



30 June 2008

Michele Bullock
Head of Payments Policy Department
Reserve Bank of Australia
SYDNEY

Re: Comments in Response to the Preliminary Conclusions of the 2007/08 Review

Dear Michele,

Coles would like to thank the RBA for the opportunity to comment on the Payment Systems Board's Preliminary Conclusions of the 2007/08 Review of the Australian Payment System released in April.

Coles supports the underlying principles that have been at the heart of the Board's reform agenda, namely transparency, efficiency and competition. We believe that both in the recent Preliminary Conclusions document and in earlier reports, the Board has identified a number of key issues, which impede the efficiency, and competitiveness of payments card systems in Australia.

From our perspective the central issue remains the extent to which competitive forces act on interchange fees. The Board has long held the view that normal forces of competition have not acted effectively on interchange fees. We share the Board's concern that in the absence of regulatory oversight, there is a significant risk that interchange fees in some systems will be set at levels that are too high.

Indeed we are of the view that the structure of the market makes it difficult to have confidence that competition could ever lead to an efficient level of interchange in some systems.

Whilst the modification of the honour-all-cards rule, and the abolition of the no surcharge rule, have assisted to increase competitive pressures on interchange, we agree with the Board that these changes have only assisted at the margin and that the most important factor keeping interchange fees low is the regulatory cap.

We are concerned that upward pressure on interchange fees remains, and that the RBA has data that suggests that interchange fees are currently above the relevant benchmarks.

Accordingly we do not support the view expressed by some that the RBA should step back from the regulation of interchange. Further just as the Board has concluded, we see no case for allowing the schemes to reintroduce the no surcharge rule, nor the reinstatement of the earlier version of the honour-all-cards rule.

As the Review points out, the key question facing the Board is how to best build on the progress that has been made improving the competitive environment and in establishing less distortionary interchange fees.

As we and the Australian Merchant Payments Forum have previously stated the easiest way for the Board to deal with distortionary interchange fees is to eliminate the interchange fees altogether, and we believe the findings of the Review support such a policy position.

The Board has offered three options with respect to interchange fees. Under Option 1, the Board has proposed retaining the credit and debit card interchange fee standards largely unchanged. Option 2 involves retaining interchange regulation, but reducing interchange fees further. Option 3 is a proposal to return to industry "self regulation" of interchange fees.

Given the Board's concern regarding the lack of competitive pressure to constrain interchange fees, and that the current difference in interchange fees between credit and debit card systems is significantly higher than can be reasonably justified, it is difficult to see how Option 1 can be supported.

Clearly either more needs to be done to improve the competitive environment in which interchange fees are set, or interchange fees need to be reduced further through direct regulation.

Whilst we understand that the Board's clear preference is for the industry to address issues of competition and efficiency rather than for the RBA to impose regulations. It remains unclear as to how this will be achieved or what framework if any will be put in place to ensure the industry adequately addresses the issues of competition and efficiency. We share the Board's concern that changes offered by the industry under Option 3 may not go far enough to create the competitive environment that is required.

Clearly the changes required under option 3 will take some time to discuss and implement, and we reserve our judgment until further details are known. In the meantime we are an active participant in the current early discussions regarding the possible establishment of an EFTPOS debit scheme, however we are not privy to any discussions as to how the issues of competition and efficiency are being addressed with respect to the credit card market.

Whilst these issues are being debated by the industry we are happy to support the Board's proposal to leave the current arrangements in place and to re-assess the progress made in improving the competitive environment at its August 2009 meeting, on the understanding that we will have an opportunity to share our thoughts as to the details of any industry proposal ahead of that meeting.

We would be happy to discuss our thoughts with you further and look forward to a continuing open dialogue with the RBA.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Douglas Swansson', written over a horizontal line.

Douglas Swansson
Head of Payment Services