FLIGHT CENTRE™ TRAVEL GROUP

Head of Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001
pysubmissions@rba.gov.au

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Dear Sir or Madam

RBA Review of Card Payments Regulation – Submission in response to Consultation Paper dated December 2015

In December 2015, the Reserve Bank of Australia (**RBA**) published a Consultation Paper entitled "Review of Card Payments Regulation" (**Consultation Paper**), in which the Board sought submissions from interested parties on the options discussed in Chapter 3 of the Consultation Paper. Flight Centre Travel Group Limited (**Flight Centre**) has a strong interest in many of the issues canvassed in the Consultation Paper, including in particular the subject of surcharging. The purpose of this submission is to draw your attention to some issues which we think the RBA should consider before finalising its policy which will be contained in the standards, drafts of which were contained in the Annex of the Consultation Paper.

1.1 The purpose of this submission

This submission focuses on 4 topics which are discussed in the Consultation Paper, namely:

Topic	Consultation Paper reference	Summary of Flight Centre submission
Surcharging	p 8-9; 28-35	The proposed 'cost of acceptance' model does not address the prepayment risk faced by Flight Centre and other merchants. More consideration needs to be given to the mechanics of the proposal for acquirers to be the sole providers of cost of acceptance data to merchants.
Companion Cards	p 9; 12-16	To boost competition and transparency, three-party schemes should be regulated in the same way as four-party schemes.
Interchange fees – Commercial cards	p 6; 16-17	Commercial cards should not be included in interchange regulations without further consideration of the impact on market dynamics.

Interchange fees – Scheme payments to issuers	p 27-28	If interchange fees continue to be regulated, then we would support the introduction of the anti-avoidance measures considered by the Board.

2 Surcharging

2.1 Summary

- *The proposed 'cost of acceptance' model does not address the prepayment risk faced by Flight Centre and other merchants.*
- *More consideration needs to be given to the mechanics of the proposal for acquirers to be the sole providers of cost of acceptance data to merchants.*

2.2 Context

We made a submission to the RBA on 17 June 2013 entitled "Submission on the 'Guidance Note: Interpretation of the Surcharging Standards' – Expansion to adequately cover chargeback risks" (**2013 Flight Centre Submission**), requesting some reasonable amendments to the Guidance Note entitled 'Interpretation of the Surcharging Standards' (**Guidance Note**).

In the 2013 Flight Centre Submission, we described the types of actual and potential costs that Flight Centre incurs when accepting credit cards and noted that some of these are not found in the list of costs in the Guidance Note. We requested that the RBA amend the Guidance Note to make it clear that the list is not exhaustive and represents examples of costs that may be included in a surcharge. We also requested that the RBA expand the list of acceptable costs in the Guidance Note so that the reasonable cost of acceptance of credit cards expressly includes actual or potential costs associated with the "prepayment risk" faced by merchants in the position of Flight Centre; namely the risk of a chargeback that arises where a merchant accepts payments by credit card for services that are to be supplied to the cardholder by a third party service provider and at a date much later than both i) the date on which the merchant accepted the payment from the consumer (usually as agent for that third party service provider) and ii) the merchant paid amounts due to the end supplier.

On 7 December 2014 the Financial System Inquiry released its Final Report (**FSI Report**). We refer in particular to the section in Chapter 3 of that report entitled "Interchange fees and customer surcharging" and to the two submissions made by the RBA to the Financial System Inquiry.

We refer to the submission made by the Australian Federation of Travel Agents (**AFTA**) in April 2015 entitled "Submission to the Reserve Bank of Australia. The review of card payments regulation and its impact on the Australian Travel sector" (**2015 AFTA Submission**). Flight Centre is a member of AFTA and supported the AFTA Submission.

In response to the RBA 'Issues Paper' entitled "Review of Card Payments Regulation" published in March 2015 (**Issues Paper**), Flight Centre made a submission to the RBA entitled "Financial System Inquiry and RBA Review of Card Payments Regulation – Customer Surcharging" dated 1 October 2015 (**2015 Flight Centre Submission**). In it, we reiterated many of the submissions made in the 2013 Flight Centre Submission, and requested that the RBA consider the potential chargeback scenarios contemplated in those submissions when formulating its policy.

We also understand that AFTA is making a submission in response to the Consultation Paper which will be submitted on or around the date of this submission (**2016 AFTA Submission**). We have been provided with a draft of the 2016 AFTA Submission.

