

Submission to RBA re EFTPOS Designation

9 July 2004

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TransAction Resources Pty Ltd

1. Executive Summary

The EFTPOS system in Australia is reliable, secure, efficient and technologically advanced. It is well used and accepted by both merchants and consumers and usage is growing strongly. The AMPF believes there is no need for the RBA to designate the EFTPOS system as it is not “broken” and does not need “fixing”.

There has been a series of wide ranging and detailed reviews over the past few years by a number of bodies including the RBA, ACCC, EFTPOS Industry Working Group (at the instigation of the RBA), EFTPOS Access Working Group (under the auspices of the Australian Payments Clearing Association, of which the RBA is a board member) and finally by the Australian Competition Tribunal. The RBA has been involved in all these reviews.

This series of reviews culminated in the Competition Tribunal finding in May 2004 that *“Any public benefits [from zero interchange] are clearly outweighed by the detriments”* and that *“There is real public detriment in the likelihood of a flow on of costs to consumers generally”*.

The RBA has based its drive for EFTPOS reform on the findings of the Joint Study of 2000. However, this was based on 1999 data which is now more than four years old and has not been updated despite significant structural changes in the payment card market. Further the data is incomplete, excluding all merchant costs for example, and applies an arbitrary allocation of some costs between credit and debit cards. For these reasons, the Joint Study cannot now be relied upon to support any decision to designate the EFTPOS system. If designation is to be considered, comprehensive new data must be collected and analysed before making any further decisions.

There are two key issues to be considered as far as EFTPOS reform is concerned - interchange and access. With regard to interchange, the Competition Tribunal has delivered a resounding decision that the RBA’s preferred position of zero interchange would not result in a public benefit and in fact would produce an outcome of a public detriment.

Opening access to the EFTPOS system will undoubtedly deliver a significant benefit in the form of increased competition from new entrants. However, there is already a process underway to develop a new access regime. This process now appears to be working well and should be allowed to proceed to completion. The RBA initiated this course of action and is involved in the process. There is currently no need to designate in relation to the access issue.

Following the extensive series of EFTPOS reviews that have already been undertaken and given the lack of evidence of any problems with the current system, the AMPF strongly believes there is no public benefit in designation. The reviews to date have been comprehensive as well as time-consuming and expensive. We can see absolutely no need for yet another review of the same issues.

2. Introduction

Following the “Joint Study” into Debit and Credit Card Schemes in Australia by the Reserve Bank of Australia (RBA) and the Australian Competition and Consumer Commission (ACCC) there has been a series of reviews of the EFTPOS system.

On 23 December 2003, the RBA wrote to a number of organisations “to offer interested parties the opportunity to put their views” on the possible designation of the EFTPOS payment system under the authority of the *Payment Systems (Regulation) Act 1998*.

This was put to one side as the Australian Competition Tribunal (ACT) presided over a hearing relating to zero interchange for EFTPOS.

Following the decision by the ACT, which found that zero interchange resoundingly was not in the public interest, the RBA has again requested interested parties to submit their views on whether the EFTPOS system should be designated.

This document puts forward the views of the Australian Merchant Payments Forum (AMPF) in relation to the potential designation of the Australian EFTPOS payment system.

The document provides input and perspectives from card payment experts (TransAction Resources), a legal perspective (MinterEllison) and an economics paper from Frontier Economics. This document attempts to ensure that, where relevant, the designation issues are viewed in the context of the ACT decision.

It should be noted that the AMPF has already made a number of submissions related to EFTPOS reform, and a more detailed discussion of many of the relevant issues is contained in either those papers or papers commissioned by the AMPF. These include:

- Submission to RBA re EFTPOS Designation (10 February 2004)
- EFTPOS Card Interchange Fee Agreement - Report by Philip Williams (Report submitted to Australian Competition Tribunal, 31 March 2004)
- Supplementary Witness Statement by Philip Williams (submitted to Australian Competition Tribunal, 7 April 2004)
- EFTPOS Interchange Fee Agreement - Report by John Gove (Expert Witness Report submitted to Australian Competition Tribunal, 31 March 2004)

In addition, individual members of the AMPF have also made a number of separate submissions.

The AMPF firmly supports a robust, secure and efficient payment system with costs fairly allocated between all participants. In this document we will argue that EFTPOS already meets these criteria and thus there is no basis for designation. The AMPF is happy to work with the RBA and other regulatory bodies to ensure the long term health of the Australian payment system.

3. Designation Criteria / Key Issues

There is no need for the RBA to designate the EFTPOS system. Australia’s EFTPOS is a world class system which is ubiquitous, efficient, secure, reliable and is well accepted by both consumers and merchants. It is not “broken” and does not need “fixing”.

