

22 October 2009

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By email to: [pysubmissions@rba.gov.au](mailto:pysubmissions@rba.gov.au)

Dear Ms Bullock

## **CONSULTATION ON PROPOSED CHANGES TO THE EFTPOS INTERCHANGE FEE STANDARD**

I refer to the Reserve Bank of Australia's (RBA's) Media Release of 22 September 2009<sup>1</sup> ("Payments Systems Issues" – specifically paragraph one "Consultation on EFTPOS Interchange Fee Regulation") and the paper attached thereto ("Consultation on Proposed Changes to the EFTPOS Interchange Fee Standard").

The Commonwealth Bank (the Bank) appreciates the opportunity afforded by this Consultation to contribute further to this important topic. The Bank has been an active contributor to the RBA's Payment System Reform process since its commencement, and had been an active participant on both sides of the EFTPOS network since its inception in the early 1980's.

We look forward to resolution of the issues identified in this latest RBA material, and take this opportunity to re-affirm earlier commitments to helping maintain a viable, efficient, safe and competitive EFTPOS network for our customers, on the basis of sustainable commercial viability. We understand, and acknowledge, that this submission will be published on the RBA web site.

In essence, the above referenced material identifies a number of key issues, which we summarise as:

- Regulatory equivalence (vis-a-vis international card scheme debit systems);
- Interchange fee setting Governance – multi-lateral or bi-lateral; and
- Governance and Access.

These issues are addressed below; we also take the opportunity to comment on a few related matters.

In summary, our position on this debate is:

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<sup>1</sup> <http://www.rba.gov.au/MediaReleases/2009/mr-09-20.html>

- We support regulatory equivalence / consistency – a weighted average interchange fee cap that applies equally to Scheme debit as for EFTPOS, is vital for the ongoing competitiveness of EFTPOS. For clarity, interchange flowing to the card issuer is essential.
- We endorse the multi-lateral setting of EFTPOS interchange fees. This will help deliver a simpler, more competitive outcome that helps address concerns around access to the EFTPOS network.
- We believe that cash out transactions should be included in the revised regime – the existing carve-out is no longer justifiable.
- We continue to support industry self management initiatives. In this regard we again commit to an active involvement in EFTPOS Payments Australia Limited (EPAL).

## Background

As mentioned above, the Bank has long been an active participant in the Reform debate, across many areas including:

- Chairing the EFTPOS Industry Working Group (2003 - 2005), including lodging an application for authorisation under the Trade Practices Act with the Australian Competition and Consumer Commission in relation to interchange fee setting;
- Membership of EFTPOS Access Australia Limited (EAAL; founding member);
- Leadership of the EFTPOS Scheme Working Group;
- Membership of EPAL (founding member); and
- Regular contributions to public debate around the broader Reform agenda.

The Attachment to this letter provides a snapshot of some views expressed since 2000 in relation to EFTPOS interchange. Without intending to represent a comprehensive review of all relevant Submissions over the past decade, and at the risk of selectively quoting from such documents, it is interesting to note that issues such as ongoing investment, incentives, innovation, multi-lateral fee setting and regulatory neutrality are not new – these have all been identified, and discussed, in prior documents.

It should be noted that each of the quotes listed in the Attachment has been extracted from material which is publicly available on the RBA web site<sup>2</sup>.

## Principles

The Bank's Submission to RBA of 31 August 2007<sup>3</sup> ("Reform of Australia's Payments System – Issues for the 2007/08 Review") articulated a number of principles that we believe are also relevant to the current discussion. These are presented in the matrix below, along with a brief comment as to their application to the current debate.

	Principle	Application to EFTPOS Interchange Fee Discussion
1	Interchange fees	<p><i>"... Typically Interchange Fees flow toward the side of the market where an incentive is required to help the network reach critical mass .... change over time to maintain/further develop a network or potentially more evenly distribute the network benefits between both sides of the market."</i></p> <p>In the current debate, we believe that the proposed changes are required to maintain the network and appropriately distribute value.</p>
2	End pricing to clients on each side of the market	<p><i>"Participants in both sides of a market need to be able to maximise their network benefit by directly pricing to their customers .... "</i></p> <p>Proposed changes are consistent with this principle.</p>

