

7 July 2004

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

Dear Dr Veale,

Possible designation of EFTPOS and ATM payment systems

This submission is in response to your letter and press release of 11 June, 2004, relating to the possible designation by the RBA of the EFTPOS payment system and the ATM payment system.

MoneySwitch Ltd is in the process of becoming an acquirer of credit cards, following the release in early 2004 by the RBA of the access regime relating to credit card acquiring. All existing acquirers offer merchants acquiring services for both credit cards and for EFTPOS PIN based debit cards, and so it is a commercial imperative that MoneySwitch must also offer EFTPOS acquiring services.

MoneySwitch believes that its entry into the market for credit card and EFTPOS acquiring will lead to greater competition and efficiency, and will lead to better services and lower costs to retailers generally. However, MoneySwitch has been unable even to commence serious discussions with financial organizations about the technical, contractual and costs of establishing interconnect agreements. The actual steps that have been undertaken are set out later in this submission, but as it stands, it appears that MoneySwitch is currently unable to enter the EFTPOS market on any reasonable terms.

MoneySwitch does not currently intend to enter the ATM market, and the comments in this submission are directed primarily at the EFTPOS payment system. However, the ATM and EFTPOS payment systems use very similar underlying encryption, switching and communications technology, and the same card and PIN is used in both systems. The EFTPOS system can also provide the cardholder with cash, in the same way as the ATM system. It is important that the ATM systems and the EFTPOS system are considered as one in the decision whether to designate or not.

Background

The EFTPOS payment system was established in its present form in the early 1990s, and reflects the technology thinking of the day. It consists of many point to point communication links between financial institutions (FIs), together with bilaterally negotiated contractual, technical and pricing terms. There are six FIs and one gateway provider that are connected to all of the other major (Tier 1) participants. These FIs are CBA, WBC, NAB, ANZ, STG and BWA with the single gateway provider being First Data (together with its recently acquisition Cashcard) . Most other FIs (Tier 2)

use the gateway service provided by First Data, although they may have clearing and settlement agreements with some of the Tier 1 FIs. Coles Myer Ltd has connections to NAB and First Data.

An intending acquirer must establish contractual, financial, technical and gateway agreements with one or more of the current participants in the EFTPOS payment system before that acquirer can process transactions. There is currently no obligation on any of the existing participants to participate in negotiations to set up the necessary agreements, or to enter into them on reasonable terms. There is the opposite incentive, because new entrants will increase competition, with a negative effect on the existing participants.

Current Status

The recent May 2004 decision of the Competition Tribunal has left in place the notion of bilaterally negotiated fees between participating financial institutions. The fees average 21 cents per transaction and flow from the issuer to the acquirer. The CTA decision was based, among other things, on the fact that there was no public benefit in changing the negative interchange fee to zero. The tribunal hearing did not consider the public benefit of leaving the fee approximately unchanged, but being determined multilaterally rather than bilaterally.

The Australian Payments Clearing Association (APCA) established in early 2003 the EFTPOS Access Working Group (EAWG) to discuss access arrangements for possible new entrants in the EFTPOS payment system. This EAWG work is ongoing, and APCA has announced that it will submit its conclusions before the end of 2004 to the ACCC for approval. The membership of EAWG is drawn from the existing participants in the EFTPOS system, together with representative of some major retailers. Despite its requests, MoneySwitch, an intending acquirer, has not been allowed to participate in the EAWG. The deliberations of the EAWG are not public, and there appears to be no way for any input or comment from MoneySwitch before the result is announced as a *fait accompli*.

Issues faced by intending acquirers

- 1. Difficulty commencing meaningful discussions.** MoneySwitch has been unable to commence meaningful discussions with Tier 1 participants in the EFTPOS payment system. It has engaged a consultant who used to work for a major Sydney bank, but his contacts in both Sydney banks were unwilling to meet with MoneySwitch. MoneySwitch has written to Cashcard (now First Data) seeking access to their EFTPOS gateway facilities, but has been told that Cashcard is too busy with integration tasks with First Data to be able to consider its application until at least 2005. We believe the lack of meaningful discussions is at least in part caused by the fact that any new entrant is likely to bring increase competition to the EFTPOS market, to the detriment of the existing participants.
- 2. No method for acquirers to conclude bilateral negotiations on price.** Even if a new entrant acquirer can start negotiations with an existing player, there is no basis on which the interchange fee can be set. In order to be competitive, a new entrant must have access to an interchange fee that is broadly similar to

