

REFORM OF DEBIT CARD SYSTEMS IN AUSTRALIA

A CONSULTATION DOCUMENT – DECEMBER 2005

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Reserve Bank

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Reform of Debit Card Systems in Australia: A Consultation Document

1. Introduction

In February 2005 the Reserve Bank of Australia released a set of proposals for reform of Australia's debit card systems.¹ These proposals addressed interchange fees in the EFTPOS and Visa Debit systems, as well as the 'honour all cards' rule in the Visa system. The issue of access arrangements to the EFTPOS system was not addressed at that time, as industry participants were developing an Access Code to facilitate entry to the system. This work has now been completed. Accordingly, the Bank is now releasing a set of proposals that complement the industry's Access Code. These proposals are set out in this Consultation Document.

The EFTPOS Access Code, developed by members of the Australian Payments Clearing Association (APCA) in consultation with the Bank, is available on APCA's website (www.apca.com.au). The Code contains detailed provisions under which existing participants in the EFTPOS system would agree to provide direct connections to new and current participants. The Bank regards development of the Code as a successful example of the co-regulatory approach envisaged by the Government when it established the Payments System Board.

The Bank is proposing to supplement the industry Access Code with an Access Regime under the *Payment Systems (Regulation) Act 1998*. This proposed Regime deals with two issues. The first is the fee that existing participants may charge entrants (or other existing participants) for establishing a direct connection; the Regime imposes a cap on this fee, and sets out a process for periodic re-calculation of this cap. The second issue is the possibility that negotiations over interchange fees might be used by existing participants to frustrate entry; the Regime includes 'no discrimination' provisions that would ensure that new entrants are offered interchange fees that do not place them at a competitive disadvantage to existing participants.

The Bank is also amending the draft EFTPOS interchange Standard released for consultation in February 2005. The amendments are designed to ensure that negotiations over interchange fees between participants in the EFTPOS system cannot be used to adversely affect competition in the system, either between existing participants or from new entrants. The effect of the proposed amendments is to constrain interchange fees in the EFTPOS system to a relatively narrow range, by placing both a cap and a floor on these fees. The Bank is not, at this stage, proposing any change to the cap included in the proposals released in February 2005.

Taken together, the EFTPOS Access Code, the proposals set out in this Consultation Document and those released in February would:

- (i) move interchange fees in the EFTPOS system and Visa Debit system closer together;

¹ Reserve Bank of Australia, *Reform of the EFTPOS and Visa Debit Systems in Australia*, Sydney, 2005.

- (ii) abolish the ‘honour all cards’ rule in the Visa system, and the no-surcharge rule in the Visa Debit system;
- (iii) establish access arrangements for direct connections to the EFTPOS system based on objective criteria and clear timetables;
- (iv) set a cap on the price for establishing a direct connection to participants in the EFTPOS system; and
- (v) ensure that bilateral negotiations over interchange fees in the EFTPOS system cannot be used to frustrate entry or reduce competition.

In the Bank’s opinion, implementation of this package of reforms would result in a set of arrangements that would promote competition and efficiency in both the EFTPOS system, and the Australian payments system more broadly.

Details of the first two parts of this package, and the reasoning behind them, can be found in the Consultation Document released in February 2005, which should be read in conjunction with this document. The Bank has already undertaken extensive consultation on these parts of the package, during which useful submissions on a broad range of issues have been made. These have included submissions on: the proposed caps on interchange fees in the EFTPOS and Visa Debit systems; the manner in which these caps are to be calculated and their impact on the market; and the effects of the removal of the honour all cards rule on the overall payments system. The Bank has not yet reached any conclusions on these matters.

The Bank is now seeking submissions from interested parties on the proposed reforms contained in this document. To the extent that these reforms affect any parties’ views on the previously released elements of the Bank’s proposals, the Bank welcomes further submissions on these issues as well. Given that the Federal Court has recently ruled in the Bank’s favour in the case brought by a group of merchants challenging the designation of the EFTPOS system, the Bank will proceed to consider issues raised in earlier consultation jointly with any issues raised in this round of consultation.

This document is structured as follows. Section 2 discusses current possible impediments to entry to the EFTPOS system and desirable features of access arrangements in the EFTPOS system. Section 3 sets out in some detail the co-regulatory process and the progress that has been made by the industry in addressing access to the EFTPOS system. Section 4 discusses the role of interchange fees in influencing access and competition within the system. Finally, Sections 5 and 6 outline the draft Access Regime and amended draft interchange Standard. The draft Access Regime and amended draft Standard are shown in Attachments A and B.

