



# AUSTRALIAN SETTLEMENTS LIMITED

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Submission to the Reserve Bank of Australia

on

## REVIEW OF THE REFORMS TO AUSTRALIA'S PAYMENTS SYSTEM

31 August 2007

## INTRODUCTION

Australian Settlements Limited ("ASL") is pleased to provide a submission to the Reserve Bank of Australia ("RBA") as input to its Review of the Reforms to Australia's Payments System. The RBA regarded the scope of the review in the following terms:

*The review will not only examine the effects of the reforms to date, but will also examine how, looking forward, the regulatory regime can best contribute to competition and efficiency in the Australian payments system. In particular, the [Payments System] Board is interested in what has changed since the reforms were introduced and how this might bear on the appropriate regulatory regime in the future.*

*The review will consider all the reforms to date. These include: the interchange standards for the credit card, scheme debit and EFTPOS systems; the standards requiring the removal of the no-surcharge rule and the modification of the honour-all-cards rule; the access reforms to the credit and debit card systems; and the increased transparency of information.*

ASL and its members are integrally involved in the payments system and impacted by the significant reform process, particularly the changes to Visa debit interchange which have severely affected the value of the Visa debit card to ASL's members and to their customers.

## IMPACT TO DATE

ASL believes that the time period that has elapsed since the various Standards and Access Regimes have been implemented is too short to draw unarguable conclusions on the effects of the reforms, let alone whether these effects have been "good" or "bad".

Because results to date are inconclusive in terms of the ultimate impact on competition and efficiency, ASL believes that there is little basis for additional reforms except to the degree that:

- Current reforms lack a solid basis in economics and the practicalities of the marketplace; or
- There are areas of the payments system in which significant issues lie unresolved, whether as a result of lack of reforms or the failure of industry self-regulation.

In this context, ASL believes that there are two areas in which the RBA should particularly focus:

1. The framework within which interchange fees for debit and credit cards are determined, and surcharge levels are set; and
2. The commercial arrangements for the ATM network.

Each of these is briefly discussed below.

## **INTERCHANGE FEES (Para 129-131 of the Issues Document)**

To date the setting of interchange fees for debit and credit cards appears to be based on the RBA's desire to impact on the relative end-user price for these payment options.

The RBA has not indicated how great the differential in end user pricing should be, how the "correct" differential should be determined, or why the differential should be the focus of RBA regulation (as opposed to allowing competitive market forces to drive pricing).

There is no indication that the RBA has a view in respect to the underlying economics of four party payment networks in which the credit card and debit card service is jointly provided and jointly consumed. We have a situation where three types of card payment, i.e. scheme credit, scheme debit and proprietary debit all have quite different interchange fees albeit with different functionality. ASL's members consider that the impact of reform has been greatest on scheme debit compared to scheme credit and EFTPOS.

For example, interchange fees for EFTPOS remain negative, i.e. flow from Issuers to Acquirers. This is a relatively unique global situation where the majority of EFTPOS interchanges are positive, i.e. flow from the Acquirer to the Issuer, or are trending that way. At zero interchange for EFTPOS, Australia would still be out of sync with overseas experience. There is no evidence that the interchange fee differential between EFTPOS and scheme debit reflects differences in the costs of providing these two types of debit card services.

We submit that the differential between scheme credit and scheme debit interchange fees does not reflect differences in the costs of providing these two types of scheme card services or the additional benefits to a cardholder or merchant.

It would appear to ASL that debit and credit cards, provided in four party networks, would fall under the same economic framework and be subject to similar economic principles. It would then follow that the setting of interchange fees in a fair and equitable manner should fall under the same set of network economic principles even if the method to do the calculations might vary for practicable reasons.

In the related surcharging regulation, the RBA has also neglected to recognise that merchants can and will surcharge in excess of their cost of accepting credit and debit cards.

