



Credit Union
Industry Association

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Dr John Veale
Head of Payments Policy
Reserve Bank of Australia
PO Box 3947
Sydney NSW 2001

Dear Dr Veale

Credit Union Industry Submission: Reform of Visa Debit and EFTPOS

Credit Union Industry Association (CUIA) welcomes the opportunity to again comment on the RBA's proposed reforms of the EFTPOS and Visa Debit card systems in Australia.

This submission draws on arguments provided in previous CUIA submissions on payments reform, with particular reference to those dated 29 April 2005, 15 October 2004, 30 July 2004, 9 July 2004 and 26 March 2004 (attached).

CUIA is a division of Cuscal and represents the majority of Australia's 155 credit unions.¹ Cuscal is the key payments provider for Australia's credit union sector, providing access for credit unions to the payments system, interchange arrangements with other payments providers, APCA representation, settling and processing, ATM network and EFTPOS services.

Cuscal is a principal member of Visa International, through which credit unions participate in the Visa Debit scheme. Australian credit unions are, collectively, the largest issuers of Visa Debit in the Asia-Pacific region.

This submission will again focus on the proposed interchange fee standards for EFTPOS and Visa Debit and the RBA's proposals on the 'honour all cards' rule. The credit union sector appreciates the RBA's assurance in its December 2005 consultation document that it has not reached any conclusions on these matters.

We have no additional comment on the draft Access Regime for the EFTPOS system and note that this remains under active consideration by APCA.

In our 29 April 2005 submission to the RBA, CUIA outlined arguments for a review of the draft standard to enable:

- Preservation of the 'honour all cards' rule in relation to Visa Debit;
- Inclusion of fraud costs and fraud prevention costs in the interchange fee cost benchmark for Visa Debit;
- Use of costs of Visa Debit issuers, rather than credit card issuers, in calculating the Visa Debit benchmark; and
- EFTPOS interchange fees to be set at zero, in line with the RBA's "pragmatic" approach, pending development of a consistent interchange fee methodology in the RBA's foreshadowed 2007 review.

CUIA again urges the RBA to amend its draft standards to reflect these changes.

¹ CUSCAL has announced a new corporate identity, with two new brands reflecting the distinction between our commercial services role and our industry association role. Our commercial and corporate arm is now identified as Cuscal, while the CUSCAL Industry Association is now CUIA.

In our previous submissions we have warned that the proposed interchange fee standard for Visa Debit would drive Visa Debit cardholders and Visa Debit card issuers to credit cards because of the differential in interchange rates between the products.

This effect is already apparent, ahead of the implementation of the RBA's proposal. The number of Visa credit cards issued by credit unions is expected to double this year largely in response to the foreshadowed changes to Visa Debit interchange fees.

Revised EFTPOS interchange fee standard

CUIA believes the proposed cap on EFTPOS interchange fees paid by issuers to acquirers (and ultimately borne by cardholders) is an improvement on current arrangements, although it is not our sector's preferred approach.

The RBA's revision of the February 2005 draft standard to add a 'floor' to the standard is a backward step that further undermines the policy intention and economic basis of the EFTPOS reforms.

The 'floor' makes the EFTPOS proposal less beneficial to issuers and cardholders. Under this proposal, acquirers are guaranteed continued compensation by issuers for services provided by issuers that benefit merchants.

The revision is couched in terms that reflect the concerns of acquirers as if they are the only "participants" - with little focus on the position of issuers and cardholders.

Issuers will be given little room to negotiate a better deal from acquirers that would benefit cardholders.

CUIA opposes a mandatory 'floor' on EFTPOS interchange fees paid by issuers to acquirers but if the rationale for a floor is to establish a limited range, the floor should be set as close to zero as possible.

MasterCard Debit

CUIA supports a consistent approach to the regulation of the payments system. MasterCard Debit should be subject to the same regulatory framework as Visa Debit.

Any standards or access arrangements relevant to scheme debit cards should apply to all scheme debit cards. There is no suggestion that selective inclusion of schemes for proprietary debit would be considered by the regulator. CUIA strongly opposes such an approach.

Visa Debit interchange fee standard

The RBA's attempt to tilt the playing field in favour of EFTPOS by imposing a punitive interchange fee standard on Visa Debit will instead decisively benefit credit cards. These arguments have been outlined in detail in earlier submissions (attached).