Submissions on the Bank’s proposals should be made by 17 February 2006, with all submissions being placed on the Bank’s website. Those making a submission will have the opportunity to discuss it with the Bank in the second half of February 2006. Submissions should be made to:

Head of Payments Policy or pysubmissions@rba.gov.au
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001

2. Gaining Access to the EFTPOS System

Concerns about the difficulty of gaining access to the EFTPOS network were first raised by the Australian Competition and Consumer Commission (ACCC) and the Bank in 2000. In particular, the Joint Study concluded that ‘Access to the debit card network through a series of bilateral agreements can put both new issuers and acquirers at a competitive disadvantage, because they may need to use more expensive gateway arrangements’.²

Access arrangements for the EFTPOS system in Australia differ significantly from access arrangements for similar systems in most other countries. Typically, in other countries, there is a single point of entry to the system for new participants, who must meet a single set of technical criteria and business requirements. Where there are entry fees, these fees are usually known in advance and, where there are interchange fees, they generally apply uniformly to all participants. In contrast, in Australia, the system is built around a series of bilateral connections and there is much less standardisation of the terms of access.

In the Australian EFTPOS system, the largest participants each have direct bilateral connections with one another; in total, there are eight institutions with direct connections. These connections are complemented by bilateral business agreements, including agreements over interchange fees. Smaller participants typically have access to the system through gateway arrangements provided by one of the organisations that has already established a series of direct connections. By entering the system this way, smaller participants can avoid the significant costs of establishing a series of direct connections, but they pay higher variable costs for each transaction processed through the gateway.

The current arrangements complicate access in two ways.

The first is that a new participant wanting to establish direct connections must separately approach each of the existing eight participants with direct connections to negotiate the technical and business arrangements for exchanging EFTPOS transactions. Each existing participant may require the new participant to meet different technical and business requirements, increasing the costs of entry.

The second complication arises from the fact that existing direct connectors have little incentive to facilitate the entry of a new participant, particularly when the entrant is likely to be a direct competitor in at least some business lines. For example, if a new participant planning to specialise in acquiring seeks to establish a bilateral connection with an issuer, the issuer may be reluctant to establish the connection in a reasonable time frame, or at a reasonable cost, if it itself has a substantial acquiring business. At present, existing participants have no obligation to establish direct connections with new participants and could frustrate the establishment of a connection in several ways.

One way of doing this would be to delay the necessary technical work to establish the connection. This would make it difficult for a new entrant to schedule the testing that is required, increasing costs and creating uncertainty as to when entry can occur. A second possible way to make entry difficult would be for existing participants to charge a potential entrant a very high

² Australian Competition and Consumer Commission and Reserve Bank of Australia, *Debit and credit card schemes in Australia: A study of interchange fees and access*, Sydney, 2000, p71.

price for establishing a connection. In addition, because the cost of connection is not known in advance, and may vary widely across institutions, potential entrants may be faced with unnecessary difficulties in developing a business plan.

A third way in which entry could be made difficult would be for an existing participant to be unwilling to agree to an interchange fee that is similar to the fee paid to, or received from, existing participants. Currently, interchange fees in the EFTPOS system are paid between direct connectors and are concentrated in a range from 18 cents to 25 cents, with the fee paid by the issuer to the acquirer. These fees are typically reciprocal, with the same fee being paid irrespective of which institution is the issuer. If, however, an existing issuer were prepared to pay only a much lower interchange fee to a new acquirer, that acquirer might find it very difficult to compete for the business of merchants against other acquirers receiving a much higher interchange fee.

These concerns are longstanding and have been raised in discussions with the Bank over a number of years. It has taken some direct connectors in the EFTPOS system many years to establish bilateral connections with some of the larger participants, who have been reluctant to give priority to establishing these connections. Some current direct connectors have not been able to establish complete sets of bilateral connections with all other direct connectors despite efforts over a number of years.

The possibility of interchange fees being used to frustrate access has also been raised in recent consultation. APCA has noted that its EFTPOS Access Code could be rendered ineffective if interchange fees were not standardised (regardless of the particular level at which they were set).³ Similar arguments were made during consultation over the Bank's proposed interchange standard for the EFTPOS system released in February 2005.⁴

Given that a potential new entrant – whether an acquirer, a gateway provider, or an issuer – may judge it important to establish direct connections with all existing direct connectors, a decision by just one existing participant to frustrate entry through any of the above responses could have a significant effect on the viability and timing of the entrant's plans. As a result, the bilateral structure of the Australian EFTPOS system means that it is particularly important that appropriate access arrangements are in place. Without such arrangements, one cannot be confident that the normal forces of competition arising from either new entry, or the possibility of new entry, can operate to produce efficient outcomes.

Overall, the Bank is of the opinion that, given the current architecture of the EFTPOS system, access arrangements should, at least, satisfy the following:

- (i) Current or prospective participants should have an ongoing right, provided that they meet objective and transparent criteria primarily relating to technical and security issues, to establish direct connections to existing direct connectors.
- (ii) There should be a clear and enforceable timetable under which existing participants are required to establish direct connections with those seeking them.
- (iii) The fee charged by existing participants to establish a new direct connection should be reasonable and not adversely affect competition and efficiency.

³ Australian Payments Clearing Association, Submission to the Reserve Bank of Australia, 21 October 2004.

⁴ MoneySwitch, 'Proposed Standards for Interchange Fees for EFTPOS', Submission to the Reserve Bank of Australia, 29 April 2005.

- (iv) Negotiations over interchange fees between new entrants and existing participants should not be able to be used as a barrier to entry.

