

Submission to the RBA on the Designation of the ATM and EFTPoS Systems

1.0 Description of CreditLink Services' Business Operation

CreditLink Services is an Approved Deposit-Taking Institution whose principle activity is to facilitate access into the Australian Payment System for smaller institutions who wish to participate in the financial services industry. Our products fall into three broad categories, namely:

- supply of the physical instrument (i.e. card products, chequing, DE and BPAY) that facilitates transactional activity in the Payment System;
- provision of the back office processing environment to process the transactions created by the access products we supply and described in the first bullet point above; and
- provision of settlement services through which we settle the corresponding financial obligations created by the products we supply.

Our client base is diverse and includes credit unions, mortgage originators, insurance companies, church funds, other non-bank financial institutions and regional and boutique banks.

2.0 Unique Position in the Payment System

Within the Australian Payment System, CreditLink has the unique position of enabling smaller institutions to enhance their core products (typically transactional accounts) by adding payment functionality. This functionality enables these institutions to compete more effectively with larger institutions (typically the major banks and regional banks) and thus widen the choice of available banking options for the consuming public.

Were it not for CreditLink and other similar institutions, these smaller financial institutions would not be able to afford to build these access products. As such, they would be prohibited from competing effectively against their larger competitors.

Institutions such as CreditLink are important to the Payment System for two key reasons. Firstly, we promote and facilitate access into the payment system and secondly, our agility gives us cost advantages over our larger competitors that allow us to customize the access instruments to best suit the needs of the smaller institutions and its customers. By doing this, we improve the quality of the value proposition these institutions can bring to market.

3.0 Proposed Designation of the ATM System

3.1 Designation Process

Reform of the ATM System as a payment system has been the subject of discussion for more than 15 months. The industry, as a group, formed the ATM Industry Steering Group (AISG) for the purposes of developing a clear path forward that would balance the views and needs of all industry stakeholders.

Up until recently, significant progress had been made under the auspice of voluntary reform, which promised to deliver a way forward that would satisfy the needs of both large and small ATM industry participants.

However, with the recent reversal by the Australian Competition Tribunal (ACT) of the Australian Competition and Consumer Commission's (ACCC) decision on the proposed voluntary reforms of the EFTPoS system, specifically the decision to reduce the interchange fee to zero, the tangible value of pursuing a voluntary reform process is questionable.

For smaller institutions like CreditLink and its members, voluntary reforms come at a significant cost, particularly in terms of the drain on scarce resources and the corresponding costs. Therefore, if the industry is going to pursue a path of voluntary reform, the process must be efficient and effective. In order to have an efficient and effective process, we must ensure that changes accepted by regulators carry with them the certainty of implementation.

Without this certainty, we can be plagued by delays in the implementation of change. These delays, in our opinion, cannot be in the public interest and in reality restrict the efficient operation of the payment system.

CreditLink believes the designation process represents a means through which change can occur with certainty of implementation and such, will support and encourage the designation of the ATM system by the RBA.

3.2 Small Networks

CreditLink, through its CueCard Network conducts a closed network, which simply means that it can, in instances where both the card issuer and ATM owner are members of the CueCard Network, act for both the card issuer and acquirer in settling the transaction. In these cases, CreditLink will also collect the interchange fee from the cardholder on behalf of the member who acquired the transaction.

Under these circumstances, it is possible for issuers and acquirers within the CueCard Network to agree between themselves a more favourable interchange regime than that ordinarily applied to other foreign transactions. This provides them with the means to widening the access their members have to ATMs in a more cost effective manner than if the members were to use the ATM of another institution, say a major bank.

This is an important benefit for CreditLink members which, if removed under any proposed reforms, would significantly disadvantage CreditLink's member credit unions and the cardholding members of those credit unions.

Typically, a key component of a credit union's service model is to reduce the cost of banking services for its members. Over the years this has proven to be an important component of the credit unions value proposition and a key differentiator against its major rivals. How a credit union delivers a lower cost of banking to its members can, *inter alia*, be a result of the credit union absorbing the cost of the interchange fee levied by the acquirer of the transaction (i.e. the owner of the ATM) against the cardholder.

