
Submissions to the Reserve Bank of Australia

Reform of Debit Card Systems in Australia

17th February 2006

1. Introduction

On 29th December 2005 the Reserve Bank of Australia (RBA) gazetted a draft Access Regime for the EFTPOS system, a revised draft Interchange Standard for the EFTPOS system, and released a consultation document setting out the Bank's reasoning. The Access Regime complements the EFTPOS Access Code developed by the Australian Payments Clearing Association (APCA).

The RBA is now seeking submissions on these proposed reforms for consideration at its next Payment Systems Board meeting currently scheduled for the end of March 2006.

The purpose for submitting this document is to raise a number of issues that arise out of the proposed reforms that First Data Resources Australia Limited and Cashcard Australia Limited (together in this submission referred to as "First Data") believe the RBA should consider as part of the consultative process.

First Data has supported the EFTPOS access reform process since its inception through its membership of the APCA's Clearing Stream 3 Management Committee (MC3) and the EFTPOS Access Working Group (EAWG).

In principle First Data supports the draft Access Regime and Interchange Standard (Regime) as released, however submits that some aspects of the Regime as it is currently proposed require further refinement. These aspects are detailed in the submissions below.

2. Access Regime & Code

2.1 Cap on the price for establishing a direct connection:

First Data's submission relates to the rationale that has been employed to arrive at the current figure of \$78,000. The RBA has taken the approach of capping the cost at the lowest result from the survey that was conducted in September 2004. This approach does not take into account the fact that the survey results demonstrated a significant divergence in reported costs with participants' estimates ranging from \$78,000 to \$460,000.

In addition, First Data submits that taking the lowest cost approach to set the initial benchmark does not take into consideration an independent operator's potentially higher connection cost as a result of its unique position as the only bureau switch within the Direct Connectors, with higher overhead for such connections that bureau responsibilities incur in ensuring multiple (rather than single) institutions are protected.

First Data submits that a fairer approach is that the price for the link is to be individually negotiated between the parties as currently occurs, however with a benchmark price provided by the Access Company with a value to be determined from the mean of the reported connection costs as opposed to the lowest cost.

2.2 Minimum Number of Direct Connectors

The RBA's objective throughout the reform process has been to improve the efficiency of the system. The proposal to allow a new Direct Connector to establish with a minimum two links within twelve months and a third with three years appears, in First Data's view, contrary to this intention.

While the low number of links is understandable from a cost perspective, and with the intention of providing minimal barriers to entry, it has the potential to fragment the industry via a multiplicity of links.

A situation could be conceived where a significant number of Direct Connectors are implemented with minimal link numbers causing more complexity and even greater cost to subsequent new entrants that are trying to establish links with all parties.

Additionally some Direct Connectors (most probably those with the largest volumes) may face an overburden of requests for direct connections while smaller institutions are relatively unaffected leading to imbalance in the connection task faced by Direct Connectors.

Understanding the RBA's view that the cost of establishing links to all current Direct Connectors could be a barrier to entry, First Data submits that the minimum number of Direct Links be increased to five to ensure the most efficient number of Direct Connectors is maintained. In the case of a party previously or continuing to maintain some connections via Indirect Connection, that connection would be viewed as one of the five.

In the consultation document, the RBA referred to the need for a clear and enforceable timetable under which existing direct connectors are required to establish direct connections with those seeking them. First Data supports this ideal. However, First Data notes that each new link requires appropriate prioritisation by existing direct connectors of the work required to achieve the new direct connection, within existing technical work schedules related to income generating work and taking into account moratorium periods. Because existing direct connectors would be required to divert resources away from other income generating work to enable direct connections with smaller direct connectors within set timetables, First Data submits that mere proof of capacity to comply with technical standards is an insufficient threshold criteria for new entry. First Data submits that, in addition to proof of the ability to adhere to technical standards, new entrants should also be required to present proof of viability or projected volumes before existing direct connectors are required to commit to a set timetable for connection. Raising the minimum link connection to five would go some way to ameliorating the concern.

