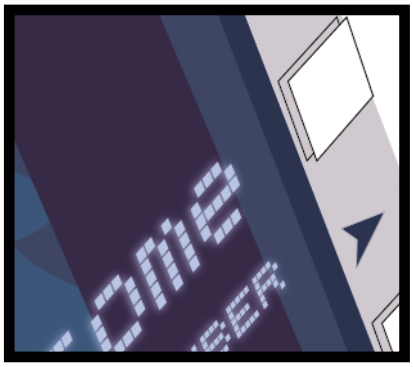


COMPETITION AND EFFICIENCY

During 1999/2000, the main endeavour of the Payments System Board, under its mandate to promote competition and efficiency, has been the study of interchange fees and conditions of entry in debit and credit card schemes, undertaken jointly with the ACCC. The study has been a comprehensive one, involving a number of staff from both organisations. In addition, the Board has been following developments in electronic commerce and, within that emerging area, has worked with billing organisations to improve consumer incentives to take up direct debits. The first Exchange Settlement account under the Board's liberalised access regime was opened during the year. The Board has continued to encourage financial institutions to speed the availability of cheque funds to what has become industry "best practice" of three days, and has endorsed a rationalisation of supervisory responsibilities for purchased payment instruments such as stored-value cards.

STUDY ON INTERCHANGE FEES AND ACCESS

Interchange fees are fees which flow between financial institutions whenever customers of one institution are provided with card services by another financial institution. For instance, a financial institution whose customer withdraws cash through an automated teller machine (ATM) owned by another institution will pay an interchange fee to that institution. Interchange fees are wholesale prices, which are reflected in the fees and charges paid by retail customers who use debit and credit cards, and in the charges generally paid by merchants to their financial institutions when they accept cards for payment.

Interchange fees are not published as "carded rates" for all to see and compare. In Australia, interchange fees for ATM and debit card payments are set in bilateral negotiations between financial institutions and the rates are closely held. Interchange fees for credit card transactions are set jointly by the financial institutions which are members of the credit card schemes. Likewise, the fees are not made public.

As a consequence, little has been known – outside the institutions directly involved – about the rationale for and the process of setting interchange fees. Most importantly, it has not been possible to determine whether these fees have been encouraging the efficient provision of debit and credit card services or of other services, such as direct debits, with which they compete. Australian authorities have raised concerns about this lack of transparency, and the apparent stickiness of interchange fees, on a number of occasions over the past decade. More recently, the Financial System Inquiry recommended that debit and credit card arrangements be reviewed by the Payments System Board and the ACCC and that the rules and membership arrangements of the credit card associations be watched closely by the ACCC. The study was a response to this recommendation and to other developments that had come to the Board's notice.

The study analysed interchange fee arrangements for ATM, credit cards and debit card payment networks separately. For each of the networks, it drew on detailed cost and revenue data provided by the main participants.

ATM Networks

Interchange fees for ATM transactions are paid by the card issuer to the financial institution which owns the ATM. They are designed to reimburse the ATM owner for costs incurred in providing a cash dispensing service to the issuer's customers. The fees were determined by bilateral negotiation mostly in the late 1980s, by which stage several separate networks had been established. These networks have now been effectively linked but interchange fees have remained largely unchanged.

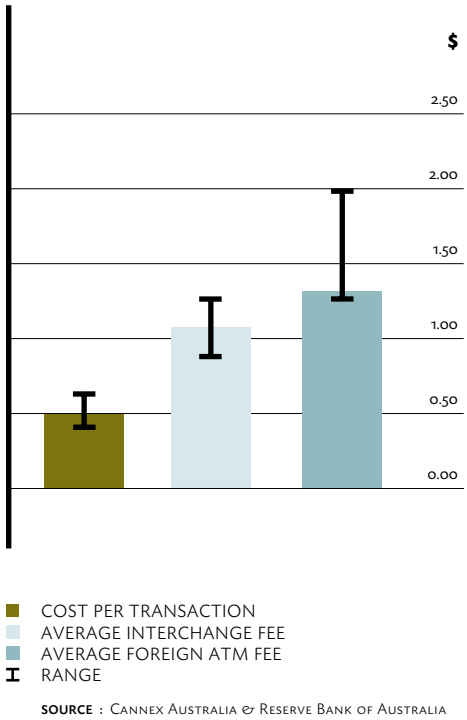
On the detailed information provided, interchange fees for cash withdrawals average $1.03 per transaction. This is double the cost of providing cash withdrawal services, which averages around $0.49. Card issuers normally pass these fees onto their cardholders whenever they use another institution's ATM, through "foreign ATM fees" which average $1.35 per transaction.

If the market were working effectively, competition between established players and the threat of new entrants would be expected to bring ATM interchange fees more into line with costs. This has not been happening in Australia. Financial institutions as a whole receive a flow of net revenue from foreign ATM fees and, as a consequence, have little incentive to negotiate lower interchange fees. Large financial institutions also possess greater bargaining power over smaller new entrants in interchange fee negotiations.

