

**Submission to the Reserve
Bank of Australia.**

**The review of card
payments regulation and
its impact on the Australian
Travel sector.**

April 2015

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For further information please contact:
Dean Long; AFTA National Manager – Strategy and Policy
Phone: 02 9287 9900
Email: Dean.Long@afta.com.au

Executive Summary

This submission is made by the Australian Federation of Travel Agents (AFTA) as representative for the Australian travel industry in respect of the RBA's issue paper on the "Review of Card Payments Regulation". It details support for most of the proposed changes the RBA has put forward within this issue paper.

However, there are a number of areas of major concern affecting the Australian travel industry, including differential surcharging based on the level of the card and the proposed further regulation of a business's ability to recover the true cost of electronic transaction through surcharging.

AFTA submits that the impact and cost of actual implementation of these changes by Australian travel agents will be high. AFTA also submits that, while the focus of the RBA is rightly on closed loop domestic transactions, Australian travel agents also have significant exposure to international markets, which should be taken into account. Therefore, it is important that any regulation of card payments takes into account trade exposed industries such as travel agencies.

In reviewing the issue paper and preparing this submission, a supplementary issue for discussion has also been identified which is of high importance to Australian travel agents and relates to the inequitable transfer of prepayment/chargeback risk from end suppliers to the travel agents who facilitate customers' travel bookings with those end suppliers. This risk arises when a travel agent accepts payment by credit card for services to be supplied by an end supplier (e.g. airline/hotel), in most cases at a date much earlier than the date on which the end supplier is due to perform the booked service, and means that the travel agent is liable for the customer chargeback when the end supplier does not perform in accordance with the booking (e.g. in the case of end supplier insolvency). This represents a significant risk to Australian travel agents (currently estimated to exceed \$5.4 billion (AFTA, 2015)) and AFTA believes it should be confirmed as "reasonable cost of acceptance" of a credit card which can be appropriately included in a credit card surcharge fee.

The above mentioned prepayment/chargeback risk is also having a major impact on small businesses who are being priced out of the market for the provision of merchant facilities. AFTA believes that this is a significant issue which must be addressed in the review of card payment systems. If the issue of prepayment/chargeback risk is not appropriately addressed, the ability of travel agents to maintain electronic payment methods could be put at risk as many travel agencies are being requested to provide a cash bond to merchant acquirers. This would have an impact on the level of competition currently occurring in the Australian market in regards to the purchase of travel products including airfares, accommodation and ground transport.

In summary; AFTA has provided comment on 12 issues raised by the RBA and provided one supplementary issue for consideration. Of the 12 issues, AFTA has provided in-principle support to 7 issues and does not support 5 of the issues.

About Australian travel agents and AFTA

Overview of the Australian Travel Sector

Australian travel agencies currently employ over 35,000 Australians throughout the nation and contributes over \$30 billion annually to the economy across nearly 4000 locations in Australia. Over the past five years the industry has seen significant change but has continued to grow at a rate between 3% - 6% annually.

The Australian travel sector contains businesses both large and small, ranging from ASX listed companies, including Flight Centre Travel Group Limited (FLT), Corporate Travel Management (CTD) and helloworld (HLO); to sole operators in small regional towns. Travel agencies are a major employer within the community in which they operate providing sought after professional advice to Australians travelling domestically and overseas both in the leisure and corporate travel space. Importantly for this submission; Australian travel agents conduct 89% of all transactions through electronic means. 40% of these total transactions are conducted using debit / eftpos; 49% are conducted using a credit card; the remainder is conducted with cash (including payments by direct deposit and BPay).

About AFTA

The Australian Federation of Travel Agents Ltd (AFTA) was founded in 1957 to:

- establish professional standards for travel agents;
- stimulate, encourage and promote travel;
- bring together those acting as intermediaries in the distribution of travel-related services;
- build strong working relationships with suppliers and consumers of travel-related services.