In addition, new entrants should have confidence that, once they become a participant in the system, future negotiations over interchange fees cannot be used to put them at a material competitive disadvantage.

The first element is aimed at ensuring that no single existing participant in the system can effectively veto entry by refusing to establish a connection to an institution that meets specified criteria that are transparent and known in advance. The second is directed towards ensuring that entry is not frustrated by an existing institution giving inadequate priority to testing or implementation of a new connection. The third is aimed at ensuring that new entrants are not charged unreasonably high fees by existing participants to establish a direct connection. The final element recognises that, due to the bilateral nature of the EFTPOS system, interchange fees can potentially affect competition by allowing larger participants to discriminate against new or smaller participants in the system.

In the Bank's opinion, access arrangements that satisfied these four elements in a reasonable fashion would promote competition and efficiency in the EFTPOS system and the payments system more generally. They would facilitate entry to the EFTPOS system by new competitors, on both the issuing and acquiring sides of the market, by affording them greater certainty in planning for participation in the system and providing entry on terms likely to be more commercially reasonable than they would be able to obtain under current access arrangements. They would also contribute to enhanced competition in credit card acquiring, since any business wishing to provide credit card acquiring services to merchants must, in practice, also be able to acquire debit card transactions. Finally, they may also encourage current EFTPOS participants to streamline their technical and business procedures for handling new connections, potentially also contributing to the increased efficiency of the system.

3. The Co-Regulatory Approach to EFTPOS Access

The Explanatory Memorandum accompanying the *Payment Systems (Regulation) Bill 1998* emphasised that 'the philosophy of the Bill is ... co-regulatory. Industry will continue to operate by self-regulation in so far as such regulation provides an efficient, competitive and stable payments system'. On access regimes, it noted 'the development of access regimes and standards will be undertaken, as far as possible, in conjunction and consultation with the private sector'. This is the approach the Bank has followed in developing the proposed access arrangements for the EFTPOS system and, in particular, the Access Regime. The result is that a large proportion of the work on access arrangements has been undertaken by APCA in consultation with the industry. The process has stretched over several years and reflects a desire by both the industry and the Bank that, as far as is appropriate, the industry play a central role in the development of suitable access rules.

Participants in the EFTPOS system have been working on access arrangements since 2003, when a group of financial institutions submitted an application to the ACCC for authorisation of a proposal to set EFTPOS interchange fees to zero. The ACCC initially denied the application, but suggested that suitable access reform could balance the benefits in favour of authorisation.

In its draft Determination, the ACCC stated ‘... the Commission considers that, in the event that suitable access reform was to be introduced, the proposed Agreement is more likely to be in the net public benefit’.⁵

In the months that followed, the financial institutions that had made the application to the ACCC asked APCA to develop an access code for the EFTPOS system. The Bank supported this request, although it noted that, should this work falter, it would consider using its regulatory powers.

On the basis of APCA’s early endeavours and the Bank’s reassurances, the ACCC concluded that more appropriate access arrangements were likely to be put in place over time. On this basis, the ACCC authorised the interchange fee application in December 2003, although the authorisation was subsequently overturned by the Australian Competition Tribunal (ACT) on appeal. Despite the ACT’s decision, APCA continued to work on its EFTPOS Access Code with the Bank taking a close interest in progress.

In June 2004, the Bank invited submissions on whether it would be in the public interest for it to designate the EFTPOS system. In commenting on possible designation of the EFTPOS system, most submissions supported the APCA process for access reform. Nevertheless, four organisations argued that the Bank should take over the process, arguing that vested interests meant that it was unlikely to deliver the best possible outcome.

In September 2004, the Bank designated the EFTPOS system with a view to considering imposing a standard that would reduce interchange fees in the system. When doing so, it noted that ‘the Board is closely monitoring work being undertaken by APCA to improve access arrangements for the EFTPOS debit card payment system and will keep under review the question of whether it would be in the public interest for it to impose an access regime under the Act’.⁶

During the second half of 2004, APCA worked with its members that are direct connectors in the EFTPOS system and, in December 2004, a draft EFTPOS Access Code was circulated to participants in the system. The draft Code addressed many of the relevant matters, but the Bank still had concerns about a number of features of the Code. It was also concerned that only a few of the direct connectors had indicated whether they were prepared to endorse the essence of the draft Access Code some months after it had been circulated.

In late January 2005, the Bank wrote to APCA indicating its view that the draft Code provided too little certainty on the price of access for new participants and that the proposed penalties for delays in testing and connections were inadequate. The Bank was also concerned that minimum volume thresholds that would have to be met by new participants would unnecessarily limit competition, and played no role in the security and stability of the system. The Bank made it clear that, unless these matters were satisfactorily addressed, the EFTPOS Access Code would not be able to fulfil its fundamental purpose of providing sufficient certainty on the cost and timing of access.

⁵ Australian Competition and Consumer Commission, ‘Draft Determination in relation to the collective setting of interchange fees’, 8 August 2003, p56.

⁶ Reserve Bank of Australia, *Media Release 2004-08*, 9 September 2004.