ATM cash withdrawal costs per transaction
(Weighted average, $A)

Operating expenses		**0.26**
Of which		
Cash		**0.13**
Cash handling	0.10	
ATM cash float	0.05	
Other		**0.13**
Processing	0.04	
Switch costs	0.02	
Installation and maintenance	0.08	
Overheads		**0.24**
Of which		
Support staff	0.04	
Site rental (off premise)	0.03	
Depreciation/leasing	0.08	
Telecommunications	0.04	
Cost per transaction		**0.49**
Interchange fee revenue		**1.03**

ATM COSTS AND FEES - CASH WITHDRAWALS



SOURCE : CANNEX AUSTRALIA & RESERVE BANK OF AUSTRALIA

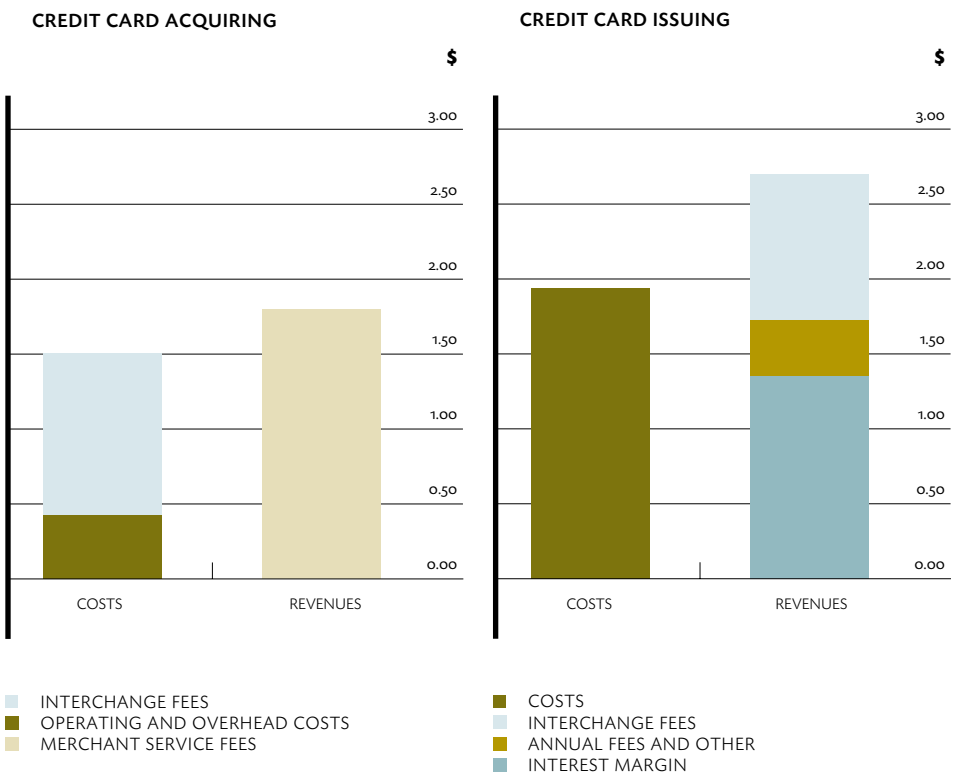
The study considered an alternative pricing regime – that of "direct charging" – which would encourage competition and greater transparency in the pricing of ATM services. Under this regime, there would be a direct relationship between the ATM owner and cardholders wishing to withdraw cash. The ATM owner would charge customers of other financial institutions a transaction fee which would be clearly posted at each ATM. That fee would be debited to the cardholder's account along with the cash withdrawal, and the resulting amounts settled between card issuers and ATM owners as at present. ATM owners which sought to recover their costs in this way should not also receive interchange fees.

Whatever approach to cost recovery is adopted by ATM owners, the study has shown that the industry's current cost structure provides ample scope to reduce fees for cardholders who use the ATMs of other financial institutions. The Board will closely monitor public discussion and industry responses on these issues over coming months.

Credit Card Networks

In credit card networks, interchange fees are paid to the card issuer by the merchant's financial institution (known as the acquirer since it is said to "acquire" the transaction from the merchant). In Australia, the interchange fees for domestic transactions are agreed jointly by the financial institutions which are members of each of the card schemes. In the international schemes (MasterCard and Visa), the interchange fees are 1.2 per cent of the value of the transaction for paper-based transactions and 0.8 per cent for electronic transactions when the card is swiped and the customer authorises the transaction by signature. The interchange fee for Bankcard is 1.2 per cent for all transactions. Taking into account the mix of paper-based and electronic transactions, the average interchange fee per transaction received by card issuers is 0.95 per cent.

The study showed that credit card issuers earn about one-third of their revenues from interchange fees and around one-half from the interest margin on credit card lending. For an average credit card transaction of $100, total revenues from credit card issuing average $2.69 per transaction compared with costs of $1.93 per transaction — a mark-up over costs of 39 per cent. Credit card



acquirers incur costs of $0.43 per transaction and have revenues, after paying interchange fees to issuers, of $0.72 per transaction – a mark-up over costs of around 67 per cent.

The economic rationale for interchange fees is that they encourage the growth of payment networks by redistributing revenues between participants to induce them to join. This can help to maximise the benefits of the payments network. In credit card networks, interchange fees are typically used to redistribute revenues from merchants to issuers. The argument is that issuers incur costs to provide the benefits of credit card services to merchants, but do not have a direct relationship with them; hence, issuers can only recoup these costs through an interchange fee paid by the acquirer, and passed on to the merchant through a "merchant service fee".