As the peak industry body in Australia, AFTA represents the majority of retail travel agents including all of the major travel agency groups. AFTA's membership accounts for approximately 80 percent of Australia's travel intermediaries that control more than 96 percent of travel intermediary turnover. It also has a substantial base of associate members, representing non-intermediary sectors of the travel-related services industry. Members are bound by AFTA's Code of Ethics and are accredited under the national industry scheme known as the AFTA Travel Accreditation Scheme (ATAS).

AFTA represents the interests of its members on many local and international associations and boards, including peak bodies of other national associations. AFTA also contributes significantly to the Australian domestic tourism industry by taking leadership on many challenges and engaging with like-minded industry representative bodies.

AFTA administers Australia's only accreditation scheme for travel agents known as ATAS. ATAS has been endorsed by all state and territory jurisdictions consumer affairs and fair trading departments, following the deregulation of the eight separate legislative regimes governing travel agents from state and territory jurisdiction.

ATAS accredited travel agents are committed to maintaining Australia's world class travel industry. In particular, ATAS accredited travel agents strongly believe in a thriving Australian tourism domestic industry, in which more and more Australians enjoy holidaying at home.

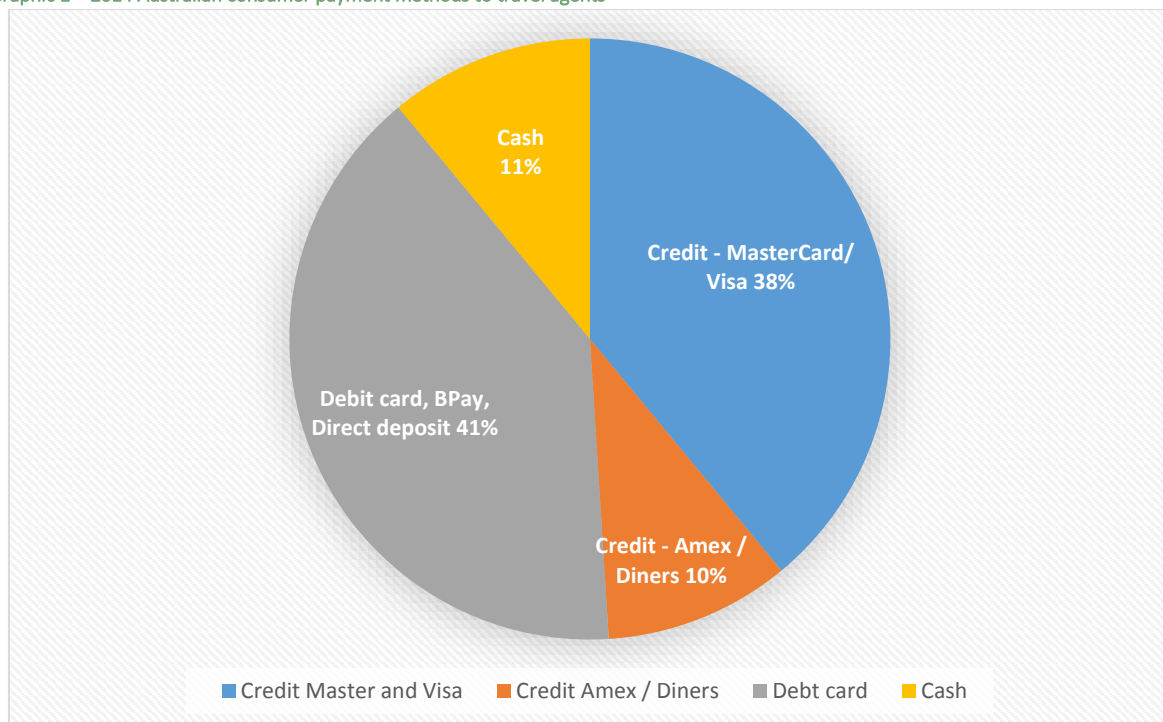
Consumer payment preference when using Australian travel agents

Travel agents in Australia transact over \$27 billion in Total Turnover Value (TTV) via electronic payments per-annum, which is nearly 89% of the TTV for the entire industry. Electronic payment through use of a payment card (broadly comprising eftpos, debit and credit cards) is the most common payment method used by consumers to purchase travel through a travel agent. Importantly, travel purchased through a travel agent is done so on average between 70 and 100 days before the product is consumed, representing a far greater prepayment period than traditional retail. This has resulted in an inequitable risk for the travel agent merchant, as at any given time 20% of the industry's TTV is subject to chargeback risk, primarily on account of end supplier insolvency throughout this period.