In providing this present submission, we refer the RBA to the 2013 Flight Centre Submission, the 2015 AFTA Submission, the 2015 Flight Centre Submission and the 2016 AFTA Submission. Other than the summary below, we do not intend to repeat here the arguments made in those submissions. Rather, we would like to respond to the comments

made about surcharging in the Consultation Paper, and in particular to the RBA's specific comments about the travel industry (Consultation Paper, page 32) and the invitation to submit views on the possible approaches for merchants wishing to surcharge to cover the potential cost of prepayment risk (Consultation Paper, p 42).

2.3 Summary of Flight Centre's surcharging rationale

As described in our 2013 Flight Centre Submission and 2015 Flight Centre Submission, travel agents such as Flight Centre face a specific risk in relation to chargebacks that arises when we accept payment by credit card for services to be supplied to the cardholder by a third party travel service provider such as an airline, tour company or hotel at a date much later than the date on which i) we accepted the payment and ii) paid the amounts due to the service provider. Where that third party travel service provider does not perform under its contract with our customer (for example, it becomes insolvent), the customer can ask the card issuer to initiate a chargeback for the full transaction value. When a chargeback occurs, the customer's credit card account is credited with the transaction value, and the same amount is charged to the merchant's acquiring bank by the card issuing bank through the card scheme. Upon receiving the chargeback, under the merchant acquiring agreement, the merchant acquiring bank charges the full transaction value to Flight Centre's account. Flight Centre then becomes an unsecured creditor of the airline for the full transaction value.

We have included these risks for the purposes of calculating the amount of our credit card surcharges.

We are grateful to the RBA for acknowledging this risk (at page 32 of the Consultation Paper) and for suggesting some possible solutions to the problem (ibid).

As noted in the 2016 AFTA Submission, this risk (described by AFTA as the "Forward Delivery Risk" or "**FDR**") applies to other industries such as ticket providers.

We make the following submissions.

2.4 Cost of acceptance

Currently, merchants are permitted to surcharge up to the reasonable cost of accepting card payments based on a broad definition of eligible costs contained in the Guidance Note. We support the concept that merchants should only be able to recover their costs of acceptance in a surcharge.

We are of the opinion that Option 3 ('Modifications to the cost of acceptance framework'), considered in the Consultation Paper (at page 29) defines cost acceptance too narrowly, in that it involves amending the threshold so that merchants would only be able to surcharge up to the cost of acceptance for a payment method, where the cost of acceptance is defined as the average cost of that payment method by reference to fees paid by the merchant to the acquirer (or payment facilitator) for payment services.

We submit that this threshold is too restrictive and inflexible. The Consultation Paper clearly states that "'[t]he cost of chargeback in this case would not be considered a cost of acceptance under Option 3 and therefore would not be included in the permissible surcharge".

We contend that any entity in a similar position to Flight Centre, which pays substantially all the money it receives to a third party supplier when a customer pays by credit card, should be able to charge customers for the actual and potential risks posed to that entity by the insolvency of the third party supplier (or its failure to perform under its contract with the customer). This is even more the case where that third party supplier is to provide its services at a future time, which may be many months away.

It is important to appreciate that the prepayment risk does not exist where a customer pays by a means other than credit card (for example, cash, direct transfer of funds to a bank account, or BPay). In other situations the customer takes the risk of the failure of the third party to perform. It is therefore reasonable and equitable for Flight Centre to apply a surcharge that seeks to allow for and recovers for the risks from those transactions (namely, card transactions) that give rise to the risk. If Flight Centre does not do this, the result will be that non-users of cards subsidise card users.

Therefore, we do not support Option 3. We would prefer to see the standards expressly recognise the cost of the prepayment risk by including it as a cost of acceptance thereby allowing merchants to pass this cost on to customers as a surcharge. This surcharge acts as a transparent signalling mechanism to consumers paying with more expensive payment methods and provides a direct cost to those consumers choosing that payment method without disadvantaging other consumers.

To ensure the RBA's goals of transparency and effective enforcement can be achieved, we propose that the RBA allows the inclusion of prepayment risk as a cost of acceptance in the surcharge calculation but only where the cost borne by the merchant is transparent and audited by an independent accounting firm. The Framework supplied at Attachment 1 to the 2016 AFTA Submission describes the relevant risks and variables that could be used by the relevant auditor to assess the cost of the prepayment risk and the way it is passed on to consumers through the surcharging mechanism. We would prefer to use independent auditors and allow the ACCC to review that process if requested.