A series of discussions followed and, in May 2005, the Bank wrote to APCA indicating that if access arrangements could not be finalised in a timely fashion, and in an acceptable form, the Bank would consider whether it was in the public interest to impose an access regime on the EFTPOS system. The Bank indicated to APCA that it expected a reasonable cap would be placed on the price of establishing a connection to existing participants; a clear timetable for the testing of connections would be set with penalties for not meeting the timetable; and the proposed requirement that entrants must meet a minimum transaction volume before the new arrangements became applicable would be removed. The Bank also sought APCA's commitment to bring the revised arrangements into effect in a timely way.

By July 2005, the Bank was able to report that APCA's members had agreed in principle to modifications to the EFTPOS Access Code to meet the Bank's requirements.⁷

The draft Access Code developed by APCA:

- (i) commits participants who sign up to the Code to provide direct connections to new participants that:
 - meet the technical requirements set out in the Consumer Electronic Clearing System Manual published by APCA; and
 - are prepared to establish two direct connections within 12 months and a third direct connection within three years.
- (ii) defines the nature of the connection service that at a minimum would have to be provided; and
- (iii) sets clear timetables for testing of connections and establishing 'live' connections. Penalties would apply if either party did not meet its obligations under these timetables.

The Bank's judgement is that the implementation of APCA's Access Code would promote competition. Given the co-regulatory philosophy on which the *Payment Systems (Regulation) Act 1998* is based, the Bank sees no need for the matters dealt with in the Code to be addressed in an access regime under the Act.

The Bank expects that all existing and new direct connectors in the EFTPOS system will sign up to APCA's Code. If this were not to occur, the Bank would need to consider whether to impose a more comprehensive access regime on the industry.

The price of access

While the draft Access Code developed by APCA addresses a number of important issues, it does not set a price of access. The industry, however, recognised from the outset that the charge for establishing a direct connection is important to access. Early drafts of the Access Code dealt with this issue by providing for arbitration if negotiations on this charge between an existing direct connector and a prospective direct connector were unsuccessful. The Bank's view, however, was that, given the unequal bargaining positions resulting from the structure of the EFTPOS system, this could lead to charges that were both high and uncertain, and that, in turn, could limit competition and efficiency by discouraging new entry.

⁷ Reserve Bank of Australia, *Media Release 2005-08*, 20 July 2005.

Participants held a variety of views about how to respond to this issue. One view was that new participants should be required to reimburse *all* of the costs that an existing participant incurs in establishing a new connection. The argument was that an existing participant has no other reason to incur these costs and receives no benefit from doing so. Another view was that a cap should be placed on the charge, in recognition of the fact that new participants should not be penalised if some existing participants have systems that can only be altered to accommodate new participants at much higher cost than is the case for other existing participants. Most existing participants agreed that there is merit in a cap on access charges in some form. There was, however, much less agreement on how the cap should be determined, and there was a reluctance among many access providers to set it at a level that did not allow them to recover all of their costs of providing a connection.

This issue was resolved after the Bank put forward a model that allowed for negotiation over the access charge, but with a cap based on the estimated incremental direct costs that would be incurred by the most efficient existing participant providing a direct connection. A 2004 survey undertaken by APCA of estimated connection costs indicated that the institution with the lowest connection costs could provide a connection for \$78 000 (excluding GST).

The Bank is of the view that such an approach provides a balance between the interests of both the existing and potential future participants, as well as meeting the Bank's statutory obligations to promote efficiency and competition. Importantly, it would ensure that the fee charged for establishing a connection cannot be used as an unreasonable barrier to entry. While setting the initial level of the cap equal to the estimated connection costs of an efficient access provider could result in commercial disadvantage to a participant whose connection costs remained high, doing so is likely to place pressure on direct connectors within the EFTPOS system to streamline their IT systems, and ensure their connection capabilities are as near as possible to best practice within the industry.

Following the participants' agreement to this model for access charges, APCA wrote to the Bank asking it to give consideration to imposing the cap under the *Payment Systems (Regulation) Act 1998*.

The Bank is now proposing to do this through an Access Regime. The alternative of leaving it to industry to put in place appropriate access charge arrangements, including possibly seeking authorisation from the ACCC for a cap on the access charge, poses considerable risks. In the event that the Bank indicated that it did not wish to impose an Access Regime to establish a cap on the price of access there is a significant possibility that the industry would not proceed with the reforms. Even if industry did proceed, and took an application to the ACCC for approval, there would be considerable uncertainty as to the timing of any final decision and implementation of improved access arrangements. Given that there are potential access seekers currently awaiting the opportunity to enter the EFTPOS system, further delays to the implementation of the Access Code would be detrimental to competition and efficiency.

Finally, a decision by the Bank not to assist industry to put in place more appropriate access arrangements, and instead to encourage an application to the ACCC, would run counter to the view of both the Bank and the ACCC that responsibility for regulation of Australia's payment systems be as clearly delineated as possible, so as to avoid uncertainty stemming from

overlapping regulatory jurisdictions. Such delineation would, in this instance, argue in favour of the Bank having responsibility for access-related arrangements in the EFTPOS system.

