20th May 2015

Dr Tony Richards
Head of Payments Policy Department,
Reserve Bank of Australia
GPO Box 3947,
SYDNEY NSW 2001
Submission by email: pysubmissions@rba.gov.au

Dear Tony,

Review of Card Payments Regulation - Issues Paper March 2015

The Finance and Treasury Association (FTA) is pleased to provide our comments on the Reserve Bank Australia (RBA) Review of Card Payments Regulation, with a particular focus on the concerns of our members working in senior treasury and finance roles in Australian-resident non-financial-sector corporations.

The RBA has raised many issues and concerns throughout the Issues Paper which are highly relevant to our members.

Our overall comments are summarised below, with an attachment containing our detailed comments covering our specific responses on the RBA issues raised.

Overall Comments

The Australian card payments system has become an integral and highly critical component of the financial payments for businesses, large and small. The Bank has identified cards as a 'must take' form of payment, which also accords with our views and experience.

Key principles and conclusions in FTA's submission are:

Despite RBA focus on interchange fees, the weighted average benchmark is no longer effective. Cards issuers and schemes are pushing higher-cost cards into the market, causing rising costs for most Australian merchants. For all but the largest players card acceptance is becoming a higher cost of doing business. FTA's concern with the current structure of the card payments system is our assessment that it is moving away from being simply a payments system, with cost and features more driven by reward benefits attributable to only a small number of card holders.

FTA considers the current system has delivered:

- An unnecessarily high cost form of payment for many Australian merchants – but one they are obliged to use

- High levels of cross subsidisation from smaller merchants to other system participants particularly card issuers, card holders, and Schemes

- Due to a lack of transparency for merchants in cost of individual cards, an inability to accurately charge cardholders

- Growing cross subsidisation from low cost cardholders to high cost cardholders.

With our submission FTA is seeking a more level playing field for all system users, to remove anti-competitive elements, and to lower barriers to entry for innovation and for new participants in the Scheme and card issuing and accepting areas.

Summary Recommendations

The card system in Australia is now highly mature, and is in effect a part of the Australian payments infrastructure. This in our view should be reflected in the approach to its regulation:

- FTA suggests that serious consideration be given to phasing out the interchange fee mechanism in what is a mature system. Ideally, users of the system should pay relevant charges consistent with the economic cost of the services provided to them, as applies with other payment systems.
- During a period of transition, the total fees payable in the system could be capped. In our view, the European approach provides a precedent and may be an appropriate benchmark too with fees for credit cards at no higher than 0.30%, subject to a small maximum charge.
- The system should provide transparency to merchants and consumers alike, with transaction charges made available at the time of the transaction. Ideally the system could facilitate recharging of transaction charges directly to the cardholder at the time of the transaction.
- The distinctions between strategic and preferred merchants, and all other merchants should reflect the economics of those relationships absent regulator-sanctioned cross-subsidisation.
- An overall aim for change would be to remove regulator-sanctioned cross-subsidisation. return the principle drivers of the system to provision of payments service, provide a level playing field for all system users and remove anti-competitive elements, provide transparency of cost and charges to all participants, and
- Actively encourage the entry of new participants in the Scheme and card issuing and accepting areas, subject to accepting the rules for participation in the infrastructure.

Concluding remarks

FTA understands that promotion of economic efficiency throughout the financial system, including the payments system to be one of the key objectives of the Reserve Bank of Australia. And note RBA's duty is also "to contribute to the economic prosperity and welfare of the Australian people".

Australia's corporate sector benefits from having a financially robust small business and individual customer base.

Given the high proportion of transactions accounted for by credit cards it is likely that reducing the cost of accepting "high cost" cards would represent a tangible improvement in small business profitability. Meaningful savings might be available to smaller businesses while not compromising the ability of larger businesses to reap scale economies and strike mutually-beneficial commercial arrangements with the card-issuing companies.

That a large proportion of submissions to the Financial System Inquiry, particularly from SMEs and individuals, were seeking reform to credit card charges, is an indication that the current arrangements are not only inefficient but also considered to be inequitable, i.e. unfair.

Perception is always important. As the Federal Government and the RBA seek to rekindle parts of the Australian economy, particularly in small business, changes of the nature we propose would represent a form of micro-economic reform. Utilising new technology and learning from the European experience, such structural change to the cost of access to key infrastructure can only send a positive signal to those investing their energies and risk capital in Australia.

FTA welcomes the opportunity to discuss our philosophy and recommended approach.