However, the potential for fragmentation of the industry would be better addressed by coupling a minimum link connection with a requirement for new entrants to also provide existing direct connectors with a viable business case. First Data submits that it is a reasonable and prudent position to adopt to ensure that a counterparty, particularly in the context of interchange, has the capacity to meet contractual and financial commitments.

2.3 Abolition of the “honour all cards” Rule in the Visa Debit system

First Data in principle supports a merchant’s right to choose which card groups it will or will not accept. However, it is submitted that a cautious approach should be taken in respect to how this capability can be deployed at point of sale, in other words, any solution provided to merchants in order that they can identify scheme debit cards with the specific purpose of allowing choice as to accept some card groups and reject others.

It is submitted that there will be significant technical difficulties associated with implementing such a solution to a requirement of this nature as well as significant cost to the industry if such a change is mandated.

The technical issues related to electronic identification of debit cards are compounded by the dual nature of scheme debit cards in the domestic arena with an underlying assumption that access to a credit account equates to scheme debit card interchange fees and access to cheque or savings account equates to EFTPOS system interchange fees.

In addition it is envisaged that a number of steps would be required to implement such a solution, including:

- 1) Design consensus.
 - APCA CECS, Visa, MasterCard, Amex, Diners, and JCB would each need to use their various domestic Industry forums/groups to agree on a particular design solution that would meet the desired objectives.
 - A minimum 12 months would be needed for appropriate discussion and review in much the same manner as has been allowed under the EFTPOS access reforms process so far.
 - Interested parties such as Merchant Groups and Consumer Groups would also want to participate no doubt.
- 2) Adoption Phase
 - A period of time would be required to process the nominated solution design to be published as a designation mandate by the RBA.
 - Allow an additional minimum 3 months for this phase
- 3) Build, Test, Implement.
 - The solution will involve changes to the way EFTPOS devices process, requiring software changes to be made by device vendors and tested by device deployers.
 - In addition, accompanying procedural changes would need to be implemented both internally at acquirers (Merchant Support Desk for example) and externally at all merchant sites (training of sales staff, etc).

- Issuers also will be impacted, as there would be significant need for cardholder education.
- There are significant logistics involved for the payments industry in such an undertaking, not in many ways unrelated to rollout of changes such as 3DES (Triple DES).
- Practicalities and the costs of such an undertaking would suggest that a minimum 2-year rollout phase would be required.

In addition there are ongoing costs to the industry to maintain the varied infrastructure such as the addition of new credit and debit card entries into EFTPOS devices, and the additional testing complexities required to regression test device software each time a change of any nature is made to the software.

First Data submits that the designated changes to EFTPOS and Visa Debit scheme interchange fees will be the tangible benefit to the Australian community in regards to this package of reforms.

Any subsequent changes (namely mandating of electronic identification of cards), if the RBA considers that these changes are required, will be better served (in terms of infrastructure costs) by voluntary incorporation when the domestic card market moves forward into EMV/CHIP card solutions.

3. Summary

In summary First Data makes the following submissions:

1. Cap on Connection Cost:
 - price for a connection to be individually negotiated between the parties with a benchmark price provided by the Access Company, the value of which to be determined from the mean of the reported connection costs as opposed to the lowest cost.
 - the Access Code and Standard should recognise that existing direct connectors can charge actual time and materials costs to new entrants for work performed at the request of the new entrant which is outside the scope of the defined "Standard Service"
2. Minimum Number of Direct Connectors
 - the minimum number of Direct Links be increased to five
 - new entrants should also be required to provide existing direct connectors with proof of a viable business case to warrant the devotion and diversion of resources to new connections.
3. Abolition of the "honour all cards" rule in the Visa Debit system
 - the designated changes to EFTPOS and Visa Debit scheme interchange fees will be the tangible benefit to the Australian community in regards to this package of reforms.
 - any requirement to electronically identify scheme Debit cards, be further deferred and encapsulate the changes related to removal of the 'honour all

cards' rule when the Australian EFTPOS community moves to EMV/CHIP card acceptance.