To date, the RBA has not provided credit unions or CUIA with a response on how this outcome is consistent with an efficient and competitive payments environment, nor how the disproportionate impact on smaller issuing institutions matches objectives of promoting competition and contestability in the payments market.

The draft Visa Debit standard clearly under-compensates Visa Debit issuers for their actual costs of processing and authorising transactions and denies them any compensation for fraud and fraud prevention costs.

Visa Debit issuers will have to recover from cardholders costs that credit card issuers recover from acquirers. The credit card's status as payment card product with the lowest transaction price to the cardholder and the highest potential return to the issuer is powerfully enhanced relative to its most immediate peer as a payment product, the Visa Debit card.

The attached graphs illustrate the effect of the RBA's proposals on a \$100 transaction and a \$1000 transaction. A cardholder buying a \$1000 washing machine with a credit card will earn the card issuer an interchange fee of around \$5.50 while a cardholder using a Visa Debit card will earn the card issuer 15 cents.

This dramatic inconsistency is proposed despite the fact the RBA recognises that *"many of the resource costs for Visa Debit would be expected to be the same as for Visa credit given that the two systems use the same technology and infrastructure."*²

The RBA also notes that EFTPOS debit is a lower-cost product. It is important to emphasise that the lower cost reflects the limited functionality of EFTPOS debit compared to Visa Debit and the limitation of risk.

Functionally, there is very little to distinguish a credit card from a Visa Debit card where the cardholder draws on a line of credit attached to a deposit account. A high proportion of credit union Visa Debit cardholders also have a credit union overdraft facility.

The RBA implies that the lack of interest free credit is the key distinguishing factor.³ However, credit cards without an interest free period are widely available and are clearly marketed as credit cards across the Australian retail market.

Credit cards without an interest free period are issued by the Commonwealth Bank, Westpac, St George, Suncorp-Metway, Bendigo Bank, Bank of Adelaide and Bank of Queensland and other providers. Such cards are often offered without an annual fee.

"If you like to use your credit card to make special larger purchases you intend to pay off over time or need a convenient source of credit in case of emergencies, this is the card for you," the Commonwealth Bank says.⁴

"No Interest-Free Days credit card is the card for emergencies, hotel or car rental reservations and just for peace of mind. You pay no annual fee, but still get all the advantages of a credit card and free membership to our Q Rewards™ program," says Bank of Queensland.⁵

The definitions and assumptions that appear to underpin the RBA's basis for the high differentials between Visa Credit and Visa Debit are at odds with market practice.

CUIA has repeatedly warned that the RBA's highly inconsistent approach to setting interchange fees for credit cards, Visa Debit and EFTPOS invites regulatory arbitrage.

As previously advised to the RBA, if only half the Visa Debit cards currently on issue in Australia are replaced by credit cards, there will be an additional 1.9 million higher cost payment products in the market.⁶

With this would come a variety of additional issues, including increased access to continuing credit to maintain access to the payments functionality of the Visa Debit product. We refer the RBA to arguments made by consumer and financial counsellor organisations on this issue.

The RBA's concern that EFTPOS issuers will switch to Visa Debit is not shared by merchants. The Australian Merchant Payments Forum itself has noted that *"there has been no move by any of the major EFTPOS issuers to move their EFTPOS card base to Visa Debit at any stage during the past 20 years despite the interchange incentive to do so."*⁷

² *Reform of the EFTPOS and Visa Debit systems in Australia, A Consultation Document* RBA – February 2005, p21.

³ *Reform of the EFTPOS and Visa Debit systems in Australia, A Consultation Document* RBA – February 2005, p10-11.

⁴ <http://www.commbank.com.au/personal/credit/StandardCardWithNIFP.asp>

⁵ http://www.boq.com.au/personal_creditcards_nointerestfree.htm

⁶ CUSCAL submission, April 2005.

⁷ AMPF submission, April 2005.

The major EFTPOS issuers – big banks – are much more interested in selling credit cards. The RBA's reform proposals will leave existing Visa Debit issuers with little alternative but to move into this market.

Variation from benchmark

Clause 9 of Draft Standard No. 4 says the "*weighted average of interchange fees in the Visa Debit system in Australia must not exceed the benchmark*" and "*weights to be used...are shares of transaction values to which each interchange fee rate applies.*"

For clarity, CUIA seeks confirmation that the Draft Standard will accommodate a range of interchange fee rates on transaction types. We would also welcome clarity on whether the weighted averages are to apply within different schemes and/or averaged or across the schemes by the RBA.

