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Dr John Veale
Head of Payments Policy
Reserve Bank of Australia
65 Martin Place
Sydney NSW 2000

Dear Dr Veale

Reform of Card Payment Systems in Australia

I am writing in response to the Reserve Bank of Australia's (**RBA**) announcement on 9 September 2004 that it has designated the EFTPOS debit card payment system (**EFTPOS**) in Australia. This letter outlines Pulse's views in relation to the RBA's decision to designate EFTPOS, and restates some key details from our 9 July letter for completeness.

Our business

Founded in 1999, Pulse operates an independent EFT switch in support of its ATM and EFTPOS businesses. We have in excess of 2100 ATMs connected to our network, representing over 10% of the total number of ATMs in Australia, and we are steadily growing our EFTPOS business, which was launched in September 2003. Over the period of our operation, Pulse has invested in substantial start-up costs that have been necessary to achieve our current position of viability and relevance in the ATM and EFTPOS systems.

Pulse connects into the interchange networks under arrangements with BankWest. We are also certified for direct connection into the MasterCard and Visa International systems as a third party processor. We have not yet established direct connections to the other participants in the ATM and EFTPOS systems. Pulse is an Associate Member of APCA and has been invited to nominate for a representative appointment on the CECS Advisory Council. We acquire transactions and operate our business according to the relevant APCA rules. Two of Pulse's executives have previously sat on APCA's SPC3/MC3 and Standards Committee, at the time representing major bank acquiring and issuing interests.

In real terms, we are a relatively new entrant to the EFTPOS market, demonstrably providing acquiring services to merchants. Currently, our EFTPOS merchants are concentrated on the mainland eastern seaboard, between Cairns and Melbourne. Pulse is not a card issuer. Pulse seeks to compete for acquiring and related business, utilising our functionally rich technology that enables us to deliver innovative payment solutions. We have entered into a strategic relationship with Travelex Australia to commercialise our dynamic currency conversion service (which allows foreign cardholders to transact in Australia in their home currency) using EFTPOS and ATM devices. As Pulse does not provide a range of commercial banking services to merchants, we cannot cross-subsidise acquiring services.

Pulse's concerns with the RBA's approach to designating EFTPOS include the extent to which 'determination of standards' may see EFTPOS interchange fees reduced to zero, or set at a rate (or rates) which is/are lower than today's prevailing interchange fees. The question of access is, we believe, also somewhat confused by the fact that incumbent acquirers are primarily involved in proceedings, rather than the range of card issuers to whom access is sought by new acquirers.

Designation of the EFTPOS system

We note the Payments System Board's (**PSB**) conclusion that '… current interchange arrangements are not conducive to the efficiency of the overall payments system …', and that this is now viewed as a matter of public interest. We also note the suggestion that EFTPOS interchange arrangements result in cardholders being charged more for EFTPOS transactions than for (eg) credit card transactions, which proceeds to the statement of '… the EFTPOS system having relatively lower costs …'.

EFTPOS transactions require the presence of a suitably secure PIN pad, immediacy of telecommunications, and on-line, real-time transaction processing through the acquirer's system out to the card issuer and then back to the EFTPOS device. The necessary infrastructure to facilitate such processing is very expensive, a fact to which Pulse can attest.

By contrast, credit card cardholders can make payments over the telephone, by mail or facsimile, through the world wide web, or in person at a merchant's premises. In the latter case, where an EFTPOS terminal is available, it has become common practice - since the mid to late 1980s - for acquirers to automate credit card transaction processing by utilising EFTPOS terminals and the extensive infrastructure that sits behind them. Similarly, this has facilitated the acceptance of Visa Debit, charge, gift, fleet/fuel, loyalty and other types of cards through EFTPOS terminals – a concept which has more recently been expanded to enable mobile telephone call cost prepayment and other forms of electronic product delivery to take place in an automated, convenient and cost-effective manner.

A significant number of credit card transactions are processed electronically from EFTPOS terminals and, in addition to the processing efficiencies and economies enjoyed by acquirers, this provides important benefits to card issuers including positive authorisation, real-time risk monitoring, and certain cost advantages. Rather than the PSB judging that a change to EFTPOS interchange arrangements '... would promote the efficiency of the overall payments system …', it should perhaps reflect positively upon the fact that credit card processing in Australia has evolved to be even more highly efficient than the EFTPOS system, which itself actually optimises the efficiency of credit cards.