4. Interchange Fees, Access and Competition

APCA's Access Code has not sought to deal with interchange fees in the EFTPOS system. As discussed above, negotiations over these fees have the potential to be used to inhibit access and competition in the system. In EFTPOS systems overseas, this potential difficulty is typically overcome by arrangements that mean that all participants receive a common, multilaterally set interchange fee. In Australia's bilateral EFTPOS system, however, these fees remain determined by bilateral negotiation between participants. The Bank sees two potential problems for access and competition in the EFTPOS system arising from these arrangements.

The first is that negotiations over interchange fees could become a barrier to entry. It is possible that a new entrant could plan to take advantage of APCA's Access Code and the cap on the access charge in the Bank's Access Regime, only to find that entry was frustrated by negotiations over interchange fees. This could happen if, for instance, a new acquirer was offered an interchange fee of say 5 cents, compared to the range of 18 to 25 cents currently received by most acquirers.

The second is that negotiations over interchange fees can also affect competition between participants already in the system. In the past, agreements between current participants, once struck, tended not to change because, if a new agreement could not be reached, the contracts remained as they were. If forced to change, say because of a merger, fees have been renegotiated, but otherwise they have typically remained unchanged because the potential loser can refuse to agree to a new fee.

Under the Bank's draft interchange Standard for the EFTPOS system, the cap on interchange fees will be re-calculated every three years, potentially requiring interchange fees to be renegotiated with the same frequency. This renegotiation may provide existing participants the opportunity to offer participants, with which they already have agreements, substantially less favourable interchange fees than currently. Smaller participants may have no choice but to take such an offer, since to refuse could effectively limit their ability to participate directly in the system. Although there is no evidence to date of any existing participants behaving in this way, the fact that there will be regular renegotiations of interchange fees raises the possibility that such behaviour could become an issue in the future. This suggests that, in the interests of competition, there may be a need to address interchange fees not only for new entrants but also existing participants.

The Bank proposes to deal with these issues in two ways.

The first is to include 'no discrimination' provisions in the Access Regime. The effect of the provisions is to ensure that, while interchange fees would still remain subject to bilateral negotiations, existing participants could not negotiate an interchange fee with a new entrant that was less favourable than the least favourable of its existing interchange agreements.

The second is to place a floor under interchange fees in the EFTPOS system, in addition to the cap previously proposed. This will ensure that an existing participant is not unduly

handicapped by being forced to accept interchange fees much less favourable than those received by competitors.

5. Draft Access Regime

The draft Access Regime is set out in Attachment A. It should be considered in conjunction with the Access Code developed by APCA. Where possible, the definitions used in the Regime are cross-referenced to APCA's Code.

As discussed above, the Bank is of the view that the industry Access Code adequately addresses two of the key elements set out earlier for improved access to the EFTPOS payment system. The draft Access Regime is therefore restricted to issues that are not fully covered in the Access Code.

Cap on the access charge

The draft Access Regime requires that there be a cap on the access charge for new participants and sets out a methodology for determining that cap. From the time that the Access Regime comes into force until 31 December 2009, it is proposed that the charge to a new entrant be capped at the lowest estimated cost for providing a direct connection as measured in APCA's 2004 costs survey (paragraph 9). That cost is \$78 000 (excluding GST).

From 1 January 2010, it is proposed that the cap be based on the minimum cost of direct connection from a survey (akin to APCA's 2004 survey) of the *actual* costs for such a connection incurred by access providers in the EFTPOS system over the preceding four years. The draft Access Regime does, however, contain provisions for the cap to be set using an alternative methodology in some circumstances. This reflects two considerations.

The first is that in the four-year period between re-calculations there may have been no new direct connections. In this event, it is proposed that the previous cap be adjusted for movements in the Consumer Price Index (CPI).

The second is that connections to too few institutions may have been made for a reasonable sample to be established to determine the connection costs of an efficient access provider. In particular, a difficulty would arise if all new direct connections happened to have been made to a small number of relatively high-cost access providers. In this case, the new cap would end up being set at a level above the connection cost of an efficient provider. This could act as a deterrent to new entrants to the EFTPOS system, reducing the competitive pressure on existing participants in the system.

To overcome this potential difficulty, it is proposed that if connections to fewer than three institutions have been made, the previous cap be adjusted for movements in the CPI, unless at least one of the institutions that provided a new connection reports a lower cost than the indexed cap. In that case, the lowest reported cost would be the new cap. If instead connections to three or more institutions have been made, the new cap would be established at the lowest reported cost. In the Bank's opinion, these arrangements strike a reasonable balance between the interests of current and potential future participants in the EFTPOS system.

The use of a four-year window between re-calculations also represents a reasonable balance between keeping the cap relevant to actual connection costs, on the one hand, and administrative burden, on the other. A longer interval might result in the access charge cap drifting out of line with prevailing actual costs for the efficient provision of a bilateral connection in the EFTPOS system – with potential ramifications for competition and efficiency. A shorter interval, however, could involve a greater compliance burden for EFTPOS access providers, as well as providing less certainty to new participants about entry costs. The Bank judges that a four-year interval between re-calculations is consistent with the promotion of competition and efficiency in the EFTPOS system.

