

The Regulatory Framework for the EFTPOS System: Final Reforms and Regulation Impact Statement

NOVEMBER 2012

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Executive Summary

The regulatory arrangements under review relate to certain interchange fees in the EFTPOS system and access to the system. Interchange regulations were first put in place in 2006 to bring interchange fees in the two types of debit system operating in Australia – EFTPOS and the international debit schemes – closer together to promote competition and efficiency. At that time, the EFTPOS system was characterised by bilateral interchange arrangements between each pair of participants, making it hard to renegotiate the fees once they were set and hence for competition to drive interchange fees lower. At the same time, a central scheme was setting fees for the international scheme debit systems, with fees flowing in the other direction – from the merchant’s bank to the card issuer. The Payments System Board (the Board) of the Reserve Bank (the Bank) became concerned about the potential for higher resource cost systems to grow at the expense of the lower-cost EFTPOS system. A related issue was access for new and prospective participants, given the difficulty and cost at that time involved in negotiating interchange and connection agreements with each EFTPOS participant.

Reflecting these concerns, the Bank introduced a cap and floor on interchange fees paid to the acquirer in the EFTPOS system, and a cap on the cost for new participants to establish a connection with an incumbent participant. At the time these regulations were put in place, the Bank aimed to ensure that interchange fees were closer in the two types of debit systems and more reflective of resource costs, and that neither unfavourable interchange fees nor unreasonably high connection costs could be used by incumbents to frustrate access for prospective participants in the EFTPOS system.

Significant developments in the industry since that time have meant that the regulatory framework may no longer be fulfilling its original objectives. Specifically, a central scheme (EFTPOS Payments Australia Limited, or ePAL) was established in 2009 to manage and promote the EFTPOS system, and the scheme introduced a multilateral interchange fee schedule with fees flowing to the issuer in late 2011. The architecture of the EFTPOS system has also changed, with a central ‘network cloud’ – the Community of Interest Network – replacing the physical element of the bilateral connections between participants. ePAL now has the ability to set access arrangements in the interests of developing the scheme, which was not a feature of the previous bilateral arrangements.

The majority of EFTPOS transactions have now shifted to ePAL’s multilateral interchange fees. Although the Bank in 2010 varied its interchange fees regulation for the EFTPOS system to place the same cap on these multilateral interchange fees as its regulation of the Visa Debit system – that is, a cap on fees flowing to the issuer – its regulation of bilateral EFTPOS fees has remained unchanged, as has its access regulation. By so constraining these remaining bilateral interchange arrangements, this combination of regulations potentially makes it more difficult for ePAL to set interchange fees than under the regulations that apply to the other debit systems and provides less incentive for issuers to promote the EFTPOS scheme over time, which may constrain ePAL’s ability to compete with the other systems. The status quo therefore has the potential to be detrimental to the

viability of a major payment system in Australia and undermine the original intent of the EFTPOS regulations – namely to promote efficiency and competition in the payments system. At the same time, regulation of interchange fees (both bilateral and multilateral) is likely to still be necessary to prevent competition from driving interchange fees higher, since higher fees can be used to provide additional incentives for issuers to promote a scheme and for cardholders to use a particular method of payment.

In line with these concerns, the Board announced in September 2011 that it would undertake a review of the regulatory framework for the EFTPOS system to ensure that the regulations continue to meet their original objectives in light of recent changes to the EFTPOS system. Factors considered in this review relate to the Board's legislative mandate, which may be broadly characterised to cover efficiency, competition and stability in the payments system.

The Bank has considered a range of options for regulating bilateral interchange fees and access – these are set out in more detail in the document, but in brief:

- Should regulation of bilateral EFTPOS interchange fees (currently between \$0.04 and \$0.05 to the acquirer):
 - remain unchanged
 - adopt a benchmark that is closer to that for multilateral interchange fees
 - place bilateral and multilateral interchange fees under a common benchmark
 - eliminate bilateral interchange fees entirely
 - cease (i.e. be revoked without imposing a new standard)?
- Should the 'no-discrimination' provisions of the EFTPOS Access Regime be reworded to be effective under the changed EFTPOS arrangements or should they be omitted?
- Should recalculation of the access charge cap for the EFTPOS system be brought forward?
- Should the access charge cap be retained?
- Should an Access Regime continue to apply to the EFTPOS system now that ePAL has been established?

