Reform of Australia's Payment System

Submission on the Issues for the 2007/08 Review

1.0 What have been the effects of the reforms to date?

1.1 Changes on the use of debit cards

With the Standards covering both EFTPoS and scheme debit not coming into effect until November 2006, insufficient time has passed for us to observe any meaningful change in the use of debit cards. Notwithstanding this, we have collected data for the 8 months to June 2007 and compared this with data for the previous two years.

With respect to EFTPoS transactions, over the 2 years to 30 June 2006, we have recorded growth of 27% in the number of transactions. In the 12 months to 30 June 2007 growth eased to 23%. The average ticket size for an EFTPoS transaction has over the three years to 30 June 2007 remained consistent at $59.83.

Our experience with Visa debit is different with growth for the two years to 30 June 2006 averaging at 8%. In comparison growth for the 12months to 30 June 2007 was 16.5%. The average ticket size of a Visa debit transaction (average of both domestic and international transactions) stands at $89.36, $78.42 and $78.63 respectively for each of the three years to 30 June 2007.

From the above data, we believe it is difficult to draw any meaningful conclusions that may in some way attribute any change in the 12 months to 30 June 2007 to the changes brought about by the reforms themselves.

Since the commencement of the Interchange Standards for both EFTPoS and scheme debit, our clients have been monitoring the financial impact of the change together with the potential change in the transactional behaviour of their customers. At this stage our clients have not made significant changes to the price structure of their transactional accounts. However, work is underway to assess what changes, if any, may be required should there be any significant change in behaviour.

1.2 Excluding EFTPoS transactions involving a cash-out component from the EFTPoS interchange Standard

The exclusion of transactions involving a cash-out component from the EFTPoS interchange Standard was unexpected and did not form part of the consultation process undertaken by the RBA in the lead up to the release of the Standard. In effect this has now created two types of transactions, namely regulated and unregulated. Regulated transactions while they are negotiated bilaterally, enjoy the price certainty afforded them by the EFTPoS Interchange Standard and consequently, are priced between 4 and 5 cents. Unregulated transactions on the other hand, while also negotiated bilaterally, do not enjoy the same price certainty.

Since the commencement of the EFTPoS Interchange Standard in November 2006, insufficient time has passed for any meaningful change in behaviour to have emerged from any sector. At present, industry statistics show that for the 8 months to June 2007 cash-out transactions represented 15% of all EFTPoS transactions. Intuitively, we do not expect that time alone will necessarily show any significant change in this number, assuming no corruption exists in the way in which EFTPoS transactions are classified and recorded. In other words, we would expect consumers not to alter their behaviour in terms of whether or not they use EFTPoS for cash-out transactions in favour of another channel such as ATMs.

Notwithstanding this however, the exclusion of cash-out transactions does raise two concerns for us. Firstly, we are concerned at the ambiguous nature of the definition used to classify transactions and secondly, we believe the creation of two separate transaction types, namely regulated and unregulated, undermines the very intent of the Standard in facilitating access to the EFTPoS system.

Looking more closely at the first of these, under the current definition, an unregulated transaction is simply defined as any transaction that includes a cash-out component irrespective of the size of the cash component relative to the size of the total transaction. That is, whether the customer withdraws $20 in cash as part of a $200 transaction, or $180 in cash as part of a $200 transaction the interchange fee is the same. In such instances, we believe the ambiguous definition fails to acknowledge the basic motivation and primary justification for the cash withdrawal which we believe is different in each case.

For example, in the case of the $20 cash withdrawal, the primary justification for the transaction would arguably be the purchase of goods at the store. The cash-out component is simply incidental and convenient. On the other hand, in the case of the $180 cash withdrawal, the primary justification for the transaction is arguably to withdraw cash. The $20 in-store purchase was simply a means to legitimise the use of the merchant to withdraw cash.

Under the current Standard the underlying motivation for the cash-out component relative to the overall transaction itself is ignored and consequently, an interchange fee is applied which fits the prescribed intent of the Standard, but does not match the motivation behind the transaction. Consequently, a higher interchange fee is applied than in practical terms is warranted, given the true nature of the transaction.

We believe it is important to take into account the motivation behind transactions that include a cash-out component. If we fail to recognise the differences, then we risk overstating the cost of many transactions where the transaction’s true nature was the purchase of goods.