While EFTPOS depends upon the security of PIN pads and on-line, real-time processing, it will have a comparatively higher cost base than certain other forms of payment. Some of these costs will be progressively reduced upon migration to chip cards, although we understand the reluctance of card issuers to issue chip cards when they perceive that Australia's current (EFTPOS system-enhanced) transaction processing detracts from the business case for migration to chip card issuance. It would be naïve to expect that EFTPOS interchange fee abolition would accelerate card issuers' migration to chip card issuing.

Conversely, the perceptions of historical efficiency of EFTPOS need to be viewed against the realities of maintenance (and, importantly, currency) of the technology which underpins EFTPOS. In particular, we understand that certain large EFTPOS acquirers and some operators of privately-owned EFTPOS device networks have become disinclined towards compliance with the requirement, agreed through APCA, for 'Triple DES' PIN encryption in all EFTPOS devices by 31 December 2005. This suggests potential compromise of the public interest by threatening financial safety and increasing risk.

If it were not for the fact that the large acquirers which are apparently dismissive of the industry-agreed, Triple DES compliance date are also major card issuers, we anticipate that they would be calling for perpetuation of current interchange fee levels in order to partially offset the considerable investment necessary to comply with Triple DES requirements. Pulse cannot afford any inaccuracy in this regard, and we are managing projects to ensure that all of our attached devices will be Triple DES compliant ahead of the industry deadline.

To summarise our views on EFTPOS interchange fees, we acknowledge that many of the costs incurred by acquirers twenty years ago (eg, terminal hardware costs, fixed telecommunications line rentals, etc) have been significantly reduced in the intervening years and, as such, it may be timely to review the quantum of, but not eliminate, EFTPOS interchange fees. We consider it largely inappropriate to compare the costs and pricing of credit cards – which factor in their versatility and convenience – with those of EFTPOS. In order to promote competition and efficiency in card payment transaction acquiring, Pulse considers it imperative to maintain a commercially sustainable level of EFTPOS interchange fees, flowing from card issuers to acquirers.

Designation of the EFTPOS system should place higher priority upon (reform of) the access regime than establishment of standards. We note the existence of the EFTPOS Access Working Group (**EAWG**), and look forward to learning the outcomes of APCA's deliberations on defining an EFTPOS access regime. We fear, however, that these may have been impaired by the predominance of incumbent acquirers, with the implicit desire to protect their current positions in acquiring. Assessment of costs incurred by parties granting access to new acquirers should be closely scrutinised by the RBA. We are concerned that EAWG participants may have reflected access costs at levels which are significantly inflated – for example, new interchange links would typically be unidirectional, rather than reciprocal, and this type of distinction needs to be accurately reflected in determination of an issuer's costs in extending access.

Of course, conventional acquirers are typically also card issuers. Card issuers can already provide access to all EFTPOS devices, so some may be reticent to deal with further (ie, new) acquirers. Access reform is of particular importance to Pulse because it impacts on our ability to deliver innovation and competition in the EFTPOS system. Such reform is also clearly in the public interest because it will create greater competition, transparency and efficiency between the participants.

EFTPOS has existed successfully in Australia for two decades, yet it is about to enter a phase of heightened change as the industry moves to Triple DES and contemplates migration to chip cards. As above, Pulse believes that until chip card migration is substantially under way, it is premature for standards to be established which eliminate EFTPOS interchange fees. For these changes to be successful in optimising the efficiency of the EFTPOS system, new acquirers need to be reasonably accommodated and, if there are inappropriate conditions suggested by APCA, we look forward to the RBA's intervention.

I look forward to discussing these matters in more detail with the RBA and to Pulse being given the opportunity to actively participate in any further EFTPOS reform processes that may be adopted by the RBA.

Yours sincerely

(Sgd.)

Neville Miles
Chief Executive
Pulse International Pty Ltd

CC Brian Sherman, Chairman, Pulse International Pty Ltd