This risk is unique to the travel industry because even though, in almost all cases, the travel agent will have fulfilled their obligations to the customer by booking and paying for the product, the travel agent will remain exposed to the risk of being required to repay to the customer (via the chargeback system) monies on-paid to an end supplier who is not able to perform their obligations. This has meant that the ability of travel agents to surcharge is critically important and any changes to regulation in this area must still allow for flexibility for business to cover the risk of end supplier failure through competitive surcharging.

Australian travel agents have low competitive surcharge rates; approximately 2% for Visa and MasterCard and 3% for Amex and Diners (AFTA, 2015). Since the introduction and growth of options in electronic transaction payment methods, the Australian travel sector has seen significant growth in the volume of bookings paid by electronic payment methods by consumers. Additionally, in the last three years, we have seen an increase in the use of platinum or premium cards driven by the auxiliary products offered by card issuers such as free travel insurance and increased award points per dollar.

Graphic 1 – 2014 Australian consumer payment methods to travel agents



Source: AFTA, 2015

Even with the increased cost to merchants through the use of premium cards, competition for services between Australian travel agencies has resulted in consumers having clear choices and low fee payment options for the travel product they have purchased. According to Tourism Research Australia, the Australian travel and tourism sector contributes close to \$101 billion to the Australian economy, of which nearly 30% is transacted using a travel agent. The remainder is purchased directly with the supplier or through an international aggregator, many of which have higher surcharge rates than Australian travel agents.

Graphic 1 details the current market payment preferences and demonstrates that the majority of Australians do so without a fee (by paying with cash or a debit card) and that, of the 48% that choose to pay using a credit card, 80% do so on average with a surcharge rate of less than 2% (AFTA, 2015).

Graphic 2 - Example of typical pricing information as part of invoice provided to Australian consumers by Australian Travel Agents

Great Holidays: Invoice for holiday at Hotel and Resort		
Payment Type	Surcharge	Price
Cash price <i>(including BPay, direct deposit)</i>	0%	\$7,000
Credit card – MasterCard	2%	\$7,140
Credit card – Visa	2%	\$7,140
Credit card – Amex	3%	\$7,210
Credit card – Diner	3%	\$7,210

Source: AFTA, 2015

Some Australian travel agents have used surcharging as an effective risk management strategy to cover the risk of chargeback caused by end supplier failure. As noted earlier, the rate of surcharge by travel agents is still competitive and low when compared to other merchants / sectors within the Australian economy. The approach taken by these travel agents ensures Australian consumers have multiple payment options including at least one surcharge free option (such as for payments by cash or debit card). Graphic 2 shows how a consumer can make an informed decision on the relative cost of each payment option. By differentiating surcharge amounts based on different scheme fees, the process followed by the majority of the travel sector limits the level of cross subsidisation between different card issuers.

Response to specific issues raised by the RBA

Australian travel agents operate in a highly competitive market and as a result offer competitive electronic payment methods for Australian consumers. The travel sector is supportive of a number of proposals put forward, however the need to ensure that these do not increase the business costs and/or levels of risk (including prepayment/chargeback risk) for Australian travel agents is paramount. Traditional Australian travel agents are in direct competition for business with international operations and therefore any additional regulation or changes to the current system that the RBA recommends must be viewed from a global perspective, not just a domestic one.

Issue 1: Publishing thresholds for which payment system providers will be subject to interchange or related regulation, possibly based on transaction values and/or market share.

