

**Financial Services
Consumer Policy Centre**

Options for EFTPOS Interchange Fee Reform

Submission

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THE UNIVERSITY OF
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Introduction

The Financial Services Consumer Policy Centre welcomes the opportunity to participate in the reform of EFTPOS interchange fee arrangements. We see this as an important step in the overall reform of payment systems in Australia to introduce fairer, more transparent pricing and more appropriate price signals for consumers. Over time, we expect consumers will benefit from reform of interchange fee arrangements for credit cards, EFTPOS, ATMs, Visa Debit and BPay.

EFTPOS is a very popular product with consumers and one which our Centre is happy to promote in the future as a fairer and more efficient payment instrument. In the medium to long term, we see EFTPOS as the preferred payment instrument for the vast majority of transactions.

However, the current interchange fee arrangements for EFTPOS are inappropriate, and reform is long overdue. Consumers have been herded towards other less efficient products as a result of current interchange fee arrangements and the poor price signals that have been sent to consumers.

Problems with the current arrangements

From our perspective, there are five key deficiencies with the current EFTPOS interchange fee arrangements:

1. The direction of interchange fee payments is not justified by any economic principle.
2. Bilateral contracts and network access arrangements act as a disincentive to new entrants.
3. The interchange fee burden on issuers has resulted in the promotion of alternative, less efficient, payment instruments (mainly credit cards).
4. There is little competitive pressure on the level of interchange fees which have remained high and static for many years.
5. The setting of interchange fees in EFTPOS is inconsistent with the principles set down for the setting of interchange fees in the recent designation of credit cards.

Preferred reform option – no interchange fee

Our preferred reform option is to eliminate EFTPOS interchange fees altogether. This would remove the majority (but not all) of the current inequities in the interchange fee arrangements. It would also remove administrative costs and simplify the system. Consumers would benefit as the reduced average transaction costs could be passed on to all consumers and the reduced issuer costs would remove part of the incentive to herd consumers towards credit card payments (leading in turn to additional benefits to merchants and consumers).

We acknowledge that under this option a few large acquirers would see reduced income from EFTPOS and some issuers might not receive some of their legitimate issuer costs.

However, the acquirer income is the result of their historical position of leadership and investment in the network, the costs of which have been returned to acquirers many times over in the last eighteen years and should not continue indefinitely. General merchant fees and the ‘bundled’ nature of banking relationships should continue to provide acquirers with benefits from offering EFTPOS services.

Although issuers might not receive all of their legitimate costs, their net position will be substantially improved by these reforms. In addition the simplicity of a no interchange fee system will have benefits for issuers (especially small institutions and potential new entrants).

We note that the ACCC/RBA joint study supported the eventual abolition of interchange fees in the EFTPOS system, and that some overseas jurisdictions do not have EFTPOS interchange fees.

The only potential consumer detriment in such an arrangement is the reduction in the incentive for future investment in EFTPOS technology and network infrastructure. However, we are confident that the ‘bundled’ nature of banking services and the increased popularity of EFTPOS (post the payment system reforms) will provide sufficient motive for maintaining and improving the EFTPOS system.

We note that acquirers will still have options to recover costs through merchant fees and issuers to recover costs through direct consumer fees. However, both these fees will be subject to greater transparency, flexibility and (potential) competitive pressure than hidden interchange fees.

Second preference – multilateral agreement (issuer costs)

If the above option were not to succeed, we might, reluctantly, be able to support a second option. This would involve:

- **A change in the direction of interchange fees from acquirer to issuer**
While we acknowledge the historical role that some acquirers have played in providing the EFTPOS network with the ‘scale’ necessary for it to succeed,

we cannot see any justification in 2002 and beyond for interchange fees to flow from the issuer to the acquirer. Australia is the only jurisdiction in which interchange fees flow in that direction. The vast majority of benefits are provided by issuers. The suggestion that ‘cash out’ facilities now justify the high interchange fees which flow to acquirers does not appear to be a network access or benefit issue and should not be included in discussions of interchange fees. The potential situation where a large bank which has a substantial acquiring business would be paid for ‘cash out’ costs by small issuers, on the rationale that large banks have closed branches, shows just how out of place this suggestion is in the interchange fee debate.