After taking into account views expressed during consultation and considering the relative merits of the available options, the Bank has decided to change its regulations by adopting the same benchmark for bilateral EFTPOS interchange fees as that for multilateral EFTPOS fees and the Visa Debit system – that is, a cap of \$0.12 paid to the issuer. The key benefit to putting in place a common benchmark for the regulation of bilateral and multilateral interchange fees in the EFTPOS system is that it would harmonise the regulation of interchange fees across all three debit card systems. This would place ePAL on a similar regulatory footing to the other debit schemes and encourage competition within the same regulatory framework. This therefore allows ePAL to have greater influence over bilateral fees, which are nonetheless capped at the same level as all other domestic debit interchange fees.

The Bank has also decided to revoke the EFTPOS access regulations currently in place – that is, the cap on connection charges and restrictions on interchange fees offered to new entrants – once ePAL has put satisfactory access arrangements in place. This is consistent with the Bank's approach to imposing regulations only where it has identified concerns with efficiency, competition and stability in the payments system. The recent establishment and widespread adoption of multilateral arrangements within the EFTPOS system means that new entrants can access the system on similar terms to most existing members, meeting the intent of the existing Access Regime without 'no-discrimination' provisions, in the interests of competition and efficiency

in the payments system. More generally, the Bank has formed the view that EFTPOS access issues may be best handled by ePAL as the governing scheme. This is likely to be more efficient and involve lower compliance costs for participants than the current approach, which imposes access obligations on participants via the Bank's Access Regime, the industry's Access Code and ePAL's rules. The preferred regulatory approach would be consistent with that taken for the other debit schemes in the context of restrictions on connection charges and pricing for access purposes.

The direct effect of the regulatory changes is likely to be in the order of cents or fractions of a cent on the average interchange fee, and any costs to consumers from the implied higher costs to merchants may be offset by lower costs (in terms of transaction fees) for making payments. More broadly, placing the three competing debit card systems on an equivalent regulatory footing is likely to result in improved competitive arrangements within the Australian payments system. In summary, the changes outlined in this document are expected to promote competition and efficiency in the payments system, and will modernise the Bank's regulatory regime for the EFTPOS system to take into account changed institutional arrangements.

1. Introduction

The Payments System Board (the Board) of the Reserve Bank (the Bank) announced in September 2011 that it would undertake a review of the regulatory framework for the EFTPOS system to ensure that the regulations continue to meet their original objectives. The review has become necessary because of industry developments in recent years. Much of the regulatory framework was put in place before the establishment of the new management structure for the system under EFTPOS Payments Australia Limited (ePAL) and the establishment of the Community of Interest Network (COIN), which simplified connections between participants in the system. The original regulatory framework did not anticipate the establishment of a scheme to govern the EFTPOS system, the subsequent change in the structure of EFTPOS interchange fees, nor the potential change in access arrangements as a result of participants' migration to the COIN.

The aim of the review is to ensure that the regulation of the EFTPOS system continues to support competition and efficiency in the payments system as a whole, in light of the significant changes to the governance and architecture of the system. That is, the review is aimed at updating the existing regulatory framework to account for these changes.

As part of this review, the Board consulted on a new designation for the EFTPOS system that would be more appropriate to the system's new governance structure and, subsequently, on the various options for the future regulatory framework for the designated system. The Board sought views on whether the provisions of the existing interchange fees Standard and Access Regime should be incorporated into the new regulatory framework for the EFTPOS system under its new designation and, if so, how they should be incorporated. In line with the views expressed during consultation, the Board decided at its November 2012 meeting that bilateral interchange fees in the EFTPOS system should be capped at the same benchmark as multilateral interchange fees; and that the Access Regime should be revoked, subject to ePAL having put appropriate access arrangements in place.

The rest of this paper is structured as follows. Section 2 discusses the mandate of the Board, while Section 3 provides the background to the review, including the existing regulatory framework, recent industry developments and the Board's decision in May 2012 on a new designation for the EFTPOS system. Section 4 discusses the specific issues that these developments have raised for the regulatory framework and the objectives of the current review. Section 5 outlines the range of options the Bank has considered for reforming its regulations, while Section 6 discusses the draft instruments (a standard for interchange fees and an access regime for the designated system) that the Bank released in June 2012 as part of its consultation on the broader regulatory framework. Section 7 summarises the views expressed by various parties during consultation, while Section 8 evaluates the options. In light of this evaluation, Section 9 presents the Bank's preferred approach, and Section 10 outlines its implementation.