This is not simply an AMPF view. For example, Manuel Rio of France, a long standing expert in payment systems and consultant to the French Government in payment systems¹, has said (emphasis added):

*“The EFTPOS (electronic funds transfer at point of sale) system in Australia is a real time, on line, PIN based, debit card system. **It is considered to be the best in the world in terms of quality, convenience, safety, technological advancements, overall cost, reliability, processing speeds and increased efficiency.** It has been a resounding success in Australia and it has been adopted by the Australian consumer and by merchants with enthusiasm.”²*

EFTPOS has been the subject of a series of extensive and detailed reviews over the past 2½ years. These reviews have involved the RBA, ACCC, Australian Competition Tribunal and all key participants, including issuers, acquirers, merchants and consumers. The reviews have covered both interchange arrangements and access.

This wide-ranging review process has included:

- establishment of the EFTPOS Industry Working Group (EIWG) at the instigation of the RBA;
- meetings with and submissions to the RBA by a wide range of parties;
- review by the ACCC following application by “The Banks” for zero interchange;
- establishment of the EFTPOS Access Working Group (EAWG) under the auspices of the Australian Payments Clearing Association (APCA); and
- a formal review of the application for zero interchange by the Australian Competition Tribunal (ACT).

This process culminated in the Competition Tribunal’s finding that:

“Any public benefits [from zero interchange] are clearly outweighed by the detriments”³

and

“There is real public detriment in the likelihood of a flow on of costs to consumers generally”⁴.

As the AMPF has previously stated, we believe that this outcome is the best possible for the on-going health of the EFTPOS network.

Even if designation were to be considered, there must be some sound basis for reaching the conclusion to do so. Such a decision would need to be based on solid, current data. The

¹ Mr. Rio is a Knight of the National Order of Merit, France (2001). He has served on the Government Advisory Committee on Banking since 1984. He was appointed to this committee in 1984 by Government Decree and has been reappointed five times since. He has also served as an official representative of the French corporate sector in ad-hoc Government advisory committees in the payments area. He was co-author of the *Code of good conduct for market operations between banks and corporations* (1997-99), which was adopted by the authorities of the French marketplace and by other countries.

² “Australia’s EFTPOS”, unpublished submission to the European Commission Enquiry into the Visa MIF, Manuel Rio, Paris, March 30 1999.

³ *Determination re EFTPOS Interchange Fees Agreement [2004] ACompT 7*, Australian Competition Tribunal, 25 May 2004, para. 153.

⁴ *Ibid*, para. 157.

only data available at present is contained in the Joint Study⁵ undertaken by the RBA and the ACCC in 2000, which itself was based on 1999 data. The AMPF believes the Joint Study data:

- is out of date - the data is now more than 4 years old and there have been significant structural changes in the payment card market since the Joint Study;
- is incomplete - for example, merchant costs are not included; and
- includes an arbitrary allocation of some costs between credit and debit cards.

At the ACT hearing, Coles Myer and the “Merchants” were critical of the lack of data on which decisions could be based. Coles Myer provided a list of data which could be collected but has not been made available. Such data should be collated, analysed and understood before undertaking any reforms. As the decision stated:

“In our opinion, these complaints were well founded and were not satisfactorily answered. Coles Myer identified the following information which the Banks could have but did not, put before the Tribunal:

1. *The level of interchange fees paid;*
2. *The breakdown of what banks are issuing banks and what banks are acquiring banks;*
3. *The breakdown of the costs of the issuing bank in processing debit cards;*
4. *The breakdown of the costs of the acquiring banks in processing debit cards;*
5. *The breakdown of where the acquiring banks actually spend the interchange fee they receive (eg. costs, past [sic] to merchants, profit on acquiring businesses linked to the merchants that they share the interchange fee with);*
6. *Each banks’ consideration of the impact to its business of a change to zero interchange fee;*
7. *Any analysis done by banks regarding the introduction of a positive interchange fee;*
8. *Issuing banks’ arrangements with cardholders as to who pays fees for accessing debit cards;*
9. *What plans, if any, the Banks have to pass on the savings in the interchange fees to customers;*
10. *What plans, if any, Banks have to grow credit card businesses;*
11. *What plans, if any, Banks have to grow the use of debit cards;*
12. *The Banks’ profit on their credit card businesses;*
13. *The ‘profit’ generated by the use of debit card;*
14. *The Banks’ commitment to access and how it would look like in practice.”*

This list was not meant to be comprehensive, but was intended to give some indication of the type of data which could have been provided to the ACT but was not. Similarly, this data is

⁵ *Debit and Credit Card Schemes in Australia – A Study of Interchange Fees and Access*, Joint Report by the RBA and ACCC, October 2000, page 5.

indicative of the type of data, at the very minimum, which should have been provided in the Joint Study.

Costs incurred by merchants were excluded from the Joint Study. Given that more than 50% of EFTPOS transactions are processed via merchant owned terminals, this is a major omission. It is inconsistent that the costs associated with terminals and card processing infrastructure owned by banks is included in the study whereas the same costs, when incurred by merchants have not been captured. This omission would have a significant impact on the balance of costs between the issuing side and the acquiring side of the business. Justice Tamberlin in the Federal Court has confirmed that merchants are an integral part of a payments system⁶. It is vitally important that merchants' costs are included in any analysis of card payment system costs.

