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Via email to: [pysubmissions@rba.gov.au](mailto:pysubmissions@rba.gov.au)

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Dear Tony

### **Review of Card Payments Regulation**

We refer to your media release dated 3 December 2016 which announced a number of changes for Card Payment Systems.

In response to the Bank's invitation to provide feedback, we have considered the proposed changes and offer comments in a number of areas.

#### Interchange fees – foreign-issued cards acquired in Australia

We are concerned that the Bank would consider pre-emptive regulation to address a perceived problem ahead of having sufficient empirical evidence to support the actual existence of the problem.

Typically foreign-issued cards represent a payment instrument through which visitors to Australia can spend foreign money domestically in Australia. The sales paid for through these foreign payment cards create value for merchants beyond what would normally be derived were only domestically funded purchases acquired. These additional sales are only possible because the merchant is willing to acquire transactions from foreign-issued cards and in exchange for the additional sales the cost to the merchant is higher than that associated with domestic payment cards.

While it is true that the merchant incurs a higher fee for accepting the foreign-issued payment card, the additional cost can be recovered if the merchant applies a surcharge. Alternatively, because of the removal of the honour all cards rule, the merchant also has the ability to choose not to accept the foreign-issued card and thus incur no costs.

We believe these two existing regulatory options adequately deal with the higher acquiring costs. To impose further regulation would in turn be excessive in our opinion.

The Bank calls out in the consultation document, the possibility of foreign banks marketing their foreign- issued payment cards to local corporates and the existence of virtual cards as potential reasons to be concerned. While possible, we do not see these are being mainstream practices or problems at this time. In the consultation document the bank does not supply evidence to support its concerns and as such we assume the problem is perceived rather than real.

While it is possible that a foreign bank could issue their payment cards to Australian domestic corporates; the practice would add significant complication to both the issuing bank and the cardholder. These complications may, amongst other things, bring into question the legal enforceability of the debt. It is likely that the complications would increase the costs of the product and as such the additional interchange and the associated benefits the customer may derived may be

adversely impacted by the additional costs for the issuer. At this stage we would see this practice as improbable in the Australian context.

The consultation document does however reference the recent work undertaken in Europe to address this practice. In the European context, we would see the possibility of this practice as being a more real problem than in Australia. For example, Europe in aggregate is a more concentrated group of countries than Asia and the geographical proximity of each country in Europe is closer than would be true of Australia in the Asian context. Cross border transactions are more common than they would be in Australia and typical at all levels of business. The existence of SEPA encourages cross border trade as does the single currency unit which removes a lot of the complexity that a foreign issuer would experience if they were to undertake this practice in Australia. We would expect that the percentage of transactions completed through foreign-issued cards in Europe would be higher than what it would typically be in Australia.

Virtual cards are potentially easier to source but have similar complications to those mentioned above particularly where the product is a credit product. In the case of prepaid, while not a credit product the complications still exist with the purchaser of the card having to forward money to a foreign based issuer. In this case funding the account is not as easy as it is for a domestic program and the purchaser would need to undertake an international money transfer which is typically only available from a bank and may take several days before the money can be accessed.

While we acknowledge that the potential for misuse exists, we do not at this time believe the Bank has enough evidence to suggest this is a problem now or that it is emerging. As such, we would not support regulation as is proposed for this issue.

#### Interchange fees – prepaid cards

We understand the similarities that are drawn between prepaid cards and debit cards. The most obvious being that both use the consumer's own money. While the origin of the funding source may make them close substitutes, the structure of the two products is fundamentally different and in this context the two products are nothing like each other and hence have different costs that underpin each one. These differences make the proposed alignment between debit and prepaid interchange overly simple. We believe that interchange for prepaid should be based on a methodology that is more akin to the way credit interchange is calculated than how debit interchange is calculated. Importantly, we are not implying that prepaid and credit ought to have the same level of interchange, but rather that similar methodologies should be used for the calculation of the relevant interchange for each product.

Debit cards of themselves are merely a means of accessing the transactional account of a consumer. It is the transaction account and not the debit card itself that is the funding source for purchases. This is in contrast to credit where the funding source is the credit account and for prepaid where the funding source is the account used to hold the customer's prepaid deposit. Importantly the money held in a credit account can only be accessed by the credit card itself as the sole payment instrument. Similarly in the case of prepaid, the money lodged by the customer, can only be accessed by the prepaid card that is attached to the account. In contrast, a customer's transactional account can be accessed through a number of different payment instruments. The debit card itself is just an access mechanism in much the same way as DE is. The account will survive the debit card in the event the debit card is surrendered. This is in contrast to the credit and prepaid products where both will cease to exist if the respective cards are surrendered.

