

Submission to the Reserve Bank of  
Australia

Designation of the Australian EFTPOS  
Payments System

October 2004



**Coles Myer Ltd.**

## 1. Introduction

This submission has been prepared in response to the decision by the Payment System Board ("PSB") to designate the EFTPOS debit card payment system in Australia as a payment system under the *Payment Systems (Regulation) Act 1998 (Cth)* on 9 September 2004, and its earlier decision of 23 February 2004 to designate the debit card scheme operated in Australia by Visa International.

In its media release<sup>1</sup>, the Reserve Bank of Australia ("RBA") indicated that it will now "proceed to consider the desirability of setting standards for interchange fees for both the EFTPOS debit card payment system and the Visa Debit payment system with the objective of improving the efficiency of Australia's payments system" and would "take into consideration any further submissions on these matters by interested parties".

This submission follows an earlier submission made by Coles Myer in July 2004 in which Coles Myer expressed the view that designation of the EFTPOS system would not be in the public interest<sup>2</sup>. Coles Myer continues to hold this view, and does not accept that there are sufficient grounds warranting the designation of the EFTPOS Payment System, and therefore no grounds warranting setting standards. Our experience of the EFTPOS system and how it developed shows us that regulating via standards would not achieve the objective of increasing competition and promoting efficiency in the EFTPOS system and could not reflect the diversity of how the market operates.

Together with other members of the Australian Merchant Payments Forum ("AMPF") on 16 September 2004 the Reserve Bank of Australia ("RBA") was requested pursuant to section 13 of the *Administrative Decisions (Judicial Review) Act 1997 (Cth)* to provide a written statement setting out the RBA's findings on material questions of fact, the material on which the RBA has relied on in reaching those findings, and the reasons for the decision.

The RBA responded to this request on 14 October 2004, one day before submissions were due. In making this submission Coles Myer has not had sufficient time to review this information, and reserves the right to make further submissions once it has had an opportunity to assess this information.

Coles Myer also makes this submission without prejudice to its rights under the *Administrative Decisions (Judicial Review) Act* in relation to the RBA's decision to designate the EFTPOS debit card payment system, Visa debit or any related matter.

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<sup>1</sup> [http://www.rba.gov.au/MediaReleases/mr\\_04\\_08.html](http://www.rba.gov.au/MediaReleases/mr_04_08.html)

<sup>2</sup> [http://www.rba.gov.au/PaymentsSystem/PaymentsPolicy/Reforms/Eftpos/SubmissionsOnPossibleDesignation/cml\\_090704\\_1.pdf](http://www.rba.gov.au/PaymentsSystem/PaymentsPolicy/Reforms/Eftpos/SubmissionsOnPossibleDesignation/cml_090704_1.pdf)

## **2. Desirability of setting standards for EFTPOS debit card interchange fees**

### **Insufficient evidence of market failure**

Regulatory intervention should only be considered when evidence has been presented to show that there is clear market failure and that intervention such as the adoption of standards for setting interchange fees will adequately address these market failures.

No evidence has been presented that supports the need for EFTPOS interchange standards to increase competition and efficiency in the payments system.

The RBA's media release provides little explanation as to why the PSB decided to designate the EFTPOS debit card payment system, other than to say:

*"...the Board concluded that current interchange arrangements are not conducive to the efficiency of the overall payments system. In particular, the nature of the interchange arrangements contribute to the effective price that cardholders are charged for payments using EFTPOS being higher than for payments using credit cards or scheme-based debit cards. This is despite the EFTPOS system having relatively lower costs. The Board judged that a narrowing of this differential in relative prices and costs would promote the efficiency of the overall payments system".*

In December 2003, in a letter to interested parties the RBA advised that it had, "identified a number of aspects of Australia's EFTPOS debit card payment system that raised important questions of competition and efficiency in its Joint Study with the Australian Competition and Consumer Commission ("ACCC") published in October 2000", and that "the study was particularly concerned about interchange fees and access in the EFTPOS debit card system.

However as previously stated, Coles Myer does not believe that the Joint Study can be relied upon in 2004 to support a decision to designate the EFTPOS payment system, nor can it be relied upon to support the introduction of interchange standards.

Since the Joint Study report in 2000, there has been no new substantial report that attempts to provide any detailed analysis of the EFTPOS debit card payment system, or attempt to provide any evidence in support of the need for regulatory intervention.