Looking at our second concern, one of the important aims of the EFTPoS Standard was the setting of a floor and a cap on interchange fees so that interchange fees themselves could not be used as a negotiating pawn by the access provider, to frustrate access for the seeker. By segregating transactions on the basis of whether or not the transaction includes a cash-out component and then making those with cash-out components fall outside the standard, the intent of the EFTPoS Interchange Standard with regards to access is frustrated. That is, in order to gain access a seeker requires agreed interchange agreements for both regulated and unregulated transactions. The standard however, only gives certainty on interchange with regards to regulated transactions. While the access provider cannot use interchange fess as a means to frustrate access for a seeker with regards to regulated transactions, he can use the negotiations on unregulated transactions as a means to frustrate access, because unregulated transactions fall outside the EFTPoS standard.

Recently we have engaged with a number of market participants in bilateral negotiations on EFTPoS interchange fees in support of changes we are making to our settlement and clearing arrangements. While we are not seeking to become a direct connector, we are seeking direct clearing and settlement arrangements which unlocks significant costs for us. Our negotiations on regulated transactions were very straight forward and quickly put in place. However, when seeking to negotiate a bilateral agreement covering unregulated transactions, we are at a stale mate with the other counterparty seeking an interchange fee higher than market standards. As a consequence, they have thus far successfully frustrated our ability to establish direct settlement and clearing arrangements, an action we consider to be against the intent of improving access to the EFTPoS system.

For so long as we have both regulated and unregulated transactions within the EFTPoS system and these transactions are both required by any access seeker, the access provider will always be able to use interchange fees as a means to frustrate and limit access.

1.3 Changes to access arrangements

As a consequence of the work undertaken to improve access, two important changes were made. Firstly, APCA developed the Access Code which in conjunction with the RBA's Access Regime (effective 12 September 2006), enabled smaller institutions to consider the appropriateness of their existing connection arrangements within the broader Australian Payment System. Secondly, in June 2005 APCA made changes to the then CECS rules to allow an institution who met certain qualifying criteria to request a direct settling and clearing relationship with another member of CECS who similarly met the same criteria.

With respect to the first change, we believe the Access Code adequately provides certainty for a new connector to be confident of establishing direct links with existing direct connectors. Similarly, the Access Standard released by the RBA adds certainty in two important areas. Firstly, it has placed a cap on the costs of establishing a connection and secondly, it removes the ability of an existing connector to use the negotiations on interchange fees as a means to frustrate access.

For an organisation such as Indue, evaluating the strategic benefits of becoming a direct connector is an ongoing process. We were well aware of the inherent uncertainties, in a pre-reform environment, of the process and the degree of inconsistency applied by the various direct connectors in how they approached the issue of establishing a new connection. Hence, we have throughout the process of reform been a strong advocate for change in the important area of access.

In the area of EFT processing, technology is a key enabler. As such, we hold the view that as technology improves or evolves; opportunities are created which previously were only justifiable on a cost basis to significantly larger institutions. Our own recent experience with EFT processing suggests that what was previously only economically sustainable for those institutions with significant transactional scale, is now sustainable in smaller institutions. This change has enabled us to apply new technology to our business and by so doing increase our understanding of the underlying cost structure on EFT processing.

This in turn has helped us determine our efficiency curves and the corresponding price relativities of scale. Our enhanced understanding has proven to be of significant importance to us in lowering our unit cost for EFT processing.

While neither the Access Code nor the Access Standard enhanced our understanding of our unit cost, they were nevertheless critical in helping us realise the savings as we had newfound certainty around the process of establishing direct connections which was not the case in the pre-reform environment. Without this certainty, it would have been difficult to gain much benefit from enhancements in technology.

The second change, namely the changes to the CECS rules introduced by APCA which enable a CECS member to establish direct settling and clearing relationships with another CECS member provided, amongst other things, they have at least 0.5% of the national volume, is in our opinion also a very significant change that was enacted in parallel with the reform process that lead to the development of the Access Code. Clearly these changes do not of themselves facilitate the process to become a direct connector, however, they do recognise that there are two levels of access to the Australian Payment System which are equally as important albeit, they serve different purposes.

Access to the Payment System can be defined by the ability of an access seeker to gain a direct physical connection with the 9 current direct connectors. Improving this process was the purpose of the Access Code and the RBA's Access Standard. Post reforms, the current process now allows a new connector to physically interact in message switching with the other 9 connectors.