AFTA comment:

AFTA in principle supports the publication of the thresholds that system providers would be able to impose on merchants. AFTA also believes that it would encourage the entrance of competitive system providers to the Australian market and importantly would provide greater flexibility for smaller travel agents. Consequentially the varying size and international nature of the businesses in the Australian travel industry would benefit from the standardisation of regulation on the use of non ADI accounts and stored value accounts would be beneficial.

A major issue for travel agencies occurs when the consumer purchases a travel package using an international credit card which falls outside of the interchange fee regulation. AFTA submits that stronger regulation is needed to ensure Australian businesses are not overcharged by international issuers. If stronger regulation is established, businesses will be able to identify and ensure the application of an accurate fee to be applied to the purchase to avoid cross subsidisation by Australian consumers.

In regards to the regulation of surcharging through the use of thresholds; Recommendation 16 of the FSI indicates different thresholds based on transaction values or payee groups. While these represent the total values transacted, it does not take into account a sector's or business' exposure to prepayment/chargeback risk and therefore the true costs of providing these payment options. AFTA believes that any expansion of regulation should only occur where there is an identified monopoly or duopoly in the market.

Issue 3: Making changes to the interchange benchmark system to reduce the upward 'drift' in average interchange rates inherent in the current three-year reset cycle.

Issue 4: Lowering interchange caps

Issue 5: Replacing weighted-average interchange caps with hard caps.

Issue 6: Applying caps as the lesser of a fixed amount and a fixed percentage of transaction values

AFTA Comment:

AFTA strongly supports changes that decrease the costs of compliance and costs associated with the provision of electronic merchant facilities. Therefore, AFTA in principle supports Issues 3 to 6.

AFTA is supportive of the removal of the floating three year average and supports no less than quarterly reviews of the interchange rates. AFTA members have advised that removing the three year floating average would put downward pressure on the interchange rates with little or no impact on the costs for business.

AFTA is also supportive of the lowering of the interchange caps. However the issues paper does not provide sufficient detail on how the RBA will address the limitations of the EU legislation. As noted in the RBA Issues paper and FSI, AFTA understands that the EU proposed changes will only cover consumer cards and that corporate cards will be exempt from the hard cap of 30 basis points for all interchange fees on all card transactions.

It is therefore critical that any changes that occur in Australia must do so across all card types. Most Australian travel agencies have a mixture of corporate and leisure travel bookings and if the regulation is not developed with significant consultation any proposed savings and simplification may not be realised. AFTA believes that these savings will not be realised because businesses will still need to develop multifaceted electronic payment transaction pricing systems rather than using an averaging model.

It is not industry practice to charge a surcharge for the use of debit cards by Australian consumers. Therefore the need for an introduction of a fixed cap for the use of debit cards is not considered necessary by AFTA.

Issue 8: Allowing for 'buying groups' for smaller merchants to group together (subject to any competition law restrictions) to negotiate to receive the lower interchange rates that are accessible to larger merchants.

AFTA comment:

AFTA supports in principle, the introduction of group buying for merchant rates and facilities (Issue 8). However, additional information is required from the RBA on who would be responsible for the prepayment/chargeback risk (i.e the buying group or the individual members of the buying group).

Independent Australian travel agents primarily purchase air tickets through group buying businesses called consolidators. Therefore, group buying would create a new avenue to lower business overheads. For these businesses, the ability to purchase group rates would create cost savings for businesses which could then be passed through to consumers.

Issue 9: A tiered surcharging system, perhaps along the lines of the FSI recommendations.

Issue 12: Strengthened transparency over the cost of payments to merchants and cardholders

Issue 13: Further easing of 'honour-all-cards' rules to allow merchants to decline to accept cards with high interchange fees.

Issue 14: Facilitation of differential surcharging by merchants

AFTA comment:

AFTA is not supportive of the changes proposed in issues 9, 12, 13 and 14 as AFTA believes assessed cost for compliance is too high.