The above views on the Joint Study were supported at the ACT hearing by both the economists (as outlined in the attached legal perspective) and by the expert on payment systems called on behalf of the merchants. The Tribunal itself found *"the figures [Joint Study data] were in any event a snapshot now almost four years out of date"*.⁷

Accordingly, the Joint Study cannot be relied upon to support any decision to designate the EFTPOS system. If designation is to be considered, comprehensive new data must be collected and analysed before making any further decisions. The Governor of the Reserve Bank, Mr Macfarlane has stated that further analysis is required prior to any decision on designation:

*"If we consult again, do further analysis and feel that there is a case for designation, we may well designate, which would bring it back into our court."*⁸

He also discussed the Competition Tribunal's finding, stating:

*"On the issue of the evidence that the Competition Tribunal wanted, I think that their legal mind-set includes a concept of evidence that is very different from ours. We think some things are very persuasive - for example, the international experience."*⁹

The AMPF disagrees with this statement. Firstly, two of the three Tribunal panel members were appointed because of their expertise in business and economics and they approached the issues from a practical perspective rather than a "legal mind-set".

We also disagree strongly that the international experience is *"very persuasive"*. The AMPF has argued consistently that Australia's EFTPOS interchange is not unique, a view supported by the Competition Tribunal. We also concur with the Tribunal's finding that:

"Frankly we do not see a great deal of value in overseas comparisons. The way a banking system operates in a given country is a result of a complex mix of historical, geographical, political, cultural and socio-economic factors."

This view is also supported by economist Dr Philip Williams (refer Appendix 2).

⁶ *Visa International Service Association & MasterCard International Inc. v Reserve Bank of Australia*, Federal Court of Australia, 19 September 2003, at 305 pg 91.

⁷ *Determination re EFTPOS Interchange Fees Agreement [2004] ACompT 7*, Australian Competition Tribunal, 25 May 2004, para. 70.

⁸ *Hansard - House Of Representatives, Standing Committee On Economics, Finance And Public Administration*, 4 June 2004, p.29.

⁹ *Ibid*, 4 June 2004, p.29.

We find it incongruous that the RBA, which is so keen on overseas comparisons, appears to be the only regulator in the world who wants to increase the interchange fee (from negative 20 cents to zero), a move which would result in end-users (merchants and consumers) actually paying more. This is a most unusual move by a regulator. As the ACT succinctly said, a move to zero interchange *“is likely to have the effect of passing on to the general body of consumers an annual cost of \$170 million, or a substantial part thereof.”*¹⁰

One final point on overseas experience. The RBA has frequently quoted the Netherlands as an example we should follow for debit cards, the most recent example being a quote by the Governor (emphasis added):

*“We asked ourselves: why is it so and is there logic behind this particular [EFTPOS] interchange fee? We came to the conclusion that there was not. There did not need to be one and in some countries overseas, particularly the ones where EFTPOS works most efficiently - Canada and the Netherlands - there is no interchange fee. You do not need one. It is totally unnecessary in our view.”*¹¹

It is interesting to note that Netherlands Competition Authority (NMa), has a different view on how well the debit card system is working, recently handing down fines of almost €50 million (around A\$80 million) for anti-competitive practices, as can be seen from the following press report.

“The Netherlands banking cartel must pay a collective fine of €47.2 million following an investigation by the Netherlands Competition Authority into the activities of Interpay - the debits payment network in that country – which the regulators found earned returns of between five times and seven times an acceptable benchmark.

NMa, as the authority is known in its Dutch abbreviation:

- ♦ *Imposed a fine of €30.2 million on Interpay, “for charging excessive rates for the provision of network services for debit card transactions.”*¹²

The NMa went on to say that *“Interpay has abused its dominant position.”*¹³

It should also be noted that although the RBA has stated on a number of occasions that Canada and the Netherlands are countries *“where EFTPOS works most efficiently”*, we are unaware of any evidence to support this proposition. We do not know of any studies undertaken by the RBA or anyone else which have compared the efficiency of various debit card systems in different countries.

As far as interchange is concerned, the ACT found that the RBA's preferred position of zero interchange would not result in a public benefit and in fact would generate an outcome of a public detriment.

On the issue of access, the AMPF believes that the benefits which will undoubtedly result from opening access to the EFTPOS system are completely independent of the interchange fees. The AMPF supports the current review of access now that its parameters have been

¹⁰ *Determination re EFTPOS Interchange Fees Agreement [2004] ACompT 7, Australian Competition Tribunal, 25 May 2004, para. 157.*

¹¹ *Hansard - House Of Representatives, Standing Committee On Economics, Finance And Public Administration, 4 June 2004, p.28.*

¹² *Dutch limit payments cartel profits, The Sheet Daily, Monday 10 May 2004 - Edition 237.*

¹³ *NMa Fines Interpay and Banks for Infringement of Competition Act, NMa Press Release 04-10, 29 April 2004.*

expanded to include delivery of a standardised interchange message format (an issue which the AMPF believes is fundamental to any genuine access reform) and other changes requested by the merchant community.