Yours sincerely,

Ross McKean CFTP (Snr)
President
Finance and Treasury Association

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Specific Responses

Issue 1 - **Publishing thresholds for which payment system providers will be subject to interchange or related regulation, possibly based on transaction values and/or market shares.**

The RBA and the Payment Systems Board must ensure that information, decisions, and decision making processes are transparent and support a highly competitive playing field. Increased choice and competition is required from alternative providers and alternative payment mechanisms for services to merchants as well as to consumers.

The access regime should recognise that the card system is a mature yet essential financial infrastructure, and hence facilitate high accessibility.

FTA supports in principle this recommendation, and in favour of greater granularity of information to ensure the cost of acceptance more closely reflects the underlying economics.

Issue 2 - **Broadening interchange fee caps to include other payments between schemes and issuers.**

Issue 3 - **Making changes to the interchange benchmark system to reduce the upward 'drift' in average interchange rates inherent in the current three-year reset cycle.**

Issue 4- **Lowering interchange caps.**

Issue 5 - **Replacing weighted-average interchange caps with hard caps.**

Issue 6 - **Applying caps as the lesser of a fixed amount and a fixed percentage of transaction values.**

FTA supports changes that reduce the cost of compliance and costs associated with the provision of electronic merchant facilities. Hence FTA supports in principle issues 3 to 6.

Arguably an interchange fee is no longer justified in the mature and well established Australian card payments system. Incentive fees are driving costs higher and churning existing cardholders to higher cost cards. Interchange fees could be phased out over a period of less than 3 years, with a hard cap on fees until that is achieved.

In our members' experience, the three year weighted average cap increases costs for most merchants, and is we understand now recognised by the RBA as an element driving greater issuance of higher fee cards.

And, the weighted average cap has only been partially effective from a consumer perspective given the high levels of cross subsidisation in the system.

On this basis, it would be appropriate that the weighted average cap be superseded by a hard cap system.

A transitional hard cap system could be similar to that adopted in Europe.

Potentially, total charges could be capped at the lesser of a fixed fee and a fixed percentage of 30 basis points on credit cards as an example. Such a cap would include all types of fees, and would need to be transparent to consumers and merchants at the time of the transaction.

Further Card issuers could be required to ensure consumers are aware of the charges applying to their card. This would see

- charges and fees in the card system fall into line with charges in other payments mechanisms,
- cards as primarily a payment mechanism rather than a rewards system as it is today,
- a transparent, pro-competitive model allowing new competitive participants and
- significantly reduce cross subsidisation between merchants and other system participants.

As outlined in the submission to this Consultation by CSR, "it is a significant concern that banks are replacing EFTPOS cards with scheme debit cards when customers' EFTPOS cards expire. Under the existing system of caps, this has the impact of lifting costs for merchants and starving the low fee EFTPOS system of revenue and therefore reducing investment in that system. The EFTPOS system is the only practical alternative for "real time" payments to merchants in many situations."

(FTA believes that a modernised low cost payments system is vital for ongoing small business health and to ensure greater financial inclusion. Left to their own devices, the major banks do not seem to have enough incentive to invest in upgrading the infrastructure.)

Issue 8 - **Allowing for 'buying groups' for smaller merchants to group together (subject to any competition law restrictions) to negotiate to receive the lower interchange rates that are accessible to larger merchants.**

FTA supports the principle of "buying groups" but believes this proposal would not be practicable in most industries without high degrees of co-ordination. Such a proposal is second-best and would only needed if the reforms to the benchmark/hard cap are not adopted.

Issue 9 - **A tiered surcharging system, perhaps along the lines of the FSI recommendations.**

- **Allowing low-cost system providers to prevent merchants from surcharging, to encourage consumers to use low-cost payment methods.**
- **Allowing medium-cost providers to limit surcharges to limits set by the Board.**
- **Allowing high-cost providers to limit surcharges to the reasonable cost of acceptance.**

FTA considers that a tiered surcharging system will prove difficult and problematic to implement due to the need for an upgrade of terminals and hard to administer given different average interchange costs across merchants. Setting a reasonable but across- the-board surcharge will be difficult without substantial rationalisation of variety in the card base.

In principle, cardholders wishing to experience reward schemes should pay these costs, rather than merchants or other cardholders.

FTA supports the phase out of interchange fees while in the interim setting fee caps as discussed. This should be combined with transparency of all fees and charges to consumers and merchants at point of sale.

Issue 12 - **Strengthened transparency over the cost of payments to merchants and cardholders.**

FTA agrees with the principle that users of services should know how much, or have the ability to know how much, they are to be charged for those services in order to make an informed decision to transact.

