



Credit Union
Industry Association

3 May 2006

Mr Stephen Boyd
Committee Secretary
Standing Committee on Economics, Finance and Public Administration
House of Representatives
Parliament House
CANBERRA ACT 2600
By e-mail: efpa.reps@aph.gov.au

Dear Mr Boyd

**Review of the Reserve Bank and Payments System Board Annual Reports
2005**

Thank you for the opportunity to provide a brief submission on the RBA's payments system reforms. We look forward to appearing before the Committee on 15 May 2006.

Credit Union Industry Association (CUIA) is the main industry body for Australia's 151 credit unions. Credit unions have 3.5 million members.

CUIA is a division of Cuscal. 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, Australian Payments Clearing Association 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. (Attachment 1 provides background on the significance of Visa Debit to credit unions since 1982.)

This submission will focus on the RBA's 27 April 2006 announcement of final standards for regulating the Visa Debit and EFTPOS debit systems and on proposals for ATM reform.

We are extremely disappointed that the RBA has failed to adjust its Visa Debit proposals to address our concerns. The RBA's Visa Debit reforms are simply overkill (see CUIA media release of 27 April 2006, attached).

Smaller ADIs are the major issuers of Visa Debit cards and will bear a disproportionate burden of the RBA's heavy handed intervention.

The RBA's EFTPOS reforms are welcome, but fall short of the optimal outcome. We are surprised and disappointed that the RBA made a last minute decision to give separate treatment to EFTPOS transactions involving 'cash out'.

The RBA's approach to regulating interchange fees for credit cards, Visa Debit and EFTPOS debit is a bewildering mix of pragmatism, arbitrariness and economic principle.

The RBA's proposals for ATM reform remain under discussion by industry. CUIA supports the RBA's reform agenda and is participating in an industry steering group.

Visa Debit interchange fees

Visa Debit interchange fees were halved in 2003 in line with the reduction in credit card interchange fees. The RBA's Visa Debit interchange fee standard will further reduce Visa Debit interchange fees, taking them from the current per transaction average of 40 cents down to 15 cents.

Credit card interchange fees are unchanged by the latest round of payments reform. This means that 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.

CUIA believes the price signals starkly shown in the above example will push Visa Debit issuers to steer cardholders towards credit cards.

If only half of the Visa Debit cards currently on issue in Australia are replaced by credit cards, there will be an extra 2 million credit cards in the market.

Such an outcome would utterly contradict the RBA's stated objective of promoting efficiency and competition.

The RBA's Regulation Impact Statement simply notes the possibility of "some substitution" away from Visa Debit towards credit cards, but provides no further analysis.

Further, the RBA notes that "the reduction in interchange fees for Visa Debit transactions may mean that Visa Debit cardholders experience less attractive pricing, either in the form of account-keeping fees, or transactions charges."

Such price signals to cardholders are precisely why credit cards will become more attractive to cardholders.

Functionally, there is very little to distinguish a credit card from a Visa Debit card where the Visa Debit 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 sometimes implies that the lack of interest free credit is the key distinguishing factor. However, credit cards without an interest free period are widely available from major banks and other issuers and are clearly marketed as credit cards.)

Like a credit card, and unlike an ordinary EFTPOS debit card, Visa Debit can be used over the internet, over the phone, through the post, and overseas. An expert submission to the RBA made on behalf of the Australian Consumers' Association¹ highlighted this distinction between Visa Debit and EFTPOS debit, noting that Visa

¹ *The consumer payments system and RBA reform program - A review for the ACA* Dr Sacha Vidler, 23 February 2006.

Debit provides benefits to consumers by allowing access to parts of the economy in which credit card networks hold strong market power, particularly 'card not present' transactions.

"The [RBA's] proposed remedy for the scheme debit/EFTPOS market share issue may have unintended consequences, including increased credit card use," the ACA submission says.

It is CUIA's strong view that the RBA's error is to look only at competition between Visa Debit and EFTPOS Debit without fully considering competition between Visa Debit and credit cards.

The RBA says it "recognised that the extra resource costs in the Visa Debit system are partly explained by the extra functionality to cardholders of the Visa Debit card [however] it did not see this as an argument for maintaining the current configuration of interchange fees. If cardholders value this extra functionality (and the value they place on it is greater than the cost of providing it), then they should be prepared to pay more for the use of Visa Debit than they are prepared to pay for use of the EFTPOS system."

Leaving aside the point that, as far as CUIA is aware, not one submission to the RBA argued for maintaining the current configuration of Visa Debit interchange fees, the RBA's rationale for its position is completely inconsistent with its treatment of credit cards.

Under the RBA's credit card standard, credit cardholders do not have to "pay more" for extra functionality because card issuers are compensated by acquirers for a set basket of costs.