In summary, the AMPF believes that designation would not be in the public interest. EFTPOS participants have been involved in a series of reviews comprising a thorough and detailed analysis of the EFTPOS system. These reviews have been comprehensive as well as time-consuming and expensive. Yet another review is simply not warranted.

4. Interchange

The issue of EFTPOS interchange fees has been the subject of a series of comprehensive reviews over an extended period, finally resulting in an unequivocal finding by the ACT that there is no public benefit in moving to zero interchange and that the current arrangements should stand.

Unlike most card schemes in the world, Australia has a truly competitive system of bilateral negotiations for EFTPOS interchange compared to the setting of a multilateral fee which, as the ACT says, is “*a per se unlawful agreement*”. The competitive nature of these arrangements is demonstrated by the wide range of interchange fees in the market and by the fact that these fees have halved in value in real terms since they were first introduced (after applying CPI adjustments)¹⁴.

The AMPF has repeatedly stated that the Australian EFTPOS system is world class and that this is due largely to the current flow of interchange fees. The current interchange arrangements reflect the user pays principle whereby the acquirers provide a significant service to issuers in allowing any individual issuer to have access to every EFTPOS terminal in Australia and are paid a fee for providing that service.

In order to provide this service, acquirers, and in some cases merchants, have made substantial and on-going investments in switching and acquiring infrastructure. Additionally, there are operating costs associated with every EFTPOS transaction which must also be recovered. For example, the communications cost associated with every EFTPOS purchase is around 6 cents per transaction on average.

We believe that moving to the RBA’s still preferred model of zero interchange will lead to reduced investment and, over time, degradation of the network. This view was supported by the Competition Tribunal who found:

“the increased cost for merchants arising from the Proposed Agreement is likely to operate as a disincentive to undertake future investment in the upgrading of the system.”¹⁵

It is not intended to repeat in detail the arguments regarding the relativity between the current EFTPOS interchange arrangements and investment in infrastructure. A more detailed

¹⁴ *EFTPOS Interchange Fee Agreement - Report by John Gove*, Expert Witness Report submitted to Australian Competition Tribunal, 31 March 2004, para.115.

¹⁵ *Determination re EFTPOS Interchange Fees Agreement [2004] ACompT 7*, Australian Competition Tribunal, 25 May 2004, para. 135.

discussion on this issue can be found in our previous submission on EFTPOS designation¹⁶ and Mr Gove's witness statement to the ACT¹⁷.

A major issue for the RBA in relation to EFTPOS interchange, as outlined in the Joint Study, is that the then existing interchange arrangements for credit cards had been sending the wrong signals to consumers, leading to credit cards being used at the expense of less costly debit cards. In particular, the RBA was concerned about the use of loyalty programs as an incentive for card holders to use credit cards rather than debit cards.

The AMPF has argued on a number of occasions that the credit card reforms have largely resolved this problem and that incorrect price signals are no longer an issue. The RBA has established specified "eligible" costs to be used for calculating the interchange fee level for credit cards and the cost of loyalty programs is not allowed as one of these eligible cost categories.

As a result of the credit card reforms, many issuers have increased annual fees for their credit cards and, for loyalty programs, have either increased fees and/or reduced the level of rewards. In addition, some merchants, such as Qantas and Telstra, have introduced surcharging for credit card payments. The combination of these changes has altered the pricing signals in the market, as the RBA intended.

As a result of these changes, credit cards have now become more expensive to the cardholder than EFTPOS and the cause of the wrong pricing signals has been removed. The growth of credit card usage has slowed and EFTPOS spend has increased strongly. The table below shows the growth in spend on both EFTPOS and credit cards for last year and the first 4 months of this year.

	EFTPOS	Credit Cards
2003 vs 2002	+1.1%	+11.5%
2004 vs 2003 (first 4 months) ¹⁸	+18.1%	+12.6%

Table 1 – Credit vs EFTPOS growth (\$ spend)¹⁹

This table demonstrates:

- EFTPOS growth is increasing dramatically - the rate of growth for this year to date is some 18 times higher than last year's growth; and
- on the other hand, credit card growth has increased only marginally (13% growth this year vs 12% growth last year).

The credit card reforms have achieved their stated aim in this area and changing the EFTPOS interchange fee will not have any additional impact upon price signals to cardholders or usage trends. As the Tribunal stated:

*"In any event, a switch to debit cards is now occurring as a result of the RBA reforms."*²⁰

¹⁶ Submission to RBA re EFTPOS Designation, AMPF, 10 February 2004.

¹⁷ EFTPOS Interchange Fee Agreement - Report by John Gove, Expert Witness Report submitted to Australian Competition Tribunal, 31 March 2004.

