



**Abacus**  
Australian Mutuals

Association of Building Societies and Credit Unions

31 August 2007

Ms Michele Bullock  
Head of Payments Policy Department  
Reserve Bank of Australia  
By email: [pysubmissions@rba.gov.au](mailto:pysubmissions@rba.gov.au)

Dear Michele

**Abacus submission to RBA's payments reform review.**

Thank you for the opportunity to contribute to the RBA's payments reform review.

*Abacus – Australian Mutuals* is the industry association for credit unions and mutual building societies. Abacus draws together the representation activities of the former Credit Union Industry Association (part of Cuscal Ltd), National Credit Union Association and Australian Association of Permanent Building Societies. For more detail on Abacus and its members, see [www.abacus.org.au](http://www.abacus.org.au).

Credit unions and building societies provide banking services to 4.5 million Australians and are Authorised Deposit-taking Institutions (ADIs) subject to the *Banking Act 1959* and Australian Financial Services Licensees subject to the *Corporations Act 2001* and the Electronic Funds Transfer Code of Conduct.

Credit unions and mutual building societies provide their members with access to the payments system through branches and agencies, EFTPOS and ATM networks, the Visa and MasterCard schemes, direct debits and credits, internet banking, B-Pay and cheques and issue a range of payment cards including EFTPOS debit cards, scheme debit cards and credit cards.

As member-owned ADIs, credit unions and mutual building societies seek to protect and promote the interests of their customers.

This submission on the RBA's reforms urges the RBA to restore some balance to regulatory settings that have strongly advantaged merchants and large acquirer financial institutions and have had a disproportionately negative impact on card issuers, particularly smaller issuers, and cardholders.

Good policy is about consistency. The RBA's interventions to regulate interchange fees have at times appeared to be inconsistent, arbitrary and discriminatory in their impact.

Free market principles have been applied to merchants with the removal of the "no surcharge" and Honour All Cards (HAC) rules, but heavy handed regulation has been imposed on interchange fees for credit and scheme debit card issuers.

One of the outcomes is that for the biggest and most powerful merchants interchange fees for scheme debit cards have fallen from around 95 cents to 4 cents on a \$100 transaction.

Another outcome is that credit card issuers are compensated via interchange fees for fraud costs and fraud prevention costs but scheme debit and EFTPOS debit issuers must recover these costs from cardholders.

Removal of the HAC rule unleashes the biggest and most powerful merchants to restrict consumer choice while promoting their own card products. This is no longer a theoretical concern, as outlined below in the case of Woolworths.

The \$2.2 billion<sup>1</sup> shift in benefits from issuers and cardholders to merchants delivered by the RBA has been offset to a limited extent by the reform to EFTPOS interchange fees. However, the RBA's last minute decision to leave EFTPOS "cash out" transactions unregulated has diminished even this benefit to issuers and cardholders.

The RBA has intervened heavily in the payment card market to set prices and disrupt issuers' businesses. Abacus questions whether the benefits have been convincingly demonstrated.

## **Q1: What have been the effects of the reforms to date?**

### ***Effect on cardholders***

Some Abacus members have increased prices for cardholders as a direct result of the RBA's reforms to Visa Debit. The reforms to EFTPOS interchange fees have resulted in some offsetting of the Visa Debit impact in the form of lower EFTPOS cardholder fees.

Fee changes include the introduction of Visa Debit transaction fees and the introduction or increase in Visa Debit account fees. At least one Abacus member has increased ATM withdrawal fees as a means of recovering income lost due to the RBA's intervention.

Visa Debit cardholders react negatively to fee increases and have an incentive to take up a card product that is generally free of transaction fees – a credit card.

### ***Effect on financial institutions***

The RBA's Issues Paper for the review says many analyses of interchange fees assume that these fees are a way of redistributing revenue from acquiring banks to issuing banks in a way that affects the prices facing cardholders and merchants, but not necessarily the net revenue of banks.<sup>2</sup>

Large banks are individually both issuers and acquirers but credit unions and mutual building societies are generally "issuers-only". The interchange fee reforms have resulted in a net reduction in revenue to credit unions and building societies, partly offset by subsequent increases in fees imposed on cardholders.