However, there is also a secondary form of access, namely gaining physical rights to clear and settle directly with another member of CECS, whether that member is a direct connector, or uses a third party gateway like First Data international (FDI). For smaller institutions it is more common that they will use the services of a third party gateway and hence, they interact with the other direct connectors indirectly through this third party gateway. However, not having a direct connection does not prevent these smaller organisations from settling direct with other CECS members. The changes made by APCA to the CECS rules recognise these two levels of access and in the case of the CECS rule changes, sought to add more certainty to how the process of establishing a direct clearing and settling relationship could be facilitated.

Over the last twelve months we have been trying to use the changes to the CECS rules to unbundle our existing indirect settlement arrangements in favour of a direct relationship with three of our most common settlement counterparties. Our progress to date with each of these three institutions has varied from very proactive and positive in terms of the spirit of improving access to extremely difficult, with establishment costs used as a means to frustrate access. The establishment price between these institutions varies with the highest cost being six times higher than the lowest. At the lowest end the fee is well within the cost benchmark set by the RBA in its Access Standard of $78,000, while at the high end, it is significantly above the benchmark. Attempts to negotiate this fee, even after highlighting the disparity between the three institutions, have failed with the institution at the high end standing firm and being unwilling to negotiate.

Regretfully appeals to APCA have also failed as the CECS rules define the cost of locking in a test slot in the pre-determined test windows, but are silent with respect to imposing a fixed recoverable cost for the institution asked to establish a new direct clearer and settler within their system. Therefore, they are technically able to set their own price at any level. For smaller institutions access to the Australian Payment System is as much about being able to establish oneself as a direct connector with certainty, as it is about being able to establish direct clearing and settling relationships with other CECS members. From a cost perspective, the financial benefit for us is a significant 66% reduction in our settlement costs for these three organisations. However, given the position thus far expressed by some of the existing CECS members, our efforts to gain direct access are being frustrated by the absence of the same certainty which has been given to anyone seeking access into the EFTPoS system as a direct connector.

We believe this inconsistency in how access to the Payment System is treated is unsustainable, with the separation between access as a direct connector and access as a direct clearer and settler in need of greater alignment in how these are treated and facilitated. Accordingly, we believe the same level of regulatory certainty that now exists over a direct connection must also exist over the establishment of direct clearing and settling links and therefore, we would like to see the powers of the existing Access Standard widen to capture access to direct clearing and settling.

2.0 What is the case for ongoing regulation of interchange fees, access arrangements and scheme rules, and what are the practical alternatives to the current regulatory approach?

2.1 Use of the no-surcharge rule to address concerns over interchange fees

In all circumstances achieving the right balance between all parties who facilitate card payments is of paramount importance if we are to have parity between participants and an efficient market.

At present there are a number of mechanisms in place to address the concerns expressed by the RBA relative to interchange fees during their initial work on reforms. We have direct intervention with regards to the calculation of the interchange fee itself, the ability of merchants to apply a surcharge on transactions and in so doing pass back to the cardholder the costs associated with any interchange fee and in the case of scheme debit, the ability for a merchant to reject acceptance of the product because of the removal of the 'honour all cards' rule.

These three mechanisms currently work in parallel and as a consequence, they have successfully weakened the strong position held by issuers in the pre-reform environment. Since the commencement of the Interchange Standard on Credit Cards the level of interchange paid to issuers has dropped significantly and as a consequence, so to has the average level of merchant service fees paid by merchants. Acknowledging the RBA's initial concerns that surcharging would not become commonplace within a reasonable time frame, intervention by the RBA has enabled the Bank to achieve its aim in terms of establishing more appropriate price signals to cardholders.

With the passage of some five years since this standard came into effect, two important changes have occurred. Firstly, in the five years since the prohibition of surcharging was lifted, we have seen evidence of a steady increase in the number of merchants that levy a surcharge (refer section V. Developments in the Market for Payment Cards; RBA Issues paper; May 2007; pages 18-19). Secondly, the 'honour all cards' rule has been lifted for scheme debit and as a consequence, merchants are now able to refuse acceptance of the scheme debit product should they feel the cost of processing payments through this instrument are inappropriate and they do not wish, or are unable for competitive reasons, to levy a surcharge.

Given what has transpired since the Interchange Standard was first released in July 2003, it is questionable whether all three mechanisms are necessary going forward, in order to continue to send appropriate price signals to cardholders. We believe that as the market in a post reform environment matures, all three mechanisms are not required. Simply they do not promote parity between participants, nor do they promote a more efficient market.