<sup>2</sup> <http://www.rba.gov.au/PaymentsSystem/>

<sup>3</sup> Available at [http://www.rba.gov.au/PaymentsSystem/Reforms/RevCardPaySys/Pdf/cba\\_31082007.pdf](http://www.rba.gov.au/PaymentsSystem/Reforms/RevCardPaySys/Pdf/cba_31082007.pdf)

3	Maintenance of Payments System integrity and customer utility	<p><i>"Participation ... maintain system integrity, and on the basis that their participation adds value to the network. Equally, participation in a network should not necessarily be mandated. ..."</i></p> <p>The proposed changes to the EFTPOS Interchange Fee Standard do not disturb this principle. Indeed, multi-lateral fee setting can help overcome perceived issues of access.</p>
4	Network self management	<p><i>"... self-manage, with transparency in approach and review"</i></p> <p>EPAL's ongoing work is key here – and regulatory parity is a necessary pre-condition for viable competition.</p>
5	Regulator intervention	<p><i>"Regulator intervention should only occur when there has been demonstrated market failure. ...."</i></p> <p>In this regard, we have argued<sup>4</sup> that the time is right for the RBA to step back from Regulation. In the absence of such a decision, regulatory consistency becomes an important requirement.</p>
6	Competitive neutrality in Regulation	<p><i>"... regulation should be competitively neutral, that is, it should not favour one business or type of business over others. ..."</i></p> <p>Competitive neutrality, or consistency, is vital to the ongoing viability of EFTPOS.</p>
7	Economic efficiency in Regulation	<p><i>".... assessment of the efficiency of various payment systems should consider all relevant factors, in particular, the structure of the original development of those systems, the value ascribed by customers, relative capabilities of those payment systems and the incentives to invest."</i></p> <p>Aspects such as these underpin our support for the proposed changes; the incentive to invest is especially germane in the current debate.</p>

Key features of several of the above principles are further explored below, but it is apparent that principles we sought to strike over two years ago, remain appropriate and relevant to the current review of the EFTPOS Interchange Fee Standard.

In addition to the above, principles inherent in the Payment Systems Regulation Act, such as the desirability of a co-regulatory approach and the need to ensure efficiency, competition and stability, are also relevant to the current debate and are endorsed.

We turn now to the specific issues identified in the RBA's 22 September 2009 Media Release and address each hereunder.

### **Regulatory Equivalence**

The desirability of regulatory parity or consistency between EFTPOS and Scheme debit is key to this current debate and underpins the RBA Consultation document.

Proprietary debit cards have remained relatively unchanged since their inception, maintaining their primary purpose of facilitating domestic based "card present" transactions at ATMs and at point of sale. More recently however, international card Scheme debit products having significantly evolved, and now offer a wide range of cardholder benefits and access points including:

- worldwide acceptance;
- card not present access – online, telephone and mail order;

<sup>4</sup> [http://www.rba.gov.au/PaymentsSystem/Reforms/RevCardPaySys/Pdf/ResPrelimConclu200708Review/cba\\_30062008\\_2.pdf](http://www.rba.gov.au/PaymentsSystem/Reforms/RevCardPaySys/Pdf/ResPrelimConclu200708Review/cba_30062008_2.pdf)

- improved security - EMV chip, use of Card Security Code (or CVC2);
- reduced risk - additional passwords, zero liability protection, merchant charge-back rights;
- superior customer service eg. MasterCard Global Service™; and
- cardholder rewards – eg MasterCard Applause, Visa Entertainment.

Additionally, Scheme debit card issuers receive positive interchange income over proprietary cards, typically an (unadjusted) income benefit of around, on average, 17c per purchase transaction (before costs are deducted).

This, coupled with growing consumer demand for Scheme debit cardholder benefits and expected future increased proprietary card issuance costs (eg. to potentially add EMV compliant 'chip' security), would suggest an industry tipping point is approaching whereby it is conceivable that proprietary cards would no longer be offered in the Australian marketplace without some form of fundamental re-alignment of economic value. In fact, some Australian card issuers have already commenced automatic re-issuance of Scheme debit cards in replacement of proprietary cards<sup>5</sup>, and many issuers are now actively promoting Scheme debit cards over proprietary debit cards.