Credit card costs and revenues per transaction
(Weighted average, $A)

ACQUIRING		ISSUING	
COSTS			
Operating expenses	**0.19**	Card production/distribution	0.06
Of which		Authorisation	0.04
Staff	0.07	Processing	0.17
Authorisation	0.04	Staff	0.39
Processing	0.04	Interest free period	0.26
Switching services	0.03	Fraud	0.07
		Credit losses	0.35
		Other	0.68
Overheads	**0.24**		
Of which		**Cost per transaction**	**1.93**
Depreciation	0.07		
Telecommunications	0.05		
Fraud	0.01		
Other	0.11		
Cost per transaction	**0.43**		
Interchange fees paid	1.06		
REVENUES			
Merchant service fees	**1.78**	Interest margin	1.36
		Annual fees	0.33
		Other	0.05
		Revenue from cardholders	1.74
		Interchange fees received	0.95
		Revenue per transaction	2.69

Credit card interchange fees in Australia are not reviewed regularly by scheme members on the basis of any formal methodology. The study reviewed those costs incurred by issuers which might, if a formal methodology were applied, be eligible for inclusion in an interchange fee and be passed on to merchants. Usually cited are the costs of funding the interest-free period between when the merchant is paid by the card issuer and when the cardholder settles his account; costs related to the guarantee of payment to the merchant (which include credit losses and the cost of fraud); and processing and overhead costs associated with maintaining the credit card system. The study argued that cardholders also benefit from the interest-free period and should bear some or all of the associated cost; it also found that financial institutions are fully recovering their credit losses from cardholders through the premium consistently built into credit card interest rates. Allowing for these two factors, the study could not see any justification, on cost grounds, for an interchange fee of more than half the current average level.

In "card not present" transactions, such as telephone and Internet purchases, merchants are unable to verify signatures and do not usually benefit from a payment guarantee by the card issuer. In many countries, a lower interchange fee is charged for such transactions to reflect the absence of a guarantee, but in Australia they attract the highest interchange fee. The study could see no logical basis for this practice. The Board believes that lower interchange fees for "card not present" transactions could be an important stimulus to the growth of business-to-consumer e-commerce in Australia.

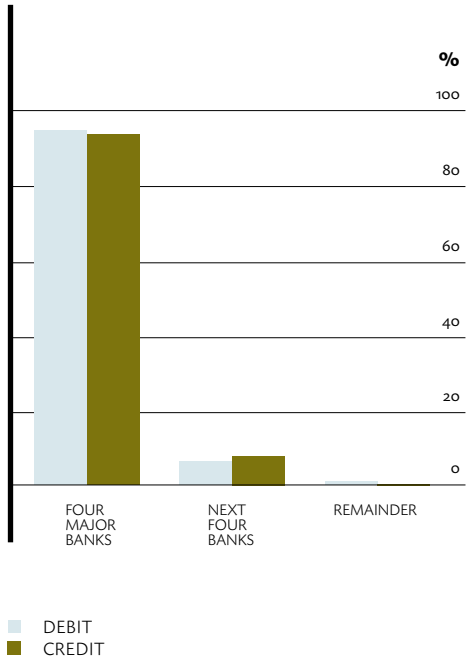
Under the current structure of interchange fees in Australia, cardholders who use the credit card purely as a payment instrument (ie who do not make use of the credit facility) contribute least to the recovery of issuers' costs. This structure is underpinned by "no surcharge" rules in credit card agreements, which forbid merchants charging a customer more than the quoted price for using a credit card. Merchants cannot pass on the mechant service fee, and thus the interchange fee, to credit card users but instead pass these fees on to all customers — not just those using credit cards — in the form of higher prices of goods and services. In this way, credit card users are being subsidised by other customers.

"No surcharge" rules have been criticised by official inquiries in Australia and overseas. The study endorsed these criticisms. "No surcharge" rules suppress important signals to end-users about the cost of the credit card network and give consumers choosing between payment instruments the impression that the cost of a credit card transaction is zero; indeed, loyalty points make the apparent cost to the consumer negative. A rule that prevents appropriate price signals to consumers limits competition, distorts consumer choices and leads to a misallocation of resources. In particular, it leads to overuse of credit cards relative to more efficient and less costly alternatives such as debit cards. The study could see no convincing reasons for the continued application of "no surcharge" rules in credit card schemes.

Conditions of entry to credit card schemes were also a critical focus of the study. Credit card schemes restrict participation to authorised deposit-taking institutions (ADIs), which are subject to prudential supervision, on the argument that this ensures the security and integrity of the card schemes. As far as credit card *issuing* was concerned, the study acknowledged that this restriction has been a long-established, simple and effective screening device for new members. Nonetheless, it concluded that there are other organisations of sound financial standing which might wish to issue credit cards and that there are no logical grounds for excluding them simply because they are not ADIs.

In the study's view, however, restrictions on access to credit card *acquiring* were harder to defend. Credit and debit card acquiring is highly concentrated in Australia, with the four major banks accounting for well over 90 per cent of both markets; other countries have the same experience. One reason for this concentration is that acquiring is predominantly a processing business with the potential for significant economies of scale. Another reason is the restriction in credit card schemes that acquirers must be ADIs, preventing other institutions from competing for acquiring business. (While the restriction does not apply formally to debit card transactions, it has that same effect since only institutions which can offer to acquire both credit and debit card transactions can offer a full service to merchants.)

MARKET SHARE OF DEBIT AND CREDIT CARD ACQUIRING



The study saw no justification for this restriction. As receivers of funds from issuers, acquirers do not introduce settlement risk to the scheme. They need to be able to process transactions for their merchants in an efficient, reliable manner; since they bear the costs of merchant fraud and failure, they also need sufficient financial substance to cover such costs and the acumen to assess these risks when signing up merchants. These functions do not require the acquirer to be an ADI.

