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Dr John Veale
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Dear Dr Veale

EFTPOS AND VISA DEBIT

Credit Union Services Corporation (Australia) Limited (CUSCAL) welcomes the RBA's decision to designate the EFTPOS debit card payment system.

CUSCAL makes this submission on behalf of its 151 affiliated credit unions. Credit unions have on issue 1.8 million Redicard EFTPOS debit cards and 1.2 million Visa Debit cards.

For more detail about CUSCAL and credit unions and payments reform, see our 9 July 2004 submission on EFTPOS and our 26 March 2004 and 30 July 2004 submissions on Visa Debit. We stand by the views expressed in those submissions.

As you know, problems with EFTPOS interchange fees have been repeatedly identified in a string of official inquiries over a decade.

In 1995 the Prices Surveillance Authority found that EFTPOS interchange fees were rigid and unrelated to costs and that the cost burden of the EFTPOS system was falling increasingly on institutions that were predominantly card issuers.¹

In 1997 the Wallis Inquiry found that card issuers bear a disproportionate share of the cost of the EFTPOS network.²

In 2000, the RBA and the ACCC found that interchange fees had hardly changed since they were introduced in the early 1990s, without regard to changes in costs.³

The case for an EFTPOS interchange fee standard, based on relevant issuer costs, is made in our earlier submissions. These are briefly restated below, for reference.

In this submission we wish to focus on the distinction between the EFTPOS debit payments system and the Visa Debit payments system.

¹ PSA Report No. 65 *Inquiry into fees and charges* p268.

² Financial System Inquiry *Final Report* March 1997 p397.

³ RBA/ACCC Joint Study *Debit and Credit Card Schemes in Australia* October 2000, p62.

EFTPOS Interchange Fee Standard

Participants in the EFTPOS voluntary reform process, including CUSCAL, took the pragmatic decision to agree on an EFTPOS interchange fee of zero. Our preferred position, however, has been for a consistent interchange fee methodology to apply to all payment cards. Under this approach, the credit card interchange fee standard provides the logical benchmark for a debit card interchange fee standard.

CUSCAL has previously argued that there should be no regulatory distinction between credit cards and debit cards. The distinction is artificial. There is a continuum of payment card products. Products along this continuum include:

- credit cards with interest-free periods (buy now, pay later);
- credit cards without interest-free periods;
- scheme debit cards (eg, Visa Debit) with a line of credit attached to the cardholder's transaction account;
- scheme debit cards without a line of credit;
- proprietary (EFTPOS) debit cards with a line of credit; and
- proprietary (EFTPOS) debit cards without a line of credit.

A consistent interchange fee standard, resulting in correct price signals, should be applied to all card payment card products. The RBA, as payments system regulator, has already concluded that debit cards in relation to credit cards are:

- potentially a strong competitor;⁴ and
- in many circumstances, a close substitute.⁵

Credit card issuers continue to receive compensation in the form of interchange fees for costs involved in providing benefits to merchants. Debit card issuers should be compensated for providing identical benefits. If debit card issuers are not so compensated, the bias in favour of credit cards - a higher cost instrument (albeit one with greater functionality and more features) - against a lower cost instrument.

The credit card interchange standard does not cover any 'credit' costs other than the interest free period. All other costs included in the standard are equally relevant to debit cards, and we endorse their application to the EFTPOS payment system.

In relation to access arrangements for the EFTPOS system, CUSCAL considers the current APCA process the most suitable mechanism for progressing this work. However, our support is premised on CUSCAL and the credit union sector having appropriate representation in governance and management arrangements for any access regime.

Visa Debit and EFTPOS

We welcome the RBA's indication that EFTPOS and Visa Debt are being considered concurrently.

However, we are deeply concerned that the RBA's publicly stated view on interchange fees for EFTPOS, i.e. that there should be no fee or a 'zero' fee⁶, may be applied to Visa Debit.

A narrowing of the differential in prices and costs between EFTPOS debit and credit cards and scheme debit cards does not require identical interchange fees for EFTPOS debit and Visa Debit.

⁴ *Reform of credit card schemes in Australia, A Consultation Document* RBA December 2001, p38

⁵ *Reform of credit card schemes in Australia, Final Reforms and Regulation Impact Statement* August 2002, p3. *Reasons for the Decision to Designate the EFTPOS Payments System* RBA 14 October 2004, paragraph 60.

⁶ RBA Governor Ian Macfarlane, House of Representatives Economics Committee hearing, 4 June 2004: "Our view has always been...that there is no case for an interchange fee, so there should be no interchange fee or it should be zero."

A zero interchange fee for Visa Debit would sharply differentiate interchange fees for Visa Debit compared to credit cards, giving credit cards (and charge cards) a significant advantage on Visa Debit from the perspective of the issuer and cardholder.

Driving cardholders from Visa Debit to credit cards or charge cards will not promote efficiency and competition in the payments system and will not reduce the overall cost of the payments system.

It is notable that a leading advocate of aligning Visa Debit interchange fees with EFTPOS debit interchange fees, Coles Myer Ltd (CML), is rapidly growing its own credit card business.

According to the banking e-zine *The Sheet*, CML is "delighted" with the performance of the Coles Myer Source MasterCard launched in October 2003. CML is aiming to expand the card base beyond the current portfolio of more than 500,000 credit cards.⁷

Woolworths is also in the credit card business, with its Ezy MasterCard.

