we see no need to distinguish between “companion” card arrangements and the more traditional American Express card”. The Bank remains of this view. We believe that the RBA’s proposed changes will result in an uneven competitive landscape to the benefit of three party networks operating outside the regulation.

Accordingly we ask for a suitable implementation period before this change takes effect. The Bank considers a two year transition to be appropriate.

Commercial Cards

The RBA proposes to continue to include Commercial Card interchange fees within the overall weighted average cap, while also having such interchange fees operate under the suggested overall caps.

Three-party card schemes have a strong presence in the market for issuance of commercial cards - in direct competition to the regulated four-party products. Commercial cards bring large volumes of business to merchants in a number of industries, including travel, entertainment and procurement. Merchants in these sectors are more likely to accept three-party cards in order to benefit from the additional sales revenue. Furthermore, staff using a three party commercial card will often have a personal card as a backup should their commercial card not be accepted. Accordingly, merchant acceptance does not seem to be an impediment to three party schemes competing vigorously in the commercial cards issuance market.

Placing an 80bp cap on interchange fees for Visa and MasterCard commercial credit cards will put these products at a significant disadvantage relative to three-party schemes. Three-party schemes will be better placed to promote their commercial card products to potential business clients, due to their fee flows being unregulated. This could well result in a shift in market share for commercial cards from four-party schemes to three-party schemes upon implementation of the RBA's proposal, analogous to the uplift in three-party scheme market share after the RBA's original reforms to credit card interchange fees.

As interchange makes up a vast majority of the revenue earned by Issuers, it is likely that they will review their cost base in providing commercial card solutions, in order to be able to continue to drive innovation, encourage usage and ensure commercial returns. This could inadvertently and disproportionately impact smaller businesses as larger corporates will be better placed to negotiate preferential terms and contracts than smaller businesses.

Furthermore, the viability of commercial pre-paid product offerings will be significantly impacted if subject to the proposed debit caps. This will impact innovation and investment in this developing segment and further exacerbate the competitive imbalance with three party prepaid offerings.

In order to help maintain the commercial competitiveness of the Visa and MasterCard commercial card offerings, the Bank recommends that commercial cards are exempted from the caps on maximum debit and credit card interchange fees.

While the Bank does not support the application of a cap on commercial interchange fees, should the RBA pursue this option, then considerable time will be needed by commercial card issuers to adjust existing contracts with their business customers. Typically, these contracts have been negotiated on a bespoke basis. Accordingly, in order to minimise market disruption and provide sufficient time for communication and negotiation, we ask for a suitable implementation period before this change takes effect. The Bank considers a two year transition to be appropriate.

Foreign-Issued Cards

The RBA proposes to bring transactions with foreign issued cards acquired in Australia under the coverage of the RBA interchange fee standards. The Bank is keen to avoid a situation in the cards market whereby Australian card issuing and acquiring businesses are subject to

undue influence from multiple regulators locally and overseas. The Bank is concerned that by capturing the interchange fees applicable to foreign-issued cards in its Standards, the RBA could be setting a precedent which, if replicated in other markets, could result in a complex web of regulations for card interchange fees on cross-border transactions.

Another concern is that foreign issued card volumes are likely to introduce considerable volatility and seasonality into benchmark compliance calculations. This could result in more frequent recalibrations of interchange fees to meet the benchmark, which would increase the operational costs of compliance with the interchange benchmarks.

The Bank expects that Card Schemes would set all cross border interchange fees captured under this regulation at the (maximum) level of the cap. This would then result in domestic interchange fees being lower than otherwise in order to achieve weighted average benchmark compliance. The outcome of such a situation is that domestic cardholders would subsidise, and effectively lose out to, foreign cardholders. From the Bank's perspective, this is an undesirable outcome. The Bank would much rather see interchange fees used to incentivise innovations in the domestic market.

The Bank recommends that the RBA instead pursues Option 1 to retain the current approach in regard to foreign issued cards.

The RBA is concerned about the risk of domestic card issuers circumventing local requirements through the issuance of foreign cards. The Bank considers that this is most unlikely and more than adequately mitigated by the mooted Anti-Avoidance clauses in the draft Standards.

