



**Submission to the
Reserve Bank of Australia**

**Regarding Designation of the EFTPOS Payment
System and the ATM Payment System**

July 2004

Executive Summary

The Reserve Bank of Australia has sought submissions regarding designation of the EFTPOS Payment System and the ATM Payment System.

In response to this request, Suncorp has outlined our response in this report taking into consideration aspects of the proposed changes that would have specific effects on Suncorp as a large regional bank and benefits to our customers and the broader public.

Suncorp is of the opinion that regulatory reform is in the public interest because it:

- removes inefficient sharing of costs
- removes the inequality of bargaining power regarding interchange fees
- provides greater fee disclosure and transparency for customers
- enables pricing for EFTPOS and ATM services which is more responsive to competitive pressure enables customers to make more informed choices when selecting their EFTPOS and ATM transactions due to price transparency
- enables participants to establish pricing structures that reflect investment and operational costs
- increases competition specifically providing greater opportunity for smaller banks and new entrants to play a more significant role in both the EFTPOS and ATM systems.

However, if designation was to proceed, due consideration should be given to:

- providing sufficient time for implementation due to development work and resource constraints required for effecting a direct charging model for the ATM Payment system
- consideration of the distinctive characteristics of the varying ATM networks and subsequent specific commercial arrangements (beyond fees) contained in the current interchange agreements.
- providing sufficient opportunity to work with the industry to resolve issues. These issues will arise in providing a workable framework taking into consideration technology, legal structure, processing and settlement standards.
- allowing APCA to develop conditions of entry which would facilitate effective and efficient access for *new entrants* to the ATM and EFTPOS systems
- allowing APCA to develop conditions that allow *existing participants* effective and efficient arrangements with other participants.

1. Designation of the Eftpos Payment System

Suncorp is supportive of the need for reform of debit card interchange and agrees with the views expressed in the Reserve Bank and ACCC Joint study on Debit and Credit Card Schemes in Australia (2000) in relation to debit card. Essentially that the viability of the network would not be threatened if, as with other payment instruments which access a transaction account, each financial institution were to recover its debit card costs from its own customers.¹

In support of the RBA and as a result of our position, Suncorp has been a participant in the EFTPOS Industry Working Group (EIWG) since its inception. The EIWG was formed as an industry forum to develop and implement options for debit card reforms.

In the current EFTPOS system, an interchange fee for each EFTPOS transaction is paid by the Issuer of the end customer's debit card to the Acquirer of the merchant's EFTPOS business. The Issuer and acquirer jointly provide the clearing and settlement arrangements for EFTPOS transactions. These arrangements, including interchange fees, are detailed in bilateral agreements between Issuers and acquirers that provide network interconnections. Some Issuers (including Suncorp) participate by entering into a gateway or switching agreement with an Issuer or an acquirer that is already interconnected.

Suncorp is supportive of the proposed reform put forward in the EIWG Submission to the ACCC. That is for all current Issuers and acquirers, to multilaterally set interchange fees to zero for any EFTPOS transaction. Suncorp is supportive of the need for designation due to the limited opportunities remaining to ensure reformation occurs of the EFTPOS Payment System.

Listed below are the reasons for our support of the EIWG proposal and designation based on our specific circumstances:

1. Compared to the major banks in the Australian market, Suncorp's issuer base is disproportionately larger than its acquiring base. We incur more than six times the amount of debit card interchange expense from our issuing base than we receive in revenue from our acquiring base.

By setting the interchange fee to zero, it would remove the inefficient sharing of costs we specifically experience due to our issuer/acquirer imbalance. Currently our issuing base is paying for the costs that acquirers incur from their merchants accepting debit card transactions. Secondly it would also enable us to benefit our larger issuer base, therefore significantly more customers benefit as a result. This would also result in greater competition in the issuing market.

The exercise in determining how the benefit of removing interchange expense will flow onto customer is complex. While there will be a definite public benefit, the exact benefits that will flow onto customers are difficult to calculate as their costs form part of the provision of transaction accounts. As a result, separating ATM and EFTPOS services from the broader account relationship is difficult. Despite the complexity of the exercise, competition will deliver these benefits, most likely in the form of lower account fees.

¹ Reserve Bank of Australia and Australian Competition and Consumer Commission, *Debit and Credit Card Schemes in Australia. A Study of Interchange Fees and Access*, October 2000, p. 69.

The complexity of the exercise, should not be a reason not to proceed. From the outcome of the analysis, Suncorp would potentially expect to see either changes to fee free thresholds, account keeping fee reductions and/or a reduction or eliminate the excess transaction fees for EFTPOS.

2. Should a reduction or elimination in excess transaction fees for EFTPOS be introduced, an increase in the use of debit card transactions would be expected as this becomes a lower cost transaction method. This would follow the trend that the countries with the highest use of debit card payments per capita are those countries with no interchange.²
3. With a zero interchange arrangement, the current imbalance between issuers and acquirers would be affected in fee increases to merchants. By the nature of the forces of competition, Suncorp would minimise fee increases to merchants for debit card transactions to reflect the cost of the transaction plus a margin for investment. To maintain its competitive position, Suncorp may also invest in new infrastructure to reduce its costs per transaction and as a result may move away from a third party gateway service.
4. By taking the above approach, Suncorp would be increasing our overall competitive position. As stated in the Joint Study³, the acquiring market is very concentrated with the four largest acquirers accounting for 90% of the debit card transactions. Suncorp would seek to redress the issuer/acquirer difference in the market, which would result in greater competition in a concentrated market and therefore benefit the public.
5. By introducing a system that is supported by the majority of the industry, it reduces the risks to the financial systems and therefore is another reason why designation is in the public interest.

