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30 June 2008

Mrs Michele Bullock  
Head of Payments Policy  
Reserve Bank of Australia  
65 Martin Place  
Sydney NSW 2000

Dear Mrs Bullock

**Re: Reserve Bank of Australia's (RBA) preliminary conclusions of the  
2007/08 Review**

ANZ welcomes the opportunity to provide comment on the Payment Systems Board's preliminary conclusions of the 2007/08 payments system review. We note the Board's preference for Option 3 in which the RBA would step back from interchange regulation and the industry would adopt a range of measures to address issues of competition, efficiency and transparency.

Those changes, as set out in Option 3, are:

- Changes in the EFTPOS system to allow it to compete more effectively with the other card schemes, including:
  - Introduction of a scheme to replace the existing bilateral contracts
  - Creation of arrangements to promote the development of the system
  - Reform of access arrangements
  - Development of alternative payment instruments for use in on-line payments
- A further watering down of the honour-all-cards rule such that merchants could make acceptance decisions about each type of card for which a separate interchange fee applies
- Schemes agreeing to publish their average interchange fees and scheme fees

We discuss these measures below.

Scheme fees

ANZ supports the publication of the average interchange fees and scheme fees, however this is a decision for the Schemes.

## EFTPOS

The banks, through APCA, are developing an EFTPOS scheme. ANZ is keen to see the development of a structure that gives EFTPOS the best prospects of long-term competitive success.

ANZ supports proceeding with implementation including a proper assessment of the functionality customers would value, including on-line functionality. Ultimately, it is customers who decide which card to use based on their preference, value proposition of the functionality offered and prices. It is these factors that will drive the development of a commercially viable scheme and customer usage.

ANZ supports APCA, on behalf of the interested parties industry group, engaging in a continuing dialogue with RBA on the timetable and development of the Scheme.

## Industry trends – online payments

It is important that trends in alternative online payment instruments are considered in discussions about the development of an EFTPOS scheme and its functionality.

Although the number and value of online payments represents a small proportion of payments in total, there is already competition in this market. While credit cards are the preferred method for online payments, competition is provided by BPay, PayPal and direct deposit online. ANZ, for example, offers its customers a “Pay Anyone” facility that enables account holders to transfer funds between their ANZ accounts and anyone else with an Australian bank account.

ANZ is currently assessing the business case of a concept that would interconnect banks, organisations and consumers using new electronic addressing capability. The service would support a range of functionalities including invoicing/billing, overdue reminders, making payments, and exchanging non-value items between parties such as notification of payments made, documentation and other information relating to payments made. The capabilities would be available for consumer to business, business to consumer, consumer to consumer and business to business payments.

Should one or more major payment services providers choose to participate then the scheme would further increase competition between payments methods. It is an example of market driven demand for a commercially viable payments system. In ANZ’s view, where there is a viable business case to meet demand for new forms of payments services, the market for payments systems is sufficiently competitive to ensure market access.

## Surcharging

Merchant ability to surcharge and improved relative price signals to customers for the competing payment methods has led to a stronger competitive market for payment methods.

The RBA's preliminary findings cite evidence of stronger competition such as increased surcharging, declining merchant service fees and successful competitive bargaining on interchange fees by large merchants. Surcharging will, we expect, become more widespread over time and this will exert further downward pressure on interchange fees.

### Blended interchange rates

It has been noted that blended interchange rates potentially blunt the price signals to merchants about their costs of accepting various cards and the basis for differential surcharging is therefore not clear.

From ANZ's perspective, the important outcome from the reforms to date is that merchants (i) have the choice of a blended rate or 'interchange plus' rate based on their commercial situation, (ii) can choose to surcharge already to reflect the costs of acceptance of electronic payment systems, and (iii) in the future, will be able to undertake differential surcharging, where that makes commercial sense for the merchant, as technological solutions have been developed to enable card readers to differentially surcharge i.e. by imposing higher surcharges on cards that have higher interchange fees.

The majority of ANZ's acquiring customers are on blended interchange rates. ANZ prices these blended rates individually for each merchant based on their card acceptance pattern. Our small business customers advise that this approach enables them to calculate their business costs with some certainty as opposed to an 'interchange plus' arrangement whereby they would be charged a margin above the scheme interchange rates per transaction based on the card used. The value proposition to smaller merchants is simplicity in acceptance and certainty around their costs. Differential surcharging would increase staff training costs for small businesses, while differential acceptance would potentially result in a poor customer experience and lost sales when cards were declined on the basis of their interchange rate.

Our experience, to date, suggests that (i) smaller merchants generally will not choose to differentially surcharge as they value the certainty in calculating their business costs provided by the blended rate and (ii) will be cautious about adopting differential acceptance due to poor customer experience at the point of sale. However, merchants already have the ability to surcharge and should they wish to do so, differential surcharging will be possible in future. Merchant decisions on these issues will ultimately be driven by their commercial preferences.

### Honour all cards

ANZ does not support the further watering down of honour all cards (HAC) and we do not believe it is necessary because the other initiatives in Option 3, including surcharging, will create an environment that keeps interchange fees at reasonable levels.

A further watering down of HAC could have undesirable affects on both customers and merchants. For customers it would increase complexity and information search costs as consumers establish which merchants accept which cards, even within their brand.

It would also remove the fundamental value proposition of scheme card products of universal worldwide acceptance. The 'honour all cards' rule is key to ANZ's branding of convenience - no matter where they are in Australia or the world, customers need to know they can use their card wherever their card's brand is accepted. To our knowledge, the RBA proposal would be unique compared to other jurisdictions, such as the EU, where interchange reform has been pursued.

For merchants, differential acceptance may be unattractive due to the complex assessments that would need to be made about non-acceptance of certain cards, the risk of alienating and/or losing customers.

The policy objective of reasonable interchange rates can be delivered by other measures within Option 3 including surcharging, publishing interchange and scheme fees, access regimes for market entrants and the development of competing products to existing scheme products including scheme EFTPOS.

Combined, these features would provide the necessary check on the level of interchange fees.

#### Industry coordination

APCA has consulted generally with its members concerning the establishment of an industry consultative and coordination body whose membership would comprise financial institutions, merchants and the schemes. APCA could provide a useful secretariat function and has wide industry membership.

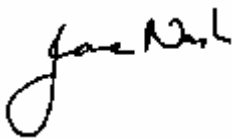
ANZ would support such a group working with the RBA to finalise the content and timing of some version of Option 3 so long as the industry can agree on the appropriate governance structure, its agenda and decision making authority and reporting arrangements.

#### Conclusion

It is ANZ's view that it would now be appropriate for the RBA to allow the market to set interchange rates given the safeguards of merchant surcharging, industry commitment to develop an EFTPOS scheme and the implementation of the access regimes.

We would welcome a further opportunity to discuss our views with the RBA as it concludes its findings.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Jane Nash', written in a cursive style.

Jane Nash—Head of Government and Regulatory Affairs