The illogical and highly selective approach to payments reform of CML, Woolworths and other members of the Australian Merchant Payments Forum is demonstrated by their simultaneous demand for RBA action on Visa Debit interchange fees and RBA inaction on EFTPOS debit interchange fees. Merchants strongly supported the RBA's action on credit cards that is now delivering merchants a benefit of \$500 million per year.

EFTPOS debit and Visa Debit are distinct payment systems with distinct costs and distinct offerings for cardholders and merchants.

Arbitrarily conflating EFTPOS debit and Visa Debit would have negative consequences for cardholders and credit unions and would reduce consumer choice.

Interchange fees for EFTPOS debit and Visa Debit should be based on the same objective, transparent and cost-based methodology. This would ensure that the distinguishing costs and features of the different payment systems are recognised in interchange fee arrangements.

The readily available benchmark for this methodology is the RBA's credit card interchange fee standard.

Assuming all other relevant costs are similar, the interchange fee for Visa Debit would be lower than the fee for Visa Credit because issuers' costs incurred in funding an interest free period would be absent. In a competitive market, the lower interchange fee for Visa Debit would be passed on to merchants through lower merchant service fees levied by acquirers.

This benefit to merchants would be lost if Visa Debit is driven out of the marketplace by ill-conceived regulatory intervention.

We do not accept that Visa Debit should be singled out in a regulatory push for PIN authorisation over signature authorisation for card-present electronic transactions. Credit cards are also signature authorised and have a much larger share of transaction volumes than Visa Debit.

CUSCAL is prepared to engage constructively in discussions with the RBA and other stakeholders about the merits of PIN authorisation of Visa Debit and credit cards.

⁷ *The Sheet* 5 October 2004.

As noted in our submission of 26 March 2004, CUSCAL also strongly supports retention of the Honour All Cards (HAC) rule in relation to Visa Debit, based on the clear public benefits associated with its retention. The HAC rule facilitates access to card issuing, promotes product development and innovation, and guarantees customer choice. Without the HAC rule, acquirers would be free to act against the interests of competitors and competitor products.

CUSCAL is conscious of the potential for competitors to seek to switch off Visa Debit if the HAC rule is removed. Comments at the recent Cards Australia conference in Sydney by Australia Post demonstrate that this is a serious prospect, with Australia Post noting in a panel session that quite a few merchants would stop accepting Visa Debit if the RBA abolished the HAC rule.

Credit unions and Visa Debit

Visa Debit provides the payment functionality of a credit card (Internet, mail, telephone, overseas etc) while allowing cardholders to choose to draw only on their own funds. Visa Debit is a crucially important credit union product and is highly valued by those credit union members who keep credit unions strong by using multiple credit union products and services. Many credit union members use Visa Debit as a de facto credit card, drawing on an overdraft to make purchases when their own funds are not available.

We note that the RBA's credit card interchange fee standard defines a "credit card" as "a card issued under the rules of the Scheme that can be used for purchasing goods or services on credit..."

CUSCAL's Research Department estimates that 41 per cent of credit union Visa Debit cardholders also have a credit union overdraft facility,⁸ compared to 12.5 per cent of Redicard holders. This data underlines the hybrid nature of Visa Debit. Further confirmation of the distinction between Visa Debit and our EFTPOS debit card product is provided by data on average transaction size: \$81 for Visa Debit; \$74 for Redicard.

Based on credit union member data held by CUSCAL⁹, higher value members are more likely to hold a Visa Debit card than a Redicard.

In the top three deciles of members by value to their credit union¹⁰, Visa Debit cardholders outnumber Redicard holders. This profile is sharply reversed in the bottom six deciles, although even in the bottom decile 25.5 per cent of members have a Visa Debit card.

Those higher value credit union members, i.e. members who use multiple credit union products and are likely to have a loan with the credit union, will switch to a credit card if Visa Debit is unavailable or uncompetitive in price terms.

Such a migration of members to credit cards due to regulatory intervention raises not only questions about efficiency and public benefit, but also poses a significant competitive risk to those credit unions who are not credit card issuers.

Younger members or low-income members who are unable to switch to a credit card will simply lose the access and functionality provided by Visa Debit or, if Visa Debit does remain available, they will pay a higher price than that paid by credit card holders for the same access and functionality.

⁸ Our data does not say whether the overdraft and the Visa Debit are always linked.

⁹ CUSCAL's Movement Marketing Database (MMD) is a central data warehouse of 2.7 million credit union members. It contains detailed demographic, product and transaction data at an individual member level and is updated monthly.

¹⁰ Value is derived from members' account balances and interest margins, together with transaction costs net of transaction fees.

Conclusion

As stated in our earlier submissions, if Visa Debit is pushed out of the market by regulatory intervention eligible credit union members seeking the same functionality will switch to credit cards.

The outcome of regulatory intervention would be:

- more credit cards;
- more personal debt;
- loss of access to merchants and the global payments network by some consumers;
- loss of some customers by some merchants;
- harm to the competitive position of credit unions in the retail banking market; and
- no improvement to competition and efficiency in the Australian payments system.

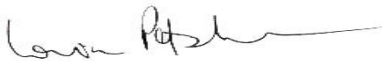
Some Visa Debit cardholders will move to charge cards, further entrenching a higher cost payments system.

Cardholders who are not eligible for a credit card or a charge card will be most disadvantaged, being put in a position of less consumer choice by regulatory intervention.

These cardholders would include young people and low-income earners.

Please don't hesitate to contact me on 02 8299 9046 or Luke Lawler on 02 6232 6666 to discuss any aspect of this submission.

Yours sincerely



LOUISE PETSCHLER
Head of Public Affairs