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09 July 2004

Dr John Veale
Head of Payments Policy
Reserve Bank of Australia
65 Martin Place
Sydney NSW 2000

Dear Dr Veale

Reform of Card Payment Systems

I refer to the request of the Reserve Bank of Australia (**Reserve Bank**) for views on whether designation of an EFTPOS payment system and an ATM payment system under the *Payment Systems (Regulation) Act (PSRA)* would be in the public interest - as sought in your letter of 11 June 2004. Thank you for the opportunity to comment.

This letter sets out the Commonwealth Bank's views in relation to ATMs. The Commonwealth Bank's views in relation to EFTPOS will be addressed separately.

Guiding Principles

The Commonwealth Bank has been involved from the outset as an active supporter of reform in relation to ATMs. The Bank chairs the ATM Industry Steering Group (**AISG**), leading its work in preparation of a draft application for authorisation to enable implementation of a direct charging arrangement for foreign ATM transactions. The Commonwealth Bank has also been active in seeking the involvement of the Australian Payments Clearing Association Limited (**APCA**) in an ATM access reform project in a direct charging environment. Each of these initiatives adopts a voluntary reform path. In the Commonwealth Bank's view, the voluntary reform path is a preferable approach for industry participants and is in the public interest.

The legislative intent as set out in the Explanatory Memorandum that accompanied the *Payment Systems (Regulation) Bill* (the **Bill**) affirms that the philosophy of the Bill is co-regulatory and that industry would continue to operate by self-regulation insofar as such regulation promoted an efficient, competitive and stable payments system. Co-regulation contemplates a combination of self-regulation, application of the *Trade Practices Act 1974* (Cth) (**TPA**) and the jurisdiction of the Australian Competition and Consumer Commission (**ACCC**) and, only as “reserve powers”, the designation powers of the Reserve Bank under the PSRA. In paragraphs 5.12 and 5.13 of the Explanatory Memorandum it is stated:

“It is expected that a sizable proportion of payment systems will not be designated. While not required by law, it is expected that designation generally will occur only after substantial consultation with participants and after consideration of alternative regulatory approaches and voluntary arrangements have been exhausted.”

The Payment Systems Board in successive Annual Reports has acknowledged the legislative intent of a co-regulatory approach and flexibility in the new regulatory regime.

The industry has actively led and continues to participate in voluntary reform initiatives in relation to ATMs. The Commonwealth Bank understands the co-operative arrangements initiated by the industry, which would ultimately have been subjected to a test for authorisation under the TPA (a rigorous public process to determine whether they satisfy an overall public benefit test) have been suspended at the Reserve Bank's suggestion. The industry process is pending the Reserve Bank's consideration of the merits or otherwise, of designation. It is the Commonwealth Bank's view that a process of authorisation, conducted by the ACCC and subject to a full merits review by the Australian Competition Tribunal, is in the public interest.

The Commonwealth Bank considers this co-regulatory structure to be appropriate. It facilitates harmonisation of the application of regulatory tests across the financial services industry in common with all other industry sectors subject to the same test for authorisation under the TPA and procedures for a merit review.

We also note that the AISG has engaged in an extensive consultation process to lay the foundation for the industry to move to a Direct Charging regime, consistent with our understanding of regulatory preference. We believe the final agreed proposal is a workable model reflecting a balance of stakeholder positions. The Commonwealth Bank has been flexible in this, given that our own preference to achieve appropriate public benefit outcomes would be for a unilateral implementation of Direct Charging across all industry participants.

The Commonwealth Bank understands that the AISG will also be providing material for the consultation process.

I should also note our pricing policy for access to Commonwealth Bank ATMs will not differentiate between different geographic locations.

Public Interest

In the Commonwealth Bank's view, alternative regulatory approaches and voluntary arrangements have not been exhausted in respect of ATM reform. The positive experience gained from the APCA EFTPOS access reform process indicates considerable potential for a comparable ATM reform process. This element of reform could well be resolved by a voluntary co-operative industry arrangement and subsequently implemented within a TPA regulatory framework subject to the appropriate consultation processes.