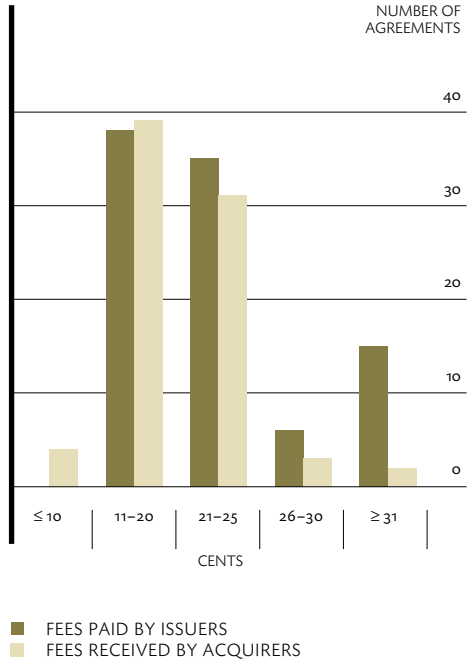
The study concluded that restrictions by credit card schemes on which institutions can enter the acquiring business were unjustified and that restrictions on access to card issuing needed to be reviewed. These restrictions reduce competition in the credit card market and hence protect card scheme members from pressure to lower margins and interchange fees.

While interchange fee arrangements may have played an important role in encouraging the development of credit card networks in Australia, the Board believes that the arrangements in their current form — embracing joint fee setting, "no surcharge" rules and restrictions on access — need to be reformed. From an economic perspective, interchange fee arrangements put into abeyance the normal market incentives and disciplines which determine consumer choice and resource allocation, and this is now proving costly to the Australian community. From a legal perspective, the ACCC in a separate action has reached the view that the joint setting of credit card interchange fees is a breach of the *Trade Practices Act 1974*, and it has encouraged the credit card schemes to seek formal authorisation of their rules. The Board acknowledges that a case could be made for interchange fees in credit card networks provided the public interest is taken fully into account; in the Board's view, this would require that financial institutions which are members of the credit card schemes set and regularly review interchange fees using an acceptable cost-based methodology and make their analysis and results public. The authorisation process under the *Trade Practices Act 1974* is the obvious mechanism for reflecting the public interest and the Board strongly endorses the approach being taken by the ACCC.

Debit Card Payment Networks

Interchange fees for debit card payments are negotiated bilaterally and are paid by the card issuer to the merchant's financial institution (the acquirer). Major banks negotiated their interchange fees about a

INTERCHANGE FEES FOR DEBIT CARD PAYMENTS



decade ago and have left the fees largely unchanged; most other fees negotiated since that time have been of the same order. The interchange fees are flat fees which average around $0.20 per transaction. In some cases, issuers also have to pay a "gateway" fee to a third party to gain access to the networks of acquirers, and a small number of acquirers pay gateway fees to gain access to issuers. Gateway arrangements mean that some acquirers receive less than $0.10 per transaction and some issuers pay more than $0.30.

Merchants negotiate fees for accepting debit card transactions directly with their financial institution. The debit card market has two distinct merchant segments:

- smaller merchants purchase the whole suite of acquiring services from their acquirer, for which they pay a flat merchant service fee averaging around $0.80 a transaction (though some merchants pay percentage fees); and
- most large merchants undertake many of the acquiring functions themselves, having invested heavily in processing infrastructure, and have negotiated arrangements to share interchange fees with their financial institution.

Debit card costs and revenues per transaction
(Weighted average, $A)

ACQUIRING		ISSUING	
COSTS			
Operating expenses	**0.08**	Card production and distribution	0.03
Of which		Authorisation	0.06
Staff	0.04	Processing	0.03
Data processing	0.01	Staff	0.01
Switching services	0.03	Fraud	0.01
		Other	0.02
Overheads	**0.18**		
Of which		**Cost per transaction**	**0.15**
Depreciation	0.06	**Interchange fees paid**	**0.21**
Telecommunications	0.05		
Other	0.07		
Cost per transaction	**0.26**		
REVENUES			
Merchant service fees	**0.12**	**Transaction fees**	**0.20**
Interchange fees received	**0.20**		

The outcome of these opposing flows is that acquirers earn revenues from merchants of around $0.12 per transaction. Taken together with revenues from interchange fees, acquirers earn total revenues of $0.32 per transaction and incur costs of around $0.26 per transaction. The mark-up over costs is 23 per cent, much lower than in credit card acquiring though infrastructure and procedures are very similar.

The direction of debit card interchange flows in Australia is unique. In other countries the flow is to the card issuer, or there are no interchange fees at all. The study heard arguments from acquirers that the current regime was necessary to recompense them for the infrastructure and other costs associated with providing cardholders with access at the checkout to their transaction account. In turn, issuers argued that fees should flow the other way so that they can recover the cost of processing and the funds guarantee from merchants. However, no formal methodology or empirical evidence was provided to the study to support either the existing pattern of fee flows or a change. The study applied interchange methodologies to the debit card payment network and concluded that, on the basis of the current cost structure, there was no convincing case for an interchange fee, in either direction.

Two countries with the most heavily used debit card payment systems — Canada and the Netherlands — do not have interchange fees. The study found no reason why Australia's debit card payment networks could not operate on the same basis. As with other means of accessing a transaction account, such as cheques, direct debits and direct credits, financial institutions offering debit card payment services could seek to recover their costs directly from their own customers.