¹⁸ January to April 2004 vs January to April 2003

¹⁹ From "C Tables" on payment systems, RBA statistical tables, (www.rba.gov.au)

The final issue with regard to interchange is the argument put forward by the RBA and the “Applicant Banks” that a zero interchange fee would:

- i) result in issuers savings being passed on to cardholders; and
- ii) these savings would result in increased usage of EFTPOS; and
- iii) this in turn would lead to a more efficient payment system

These issues have been argued in front of the Australian Competition Tribunal which found that:

- any changes to interchange fees are unlikely to increase EFTPOS usage; and
- increased usage of EFTPOS at the expense of credit cards does not equate to an increase in efficiency - they are different products.

Firstly, as the ACT found, increased EFTPOS usage by cardholders can only be achieved if there is a reduction in their EFTPOS usage fees. Any general reduction in monthly account fees or increasing services instead of reducing EFTPOS fees, as proposed by some issuers, will have no impact on EFTPOS demand.

“All economists who gave evidence agreed with the proposition that the proposed arrangements are only likely to have the effect of increasing demand by cardholders for EFTPOS if they decrease the price that cardholders pay for marginal transactions.”²¹

It has been clearly demonstrated that a move to zero interchange would not result in lower EFTPOS fees being passed on to cardholders.

The majority of EFTPOS cardholders do not pay fees. As was stated by the ACT²²

“According to the EFTPOS Industry Working Group (EIWG), a group composed mainly of the Banks, in a discussion paper published in July 2002:

“cardholders are not charged for EFTPOS transactions below a threshold (on average eight free EFTPOS, ATM and other electronic transactions per month).”

“as the average number of EFTPOS plus ATM transactions per account per month for 2003 was 5.76, it seems likely that many cardholders currently pay no EFTPOS transaction fees.”

This is supported by evidence from the ANZ, who have stated (emphasis added):

*“The incidence of excess withdrawal fees²³ is low, **with about 80% of customers in any given month not paying these fees.** About 30% of*

²⁰ *Determination re EFTPOS Interchange Fees Agreement [2004] ACompT 7, Australian Competition Tribunal, 25 May 2004, para. 156.*

²¹ *Determination re EFTPOS Interchange Fees Agreement [2004] ACompT 7, Australian Competition Tribunal, 25 May 2004, para. 116.*

²² *Ibid*, para. 58-59.

²³ “withdrawal fee” means a fee charged for withdrawing funds from a customer’s account whether by EFTPOS, ATM, internet, etc.

customers are exempt, including full time students, children and customers with home loans.”²⁴

This means that even if the banks charge no fees at all for EFTPOS transactions, this could only affect 20% of transactions at the most. In other words, a move to zero interchange is not able to result in any reductions in EFTPOS fees for the large majority of cardholders.

Since the Tribunal hearing, the National Australia Bank (NAB) has announced it has introduced a new account with no EFTPOS fees, continuing the trend to monthly account fees rather than transaction based fees. This is described in a press article as follows:

“The new \$5 Smart Access account is a nearly identical offering to ANZ’s highly successful Access Advantage account, which was introduced in early 2002.

“Both accounts allow unlimited use of all forms of banking - including Eftpos, over-the-counter, internet, ATM - for the \$5 fee.”²⁵

In other words, it is becoming increasingly prevalent for banks not to charge specific EFTPOS fees. Again, quoting the Tribunal decision:

“From this complicated picture however emerges the important fact that, in Mr Gove’s words, ‘most consumers pay no EFTPOS fees today’.”²⁶

Given the above evidence, we are surprised at Mr Macfarlane’s view that:

“On EFTPOS, instead of looking at the banks’ customers in totality and simply looking at the cardholder, I do not think there is any doubt that the cardholder or the consumer is going to benefit.”²⁷

We believe it has been demonstrated beyond doubt that general consumers will pay more and the vast majority of cardholders will not receive any reduction in EFTPOS transaction fees.

It should be noted that even if there was a reduction in cardholder EFTPOS transaction fees and even if this did result in increased usage of EFTPOS (at the expense of credit cards), this does not mean it would result in a more efficient payment system. Credit and debit cards are different products with different characteristics and different customer value propositions. As the ACT decision stated:

“all five economists who gave evidence agreed with the proposition that in assessing the efficiency with which resources are allocated among products with different characteristics, one cannot say that all resources should be allocated to those products whose production involves the least cost.”²⁸

Finally, the RBA has consistently stated that it sees no need for an interchange fee for debit cards. However, no sound basis has been provided for this stance. It is worth noting

²⁴ “Report on Fees on Electronic and Telephone Banking”, Parliamentary Joint Statutory Committee on Corporations and Securities, February 2001, p.7.

²⁵ NAB Out to Appease, Herald Sun, 23 June 2004

²⁶ Determination re EFTPOS Interchange Fees Agreement [2004] ACompT 7, Australian Competition Tribunal, 25 May 2004, para. 57.

²⁷ Hansard - House Of Representatives, Standing Committee On Economics, Finance And Public Administration, 4 June 2004, p.34.