Benchmark Compliance

The RBA proposes a move to quarterly compliance. While the Bank supports a move to a more frequent interchange compliance cycle, a quarterly compliance cycle will result in considerable operational imposts.

It is unlikely that an annual compliance cycle would permit or incentivise any drift above the weighted average benchmark. Accordingly, in the interests of efficiency, the Bank proposes that the interchange compliance cycle move to an annual frequency, rather than the quarterly cycle currently proposed. As acknowledged by the RBA, shifting to an annual cycle would, in itself, be an improvement over the current three year cycle.

Quarterly reporting could still be used to assure the RBA that annual compliance is not resulting in any meaningful drift above the weighted average benchmark. A forward looking commitment from card schemes that drift above the benchmark over the ensuing year is not considered likely might provide an additional level of comfort to the RBA (in conjunction with annual compliance) – if required.

The Bank wishes to avoid an increase in the frequency of interchange schedule resets. An interchange reset requires our acquiring business to provide at least 30 days' notice of price changes to our merchant clients. System changes are also necessary.

Quarterly compliance would also expose the weighted average benchmark to the effects of seasonality (potentially compounded by an overlay of seasonality introduced by large merchants). This would greatly increase the chances of a seasonal spike in a particular category(ies) of cards triggering an interchange reset, which would otherwise have been unnecessary under an annual compliance regime.

Interchange Benchmarks and Ceilings

The RBA's draft Standard 1 for Credit Cards defines interchange fees as payable from an acquirer to an issuer. The definition of interchange fees in the draft Standard 2 for Debit and Prepaid Cards is not consistent with Standard 1 - it does not stipulate that interchange fees are payable from acquirer to issuer.

The Bank suggests the RBA modifies Standard 2 for Debit Cards to change the definition of interchange fees to be consistent with Standard 1 for Credit Cards.²

Surcharging

The Bank has serious concerns about the implementation of the changes required of acquirers to merchant statements, as proposed by the RBA. The RBA's proposed changes to merchant statements are a prescriptive means to achieving its desired outcome. Compliance with this proposal will incur considerable cost and changes for acquirers and payments processors.

CBA does not currently provide merchants with an annual statement of their acquiring activity and merchant service fees. We believe this is also true for most of our competitors. To create this would require significant one-time and ongoing expense. However, we fail to see why this is necessary when a merchant's regular statements will provide suitable information about the maximum permissible surcharge price for a merchant. As such, we think an annual merchant statement is unnecessary and should not be required by the RBA if the acquirer does not presently offer this.

CBA also currently provides its merchant clients with separate statements for Visa/MasterCard transactions and eftpos/UnionPay transactions. We would appreciate clarification from the RBA that this practice is acceptable and acquirers do not need to display the maximum permissible surcharge for every card category on a single merchant statement.

Furthermore, apportioning a merchant's other costs to each interchange category to calculate the maximum surcharge price will require considerable system development. This data does not currently feed into the relevant merchant billing system, and to do so would necessitate a costly IT project.

Another complexity with implementing the RBA's proposed surcharging reforms comes about from third party costs. Some larger merchants will have costs relevant for inclusion in the calculation of the maximum permissible surcharge which are unknown by the acquirer. For example a merchant may: have sourced their own PINpads, have an arrangement directly with an e-payments gateway, or use a fraud checking service. The merchant's acquirer will not know these costs and accordingly will not be able to incorporate them into monitoring the maximum allowable surcharge. Furthermore, some merchants use multiple acquirers - which acquirer's statement do they use to determine their maximum allowable surcharge?

The Bank thus considers the RBA's currently proposed approach to be unnecessarily complex. The Bank suggests a much simpler means of achieving a similar outcome would be for the RBA to stipulate that merchants can surcharge up to "1.x" times the relevant merchant service fee, with this multiple set by the RBA. This is a rule of thumb type approach to cater for non MSF costs incurred by the merchant. The RBA could choose to survey some

² The Bank's suggestion would prevent debit card interchange fees from flowing to the acquirer, including for cashout transactions. Some large merchants presently benefit from a rebate from their acquirer for cashout transactions, on the back of the interchange fee paid to the acquirer. The Bank does not perceive cashouts as a service for which merchants require compensation since much of the value from this transaction, before interchange fees, already accrues to the merchant by way of reduced cash-handling costs and better customer service.

merchants and acquirers if it wanted the multiple to reflect the cost profile of a sample of merchants.