No discrimination in interchange fees

The draft Access Regime also requires participants in the EFTPOS system to negotiate an interchange fee with a new entrant that is no less favourable to the new entrant than the least favourable interchange fee agreement the existing participant has with other existing participants. The provisions achieve this by requiring that, for any issuer, the interchange fee paid to a new acquirer be no less than the lowest interchange fee currently paid by that issuer to an acquirer. Similarly, for any acquirer, the interchange fee received from a new issuer must be no more than the highest interchange fee currently received by that acquirer from existing issuers. These requirements reflect the Bank's concern that negotiations over interchange fees could be used to frustrate entry of new participants, especially on the acquiring side of the market.

6. Amended Draft Standard

The other element of the reforms proposed in this Consultation Document is an amended draft Standard for the setting of interchange fees in the EFTPOS system. This amended draft Standard is shown in Attachment B.

When the previous version of this draft Standard was released in February 2005, the Bank said that it expected that, if the Standard were implemented, 'the maximum interchange fee in the EFTPOS system would be likely to be around 5 cents paid to the merchant's bank'.⁸ That expectation is unaffected by the proposed amendments. The amended draft Standard continues to set a benchmark capping the interchange fee that may be paid to an acquirer (or a merchant principal), and does not change the way in which the benchmark is to be calculated.

The effect of the amendments is to narrow the range of possible interchange fees in the EFTPOS system. This reflects the Bank's concern that negotiations over interchange fees could be used to limit competition in the EFTPOS system. The Bank has not formed the view that non-zero interchange fees in the EFTPOS system are necessarily optimal, or that any non-zero interchange fee ought to flow from issuers to acquirers rather than vice versa. Rather, the amendments reflect a view that, to ensure a level playing field between participants in the EFTPOS system, both existing and potential, interchange fees paid and received should not vary greatly between participants. The amendments to the draft interchange Standard therefore narrow the range of possible interchange fees by requiring that the minimum fee that can be paid by an issuer to an acquirer (or a merchant principal) is 80 per cent of the benchmark (maximum) fee.

⁸ Reserve Bank of Australia, *Reform of the EFTPOS and Visa Debit System in Australia*, Sydney, 2005, p2.

On the basis of the information currently available to it, the Bank estimates that the amended Standard would result in interchange fees ranging from 4 cents to the previously estimated cap of 5 cents, paid by issuers to acquirers. This would prevent participants in the system being placed at a material disadvantage to others. Lack of a floor – or allowance of a wider range of fees, as would result from using a lower percentage – could expose some existing and/or new participants (or gateways) to the risk of significantly less advantageous interchange fees than those applying to other participants. If this were to occur, it could undo the beneficial effects on competition of the proposed Access Regime and APCA’s Access Code.

The Bank’s earlier draft Standard on EFTPOS interchange fees has been amended to give effect to the changes described above. The paragraphs that have been added to or amended as a result are numbers 9, 15 and 16. Several other paragraphs incorporate minor drafting changes, including amending the definition of a ‘debit card transaction’ and replacing ‘benchmark’ with ‘interchange fee benchmark’ for clarity.

Attachment A

Draft Access Regime for the EFTPOS System

Objective

The objective of this Access Regime is to promote competition and efficiency in the Australian payments system, having regard to:

- (i) the interests of current participants in the EFTPOS system;*
- (ii) the interests of people who, in the future, may want access to the EFTPOS system;*
- (iii) the public interest; and*
- (iv) the financial stability of the EFTPOS system.*

Application

1. This Access Regime is imposed under Section 12 of the *Payment Systems (Regulation) Act 1998*.
2. This Access Regime applies to the payment system operated within Australia known as the EFTPOS system, which was designated as a payment system on 9 September 2004 and referred to below as the EFTPOS system.
3. In this Access Regime:

‘Access Agreement’ has the same meaning as in the EFTPOS Access Code;

‘Access Provider’ has the same meaning as in the EFTPOS Access Code;

‘Access Seeker’ has the same meaning as in the EFTPOS Access Code;

‘Access Charge’ means the charge payable by an Access Seeker to an Access Provider under an Access Agreement as described in clause 3 of Schedule 3 to the EFTPOS Access Code;

an ‘acquirer’ is a participant in the EFTPOS system that provides services to a merchant to allow that merchant to accept a debit card;

‘APCA’ means the Australian Payments Clearing Association Limited (ABN 12 055 136 519);

‘cash out’ means the provision of cash to a cardholder by a merchant, as a result of a debit card transaction at the merchant;

‘debit card’ means a card issued by a participant in the EFTPOS system that allows the cardholder to make payments to merchants for goods or services and/or obtain cash out using the EFTPOS system by accessing a deposit account held at the participant;

‘debit card transaction’ or ‘transaction’ means a transaction in Australia using the EFTPOS system;

‘Direct Connector’ has the same meaning as in the EFTPOS Access Code;

