



**AUSTRALIAN BANKERS'
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24 April 2015

Dr Tony Richards
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Dear Tony,

Review of Card Payments Regulation, Issues Paper, March 2015

The Australian Bankers' Association (**ABA**) welcomes the opportunity to contribute to the Reserve Bank of Australia (**RBA**) "Review of Card Payments Regulation" (**Issues Paper**).

The ABA welcomes the review and agrees with the sentiment expressed by the RBA that the review is an opportunity to think very carefully about the issues, to assess the evidence and experience since previous reforms were implemented in 2003, and consider if there is an actual case to make incremental or more significant changes to the existing policy framework.

The ABA would also like to express our support for the submission of The Australian Payments Clearing Association (**APCA**), as we are broadly aligned as an industry with key messages expressed in their feedback.

The Payments System Board (**PSB**) was established as a result of the Wallis Report to promote efficiency, competition and stability in the payments system. There have been significant changes in the payments system since the RBA was given its powers to regulate in 1998. There are considerably more players, greater transparency around interchange fees, and clearer signals between costs and prices. An ever expanding range of payment instruments and mechanisms are now available to consumers and merchants, supported by an effective system of industry self-regulation and cooperation. To this end, the ABA view is that the focus of this review should be on how competition and efficiency can be further enhanced and system integrity be preserved as payment technologies evolve.

The Issues Paper as it stands does not identify any significant market failure which would now require a costly regulatory intervention to further contribute to an already efficient and competitive payments system. The RBA should instead seek to have the participants of this mature system resolve any perception of market failure through the interplay of competitive pressures. Competition has already resulted in a number of innovations (i.e. NFC, PIN and self-checkout innovations) yielding productivity gains for merchants. The RBA also needs to be mindful of the primary need to maintain the security and stability of card payment networks.

The ABA is concerned that the Issues Paper has insufficient focus on overall economic welfare and is perhaps too focused on one segment of the system i.e. merchant pricing. Even then, it is not clear that the RBA have evidenced the need for intervention. While the ABA welcomes and supports this important review, ultimately the need for any regulatory intervention must be clearly commensurate with the problem being addressed.

The impact of this review must also be considered in the light of the banking industry's significant financial commitment to the New Payments Platform (**NPP**). The NPP is being developed collaboratively by authorised deposit-taking institutions. It is the industry response to the RBA's strategic objectives on payments innovation. The NPP's multi-layered infrastructure has been designed to promote competition and drive innovation in payment services. It ensures the NPP will be equipped to meet the evolving needs of Australians in the digital age and beyond.

Overall, reforms should not impede the migration to new more efficient (card and other) payment channels. Unnecessary additional regulation and associated costs can act as an impediment to the adoption of new technologies. Alongside continuing to facilitate competition and innovation, the RBA should also be promoting the decline of less efficient payment methods such as cheques and cash.

The ABA believes the RBA has not yet established the case for additional regulation, it should be considered only as a last resort option to address a real and identified market failure that cannot otherwise be addressed by industry initiatives. The RBA should resist the temptation to intrude into otherwise bi-lateral contractual relationships between a scheme and its members.

The ABA would like to offer some observations on key issues raised in the Issues Paper.

Interchange Fees

In regards to broadening interchange fee caps to include other payments between schemes and issuers, the ABA does not support that all payments between schemes and issuers should be included in the interchange fee calculation.

The ABA agrees with the RBA in that there is a degree of ambiguity in how prepaid cards are dealt with under the interchange benchmarks. The ABA supports the proposition that the treatment of prepaid cards should be aligned to those instruments of similar economic substance i.e. debit cards. The ABA also notes that the business model behind prepaid card can differ to that of debit cards; therefore further discussion will be needed to ensure any reform does not hinder innovation and growth in any particular card sector.

Lowering interchange caps

The FSI Final Report suggests that payments system efficiency could be enhanced by lowering interchange fee caps, with the benefits including lower product prices for all consumers as a result of lower merchant service fees, and less cross-subsidisation in the payments system. The ABA does not support the further lowering or removal of interchange fees. It is suggested in the FSI Final Report that lower merchant service fees will flow through in the form of lower product prices; this is not a guaranteed outcome and not an adequate basis for regulatory intervention. The RBA Issues Paper therefore provides no rationale for a further reduction in interchange fee caps, equally there is no evidence of a market failure warranting such an intervention. The Issues Paper notes¹ that Australian interchange rates are already low by international standards; further reductions may have unintended consequences for adjacent industries or for product types that rely on interchange fees to be economically viable (e.g.