² Joint Study, op.cit., p. 69

³ Ibid., p. 71

2. Designation the ATM Payment System

Similarly to the reforms for EFTPOS, Suncorp is supportive of the need to reform the ATM Payment System and has been a participant in the ATM Industry Steering Group since its inception.

The current ATM Payment System allows customers of one financial institution to be able to access their accounts through another institution's ATM network. Today over 30% of ATM transactions are undertaken in this way and are referred to as "foreign" ATM transactions. With foreign ATM transactions, ATM operators have no account relationship with the customer and therefore seek to recover their costs via interchange issuer fees. Historically, a card issuer wanting to provide its cardholders with access to the ATM network of another financial institution bilaterally negotiates an interchange agreement with that institution. The agreement includes an interchange fee to be paid by the card issuer to the ATM Acquirer.

Suncorp agrees with the Joint Study's recommendation for ATM owners to directly charge cardholders of other institutions using their ATMs. Specifically, the model should allow ATM operators to charge an ATM Operator Direct Fee to the Cardholder for the transaction if they are not using their own bank's ATM network. The ATM Operator should disclose the ATM Operator Direct Fee to the Cardholder prior to the Cardholder committing to the transaction and permit the Cardholder to cancel the transaction without charge. Disclosure of the possible existence of a Card Issuer Transaction Fee at the transaction point should be made to the customer.

Listed below are the reasons for our support of a direct charging model based on Suncorp's specific circumstances:

1. Direct charging would enable Suncorp to charge transaction fees to non-Suncorp customers more in line with costs and would promote transparency of fees.
2. It would prevent high-cost ATM locations having to subsidise low cost locations. Where Suncorp does have an ATM in regional and remote areas, it would be attractive on a purely economic basis to charge a higher fee to non-Suncorp customers to recoup some of the losses incurred by operating lower transacting ATMs. The economic decision is balanced by the forces of competition, where open markets with returns above normal investment return will attract new entrants.

We acknowledge that community response has a significant impact on the effectiveness of any change we may wish to implement. In the UK, a similar regime to Direct Charging was implemented, but due to community backlash was disbanded. We acknowledge that one of the critical success factors in successfully implementing Direct Charging will be customer education and impacts to the community.

3. By introducing a system that is supported by the majority of the industry it reduces the risks to the financial systems and therefore is in the interest of the public.
4. By unbundling of existing foreign ATM fees for issuers, it provides greater disclosure for customers and may enable them to make more informed choices.

5. The proposed model would encourage increased competition in the convenience ATM market. New entrants may be attracted into areas currently under serviced, as with current interchange arrangement it is financially not viable to install ATMs in locations likely to experience low transaction volumes. As well as providing increased competitive pressure on prices, it would enhance consumers choice.
6. Consequently, the direct charging would facilitate more competitive outcomes, by making it easier to amend the fees in response to changes in the market.

Therefore if designation was to occur, the direct charging model is the system we would prefer. However Suncorp has concerns over the benefits of designation of the ATM Payment System.

This is due to:

- The various types of ATM networks which increases the difficulty in developing a standard technology solution for all participants.
- Commercial arrangements outside of the interchange fee which differ between parties due to individual organisations requirements. It may therefore be difficult to develop a standard set of arrangements that enable effective authorisation, processing, settlement and clearing of transactions for all participants.
- Flexibility required for various telecommunication infrastructures for effective message handling, managing the amount of data sent, provision for future technologies and the potential to cause network architecture difficulties.

To resolve these issues, a voluntary industry reform should continue to be pursued to ensure an effective outcome that minimises risks to the financial system and delivers benefit to the public. A voluntary industry reform would be expected to be implemented within a Trade Practices Act regulatory framework, and subject to a consultation process.

3. Issues for consideration in designation

In delivering an outcome that is in the public benefit, the RBA should consider a number of additional factors that would assist in ensuring designation for EFTPOS is successful and continued voluntary reforms for ATMs Payment Systems produces suitable outcomes.

The RBA need to be aware that significant development work is involved in enabling ATMs to provide a direct charge due to the following determinants:

- ◆ Significant technology enhancements in the form of software development and testing.
- ◆ Increased transmission of data from the mainframe to the ATM due to fee disclosure and the option for the customer to cancel the transaction.
- ◆ Recent compliance requirements such as Triple DES will continue to use scarce IT resources over the next 18 months. Particularly for smaller players, additional regulatory requirements limit our ability to redirect their focus to ensure all industry requirements are met within designated timeframes. Therefore timing of the implementation, specifically for ATM Direct Charging should be no earlier than December 2006.
- ◆ A detailed understanding of the complexity of the ATM System, as discussed in the previous section of this document.
- ◆ Furthermore, Suncorp believes APCA is best positioned to undertake the project to develop conditions of entry that would facilitate effective access to the EFTPOS and ATM networks for relevant parties. This is because APCA's role within the industry is to preserve the integrity of the Payment Clearing System, improve the effectiveness and efficiency of the system and ensure principles of equity and competitive neutrality are applied in determining participation in the system.

4. Conclusion

In summary, Suncorp is supportive of industry reforms as it provides a public benefit. Due to the limited avenues available to ensure this public benefit is delivered, we are supportive of designation for the EFTPOS Payment System.

However due to avenues still open to pursue voluntary reform for the ATM Payment System, Suncorp supports this option (as opposed to designation). These voluntary industry reforms would be expected to be implemented within a Trade Practices Act regulatory framework, and subject to a consultation process.