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Confidential communication

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Mr Tony Richards
Head of Payments Policy Department
Reserve Bank of Australia
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By email: mailto:pysubmissions@rba.gov.au

Dear Mr Richards

Response to Review of Card Payments Regulation – Consultation Paper

Cuscal appreciates the opportunity to respond to the Reserve Bank Australia's (RBA) December 2015 *Review of Card Payments Regulation – Consultation Paper.*

Cuscal is an end-to-end payments provider that services more than 100 established and challenger brand clients with access to Australia's financial system and payments landscape. In providing services to our clients Cuscal acts in the capacity of a third party payment processor, card Issuer and card Acquirer.

Our response reflects our views from each of the above capacities in which we act and provides specific comment in the following areas:

- Interchange benchmarks and ceilings;
- Surcharging;
- Scheme payments to issuers; and
- Other requests for feedback.

We also provide our overall conclusions of the RBA implementing the proposed draft standards covering:

1. The Setting of Interchange Fees in the Designated Credit Card Schemes and Net Payments to Issuers;
2. The Setting of Interchange Fees in the Designated Debit and Prepaid Card Schemes and Net Payments to Issuers; and
3. Scheme Rules Relating to Merchant Pricing for Credit, Debit and Prepaid Card Transactions.

Interchange benchmarks and ceilings regulation

Credit cards
Cuscal supports making American Express companion cards subject to the same interchange fee regulation that applies to MasterCard and Visa as it is sound public policy to have competitive neutrality for like payment types that have a substantial market share.

Cuscal is concerned that there is still potential for the creation of a non-level playing field for American Express even with the regulation of American Express companion cards through the use of mechanism such as American Express issued co-branded cards for financial institutions. Cuscal believes that the RBA needs to think through this issue more carefully to avoid situations such as this.

Cuscal also supports the RBA's view of retaining the credit card weighted average for interchange at 0.50% as it continues to provide income certainty for issuers in a period of significant change and investment in the payments space.

As per our previous submissions to the RBA, Cuscal is supportive of the 0.80% as a component in restraining the upward drift of weighted-average interchange above the cap over the compliance period. We note that our views on this also align with that of APCA which recommends the exploration of a cap on the highest individual interchange fee rate that a regulated scheme could offer in response to the RBA's previous consultation paper.

Debit cards

Although Cuscal supports the concept of a cap for interchange as either a fixed amount or as a percentage of transaction value, as per our reasons for credit card caps, we do not support the quanta of them (ie 15¢ for a fixed amount or 0.20% as a percentage amount) or the reduction of the weighted-average interchange cap from 12¢ to 8¢.

We do not support the reduction because we think that, on balance, the RBA has not made a sufficient case to warrant a reduction and moreover by doing so it would reduce smaller issuers' revenue. This is because smaller issuers generally have a card-base which is strongly weighted to debit cards – disproportionately to that of larger issuers who have a more balance mix of debit and credit cards - thus placing smaller issuers at a competitive disadvantage.

Foreign issued cards

Cuscal does not support the RBA's proposal to include foreign issued cards in the domestic card weighted-average interchange benchmark calculation as we do not believe it has made a sufficient case for its inclusion based on their current reasoning.

The RBA states that "The Bank's consideration of the treatment of foreign-issued cards is mostly a reflection of an increased possibility of circumvention of the interchange standards through the use of such cards."

It then goes on to postulate that foreign virtual cards could be marketed by offshore issuers to Australian corporates who could take advantage of the higher interchange rates to side-step the weighted-average interchange benchmark cap.

There are two potential ways in which the RBA's approach could be implemented by the card schemes:

- The first is to reduce the interchange rates for overseas issuers using the Australian cap approach. This would likely create significant administrative difficulties in complying within designated timeframes. It could also be viewed as an attempt by the RBA to regulate overseas issuers. The other is to include the higher overseas interchange rates in the calculation. This would have the effect of reducing the Australian domestic interchange revenue to issuers by, say, 2 to 4 basis points for credit cards. This is tantamount to interchange reduction by stealth.

A much simpler way to avoid potential circumvention would be to designate scheme rule changes to prevent marketing of 'virtual' or other card products by offshore issuers to Australian corporates.

Benchmark compliance

Cuscal supports the inclusion of transactions on prepaid cards with debit cards in the observance of the debit benchmark, however, we strongly disagree with the shift from three-yearly to quarterly compliance of the domestic average-weighted interchange rate within 45 days.

As mentioned above, Cuscal supports the need to eliminate weighted-average interchange drift, however doing this on a quarterly basis and complying within 45 days is impracticable.

It is impracticable and costly because there will be insufficient time to:

1. Have schemes recalculate individual interchange rates;
2. Advise issuers and acquirers of the new interchange rates for each card/ transaction type
3. Update issuing and acquiring systems with the new rates;
4. Reprice merchants who are on single MSF and Multiple MSF based on card groupings;
5. Communicate to merchants their new rates and provide notice in advance; and
6. Issue and execute new contracts with merchants.

However, Cuscal is of the understanding that the RBA believes that the above 6 steps will be unnecessary as card schemes could create a buffer between the actual average-weighted interchange rate and its mandated cap – say for example somewhere between 5 to 10 basis points (for credit) and will rebalance individual card/transaction types less frequently.

If the above happens, we believe it will have the effect of reducing issuer interchange income and is at odds with the RBA's own proposal not to reduce the weighted-average interchange cap for credit cards.

