



9 July 2004

Dr John Veale  
Head of Payments Policy  
Reserve Bank of Australia  
65 Martin Place  
SYDNEY NSW 2000  
[payments@rba.gov.au](mailto:payments@rba.gov.au)

Dear Dr Veale

### Designation of EFTPOS

Thank you for the invitation dated 11 June 2004 to provide our views on whether it would be in the public interest for the Reserve Bank of Australia (RBA) to designate the EFTPOS and ATM payments systems in accordance with the *Reserve Bank Act 1959* and the *Payments System (Regulation) Act 1998*.

This submission will address Credit Union Services Corporation (Australia) Ltd's (CUSCAL's) views on EFTPOS. CUSCAL's views on ATMs will be provided in a separate submission.

CUSCAL believes designation of EFTPOS would be in the public interest. Determination of a standard for EFTPOS interchange fees would promote efficiency and competition in the Australian payments system.

There has been no progress on EFTPOS reform since the Prices Surveillance Authority reported almost a decade ago that:

- EFTPOS interchange fees were rigid and unrelated to costs, even though costs had fallen;
- The cost burden of the EFTPOS system was falling increasingly on institutions that were predominantly card issuers; and
- These card issuers – credit unions, building societies and regional banks – were “clearly losers”.<sup>1</sup>

After the recent failure of industry's lengthy voluntary reform process, we agree with the chairman of the ACCC, Mr Graeme Samuel, that EFTPOS reform is now best achieved through a regulatory solution.

Voluntary reform could not overcome the determined resistance of big retailers to protect the revenue they earn from current EFTPOS arrangements while reaping the benefits of credit card reform. For credit unions, the voluntary reform process was a waste of time and scarce resources.

We urge immediate designation of the EFTPOS payments system and the prompt implementation of an EFTPOS interchange fee standard.

---

<sup>1</sup> PSA Report No. 65 *Inquiry into fees and charges* p268.

The voluntary reform proposal, supported by CUSCAL and based on a willingness to compromise by all parties to the agreement, was for an EFTPOS interchange fee of zero. In this submission, CUSCAL urges the adoption of an EFTPOS standard using the credit card standard as a benchmark, resulting in a small positive interchange.

This will lead to more appropriate price signals to cardholders between payment instruments and will deliver a more efficient and competitive payments system.

### **Credit unions and the payments system**

CUSCAL is the industry body for the majority of Australia's 176 credit unions. The CUSCAL Industry Association represents 154 credit unions which hold over 80% of the sector's assets of \$30 billion. Credit unions play an essential role in Australia's financial services sector, providing banking and financial services to more than three and a half million members, and offering a genuine and community based alternative to the major banks.

Credit unions in Australia:

- are the main financial institution for 9% of the population;
- are mutuals, where members own the credit union in which they are customers;
- are focussed on delivering benefits to members and a common set of values and ethics which govern credit union operations;
- have a strong record of protecting depositors' funds; and
- continually report strong service outcomes – research in 2003 showed more than eight out of ten members rated satisfaction with their credit union as "excellent" or "very good" compared with less than four in ten customers of major banks.

CUSCAL is owned by credit unions and provides credit unions with a range of commercial, banking and industry association services. These include a debit card product under the Redicard brand. There are 1.8 million Redicards on issue.

On behalf of credit unions, CUSCAL has bilateral EFTPOS interchange agreements with major banks, regional banks, Cashcard and Coles Myer Ltd.

The EFTPOS payments system is made up of issuers and acquirers. Some participants earn net revenue from EFTPOS, other participants have roughly balancing inward and outward EFTPOS fee flows, and for the remaining participants EFTPOS interchange fees are a net cost.

Credit unions fall into the latter category, bearing a net cost from EFTPOS interchange fees of around \$19 million per year.

This cost is recovered from credit union members as customers and owners.