As these issues are based on Recommendation 17 of the FSI, AFTA has reviewed the FSI and found significant issues with the real world application of the recommendation. As detailed in Section 1 of this submission, consumers using Australian travel agents already have very low rates of surcharge for credit cards and therefore AFTA does not believe further enforcement or disclosure is required. Travel agents already comply with Australian Competition Law (ACL) by ensuring that all advertisements include sufficient detail regarding product inclusions/exclusions and booking terms so that they are not false and misleading; provide a true representation of the product / experience and show prices that are clearly stated and all inclusive (ACL, Schedule 2, Competition and Consumer Act 2010 (Cth)). AFTA does not believe that increasing the complexity of accepting credit cards through the easing of the honour all cards rule (and allowing differential surcharging for different card levels) would result in any productivity or real savings for businesses. Graphic 3 shows that differentiating credit card surcharges by card level overly complicates the advertisement terms.

Graphic 3 – A hypothetical advertisement to comply with the proposed new regulation as detailed in the RBA issues paper.

EXPERIENCE YOUR DREAM HOLIDAY AT THE HOTEL AND RESORT 7 NIGHTS ONLY \$7,000

Restrictions and conditions apply. Please ask us for further details or visit our website at www.greatholiday.com *Travel restrictions and conditions apply. Prices and taxes are correct as at 14 Apr15 and are subject to change without notice. Visit our website to see updates and corrections to advertised product at www.greatholiday.com. Prices quoted are on sale until 15 May 15 unless sold out prior. Prices are based on per person, twin share, and subject to availability. Offers are not combinable, unless otherwise stated. **Payments made by credit card may incur a surcharge based on the type of card. Greatholiday only accepts, MasterCard fun bank basic (1%), Visa travel express platinum (3%), Visa Bank doorbell (2%), Amex frame (2.85%) and Diners dinner (4%). Other cards maybe accepted and rates will vary. Full payment due within 7 days of booking.. AIRFARE NOT INCLUDED. ATAS Accreditation No. A1000GREATHOLIDAY**

Payments made by credit card may incur a surcharge based on the type of card. Great Holiday only accepts, MasterCard fun bank basic (1%), Visa travel express platinum (3%), Visa Bank doorbell (2%), Amex frame (2.85%) and Diners dinner (4%). Other cards may be accepted and rates will vary.

Allowing merchants to charge different surcharge rates based on the level of the card would add significant administrative costs to business. This is because the terminals are unable to confirm the level of the card at the point of sale or enquiry. If this was to be introduced, the open system architecture of the interchange system would need to be upgraded to allow the merchant to automatically and instantly recognise the cost of the card and adjust the surcharge within company policy. This would require consistency across all service providers to ensure the consumer is notified of the charging rate.

The fundamental reason for not supporting the recommendations put forward in the FSI, is because the FSI did not take into account the pre-payment risk profile of Australian travel agents. While further analysis of this issue is detailed in Section 4 of this submission, Australian travel agents have developed competitive options to allow for the use of a credit card regardless of the level (low cost, premium and platinum).

AFTA members have also advised that this recommendation would cause further confusion for the consumer (most of whom do not realise that different card levels mean different interchange fees for merchants) and in effect decrease the productivity of front line selling staff. As noted in the RBA issues paper, consumers already have a number of different level cards especially as a result of the increase in the availability of companion card schemes. AFTA believes due to MasterCard and Visa having 42 different interchange rates, it would create an unmanageable administrative situation for travel agents and increase the confusion for consumers (RBA, 2015).

In the current environment the varying level of interchange rates for differing levels of cards means surcharging is set on the average, not on the level of the card. If surcharges are to be set and enforced, clear advice from the acquirer and issuer institutions is required to ensure travel agents can comply with the regulations. Standards will also be required for automatic electronic referencing which will need to be rolled out over a period of time to allow any system upgrades to occur.

Section 4 of this submission details modelling conducted by AFTA to illustrate the significant pre-payment risk due to end supplier insolvency and request that the RBA includes such risk management strategies in the RBA guidance note. Such strategies are critical for a sector which does not control the ultimate provision of the good/service to the consumer by the end supplier, but simply facilitates the sale.