‘EFTPOS Access Code’ means the EFTPOS Access Code dated [] developed by APCA, and published on APCA’s website;

an ‘issuer’ is a participant in the EFTPOS system that issues debit cards to its customers;

an ‘interchange fee’ is a wholesale fee which is payable between an issuer and an acquirer or merchant principal, directly or indirectly, in relation to a debit card transaction in the EFTPOS system;

‘merchant’ means a merchant in Australia that accepts a debit card for payment for goods or services and/or that provides cash out;

a ‘merchant principal’ is a participant in the EFTPOS system that is a merchant that sends transactions directly to issuers rather than through an acquirer and takes on the responsibilities usually undertaken by an acquirer;

‘Standard Service’ has the same meaning as in the EFTPOS Access Code;

‘APCA’s 2004 costs survey’ is the survey of Direct Connectors in the EFTPOS system, conducted by APCA, on the expected incremental direct costs of connecting new direct connectors, the results of which were supplied to the Reserve Bank of Australia on 15 April 2005;

terms defined in the *Payment Systems (Regulation) Act 1998* have the same meaning in this Access Regime.

4. Each participant in the EFTPOS system must do all things necessary on its part to ensure compliance with this Access Regime.
5. If any part of this Access Regime is invalid, it is ineffective only to the extent of such part without invalidating the remaining parts of this Access Regime.
6. This Access Regime is to be interpreted:
 - in accordance with its objective; and
 - by looking beyond form to substance.
7. This Access Regime comes into force on [17 April 2006].

Price of access

8. The Access Charge levied by an Access Provider for providing the Standard Service to an Access Seeker must not exceed the benchmark, calculated in accordance with paragraphs 9 to 16 below, applying on the date the Access Agreement is entered into.

Methodology for calculation of the Access Charge benchmark

9. For the period from [17 April 2006] to 31 December 2009 the benchmark for the Access Charge in the EFTPOS system is the lowest estimated cost for providing a direct connection as measured in APCA's 2004 costs survey. This cost is \$78 000 (excluding GST).
10. A new benchmark will apply from 1 January 2010, and every four years thereafter, determined in accordance with paragraphs 11 to 16 below.
11. In the final year of application of a given benchmark, to be known as the 're-calculation year', all Access Providers in the EFTPOS system who have provided the Standard Service to an Access Seeker during the four years to 30 June of that year must complete a survey of the eligible costs they incurred in providing the service to each such Access Seeker.
12. The form of the survey, including the set of assumptions, is to be substantively the same as APCA's 2004 costs survey, with any variations to be approved by the Reserve Bank of Australia prior to the survey being undertaken. Eligible costs are to be specified in the survey, and must include only incremental direct costs incurred in providing the Standard Service. Access Providers may appoint an agent to co-ordinate this survey.
13. Access Providers must use data on eligible costs drawn from accounting records prepared in accordance with generally accepted accounting principles and Australian accounting standards. Where an Access Provider has provided the Standard Service to more than one Access Seeker during the four years to 30 June of the re-calculation year, it must provide separate data on the costs incurred in providing each Standard Service. Each such provision of data counts as a separate survey response for the purposes of paragraph 16 below.
14. Results of the survey are to be provided by each Access Provider to the Reserve Bank of Australia on a confidential basis by [15 August] of the re-calculation year, unless an extension of this deadline is agreed to in writing by the Reserve Bank of Australia.
15. Each Access Provider may be required by the Reserve Bank of Australia to explain information in its survey responses. The Reserve Bank of Australia will review the data from each Access Provider to determine if the costs included are eligible costs and the Reserve Bank of Australia will use only eligible costs to calculate the benchmark in accordance with paragraph 16 below.
16. The Reserve Bank of Australia will calculate the new benchmark to apply for the four-year period commencing 1 January of the year following the re-calculation year. If the Reserve Bank of Australia receives responses from three or more different Access Providers to the survey, the new benchmark is to be the lowest actual cost for provision of the Standard Service from among all survey responses.

If the Reserve Bank of Australia receives responses from fewer than three different Access Providers to the survey, the new benchmark is to be the lower of:

- (i) the lowest actual cost for provision of the Standard Service from among all survey responses; and
- (ii) the benchmark applying during the re-calculation year adjusted for the change in the Australian Consumer Price Index between the June quarter of that year and the June quarter of four years earlier.

Transparency

- 17. The Reserve Bank of Australia will publish the new benchmark by [30 September] of the re-calculation year.

No discrimination

- 18. An acquirer or merchant principal who becomes a participant in the EFTPOS system for the first time on or after [17 April 2006] is for [three] years entitled to receive an interchange fee, from an issuer with whom it has an Access Agreement, no less than the lowest interchange fee payable by that issuer to an existing acquirer or merchant principal.
- 19. An issuer who becomes a participant in the EFTPOS system for the first time on or after [17 April 2006] is for [three] years not required to pay an acquirer or merchant principal, with whom it has an Access Agreement, an interchange fee greater than the highest interchange fee payable by an existing issuer to that acquirer or merchant principal.