The Board acknowledges that interchange fee arrangements in debit card payment networks have been in place for a decade and are under no strong competitive pressure to change. Because the fees are bilaterally negotiated, the industry also lacks a decision-making body with authority on questions of fees. The Board is willing to work with industry participants to bring about more efficient pricing arrangements for debit card payments.

Implications of Current Interchange Fee Arrangements

In summing up, the study found that interchange fees in all three card networks in Australia are higher than are needed to cover the relevant costs of financial institutions — and particularly so in the ATM and credit card networks — and these fees are not regularly reviewed. A major reason for this stickiness is that financial institutions lack clear incentives to bring interchange fees into line with costs. Large financial institutions in particular are both card issuers and acquirers and benefit from the revenue generated; they are also in a strong bargaining position in bilateral negotiations with potential new entrants. In the face of such informal barriers to entry, and explicit barriers in credit card schemes, new entrants into the networks have not been effective in putting pressure on interchange fees. In

some networks, interchange fees can also be readily passed onto customers.

The weakness of normal market disciplines in card networks in Australia is producing a distorted form of competition, in which credit card usage has been encouraged to grow at the expense of other payment instruments, particularly debit cards and direct debits, that consume fewer resources. Cardholders are effectively being paid by card issuers to use a credit card as a payment instrument, but face a transaction fee for using a debit card (after a number of fee-free transactions). Since an average credit card transaction consumes around five times more resources than a debit card transaction for the same amount, the current pricing of card payment services, in which interchange fees play an integral role, is giving Australia a higher cost retail payments system than is necessary. The cost is largely hidden, however, but is borne by the community as a whole.

The Board is mindful that interchange fees are a complex subject and that an overhaul of long-standing arrangements will not be easy to achieve. Nonetheless, it is obvious to the Board that financial institutions will need to revisit the setting of interchange fees in each of the networks. They will need to reassess:

- whether interchange fees are still relevant to these now mature and widely-accepted networks. As the study shows, there are alternative pricing arrangements which could be used in ATM and debit card payment networks; and
- if there is a case for an interchange fee, they will need to consider how the interests of end-users — that is, the cardholders and merchants — can be more effectively taken into account in the setting of these fees. As far as the credit card network is concerned, the *Trade Practices Act 1974* provides a well-established authorisation process for ensuring that the public interest is taken into account, and the Board strongly encourages financial institutions which are members of the card schemes to pursue this course.

ELECTRONIC COMMERCE AND THE PAYMENTS SYSTEM

Electronic commerce and its interaction with the payments system have become of increasing interest to the Board. It is well aware of concerns that the failure of payments arrangements to adapt sufficiently quickly to the demands of e-commerce may inhibit the spread and power of this emerging technology. An outcome in which firms negotiate and order on-line but continue to complete the payment by writing and posting a cheque would obviously disappoint. Financial institutions globally are conscious that if payments arrangements fail to keep pace, the institutions themselves run the risk of being by-passed in the payments chain.

Business-to-business e-commerce in Australia is already substantial, with estimates of turnover at around $25 billion a year. If it is to realise its potential, the associated payments process needs to be efficient for both payers and payees:

- the paying business needs to be able to use its accounting and messaging systems

to instruct its financial institution, electronically, to debit its account and credit the payee's account; and

- the payee requires electronic confirmation from its financial institution that the payment has been made, along with a message allowing it to reconcile the payment with the invoice.

Overseas experience is that financial institutions and businesses have had difficulty in automating payment and reconciliation processes. Replicating the flexibility of checking and confirming hard-copy accounts by hand and attaching a cheque is a challenging task. Even if a single bank develops highly sophisticated and flexible business-to-business payment facilities for its customers, businesses involved in a transaction can only benefit fully where both use the same bank. Until information can be sent between banks, fully automated payment and reconciliation cannot be achieved. Change has proven difficult to achieve even where the driving force is the domestic rule-setting body for the payments system or a major user of payment services such as the government.

Australian banks have, to date, focussed on strengthening links with their customers using the existing payments infrastructure, rather than establishing the industry standards and systems that would allow the exchange of invoice data along with payment instructions. While interfaces and software have been developed to assist the customer, these are proprietary. Some banks, for instance, offer their customers a software package which accepts payment information from, and reconciles to, most accounting packages. However, none of these proprietary solutions is linked to electronic payment systems which can include remittance information together with a payment.

Links to existing systems are one way ahead. For both payers and payees, the direct entry system has many advantages. It is inexpensive (around $15 a file no matter how many transactions, or $0.10 to $0.50 an individual transaction) and, as a long-standing system, is well understood. Equally well known, however, are the restrictions on the size and format of the messaging that it can support. APCA is currently reviewing the direct entry system with these issues in mind. This is an encouraging development, but decisions will be needed quickly on whether the current direct entry system is the appropriate platform or whether a fresh start is needed.

Business-to-consumer e-commerce faces a different set of challenges. Some of the purchases made on-line are paid for on delivery, using cash, mobile EFTPOS or credit cards. Some are also paid for on-line, usually with a credit card. Customers simply authorise payment as they make the purchase by entering their card details, just as they would for a mail-order or over-the-telephone purchase. Such transactions are potentially open to later dispute by the cardholder because there is no signed authorisation. Where the credit card is not present, the standard merchant agreement stipulates that the merchant takes the financial risk if the customer disputes a transaction.