If the RBA is to continue to intervene by establishing interchange benchmarks, then what is the future role of surcharging or indeed, does the original reason for removing the 'honour all cards' rule still apply? If the intent of the RBA's intervention on interchange fees is to more appropriately shift the cost associated with the issuer features of the product to the cardholder rather than the merchant, then we believe the RBA's intervention satisfies this aim. Surcharging and the removal of the 'honour all cards' rule serves only then to strengthen the position of the merchant against the issuer. For the merchant, having access to the other two mechanisms, particularly the 'honour all cards' rule, means it is able to use acceptance as a means of leverage even though the RBA's intervention has already shifted costs away from the merchant to the cardholder and in essence achieved balance in terms of the interchange fee applicable. We believe persisting with all three mechanisms creates imbalance which does not promote an efficient market nor will it allow the market to mature so that self regulation through normal market operation will replace the more artificial regulation imposed by the regulator.

To this end, we believe that intervention by the RBA in the setting of interchange fees should not persist beyond the 2007/08 review. Rather surcharging in conjunction with the 'honour all cards' rule should be the chosen mechanisms through which the RBA abates its concerns over interchange fees. Given merchants have over the last five years shown an increased propensity for surcharging, we expect the practice to continue to increase. Further, consumer sentiment today appears to be more accepting of surcharging than what it may have been in 2002 when prohibition prevented surcharging. Therefore, irrespective of the level of interchange, the merchant will then have sufficient tools to neutralise the effect of interchange on their cost base.

2.2 The effectiveness of existing access arrangements

As stated in section 1.3 of this submission, we believe that access to the Australian Payment System must be considered at two separate levels. These levels are:

- *Direct connection*: where there are physical communication links established with the existing 9 direct connectors
- *Direct clearing and settling*: where the connection with a direct connector may be through a third party gateway like FDI, but clearing and settling links are direct between the various CECS members

The work undertaken through the reform process primarily focused on the first level of access, namely establishing a direct connection. In the main we believe the current Access Code and the complementary Access Standard have together created a robust framework for any institution seeking access to follow with certainty.

This said we also believe that the current access code has limitations which will become more prevalent should the number of direct connectors increase. Specifically, we remain cautious that the cost benchmark for the recoverable connection fee of $78,000 may become prohibitive as the number of connections required by a new access seeker increases in proportion to the number of direct connectors. At current levels, to secure 9 connections would cost $702,000 and increase at a rate of $78,000 for each new connection. Secondly, as the number of connectors increase the number of physical links similarly increases adding technical complexity.

To this end we believe the current structure of the communications links that underpins the direct connectors and hence, the exchange of messages, must evolve to simplify access and reduce the potential for cost escalation for new access seekers. Work such as that to be undertaken by APCA's CECS Interchange Communications Facility Project must be encouraged and allowed to continue as it is through this work that access for new entrants will be sustained in economically viable terms.

It is disappointing that this project did not receive funding for the 2007/08 year and while we live in the hope that this position will be reversed in 2008/09, clearly there are no guarantees and hence, the evolution of the payment system may suffer. We believe that industry wide change such as that which may emerge from the work of the CECS Interchange Communications Facility Project, should not be left up to the industry alone. Rather we believe the Access Code should make such work compulsory.

With regards to the second level of access, the attempt by APCA to improve access for those seeking direct clearing and settling links is admirable. However, without the certainty afforded to establishing a direct connection, we consider this work inadequate because it is unable to guarantee access as a direct settler and clearer. Specifically, any institutions is able to frustrate the process of granting access, by refusing to negotiate a connection price that is in line with the benchmark set by the RBA in the Access Standard for direct connection.

We believe that the certainty afforded to direct connectors must be equally afforded to the establishment of direct clearing and settling links between CECS members. Without this same level of certainty, we do not consider that access to the Australian Payment System has been truly improved through the reform process. To this end we would like to see the changes invoked by APCA in the CECS rule in June 2005 complemented by the Access Standard in a similar way to how the Standard currently complements the Access Code.

3.0 If the current regulatory approach is retained, what changes, if any, should be made to standards and access regimes?

3.1 Further reduction in credit card interchange fees and/or the adoption of a uniform approach to the setting of all regulated interchange fees

In the RBA's issues paper dated May 2007, the Bank calls for views with respect to whether a common methodology, perhaps using the same cost categories, should be used to determine the various interchange Standards.

As a matter of principle we believe that there should be integrity in the calculation of the various interchange fees and where similarities exist between products, there should be logical and practical consistency in terms of how the methodology is applied. However, applying consistency does not mean that the methodology is used in an identical fashion across all products. Rather, we believe that it is important to understand how each product creates value and as a consequence, isolate those component that are fundamental to the product delivering value to the users. It is then the specific components used that will vary from product to product rather than the methodology itself.

