



Submission to the Reserve Bank of Australia

Comment on Draft Standards for EFTPOS & Visa Debit

17 February 2006

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This document has been prepared with the assistance of
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1 Introduction

Following designation of the Visa Debit system (February 2004) and the EFTPOS system (September 2004), the Reserve Bank of Australia (RBA) published a consultation document on the reform of both the EFTPOS and Visa Debit systems in February 2005. This document included draft Standards for:

- EFTPOS interchange,
- Visa Debit interchange, and
- Visa's Honour All Cards Rule

A second consultation document was released in December 2005 which contained further draft Standards for:

- an EFTPOS access regime, and
- an updated Draft Standard for EFTPOS interchange.

The Australian Merchant Payments Forum (AMPF) generally supports the reform of the card payment system and has participated actively in this process. We appreciate the opportunity to offer comment on the Draft Standards and would welcome the opportunity to discuss these views with the RBA in more depth.

As requested in the December 2005 Consultation document, the AMPF is commenting not only on the proposed reforms in that document, but also on the Draft Standards in the previous consultation document of February 2005, where relevant.

2 General Comments

Before commenting on specific Draft Standards, the AMPF would like to make some general remarks.

2.1 Public Detriment

The AMPF remains of the view, as we argued in our court case, that there are serious concerns regarding public detriment with the proposed EFTPOS Interchange standard. There is no evidence of market failure or clear public benefit to support market intervention in the first instance.

Reducing the EFTPOS interchange fee will not reduce costs; it will simply transfer costs away from issuing banks and impose those costs on merchants and ultimately to consumers in the form of a general increase in the price for goods and services.

The proposal would see more cross-subsidised transactions, paid for through a general rise in the price of goods and services which is counter to the RBA's goal of 'transparency' of prices for payment services.

The AMPF believes that lowering the EFTPOS interchange fee will do little to promote the use of debit cards in preference to credit cards by consumers. In fact we are currently seeing a move from credit to American Express and Diners Club. The growth in popularity and use of these cards continues without any regulatory response, and banks will continue to promote credit cards as they still receive a significant level of subsidy through the RBA regulated credit card interchange.

2.2 Terminology

Self Acquirer

The term “self acquirer” should be substituted for “merchant principal” in all Draft Standards where it appears, to be consistent with terminology in the APCA access code for EFTPOS and the CECS regulations.

Debit Systems

For the sake of clarity it is recommended that “Scheme debit” and “EFTPOS debit” be adopted in the Draft Standards to avoid any possible confusion over the term “debit card” which currently covers either, depending upon which Standard is being referred to.

2.3 Data on Debit Card Usage

The AMPF continues to support the RBA’s moves to provide more comprehensive data on the Australian card market to aid in sounder analysis. While significant progress has been made, there are still areas where there is room for improvement, such as the lack of any separate data on Scheme debit cards.

The RBA should collect and publish data separately for Scheme debit and EFTPOS debit to allow better informed decisions by all parties. This is in line with the RBA’s desire for increased transparency in the payments system.

The AMPF provided detailed input on reporting and data in its submission to the RBA in April 2005.¹ The AMPF believes that public access to the type of data detailed in that submission would be of substantial value in any discussions on the future of payment systems in Australia.

2.4 Timing

The RBA has stated in its February 2005 consultation document that it “*intends to review interchange fees in all card payment systems*” in 2007.

The AMPF agrees with the RBA’s desire to consider a more integrated view of the effect of interchange across the various payment systems. Accordingly, the AMPF believes it would make more sense to leave any changes in interchange rates for Visa Debit and EFTPOS until that time.

Following the changes to credit card interchange fees, there has been an increase in EFTPOS usage, as desired by the RBA. The RBA has consistently argued that the difference between credit card and EFTPOS interchange fees has sent the wrong price signals to cardholders. **The AMPF believes that credit card interchange fees are still the major problem and believes reviewing the various interchange rates together, rather than in isolation, is very sensible.**

¹ Submission to RBA re Credit Card Interchange and Other Issues, AMPF, 8 April 2005.

2.5 ATM Interchange

The AMPF believes there is a major inconsistency in the current Standard as it relates to cash out transactions. EFTPOS is a major cash access channel for consumers as it is very cost effective, reliable and secure. The main alternative for accessing cash electronically is utilising ATMs.

Under the RBA's proposal, EFTPOS network owners' ability to negotiate interchange fees for EFTPOS cash withdrawal transactions will be significantly restricted, but as a consequence of the RBA's decision not to regulate ATM interchange fees, ATM network owners will continue to be free to negotiate interchange fees for cash withdrawal transaction at an ATM.