all other participants, ie currently around negative 21 cents. However, the existing issuers can ask for any interchange fee, even perhaps flowing in the opposite direction, from the acquirer to the issuer. The intending acquirer is the supplicant in this negotiation, and can only take whatever price is offered. He has nothing else to offer the issuers with whom he is attempting to negotiate the interconnect agreement. More difficult still is the fact that by providing interchange to a new entrant acquirer, the existing participant is facilitating competition with his own existing acquiring operation. This gives the existing participant an incentive to offer interchange fees that cause the new entrant a significant competitive disadvantage.

3. No method for acquirers to get reasonable fees for connection testing.

Because the new entrant is viewed as a competitive threat, there is no incentive for the existing participants to make it easy or reasonably priced for the new entrant to gain physical connectivity. The existing participant can set any technical standards, testing criteria and timeframe that it wishes. In fact, the charter for the EAWG specifically excludes consideration of different architectures for the physical network connectivity.

4. Lack of efficiency in the current bilateral network. The existing interconnection between participants uses many point to point links between the Tier 1 FIs, together with gateways for Tier 2 FIs. These point to point links have been installed for many years, and represent the state of technology and thinking in the mid 1980s. In the past 20 years there have been significant developments in networking and security technology, but the bilateral point to point links in the EFTPOS network have not changed. The new networking technology has been embraced by banks for communications with their Internet customers for online banking, but has been ignored in the EFTPOS system. The fact that these obsolete point to point links still exist adds significant cost to the provision of an EFTPOS payment system. It is also a significant barrier to entry for new participants because they have to install their own point to point links to all other participants. A significant reason that the EFTPOS communications technology has not been modernized is that it is effectively a defensive weapon to lessen the risk of competition for the existing participants.

Because of these issues, MoneySwitch is strongly of the belief that the EFTPOS payment system should be designated to allow increased competition and better efficiency. The ATM payment system uses similar messages and communications facilities, and also should be designated. If they are not both designated at the same time and with similar rules, then participants will take advantage of the situation through regulatory arbitrage, to the detriment of overall efficiency.

However, designation is only the first step to gaining the advantages of competition and efficiency, and it is the rules that are put in place that will provide the beneficial outcomes. MoneySwitch realizes that there will be future consultation on these rules, but we would like to suggest some key issues that should be covered.

Requirements following designation

- 1. Appropriate network technology.** MoneySwitch believes that each new entrant should be able to connect once to a network, and that network provides the physical connectivity to all other participants. Existing participants must be required to connect once to this network, to allow new entrants to connect. This will overcome the inefficiency and barriers to entry caused by the existing bilateral point to point links. The technical details of the new network should be determined by consultation, but it is likely that a suitable network would be based on Internet Protocol technology, and could be operated by two carriers such as Telstra and Optus. There would be no central payment switch, but participants would still clear and settle bilaterally. This is similar to the way a bank provides online banking services to its business and individual customers using a secure connection over the Internet.
- 2. Certainty of interchange fee.** The interchange fee should be set as part of the designation so that all participants can compete on the same footing. From a contestability point of view, the absolute value or even the direction of the fee does not matter, so long as all participants pay the same fee.
- 3. Access certainty.** New entrants should be able exchange transactions with existing participants using a single set of technical and contractual conditions. The fee to establish and test logical connectivity to each existing participant should be objectively determined, and should be the same for each participant. The time scale of testing must be defined. Perhaps a third party technical certification facility could be used for testing, and all participants would accept its certification. This certification could be used as part of a Public Key Infrastructure (PKI) that would provide network security and authentication.
- 4. Authorization of participants.** New entrants should be approved by APRA, similarly to the Specialized Credit Card Institutions requirement introduced as part of the credit card reforms. In fact, most new participants will acquire both credit and EFTPOS cards, and the same SCCI authorization should be applicable for both systems.

MoneySwitch is strongly of the opinion that the EFTPOS payment system must be designated in order to provide competition, efficiency and contestability.

MoneySwitch would be please to discuss this submission, or to provide any further information required.

Sincerely,

A handwritten signature in black ink that reads "Paul A Wood".

Paul A Wood
CEO, MoneySwitch Ltd