For example, in the case of EFTPoS we believe that there are some issuer costs that are paramount to adding integrity to the EFTPoS payment system, namely the provision of authorisations, and once authorised, the payment guarantee provided by the issuer. These two components of the issuer's costs add integrity to the payment system and without them it is questionable that EFTPoS would be an accepted and robust payment system. However, in practical terms these two components are ignored from the calculation of interchange.

We believe that as a first step towards achieving consistency, it is important that rather than limiting ones view to only considering the costs of either issuers or acquires, one should consider how the payment system creates value on an end-to-end basis across both the issuers and acquirers domains. Then one should isolate those components which both rely on to deliver integrity to the system. This then should represent the level at which cost structures are established for the determination of eligible costs.

Once one has consistency as to how eligible costs are determined, it is important that consistency with respect to the data used is achieved. For example, in the Interchange Standard for Scheme Debit, we believe that inconsistency was applied by the RBA when it used credit card data in the calculation of the interchange fee for this product. It is difficult for anyone to maintain integrity in the calculation of an interchange fee if the data being used is not that sourced from that applicable for the product under review. The use of data from a product which clearly had more significant scale and as such benefited from its critical mass, has the potential to produce a result which is not consistent with what would have been derived had the data from the product itself been used. In the case of scheme debit we believe the inconsistent use of data lead to a result which understated the true costs applicable to the payment system.

In summary, we believe that it is practical to have one methodology which can consistently be applied across every product. Application of the methodology however, should focus on the value added on an end-to-end basis across both issuer and acquirer costs and use only cost data relevant to the specific product (or payment system) under review.

3.2 Setting all interchange fees to zero

Since the introduction of EFTPoS and credit cards in this country, we have today reached a high level of maturity which in turn sees very wide acceptance for these products. This wide acceptance clearly has added both depth and integrity to the payment systems that supports these products. Given the level of maturity (specifically the wide level of acceptance) in these payment systems, one could question the ongoing need for interchange fees.

If interchange fees were solely a mechanism to facilitate acceptance, then the abolishment of interchange fees in a mature market characterised by wide acceptance would be an appropriate action in keeping with an efficient market. However, we do not regard that a market reaching maturity and having wide acceptance is reason enough to effect such a change. The reason being that interchange fees in themselves were traditionally put in place to account for processing methods.

To the extent that interchange fees relate to processing rather than just acceptance, interchange fees should reflect the inherent costs associated with the processing of payments in each payment system. More specifically, the processing costs that should form part of any interchange calculation should be those elements that exist across the payment system's value chain and deliver value to the facilitators of the payment system, namely the issuers and acquires, as opposed to the cardholder themselves. The reason being that the cost of the payment system that facilitates benefit solely for the cardholder should be borne by the cardholder themselves and charged to them directly by the issuer.

Further, it is important to recognise that some of the features inherent in the product and the payment system itself benefit the facilitators of the payment system more so than the cardholders and to this extent, these should be met by the facilitator receiving the benefit. One example of this in the credit card payment system is the issuer costs associated with authorisations (and the subsequent payment guarantee). These elements are important to the payment system overall as they underpin the integrity of the system. Without them it would be difficult to have a viable payment system.

While the cardholder benefits from these features, so to does the merchant. These features are important elements of the payment system itself and without them it is difficult to see how the system would be an effective payment mechanism between its users. In regards to features such as these, where the benefit is principally derived by a facilitator of the payment system, we believe it is appropriate for that facilitator (in this case the acquirer) to bear the cost of these elements of the payment system via an appropriate interchange fee.

Recognising the costs associated with processing in a particular payment system and that different users benefit in different ways from the various features, it is important that interchange rates are not set at zero to enable this important redistributing of costs to occur.

3.3 Modification of the compliance aspects of the interchange standards

Philosophically, we believe that schemes ought to be allowed to set their own interchange categories and fees provided that the weighted average fee remains below the appropriate benchmark.

As such, our concern with the current arrangement is more with regards to the downstream effect of paying a significantly higher interchange fee on a certain category of transactions, where the category may currently only have a low volume of transactions. In this instance, as transaction volumes shift in response to issuers seeking to take advantage of significantly higher rates (particularly in consumer card portfolios), a scheme's weighted average interchange fee could be non-compliant with the benchmark and remain so until the next test window. While the situation described relates to activity within a scheme, the same activity can clearly also occur between schemes.