This is a significant distortion in the reform agenda. Owners of EFTPOS networks invest in establishing the technology and its maintenance just as owners of ATM networks do, yet EFTPOS network owners are facing commercial restrictions unlike ATM network owners who are free to establish their commercial arrangements as they see fit. This is discriminatory.

In our view, now more than ever, ATM providers need to be subject to more competitive pressures to reduce fees faced by consumers. EFTPOS cash withdrawal services should be allowed to compete unrestricted with ATM cash withdrawal services, particularly in light of recent increases in fees to consumers for "foreign ATM" transactions.

Therefore cash out transactions using the EFTPOS must be carved out of the proposed Standard, to allow competition and avoid discrimination between access channels.

3 Draft Standards

3.1 EFTPOS Interchange

3.1.1 Processing Costs

In the Draft Standard for The Setting of Interchange Fees in the EFTPOS System² the definition of "eligible costs" is given as follows:

"Eligible costs are those directly related to processing and switching EFTPOS transactions incurred by an acquirer or merchant principal when performing the business responsibilities usually undertaken by an acquirer."

On 14 December 2005 the RBA sent to the AMPF a copy of the *Cost and Revenue Survey – Debit Cards* which had earlier been sent to the Australian banks and Coles Myer. This document was supplied to the AMPF to allow merchants to submit their own cost data using the same template and categories previously used by the banks.

This document has a category called *Transaction Capture* which, according to the RBA definition, contains all the costs relating to card terminals, PIN pads and on-line, real-time communications networks. The RBA then has a separate category called *Processing and Switching Costs* which contains only those costs incurred after the transaction has been received from the merchant by the acquirer or switch.

² *Reform of Debit Card Systems in Australia: A Consultation Document*, Reserve Bank of Australia, December 2005, p 19 (hereafter *Reform of Debit Card Systems*)

If these same definitions were to be applied for the purpose of the “eligible costs” for “processing and switching EFTPOS transactions” contained in the Draft Standard quoted above, then all the merchants’ and acquirers’ transaction processing costs would be excluded from the “eligible costs” for the purpose of calculating the new interchange fee benchmark.

The card terminal is a key component of processing an EFTPOS transaction, including the encryption of the cardholder’s PIN, assembling the financial transaction request message to be sent to the acquirer and generating the Message Authentication Code. The communications network used to transmit and receive these messages between the merchant and the acquirer is also an integral and essential part of processing an EFTPOS transaction. **The cost of the card terminal and the cost of the communications are direct costs incurred in processing EFTPOS transactions and must be included in the scope of “eligible costs”.**

Around half of all EFTPOS transactions are processed through secure card terminals owned and maintained by merchants. These same merchants also provide and pay for the communications networks which are required to deliver these transactions to acquirers. If these merchants did not supply and pay for this “processing” infrastructure, the acquirers would have to provide it themselves.

If the RBA decides not to survey merchants for the purposes of establishing the interchange benchmark then there are a couple of approaches that could be adopted that would establish a closer proxy for the average cost of all transactions. Otherwise the considerable costs incurred by merchants will not be reflected in the new EFTPOS interchange fee benchmark.

The EFTPOS transactions received by an acquirer from merchant-owned infrastructure, should be subtracted from “the aggregate number of transactions” to be employed as the divisor when the RBA calculates the EFTPOS interchange fee benchmark. Alternatively a less effective approach would be to include the fees that are paid to merchants in recognition of their investment, and the fact that the acquirer receives these transactions at almost zero cost, as an eligible cost rather than a “negative revenue”. Fees paid to an outsourced switching supplier for example are included as a cost and the principle is exactly the same.

3.1.2 Bilateral Fees

The existence of bilateral interchange fees has been a distinguishing feature of the Australian EFTPOS PIN debit system since its inception. At present, there are a range of fees operating in the market between 18 cents and circa 35 cents per transaction. It is generally considered that bilateral fees are more open to competition and market forces than a centrally determined multilateral fee. Indeed, the Australian bilateral EFTPOS interchange fees have, on average, declined by 50% in real terms over the last 20 years³.

The AMPF continues to support the existing bilateral interchange fee arrangements and does not believe there is a need for an EFTPOS interchange standard. However, the following comments are made based on the assumption that the RBA will proceed with the introduction of a benchmark interchange fee for EFTPOS.

³ *Expert Witness Statement*, Charles John Gove, Australian Competition Tribunal, March 2004, para.115.

The Draft Standard proposes to restrict the bilateral fees to a narrow band between the benchmark calculated by the RBA, and 80% of this benchmark. The RBA has suggested that it believes the new benchmark will be in the order of 5 cents per transaction based upon the cost data already in its possession. If this is correct in practice, then the negotiation of bilateral fees will be allowed to result in a figure anywhere between 4 cents and 5 cents per transaction.

In this situation, the ability of a bilateral fee structure to react in any way to prevailing competitive or market forces (such as changes to technology platforms, security issues etc), is reduced almost to zero.