Credit card details sent over the Internet might also be obtained by a third party and used fraudulently. Credit card companies have developed encryption technology to reduce these risks but are yet to implement it because of costs and the slowing in transaction speed that results. An alternative technology with a lower level of security provides a secure connection during transmission but does not authenticate the parties at either end of the transaction, and allows the merchant to see the purchaser's credit card details.

Although there is more work to be done in this area, security issues do not appear to be slowing the growth of business-to-consumer e-commerce. Consumers seem increasingly prepared to pay over the Internet by credit card, no doubt driven by the same incentives — such as loyalty programs and the availability of credit — which apply to other types of transactions. While this mechanism works, it may not be the least cost or most efficient solution. No real attempt has been made to incorporate other payment mechanisms such as debit cards or direct entry (under which a trusted third party could hold, and then act on, a consumer's authorisation to debit a bank account).

The development of appropriate payment mechanisms might also spur completely new forms of e-commerce. For example, people may be prepared to pay over the Internet for music selections or for information such as articles from particular foreign newspapers. There is currently no economic way to collect the small (micro) amounts involved. Making small value transactions over the Internet requires a new payments solution with a low cost base. One possibility is the "electronic purse", either in the form of a stored-value card or digital cash which resides on a computer. At present, however, neither of these options has gained the acceptance necessary to allow e-commerce involving micro payments to prosper.

BILL PAYMENTS AND DIRECT DEBITS

The sending ("presentment") and payment of bills are time-consuming tasks for businesses and households, and have become an important focus of e-commerce. Each year, Australian households pay around 650 million routine bills for utilities, insurance, telephone and other recurring expenses. Businesses make a similar range of payments.

The traditional means of presenting bills has been by post. Over the past year, however, developments both abroad and in Australia promise substantial efficiencies in this general area. Electronic presentment — the simplest form being a bill to the customer by e-mail — is emerging as a replacement to the letter-box. Until recently, the scope for this technology was limited because few bill payers had Internet access. That situation is changing quickly. In 1999, some 22 per cent of Australian households had Internet access and coverage is growing rapidly. On its own, e-mail presentment might provide some savings in presentment costs, but it does not reduce payment costs to the customer or reconciliation and processing costs for the biller. More commonly, the e-mail will include a link to the web site of the biller or

of a "consolidator", which provides the facility for a customer to view and pay a number of bills together. Such links offer customers a convenient means of authorising payments and have the potential to deliver considerable cost savings to billers.

None of these recent developments involves any changes in underlying payment instruments and processes, which vary considerably in their efficiency. If the bill payment still involves the customer posting a cheque to the biller, or having their financial institution do so on their behalf, there is no efficiency dividend on the payments side. If the bill is paid by a charge to a credit card account, the potential cost savings to billers will be offset by the merchant service fee they must pay. Bill collection costs would be minimised if customers used direct debits. These cost billers no more than $0.15 a transaction, compared to around 2 per cent of the transaction value when a credit card is used.

The gains from electronic bill presentment and payment could be substantial, but remain to be exploited. In the meantime, the Board has been working closely with billing organisations to encourage the take-up of direct debits using existing technology.

Though popular abroad, Australians have been reluctant to adopt this means of payment. Obviously, the current incentives to use credit cards for bill payments are strong; at the same time, Australian consumers may not have had full confidence that they will be able to stop any incorrect payments under direct debit arrangements. Consumer safeguards have been effective in promoting direct debits in countries such as the United Kingdom and France, which are also high-cheque-use countries.

The work with billers, which include telephone companies, electricity suppliers, local councils and health funds, has culminated in the Charter for Direct Debit Customers, which guarantees service levels for retail customers. The Charter confirms, most importantly, that customers will be given adequate notice of debits to be made to their accounts and will be able to stop the debit if they believe that they have been incorrectly billed. A number of billing organisations have already adopted the Charter. The Board commends the Charter as a valuable set of safeguards for consumers and a basis for promoting a highly efficient method of bill payment to the Australian community.

CHARTER FOR DIRECT DEBIT CUSTOMERS

1. **Notification that payment is due**
   Where the amount of payment due varies from bill to bill (eg phone and electricity), we will always provide you with a bill at least 10 business days (or such time as agreed with you) before payment is due. On the due date, the amount will be debited from the account you have nominated at your financial institution.

   Where the amount of payment due is "fixed" according to a pre-agreed arrangement (eg health insurance), we will always notify you at least 10 business days (or such time as agreed with you) before the due date if there is a change in the amount to be paid.

2. **Direct debit guarantee**
   If you dispute any amount on a bill, or on a notification of payments due under a pre-agreed arrangement, and let us know at least 2 business days before payment is due, we guarantee we will not debit your account for the amount in dispute until the dispute is resolved. This notice will allow us enough time to resolve the problem or to halt processing of the payment.

3. **Change in payment method or cancellation**
   You may cancel the direct debit or change your nominated account by simply letting us know at least 2 business days (or such time as agreed with you) before payment is due.

4. **Privacy**
   We will maintain strict control over the information you provide to us. We will act only on your instructions or those of your authorised representative.

5. **Complaints**
   We will provide you with contact details for lodging complaints when the direct debit is established, and these details will be repeated on regular bills. We will respond to any complaint promptly.

