



Abacus
Australian Mutuals

Association of Building Societies and Credit Unions

30 June 2008

Ms Michele Bullock
Head of Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
SYDNEY NSW 2001
By email: pysubmissions@rba.gov.au

Dear Michele,

Thank you for the opportunity to comment on the RBA's paper *Reform of Australia's Payments System – Preliminary Conclusions of the 2007-08 Review*.

Abacus Recommendations

- Abacus supports the promotion and development of an efficient and competitive EFTPOS payments channel;
- Abacus believes that Option 3 should be pursued but that the RBA should immediately reverse the interchange flow for EFTPOS debit as an interim measure;
- Abacus does not support further changes to the Honour All Cards (HAC) rule given the limited competitive impact of such a change and the disproportionate effects on smaller financial institutions;
- Abacus also recommends that if Option 2 was implemented, then the changes to scheme debit interchange should not be implemented given the clear superiority of scheme debit over EFTPOS debit at this time;
- Abacus finally recommends that the disclosure requirements and monitoring of behaviour of merchants be strengthened to ensure that consumers are well-informed of charges at the point of sale.

Background

Abacus – Australian Mutuals is the industry body for Australia's 140 credit unions and mutual building societies.

Credit unions and building societies comprise the customer-owned banking sector and provide banking services to 4.5 million Australians. Credit unions and mutual building societies are:

- Authorised Deposit-taking Institutions (ADIs) subject to the *Banking Act 1959* and are collectively the second biggest holder of household deposits after the Commonwealth Bank;
- Australian Financial Services Licensees subject to the *Corporations Act 2001*;
- Signatories to the Electronic Funds Transfer Code of Conduct; and
- Collectively, significant issuers of EFTPOS debit, scheme debit and credit cards.

Mutual ADIs also provide their members with access to the payments system through branches and agencies, ATM networks, direct debits and credits, telephone and internet banking, B-Pay and cheques.

RBA options

Abacus proposes a variation of the RBA's Option 3 as the best way forward for an efficient and competitive payments system.

Option 3 would see the RBA "step back from interchange regulation if the industry is able to address a number of issues that would promote competition and efficiency in a timely fashion."

The key issue identified by the RBA in this context is strengthening the EFTPOS system to enable it to provide effective competition to Visa and MasterCard and other payments systems.

The RBA has suggested specific developments such as transforming EFTPOS into a scheme rather than a series of bilateral contracts, with effective promotion and development of the scheme including on-line payment functionality.

Abacus believes a stronger EFTPOS system would benefit consumers by increasing choice and competition in the payments market.

Credit unions and mutual building societies are significant participants in the EFTPOS system and have consistently advocated measures to improve the system for card issuers and cardholders.

Credit unions and mutual building societies use suppliers such as Cuscal Ltd, Indue Ltd and Australian Settlements Ltd to connect with other EFTPOS system participants, such as major banks. By way of example, Cuscal Ltd has bilateral interchange agreements with the major banks and other participants and processes more than 90 million EFTPOS debit transactions annually.

Abacus has welcomed the commencement of work by the Australian Payments Clearing Association (APCA) on a proposal to transform the EFTPOS debit network into a genuine scheme that can compete with Visa and MasterCard.

From a card issuer's perspective, EFTPOS debit has always been at a significant competitive disadvantage to scheme debit because of the interchange fee arrangements and the product's limited functionality. Overcoming these disadvantages is the key to the long-term survival and competitive position of EFTPOS.

EFTPOS debit issuers pay acquirers per transaction while scheme debit issuers are paid by acquirers per transaction.

The RBA's Option 2 proposes to remedy the interchange fee disadvantage by reversing the current interchange fee flow for EFTPOS debit so that acquirers pay issuers a fee per transaction. Interchange fees for EFTPOS debit and scheme debit would be aligned "with, perhaps, a benchmark of around 5 cents capping the weighted-average fee in the various debit card systems."

The RBA notes that positive interchange fees for debit card issuers "may be useful, and could potentially allow the schemes to use interchange fees in a way that promotes innovation in the system."

Abacus recommends that the RBA should use its powers to introduce positive interchange fees for EFTPOS debit issuers as soon as possible as an interim measure to provide a powerful practical incentive for development of an EFTPOS scheme.

Once the RBA is satisfied that tangible progress has been made in transforming EFTPOS into a genuine long-term competitor, the RBA could “step back” from EFTPOS interchange fee regulation.

We do not support a further reduction in the scheme debit interchange fee. Scheme debit, for the time being, is a significantly superior payment product to EFTPOS debit and has distinct costs and risks. Unlike EFTPOS debit, scheme debit cards can be used online, over the phone, by mail and overseas.

The RBA’s intervention into the payments market has already seen scheme debit interchange fees cut from around 95 cent for a \$100 transaction to 4 cents for the largest and most powerful merchants.

Scheme debit cardholders have felt the impact of these dramatic reductions in the form of new or higher fees. Scheme debit cardholders, along with credit cardholders, have borne the brunt of the RBA’s reform agenda, as merchants have benefited by billions of dollars in lower merchant service fees. As recommended in previous Abacus submissions, balance needs to be restored to regulatory settings that have strongly benefited merchants and large acquirer institutions and have had a disproportionately negative impact on card issuers and cardholders.

Introducing positive interchange fees for EFTPOS debit as soon as possible would go some way towards restoring the balance while at the same time accelerating development of an EFTPOS scheme.