The important point here is that because the prepaid card must have a prepaid account from which to draw funding, appropriate costs associated with the operation of the account should be taken into account when calculating interchange. Again in contrast, because the transactional account survives

the debit card, interchange should only take into account those costs associated with the debit card operation itself. The costs associated with the transactional account would typically be spread across the different payment instruments that access the transactional account.

With this in mind, while we support the regulation of interchange for prepaid products in a similar way to how interchange is calculated for both credit and debit, we would not support the alignment of prepaid interchange with debit.

#### Interchange benchmarks and ceilings

Of the options proposed, we would support option two for both credit and debit. In the case of credit, imposing a cap still allows for product innovation but limits the potential for excessive levels of interchange to be awarded to these innovations. A cap of 0.8% limits the excesses and when combined with a regulated companion card, makes for a more neutral outcome for the consumer because the potential for arbitrage between schemes on the same account is removed.

In the case of debit, however, we acknowledge that with the introduction of contactless by the international schemes; the result has seen more consumers choosing to use their debit card for more payments than perhaps may have been the case pre-contactless. No doubt the shift in consumer behaviour has resulted in a higher number of lower value transactions and this in turn accounts for the reduction in the average transaction size of 17%.

One reason given for the proposed reduction in debit card interchange fees is the higher cost to merchants of processing debit cards. In contrast the alternative to using debit cards is to use cash. Cash however, results in even higher costs to the merchant. If we were to assume that the cost of cash is zero, then the increase use of debit cards would result in an absolute increase in the merchant's costs. Importantly however, the cost of cash is not zero. Its costs are higher than those attributed to debit cards as illustrates in the RBA's own cost study released in December 2014 so any change in consumer behaviour that results in a higher level of debit card use, will result in lower payment related costs for merchants when compared to cash.

With this in mind, we find the proposed reduction of 50% of the current interchange fee counter-intuitive given that higher debit card usage results in a lower cost to merchants than if they had to deal and manage the alternative, namely cash. (It is important to note that the additional lower value transactions that contactless is responsible for directing to debit cards would ordinarily have been cash transactions rather than PIN based debit transactions.)

We believe that shifting consumer behaviour to favour debit cards over cash should be encouraged. This shift however, does not come without a cost to issuers and the current interchange fee standard allows for the recovery of some of this cost. Interchange fees, in principle, should not be allowed to be a deterrent that stops merchants from accepting important products that serve the public interest by being more efficient and secure than their alternatives. Rather it should create the means for more equity to exist between the cost of accepting a debit card by a merchant and the cost of product innovations that deliver efficiency and security in our payment system.

We believe that option 2 for debit cards allows for a reduction in interchange fees against today's fee structure, while still allowing for innovation at the issuer level to continue to be encouraged. This innovation invariably supports important changes in retailing that often require more efficient and streamline payments than are available today (for example remote ordering apps that combine payments with merchant ordering systems allowing for an improved consumer experience at the point of sale and a more efficient and lower cost delivery of products by merchants).

## Scheme payments to issuers

In our earlier response to the Bank's current review, we stated our position was that non-interchange payments between schemes should not be included in the calculation of the interchange fee cap. We remain of this view albeit understand that in some instances incentive structures display interchange-like characteristic and as such perhaps should be included in the overall interchange benchmark.

In our experience, incentives we have received from international schemes have sought to assist us with product development, the introduction of new technologies and in making important security changes. The delivery of these changes results in Indue incurring real costs and as such the incentive received usually offsets some of these costs rather than being accounted for as part of the transactional income associated with the operation of the card product. We believe these incentives should be clearly excluded from the standard.

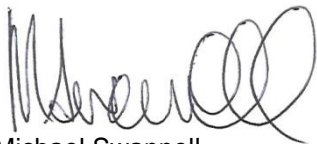
Other incentives typically received by us are marketing driven incentives that reward us for our work in influencing cardholder behaviour in favour of our card over someone else's. These incentives we believe show some of the general attributes of interchange (i.e. like interchange they tend to be transactional based) and as such should be included in the interchange calculation.

While we would support the inclusion of transactional based incentives in the calculation of interchange, we believe the new standard should look for issuers to comply as existing agreements expire. A progressive adoption of the standard will allow the industry time to adjust to the financial impact this change will have on issuers. There is no doubt that this will impact both large and small issuers, however, the financial reality of the change is more material for small issuers and hence a "grace period" we believe would be appropriate.

In conclusion, we thank you for the opportunity to provide feedback on the consultation document and the changes highlighted and look forward to the opportunity to discuss our submission with the Bank.

In the meantime, if you have any questions, feel free to give me a call on 07 3258 4248.

Yours sincerely



Michael Swannell

Executive Manager - Payments