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Ms Michele Bullock  
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Reserve Bank of Australia  
GPO Box 3947  
Sydney NSW 2001

Your ref: Media Release No. 2008-05 dated 21/4/2008

Dear Michele

**Submission to the RBA on the Preliminary Conclusions of the 2007/08 Review**

We refer to your above media release and the invitation to comment on the Bank's preliminary conclusions to the 2007/08 Review.

Overall, we believe that the process of reform has generally driven change that is in the structural long term interest of our industry. A notable example of this is the work undertaken to improve access to the payment system which we believe will foster a more competitive environment and allow for more product and technical innovations to be brought to market.

We agree that while much has been achieved through regulatory intervention, the process of reform is ongoing and welcome the Board's willingness to consider industry self regulation as a real alternative in the future.

Turning our attention specifically to the Board's conclusions as set out in your publication (Section 7, page 38-41, Reform of Australia's Payment System, April 2008), we offer the following specific comments on the following important areas:

- 'Honour all Cards' rule
- Access Regime
- Creating an EFTPoS Scheme
- Interchange Fees

**'Honour all Cards' Rule**

In broad terms we believe that the removal of the "honour all cards" rule is not an unreasonable outcome, particularly were we to move to a non-regulated interchange environment. We accept that schemes have the right to differentiate their products in part by using different interchange rates. Similarly the merchant should equally have the right to either accept or reject a product based on the different cost structure that underpins it.

This said, acceptance is of paramount importance in order to maintain integrity with the consumer and as such, product acceptance choices must be consistently upheld by merchants, particularly the larger merchants. In this regards, for the sake of clarity we restate the importance of preserving the aspect of the 'honour all cards' rule which relates to acceptance of all issuers. This was discussed in the Bank's publication titled Reforms of Australia's Payment System – Issues for the 2007/08 Review (May 2007), page 9-10, paragraph 45.

We note that in section 5.3.3 of the Bank's Preliminary Conclusions of the 2007/08 Review (April 2008) document that specific reference is made to the acceptance of pre-paid products in the context of the 'honour all cards' rule, in particular; *"The forced acceptance of the pre-paid card is inconsistent with the general approach that the Board has taken. It has the potential to make it more difficult for other, non-scheme pre-paid cards to compete ... Given the potential for pre-paid cards to become a significant part of the payments system in the future, the Board sees a strong case for merchants being allowed to make independent acceptance decisions about this form of card."* (page 27).

We agree with the Board's conclusion that prepaid cards have the potential to become a significant part of the payment system. However, it is important to also recognise that prepaid cards exist today in both scheme and non-scheme variants. These products collectively have common product structures which make them reasonable substitutes of each other, at least in the domestic payment system. That is, both require an account to be established and this account to be intrinsically linked to the card. It would be difficult to separate the account from the pre-paid card in much the same way as it is difficult to see a credit card separately to the account that supports it. This is quite different to the scheme debit product where the account and the access mechanism, namely the card, are quite separate with the account able to exist without the card.

Given the similarities of both variants of the products, there is inconsistency in how acceptance rules are applied to each. On the one hand the Board is concerned that scheme pre-paid may make it difficult for non-scheme pre-paid cards to compete. Yet on the other hand it allows merchants to reject scheme pre-paid products making it hard for them to compete against non-scheme variants. We believe this places merchants, who act as both issuers and acquires of pre-paid products, in a stronger position than institutions who are just issuers. This gives merchants a significant competitive advantage.

We do not believe this is a sustainable position that is in the public interest nor will it promote efficiency in the payments system. We believe that there must be a consistent application of acceptance rules for products that are substitutes of each other. While it is reasonable for a merchant to reserve the right to reject a product once they have made their product acceptance decision, that decision must then be consistently applied across all issuers. In this case, if a merchant chooses to reject pre-paid products as a category, then they must reject all pre-paid products (both scheme and non-scheme) including their own products.

## **Access Regime**

In broad terms we agree with the Board that access to the payment system has been enhanced because of the work undertaken through the reform process. Equally so, we agree that more is required particularly in the EFTPoS system where the current bilateral links make it unnecessarily difficult for access seekers.

One area where we are disappointed that the Board has not been more direct in bringing this into line with the Access Standard covering direct connection, is that concerning the establishment of direct clearing and settling arrangements. This is an important issue that at present does not enjoy the same level of certainty with respect to costs and timing as that of establishing a direct connection.

Over the period of the reform process we have been endeavoring to establish direct clearing and settling arrangements with three parties. Over this time the cost and level of co-operation has improved largely, we believe, because the reform process made regulation a more tangible outcome. While we have benefited from this impending threat, the potential remains for future access seekers to be frustrated by the uncertainty inherent in the process for the establishment of direct clearing and settling arrangements.