²⁸ Determination re EFTPOS Interchange Fees Agreement [2004] ACompT 7, Australian Competition Tribunal, 25 May 2004, para. 149.

comments by recently appointed ACCC Commissioner Dr Stephen King in an article co-authored by Professor Gans (emphasis added):

“... the Joint Study starts from the assumption that an interchange fee is a necessary evil and that, in fact, a zero interchange fee is a clear benchmark. This assumption pervades the Joint Study’s analysis: it always searches for a way to make the interchange fee as close to zero as possible. However, there is no economic basis for the assumption that zero is the desired benchmark.”²⁹

and

“All this adds up to an interchange fee that is ‘negative,’ being paid from card issuers to acquirers. The Joint Study is perplexed by this. However, when you think about it, as merchant benefits are lower relative to customer benefits, there are fewer issuer risks and there is potentially more acquirer competition, it is not surprising that a fair cost-sharing bargain might involve issuers compensating acquirers in this instance.”³⁰

In summary, the AMPF believes there is no need for designation in relation to interchange fees. We can see no public benefit in changing the EFTPOS interchange fee arrangements. We believe any move towards zero interchange fees would increase prices to all consumers. The situation is well summed up by the ACT when it says:

“All in all we find the most likely consequence (without excluding at all the possibility of other consequences) is a general price increase.”³¹

5. Access

The AMPF believes access reform and the introduction of a more open access regime is the most important element of EFTPOS reform. From an acquiring perspective, it is very difficult to gain access to EFTPOS due to the large number of differing technical links that a new entrant is required to develop.

At least at a high level, all stakeholders agree on access reform. As the Competition Tribunal stated:

“All parties agree that access reform is desirable because it will enhance competition, and as a consequence efficiency, in the issuing and acquiring markets. However it seems preferable, all other things being equal, to achieve that objective by access reform rather than an agreement which is per se unlawful.”³²

During the ACCC consideration on EFTPOS interchange, the EFTPOS Access Working Group (EAWG) was established under the auspices of the Australian Payments Clearing Association (APCA) for the express purpose of developing a new access regime for the EFTPOS payment system. The RBA is actively involved in this process, being represented on both the EAWG and the APCA board.

²⁹ Observations on the Joint RBA/ACCC Study *Debit and Credit Card Schemes in Australia - A Study of Interchange Fees and Access*, Joshua Gans and Stephen King, University of Melbourne, 9 November 2000, p.5.

³⁰ Ibid, p.10.

³¹ *Determination re EFTPOS Interchange Fees Agreement [2004] ACompT 7*, Australian Competition Tribunal, 25 May 2004, para. 134.

³² Ibid, para. 140.

The AMPF has previously had some concerns about the scope of the work being undertaken by the EAWG. APCA had originally ruled any changes to the technical architecture as “out of scope”, including the development of a single standard interchange message format. The absence of such a standard in the past had led to separate development and testing projects being required for each interchange partner. This issue is now being addressed and the development of a standard interchange message format is now included as part of the proposed access regime.

Whilst the detail is still being worked through, the AMPF believes the current EAWG process is on track and is likely to deliver a new access regime which will facilitate the entry of new organisations into the market. The AMPF believes increased competition resulting from new entrants into the acquiring market will drive prices down for merchants and ultimately for consumers.

This was certainly the experience with Canada’s Interac debit system, where opening access has driven down prices. The average fee charged to large merchants has dropped from around 15 cents per transaction to around 5 cents per transaction since access to the Interac system was opened by government decree in 1996. There has been no change to the interchange fee over this period. The decrease in merchant fees has resulted from increased competition in the acquiring market as a result of opening access to a broader range of institutions.

The RBA has supported the APCA/EAWG process, stating that it will only consider designation should the process falter. It has not faltered and there is no need at this stage to designate EFTPOS in order to facilitate a new access regime.

6. Context of Other Card Payment Systems

The AMPF was requested to include a perspective of EFTPOS reform in relation to other card payment systems and to comment on the interplay between the various systems, particularly any relationship between EFTPOS and Visa Debit.

The short time-frame in which this paper has been developed has precluded any detailed analysis of these contextual issues, but the AMPF is happy to work with the RBA in this area if the RBA so desires.

With regard to Visa Debit and EFTPOS, the AMPF has already stated its position which is that interchange for Visa Debit should be the same as that for EFTPOS when used at the point of sale. EFTPOS is cheaper and more secure than signature-based Visa Debit at the point of sale and there is no rationale for a higher interchange fee for Visa Debit. Our views on Visa Debit are contained in our submissions to the RBA on Visa Debit ³³.

However, the AMPF does not believe these issues bear any relevance to the designation of EFTPOS. As stated earlier, the EFTPOS system is working well; there are no problems and it would not be in the public interest to designate.

³³ *Submission to the Reserve Bank of Australia - Designation of Visa Debit*, 2 April 2004, and *Supplementary Submission to the Reserve Bank of Australia - Designation of Visa Debit*, 11 June 2004.