While all of our clients' transactions are not acquired through the CueCard network, a large number are and hence, maintaining the ability for our clients to reduce the cost of foreign transactions acquired within the CueCard network is an important advantage in sustaining their ability to continue to absorb these fees. To do otherwise will bring into question the ability of a credit union to continue to absorb these fees, and should credit union members be denied this benefit, it will destroy an important public benefit for over 450,000 Australian who obtain banking services from a CreditLink affiliated credit union. This we believe goes strongly against the spirit of what is at the heart of reforms, namely the pursuit of the public interest.

3.3 Direct Charging Model

Under the current interchange regime, the cardholder, when transacting at a foreign ATM, is unaware at the point of transacting what fees they will incur for having elected to use an ATM other than one owned by their institution. Further, often the cost of this transaction is not brought to the attention of the cardholder until they receive their regular statement. By this time it is difficult for the cardholder to link the fee with the use of the ATM device and hence, the meaningfulness of the fee on the statement becomes questionable.

We believe this situation is not in the public interest. Consequently, we believe the cardholder ought to be in a position, at the point of transacting, to know what the cost will be of using a foreign ATM. With this information, the cardholder is then in a position to choose whether or not to proceed with the transaction. For this reason we support a shift to a Direct Charging Model as a means of improving transparency.

Notwithstanding this, we believe that there are a number of issues that must be taken into consideration when introducing a Direct Charging Model. These are:

- The calculation of the direct charging fee itself;
- Applicability of direct charging in a closed network; and
- The time it will take to make the necessary changes to systems to accommodate direct charging.

3.3.1 Calculation of the Direct Charging Fee

Looking firstly at how the direct charge fee will be calculated, we believe that as a principle we ought not to prescribe the size of the actual fee to be charged to the ATM owner. Rather, we should allow them to set their own fee and allow competition to influence the size of the fee.

Further, we should allow the ATM owner the ability to differentiate price between ATM devices in their network. In this way we acknowledge that costs may vary between devices reflecting differences in the underlying cost structure of each device. Clearly, this cost will be significantly influenced by the transactional throughput experienced by each device.

This said the principle behind how interchange fees are calculated should equally apply to a Direct Charging Model. Interchange is a cost driven fee which represents the costs associated with owning and operating a particular ATM in a particular location. In the same way, the proposed direct charge fee should be based on a cost

recovery methodology reflecting the underlying cost structure of each particular device.

3.3.2 Direct Charging in a Closed Network

As explained under section 3.2, closed networks are important for smaller financial institutions. As such, we would not expect members of a closed network to have to use a Direct Charge Model should they chose not to use this type of model for foreign transactions generated from within the network. The reason for this being that the member of the closed network does not enter into any bilateral agreement with a direct market participant. Rather, they tend to use the agreements of the direct contracting party, in the case of the CueCard Network, this would be CreditLink. As such, it should only be the principle party to the bilateral agreements who is obligated to apply the standard Direct Charging Model to any ATM they have deployed in their own right.

Accepting this, the member of a closed network could then elect to apply one of two models for foreign transactions (within the network) occurring on their ATMs. The first is to apply a Direct Charge Model, albeit that the actual fee to be charged is discounted to reflect agreements between members. Alternatively, they could continue with an interchange fee model.

3.3.3 Implementation Timeframe

In moving the industry to a Direct Charging Model, there are significant changes that need to be made to existing systems to cater for the level of transparency expected under a Direct Charging Model. While it is desirable to implement in as short a time as a possible, it is important that changes are made in a prudent manner.

The AISG reached a view that an 18 month implementation window was needed to introduce direct charging. We would support this view and ask that should direct charging be introduced, we allow 18 months from the time the standards are finalized to become compliant.

4.0 Proposed Designation of the EFTPoS System

4.1 Designation Process

Reform of the EFTPoS System as a payment system has been under consideration for some time. The industry as a group formed an industry group for the purposes of developing a clear path forward, which would balance the views and needs of all industry stakeholders.