The risk to proprietary card usage (reflected in current growth rates of Scheme debit and EFTPOS) is evidenced by RBA industry data<sup>6</sup> which show that the number of Scheme debit transactions have grown by 32% over the last 12 months since July 2008, while EFTPOS transactions have grown only 10%. Over the same period, the value of Scheme debit transactions have increased by 31%, compared to only 7% growth in EFTPOS. The average Scheme debit transaction size is almost double that of EFTPOS.

Accordingly, we support regulatory equivalence that thus enables comparable economic arrangements to be implemented, and which then facilitates more equal competition between the two products.

As indicated above, the Bank supports the view that the current EFTPOS interchange pricing provides no incentive for card issuers to invest in proprietary card enhancements or marketing, versus simply offering a Scheme debit product.

Adopting the proposed (positive) cap of interchange payments for EFTPOS transactions to card issuers would support future investment in proprietary cards, and provide the necessary funding for future enhancements to maintain its market competitiveness. This would enable potential enhancements such as adding 'chip' security to cards to address the recent significant rise in card 'skimming' losses, and other enhancements driven by customer demand.

It is worth noting that under a weighted average cap equivalent to that in place for Scheme debit (12c per transaction, payable to the issuer), a variety of product or feature specific rates would be feasible, in conjunction with exploring a move beyond the traditional card present / point of sale transaction in place for EFTPOS today. Clearly, any such move would require careful assessment of underlying commercial viability and competing market offerings.

The Bank agrees with the view that imposing a weighted average cap of 12 cents on EFTPOS interchange fees paid to the issuer will provide more freedom to compete with Scheme debit. Furthermore, it is the Bank's view is that the actual level of the interchange fee should be determined and set by the EFTPOS industry scheme body, EPAL.

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<sup>5</sup> We have, to date, refrained from such an initiative.

<sup>6</sup> RBA data: (<http://www.rba.gov.au/Statistics/Bulletin/index.html> - Debit Card Statistics).

The proposed changes to EFTPOS interchange would benefit consumers by increasing choice and competition in the payments market. However, for clarity it should be noted that the Bank does not support any further reduction to the weighted average designated Scheme debit interchange fee. This is due to the increased costs of Scheme debit transactions over EFTPOS transactions. These additional costs include fraud mitigation and management (including higher collection costs and write-offs) especially for card not present transactions, and higher transaction processing and authorisation costs.

We allude, above, to the ability to fund future functional enhancements to build on the currently limited range of features and applications that characterise EFTPOS today. Without regulatory parity, such enhancements would be uneconomic and unlikely to proceed.

In 2007 and 2008<sup>7</sup>, we argued in support of what was known, then, as “Option 3” – the de-regulatory option. RBA chose (August 2009) to defer a decision on this aspect<sup>8</sup>. Our support for an outcome such as Option 3 remains, and in the absence of RBA support for such a path, then the implementation of equivalent regulatory regimes for debit products becomes, in our view, a necessary pre-condition for competition and efficiency in this market.

### **Interchange Fee Setting Governance**

The Bank also supports the elimination of bilateral interchange fee arrangements - to be replaced with interchange fees to be agreed multilaterally by EPAL. This should facilitate speed, ease and lower cost access for new entrants to the EFTPOS network and is also administratively easier than the alternative process for calculation and reporting as described in the current RBA Consultation document. Clearly, implementation issues would need to be considered, as commercial agreements are unwound, but we doubt this would be insurmountable.

It is important, also, to distinguish commercial agreements from technical linkages in this regard. Whilst supporting multi-lateral interchange fee setting, we see debate around technical architecture as beyond the scope of this current discussion.

### **Governance and Access**

The Bank agrees with the need for ongoing Reform initiatives to remain mindful of the issue of access to the EFTPOS network. As argued above, we agree that current bilateral commercial arrangements are not conducive to ease of access for new entrants. While we have previously expressed concern over the level of fees built into the current EFTPOS Access Regime, we also believe that Access arrangements have undergone significant reform over past years and there is no need for further regulatory response in this area.

Ongoing work of EAAL and EPAL will be important in this area and we again commit to supporting those bodies.

### **Other Issues**

A number of other issues are also relevant to this discussion.

#### **1. Cash Out**

The Bank recommends that EFTPOS ‘cash out’ transactions should also be included in the proposed Standard on EFTPOS Interchange Fee setting (currently omitted). Under current arrangements, interchange fees on transactions involving a cash-out are excluded from the EFTPOS interchange fee Standard. We believe that the current “carve out” approach

<sup>7</sup> Submissions to RBA dated 31 August 2007 and 30 June 2008.