### **Payments system reform**

CUSCAL supports the RBA's efforts to ensure payments systems in Australia are efficient and competitive. These payments systems include ATMs, EFTPOS, Visa Debit, Credit Cards and BPay.

However, we have consistently emphasised the importance of a concurrent reform processes. Individual payments system reforms cannot be considered in isolation and the impact of reforms on institutions and consumers must be considered collectively.

Voluntary reform of EFTPOS by industry proved to be an expensive failure.

The RBA convened the EFTPOS industry group in February 2002. Members of the group started out with widely differing positions on the need for EFTPOS reform. Three of the four major banks were on record opposing EFTPOS reform. However, the group was able to reach an agreed position and in February 2003 an application was made to the ACCC for authorisation of zero EFTPOS interchange fees.

“EFTPOS represents one of the cheapest forms of payment to merchants (as well as reducing their cash holding costs),” the EFTPOS Industry Applicants Group (EIAG) said in its submission to the ACCC. “EFTPOS transactions are cheaper to process than other card-based transactions and identification through a PIN and the need to present the card make them less open to fraud. Despite these systemic advantages of EFTPOS, the cost to cardholders of using a debit card is more than the cost of using a credit card, in part, because of the transaction fees a debit cardholder pays on transactions beyond any fee-free period.”

Taking a pragmatic approach and with participants demonstrating a willingness to compromise, the EIAG proposed reducing EFTPOS interchange fees to zero.

Given that the ACCC was joint author of the 2001 Joint Study that had launched the payments reform agenda, it was expected that zero EFTPOS interchange fees could be approved in time to be implemented to coincide with credit card interchange fee reform due to take effect at the end of October 2003.

However, authorisation was not forthcoming until December 2003 and was subsequently challenged in the Australian Competition Tribunal by retailers.

Complaining about a paucity of hard information, the Tribunal overturned the ACCC’s determination. The Tribunal said “the banks have provided nothing by way of concrete commitment to this Tribunal, or the ACCC, for the passing through to cardholders of savings from a zero interchange fee.”

The Tribunal concluded that zero EFTPOS interchange fees would not necessarily benefit cardholders but would be “likely to have the effect of passing on to the general body of consumers an annual cost of \$170 million, or a substantial part thereof.”

In other words, the Tribunal concluded that getting rid of a hidden wholesale fee would be absorbed by issuers but not absorbed by acquirers or merchants. Lowering issuers’ costs would not be reflected in issuers’ prices but increasing acquirers’ and merchants’ costs would be reflected in acquirers’ and merchants’ prices.

This conclusion defied the Tribunal’s separate finding that “all economists who gave evidence agreed with the general proposition that the proposed change in interchange fees is likely to be passed on (at least to some extent) to cardholders...”

The Tribunal’s findings appear to contradict fundamental assumptions underpinning the RBA’s payments reform agenda. In particular, the RBA’s view that credit cards and debit cards are close substitutes<sup>2</sup> was not shared by the Tribunal, which decided “they are simply different products”.

The Tribunal also:

- Accepted as an “important fact” the controversial claim by retailers that “most consumers pay no EFTPOS fees today”; and

---

<sup>2</sup> *Reform of credit card schemes in Australia, Final Reforms and Regulation Impact Statement August 2002, p3.*

- embraced the retailers' portrayal of EFTPOS as a branch reduction strategy by banks, rather than a system that provides benefits to cardholders and merchants.

The Tribunal observed in its judgement that:

"It is a matter of notoriety that profits of banks, and in particular the major banks, increased greatly over the 1990s."

"In 1990 there were slightly over two EFTPOS terminals for every bank branch in Australia. The figure is now 89 terminals for every bank branch."

CUSCAL questions the relevance of these observations to EFTPOS interchange.

The voluntary reform process foundered because it was vigorously opposed by interests with deep pockets (retailers) and because some of the proponents (large banks), who were only ever reluctant conscripts to the reform cause, did not provide "concrete commitments" about the outcome.