¹ Page 24, Review of Card Payments Regulation - Issues Paper, March 2015

commercial cards). It is the ABA's view that such changes will not result in a more efficient, secure and competitive payments system.

In regards to the proposal to replace weighted-average interchange caps with hard caps. The ABA believes that any 'hard cap' would need to be designed in a way that promoted effective competition between 3 and 4 party schemes. The ABA would welcome further discussion on this proposal. The Issues Paper does not sufficiently justify why such a change needs to be made. One option for further discussion could be for a cap around the retention of the weighted-average caps at current levels. The ABA would also encourage the RBA to look beyond the new European Union (EU) payments regulation; the Canadian approach to interchange fees (widely welcomed by Canadian merchants²) may be more appropriate benchmark for Australia given the similarities between the banking sectors of the Australian and Canadian jurisdictions.

The ABA does not support imposing caps as the lesser of a fixed amount and a fixed percentage of transaction values, particularly for credit transactions, as in this case costs typically are proportional to transaction size and as such this change may have unintended consequences that reduce the efficiency of the payment system. The ABA notes that certain schemes already apply this approach in selected cases, however the approach is complex and very costly to implement.

The ABA is also opposed to the view that 'buying groups' is an effective and efficient regulatory response. Conceptually, aspects of the idea have value, however in practice this change would introduce significant cost and complexity (e.g. in relation to managing buying group members, multiple group membership etc.). The ABA notes that such an initiative would not be required under an interchange fee regime based on a cap around current weighted average interchange fees.

Surcharging

Consistent with the ABA submission³ to the 2007/08 Payments System Review, the ability for merchants to surcharge undermines the rationale for interchange regulation which aims to configure retail payment prices according to underlying resource cost. However, instances of excessive surcharging are a concern as this can adversely impact on payments system efficiency.

The ABA notes and agrees with APCA's existing policy position that market and self-regulatory based solutions or existing legislation should be explored before consideration of any new price capping response to address excessive surcharging. This includes the application of existing consumer protection provisions on pricing.

Excessive surcharging which is a potential indicator of the misuse of market power, rather than an underlying payments regulation issue, should be referred to ACCC. In regard to the seeking of views on targeted changes to reduce particular cases of excessive surcharging; a simple cap or upper limit might be a useful compromise for consideration.

The ABA also agrees with APCA that the FSI recommendation for three-tiered surcharging not be pursued. ABA members have indicated that the technology changes required to underpin differential surcharging would be significant, and would divert finite resources from other important payment related initiatives like the NPP.

The ABA notes that the above ABA position on surcharging is not a universally held view across our membership. The ABA would encourage the RBA to meet with interested parties to discuss potential options before any further decision is made.

² <http://www.fin.gc.ca/n15/15-040-eng.asp> Department of Finance, Canada (April 2015)

³ <http://www.rba.gov.au/payments-system/reforms/review-card-reforms/pdf/aba-31082007.pdf> ABA Submission to the 2007/08 Payments System Review.

Other possible regulatory changes

The ABA also has views on some other potential regulatory changes that could improve the way that market forces operate in the card payments system. The ABA supports measures to improve transparency such as better identification of debit and credit cards (both visually and electronically), but notes some banks may incur significant costs to implement such a change. The ABA does not support providing merchants and cardholders with real time pricing information given the significant technology challenges involved and the operational implications for both the merchant, their staff and the customer.

The ABA does not support further easing of 'honour-all-cards' rules to allow merchants to decline to accept cards with high interchange fees as this could add confusion and friction to the payments process. The ABA believes that merchants should accept all credit cards from a given scheme and that measures to limit interchange are a more appropriate action.

The ABA does not support the proposal to enable merchants to choose which scheme and/or network to route transactions through. The ABA is concerned that network routing other than that made at the direction of the customer, would lead to customer confusion and complaints as it may result in some features the customer expected to have in relation to the payment not applying (e.g. insurances or points). This would not be a satisfactory outcome for consumers.

In regards to clarifying arrangements for competing payment options within a single device or application, the ABA strongly supports the principle of customer choice, and would support changes to remove discriminatory routing and limit attempts to restrict payment methods.

It is the view of the ABA and its members that any review of card payments regulation or discussion about policy settings should seek to ensure that the payments system continues to achieve a balance between security, stability, convenience and confidence, while maintaining competitive tensions and positive outcomes for consumers.

The ABA believes that the existing framework provides sufficient flexibility to facilitate innovation and competition while being in the best interest of the public, and has already proved effective as framework for the management of systemic risk within the financial system.

The ABA looks forward to the opportunity to further discuss the options once the RBA has considered all submissions.

Yours sincerely,



Aidan O'Shaughnessy