29 August 2025

Mr Ellis Connolly
Head of Payments Policy Department
Reserve Bank of Australia

Via email: pysubmissions@rba.gov.au

Dear Mr Connolly

Public consultation on the Reserve Bank of Australia's Review of Merchant Card Payment Costs and Surcharging consultation paper

COBA welcomes the opportunity to respond to the RBA's consultation on its review of merchant card payment costs and surcharging.

COBA is the industry association for Australia's customer-owned banks (mutual banks, credit unions and building societies). Collectively, our sector has over $185 billion in assets and is the fifth largest holder of household deposits. Our members range in size from less than $200 million in assets to around $25 billion in assets – all significantly smaller than our ASX-listed peers.

Key points

COBA does not support the RBA's proposal to lower the caps on interchange fees for domestic debit, credit and prepaid cards.

As it stands, this proposal will reshape the economics of the payments system further to the detriment of card issuers, particularly small issuers. Card issuers will bear the costs of the surcharging ban while other ecosystem participants will remain less affected.

Reducing interchange fees will disproportionately affect small issuers. This will adversely impact competition, innovation and consumer choice in banking and payments. This could lead to higher account fees, reduced fraud protections and weaker digital inclusion for customers.

Small issuers are already subject to loss-making card businesses and as well as a structural disadvantage due to a lack of a merchant acquiring business.

We expect small issuer card issuance costs to continue to exceed the new caps, with little or no ability for COBA members to recover these additional costs from other banking activities. This also does not account for the other related costs of offering the underlying products.

Key points

Exempting small issuers from the interchange fee reduction proposal would reduce the negative impact on small issuers such as customer-owned banks. Overseas experience would suggest that a small issuer exemption does not adversely affect the aim of reducing merchant card payment costs.

The RBA proposal to lower interchange fee caps for domestic debit, credit and prepaid cards will reshape the economics of the payments system, by further putting undue pressure on card issuers. The changes have the potential to making card issuing, and associated card payment services, a more unattractive commercial proposition. As Australian retail banks, debit and credit cards are a key part of the customer proposition, so customer-owned banks must absorb any decline in commercial proposition. It is therefore important to make sure that the costs and revenue sources for card issuers, particularly small issuers, stay fair and balanced. Any regulatory reforms must also consider the reliance of issuer-only institutions on aggregators, and the structural differences that limit our ability to offset revenue pressures.

Further reductions in interchange fees will detrimentally impact small issuers, including all customer-owned banks. The proposed changes will:

- disproportionately affect small issuers, which face a higher cost base for card issuance compared to large issuers – a point acknowledged in the RBA's consultation paper,[1]
- unnecessarily undermine the competitiveness of the customer-owned banking sector and other small issuers such as fintechs; and
- conflict directly with the Government's stated goal of strengthening competition in banking and supporting small and medium banks in Australia.

Under the proposal, card issuers primarily bear the costs of achieving the RBA's aim of eliminating card payment surcharges. This is despite card issuers playing a vital role in enabling consumer access to fast, low-cost card payment methods as well as broader financial inclusion. Little of this cost burden falls on others in the payments value chain such as card schemes, digital wallets and acquirers. Furthermore, the absence of regulatory constraints on payment providers outside the current regulatory perimeter (such as mobile wallet providers) further shifts the burden of this reform onto card issuers. Issuers will be competitively disadvantaged as a result.

COBA supports a competitive, efficient payments system that delivers value for merchants and consumers. But reform must be proportionate, targeted and consistent with broader public policy objectives. The proposal to further reduce interchange fees will continue to erode the economics of card issuance for small incumbent issuers and new entrants who provide valuable competition in the provision of payments and other financial services in the marketplace.

[1] Review of Merchant Card Payment Costs and Surcharging Consultation Paper – July 2025, p.34

Small card issuers face higher costs

The RBA's proposed interchange fee cap reduction is a measure that is deeply harmful to competition. It will reduce income for small card issuers, including customer-owned banks, who already face substantially higher issuance costs than large card issuers.