BILLERS COMMITTED TO CHARTER

(AS AT OCTOBER 2000)

ActewAGL
AGL
Ballina Shire Council
Citipower
Dubbo City Council
Energex
Fairfield City Council
Great Lakes Council
Great Southern Energy
Greater Taree City Council
Holroyd City Council
Hospitals Contribution Fund of Australia Ltd
Inverell Shire Council
Maitland Council
Medibank Private Limited
Motorcharge Limited
North Sydney Council
Orange City Council
Origin Energy
Parramatta City Council
Pittwater Council
Powercor Australia Ltd
Rylstone Shire Council
Shoalhaven City Council
Sutherland Shire Council
Sydney Water Corporation
Tamworth City Council
Telstra Limited
TXU Pty Ltd
Vodafone Australia Pty Ltd
Water Corporation
Wollongong City Council
Yarra Valley Water Ltd

The bill payments of businesses can be large and variable and their needs are therefore different to those of retail customers. Nevertheless, businesses issuing and paying bills could both achieve lower costs and greater efficiencies by making more use of direct debits. The Board is supporting the efforts of billers which are developing a separate charter tailored to the needs of business customers.

EXCHANGE SETTLEMENT ACCOUNTS

Exchange Settlement (ES) accounts at the Reserve Bank are the means by which providers of payment services settle obligations they have accrued in the clearing process. For example, a financial institution on which a cheque is drawn settles its obligations with the financial institution at which the cheque is deposited through an entry to each of their ES accounts.

Last year, the Board announced more liberal access arrangements that would allow institutions other than banks, and the Special Service Providers for building societies and credit unions, to apply for ES accounts. The new arrangements are intended to promote competition and efficiency — albeit probably at the margin — by allowing eligible institutions to settle their own payments without reliance on another institution which may otherwise be a competitor. All providers of third-party (customer) payments services which have a need to settle clearing obligations with other providers are eligible to apply for an ES account. Applicants need to demonstrate that they have the liquidity necessary to meet their settlement obligations under routine, seasonal peak and stress conditions. Institutions authorised and supervised by the Australian Prudential Regulation Authority (APRA), and applicants proposing to operate exclusively on a real-time gross settlement (RTGS) basis, will not be required to lodge collateral. Institutions not supervised by APRA operating in deferred net settlement systems may be required to lodge collateral on an ongoing basis.

In November 1999, the Sydney Futures Exchange Clearing House (SFECH) was the first organisation to be granted an ES account under the new arrangements. The SFECH acts as a central counterparty to its members' trades and receives and makes payments related to initial and variation margins, and the management of funds which it holds as a clearing house. It operates its ES account exclusively on an RTGS basis.

ES accounts are normally used to settle transactions between issuers and acquirers in card schemes, whether through accounts held in their own name as ADIs or through the account of a Special Service Provider. However, settlement between issuers and acquirers does not require an ES account, and the Board can see no reason why an institution should be precluded from entering the acquiring business because it does not have one. The ACCC made similar observations in its recent determination on APCA's rules for the Consumer Electronic Clearing System. More generally, the study on interchange fees and access found no justification for restrictions which prevent organisations other than ADIs from undertaking acquiring functions for credit or debit cards.

CHEQUE-CLEARING TIMES

Although their relative importance is giving way to electronic alternatives, cheques remain the most frequently used non-cash payment instrument in Australia. For small to medium-sized businesses, in particular, cheque funds are critical to cash flows. The Board believes that cheque processing should meet world standards and it has supported industry initiatives to achieve this.

In April last year, APCA introduced arrangements for electronic clearing and dishonour of cheques, which allow a "three-day" cheque-clearing cycle. That is, if a cheque is deposited at an institution on a Monday and cleared electronically, that institution could make the funds available to its customer on a Wednesday. Around 95 per cent of cheques are now cleared electronically. In its first Report, the Board was pleased to note that 17 banks, including two major banks and three retail banks, had taken advantage of these more efficient arrangements and were making funds for cheques cleared electronically available on a three-day cycle. (Many banks also have special arrangements with some customers to make funds available more quickly.) Some building societies and credit unions also met this standard. A retail bank subsequently advised that it had also moved to what had clearly become industry "best practice".

Recently, the Chairman of the Board wrote to the chief executives of institutions which had not originally met the standard to follow up on their progress in cheque clearing. Eight additional banks have now moved to a three-day cycle, bringing the total to 26 banks. However, a number of banks still have a four-day cycle or longer, although some have indicated that they will move to "best practice" during the course of 2000/2001. The Board encourages institutions to commit to the necssary changes in internal systems and procedures to ensure that all their customers gain more prompt access to cheque deposits as a matter of course.

BANKS WITH THREE-DAY AVAILABILITY OF FUNDS*
(AS AT OCTOBER 2000)

Adelaide Bank
Asahi Bank
Australia and New Zealand Banking Group
Bank of America
Bank of Queensland
Bank of Western Australia
Bank One, NA
Banque Nationale de Paris
Chase Manhattan Bank
Colonial State Bank
Dai-Ichi Kangyo Bank
Deutsche Bank
Dresdner Bank
IBJ Australia Bank
International Commercial Bank of China
Macquarie Bank
National Australia Bank
Oversea-Chinese Banking Corporation
Overseas Union Bank
Primary Industry Bank of Australia
Rabobank Nederland
Reserve Bank of Australia
Standard Chartered Bank Australia
State Street Bank and Trust Company
Toronto Dominion Bank
United Overseas Bank