Since it is less than one year since the Visa Debit and EFTPOS reforms were implemented, Abacus members are at different stages in responding. Some members have not yet

---

<sup>1</sup> RBA Issues Paper, May 2007, p22.

<sup>2</sup> RBA Issues Paper, May 2007, p25.

changed pricing while others have introduced or increased Visa Debit fees while lowering EFTPOS debit fees.

"The society is yet to complete a full fee review of all accounts," says one Abacus member. "Therefore, the current fee structures have not changed for our members since the reforms were introduced."

Another Abacus member says that overall the impact has been revenue neutral because of the introduction of a new fee.

Another Abacus member based its re-pricing planning on an expected interchange fee level for Visa Debit of 15 cents as flagged by the RBA. "Ultimately, and at the last minute, the RBA set the level at 20 per cent lower [12 cents]. Consequently, our income recovery was underestimated by approximately \$180,000 per annum. Software changes to implement a new fee and distinguish between EFTPOS with and without 'cash out' diverted some tens of thousands of dollars. Planning resource costs for the changes have not been estimated but were considerable."

The net revenue impact on another Abacus member is approximately \$1.4 million per annum but this member is implementing a fee increase from September 2007 to recover some of the lost revenue.

Another member says the impact of Visa Debit reform is \$220,000, or 20 per cent of the institution's annual post tax net profit, partly offset by a saving of approximately \$40,000 as a result of the EFTPOS change. "We have considered introducing an on-balance sheet credit card to complement (or even replace) the Visa Debit offering as a result of the reform," the member says. "This will become necessary if retailers start declining use of Visa Debit as a result of abolition of the Honour All Cards rule."

As this member notes, there is a concern that an unintended consequence of the removal of the HAC rule is to raise a barrier to entry into card issuing because issuers will need to offer multiple cards. This is more of a challenge for smaller card issuers and therefore potentially reduces competition and choice for consumers.

### ***HAC rule***

Abacus is concerned we are witnessing the thin end of the wedge in market developments flowing from the abolition of the HAC rule in relation to scheme debit on 1 January 2007.

As argued by Abacus in earlier submissions to the RBA, removal of the HAC rule hands a strong advantage to big retailers seeking to compete in the payment cards business.

We are now seeing Australia's most powerful retailer take advantage of removal of the HAC rule to prevent shoppers using Australian-issued pre-paid scheme debit cards.

In a direct assault on consumer choice, Woolworths is, in effect, saying to shoppers with pre-paid scheme cards: "we will decide what payment cards you can use here." This will effect some customer segments more than others. For example, the *bopo* pre-paid card that is issued by Cuscal Ltd in partnership with BillExpress is targeted at young people and the under banked.<sup>3</sup>

---

<sup>3</sup> The *bopo* card is Australia's first general purpose pre-paid Visa card.

Woolworths' share of the food, liquor and grocery market is just below 30 per cent<sup>4</sup> and the retailer has announced plans to compete more aggressively in the payment cards business. Woolworths issues its own pre-paid card product and is about to launch a Woolworths branded credit card.<sup>5</sup>

The RBA's removal of the HAC rule is reducing consumer choice and boosting the market power of an already dominant participant.

Unconstrained, the pre-paid card market has considerable potential for growth. In the US, the percentage of consumers who purchased or received a gift card in 2006 was 76 per cent compared to 36 per cent in 2001.<sup>6</sup>

Removal of the HAC rule strengthens the position of the strongest merchants and makes it harder for smaller financial institutions to compete against large rivals. Big financial institutions are better equipped to offer multiple products to consumers and avoid negative consequences from the removal of the HAC rule.

As noted above, uncertainty about card acceptance is, in effect, a new barrier to entry. Commercial reality means multiple cards will need to be offered thereby reducing economies of scale and commercial sustainability. Barriers to entry increase for potential new entrants.

### ***Competitive position of different payment systems***

Despite only a short period of time elapsing since implementation of the Visa Debit and EFTPOS interchange standards, some trends in competition between card products are emerging.