With disclosure of costs, charges and fees merchants would in principle have the option to recover them and consumers have a choice as to how much they wish to pay for a transaction. It would have the impact of reducing overcharging and reducing system cross subsidisation.

It has been argued that such disclosure in other sectors has led to excessive documentation with the message buried by legal disclaimers, and that it might deter customers. However it ought to be possible in the near future for upgraded terminals and smart phones linked to cards to provide the cost of a transaction nearly instantaneously.

Issue 13 - **Further easing of 'honour-all-cards' rules to allow merchants to decline to accept cards with high interchange fees.**

As noted above, FTA agrees with the principle that users of services should know how much, or have the ability to know how much, they are to be charged for those services in order to make an informed decision to transact.

While designed as a consumer protection, the "honour=all-cards" rule is one of the reasons for the rising average cost of card acceptance.

The credit card system may be unique in that it requires merchants to accept charges and services for a product without knowing the cost in advance. Unless a hard fee cap applies, RBA should consider eliminating, or qualifying, the honour all cards rule in order to allow merchants more freedom to choose which services they wish to use.

Issue 14 - **Facilitation of differential surcharging by merchants.**

FTA supports transparency of all charges by card/transaction type as an essential pre-requisite for a competitive and functioning market. Differential surcharging would improve market function, and provides merchants and consumers with choice. The technology should be capable of instant recharging.

Differential surcharging would not eliminate cross subsidisation between strategic/non-strategic merchants or from merchants to other system participants. Larger customer-facing businesses would still be able to reap scale economies and strike mutually-beneficial commercial arrangements with the card-issuing companies consistent with their market position.

Issue 15 - **Ensuring that merchants have the ability to choose to route their transactions via lower-cost networks or processors.**

FTA supports this proposal. While merchants bear the cost of payment processing, it is important merchants can exercise choice over payment pathways.

Issue 16 - **Clarifying arrangements for competing payment options within a single device or application.**

FTA considers that best solution will ensure transparency, competitiveness, minimise cross subsidisation, encourage conscious consumer choice and be device or application-neutral.

About FTA

The Finance and Treasury Association engages in Advocacy activities on behalf its members and the broader treasury and finance profession in order ***to inform policy, regulation and market operations that impact on the corporate treasury function and more generally the Australian financial markets.*** *Furthermore, FTA's Advocacy activities are intended to raise the profile of treasury functions in non-financial and public sector organisations and the community at large as it is considered that treasury and financial risk professionals have a unique and valuable perspective.*

FTA's more senior members tend to be corporate treasurers. They are the natural counterparts externally to banks and investment banks, and to specialist risk, legal, tax and accounting advisors. (And with their CFOs they have a primary responsibility for interaction with debt investors and ratings agencies.)

And due to their core centralised cash management function, corporate treasurers interact with a range of internal stakeholders i.e. most of their company's key business units. As the corporate finance professionals who are the in-house corporate finance experts, corporate treasurers are trusted to make decisions about sources of capital; for instance, internally they are the key drivers of corporate bond issuance.

With this responsibility for both liquidity and funding, treasurers are required to implement strategies to ensure solvency and to protect corporate balance sheets. A key activity of most sophisticated treasuries is thus hedging of interest rate and exchange rates, and commodity price inputs and outputs. Key tools used by treasurers are exchange-traded and over-the-counter derivatives. Corporate treasurers are primary end-users of financial services.

Corporate treasurers have corporate governance responsibilities and must operate within board-approved policies. Most corporate treasurers have reporting lines into Board committees, the Chief Executives and Chief Financial Officers.

Ultimately, finance and treasury professionals are key custodians of corporate value and reputation. As such FTA considers that corporate treasurers have a vital and differentiated perspective to provide to policy-makers, regulators, service providers and other financial market participants.

FTA seeks to elevate the understanding of treasury activities and responsibilities among external and internal stakeholders and to provide an authoritative voice on all matters that relate to the practice of corporate treasury and financial risk management.

FTA develops its advocacy positions independently of its own commercial considerations.
In its advocacy activities FTA takes the standpoint of non-financial-sector corporations although as a skill-set based body, FTA's membership includes members whose professional role is to provide services to non-financial-sector corporations. FTA works with like-minded Associations on matters of common interest and to share resources.

FTA will respond to formal and informal consultations from governments and regulators as well as other associations which set or oversee market practices in the following areas:

- Role of non-financial corporations as end users of financial products/services/markets
- Corporate financial policy and financial management
- Risk management
- Banking and payment systems
- Tax
- Relevant accounting and other disclosure practices and standards
- Corporate governance