The RBA intervened because of its concern that the Visa Debit system would grow at the expense of the EFTPOS system "simply because of the structure of interchange fees." The RBA's intervention decisively advantages credit cards compared to Visa Debit simply because of the structure of interchange fees.

Even without this new advantage, credit cards are highly profitable. A recent study by the European Commission² found that:

- The business of credit card issuing is particularly profitable and high profitability has been sustained over time;
- Profitability is higher for credit cards than for debit cards; and
- Even without interchange fees, credit card issuing remains profitable.

Visa Debit Honour All Cards rule

The RBA has decided to remove the 'honour all cards' (HAC) rule by 1 January 2007. This means merchants accepting Visa credit cards can choose not to accept Visa Debit cards.

In submissions to the RBA on the draft standards, CUIA repeatedly argued that removing the HAC rule is unnecessary and potentially restricts access to funds for over 1.2 million Australians.

This risk is underplayed by the RBA in its Regulation Impact Statement.

² *Interim Report 1, Payment Cards* European Commission 12 April 2006.

"If some merchants do not accept scheme debit cards, cardholders would bear some costs of having to identify which merchants accepted scheme debit cards," the RBA says.

One of these "costs" is suddenly being refused access to your savings account via your preferred payment mechanism.

We put the view that the right to surcharge clearly gives merchants capacity to directly recoup any costs they incur as a result of Visa Debit acceptance. Giving merchants the power to refuse to accept Visa Debit while accepting Visa Credit is using a sledgehammer to crack a peanut. It hands significant power to large merchants who have rapidly growing credit card businesses as part of their operations, such as Coles Myer. Harvey Norman has also announced it will offer a MasterCard credit card.

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.

EFTPOS interchange fees

CUIA, along with the rest of the ADI sector, supported moving EFTPOS interchange fees to zero. This was opposed by merchants and reform was delayed as merchants launched appeals and legal challenges.

It now appears that a flaw in the legislative framework and the RBA's fear of another legal challenge by merchants is blocking a move to zero interchange fees.

The RBA says the zero option "had considerable appeal [but] the Bank viewed it as raising considerable legal risks, given the uncertainty over whether a requirement to set the interchange fee at zero would meet the legal test of a 'standard'."

Merchant pressure has also persuaded the RBA to exempt 'cash out' transactions from its EFTPOS interchange fee standard. This means that issuers may continue to pay acquirers, including big merchants, a higher interchange fee for 'cash out' transactions. Cardholders will ultimately bear this cost.

CUIA objects strongly to this significant and complex amendment to the draft standard, which was introduced without consultation. It appears to be based on the contentious assumption that providing cash out at an EFTPOS terminal is a service provided on an altruistic basis and is an additional cost to merchants.

ATM reform: access & direct charging

Cuscal manages and operates the Rediteller ATM network. Rediteller is an aggregated ATM network with approximately 1400 ATMs owned by Cuscal and participating credit unions. Cuscal holds the bilateral interchange agreements with major banks and other participants in the ATM payments framework.

On behalf of credit unions, CUIA has been an active participant in the ATM voluntary reform process for many years. CUIA has consistently argued that any ATM reforms should recognise the important competition and choice benefits provided by small

aggregated networks (such as Rediteller) and allow those networks to continue to operate.

We applaud the RBA's recent announcement recognising the importance of these networks. The RBA has now changed its stance on the abolition of interchange fees and accepted the positive competitive benefits provided by small aggregated ATM networks.

The RBA's revised reform agenda for ATMs is now focussed on:

- Open and transparent access arrangements to the ATM system, including the possibility of introducing a common interchange fee in the ATM system; and
- Giving ATM owners the capacity to levy a direct charge on ATM users if they wish to do so.

Whilst acknowledging the merits of encouraging competition from potential new market participants, CUIA also believes that the competitive benefits of smaller existing participants should also be recognised. Credit unions rely on aggregation as a means of providing an essential ATM service to their members and to compete with their larger competitors. To do this we need to operate an aggregated network with interchange fees between participants – CUIA is cautious therefore about market participants setting common interchange fees, particularly where those fees are set with reference to the lowest market cost bases which smaller institutions are unlikely to be able to match.

CUIA is supportive of moves to allow direct charging if an ATM deployer chooses to do so. However, implementation of this proposal must be fair and equitable to all market participants. Currently, there is no community of interest between those organisations that will benefit from direct charging and those institutions bearing the most significant costs of its implementation. For example, some of the most significant beneficiaries will be independent deployers of "convenience" ATMs that will derive additional revenue direct from cardholders. However, the institutions bearing the cost of the implementation of the direct charging reforms are the existing bilateral partners on the network and the card issuers. The bilateral partners will have to bear the cost of the technical and other adjustments to the existing networks, whilst it will be the large card issuers that will bear the brunt of the customer education campaign that will need to accompany any direct charging regime.