The discontinued interchange cost survey was seen as an expensive, burdensome and unnecessary means of arriving at an interchange benchmark. This applies equally, in the Bank's view, to setting a merchant's maximum surcharge price by incorporating an apportionment of their other costs to each interchange category. Using a RBA-set multiple will achieve an almost identical outcome, while saving acquirers considerable cost and complexity.

The Bank's suggested approach would be flexible in accommodating industries consisting of 'agency' merchants, such as travel agencies and entertainment ticket retailers. These merchants often incur additional costs arising from chargebacks due to the failure of the ultimate supplier to deliver the purchased goods/service to the cardholder. The RBA could, by exception, set a separate multiple for an individual industry to accommodate unique costs in accepting card payments particular to that industry.

In regards to the issue of excessive surcharging by merchants, the Bank (as we have previously argued) considers this issue should be addressed under competition law. As such, the Bank suggests the Australian Competition and Consumer Commission should examine surcharging practices within specific industries where excessive surcharging is experienced by cardholders. The RBA is unsuited to monitoring and enforcing compliance of the Government's proposed surcharging legislation.

By placing a cap on the maximum permissible surcharge for each merchant, the merchant service fee pricing structure for some merchants could result in unusual outcomes. CBA offers a Simple Merchant Plan to its merchants, with a fixed fee for acquiring turnover up to a specified level. Calculating the average merchant service fee in a period of abnormally low turnover for a merchant will result in an unusually high maximum allowable surcharge.

Similarly, the Bank offers bundled pricing for multiple banking products to some of its business clients. This would require some discretion on the acquirer's behalf to determine the merchant service fee applicable for such clients.

The Bank recommends that the RBA's requirements for merchant statements be as light touch as possible in order to minimise any resulting complexities, whilst still adhering to principles of transparency and disclosure. Regardless of the approach adopted, the implementation period should be sufficient to allow for considered systems and operational development and deployment.

The Bank has written separately to the RBA regarding changes to merchant statements to support a revised surcharging framework. We would welcome the opportunity for further discussion on this matter.

Other Matters

The definition of 'Issuer' and 'Acquirer' within the RBA's draft Standards is ambiguous. The definitions in the RBA's Standards could refer to either the individual business units within the Bank performing these functions, or to the entire Bank as an entity. The Bank suggests that a "whole of Bank" approach be adopted and would appreciate clarity in this regard.

The RBA's draft standards are, in our view, written in legalistic language which is not easily interpreted by new readers. The clauses within these Standards are quite complex, and many readers will call upon a legal interpretation to clarify the ultimate meaning and application of these clauses. The use of legal wording can be effective in closing off loopholes; however this comes at the expense of readability and ease of interpretation.

The Bank recommends that these Standards are redrafted using more conversational plain English, where permissible. Ordinarily, this approach may be eschewed in an attempt to prevent loopholes from emerging within the wording. However, the anti-avoidance provisions within the Standards mean that any potential loopholes will not be able to be exploited.

Also, the RBA requires that merchants are able to access an up to date list of credit and debit card BINs. The process whereby merchants who wish to obtain this information need to contact their acquirer, and the acquirer obtains an up to date listing from each scheme, is unnecessarily cumbersome. A preferable approach would be for each scheme to maintain a central listing on their website, with access available to merchants. The Bank suggests the RBA endorses this approach.

The Bank's views in relation to Companion Cards and three party networks in general have been expressed above, and previously. We note with interest that the Payments System Board would consider designation of the AMEX proprietary card system if "appropriate" outcomes are not forthcoming following implementation of the current round of proposed changes. The Bank would welcome the opportunity to contribute to any consultation process that might precede any such possible designation.

Thank you for the opportunity to lodge this Submission. We would appreciate the opportunity to discuss the above, and related, matters with you and ask that you contact the undersigned to arrange a suitable opportunity.

Yours sincerely

[Signed]

Stuart Woodward
General Manager
Payments Representation