In December 2003, the ACCC announced that it would overturn its draft determination and support the proposed reforms for EFTPoS interchange. These reforms were to have seen interchange drop to zero, 90 days after the effective date of 3 January 2004.

However, with the recent reversal by the ACT of the ACCC's decision on the proposed voluntary reforms of the EFTPoS system, specifically the decision to

reduce the interchange fee to zero, the tangible value of pursuing a voluntary reform process is questionable.

For smaller instructions like CreditLink and its members, voluntary reforms come at a significant cost, particularly in terms of the drain on scarce resources and the corresponding costs. Therefore, if the industry is going to pursue a path of voluntary reform, the process must be efficient and effective. In order to have an efficient and effective process, we must ensure that changes accepted by regulators carry with them the certainty of implementation.

Without this certainty, we can be plagued by delays in the implementation of change. These delays, in our opinion, cannot be in the public interest and in reality restrict the efficient operation of the payment system.

CreditLink believes the designation process represents a means through which change can occur with certainty of implementation. In our submission of February 2004, we stated a preference for designation of the EFTPoS System by the RBA. In light of recent events our position remains unchanged and hence, we would encourage the RBA to designate the EFTPoS payment system.

4.2 Interchange Model

The current interchange model that supports the EFTPoS payment system in Australia, levies an interchange fee by the acquirer to the issuer. This fee acknowledges the costs of the acquirer for providing the card issuer with such services as a secure network and cash-out services. In some instances, this fee is shared with merchant principals and acknowledges their involvement in the provision of the EFTPoS network.

While without doubt, this acknowledges the costs incurred by the acquirer and merchants in facilitating a cardholder's payment options, we ignore any costs incurred by the issuer. The issuer, for its part, adds to the integrity of the EFTPoS payment system by providing such services as authorizations, processing and payment guarantee functions. Clearly without these services from the issuer, the EFTPoS payment system could not operate in an efficient and effective manner and if ceased, EFTPoS would stop being a viable payment system (or option) for the merchants.

We believe it is only fair that the methodology for calculating EFTPoS interchange should be cost based and take into account all costs (both acquirer and issuer) required to make the EFTPoS system an effective end-to-end payment system.

During the designation process for credit cards, it was argued that merchants ought to have the right to pass on the additional cost to consumers who choose to pay for their goods or services with a credit card as opposed to cash. The reasoning for this being that the credit card payment was a more expensive payment option to process for the merchant. Upholding this right lead to the abolishment of the "no surcharge rule" on the basis that the user should pay for the choices they make.

In the same way, it is inconceivable that merchants can ignore the benefit they derive from the services provided by the issuer, not least of which is the payment guarantee function. Without it, the integrity of the EFTPoS payment system comes under question. As with the credit card, the payment guarantee function (for example) is a

service that benefits the merchant. Similar to the credit card, the user should pay for the benefits they receive and hence, the merchant should pay for this service.

We believe the current position, following the recent decision by the ACT to over turn the ACCC's determination, cannot possibly be in the best interest of the public so long as it leaves the public bearing the full cost of the issuers costs, albeit the merchant clearly benefits from the services provided by the issuer.

We acknowledge comments by the retailers in the press that some \$170m in costs, for maintaining the EFTPoS system, would need to be passed on to consumers should EFTPoS interchange drop to zero. This said, we also note that we cannot see tangible evidence that savings from credit card reforms passed on to the merchants, through a reduction in interchange, have translated into cheaper prices for consumers.

Our strong position remains for the EFTPoS interchange to be calculated as a cost based methodology on the basis that it will take into account all the applicable costs of both the acquirers and the issuers. Once the costs of the issuer and acquirer are balanced, only the shortfall should then be levied as interchange.

From the work carried out by the industry group, which formed the basis of the submission to the ACCC, the resultant interchange rate should be zero or at best marginally positive in favour of the issuer.