Average spending on credit union Visa credit cards is increasing at twice the rate of Visa Debit, indicating that credit unions are promoting credit cards to members and promoting the use of credit cards in preference to Visa Debit.<sup>7</sup>

"The increased transaction fee impact on members has seen Visa Debit volumes reduce and EFTPOS increase," an Abacus member says. "Visa credit transactions have more than doubled from a low base and now represent 10 per cent of [our] total Visa transactions and are increasing."

Anticipating the big reduction in Visa Debit interchange fees, another Abacus member introduced a Visa Debit transaction fee in March 2006. "Members have reacted negatively to this and as a result transaction volumes decreased. Prior to the introduction of this fee, Visa Debit transactions were growing by around 8-12 per cent per annum but this dropped to 3 per cent post the introduction of the fee. Member usage of EFTPOS has increased as a result of the Visa Debit fee impact." This Abacus member outsources its credit card product and reports that the value of the reward scheme for the credit card product has been reduced.

Credit unions and mutual building societies have been strong supporters of Visa Debit for 25 years and currently issue around one third of all Visa Debit cards in Australia.

---

<sup>4</sup> *Woolworths putting the boot in* p21, SMH 28 Aug 2007

<sup>5</sup> *Woolies' \$1bn assault on Coles* p1 AFR 28 Aug 2007

<sup>6</sup> 2006 US Gift Card Market Survey, First Data International.

<sup>7</sup> Source: Cuscal Ltd

Visa Debit enables credit unions and mutual building societies to offer their members a card with the payment utility of a credit card (i.e. internet, overseas, post, telephone) but without the need to borrow money.

EFTPOS debit cards, like Visa Debit, provide cardholders with access to their own funds but EFTPOS debit can only be used with the card present at the point of sale in the domestic market.

The RBA's dramatic reduction in Visa Debit interchange fees compared to credit card interchange fees has created a strong incentive for credit unions and mutual building societies to issue credit cards.

**Q2: What is the case for ongoing regulation of interchange fees, access arrangements and scheme rules, and what are the practical alternatives to the current regulatory approach?**

Ongoing regulation of interchange fees is not necessary with the removal of the "no surcharge" rule and the HAC rule.

Removal of the "no surcharge" rule means merchants can recover their costs directly from cardholders and hence send price signals to cardholders about payment instruments. Removal of the HAC rule in relation to scheme debit gives merchants considerable power over consumers' payment instrument choices. These rights held by merchants put enormous downward pressure on interchange fees paid by acquirers to issuers.

If the RBA is to continue to regulate interchange fees, it should reverse its abolition of the HAC rule and work with the ACCC to prevent predatory surcharging by merchants.

Abacus supports a regulatory approach that is balanced, consistent and based on clear objectives.

The current review provides an opportunity for the RBA, APCA and the card schemes to agree on more self-regulation to encourage flexibility, innovation and competition.

Abacus supports an enhanced role by APCA in industry self regulation subject to RBA oversight to prevent abuse of market power by the largest participants in the payments system. APCA's governance structures will need to be reconstituted to better reflect a new role as self regulator and genuinely representative forum of a wider range of entities than the big four banks.

**Q3: If the current regulatory approach is retained, what changes, if any, should be made to standards and access regimes?**

The regulatory settings must be rebalanced to give a fairer deal to issuers and cardholders. There is an arbitrary and punitive quality to the current interchange fee arrangements for Visa Debit and EFTPOS, particularly when compared to credit card interchange fees.

The RBA has slashed interchange fees for scheme debit as a means to prop up EFTPOS debit. However, it should not be the RBA's role to put EFTPOS on life support. The future of EFTPOS should be up to EFTPOS issuers and acquirers agreeing on an appropriate

accommodation of the interests of merchants and cardholders, appropriate governance arrangements, and promotion and development of the product.