To overcome this issue, we believe the frequency of compliance tests should be changed from 3 yearly to annually. In this way issuers will lack the incentive to shift volume of accounts in between products, particularly if that category of transaction was only going to deliver short term gain.

3.4 Modifications to the honour-all cards rule to include premium and/or pre-paid cards

As a matter of principle, to sustain the integrity of scheme, acceptance is an important consideration and for the cardholder, acceptance is paramount. In other words cardholders expect that any merchant displaying a scheme's flag to signify acceptance of that scheme's products, will accepts all the cards presented which bear the flag of that scheme. We do not believe this to be an unrealistic expectation.

However, given that through the reform process for scheme debit the 'honour all cards' rule was removed, we have a precedent under which merchants can reject acceptance of the scheme debit product yet accept that same issuers credit card product. Given this, to extend the application of the Standard which covers 'honour all cards' beyond scheme debit would no longer be a significant change.

This said however, the backlash from cardholders concerning acceptance, or lack thereof, has not been significant. One reason for this is that merchant's refusal to accept scheme products has been minimal. Therefore, for the cardholder, there has been minimal disruption and hence little reason to complain.

This said if the application of the removal of the 'honour all cards' rule is extended across other products, it is important that we ensure that non-acceptance is consistently applied across all issuers. That is, a merchant should not be able to discriminate between issuers. A key consideration here would be that where the merchant is involved with an issuer in a co-branded issuing program, that merchant cannot accept its own product if they do not accept the same product from other issuers. This is of particular importance given that there are already merchants in the market involved is issuing co-branded card products with issuers (e.g. Coles and Harvey Norman, both of which have programs with GE).

Furthermore, we believe that if acceptance is going to become less certain, it is important that a supervisory body is established to ensure that a merchant exercises no discrimination between issuers if it is going to exercise its rights and refuse acceptance of a product under the removal of the 'honour all cards' rule.

3.5 Regulation of Interchange fees on EFTPoS cash-out transactions

Essentially there are three types of EFTPoS transactions, namely a purchase transaction, a purchase with cash transaction and a cash-out transaction. Under the current EFTPoS Interchange Standard, only the first type of transaction is regulated and hence covered by the Standard. The second and third types of transactions, because they involve cash-out, fall outside the Standard and hence are unregulated.

Looking at the second type of transaction first (i.e. a purchase with cash transaction), for reasons outlined in section 1.2, we believe the current classification is inappropriate as it categorises all transactions the same irrespective of what percentage of the total transaction is represented by the cash component. We believe that the primary motivation for the transaction is important and where the cash-out component is not the majority of the transaction, it ought to be captured by the Standard and treated as a regulated transaction.

Furthermore, one of the reasons why the RBA introduced a cap and floor for interchange was to stop an existing connector from using interchange as a means to frustrate access given that a new direct connector needed to have in place appropriate interchange agreements in order to make use of their direct connection. By excluding 'purchases with cash' transactions from the Standard, as it currently stands the original intent of the Standard is frustrated. That is, an existing connector can now use the interchange negotiation on unregulated transactions as a means to frustrate access.

We believe, that for simplicity, transactions that are 'purchases with cash' should be captured by the standard and hence, treated as a regulated transaction with the same certainty on interchange fees applied to these transactions as currently exists with straight purchase transactions.

With respect to the third type of transaction (i.e. cash-out transactions), we believe that the nature of the transaction irrespective of the channel used, is consistent with the nature of an ATM transaction. In this case we believe that it would be appropriate for these transactions to remain unregulated and as such, an acquirer (and by default the merchant) should be able to negotiate a separate fee with the issuer that is more aligned to ATM interchange fees. In the event that the fee proposed by the acquirer is not acceptable to the issuer, then the issuer can elect not to use the merchants under that particular acquirer for cash out transactions. Given that these types of transactions, according to industry data, represented on average only 1% of all EFTPoS transactions over the last 3 years, the impact on an issuer is not considered material.

3.6 Possible changes to legislation to allow the RBA to set interchange fees directly

We do not believe that the RBA should be allowed to set interchange fees directly. Rather we believe that debate is a necessary step in the industry reaching maturity and in gaining acceptance and buy-in for major structural change.

Philosophically, we believe that the schemes should be allowed to set their own interchange categories and fees. As argued in section 2.2 we do not believe that the RBA over the medium term should have a role in the setting of interchange fees. Rather other mechanisms such as surcharging and the ‘honour cards’ rule should be used as a means through which appropriate price signals are given to cardholders.