In this regard while we acknowledge the Board's desire to have the industry take a more constructively active part in future reforms, the success of this will largely depend on whether or not an effective governance structure exists. During the reforms process to date, the Bank has played the role of governance and for this reason progress has been made. At this stage the governance structure for future change is not entirely clear. Until such time as we have an effective governance structure where none of the larger banks have dominance either individually or collectively as a group, we will be concerned with the level of uncertainty that exists with respect to gaining access to the EFTPoS system, particularly with respect to direct clearing and settling.

## **Creating an EFTPoS Scheme**

We believe APCA is showing leadership in fostering ideas and concepts which they believe will improve the governance of Australia's payment card system. Generally we support APCA in this work and will work with them on this important issue. At this stage we have not yet completed our assessment of their whitepaper (and on which comment is not due until October 2008) and hence, will not make reference to their paper.

Generally the creation of an EFTPoS Scheme to govern the EFTPoS payment system is sensible. The current governance structure, which is characterised by a series of bilateral arrangements between institutions, makes it a difficult system to gain access to and problematic to work within. The reason for this being that any resultant change required to support a new innovation must be accepted by each participant individually rather than collectively as a group. Clearly this is highly ineffective and unsustainable.

In contrast a centrally administered scheme would be more effective in facilitating change and access. However, bureaucracy can exist within a scheme just as well as it does in the present bilateral system. If we are to move

away from the present bilateral system, then it is paramount that the move occurs out of a desire to improve fundamentally the governance of the system so that it operates on the premise of what is good for the system as a whole, rather than on what is preferred or good for a small number of participants.

We believe that improving the EFTPoS system is less about the type of structure we move to and more about the effectiveness of the governance structure or system. In practical terms effective governance is conducive to an environment that facilitates change and access. In such an environment, scale while considered, cannot alone be the sole determinate of whether or not change occurs or access is granted. In our market scale is significantly skewed to the 4 major banks whom represent collectively more than 65% of the system's throughput. While this presents challenges, we must nevertheless find a way to acknowledge the significant scale of the 4 majors but still be able to act in the best interest of the system as a whole.

To this end we believe that we can learn some lessons from the reform process to date in terms of what has helped drive change. Thus far the reform process has been extensive and significant change has occurred. An important reason for this change has been the involvement of the Bank in administering the change agenda. In this regard its success has been due in part to two attributes, namely its formal authority and its independence to system participants. This independence has enabled it to act for what it believes to have been in the public interest and in creating a more competitive and efficient system.

Our challenge is to replicate these attributes in an environment where clearly formal authority is unlikely to be as strong as that that exists for the Bank. Notwithstanding this, it is important that the governance body have some formal authority to give it some substance in times of difficult decisions. Secondly, while the temptation is to have representatives at the governance level from the industry, we will struggle if the composition of the governance body is dominated by either the 4 majors because voting rights are assigned on the basis of volume, or if assigned on the basis of one member one vote. In the case of the latter, this would unfairly shift the power base to the smaller members which would be equally problematic particularly for the 4 majors. For this reason, we believe that while all participants need to be represented, the governance structure must be made up of a majority of individuals who understand the payment system and importantly are independent to all system participants.

Unless we are confident that an independent structure can be achieved, best intentions will fail to create an effective governance structure that will facilitate access, change and the general evolution of the system beyond what we have today.

### **Interchange Fees**

We would support the removal of explicit interchange regulations as currently characterized by the various payment systems. Essentially we believe that a mature market ought to be able to effectively self regulate.

The Board has outlined in detail its expectations of the ongoing reforms it expects, a general statement of belief of acceptable movements in interchange fees and the consequences of what will happen should system participants fail

to act appropriately in satisfying its expectations. Clearly like other market participants, we would not like to see the Board act on its threat.

To achieve the type of changes outlined in the Board's conclusions, we must develop an effective governance structure at multiple levels. At the EFTPoS level, we have APCA leading this work and the industry at large engaged. We appreciate APCA's commitment to this task and believe that it is possible to develop an effective governance structure that will deliver on the Board's requirements for the development of an effective EFPoS system. Equally so we believe that interchange fees can be maintained at levels that will not disadvantage one system against the other. Our only concern in this regards is time, specifically the time that may need to be expended in reconciling all the many participates engaged in this system.

With regards to scheme systems, given that both schemes are now public companies, with their demutualisation its members no longer have a significant say in their operations. We are somewhat at the mercy of the integrity of each scheme in acting in the best interest of the issuing institutions in this country in contrast to global strategy and rule mandates. This may lead to conflict, with the schemes ultimately choosing, for reasons best known to them, to follow a global directive rather than acting in the Australian issuers best interest. While we trust that common sense will prevail in all circumstances, we believe the Board should not pass judgment of our progress and success unilaterally. Rather we trust the Board will look at each system individually and rule accordingly in August 2009 when next it makes its assessment.

We appreciate the opportunity to comment on the Board's preliminary conclusions. Should you require any further information or wish to discuss any comment made in this letter, please do not hesitate to contact me on (07) 3258 4250.

Yours faithfully



Manuel Garcia  
Chief Executive Officer