Also, the market has undergone considerable change since the Joint Study was released. Following the introduction of the credit card reforms, banks have changed the fee structures and programme benefits for their credit card accounts. There have also been changes in the pricing of cheque and saving accounts with the promotion of accounts that offer unlimited EFTPOS

transactions for a low flat monthly fee<sup>3</sup>. Following these changes in recent months we have seen the growth in EFTPOS transactions exceeding credit card growth.

The assumption that EFTPOS interchange fees required reform to increase competition and efficiency was further challenged in the proceedings before the Australian Competition Tribunal (“Tribunal”) (in respect of which the RBA was granted leave to intervene). In rejecting a proposal to introduce a zero interchange fee, the Tribunal determined that such a proposal would result in a clear public detriment.

In reaching their decision the Tribunal concluded that the notion that a proposal to set interchange fees at zero was,

*“...an odd solution to a perceived problem of insufficient competitive activity to authorise an agreement deemed by law to be anti-competitive.”*

The Tribunal also noted that senior counsel for both the Merchants and Coles Myer strongly criticised the lack of provision of hard information by the banks and the RBA. The Tribunal stated,

“In our opinion, these complaints were well founded and were not satisfactorily answered.”<sup>4</sup>

The economic and payment system experts engaged by parties to the Tribunal made a number of conclusions regarding the Joint Study and its findings. They agreed:

- (a) the data recorded in the Joint Study was out of date, being data collected in 1999
- (b) the data was incomplete;
  - (i) it only included data from eight financial institutions and did not include merchants costs, including those costs that some merchants incur that would otherwise be costs an acquirer would be responsible for, despite recognising the significant investment and involvement of merchants particularly larger merchants who represent a significant proportion of total EFTPOS transactions
  - (ii) it was only a snap shot in time and to the extent that the data was to be used to assess the relationship between price and long run average costs, data collected over a period of time would be more appropriate
  - (iii) the margins between revenues and average costs did not incorporate a return on capital committed to credit card issuing and acquiring, because the banks were unable to provide data

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<sup>3</sup> For example the National Australia Bank has recently introduced two new personal transaction accounts that have a simple flat monthly fee and offer unlimited EFTPOS usage and the ANZ now offers an “all you can eat” transaction account for a flat monthly fee.

<sup>4</sup> EFTPOS Tribunal Decision para 75

- on this, though it could be said they were simply unwilling to do so
- (iv) issuing revenue information was difficult to unbundle from other product and services revenue
  - (v) there was no consideration of the extent to which customers pay any EFTPOS fees at all
  - (vi) there was no detailed analysis of the different characteristics of payment types
  - (vii) there was no data on the degree of substitutability between debit and credit, or any assessment of non-price factors that affect consumers choice of payment tender
  - (viii) little attention was paid to the implications of its findings for investment and innovation.
  - (ix) the Tribunal also questioned the validity of using transaction volumes as the basis of allocation of joint and common costs

### **“Effective” prices of debit and credit cards**

The RBA’s media release notes that the PSB concluded that,

*“...the nature of interchange arrangements contribute to the **effective price** (emphasis added) that cardholders are charged for payments using EFTPOS being higher than for payments using credit cards or scheme-based debit cards.”<sup>5</sup>*

No evidence supporting this finding has been provided. No definition of what is meant by an ‘effective price’ has been given nor has any data or assumptions been provided to measure this effective cost in order to reach this conclusion.

The effective price cardholders pay for credit card transactions will depend on how a cardholder manages the use of their credit card, and the features attached to that credit card. The many variables involved in a credit card transaction would make it difficult to definitively allocate a single effective price that could be used to compare credit card transactions with other payment types.

- The interest cost incurred will be dependent upon whether or not the cardholder revolves, the outstanding balance and the interest rate applicable to their card. Interest rates on credit cards vary significantly. The interest expense incurred will also depend on the number of interest free days offered by the credit card issuer.
- Credit cardholders may incur annual fees and they may also pay additional fees for a loyalty program attached to the card.
- Late payment fees and over limit fees may also be payable by cardholders.

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<sup>5</sup> RBA Media Release 9<sup>th</sup> September 2004

- Cost and value of benefits obtained through loyalty programs.

The effective price of a credit card transaction will therefore vary depending on the behaviour of the cardholder and the underlying features and charges that apply to the product.

In the same way that the cost of credit card transactions will vary according to the cardholder's behavioural patterns and the underlying product characteristics, the effective price of EFTPOS transactions will also vary.