Attachment B

Draft Standard

The Setting of Interchange Fees in the EFTPOS System

Objective

The objective of this Standard is to ensure that the setting of interchange fees in the designated EFTPOS payment system promotes:

(i) efficiency; and

(ii) competition

in the Australian payments system.

Application

1. This Standard is determined under Section 18 of the *Payment Systems (Regulation) Act 1998*.
2. This Standard applies to the payment system operated within Australia known as the EFTPOS system, which was designated as a payment system on 9 September 2004 and referred to below as the EFTPOS system.
3. In this Standard:

an ‘acquirer’ is a participant in the EFTPOS system that provides services to a merchant to allow that merchant to accept a debit card;

‘cash out’ means the provision of cash to a cardholder by a merchant, as a result of a debit card transaction at the merchant;

‘debit card’ means a card issued by a participant in the EFTPOS system that allows the cardholder to make payments to merchants for goods or services and/or obtain cash out using the EFTPOS system by accessing a deposit account held at the participant;

‘debit card transaction’ or ‘transaction’ means a transaction in Australia using the EFTPOS system;

‘financial year’ is the 12-month period ending 30 June;

an ‘issuer’ is a participant in the EFTPOS system that issues debit cards to its customers;

‘merchant’ means a merchant in Australia that accepts a debit card for payment for goods or services and/or that provides cash out;

a ‘merchant principal’ is a participant in the EFTPOS system that is a merchant that sends transactions directly to issuers rather than through an acquirer and takes on the responsibilities usually undertaken by an acquirer;

‘nominated EFTPOS acquirers’ are those acquirers and merchant principals determined by the Reserve Bank of Australia, selected in order of their share of the number of transactions, who comprise the minimum number of such acquirers or merchant principals required to account for at least 90 per cent of the number of transactions acquired in the EFTPOS system in the ‘reference year’;

‘reference year’ is the financial year prior to the relevant year;

‘relevant year’ is the financial year in which the interchange fee benchmark is calculated;

terms defined in the *Payment Systems (Regulation) Act 1998* have the same meaning in this Standard.

4. This Standard refers to wholesale fees, known as ‘interchange’ fees, which are payable between an issuer and an acquirer or merchant principal, directly or indirectly, in relation to a debit card transaction in the EFTPOS system.
5. Each participant in the EFTPOS system must do all things necessary on its part to ensure compliance with this Standard.
6. If any part of this Standard is invalid, the Standard is ineffective only to the extent of such part without invalidating the remaining parts of this Standard.
7. This Standard is to be interpreted:
 - in accordance with its objective; and
 - by looking beyond form to substance.
8. This Standard comes into force on [1 July 2006].

Interchange fees

9. From [1 November 2006], an interchange fee must be paid by an issuer to an acquirer (or merchant principal) and must be no more than the interchange fee benchmark applying in accordance with paragraph 15 and no less than the minimum fee specified in paragraph 16.

Methodology

10. The interchange fee benchmark for the EFTPOS system is to be calculated by the Reserve Bank of Australia as follows:
 - (i) for each of the nominated EFTPOS acquirers, the aggregate value of eligible costs in the reference year is to be divided by the number of debit card transactions in the reference year. This ratio is to be expressed as a number of cents per transaction;

- (ii) the interchange fee benchmark is to be calculated by the Reserve Bank of Australia as the aggregate value of eligible costs in the reference year of the three nominated EFTPOS acquirers with the lowest ratios as calculated in 10(i), divided by the aggregate number of transactions undertaken by the same three nominated EFTPOS acquirers in the reference year. The result is to be expressed as a number of cents per transaction, rounded to the nearest cent.
11. 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.
 12. Data on eligible costs must be drawn from accounting records of the nominated EFTPOS acquirers, prepared in accordance with generally accepted accounting principles and Australian accounting standards.
 13. Data on eligible costs must be provided by each nominated EFTPOS acquirer to the Reserve Bank of Australia, or its agent, by [15 August] in the relevant year.
 14. The Reserve Bank of Australia, or its agent, will review the data to determine if the costs included are eligible costs and the Reserve Bank of Australia will use the eligible costs to calculate the interchange fee benchmark in accordance with paragraph 10.
 15. The Reserve Bank of Australia will publish the interchange fee benchmark for the EFTPOS system by [15 September] in the relevant year, and this benchmark will apply for three years from 1 November in the relevant year.
 16. The minimum fee determined for the purposes of paragraph 9 is 80 per cent of the applicable interchange fee benchmark.

Initial and subsequent interchange fee benchmarks

17. For the initial interchange fee benchmark the relevant year is the financial year [2006/07].
18. The interchange fee benchmark is to be re-calculated in the financial year [2009/10] and every three years thereafter.

Transparency

19. Commencing in 2007, acquirers and merchant principals in the EFTPOS system must report to the Reserve Bank of Australia the weighted average interchange fee they received and the range of interchange fees received in the previous financial year by [30 September] each year. The weights to be used in this calculation are the shares of transaction value to which each interchange fee applies. In 2007, this requirement applies to the [8] months ending [30 June 2007].
20. The Reserve Bank of Australia will publish the industry weighted average of interchange fees on its website.