This potential decrease could be exacerbated by the need to increase the buffer to cater for seasonality.

If the schemes adopt the process envisaged by the RBA it is another form of interchange reduction by stealth.

Cuscal proposes that the introduction of an annual rebalancing of average-weighted interchange, coupled with the RBA's proposed cap of 0.80%, is a much more sensible and practical solution.

Implementation and timing considerations

Cuscal believes that, irrespective of the approach adopted, a working group of industry representatives (issuers and acquirers) should be formed to work through the issues in more detail and establish a jointly agreed, feasible, implementation timeframe.

Establishing implementation timing is also more problematic for Cuscal, when compared to other acquirers, because our acquiring business model comprises both "traditional" acquiring and "non-traditional" acquiring where we have disaggregated aspects of the acquiring value chain.

In our "non-traditional" disaggregated value chain, Cuscal acts as the acquirer of record and provides switching and settlement services with our clients providing the remaining acquiring services in the value chain.

We process a fleet of about 27,000 "traditional" merchant terminals for a high street bank, however, the bulk of our acquiring business is in the "non-traditional" space, where we work with a range of newer, non-traditional payment acceptance organisations.

Because of the Christmas period and the short time to respond we have had insufficient time to engage with the above organisations to establish the impact on them.

Cuscal is also not sure of the extent to which the RBA has considered the regulatory implication on "non-traditional" acquiring models.

Surcharging regulation

Allowable cost definitions and calculation
Cuscal supports, in general, the concept of explicitly defined card acceptance costs, however, we feel that that it needs more specificity around definitions such as Payment Facilitator, to eliminate any uncertainty as to what is included or not.

The draft standards state that costs for a permitted surcharge can only be for fees charged by either an acquirer or payment facilitator and that a payment facilitator must have arrangements with acquirers. Cuscal believes there are situations in the payments value chain where entities who do not have an arrangement with an acquirer have transaction costs that should be considered permissible e.g. ecommerce, fraud detection and terminal rental.

Also Cuscal is unclear as to what constitutes a payment facilitator/acquirer relationship and in particular if payment gateway fees for ecommerce, which can be substantial, are included.

Cuscal believes that further industry consultation is required, establishing in detail, what the types of cost in the payments value chain are, and the types of entities that facilitate payments.

Supply of information to merchants
Cuscal supports supplying to merchants the cost of acceptance information required in Draft Standard.

Implementation and timing considerations
Because of the complexity of the draft standard, a guidance note for merchants and acquirers is considered essential by Cuscal. This guidance note should provide examples of costs covered and how surcharges are to be calculated for the various scenarios described in the draft standard.

In setting implementation timeframes, consideration needs to be given to:

- Further consultation on the costs and entities in the payments value chain with respect to "surchargeable costs" as described above;
- The time and cost of modifying:

  - Merchant statements to provide acceptance costs as a % of card value transactions or as an amount per transaction for Statement Period (less than or equal to 3 months) and annually
  - Terminal software to cater for differential surcharging
- The constraint of resources due to allocation of specialist IT resources working on other critical IT projects and;
- The development of detailed guidance notes and industry standard merchant communications.

The comments that Cuscal made about "non-traditional" acquiring models for the implementation and timing of Benchmark Compliance are equally applicable surcharge regulations.

Payments to issuers
Cuscal understands the RBA's rationale behind the introduction of a Standard to limit incentive payments to issuers as they could potentially be used as another form of interchange.

We also agree companion card issuance and traditional 'four-party' card issuance should subject to rules on 'other net payments' to Issuers.

Other requests for feedback

Feedback on potential inclusion for chargeback costs for insolvency of a third party
Cuscal thinks there is some merit in inclusion of this on a cost/consumer protection basis for surcharging.

Feedback on approach to industries operating on a non-standard payment model
Cuscal believes that the approach to the taxi industry and whether there are other industries operating on a non-standard payment model should warrant further consideration to ensure regulatory parity between standard and non standard models.

RBA discussion with PayPal regarding its no surcharge rule
Cuscal supports the RBA examining PayPal's no surcharge rule on the grounds of regulatory parity for its online business.

Overall conclusions

While Cuscal is generally supportive of the broad thrust of most the proposed draft standards we:

- Do not believe the RBA has made a sufficient case to reduce debit/prepaid card interchange;
- Think that an annual reset of the weighted-average is more practical than the proposed quarterly reset; and
- Do not believe that foreign card interchange should be included in the average-weighted interchange cap. We think a better approach to avoid foreign cards issued by domestic corporations would be to re-inforce scheme rules.

We are concerned about the limited time we have had to respond to the consultation document, which has been exacerbated by the absence of key staff over the Christmas break. We suspect that this may be an issue with other stakeholders as well.

As a result of this, the depth and detail of the reforms and the need to establish realistic implementation timeframes, we believe that an industry working group should be set up to:

- Establish weighted-average interchange benchmark compliance frequency and compliance periods that can be practically implemented;
- Review process and industry entities within the payments value chain whose costs should be considered 'surchargeable';
- Establish a realistic implementation timeframe for surcharging reform;

We are also concerned about potential unintended consequences due to the scope and scale of proposed reform and would request that the RBA address them urgently should they occur.

Yours sincerely,

ADRIAN LOVNEY
General Manager, Product & Service