If the structure of the merchant sector allows surcharging above cost therefore to the detriment of consumers, safeguards need to be established consistent with the RBA's "whole of system" perspective. The RBA wrote to all Visa card issuers seeking assurance that they would implement separate card numbering to allow merchants to be able to distinguish Visa debit cards from Visa credit cards. The intent of the RBA was to enable merchants to not accept Visa debit cards as was muted in the US by abolishing the honour all cards rule.

Merchants who surcharge above cost are in effect adding to the price of the goods or services they are supplying and misleading their customers into believing that the surcharge is a recovery of fees the merchant suffers. This is frequently not the case. Of particular concern are surcharges that do not distinguish between payments by scheme debit and scheme credit. The impact of reform has been to significantly reduce merchants' fees on scheme debit transactions which are not reflected in the surcharges applied by merchants. Look no further than Qantas as an example of

impacting consumers by applying surcharges above cost and not differentiating between scheme debit and scheme credit.

In summary:

- ASL would like the RBA to readdress the framework for the determination of interchange fees for debit and credit cards so that the fees are reflective of sound economics and commercial practices.
- In addition, ASL would like the RBA to establish guidelines, for example, on the degree to which merchants can surcharge payment options.

## ATM NETWORK ACCESS

The goal of the RBA reforms is a competitive, efficient, innovative payments system. This suggests that payment services would be provided at least cost given value and benefits provided.

To date the RBA has addressed access, intermediate pricing and end user pricing with the credit card and EFTPOS networks. However, for the ATM network, the industry attempted self-regulation has progressed little for over four years. This work has canvassed views from many interested parties and explored the advantages and disadvantages of various commercial arrangements, for example direct charging, no interchange fees, cost-based interchange fees, opt-in and opt-out scenarios, sub-networks and so forth.

Today, the RBA has announced key elements of proposed reforms:

- The development of an objective and transparent access code by the Australian Payments Clearing Association (APCA), setting out the conditions that new entrants are required to meet, the rights of new entrants, and the requirements on current participants in dealing with new entrants;
- The clear disclosure of any charges levied by the ATM owner *before* the customer proceeds with a withdrawal, with the customer able to cancel the transaction at no cost; and
- The abolition of the *bilateral* interchange fees paid by banks and other financial institutions to ATM owners for the provision of ATM services. These fees – which average around \$1 per transaction – are neither transparent to customers nor subject to the normal forces of competition. With these fees abolished, ATM owners will be free to charge customers who use their ATMs but must disclose the fee, increasing the overall transparency of pricing.

The RBA added that under this proposed reform model, *multilateral* interchange fees in sub-networks – either those currently in existence (in the Rediteller and Cashcard networks) or those that may form in the future – would be possible. However, the Board's view is that if such fees exist, they should be publicly disclosed. In addition, the rules that govern access to sub-networks should be transparent and objective and not impair efficiency and competition in the payments system.

This development goes a long way toward achieving guided self-regulation to the ATM network.

At the same time, there are a number of important issues that still need to be resolved under these guidelines. The most important of these are:

- The intersection of sub-networks with other ATM networks which we would expect would be on the basis of the charge applicable by the ATM owner whether as a member of the sub-network or not;
- A framework to negotiate with an ATM owner instantaneous rebating of a direct charge such that cardholders would not be confronted with a fee to use a particular ATM or network of ATMs; and
- A framework for an ATM owner to charge different card issuers differently.

ASL accepts that these issuers are “in the detail” but seeks the RBA’s recognition of the importance for regionally based institutions accessing national ATM network(s) on a competitive basis.

## **CONCLUSIONS**

Notwithstanding that the evidence to date is inconclusive in terms of the ultimate impact on competition and efficiency, there are several conclusions which ASL wishes to submit that:

- the RBA readdress the framework for the determination of interchange fees for debit and credit cards so that the fees are reflective of sound economics and commercial practices;
- the RBA to establish guidelines, for example, on the degree to which merchants can surcharge payment options; and
- the framework provide flexibility for regionally based institutions to negotiate access to national ATM networks.

The RBA cannot rely on market forces alone to drive the benefit of reforms to consumers.