2. The Payments System Board's Mandate and Objectives

The Board's responsibilities stem from the Financial System Inquiry, whose findings and recommendations were released in 1997.¹ The Inquiry found that, while earlier deregulation had improved competition and efficiency in Australia's payments system, further gains were possible. To that end, it recommended the establishment of a board at the Bank with the responsibility and powers to promote greater competition, efficiency and stability in the payments system. The government accepted those recommendations and established the Payments System Board in 1998.

The Board's responsibilities are set out in the *Reserve Bank Act 1959*, which requires the Board to determine the Bank's payments system policy so as to best contribute to: controlling risk in the financial system; promoting the efficiency of the payments system; and promoting competition in the market for payment services, consistent with the overall stability of the financial system.

At the time the Board was established, the government also provided the Bank with specific powers to regulate payment systems in order to implement the Board's policies. The most relevant powers in the context of the card payment reforms are those set out in the *Payment Systems (Regulation) Act 1998* (the Act). Under the Act, the Bank has the power to designate payment systems and to set standards and access regimes in designated systems.² The Act also sets out the matters that the Bank must take into account when using these powers, including the desirability for payment systems to be financially safe for use by participants, efficient and competitive, and not materially cause or contribute to increased risk in the financial system.

1 Financial System Inquiry (Wallis Committee) (1997), *Financial System Inquiry – Final Report*, Australian Government Publishing Service, Canberra. Available at <<http://fsi.treasury.gov.au/content/FinalReport.asp>>.

2 Designation under section 11 of the *Payment Systems (Regulation) Act 1998* is the legal means by which a payments system comes under the Bank's regulatory powers – it is simply the first of a number of steps the Bank must take to exercise its powers and has no other effect. See more generally the Bank's website at <<http://www.rba.gov.au/payments-system/policy-framework/psb-board.html>>. The Board's preferred approach has been to treat its regulatory powers as 'reserve powers' to be exercised if other methods of persuasion and implementation prove to be ineffective.

3. Background

The EFTPOS system is one of two types of debit card systems in Australia, along with systems operating under two international card schemes (MasterCard and Visa). Both types of system allow cardholders to make payments to merchants from a deposit account and, in some cases, to withdraw cash at the merchant. Debit/ATM cards are issued by financial institutions typically as part of a deposit account. Some of these cards are 'multi-network' cards, which provide – through a single card – point-of-sale access to the cardholder's funds via the EFTPOS system as well as through the international schemes. The system utilised is determined by whether the 'cheque'/savings' or 'credit' button is pressed at the terminal: in the former case, the transaction is processed through the EFTPOS system and in the latter, through the relevant international scheme.

Although the majority of debit card purchases are made through the EFTPOS system in Australia, they account for only a very small proportion of all non-cash payments in Australia. There were \$121 billion in EFTPOS purchases in the year to September 2012, accounting for around 73 per cent of all debit card purchases, 29 per cent of all card purchases, 0.8 per cent of non-cash retail payments, and 0.2 per cent of the \$56 trillion value of non-cash payments in the year.³

The current regulatory framework for the EFTPOS system reflects reforms undertaken by the Bank to address a number of concerns regarding the system. These included the nature of competition between EFTPOS and the debit card systems of the international schemes; the effect on efficiency in the payments system as a whole from the difference in interchange fees in the two types of debit card systems; and the difficulties faced by entrants seeking access to the EFTPOS system. As a result, the Bank imposed (and later varied) an interchange fees standard and introduced an access regime to complement an industry-developed access code for new entrants seeking access to the EFTPOS system. The history of these reforms is discussed in more detail below.

At the time these regulations were first imposed, governance of the EFTPOS system was based largely on bilateral agreements between financial institutions. In particular, interchange fees and connection arrangements were both agreed bilaterally between individual participants in the system, making it difficult for the EFTPOS system to adapt to changing technology and the demands of end users, and to compete effectively with the other debit systems. The Bank noted these concerns and encouraged the industry to establish a scheme that could promote and make decisions in the interests of the EFTPOS system as a whole; the industry's response was the establishment of ePAL in April 2009.⁴ Since its establishment, ePAL has been active in promoting the use of EFTPOS and in positioning the system in a way that makes it attractive to the

3 Non-cash payments comprise retail payments (cheques, direct debits, direct credits, debit cards, credit cards and BPAY) and transactions settled through the real-time gross settlement (RTGS) system, excluding intraday repos and batch settlement transactions.