- **A standard multilateral agreement on a flat fee interchange fee**
We oppose bilateral agreements because of the disincentive they provide to new entrants. We prefer a standard agreement, as we believe the “default rate” model introduces unnecessary complexity into the system, and the disincentive to new entrants is likely to outweigh any potential benefits from competition via bilateral agreements.
- **Calculation of the interchange fee based on issuer costs**
We believe the interchange fee should be calculated on issuer costs as the main benefit appears to flow to merchants and acquirers from the payment guarantee, transaction processing and card-holder services.
- **Issuer costs strictly limited to those essential items which deliver real benefits to merchants and acquirers**
We oppose the broad inclusion of all issuer costs in this model. Some issuer costs should more reasonably be absorbed as the general overheads of providing payment system services and only those costs which provide a real benefit to merchants and acquirers, in accordance with the economic principles established in the Payment System Board’s designation of credit cards, should be included in the calculation. We would certainly oppose the inclusion of all of the items listed as possible issuer costs in the Issues Paper.
- **Issuer costs calculated by an independent outsider**
We believe the issuer costs should be calculated by an independent party based on data provided by participants, in a similar way to the calculation which will now take place under the Payment Systems Board’s designation of credit cards. We believe that it is important to subject collective fee setting to outside expert scrutiny.
- **Multilateral agreement to be reviewed every three years**
We believe that any interchange fee which is in the form of a multilateral agreement should not remain static for long periods of time. Reductions in the cost of data processing, information technology and communications plus reduced costs from fraud prevention measures and security upgrades in addition to expected ‘volume savings’ as the use of EFTPOS increases should all contribute to potential interchange fee reductions. The multilateral agreement should be reviewed at least every three years and subject to the same outside expert scrutiny as occurs in the initial assessment of issuer costs.

- **Improved transparency and oversight of interchange fees**
We believe that the community have the right to know the level of interchange fees agreed upon by the participants, and any changes to those fees (eg. following reviews). We believe information on the level of fees, aggregate data on fees collected, information on how fees are calculated and set, plus information on any changes should be widely published by participants and regulators. As a *minimum* the Payment Systems Board should publicly report on all of the above matters and statistical data should be included in the Reserve Bank Bulletin statistical tables.
- **Authorisation against the ‘net public benefit’ test by the ACCC**
We believe that there are some dangers inherent in financial institutions engaging in collective fee setting, and that the initial multilateral agreement should be subject to ACCC authorisation to ensure that the public benefit outweighs any risks of reduction in competition.

Overall, we have concerns about this second option leading to gradual increases in interchange fees, rather than their eventual abolition. However, with *all* of the additional protections outlined above in place, it is possible that we could support a multilateral agreement.

Other options

At this stage we do not believe any other options set out in the issues paper would be in the broad interests of consumers.

- **Bilateral agreements**
We believe that bilateral agreements have failed consumer interests to date, by acting as a disincentive for new entrants, and by entrenching interchange fee flows and levels which may have been relevant in the 1980s, but which have not been altered to reflect lower network costs and the emerging interests of issuers. None of the suggestions in the issues paper (circuit breakers, “agreed” methodologies etc.) are attractive to either new entrants or consumers.
- **Multilateral default rates**
We believe multilateral default rates add an unnecessary layer of complexity without offering any real prospects of competition. Instead they will make it difficult for new entrants to enter the market with certainty, cloud the information available to consumers and stakeholders about the level of interchange fees, and reduce incentives for parties to push for a low multilateral fee. Ultimately we see this option as resulting in a higher average fee as the default rate will be subject to less pressure, but is likely to apply to the vast majority of transactions.
- **Acquirer costs**
As discussed above, we believe that acquirer costs are largely justified on

historical reasons which are no longer as relevant to the setting of the interchange fee. The initial network costs have been repaid many times over by consumers and merchants, and it is time to subject these costs to true openness, fairness and competitive pressure. Our other comments on acquirer costs also apply.

- **Net costs**

While the net costs option appears theoretically attractive, we believe it would be likely to give too much weight to acquirer costs and would reduce overall benefits to consumers. It also appears prohibitively complex compared to the simplicity of having no interchange fees or calculating the interchange fee based on the costs of only one party.

Conclusion

This submission has set out our preferred option plus our second option for EFTPOS interchange fee reform at this stage.

This submission is based on our current understanding of the pros and cons of the options as outlined in the issues paper. However, we will certainly be reading the other stakeholder submissions with great interest, and we will have an open mind on all options if additional data and arguments are put forward.

We would be very interested to participate in any follow up discussions of the reform options. Ultimately we believe it is in the interests of payment system participants to carry the broad support of stakeholders, including consumers.

Finally, we see the EFTPOS reforms as part of the broader reform of payment system interchange fees, and we look forward to continued participation in that process.

About the Centre

The Financial Services Consumer Policy Centre is a not for profit consumer advocacy and research organisation affiliated with the University of New South Wales Faculty of Law.

The Centre has expertise in all issues of consumer banking and has been at the fore of advocating for responsible and ethical banking practice.

Our web site, including the majority of our research papers, is at:

<http://www.fscpc.org.au>

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