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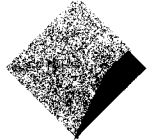
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8 April 2005

Dr John Veale
Head of Payments Policy
Reserve Bank of Australia
65 Martin Place
SYDNEY NSW 2000



Dear Dr Veale

PAYMENTS SYSTEM REFORM

I refer to the Reserve Bank of Australia's Media Release of 24 February 2005. That Media Release addressed:

- EFTPOS and Visa Debit systems and referred to the Consultation Document setting out draft standards in relation to proposed reforms to these systems;
- The non regulation of American Express and Diners Club; and
- Aspects relating to the setting of credit card interchange fees.

This letter sets out the Commonwealth Bank's views in relation to the third dot point above only; other aspects addressed in the Media Release and related documents shall be separately addressed. The Commonwealth Bank (the Bank) appreciates this opportunity to contribute to this discussion and sets out, below, matters for consideration by the RBA. This letter has been prepared in the knowledge that it may be published on the Reserve Bank web site.

Background

RBA Standard No 1 (The Setting of Wholesale ("Interchange") Fees) requires that a cost based benchmark of aggregate eligible issuer costs be calculated - on a credit card scheme specific basis - by an independent expert and advised to the Reserve Bank every third year, with annual certification by scheme participants.

Currently, benchmark interchange fees, as calculated under Standard No 1, vary between credit card schemes - reflecting differing cost levels and scheme specific transaction volumes to the extent that these impact on the overall weighted average calculation for that scheme.

Current Proposal

The RBA Media Release of 24 February 2005 seeks submissions on whether *"the standards should be amended so that the same benchmark interchange fee applies in all schemes ... one possibility would be to set a benchmark based on average eligible costs measured across all three credit card schemes. An alternative would be to set a benchmark based on the costs of the lowest-cost scheme."*

Commonwealth Bank Position

Without re-opening debate as to the merits, or otherwise, of a cost based methodology (or the narrow range of eligible cost categories), it occurs to the Bank that:

- If a cost based methodology is to apply, it should, as a matter of principle, genuinely reflect the relevant costs applicable to each scheme and to the extent that standardising or averaging mitigates this principle, then that development would be inappropriate.
- Facilitating different interchange fees between schemes is pro-competitive and would maintain a useful competitive tension between card schemes. (Please note that we have not sought legal advice as to the possible anti-competitive ramifications of removing a potential competitive tool that currently resides between card schemes.)
- A-priori, different card schemes have different cost structures and it can be expected that this would, and should, reflect in costs for re-imburement to card issuers.
- Individual credit card schemes have been separately designated under the Payment Systems Regulation Act - logic suggests that differing interchange fees should thus apply to the separately designated card schemes.

It could be argued that standardising interchange fees across credit card schemes might introduce efficiency for acquirers by way of reduced complexity attributable to differing interchange fees. We believe that such administrative gains are likely to be marginal at best, and that implementation of further systems changes would prove expensive - likely eroding any marginal benefit.

Furthermore, scheme specific authorisation and settlement require recognition of scheme specific interchange fees - regardless of whether the rates are identical. Thus, maintenance of differing interchange fees is not an onerous imposition. In our view, it would be preferable for the interchange fees to reflect actual costs, rather than some sort of average.


Although not addressed in the 24 February 2005 Media Release, the independent expert plays an important role in calculating credit card interchange fees, and certifying compliance. One possible interpretation of the Media Release is that the independent experts would no longer be required under a standardised approach. In our view, such a development would be counterproductive - the independent expert brings transparency, efficiency and understanding, which should not be sacrificed under the guise of administrative efficiency.

If an averaging model were to be applied, a transaction volume weighted average rather than an arithmetic average, would be most equitable.

An alternative option canvassed in the Media Release is that of determining a benchmark based on the costs of the "*lowest-cost scheme*". Such an approach would be unfair (especially on top of the narrowly define range of eligible costs) and would under-compensate scheme members for costs legitimately incurred. The Bank believes that this approach is at odds with being reflective of genuine (incurred) costs, cannot be justified, and would likely inhibit product development and ultimately the network economics underpinning credit card schemes. Such an approach would, in our view, be a retrograde step and cannot be justified.

The Bank looks forward to continuing its active participation in regard to this issue, and related matters. We remain willing to meet at any time to discuss these issues and to this end, we request you contact the writer directly.

Yours sincerely



Stuart Woodward
Acting General Manager