4 See Reserve Bank of Australia (2008), *Reform of Australia's Payments System: Conclusions of the 2007/08 Review*, September. Available at <<http://www.rba.gov.au/payments-system/reforms/review-card-reforms/review-0708-conclusions/index.html>>.

various stakeholders. A notable strategic decision made by ePAL has been the introduction of a common multilateral interchange fee schedule for the EFTPOS system.

Given the major changes in the landscape for the EFTPOS system that these developments represented, the Bank announced in September 2011 that it would undertake a review of the regulatory framework for the system. As a formal step in the review, in March 2012 the Bank consulted on a new designation of the EFTPOS system. The Board decided in May 2012 that the original EFTPOS designation was no longer appropriate in light of the changes to the EFTPOS system since it was first designated, and a new designation would be put in place.

The infrastructure, processes and concepts in payment systems can be quite technical. To assist the reader with understanding these details, Box A draws upon material from work done by the Bank over the past few years to outline the key processes and principles, and the market failures that may arise, in relation to interchange fees. A Glossary of key terms and concepts is provided at the end of the document.

3.1 Interchange Fees

Interchange fees are a key difference between EFTPOS and the other debit systems. Prior to the establishment of ePAL, EFTPOS interchange fees were bilaterally negotiated and paid by card issuers to card acquirers. Interchange fees in the international debit systems, by contrast, are centrally set by the scheme operator and flow from the acquirer to the issuer. This difference had been a longstanding public policy concern, and was discussed by the Bank and the Australian Competition and Consumer Commission (ACCC) in a 2000 study.⁵ The study found that the difference in interchange fees between the international debit schemes and EFTPOS (up to \$1.15 on a \$100 transaction) did not reflect the underlying costs of each system; it also found that bilateral negotiations over access disadvantaged smaller providers seeking entry to the EFTPOS system.

At that time, the Board was concerned that interchange fees in both types of systems were subject to limited competition and that the large discrepancy between fees provided issuers with an incentive to promote the international debit schemes over EFTPOS, even though the resource costs of the latter were lower. Competitive pressure in the international debit systems tended to raise interchange fees above efficient levels (see Box A). Normal competitive pressures also did not act on EFTPOS interchange fees; once the bilateral fees were set, it was very difficult, if not impossible, to renegotiate them.

As a result of this and the history of the two types of systems, the difference in interchange fees became entrenched. This meant that prices to cardholders did not reflect the relative resource costs of the different systems, resulting in the potential for the higher-cost systems to grow at the expense of the lower-cost EFTPOS system and for merchants' payment costs to rise. The Board was therefore of the view that competition and efficiency would be promoted if the interchange fees in the two types of debit systems were closer together.

⁵ Reserve Bank of Australia and Australian Competition and Consumer Commission (2000), *Debit and Credit Card Schemes in Australia: A Study of Interchange Fees and Access*, October. Available at <<http://www.rba.gov.au/payments-system/resources/publications/payments-au/interchg-fees-study.pdf>>.

Box A

Key Concepts – Interchange Fees in Card Payment Systems

A card payment typically contains four parties:

- the person making the payment (cardholder)
- the person receiving the payment (merchant)
- the cardholder's financial institution (card issuer)
- the merchant's financial institution (card acquirer).

The financial institutions involved in the payment typically charge fees to their customers for payment services, such as account-keeping fees and sometimes transaction fees for cardholders, and merchant service fees for merchants. The financial institutions may also pay 'transfer' fees to one another – known as 'interchange fees' and typically set by the scheme (or network) managing the payment system – for each transaction. These interchange fees are often not transparent; cardholders and merchants do not typically see them, but they have an impact on the fees that cardholders and merchants pay.

Interchange fees may alter the effective cost of card payments for cardholders and merchants. For example, if an interchange fee flows from the merchant's financial institution to the card issuer, the merchant is likely to be charged that fee plus a margin for the provision of card acquiring services. At the same time, the cardholder may receive benefits funded by the fee that their issuer receives – including reward points, interest-free periods on credit transactions or lower account-keeping fees than otherwise – and may even face a negative price (i.e. effectively being subsidised to use their card).

The higher the interchange fee (where the interchange fee is defined as the amount paid by the acquirer to the issuer), the more attractive it is to issue a card and the more benefits the card issuer can offer cardholders to use the card. At the same time, merchants typically find it difficult to decline acceptance of some cards, even if fees are rising; the reason a merchant accepts cards is to sell goods and services, so it usually seeks to provide customers with as many payment methods as possible. There has therefore been a tendency for interchange fees to be set at relatively high levels, adding to merchants' costs while providing benefits to card issuers and cardholders.