Attachment 1 - Legal Perspective

The AMPF in consultation with MinterEllison has developed this attachment to provide a legal perspective of the key issues involved in relation to the RBA's request for input on EFTPOS designation. Some of the issues in this section have been covered earlier, but they are reviewed here from a legal point of view.

On 23 December 2003 the Reserve Bank of Australia (RBA) began a consultation process in relation to its consideration whether it would be in the public interest to designate the EFTPOS debit card payment system as a payment system under Section 11 of the *Payment Systems (Regulation) Act 1998*. In its letter to interested parties, RBA advised that it was particularly concerned about interchange fee and access in the EFTPOS debit card system. In a previous letter to the ACCC (12 November 2003) it had advised that it supported a move to zero interchange fees and improved access for the EFTPOS system.

In submissions dated 10 February 2004 the Australian Merchant Payments Forum (AMPF) submitted that designation was not in the public interest. The issue of EFTPOS interchange fees was at that time being considered by the Australian Competition Tribunal in an application by banks for authorisation of a zero interchange fee arrangement, and there was already in place a process involving APCA, RBA and other stakeholders to develop an EFTPOS access regime.

On 25 May 2004 the Australian Competition Tribunal ruled that the public benefits flowing from the proposed zero interchange arrangement were “*clearly outweighed by the detriments*” and authorisation was declined³⁴. In addition, Dr Peter Smith from APCA gave evidence on the access reform process and particularly that a standardised interchange message format (which the AMPF had identified as a critical component of an effective access regime) was being dealt with in a companion project. Dr Smith said that work on that project, would be completed in tandem with the work of the access reform group.

On 11 June 2004 the RBA stated that it

*“is now considering whether it would be in the public interest for it to designate the EFTPOS payment system...[as] a precursor to the Bank deciding whether to determine standards and/or impose access regimes that would promote efficiency and competition in the Australian payment systems”.*³⁵

For the reasons set out below, the AMPF submits that designation of the EFTPOS payment system would manifestly not be in the public interest, and that in light of the findings of the Tribunal in the EFTPOS case (in respect of which the RBA was granted leave to intervene) a decision to designate would be so unreasonable that no reasonable authority would have come to that decision.

The Joint Study

The RBA's Media Release refers to its 2000 Study on Debit and Credit Card Schemes in Australia (Joint Study). This study was completely discredited in the Tribunal, and it can not reasonably be relied on in 2004 to support a decision to designate the EFTPOS payment system.

³⁴ *Re EFTPOS Interchange Fees Agreement [2004] ACompT 7 & 9, 25 May 2004)*

³⁵ RBA Media Release 2004/06

Economists at the Tribunal hearing agreed:

- the data recorded in the joint study (being 1999 data) was out of date (*Transcript of Proceedings, 27 April 2004, T400/18*);
- the data was incomplete (*T401/23-38; T402/29-34*); and
- the data could not be relied on to reach the conclusions set out in the study (*T403/3-14; T404/15-28; T405/10-18*).

In addition, the five economists were unanimous that in assessing the efficiency with which resources are allocated among products with differing characteristics, one can not say that all resources should be allocated to those products whose production involves the least cost (Conference of Economics Experts held on 1 April 2004, proposition 22). This finding was completely at odds with the Joint Study conclusion that,

*“The incentives in an economy should ensure that the lowest cost and most efficient payment instruments thrive at the expense of the more expensive or less efficient ones”*³⁶

As a consequence no reasonable regulator could rely on the Joint Study as a basis for making a decision that it was in the public interest to designate the EFTPOS payment system.

The AMPF understands that the Governor of the RBA accepts this is the case. He indicated to the Economic Finance and Public Administration Committee of the House of Representatives at the committee hearing on 4 June 2004 that the RBA would “do further analysis” before determining whether there was a case for designation (EFPA 29). In the view of the AMPF, such analysis would be necessary before any public consultation, and public consultation would be appropriate only if that analysis, properly conducted, suggested that there was cause for concern.

The Tribunal Decision

The Tribunal decision is of overwhelming importance for a proper consideration of whether designation is in the public interest. The proposition that zero interchange for EFTPOS was in the public interest (which was the conclusion of the Joint Study, and the view advocated by the RBA) was tested by evidence which was subject to cross examination. In addition, the Tribunal had the benefit of expert testimony from five economists.

The economic evidence was unanimous that the fundamental proposition advanced in the Joint Study for a zero interchange fee for EFTPOS (that a move of consumers from higher cost credit cards to lower cost EFTPOS would enhance efficiencies in the payment system) was flawed as a matter of economics. The Tribunal also found that the zero interchange proposal would not in any event bring about such a change in behaviour for the reasons set out in detail in the Tribunal's decision.

It is accordingly the submission of AMPF that the RBA could not, after applying proper weight to consideration of the Tribunal evidence and findings (with an open mind putting aside preconceptions based on the view enunciated four years ago) reasonably come to a view that the imposition of a zero interchange fee was in the public interest, or that

³⁶ *Debit and Credit Card Schemes in Australia – A Study of Interchange Fees and Access*, Joint Report by the RBA and ACCC, October 2000, (i).

designation (as a first step toward the imposition of zero interchange fee) was in the public interest.