'Honour all cards'

CUIA reiterates its view that removing the 'honour all cards' rule is unnecessary and potentially restricts access to funds for over 1.2 million Australians.

The ability to surcharge clearly gives merchants an ability to recoup any costs they incur as a result of Visa Debit acceptance. Surcharging on Visa Debit is occurring today. Merchants can identify Visa Debit via BIN numbers should they wish to invest in these systems.

Allowing merchants who accept Visa credit to refuse to accept Visa Debit is potentially highly disruptive. At a stroke it will hand significant power to large merchants who have rapidly growing credit card businesses as part of their operations, such as Coles Myer. Harvey Norman recently announced it would offer a MasterCard.⁸

Removal of the HAC rule would give a further incentive to large retailers to discriminate against other issuers as they seek to increase their own card issuing activity. This would herald a significant competitive shift, to the disadvantage of smaller issuing institutions.

CUIA is of the strong view that the risks to small card issuers and to competition outweigh any potential public benefits flowing from such a shift in power to large merchants. This issue is a serious concern for credit unions, who have historically faced different challenges to their participation in the payments market.

Having our cardholders face potential refusal of access to their savings where Visa Debit cards are not accepted would be damaging to our sector's competitive position and highly disruptive to members.

Allowing merchants to surcharge Visa Debit cardholders is a balanced reform. Allowing merchants to dictate to cardholders what cards they can use is going too far, and exacerbates the competitive issues faced within the payments context by small issuers.

The RBA has not given enough weight to the role of HAC in ensuring access to payments by all issuers. The RBA has not given enough weight to the high risks for our sector's cardholders and competitive position were the rule to be removed for a perceived or theoretical risk already well balanced by the introduction of surcharging.

We again urge the RBA to change its position on HAC.

Distinguishing Visa Debit

Credit union Visa Debit cards issued or re-issued after 1 July 2006 will be clearly marked as 'Debit' cards. CUIA urges the RBA to allow the rollout of the 'Debit' brand to occur according to normal card replacement schedules to avoid unnecessary costs. Cards on issue have a lifespan of two or three years.

⁸ *Retailer offers its own plastic* Hobart Mercury 23 Nov 2005 p29.

We have previously advised the RBA about the significant costs that would arise from a mass re-issue of Visa Debit cards and would be happy to provide further figures if required. As the RBA would appreciate, the credit union sector is focused on ensuring that the significant costs of rebadging are managed in the most cost-effective and least disruptive manner.⁹

These costs include:

- management;
- artwork;
- plastic;
- embossing;
- stationary;
- postage;
- PIN and postage;
- POS marketing design and printing;
- cardholder communications;
- training; and
- call centre.

A mass re-issue of Visa Debit cards would also expose card issuers to increased fraud and associated costs as well as cardholder attrition due to inconvenience to cardholders. Visa Debit can be distinguished electronically from Visa credit through the BIN (i.e distinguishable at acquirer level, but not necessarily at terminal level).

Conclusion

As the RBA's Assistant Governor Dr Philip Lowe has said, "*good public policy is about consistency.*"¹⁰

CUIA urges the RBA to adopt, in these draft standards, a more consistent approach to setting interchange fees for payment card products. The RBA's approach has been to move interchange fees in the right direction rather than to seek the perfect solution in one step. Another major review of interchange fees is due next year.¹¹

Yet, the Visa Debit interchange fee draft standard is clearly punitive and arbitrary when it is lined up against the credit card interchange fee standard.

The RBA's broad discretion under the relevant statutory regime has been recognised and upheld by the Federal Court.¹² However, broad discretion does not justify discriminatory and heavy-handed intervention into the payments marketplace. If implemented, the Visa Debit standard and removal of the HAC rule would be a clear example of such intervention.

CUIA would be pleased to discuss the issues raised in this submission, and looks forward to consultation as the reforms are finalised. Please contact Luke Lawler, Senior Adviser Policy & Public Affairs, on 02 6232 6666 or llawler@cuscal.com.au in the first instance, or contact me on 02 8299 9046 or lpetschler@cuscal.com.au.

Yours sincerely



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⁹ Letter to John Simon, 2 August 2005.

¹⁰ *RBA poised to act on reform agenda* AFR 20 May 2005 p80.

¹¹ *Payments System Reform: The Australian Experience* RBA Paper, 7 May 2005

¹² *Australian Retailers Association vs RBA* [2005] FCA 1707 Summary, p3.