Customer-owned banks are particularly concerned about the reduction in debit card interchange fees, given debit cards form our members' primary card issuance business. Where COBA members offer credit cards, they typically focus on low-interest, low-fee products, which provides valuable access to credit for their customers. Interchange fee revenue is an essential source of cost recovery for these services.

For customer-owned banks, existing debit interchange fee revenue already falls short of their issuance costs. A reduction in these fees will exacerbate these losses which will impact on profitability and competitiveness. This shortfall is further exacerbated when it comes to strategic merchants who are subject to very low interchange fees as low as 1 cent per debit transaction, ten times lower than the RBA's own estimate of the cost to process a debit transaction for small issuers.

The RBA's Issuer Cost Study shows that small issuers face significantly higher costs compared to the industry average. This is primarily due to higher relative fixed costs spread over a smaller customer base and weaker bargaining power with key suppliers in the payments value chain. For scale comparisons, COBA's largest member has a 3.4% of the deposits of a major bank and 1.5% of the credit card balances.[2] The proposed reduction will see caps set below the *RBA's own estimate of the cost of issuance* for smaller financial institutions, particularly for debit cards. The RBA finds that non-major bank card issuers incur 10 cents of eligible costs per transaction which far exceeds the proposed 6 cent cap.[3] Customer-owned banks are at the smaller end of this group in terms of scale. This means they face even higher relative costs than outlined in the RBA study.

Furthermore, the estimate of issuer costs does not adequately account for rising future costs or broader costs beyond the RBA-defined 'eligible costs'. Increases in fraud claims (for example, from an increase in card not present transactions relative to in-person), additional regulatory requirements (for example, CPS 230 Operational Risk requirements for critical operations) and ongoing investment needs in payment product innovation to remain competitive in the banking market will occur at the same time that the RBA is reducing the revenue issuers can receive to partially offset these costs. Banks also face heightened costs in the provision of their underlying transactional banking products from other regulatory interventions, including growing Consumer Data Right requirements, increased scams protections, or increasing public pressure to provide low or no fee accounts. Further adding to the cost base are expectations for small issuers to provide dual network debit cards as they reach the relevant threshold.

For small issuers, the level of interchange fee revenue is highly dependent on their customer base and how the use their debit and/or credit cards. This means averages can skew the impacts on individual institutions. Issuers with a customer base concentrated in certain geographical areas or representing a narrow demographic or occupational segment of the population may already face different issuance costs and be receiving differing levels of interchange fees compared to the industry average. A

[2] See APRA Monthly ADI Statistics August 2025

[3] Table 3, Review of Merchant Card Payment Costs and Surcharging Consultation Paper – July 2025, p.34

reduction in interchange fee revenue could impact these institutions to a greater degree, if their interchange fee revenue is skewed more heavily to higher interchange fee category merchants.

Large card issuers are less likely to be impacted by this proposal due to their lower existing issuance costs[4], a larger customer base over which to spread their fixed costs and are also able to rebalance issuer fee losses against their merchant acquiring business, which is not significantly affected by the RBA's proposals. Customer-owned banks do not offer acquiring services and are primarily focused on issuing debit cards to retail customers, and as a result, have no such ability to cross-subsidise, meaning interchange fee reductions directly erode their capacity to recover costs.

Eroding the competitiveness of small card issuers

Transaction accounts with linked debit cards are a core non-negotiable banking offering for ADIs in Australia. Credit cards are also an important offering for customers who want to keep all their banking services with one provider. Lower interchange fee revenue will make it more costly for COBA members to offer these services, with very limited levers to offset the revenue loss.

In response to the proposed changes, customer-owned banks could:

- increase fees for retail transaction account products,
- increase fees and interest rates and/or reduce benefits for credit card account products,
- reduce the card-related services on their products to reduce costs, and/or
- absorb the costs, which would reduce profitability which impacts on internal capital generation[5] and therefore future growth and sustainability.