It appears that despite the Tribunal finding, the RBA still advocates zero interchange. The following exchange took place between the Governor of the RBA in the House of Representatives Committee:

Chair: "What is the Reserve Bank's view of the Competition Tribunal decision?"

Mr Macfarlane 'Our view has always been - and our published view has always been - that there no case for an interchange fee, so there should either be no interchange fee or it should be zero. This has always been our case. In the Competition Tribunal hearing, we were not actually a principal in the hearing. I believe the hearing was between the merchants and the ACCC, and we were there as what is known as a friend of court and we put in a submission on which we argued that there was no case for an interchange fee.'

Mr Griffin "The questions is: what happens now? In tennis terms the ball is in your court. Are you able to enlighten the committee as to what the next step will be, if there will be a next step?"

Mr Macfarlane "The Competition Tribunal finding is a new piece of information. We will summarise that piece of information and submit it to the public again for consultation and see what their views are, and whether those views have changed. We believe that the majority of participants in the payment system would be in favour of having no interchange fee, but we are not going to go ahead and ignore the Competition Tribunal. We regard this as a new piece of information and we consult again with the public. If we consult again, do further analysis and feel that there is a case for designation, we may well designate, which would bring it back into our court."

What is significant in this exchange is that there is no suggestion that the RBA will critically assess the Tribunal decision and determine whether it should change its preconceived view that zero interchange is appropriate. Mr Macfarlane says that the RBA will see what the public's views are and whether those views have changed. He does not suggest that the RBA will independently reconsider its own views.

The Governor explained to the Committee that the Tribunal *"came to the conclusion that the ACCC had not made a strong enough case that reducing the interchange fee to zero was in the public interest, and so they did not uphold the ACCC's judgement."* It was not the ACCC that was making a case before the Tribunal. The case was made by the Banks. Even with the assistance of the RBA, the Banks were unable to satisfy the Tribunal that the public benefits of zero interchange exceeded the detriments because, as the Tribunal found, the detriments manifestly out weighed the benefits.

When the Governor was asked by Mr Griffin that *“the actual decision by the Competition Tribunal was quite critical of the Bank in relation to its submissions - and also of the banks”*, Mr Macfarlane responded:

*“On the issue of the evidence that the Competition Tribunal wanted, I think their legal mindset includes a concept of evidence that is very different from ours. We think some things are very persuasive - for example, the international experience. We think this is a very persuasive economic case, but they are not persuaded by things like that.”*³⁷

The AMPF submits that this is a misunderstanding of the Tribunal decision, and suggests a closed mind, unprepared to accept the evidence that was accepted by the Tribunal. The RBA argued that the current negative interchange arrangement in Australia was unique: this was rejected by the Tribunal simply because the evidence did not support that view. The five economists were unanimous that the economic basis for the RBA's view on zero interchange was flawed, whereas the RBA continues to describe it as *“a very persuasive economic test case”*.

Consultation Process

Mr Macfarlane advised the House of Representatives Committee that the RBA would summarise the Competition Tribunal finding and *“submit it to the public again for consultation and see what their views where and whether those views have changed”*.³⁸

The RBA's press release of 11 June 2004 (the week following Mr Macfarlane's evidence to the House of Representatives Committee) makes no mention of the Tribunal decision. It does not *“summarise that piece of information”*. It does not submit that summary for consultation.

As submissions are to be lodged by 9 July 2004 it appears that the RBA has no intention of doing so.

Zero Interchange Not a Standard

The imposition of zero interchange would be ultra vires the RBA's powers under the *Payment Systems (Regulation) Act*.

Designation allows the RBA to determine standards and/or impose access regimes that would promote efficiency and competition in the Australian Payment System. In *Visa International Service Association v Reserve Bank of Australia*³⁹, the Federal Court considered what was involved in the imposition of a standard and said *“the regulation of interchange fees by reference to a determined benchmark, calculated on a specified basis, can be said to prescribe a definitive level of conduct”*⁴⁰.

³⁷ *Hansard - House Of Representatives, Standing Committee On Economics, Finance And Public Administration*, 4 June 2004, p.29.

³⁸ *Ibid*, 4 June 2004, p.29.

³⁹ [2003] FCA 977, 19 September 2003

⁴⁰ at [393]

The imposition of an arbitrary interchange fee (whether zero or any other number) which is not calculated in accordance with a determined benchmark ie specified basis is not the determination of a standard.

Counsel for the RBA, in submissions to the Tribunal conceded that *“there may be some difficulty with the bank directly setting a standard that there shall be no interchange fee”*⁴¹.

Access

The only other ground upon which the RBA could consider designation would be if it believed that it was in the public interest in order to impose an access regime for EFTPOS.

It is abundantly clear that there is no public interest in evoking a regulatory regime when there is a process in train involving all stakeholders (including the RBA) which is working to a very tight timetable towards agreement on an access regime.

⁴¹ T64/18