As a result of these incentives, interchange fees are not subject to the normal forces of competition. Indeed, competition may drive interchange fees higher, since higher fees can be used to provide additional incentives for issuers to promote a scheme and for cardholders to use a particular method of payment. The result can be a series of competitive increases in fees, potentially resulting in systems with high interchange fees driving out other systems, regardless of the other attributes of those systems or the relative resource costs of providing them.

In the EFTPOS system, interchange fees had historically flowed from the card issuer to the card acquirer (Figure A1) – the opposite direction of fee flow to the other debit card and credit card systems operating in Australia (and most systems in other countries). EFTPOS interchange fees had previously remained unchanged

for many years despite significant changes in costs and revenues on both the issuing and acquiring sides of the market. Following reforms by the Bank and changes introduced by ePAL, interchange fees for most EFTPOS transactions now flow from the acquirer to the issuer, although a small number of participants have, for now, retained arrangements that provide for fees flowing from the issuer to the acquirer (Figure A2).

The extent to which these interchange fees are passed on to merchants, cardholders and consumers more generally may depend on several factors exogenous to competition in the payments system. A merchant with a dominant position in its market, for instance, may be more able than a smaller merchant to pass on to consumers the fees it must pay to its acquirer; a merchant may also decide to pass on its costs of accepting card payments to all consumers via the general prices for its goods or services, rather than directly to cardholders via a surcharge.

Figure A1
Selected Flows in an EFTPOS Transaction (pre-ePAL)

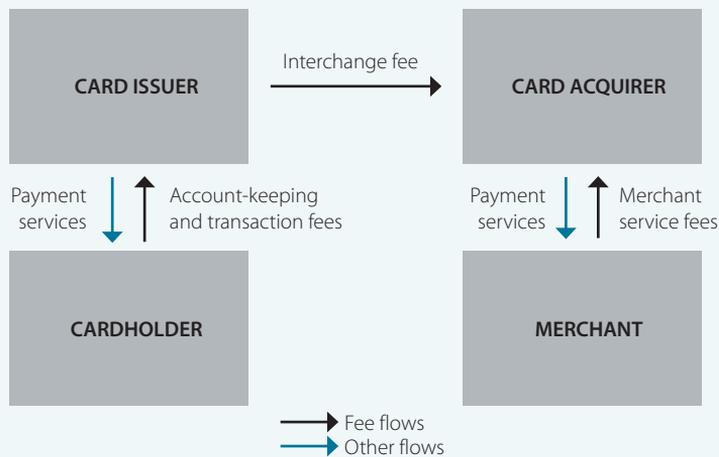
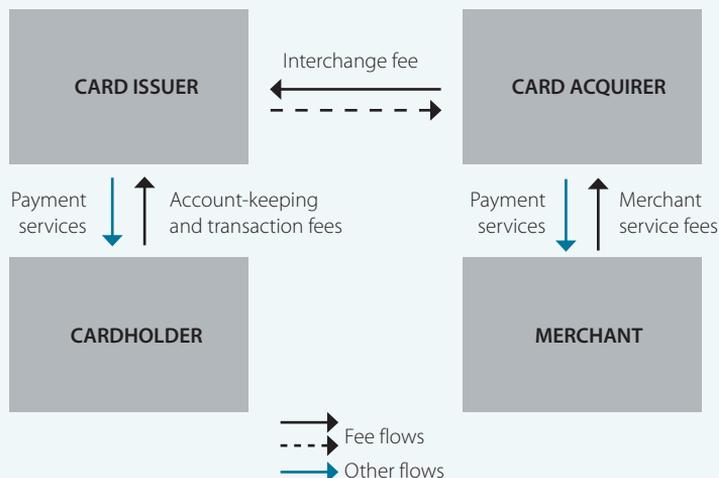


Figure A2
Selected Flows in an EFTPOS Transaction (current)



Reflecting these concerns, the Bank regulated to address the difference in interchange fees in the two types of debit systems.⁶ For the EFTPOS system, the Bank introduced a standard in 2006, *The Setting of Interchange Fees in the EFTPOS System* (the interchange fees Standard), to reduce bilateral interchange fees for purchases from around \$0.20 paid to the acquirer to within a range between \$0.04 and \$0.05.⁷ The floor-and-cap approach was taken because of the bilateral negotiations required to access the EFTPOS system at the time. The Bank's concern was that, without a floor and a cap, new entrants might not be able to negotiate interchange fees on as favourable terms as existing participants, which could be detrimental to competition and efficiency.