<sup>8</sup> <http://www.rba.gov.au/MediaReleases/2009/mr-09-18.html>

cannot be justified – especially in light of ATM reform introduced in early 2009.<sup>9</sup> Removing the current cash-out exclusion would simplify the setting of EFTPOS interchange fees, lower costs for industry participants, and contribute to easier access – and would represent another important step towards regulatory equivalence (vis-a-vis both Scheme debit and ATMs).

It is interesting to note that combined purchase and ‘cash out’ transactions across the industry represent low volumes (approximately only 11% of total industry EFTPOS transactions, with the addition of less than 1% of transactions being pure ‘cash out’ only transactions). Given the widespread availability of cash via ATMs situated in shopping malls, merchants are today the primary beneficiary of offering ‘cash-out’ (enabling immediate banking of their funds and reduced cash handling and theft costs).

Accordingly, and against the background of support for transparent multilateral fee setting and ease of scheme access, we believe that the current “carve out” arrangements are inconsistent, unsustainable and unnecessary. We believe that one weighted average rate covering purchase and ‘cash out’ transactions (including transactions that are a combination thereof) is the preferable way forward, with that rate determined by EPAL.

## 2. Combination Cards

The RBA in its September 2008 “Conclusions of the 2007/08 Review” document<sup>10</sup> noted the role of multi-function cards (or “combo cards” – international Scheme branded cards that permit EFTPOS transactions via selection of the “cheque or savings” button at POS terminals<sup>11</sup>) and opined that such cards facilitate network choice, enable steering, and are important in encouraging competition between EFTPOS and international Schemes. RBA went on to note that an important indicator of the competitive environment would, inter alia, be the continued maintenance of multi-function cards.

CBA’s current range of Scheme branded cards are able to act as combination or multi-function cards<sup>12</sup>. Our ongoing support for this functionality is predicated on the relative viability of EFTPOS transactions vis-a-vis Scheme debit transactions. Our approach to cardholder communication and education in this regard has, to date, been low key. However, should EFTPOS economic viability be significantly enhanced in the near future, we see the opportunity to consider marketing and incentives to further encourage EFTPOS usage.

## 3. Public interest

In assessing various options for further reform of EFTPOS Interchange fee arrangements, the Bank considered the likely impact on users and providers of payment services, including:

- the institutions that are participants in the EFTPOS, Scheme debit and credit card systems;
- potential new participants in the payments system;
- merchants that accept EFTPOS and Scheme debit cards;
- EFTPOS and Scheme debit cardholders; and
- the community as a whole.

Under the mooted changes we acknowledge that debit card acquirers will likely seek to recoup the loss of interchange fee revenue directly from merchants via increased merchant service fees. However, the Bank does not believe this will cause a reduction in the

<sup>9</sup> RBA data (<http://www.rba.gov.au/Statistics/Bulletin/index.html> - Debit Card Statistics) shows an increase in cash out transactions following ATM Reforms implemented in March 2009 – suggesting substitution and an opportunity for further equivalence.

<sup>10</sup> <http://www.rba.gov.au/PaymentsSystem/Reforms/RevCardPaySys/Conclusions20072008Review/br.html>

<sup>11</sup> Selection of the “credit” button, when using a Scheme Debit or Scheme Credit card, will see the transaction routed via the Card Scheme networks, regardless of whether the underlying account is a credit or transaction account.

<sup>12</sup> The CommSec Debit MasterCard is unable to act in this fashion. Cardholders are advised to always select “CR” when using an ATM or when making purchases.

availability of accepting EFTPOS payments, nor would it be significant enough to raise the price of goods and services. In fact, given the net benefits that retailers have enjoyed from previous “reform” initiatives, merchants should, we believe, be able to absorb the proposed change within current margins.

Furthermore, the Bank believes that retailers should be mindful that without changes to the current EFTPOS interchange regime, Scheme debit transaction volumes can be expected to grow significantly on the back of major marketing initiatives which will inevitably raise the amount of fees they pay. As mentioned, a tipping point would likely arise whereby the EFTPOS payments network is no longer commercially viable, thereby creating a situation where all debit transactions including ‘cash out’ are routed via the Scheme payment networks. Therefore, it is, we suggest, in merchants’ commercial interests to support the active competition of the EFTPOS payments system.