CUIA believes that it is critical that the costs and benefits of direct charging are borne equitably if the RBA's desired reforms are to succeed.

CUIA is currently working with the industry group on a range of issues raised by the RBA. The reform process has been difficult, partly because of the varying interests of participants (eg, large financial institutions, ATM deployers, card issuers, independent ATM operators.) It is also difficult because some ATM market participants have chosen not to engage with the industry working group.

A significant issue currently being considered by the industry group at the request of the RBA is the question of access to the ATM market for new participants. Currently, arrangements between market participants are conducted through a series of bilateral interchange agreements – these agreements to date have assisted in the near universal acceptance of cards across the ATM network. Potential new participants have argued that the nature of the bilateral interchange agreement framework makes it difficult for new participants to join the market.

CUIA is not yet convinced of the validity of this argument and has yet to see evidence from potential new participants of the barriers to entry that they have allegedly encountered. Competition from new entrants is welcomed and may have competitive benefits for consumers. It is important however that any reforms balance the desirability of new entrants with the importance of protecting the integrity of the ATM network. The network's integrity relies on significant financial investment by existing participants and the technical and operational requirements of the ATM bilateral framework.

In CUIA's view, progress with ATM reform requires the new players to come to the table and:

- indicate the nature of the access difficulties they are encountering; and
- indicate how they will contribute to the costs of network reforms and consumer education.

If the Committee wishes to discuss any of the points raised in this submission, please don't hesitate to contact me on 02 8299 9046 or 0408 239 226.

Yours sincerely



LOUISE PETSCHLER
Head of Public Affairs

ATTACHMENT 1

'Visa Debit Australia, Discussion Paper September 2001', authored by CUSCAL, AAPBS, St George Bank, Bendigo Bank.

Extract:

3.1 History of the introduction of Visa Debit in Australia

The Visa Debit Card (also referred to as the Visa Payment Card) was introduced into Australia in 1982. Building societies³ and credit unions were early adopters of the Visa Debit Card.

The Visa Debit Card enabled the smaller institutions in the retail banking sector to:

- Overcome barriers to their participation in the payments system (e.g., issuing credit cards; market power in negotiating bilateral EFTPOS arrangements); and
- Provide their members and customers with an efficient payment card without the reliance on a credit facility – many members and customers either did not qualify for, or did not want, credit.

As the Financial System [Wallis] Inquiry found,

*"Historically, building societies and credit unions have been innovative in the provision of financial services..."*⁴

The smaller institutions had to be innovative to meet their members' and customers' needs in the face of the significant market power held by the largest institutions.

In addition, non-bank institutions in the 1970s and 1980s were locked into a complex federal and state legislative framework with complex and incompatible legislation. This restrictive legislative framework was not reformed until 1992 with the introduction of the Financial Institutions Scheme.

Banks launched Bankcard in 1974 and credit unions sought access to the Bankcard scheme in 1976⁵. By 1978, negotiations had broken down. Credit unions argued that the Bankcard agreement was anti-competitive:

*"The banks responded in August 1979: credit unions were free to start their own payments system; no one was stopping them. All they had to do was finance it – a massive undertaking."*⁶

Credit unions and building societies turned to the Visa Debit Card as the solution to providing their members and customers with a payment card with very wide acceptance and that suited their members' and customers' needs.

Bendigo Bank, then a building society, and credit unions issued the first Australian Visa Debit Cards in 1982.

In December 1983, CUSCAL's predecessor body became a principal member of the Visa International Card system. Credit unions in New South Wales, Queensland, Victoria, South Australia, Western Australia and the ACT gained access to a dual

³ St George Bank was a building society until 1992. Bendigo Bank was a building society until 1995.

⁴ *Financial System Inquiry Final Report*, March 1997, p307.

⁵ *People Before Profit: The Credit Union Movement in Australia*, G Lewis, Wakefield Press, 1996, p281.

⁶ *People Before Profit*, p282.

Redicard-Visa network. (Redicard was the credit union ATM card.) Work began on linking Redicard and VISA with a national ATM network and national EFT switch.

“The VISA Card arrangement already highlighted the absurdity of denying credit unions access to the domestic payments system when Australian credit unions were accepted on an equal footing with banks in an international system.”⁷

Credit unions gained access to the national EFTPOS network in late 1985, reaching an agreement with Westpac and the Commonwealth Bank on accepting Redicard at EFTPOS terminals.

The Visa Debit Card was an important means for building societies and credit unions to overcome the competitive and regulatory obstacles they faced in the 1970s and 1980s.

Although the retail banking market has changed considerably since then, the benefits of the Visa Debit Card to cardholders and merchants are as relevant today as in 1982. In fact, as technology has delivered new access channels for merchants such as the Internet, the value of the product has grown.

⁷ *People Before Profit*, p304.