The price of EFTPOS transactions will be dependant on the underlying characteristics of the Transaction/Saving account, and on the transactional behaviour patterns of the cardholder. The many variables and combinations again make it difficult to determine an effective price per transaction for comparison purposes. The effective price of an EFTPOS transaction will be dependant upon the following:

- The number of fee free transactions allocated to the particular product/account.
- The number of debit card transactions undertaken by the cardholder.
- The fee structure of the underlying account. The fee structure of accounts are many and varied:
  - A single monthly fee with unlimited EFTPOS transactions
  - Fee free dependant on account balance
  - Fees charged for transactions in excess of a certain fee free transaction threshold
  - Fee exemptions for certain customer groups

### **“Effective” prices and the efficiency of the overall payments system**

Notwithstanding that the “effective” price for either debit or credit card transactions has not been established, no explanation has been provided as to how the PSB was then able to conclude that, “a narrowing of this differential in relative prices and costs would promote the efficiency of the overall payments system”.

The Tribunal rejected this proposition. The economic experts all agreed that a key conclusion of the Joint Study that, “[t]he incentives in an economy should ensure that the lowest cost and most efficient payment instruments thrive at the expense of the more expensive or less efficient ones”<sup>6</sup> could neither be supported by the data in the Joint Study, nor by any proposition in economics.

The Tribunal stated:

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<sup>6</sup> Joint Study at i

*“The fundamental benefit claimed in support of the authorisation is that increased use of EFTPOS will mean greater use of a lower cost means of payment and therefore more efficient payment systems as a whole.*

*However, all five economists who gave evidence agreed with the proposition that in assessing the efficiency with which resources are allocated among products with different characteristics, one cannot say that all resources should be allocated to those products whose production involves the least cost. In any case, on the evidence we have, it is not even clear that EFTPOS has the lowest cost, as we have noted in relation to the Joint Study ([70] above). By the same token, the Banks’ argument that there are currently distorted price signals has not been established.”<sup>7</sup>*

The Tribunal also stated,

*“...again accepting Dr William’s evidence, as a matter of allocative efficiency (as distinct from productive efficiency) one cannot assess relative efficiency simply by comparing costs. It is not necessarily more efficient to use a cheaper product as opposed to a more expensive product if they confer different benefits. One of the benefits of free markets is that they provide a range of products in accordance with the preferences of consumers, thus encouraging greater use of a less costly product at the expense of a more costly product where the two products have different characteristics. That the differing characteristics are likely to affect the relative value of the products to consumers does not encourage efficiency and is not necessarily a public benefit from an economic perspective.”<sup>8</sup>*

### **Effectiveness of a standard for EFTPOS interchange fees**

The desirability of imposing standards also needs to be assessed in the context that no standard could adequately address all the circumstances of each agreement, the services provided under these agreements and the level and direction of fees paid in consideration for these services, that market determined bilateral agreements address.

At present the EFTPOS system in Australia consists of a number of individual agreements established between issuers and acquirers or in Coles Myer’s case, a hybrid of both.

These agreements are freely negotiated between participants in the EFTPOS system and reflect the individual economic imperatives of each party.

We are not satisfied that any standard can adequately take into consideration the individual commercial and economic reasons underpinning the existing negotiated fee arrangements which reflect:

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<sup>7</sup> EFTPOS Tribunal Decision para 148, 149

<sup>8</sup> EFTPOS Tribunal Decision para 151

- (a) a payment for the provision of a national, secure, online network which provides issuing bank's customers access to their funds in real-time
- (b) a payment that balances or redistributes the value derived from the system by participants, where the value is the difference between the benefits received and the costs incurred by network owners, and
- (c) a payment that creates incentives for network owners to undertake and maintain investment in the EFTPOS system, including the proposed Triple DES initiative.

### **3. A Standard for Visa Debit**

The Joint Study highlighted concerns with respect to "Visa Debit" cards, it stating:

*"...there is no case for simply extending credit card interchange fees to debit card transactions...issuing institutions are being over-compensated for what is, to all intents, a debit card transaction"<sup>9</sup>*

These concerns have also been highlighted in a number of submissions made by the AMPF, and CML supports the arguments presented in these submissions.

Fundamentally "Visa Debit" is a debit card and there is no justification for the imposition of credit card interchange fees.

The current interchange arrangements that apply to "Visa Debit" significantly increase the costs of processing debit card transactions for merchants through higher merchant service fees, and as they are non PIN based, expose both merchants and cardholders to greater risks of fraud.