2.5 Possible solutions

In section 2.1 of this submission, we described the prepayment risk and stated our preferred approach.

If the RBA decides not to include the cost of the prepayment risk as a cost of acceptance, then there needs to be another solution for merchants such as Flight Centre.

We believe Option 1 ('No change to the existing definition of reasonable cost of card acceptance') considered in the Consultation Paper (at page 29) is a more appropriate basis for controlling surcharging behaviour in the economy, although we do agree that the current definitions are too broad. Including an additional cost of acceptance recognising the particular issues caused by prepayment risk for Agents, along the lines discussed above involving transparency and independent verification would solve problems with the existing framework. Alternatively basing a framework on Option 3 but widening the costs of acceptance as discussed above would also support the aims of the RBA and provide transparency to consumers and protection for merchants.

In the Consultation Paper, the RBA stated that it was "interested in views on possible alternative approaches – ones that would not excessively complicate the 'cost of acceptance' measure." (at page 32). Three possible solutions were proposed. Please find below our views on these solutions.

(a) *Introducing a carve-out from chargeback obligations in the case of insolvency of a supplier.*

We do not support this solution because it would be logistically difficult to manage and removes a valuable protection for consumers.

(b) *Acquirers providing explicit insurance for insolvency, which would then become part of the cost of acceptance.*

We consider that insuring against the risk of the insolvency of suppliers is a viable solution. However, in order to ensure a competitive process and reasonable pricing, merchants should not be limited to obtaining insurance only from acquirers. It is essential that the cost of the insurance be included as a direct cost of credit card acceptance and within the scope of the surcharge criteria (subject to transparency and audit of the kind described in section 2.4 of this submission).

(c) *Travel agents making their payments to suppliers with cards that also carry chargeback rights.*

We would support this solution. It would enable merchants to have the benefit of the chargeback regime and transfer the insolvency risk to the airlines' acquirers. These acquirers are arguably better placed to manage the risk than travel agents and it would be more sensible for the economy as a whole to have the risk managed by the banking system rather than by individual travel agents. Transferring the risk to the principals is self-evidently more transparent and would support a clear allocation of risk across the industry.

However, travel agents such as Flight Centre are currently constrained by the rules of the International Air Transport Association (**IATA**) which currently do not permit travel agents to pay airlines using credit cards where the travel agency is the cardholder. We understand IATA are currently re-considering this restriction but have not given any formal indication that the restriction will be lifted.

We would expect that airlines acquirers and the airlines themselves would not be supportive of such a change and we do recognise the risk that this may impact commercial negotiations between Agents and Principals. This has the potential to disadvantage small business who are less able to manage robust supplier relationships, hence we believe the option discussed earlier, namely the inclusion of prepayment risk in the cost of acceptance in a transparent manner is a more suitable solution.

We have also considered another solution. This involves changing the payment terms to suppliers so that agents such as Flight Centre pay suppliers once the consumer has travelled, meaning that the agents would not need to pay the supplier if the supplier is unable to deliver the service (for example due to insolvency) and ensuring that the agent is holding funds ready to honour the chargeback lodged. This would solve the industry specific problem and would be a suitable solution for large agencies such as Flight Centre but we do not believe this is a realistic outcome as it would increase risks faced by consumers with monies lodged with smaller agencies increasing the risk of default and losses to consumers.

2.6 Information provided by acquirers

Under Option 3, acquirers (or payment facilitators) would be required to provide merchants with statements providing separate information on the average cost of accepting each card type. The Consultation Paper contemplates this being provided both monthly (or quarterly) and also in an annual statement at the end of each financial year (page 33).

We are fully supportive of greater transparency of acceptance costs. However, some consideration needs to be given to the mechanics of the proposal: assuming acquirers provide historical information to merchants on a monthly (or quarterly) basis, will that data be the source for the ongoing surcharging level used by that merchant? If this changes significantly month on month (or quarter on quarter), will the merchant be able to apply an average surcharging rate over time and to round the surcharge to a reasonable rate? For example if direct costs of acceptance are 97bps one month and 103bps the following month (with similar rates for next 10 months), will the merchant be permitted to round to 1% for a 12 month period? Or will merchants need to change the surcharging rate every month?

All merchants will want to be able to clearly communicate surcharges to their customers and ideally impose a consistent surcharging rate over time to avoid confusion. Constant changes will also impose costs due to frequent system and documentation changes.