If this is to be the effective outcome of the Draft Standard, then why not simply impose the new benchmark interchange fee as a new multilateral EFTPOS interchange fee and remove the requirement for bilateral fee negotiation completely?

A further concern with the Draft Standard is that the weaker party to any interchange negotiation is still able to be 20% worse off than the stronger party. A single benchmark would eliminate this problem.

3.2 Visa Debit Interchange

The Draft Standard, as attached to the February 2005 Consultation Document should be amended to cover all "Scheme" debit cards. Now MasterCard Debit cards are being issued for domestic Australian use, these cards should be specifically covered in the Standard.

3.2.1 Interchange Categories

The AMPF supports the concept that separate interchange categories be allowed, as with credit cards, as long as the weighted average meets the benchmark. Importantly, this would allow separate rates for POS (card present) transactions and Internet or MOTO (card not present) transactions which have significantly different fraud levels and cost structures. The Card Schemes should be encouraged to keep this structure when the new interchange benchmark is introduced (both Visa and MasterCard currently have separate rates for card present and card not present transactions under the current credit card interchange structure). This would also allow a lower rate for small value transactions if desired.

3.2.2 PIN Processing

Currently Visa Debit cards can be processed via the EFTPOS system with a PIN. This option must continue to be allowed until Visa can provide PIN authorisation for its debit cards at the POS. Otherwise merchants potentially face increased fraud, increased chargebacks and longer processing times due to signature verification. It is important that the security of Australia's debit system is not lessened by increased use of signatures; PIN authorisation is significantly more secure than signature authorisation.

3.2.3 Scheme Fees

Consideration should be given to the impact of "Scheme fees". This issue has been raised by the AMPF previously⁴ and applies to credit cards as well as Scheme debit cards. Both

⁴ *Submission to RBA re Credit Card Interchange and Other Issues, AMPF, 8 April 2005.*

Visa and MasterCard charge a range of fees to issuers and acquirers and these fees are not subject to any Standards mandated by the RBA. Last year, Visa increased fees to acquirers, but not issuers, by a significant amount. These Scheme fees can be used to take funds from acquirers and pass them to issuers in a manner that effectively bypasses the RBA reforms to interchange through substituting an alternative mechanism to achieve the same objective.

Further, these Scheme fees are secret and under Scheme rules are not allowed to be divulged to merchants or the public, unlike interchange fees. This is against the spirit of the RBA's reforms in that there is no transparency and merchants are unable to gain insight into this important cost component of their Merchant Service Fee.

It is vital that these Scheme fees are not allowed to be included as a component of the eligible costs related to processing and authorisation, otherwise any increases in these fees would be directly reflected in an increased interchange fee.

3.2.4 Cost To Merchants

The AMPF would like to comment on the impact of the Draft Standards on merchant costs.

The overall cost of all debit transactions (Visa + EFTPOS) will increase for merchants if the Draft Standards result in the price levels anticipated by the RBA.

Based on an average ticket of \$80 for Visa Debit and \$60 for EFTPOS⁵, and the RBA's statement that spend on EFTPOS is 6 times higher than for Visa Debit, there would be 8 EFTPOS transactions for every Visa Debit transaction at present. Over these 9 transactions, the merchant saves \$0.25 on Visa Debit and loses \$1.20 (\$0.15 per transaction) on the 8 EFTPOS transactions. This means the merchant is \$0.95 worse off across the 9 transactions, which equates to \$0.105 per transaction worse off. This cost will be passed on to ALL customers resulting in higher overall retail prices for consumers.

For transactions under \$25, merchant costs will actually increase for Visa Debit under the proposed Standards compared to the current interchange rate. For example, for a \$15 purchase under the existing Visa Debit structure, the interchange fee would be \$0.07 whereas under the proposed standard, according to the RBA's estimate, the interchange fee would be \$0.15, which is more than double the current amount. For those merchants with low average value transactions, this represents a significant increase in costs.

Further, the AMPF does not agree with the RBA's assertion that there will be a substantial movement from credit cards to EFTPOS as we do not believe these are significantly substitutable products.

3.3 Honour All Cards Rule

The AMPF supports and agrees with the RBA's position on the Honour All Cards Rule, particularly with respect to the "honour all issuers" compared to the "honour all products" aspect. However, we do not believe the arguments and philosophy outlined in the Consultation Document are fully reflected in the Draft Standard.

⁵ There is no published data on actual figures for Visa Debit compared to EFTPOS, so these are assumptions based on the limited data available.

The AMPF believes that the Draft Standard should not be restricted to Visa Debit and the Visa credit systems, but should apply to all card payment schemes, including MasterCard and American Express. For example, merchants cannot currently accept the American Express charge card unless they also accept the credit card, which is always priced at the same merchant fee.