We believe that "Visa Debit" issuers should not be rewarded for introducing greater costs and risks to merchants and cardholders, and reducing the efficiency of the Australian debit card market.

We also support the abolishing of the Honour all Cards Rule (HACR), in so far as it applies to "Visa Debit". We believe that the effect of this rule has been to unjustly force merchants to accept this expensive debit card product.

We note that similar concerns regarding the HACR have been the subject of litigation in the United States, which resulted in a multi billion-dollar settlement for merchants.

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<sup>9</sup> Debit and Credit Card Schemes in Australia – A Study of Interchange Fees and Access, Reserve Bank of Australia (RBA) and Australian Competition and Consumer Commission (ACCC), October 2000, pg70



Merchants ought to have the right to choose whether they wish to accept “Visa Debit” regardless of whether they choose to accept other Visa products or not.

Proponents for “Visa Debit” seek to distinguish “Visa Debit” from EFTPOS debit by reference to so called “wider range of functionalities”. These wider functionalities are stated as being:

1. the ability to use “Visa Debit” for telephone and internet purchases
2. the wider acceptance of “Visa Debit” in Australia and the ability to use “Visa Debit” cards overseas
3. the ability for smaller financial institutions to compete with larger competitors by enabling them to offer a product, which has different benefits to the EFTPOS product typically promoted by the big four banks

However none of these “differences” on closer examination justify any different treatment for “Visa Debit” from EFTPOS debit.

Whilst it is true that “Visa Debit” unlike EFTPOS debit can be used over the telephone and Internet, that is not to say that with current technologies the industry could adopt wider acceptance of EFTPOS debit. The fact is it is in the banks’ commercial interests not to promote such initiatives. The argument also ignores the fact that Internet and telephone merchants, not issuers, accept the risk of fraud if a customer later disputes a transaction.

With respect to wider acceptance, it is highly questionable what value should be attached, to this to the extent that this is only made possible by a rule that forces merchants to accept these cards if they wish to accept Visa credit cards, a rule which many regard to be anti-competitive and which was the basis of a multi-billion dollar lawsuit in the United States. Further, the present system differentiating between “Visa Debit” and other debit cards provides an incentive to the Banks not to advance the extended use of debit cards other than “Visa Debit”. Put simply, as “Visa Debit” is now treated as a credit card, the Banks have a financial interest in promoting the use of credit over debit. Therefore, the Banks’ interests are best served by the use of “Visa Debit” over any other debit card.

As to international acceptance, there is no mention by any of the “Visa Debit” proponents that transactions conducted overseas by their customers already attract interchange revenues paid by the overseas acquirer. There is no suggestion that this arrangement will cease and it is not as we understand within the scope of the RBA’s current considerations. There is simply no

justification on the grounds of overseas acceptance for a domestic interchange fee arrangement.

Finally it is argued that “Visa Debit” provides smaller institutions with a competitive edge, enabling them to compete with the big four banks. It is difficult to understand how this could be the case when you consider that not all small institutions issue “Visa Debit”. Similarly it is difficult to see how “Visa Debit” can be said to give smaller issuers a competitive edge when you consider that any member of Visa big or small is entitled to issue these cards.

#### **4. Summary**

In the absence of any evidence to support the findings and conclusions reached by the PSB, Coles Myer does not consider that a standard for setting EFTPOS interchange fees is necessary, desirable, defensible or in the public interest.

We do not believe that regulatory intervention will achieve the objective of increasing the overall efficiency of the payments system. Our direct experience of the debit card system also tells us this:

- the debit card market has undergone significant change since the Joint Study report in 2000, and we see strong evidence that the market is adjusting to meet the objectives of promoting efficiency, without the need for regulatory intervention
- such intervention via a standard would fail to adequately address all the circumstances of agreements between issuers and acquirers and fail to keep pace with change, nor provide sufficient incentives for network owners to continue to re-invest in their networks including 3DES upgrades, or provide any incentives to encourage new network participants
- the assumption that the “effective price” of EFTPOS transactions is greater than credit cards is not supported by any evidence, and there is no evidence to show that narrowing any differential would lead to greater efficiency in the payments system

Further following the resounding decision of the Tribunal, there is no basis for the RBA to take contrary steps to impose a zero interchange regime through designation.

With respect to “Visa Debit”, we believe that the way in which the “Visa Debit” card operates and the impact it has on the Australian debit card market is improper and arguably misleading and deceptive.