While the Australian Competition Tribunal decision to set aside the ACCC authorisation of zero EFTPOS interchange fees is instructive, it does not automatically follow that a similar application with respect to ATMs would share the same fate.

Scope of Potential Designation

The Commonwealth Bank is also concerned that, in the event the Reserve Bank considers a designation with respect to ATMs to be in the public interest, it may be difficult to determine a scope of designation that provides a useful basis for ATM reform. The proprietary nature of the ATM networks and the independent bilateral commercial arrangements establishing the terms of interconnection and interchange across those networks, are fundamental issues to be considered to achieve effective ATM reform.

The infrastructure supporting the proprietary ATM networks broadly comprises:

- ◆ several networks of ATMs provided to cardholders to facilitate secure transactions by entry of a card and PIN;
- ◆ internal acquirer and issuer switches; and
- ◆ telecommunications switching infrastructure to facilitate communications links between the Acquiring and Issuing participants in each transaction.

The majority of this infrastructure is separately owned and operated by a variety of network principals (including the Commonwealth Bank). Other significant network infrastructure operators include Cashcard Limited, Pulse International Pty Ltd and The Banktech Group Pty Ltd ATM networks. Some of this infrastructure has multiple uses, for ATM and EFTPOS transactions and some credit card transactions. The propriety ATM networks are supported by bilateral interchange agreements that include standards concerning authorisation, clearing, settlement and interchange fee arrangements. These arrangements support the set of ATM transactions - cash withdrawal, balance inquiry and declined. In the event that the Reserve Bank considers a designation with respect to ATM to be in the public interest, it is this set of transaction types which will need to form the scope of regulatory attention.

Bearing these issues in mind, any decision on designation needs to account for full range of potential consequences, both intended and unintended.

In the prevailing technical, commercial and legal structure it is not possible to identify a system either in terms of a single physical or logical network, or a single set of key commercial terms, or a single set of mandatory rules or scheme. Standards relating to the processing and settlement of ATM transactions are administered by APCA through the Consumer Electronic Clearing System (**CECS**) regulations and procedures. These standards however, apply voluntarily and there is no mandatory requirement to be an APCA member. Consequently, there are presently participants in the provision of ATM payment services who are not APCA members and who are not covered by APCA regulations and procedures.

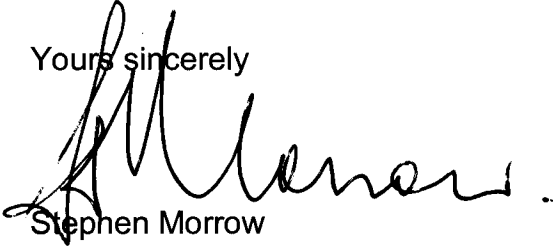
Commonwealth Bank Position

Against this complex regulatory and commercial background, the Commonwealth Bank's position may be summarised as follows:

- ◆ ATM reform should be pursued as far as possible through voluntary industry reform and the co-regulatory structure envisaged under the PSRA;
- ◆ the APCA process provides opportunity to address ATM access reform in a direct charging environment;
- ◆ in the context of seeking an ACCC authorisation the AISG has developed a Direct Charging proposal that has clear public benefits as well as addressing the concerns raised in the Joint Study and the needs of smaller financial institutions.
- ◆ the model for Direct Charging as proposed by the AISG is supported, although the Bank's own preference would be for a unilateral implementation across all industry participants;
- ◆ in the event the Reserve Bank considers designation in the public interest, it is difficult to determine the scope of designation of a system that provides a useful basis for ATM reform.

We note that the Reserve Bank intends to provide the opportunity for discussion with parties lodging submissions. The Commonwealth Bank will continue to be an active participant in industry initiatives relating to ATM reforms. We would welcome discussion and debate with the Reserve Bank in its consultation process in respect to designation. To this end, you should contact Gavin Napier (02 9696 6735) in the first instance to arrange such discussions.

Yours sincerely

A handwritten signature in black ink, appearing to read 'S. Morrow', written over the typed name.

Stephen Morrow
Executive General Manager