Similarly, in line with the RBA's philosophy on the honour all products element of the rule, Card Schemes should not be allowed to introduce completely new products at whatever rate they choose and the merchant then be forced to accept this card. For example, both Visa and MasterCard have introduced Fleet cards into the US market and these have very high interchange rates (the interchange fee for MasterCard Fleet card in the USA is up to 2.7% +\$.10 per transaction). Even though the weighted average interchange fees are not allowed to exceed the benchmark across the whole market, new cards with high interchange rates could have a large detriment on particular merchants and merchant categories.

While the Draft Standard states that Visa Debit cards must be identifiable as such, both visually and electronically, it does not specify that the electronic identification data must be made available to merchants. It is essential that merchants can distinguish between Visa Debit and credit, and other card types as appropriate, electronically and such data must be supplied to merchants on request.

Similarly, separate reporting should be provided on each card product at the merchant's request. Currently merchants are not provided with any reporting which separately details Visa Debit and credit cards.

The AMPF believes the Standard relating to the Honour All Cards Rule should be introduced immediately. This Standard is not linked to or dependant on any changes in interchange for Visa Debit. It is now 2 years since Visa Debit was designated, and there is no reason why merchants should continue to be forced to accept the more expensive, less secure Scheme debit cards if they do not wish to do so.

3.4 EFTPOS Access Regime

3.4.1 Single Point of Access

The EFTPOS Access Code produced by APCA, and complemented by the RBA's Draft Access Regime⁶, represents a good step in the right direction, but there remains a distance to go in the future to further streamline the access process and minimise cost to new entrants.

The long term objective should be for a single point of access, both technically and contractually, with a single Access Charge paid for connection to the EFTPOS network. A Direct Connector should be able, in the future, to switch transactions to any other acquirer or issuer without requiring separate technical links and separate charges for each one.

Once the new EFTPOS interchange message format, now mandated by APCA for all new interchange links, has been implemented by all "members" of the EFTPOS system, then the way will be open for implementation of a secure distributed processing network similar to the Canadian Interac system. In this future model, a new entrant to the EFTPOS system would be able to implement the standard interchange message set once, test and connect to the

⁶ *Reform of Debit Card Systems*, Reserve Bank, December 2005, p 13

network once, sign a single network contract and then process transactions to any other Direct Connector after payment of a single Access Charge.

Not only will this reduce the time and cost overheads for new entrants, but it will also lessen the time and cost for all members as well.

It is clearly not sensible to expect new entrants to have to pay a fee of \$78,000 for connection to each other Direct Connector. As the number of Direct Connectors increases over time, new entrants could find themselves paying out around \$1 million in addition to their own internal costs, simply to participate on equal terms with existing “members”. Unless the \$78,000 charge falls to very low levels, the current approach will be less and less workable as the number of Direct Connectors increases.

A single point of access will also remove the need for a rule requiring a minimum number of connections to be established within a specified time period.

3.4.2 Access Charge

The proposed initial Access Charge of \$78,000 per direct connection is based upon a survey of members taken by APCA in 2004. This survey has not been seen by any parties other than the RBA, APCA and CECS members. The principle of transparency in relation to costs is an important one, and should apply equally to this Access Charge and the way in which it is determined. The results of this survey should be placed in the public domain. To provide confidentiality for those participating in the survey, the APCA members should remain anonymous.

Direct Connectors which have systems which generate high internal costs when implementing a connection to a new entrant should be encouraged to make their systems and processes more efficient.

The incremental costs allowed for recovery, and reported by CECS members in the 2004 survey, should not have included any costs associated with the development, and first-time implementation, of the new standard EFTPOS interchange message format. Only the direct costs of connection and testing should be allowed. The interchange system of the new entrant is to be certified before any testing takes place, and this should minimise the amount of time required to complete the testing process. The time to connect to the second and subsequent interchange partners should be much quicker for the new entrant, given that the interchange message set will be identical in each case.

It is therefore anticipated that the actual cost incurred by each Direct Connector should reduce over time as the new standard process is bedded down and better understood by existing “members”. It is unfortunate that early new entrants are likely to face higher costs of entry than those that follow.

The process of arriving at a revised Access Charge, over time, should never be permitted to result in the Access Charge being increased. Only a lower Access Charge should replace the current charge. If a higher cost is revealed by the re-calculation process, then the Access Charge should remain unchanged.

3.4.3 Fees

The annual fees (and any other fees) to be paid by Direct Connectors have not been quantified in the draft Access Code. These fees must be finalised and published for transparency and to allow potential new entrants to budget for these in their business plan.

The amount and nature of any fees to be paid should not be discriminatory against new entrants and should not be sufficiently high to become a potential new barrier to entry.