Issue 11: Any other changes to enforcement procedures and disclosure practices

AFTA comment:

It is standard practice for Australian travel agents to provide a number of different payment options to Australian consumers. Therefore, AFTA does not believe there is a need for enforcement or disclosure procedures. Typically, Australians who purchase travel through a travel agent have at least two fee free payment options (generally cash and eftpos/debit card) and these transactions account for 51% of the industry's TTV.

AFTA has not been advised of consumer requests for greater disclosure of the breakdown of fees by travel agents. AFTA believes this is because of the low surcharging rates and fee free options the industry allows for. The RBA should not apply a single approach across all industries because certain industries and businesses do not have the competition levels to drive lower payment options for consumers. Therefore, a possible approach could be to enforce enhanced disclosure practices where there is a monopoly or duopoly in the market by identified the ACCC. This would allow the RBA to focus regulatory attention where the possibility for excessive surcharging is likely to occur.

Issue 15: Ensuring that merchants have the ability to choose to route their transactions via lower-cost networks or processors

AFTA Comment:

AFTA supports this process as it will allow increased competition between providers and is likely to lower costs that are passed on to consumers. However, AFTA believes if there is to be a separation of card issuers and card payment infrastructure, significant lead time would be required to ensure individual businesses can adjust their own transaction and accounting processes.

Supplementary issue for discussion.

The issue of chargeback, because of end supplier insolvency in a travel agency business model.

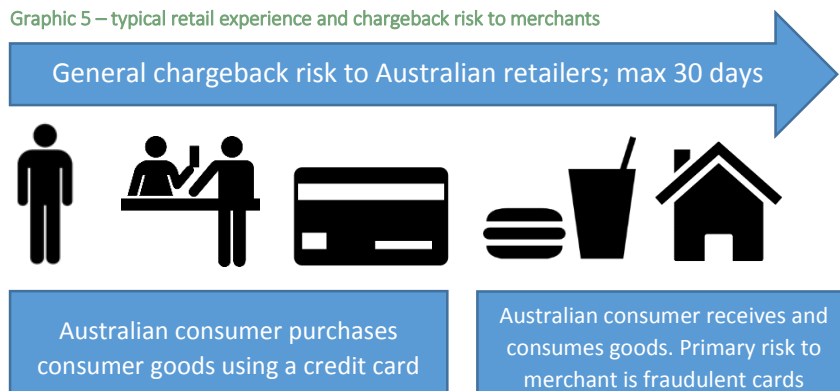
Travel agents are uniquely positioned in that their exposure to insolvency chargeback is greater than other sectors that sell a product or service directly to the consumer and/or take payment at the same time the relevant good or service is provided. AFTA's research indicates that the average period of prepayment for a travel booking is between 70 - 100 days before travel commences, with industry exposure to chargeback risk in excess of \$5.4 billion, primarily because of end supplier insolvency (Graphic 4). This has created a significant issue for travel agents with respect to attaining and maintaining merchant facilities because of requests by merchant acquirers for significant bonds to cover this risk (AFTA, 2015). The reason for this is that the prepayment risk for the travel agent is substantially greater than other members of the travel and tourism industry including hotels, airlines and other retailers who control the purchase and ultimate provision of the product.

Travel agents are in an inequitable and untenable situation whereby they can fulfil their obligation to the consumer and still face a chargeback due to end supplier insolvency. More specifically, an agent can arrange a booking and facilitate payment for a consumer, however if the end supplier which has taken payment becomes insolvent before the product is to be used the chargeback liability which can be initiated by the consumer is held against the travel agent (Graphics 4 & 5). As the travel agent carries the risk of chargeback (not the supplier, e.g. airline or hotel) for an average of between 70 to 100 days, the Australian travel agent sector has at any given time a minimum of \$5.4 billion of chargeback risk on its balance sheet. Graphics 4 & 5 demonstrate the major differences facing Australian travel agents to other merchants operating domestic retail operations such as, a café or department store. AFTA believes that the use of chargeback for this purpose falls outside of the governing principles of merchant error, services not provided and fraud.