This disappointing result begs the question: who is in charge of payments reform?

#### **EFTPOS interchange fee standard**

There should be no regulatory distinction between credit cards and debit cards. The distinction is artificial. There is a continuum of payment card products. Products along this continuum include:

- credit cards with interest-free periods (buy now, pay later);
- credit cards without interest-free periods;
- scheme debit cards (eg, Visa Debit) with a line of credit attached to the cardholder's transaction account;
- scheme debit cards without a line of credit;
- proprietary (EFTPOS) debit cards with a line of credit; and
- proprietary debit cards without a line of credit.

Current price signals to cardholders drive them towards credit cards for transaction purposes whether or not they want access to credit. A consistent interchange fee standard, resulting in correct price signals, should be applied to all card payment card products.

The RBA, as payments system regulator, has already concluded that debit cards in relation to credit cards are:

- potentially a strong competitor,<sup>3</sup> and
- in many circumstances, a close substitute.<sup>4</sup>

The RBA has recognised that card issuers provide payment services to merchants. The credit card interchange fee standard gives regulatory recognition to these payment services provided by card issuers to merchants.

"From the viewpoint of the merchant, a debit card also provides a guaranteed, pre-authorised payment," the RBA says.<sup>5</sup>

---

<sup>3</sup> *Reform of credit card schemes in Australia, A Consultation Document* RBA December 2001, p38

<sup>4</sup> *Reform of credit card schemes in Australia, Final Reforms and Regulation Impact Statement* August 2002, p3.

<sup>5</sup> *Reform of credit card schemes in Australia, A Consultation Document* RBA December 2001, p38

Credit card issuers continue to receive compensation in the form of interchange fees for costs involved in providing benefits to merchants. Debit card issuers should be compensated for providing identical benefits.

If debit card issuers are not compensated by merchants, through acquirers, for these costs, these costs will have to continue to be recovered from cardholders. This will perpetuate the bias in favour of credit cards - a higher cost payment instrument (albeit one with greater functionality and more features for the cardholder) - against a lower cost payment instrument.

Cardholders should not have to pay for benefits provided to merchants.

The credit card interchange fee does not cover any 'credit' costs other than the interest free period. All other costs included in the standard are equally relevant to debit cards. The credit card interchange fee standard provides the logical benchmark for a debit card interchange fee standard.

The RBA/ACCC Joint Study published a figure of \$0.07 as an indicative fee to the issuer based on this approach. The fee is much lower than a credit card interchange fee because there is no interest free period, EFTPOS debit card fraud costs are much lower, and processing and authorisation costs are also lower.

Without reform of EFTPOS, the distortion in the current interchange fee environment will continue to push cardholders towards credit cards.

### **Conclusion**

Reforms to the payments system should be implemented concurrently and on a consistent basis. It is disappointing that this has not happened so far, but the RBA has the opportunity to do so with EFTPOS, Visa Debit, and ATMs.

Small financial institutions and their members need certainty and consistency and for payments reform to be delivered equitably across all payments systems. This will ensure that no group of stakeholders is unfairly advantaged through delays in the regulatory process.

We believe designation of the EFTPOS payments system is in the public interest because a transparent, cost-based EFTPOS interchange fee standard will:

- reduce the overall cost of the payments system by reducing the cost to cardholders of using EFTPOS and encouraging greater use of EFTPOS; and
- increase competition in debit card issuing and acquiring by removing a barrier to entry (i.e. the need to negotiate an interchange fee).

We note that the RBA has carried out a round of consultations on designation of the EFTPOS system and held meetings with participants in the February 2004.

We are available to discuss this submission and EFTPOS reform generally at any time and would be happy to provide further information as requested by the RBA. In the meantime, if you have any questions regarding this submission, please do not hesitate to contact Luke Lawler (tel: 02-6232 6666) or myself (tel: 02-8299 9046).

Yours sincerely

**LOUISE PETSCHLER**  
Head of Public Affairs