4.3 Access Regime

We note that access has been given to APCA and fell outside the ACCC submission presented by the industry group. While APCA is yet to complete its work, we would not change our position on designation of the EFTPoS system because of this. We do not believe that designation need hold up access reforms if the RBA leverages the work completed by APCA.

This said, access to the EFTPoS system is both problematic and difficult. The difficulty stems from two concerns. Firstly, there is no set time when all participants of the EFTPoS system allow new entrant access. And secondly, entry into the EFTPoS system is dependant on the creation of the electronic links between institutions, rather than on the actual settlement process that supports the EFTPoS system. Until one, or both of these concerns are addressed, the time required to work ones way through the "system" will discourage any new entrant.

With regards to the first of these, at present if a new entrant seeks to gain access into the EFTPoS system, they must open dialogue with all the banks. Typically, this will result in a project proposal being raised by the bank that then awaits internal prioritisation. In terms of benefits that would offset the costs, it is difficult for the banks to realize any new traffic and, in the main, the throughput is unlikely to increase given that a new entrant will either already be sourcing services through someone else (e.g. Cashcard), or the new entrant is a start-up reliant on poaching business from another supplier.

A further complication in this process, is that it must be repeated for every bank, and while an aligned "go live" date would be desirable the more likely scenario is that each bank will work towards its own date, irrespective of the others. All of this clearly adds complexity to the project and time.

Under the second option, although one can obtain gateway access to the EFTPoS system through switching suppliers (like First Data) and settle the corresponding transactions direct, the banks will not recognize you as a direct participant in the EFTPoS system, and hence, will not negotiate a direct bilateral agreement until such time that the electronic links are in place. As in the first issue, the second suffers from the same time and complexity concerns, and hence, unless something is done to remove these obstacles, we cannot see an effective way to gain access to the EFTPoS system within a reasonable period of time.

In addressing the first issue, we believe that in order to free up access, one must create a predictable window during which all the banks will do the necessary work to bring new entrants into the EFTPoS system. This at least, enables a new entrant to develop their capability and infrastructure to a set date and then providing they are ready, the banks themselves will not slow up entry.

Under the second issue, we believe that the heavy reliance on the electronic links between institutions, before access to the EFTPoS system can be created, has the focus on the wrong components. We believe institutions should develop bilaterals based on settlement relationships rather than electronic links. Arguably, First Data already has the infrastructure in place to grant access to a new entrant to the EFTPoS system via its existing electronic links. This allows transactions to route through to the settling institution from the acquirer, and hence, facilitate settlement between the two.

We remain strong advocates for an improved access regime, which we believe is important in maintaining an efficient and effective EFTPoS system and will create a more competitive environment.

5.0 Delivering on the Public Interest

We believe that it is important that the public interest benefits, proposed to be delivered through the reform of both the ATM and EFTPoS payment systems, are pursued and delivered.

Our experience thus far with credit card reforms has been that they have not delivered a number of important benefits that would form the basis of why the product was designated. We note that no one party appears to have assumed responsibility for ensuring that the benefits identified are delivered. For as long as this position remains, we believe that it is questionable how much of the identified public interest benefit will actually materialize.

For this reason, we believe that the regulator (if it chooses to exercise its powers to designate the ATM and EFTPoS systems) not only has the obligation to press for reforms that will benefit the industry as a whole, but equally has the obligation to complete the full picture on reforms by ensuring the benefits of the reform package are fully realized.

6.0 Conclusion

Overall, we strongly support the designation of both the ATM and EFTPoS payment systems and will support and collaborate with the RBA, as required, should they designate these payment systems.

In supporting the designation of these payment systems, our motivation centers on two key drivers. Firstly, we believe the reform process, while it has provided a number of important benefits, has now been with us for some time. We believe it is important to complete the process with some urgency and restore stability to the payment system at large.

Secondly, while voluntary reforms have provided good direction, we must have certainty that the reforms recommended by the industry (once approved by regulators) will be implemented. The recent decision by the ACT regarding interchange in the EFTPoS system, significantly compromises the value of the voluntary reform process and hence, we see designation as a means through which certainty can be restored.