



AUSTRALIAN BANKERS' ASSOCIATION INC.

Nicholas Hossack
Policy Director

Level 3, 56 Pitt Street
Sydney NSW 2000
Telephone: (02) 8298 0408
Facsimile: (02) 8298 0402

16 January 2009

Ms Michele Bullock
Head of Payments Policy
Reserve Bank of Australia
Sydney
e-mail: pysubmissions@rba.gov.au

Dear Michele,

ATM designation

Thank you for the opportunity to comment on the designation of ATM system and the Reserve Bank's Draft Access Regime that was issued for comment on 10 December 2008.

Designation of ATM system

The Australian Bankers' Association (ABA) agrees with the Reserve Bank's sentiments that it was unfortunate that ATM reform could not be implemented without RBA designation. There was a genuine effort to avoid RBA designation.

Apart from designation, three options were considered by APCA's ATM working group. The first option had the banks simply ignoring any legal risks and multilaterally agreeing to reduce ATM interchange fees to zero. The problem here is that there was a legal risk (i.e. price fixing which is prohibited under the *Trade Practice Act 1974*) that banks were unwilling to absorb.

Another option was for the Commonwealth Government to amend the *Payments Systems Regulation Act 1998 (PSRA)* to provide sufficient legal certainty for the ATM reforms, specifically to reduce ATM interchange fees to zero and agree connection fees. We understand that the Commonwealth Government indicated an unwillingness to do this.

Another alternative was for the ATM participants to draw up an ACCC authorisation proposal. In the past, this option was not advanced because of strong differences of opinion amongst ATM industry participants on the optimal model to be authorised. For example, the credit union representatives were unwilling to support a model that meant that credit unions could not charge interchange fees within their network. Further, an authorisation approach was likely to be costly and yet still unlikely to deliver a suitable framework to deliver on-going legal certainty and an efficient means to address practical challenges that arose i.e. a means of arbitrating commercial issues.

Timing also became a problem. As the 2008 calendar year progressed towards the March 2009 implementation date, the reality emerged that an ACCC authorisation clearance could not be guaranteed within the timeframe.

This really gave the APCA ATM working group little option other than to propose legal certainty for an agreement on zero interchange and connection fees through an RBA designation process.

Direct connection costs

The Draft Access Regime caps the cost of direct connection to existing ATM participants at \$76,700. The cap is the lowest cost for this connection reported by APCA members via APCA's 2008 costs survey.

This methodology means that, by definition, all except one incumbent participant will be subsidising new entrants into ATM direct connection. In the ABA's view, a more appropriate methodology would be for the direct connection fee based on an average cost of incumbents. Even under this methodology the access seeker receives a subsidy.

An averaging methodology would still encourage all incumbent institutions to reduce these connection costs. For those with costs above the average fee, there is an obvious incentive to reduce the subsidy. For those institutions with costs below the average, then there is still an incentive to reduce costs further and indeed provides an incentive to hasten connection to the new entrant.

Another point about the fee methodology is important. The institution with the lowest connection costs may not be the most efficient, the level may reflect the fact their systems are less complex which reflects a relatively small scale operation. By basing the fee on an average, this and any other idiosyncratic distortions can be smoothed out.

Direct Clearing or Settlement Arrangement

The Reserve Bank's Draft Access Regime caps at zero the fee an incumbent can charge a new entrant to establish clearing and settlement arrangements. The Draft Access Regime does, however, recognise that new entrants seeking direct clearing and settlement arrangements must comply with relevant prudential standards as specified under APCA's Access Code.

The principle that institutions should be free to recover incurred costs is an important pricing principle in ensuring the interests of shareholders, staff and customers are appropriately protected. In this respect, ABA recommends that participants be allowed to set a fee to recover their costs.

Assuming there is a policy change to allow cost-recovery, the ability to charge a fee will need to be reflected in both the RBA's Access Regime and APCA's Access Code.

Retail fees

The Reserve Bank stated in its media release and consultation document that, once direct charging commences, it no longer sees a case for card issuers to charge foreign ATM fees. This is curious to the ABA, as our understanding is that the Reserve Bank does not have powers to influence retail prices of banking products.

Even though the Reserve Bank is not attempting to directly influence these fees through regulated price capping, the effect of making such comments is that any bank card issuer wanting to recover costs directly through a foreign ATM fee may be erroneously criticised and the critic may use the Reserve Bank's stated view to legitimise the criticism.

Retail fees should be determined by costs and competition, not by suasion. These costs should not be underestimated, particularly if the reforms lead to a greater proportion of low cost, poor quality ATMs that result in costly disputes and incidences of fraud.

Of course, if a bank charges a foreign fee that is too high, then it will risk losing customers. This is a commercial decision.

The Reserve Bank's decision to comment on foreign fees now creates an expectation it will also comment on the fees and margins being earned by institutions operating in sub-networks where interchange fees will be permissible.

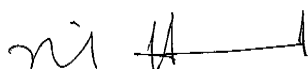
Alternative to Bilateral Interchange System

The Reserve Bank has also raised the prospect of introducing ATM architecture that enables new entrants to establish just one connection to facilitate direct participation in the system.

The ABA will provide further comment on this issue in due course, but it is important to recognise (a) that Australia has a very popular, ubiquitous and highly reliable ATM system and, (b) introducing any new technology must be done in the least costly means possible.

If you have any questions, please give me a call on 02 8298 0408 or by e-mail: nickh@bankers.asn.au.

Yours sincerely



Nicholas Hossack