The declining competitive position of EFTPOS compared to scheme debit is illustrated by trends identified from data in Abacus’ Movement Marketing Database (MMD).

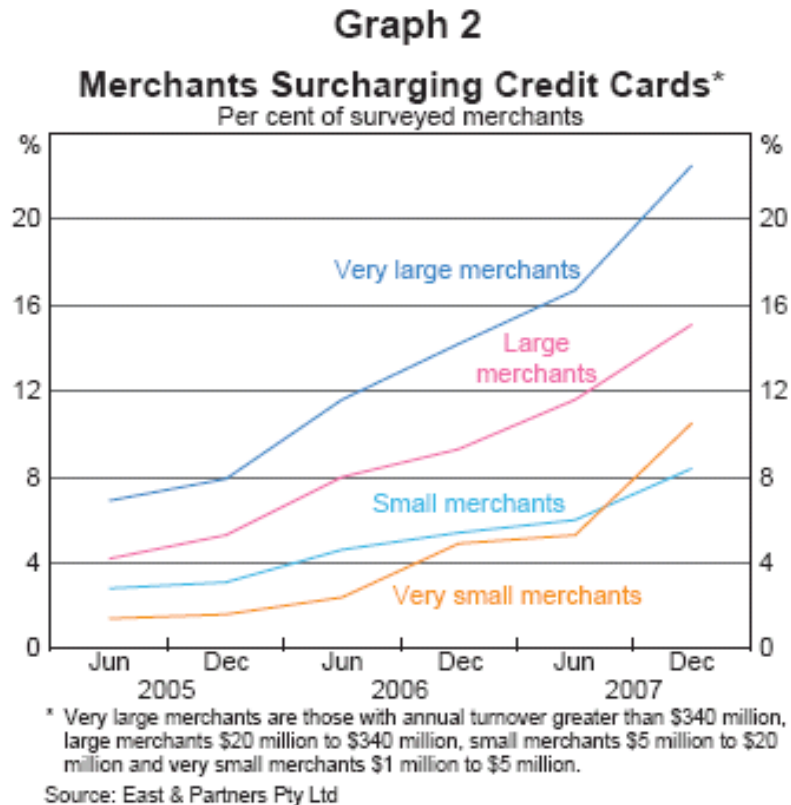
The proportion of credit union members with a Visa Debit card has climbed consistently from 27 per cent in March 2001 to 42 per cent. Late in 2007, the number of Visa Debit cards passed the Redicard (Cuscal Ltd’s EFTPOS debit card brand) as the most issued card.

In April 2008, the number of Visa Debit transactions exceeded EFTPOS transactions for the first time.

The MMD holds data from 112 credit unions and 3.1 million members, representing more than 90 per cent of the credit union sector’s memberships.

Surcharging and the HAC rules

As illustrated in the graph below from the RBA's discussion paper, surcharging by merchants of credit cardholders is on a sharply upwards trajectory.



"At the end of 2007, around 23 per cent of very large merchants imposed a surcharge; for small or very small merchants, the percentage was closer to 10 per cent. Although the size of the surcharge varies across merchants, the average surcharge imposed is currently around 1 per cent for MasterCard and Visa transactions, and around 2 per cent for American Express and Diners Club transactions," the discussion paper says.

RBA Assistant Governor Dr Philip Lowe observed in a recent speech that the culture against surcharging is changing and is doing so faster than many had expected. "According to the surveys conducted for the Bank, the number of merchants surcharging is steadily increasing, and many merchants indicate that they are currently considering introducing a surcharge," Dr Lowe said.

The RBA is seeking to further empower merchants by additional changes to the Honour All Cards principles which could reduce cardholder choice. Abacus believes that the ability for merchants to surcharge already provides merchants with the ability to influence cardholder behaviour and to provide clear pricing signals to those cardholders.

Providing further power to merchants in this regard however would have detrimental impacts, through:

- unclear signals of market and merchant acceptance to consumers, and
- disproportionate competitive impacts on smaller institutions and issuers.

Removal of the HAC rule strengthens the position of the strongest merchants and makes it harder for smaller financial institutions to compete against large rivals. Big financial institutions are better equipped to offer multiple products to consumers and avoid negative consequences from the removal of the HAC rule.

Abacus is of the view that the negative impacts of further HAC reform proposals far outweigh the illusory benefits of such a change.

Abacus agrees that merchants are entitled to impose surcharges and has consistently supported the RBA's intervention to remove 'no surcharge' rules.

However, given the exploding incidence of surcharging, Abacus recommends that RBA, perhaps in consultation with the ACCC, should take steps to monitor disclosure of surcharges by merchants. This will help to ensure that merchants who impose surcharges that are much higher than merchant service fees do not engage in misleading and deceptive conduct by claiming their surcharges are based on costs.

Abacus suggests that the RBA investigate the introduction of a 'name and shame' service to expose merchants gouging cardholders with unreasonable surcharges.

Conclusion

Abacus recommends that the Payments System Board should adopt Option 3, but should act as soon as possible to introduce an interim EFTPOS interchange fee of 5 cents flowing to the card issuer. The Board need not wait until August 2009 to take this step. A positive interchange fee flow could ignite issuer engagement with development of an EFTPOS scheme and would immediately improve the competitive position of EFTPOS debit against scheme debit.

Please contact me on 02 8299 9046 or Luke Lawler on 02 6232 6666 to discuss any aspect of this submission.

Yours sincerely



LOUISE PETSCHLER
Chief Executive Officer