3 Companion cards

3.1 Summary

- *To boost competition and transparency, three-party schemes should be regulated in the same way as four-party schemes.*

3.2 Submission

We note that in their previous submissions to the RBA, all the four-party schemes (and most merchants) argued that if four-party systems continue to be regulated, then all the payments in bank-issued companion cards from three-party schemes should be subject to interchange regulation. We agree with this. We also agree with the submission made by one of the international four-party schemes that proprietary three-party cards should also be brought within equivalent regulation.

We contend that if the proposed amendments to the surcharging regulation are implemented, it will be hard for merchants to differentiate at point of sale between a regulated card (ie a card from a four-party scheme) and an unregulated card (ie a card from a three-party scheme), and therefore it will be difficult for merchants to ascertain what surcharge is applicable to a given customer. This confusion is inconsistent with the desired aim of transparency for consumers.

Regulation of interchange-like fees paid to issuers by three-party schemes such as American Express is consistent with the policy of competitive neutrality.

We therefore support the implementation of Option 3 (Consultation Paper page 12).

4 Interchange fees

4.1 Summary

- *Commercial cards should not be included in interchange regulations without further consideration of the impact on market dynamics.*
- *If interchange fees continue to be regulated, then we would support the introduction of the anti-avoidance measures considered by the Board.*

4.2 Commercial cards

We understand that the Board's preliminary view is to maintain the status quo with respect to commercial cards (Consultation Paper, page 17). This means that commercial cards would continue to be covered by the RBA's standards and the schemes would need to ensure that the interchange rates for these products are consistent with the weighted-average benchmarks set by the RBA.

We respectfully disagree and consider that Option 2 (summarised at Consultation Paper, page 17) would lead to greater competition for the following reason.

If three-party scheme proprietary cards remain unregulated, but four-party scheme commercial cards are included in the interchange regulation, then the four-party schemes will continue to be limited in the incentives they can offer to corporate customers but customers of three-party schemes will be able to receive (as a rebate from their issuer) a share of the attractive interchange fee received from the third-party scheme. The higher revenue sharing arrangements would incentivise commercial card holders to move to three-party schemes. We believe there is therefore a risk that the three-party schemes could find themselves at a competitive advantage leading to a significantly increased market share in the corporate card market. This could create a strong market position for three-party schemes, and in turn, this could limit incentives for innovation, reduce transparency across the market and also may allow three-party schemes to limit the data provided to corporate customers.

If commercial cards remain regulated, then measures need to be taken to address this concern. An obvious solution would be to raise the interchange weighted-average benchmarks. This concern is particularly relevant in the travel industry with prevalence of corporate cards for travel and entertainment (as noted in the Consultation Paper) and further compounded by the reliance on the card schemes for sourcing enhanced data to provide to customers.

We do understand that there could be perceived to be a risk that commercial cards would be issued to non-corporate bodies, thereby circumventing the objectives of the Consultation Paper, but we contend that simple controls could be enforced on issuers for example, to ensure that commercial cards may only be issued to ABN holders.

4.3 Scheme payments to issuers

As the Consultation Paper acknowledges (at page 27), it is common practice for card schemes to make payments to issuers. The result is circumvention of the interchange regulation, which limits the fees paid by acquirers to issuers.

If interchange fees continue to be regulated, then we would support the introduction of the anti-avoidance measures considered in Option 2 (Consultation Paper, page 27).

In addition to focusing on payments made by the schemes to issuers, these measures should also focus on scheme fees (ie the fees paid by acquirers to the card schemes). This would ensure a holistic approach to the fee arrangements between issuers, acquirers and the schemes and would prevent netting-off being used as an anti-avoidance mechanism. Failure to do so means that banks with both acquiring and issuing businesses could simply negotiate lower scheme fees and use this reduction to offset reduced payments from the schemes to the issuing side of the business.

There is also an argument for ensuring full transparency on scheme fees passed through to merchants from acquirers. This is arguably implied in the current reporting requirements but we submit there is a need to clarify and enforce this obligation. Better transparency will enable merchants to be fully informed about the true costs incurred by the acquirer and, assuming scheme fees are negotiated by acquirers on a bilateral basis, ensure merchants are benefitting from efficiencies and able to pass on efficiencies to consumers via the surcharging mechanism.

We are keen to discuss these points further with you. Please feel free to contact me on my details below.

Yours sincerely

Graham Turner

Managing Director

FLIGHT CENTRE TRAVEL GROUP LIMITED