Attempts by ADIs to arrive at a voluntary EFTPOS interchange fee reform outcome acceptable to the RBA were blocked by merchant interests. The RBA's EFTPOS interchange standard resulting in interchange fees of 4-5 cents flowing from issuers to acquirers is a worse outcome for issuers than industry's voluntarily agreed position of a 'zero' interchange fee.

The last minute carve out of EFTPOS 'cash out' transactions from the interchange fee standard at the insistence of large merchants is another example of issuers and cardholders losing out. During renegotiation of these interchange fees, large acquirers sought to increase the rate to around \$1 – a 500 per cent increase. While Abacus is unaware of any EFTPOS bilateral partner agreeing to this particular pricing proposal, EFTPOS 'cash out' interchange fees remain considerably higher than the 4-5c regulated transaction rates.

The fact that a considerable proportion of EFTPOS transactions are unregulated and subject to unpredictable negotiating parameters creates a significant barrier to entry into the EFTPOS market for new issuers.

If the majority of EFTPOS transactions are to be subject to an interchange fee standard then the significant minority (around 15 per cent) of EFTPOS transactions that involve 'cash out' should also be regulated. At the very least the carve out of 'cash out' transactions must end when ATM bilateral interchange fees are reduced to zero or abolished. The RBA expects this to happen by 1 October 2008.

The solution we favour in the near term for all payment card interchange fees is for them to be based on the same formula of relevant costs, using the existing credit card standard as the benchmark. This would restore equity to the regulatory arrangements and remove the imbalance that now exists in favour of credit cards.

Abacus does not support setting all interchange fees to zero. This is an outcome sought by merchants who wish to force cardholders to bear the cost of services that benefit merchants.

Merchants have already saved \$2.2 billion in lower merchant service fees thanks to the RBA.

The future of the EFTPOS network is a test for payment system participants and the RBA to work out an improved regulatory model that gives space and responsibility to industry.

Abacus welcomes consideration of a commercial scheme to operate the EFTPOS system and for the promotion and development of the EFTPOS system.

Credit unions and mutual building societies are significant participants in the EFTPOS system<sup>8</sup> and see potential for the system to become even stronger, for example, through further reform of interchange fees.

A strong EFTPOS scheme could provide significant long-term competition for Visa and MasterCard.

---

<sup>8</sup> Credit unions and building societies use suppliers such as Cuscal Ltd, Indue and Australian Settlements Limited to connect with other EFTPOS system participants, such as large banks. Cuscal has bilateral interchange agreements with the major banks and others. As an example of the sector's participation in EFTPOS, over the past 12 months Cuscal processed more than 90 million EFTPOS debit transactions.

One of the most frequent observations about payments system reform is that it has been implemented piecemeal with reform proposals subject to long delays and related uncertainty for stakeholders.

The RBA's seven-year pursuit of reform of the ATM system is a case study. Developments in the ATM market since the RBA first called for reform appear to indicate that the objectives of the reform have been substantially achieved before any reform has actually been implemented.

After years of industry debate on the RBA's proposal for a direct charging regime, the RBA's threat to designate the ATM system has delivered an industry agreement for implementation of direct charging, with the Payments System Board expecting commencement no later than 1 October 2008.

The RBA expects the reforms to lead, over time, to more ATMs in a wider variety of locations. However, in the absence of reform, the number of ATMs has doubled and the industry has transformed itself with more ATMs now owned by non-ADIs than ATMs owned by ADIs.

### ***Conclusion***

Abacus wishes the RBA well in its review and we look forward to continuing to engage positively in the process.

In summary, Abacus urges the RBA to:

- Adopt a consistent, fair and reasonable interchange fee methodology based on relevant issuers' costs to apply to EFTPOS debit and scheme debit and credit cards;
- Reinstate the card scheme HAC rule before any more disruption and uncertainty is created and consumer choice further restricted by large merchants seeking to promote their own payment card products; and
- Encourage industry moves towards a centralised commercial governance structure to promote and develop the EFTPOS system.

Please don't hesitate to contact me on 02 8299 9046 or Luke Lawler on 02 6232 6666 to discuss any aspect of this submission.

Yours sincerely



**Louise Petschler**  
**Head of Public Affairs**