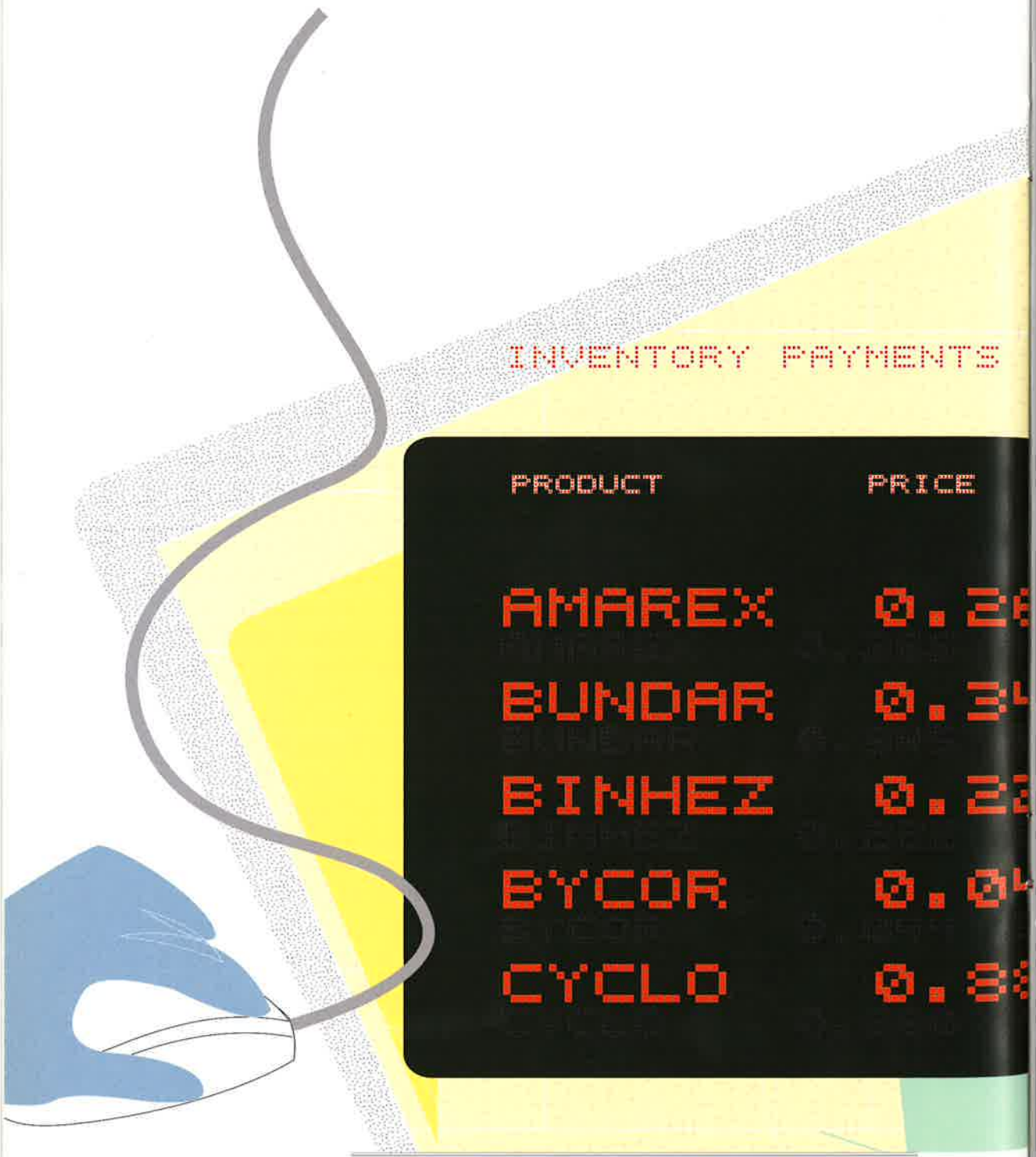
* *Funds availability for cheques deposited at the bank and cleared electronically; cheques deposited at an agency or not cleared electronically may be subject to longer schedules.*

PURCHASED PAYMENT FACILITIES

Purchased payment facilities, such as smart cards and electronic cash, are facilities which consumers pay for in advance and use to make various types of payments. Several such schemes are in use in Australia for specific "closed" applications such as telephones, public transport and tollways; some broader applications, such as using telephone cards in vending machines, have also been tested. Australian banks have conducted limited trials of general purpose smart cards but, despite high expectations over recent years, no schemes have progressed beyond the trial stage.

The *Payment Systems (Regulation) Act 1998* anticipated the need to protect consumers using purchased payment facilities. The particular provisions are directed at the "holder of the stored value" backing such a facility — that is, the entity receiving the proceeds from the sale of the facility — because consumers rely on the holder to subsequently redeem that value on demand. The Act requires a holder of stored value to be an ADI subject to regulation by APRA, or have an authority or exemption issued by the Reserve Bank.

The stored value backing a purchased payment facility represents a promise by the holder to repay in full. Where the customer is entitled to demand repayment, in Australian currency, of part or all of the balance of the stored value, the facility is akin to a deposit. For this reason, the Reserve Bank and APRA have agreed that it would make sense to have all such purchased payment facilities regulated by APRA as "banking business", under a common regime. This will ensure consistency in regulatory treatment of these emerging payment instruments and is in line with the approach taken in a number of other countries. A regulation has been enacted under the *Banking Act 1959* to give effect to these new arrangements.


INVENTORY PAYMENTS
PRODUCT
PRICE
AMAREX
BUNDAR
BINHEZ
BYCOR
CYCLO