Any of these responses would significantly impact customer-owned banks' competitiveness in the retail banking landscape – as larger competitors will be better able to absorb these higher costs or cross-subsidise from other aspects of their business such as merchant acquiring.

Instead of levelling the playing field, the proposal risks widening the competitive gap between major banks and small ADIs.

This anti-competitive proposal directly undermines the Government's stated objective of supporting the growth and competitiveness of small banks, as set out in the Council of Financial Regulators' (CFR) recently released review into small and medium banks.[6] The RBA is a member of the CFR.

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[4] Table 2, Review of Merchant Card Payment Costs and Surcharging Consultation Paper – July 2025, p.31

[5] To provide loans, banks must hold regulatory capital for credit risk losses under APRA's prudential framework. As customer-owned institutions, our sector relies upon retained earnings to generate this capital.

[6] See: https://www.cfr.gov.au/publications/consultations/2025/review-into-small-and-medium-sized-banks/

That review outlines observations and recommendations aimed at reducing the regulatory burden on smaller and medium-sized banks and includes Recommendation 3 that states:

> *"The Government and regulators should seek to give due consideration to how future policy changes will affect smaller banks relative to their larger peers, including the impacts of different implementation approaches. This should include consideration of different options for staging commencements, having regard to organisational size and capabilities."*

Card issuers bear a disproportionate share of the cost burden

The burden of the RBA's plan to reduce merchant card payment costs primarily and disproportionately falls on card issuers and adds to the ever-increasing regulatory burden on Australian banks.

This occurs while many high-cost participants in the payments system (such as Apple through the provision of Apple Pay, or the providers of Buy Now Pay Later services) are unregulated, hold significant market power and would remain unaffected by this proposal, distorting competition. We recognise that legislation to expand the regulatory perimeter remains before the Parliament, after significant delays in securing its passage over preceding years.

We urge the RBA to bring such participants within the regulatory perimeter as a matter of urgency if the objective is to achieve a genuinely level and efficient payments landscape. Given card issuers are subject to significant restraints on their revenue, more transparency on others in the payments value chain and broader payments system would be welcome.

Small card issuers should be exempt from interchange reductions

We believe that the most effective path forward if the RBA bans surcharging is for a targeted exemption for small issuers from the proposal to reduce interchange fees. This would see small issuers[7] retain the existing interchange fee caps. We are happy to work with the RBA on the design and scope of this exemption.

This targeted tiered approach would preserve small issuer competitiveness at minimal cost to the broader market. The RBA can still achieve its broader objective of lowering overall merchant costs given the limited market share of small issuers – the CFR Review found that the smallest 74 banks, most of which are customer-owned institutions, account for only 6% of the banking system[8] – and it would avoid further concentration of retail customer market share in the hands of the major banks. This approach would recognise that small issuers face structural disadvantages but play an important role in providing competition, innovation and choice for Australians.

Reforms to debit card interchange fees in the United States included an exemption for small card issuers with assets under US$10 billion from reduced interchange fee caps on debit cards.[9] This exemption has maintained the competitive position of credit unions and community banks in the US, enhanced their attractiveness as partners for fintechs and payment innovators, and maintained competition in the US retail banking market without undermining the objective of lowering merchant costs.

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[7] For example, those with less than 1,000,000 debit cards issued

[8] See: https://www.cfr.gov.au/publications/consultations/2024/review-into-small-and-medium-sized-banks/review-into-small-and-medium-sized-banks.html

[9] See https://www.federalreserve.gov/paymentsystems/regii-interchange-fee-standards.htm

We expect that similar reforms to support small issuers in Australia would also benefit competition in the market without materially increasing merchant costs.

Recommendation 1

The RBA adopt a small issuer exemption in Australia to, at minimum, maintain the current interchange arrangements for these issuers for all card types. This exemption would support competition and innovation from small issuers and fintechs.

Thank you for taking the time to consider our submission. If you wish to discuss any aspect of this submission, please contact Alexander Woloszyn, Policy Manager (awoloszyn@coba.asn.au).

Yours sincerely

MICHAEL LAWRENCE
Chief Executive Officer