Graphic 4 – Travel agent risk of chargeback explained

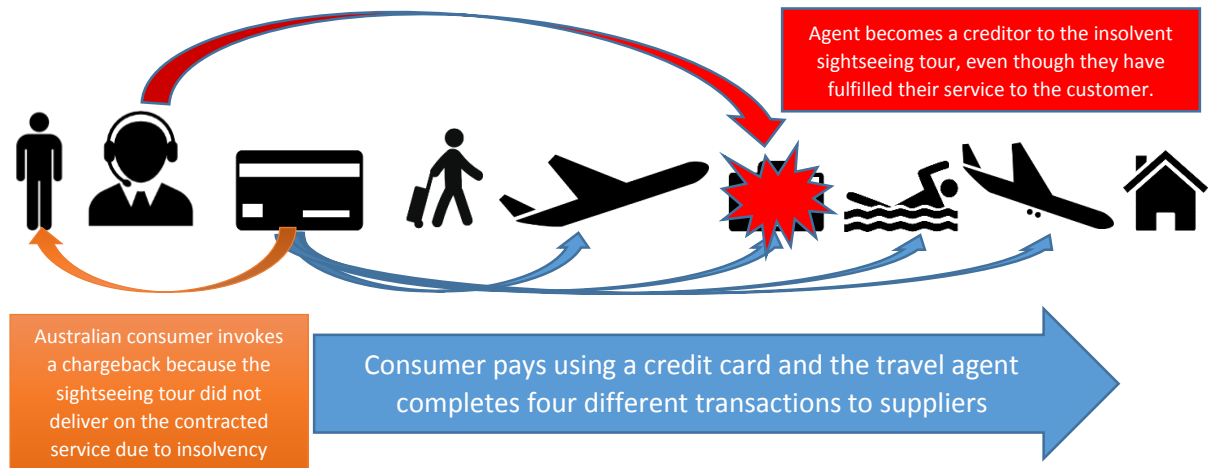


Graphic 5 – typical retail experience and chargeback risk to merchants



Such high risk exposure means that merchant acquirers are requiring large lump sum bonds from Australian travel agents to act as guarantee against this risk. These bonds cannot be provided without significantly impacting the viability of the business due to the small margins in a high turnover industry. A person choosing to purchase their travel package through a travel agent is also more likely to use a high value card so as to activate other auxiliary benefits including free travel insurance and accumulate frequent flyer points.

Graphic 6 – Travel agent prepayment risk and becoming a creditor



Some Australian travel agents have sought to minimise their exposure to this chargeback risk through pricing this risk into their credit card surcharge rate as a "reasonable cost of acceptance" of a credit card (RBA Guidance Note entitled "Interpretation of the Surcharging Standards", 2012). This is not currently included within the RBA surcharging Guidance Note as a cost that can be appropriately included as a "reasonable cost of acceptance", even though the industry has requested this from the RBA (RBA, 2012).

These surcharge fees are only payable on transactions using credit cards; meaning 51% of consumers who do not use a credit card are not cross-subsidising those that do. AFTA notes, that while not formally included in the RBA issue paper (RBA, 2015), such pricing strategies are aligned to the principles of the issue paper, and the RBA issue paper therefore should formally consider this matter as part of the RBA's overarching review of card payments regulation. Furthermore, AFTA requests that the RBA confirm that the list of "reasonable costs of acceptance" that may be included in a credit card surcharge fee (as provided in the Guidance Note) are not exhaustive. Alternatively, AFTA requests that the list be updated to specifically include, in the category of the "Merchants' own costs related to card acceptance":

If the merchant is not the ultimate service provider (for example, a travel agent), the merchant's actual or potential costs or expenses associated with any chargeback that may arise due to the failure of a third party to supply goods or services paid for in advance by use of the card, including as a result of insolvency of that third party.

AFTA also requests that the RBA consider reviewing the ability for consumers to request a chargeback against an agent (where the booking, payment and confirmation services required of a travel agent have been fulfilled) because of end supplier failure. This would ensure that the risk is placed against the end supplier of the service of product (the principal on whose behalf the travel agent makes the travel booking) and not the agent.

Reference List:

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