The Bank thus sees considerable public benefits in the proposal.

#### 4. Price Setting

As foreshadowed above, we suggest that removal of regulatory impediments to competition will allow EPAL to strike a commercial interchange fee structure that proves economic for all participants. Inherent in this is seeking a “sweet spot” which proves competitively viable after costs are considered and which delivers net benefit to all. We will encourage EPAL’s efforts in this regard.

#### **The Bank’s Position**

Taking the above into account, our position on these matters can be summarised as follows:

- We support regulatory equivalence / consistency – a weighted average interchange fee cap that applies equally to Scheme debit as for EFTPOS, is vital for the ongoing competitiveness of EFTPOS. For clarity, interchange flowing to the card issuer is essential.
- We endorse the multi-lateral setting of EFTPOS interchange fees. This will help deliver a simpler, more competitive outcome that helps address concerns around access to the EFTPOS network.
- We believe that cash out transactions should be included in the revised regime – the existing carve-out is no longer justifiable.
- We continue to support industry self management initiatives. In this regard we again commit to an active involvement in EFTPOS Payments Australia Limited.

Overall, it is important that EPAL, and EFTPOS itself, stand on own its own feet and compete on its merits – without the impediment of an uneven regulatory playing field. This position is supported, we believe, based on the principles articulated above as well as on public interest grounds.

#### **Conclusion**

We thank you again for the opportunity to lodge this Submission and look forward to our ongoing involvement with these matters. We remain willing to meet at any time to discuss this Submission or any related matters, and to this end, please contact the writer.

Yours sincerely

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Stuart Woodward  
General Manager  
Representation

### **Brief Chronology Of Selected Views Expressed in Relation to EFTPOS Interchange<sup>13</sup>**

Commonwealth Bank of Australia “Comments”, 20 December 2000

*“... current structure of debit card interchange payments clearly values the benefit received by different participants and has contributed to the investment necessary to foster the world class system ...”*

EFTPOS Industry Working Group Discussion paper on EFTPOS Interchange Fee Reform, July 2002<sup>14</sup>

*“... there is the potential for shifting of issuer and consumer incentives away from promotion and use of EFTPOS ... apparent lack of consistency ... Options ...”*

Commonwealth Bank of Australia “Options for EFTPOS Interchange Fee Reform”, 13 September 2002

*“... ensure that the financial institutions continue to have the incentive to develop innovative payment instruments ... concerned, therefore, for the long-term implications for investment if reduced returns to financial institutions ... lessen the incentive for financial institutions to invest in the maintenance of existing facilities or the development of new technologies”<sup>15</sup>*

Commonwealth Bank of Australia “Reform of Card Payment Systems”, 8 July 2004

*“... an interchange fee structure, providing future flexibility to address investment incentives, cost / benefit imbalances, or to fund significant one-off industry developments should be considered.”*

Commonwealth Bank of Australia “Reform of Card Payment Systems in Australia”, 15 October 2004

*“... urges the RBA to introduce interchange fee neutrality between proprietary debit and scheme debit.”*

Commonwealth Bank of Australia “Payments System Reform”, 29 April 2005

*“... The Bank ... previously indicated support for interchange fee neutrality between proprietary debit and scheme debit”.*

Commonwealth Bank of Australia “Reform of Australia’s Payments Systems – Issues for the 2007/2008 Review”, 31 August 2007

*“Principles ... Competitive neutrality ... incentives to invest.”<sup>16</sup>*

*“...lack of innovation and development of EFTPOS ... include aligning the Interchange fees for cash-out transactions with purchase-only transactions”*

Commonwealth Bank of Australia “Reform of Australia’s Payments Systems – Preliminary Conclusions of the 2007/2008 Review”, 30 June 2008

*“Principles ...”*

*“... EFTPOS Scheme, including multilateral setting of interchange fees ... continue to actively support that work ...”*

<sup>13</sup> Each of the documents mentioned in this Attachment can be found at: <http://www.rba.gov.au/PaymentsSystem/>

<sup>14</sup> Although not a CBA document, this discussion paper was a major contribution to the current debate, large parts of which remain relevant.

<sup>15</sup> Originally noted in a letter to the Governor RBA dated 20 December 2000, but quoted in our submission of September 2002.

<sup>16</sup> These principles are further explored on the body of this Submission.