At the same time, the Bank also set an interchange fees standard on the Visa Debit system (the Visa Debit interchange fees Standard). Prior to the reforms, the Visa Debit system had interchange fees of around 0.95 per cent of the transaction value paid to the issuer – the opposite direction to the flow of interchange fees in the EFTPOS system. The Visa Debit interchange fees Standard imposed a cap of \$0.12, paid to the issuer, on the weighted average of interchange fees paid in the Visa Debit system.⁸

The introduction of interchange fees standards in the two debit card systems resulted in not only a reduction in interchange fees in each system, but also a narrowing in the differential of fees between the systems, from \$1.15 to around \$0.17 on a \$100 transaction (Graph 1). Nonetheless, the Board was concerned that the remaining difference preserved a strong incentive for issuers to promote the use of international scheme debit over EFTPOS, despite the two transaction types drawing funds from the same deposit account. That such incentives remained was evident in the increased promotion of the international schemes by some issuers from the late 2000s, which saw the share of debit card transactions processed through the MasterCard and Visa networks increase (Graph 2).⁹ One outcome could have been the decline of the lower-cost EFTPOS system in favour of the higher-cost debit systems of the international card schemes solely as a result of the difference in interchange fees, regardless of the services each system offered.¹⁰

Concerns about the ability of the bilateral EFTPOS system to respond to competition from the international debit card schemes led the Board to encourage the establishment of an EFTPOS scheme with centralised governance during its 2007/08 review of the payments system reforms; ePAL was established by the industry in April 2009. The Bank subsequently varied its interchange fees Standard to accommodate the possibility that ePAL might wish to set a multilateral interchange fee for the EFTPOS system. The Bank took the view that ePAL should be able to do so within the same regulatory constraints as the Visa Debit system. As a result, the current Standard distinguishes between interchange fees agreed bilaterally (which remain constrained between \$0.04

6 A self-regulatory solution – of setting interchange fees in the EFTPOS system to zero – was initially proposed by the industry and approved by the ACCC in 2003. This was subsequently overturned by the Australian Competition Tribunal. With little prospect remaining of an industry-initiated solution, the Bank designated the EFTPOS system in September 2004 with a view to establishing lower interchange fees via a standard. After delays related to further legal action and the development of an industry access code for the EFTPOS system, the EFTPOS interchange fees Standard was finally released as part of a regulatory package for the debit card systems in April 2006 and came into force from July that year. For more detail, see Reserve Bank of Australia (2006), *Reform of the EFTPOS and Visa Debit Systems in Australia: Final Reforms and Regulation Impact Statement*, April. Available at <<http://www.rba.gov.au/payments-system/reforms/debit-card-systems/impact-stmt-apr06/index.html>>.

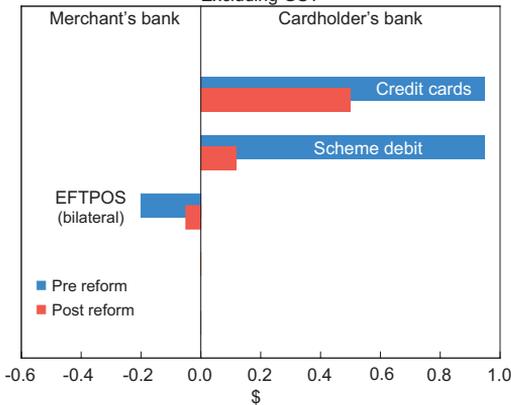
7 The cap was set based on the cost to the acquirer of authorisation and processing of EFTPOS transactions; the floor was specified to be 80 per cent of the cap paid to the acquirer.

8 The cap was set based on the cost to the issuer of authorisation and processing of debit transactions in the international schemes. MasterCard provided a written undertaking to the Bank to meet the same benchmark for the Debit MasterCard system.

9 For instance, some issuers replaced their customers' EFTPOS-only cards with 'multi-network' cards with both EFTPOS and MasterCard/Visa debit functionality, and encouraged customers to press the 'credit' button (instead of 'cheque' or 'savings') at the point of sale to route transactions through the networks of the international schemes.

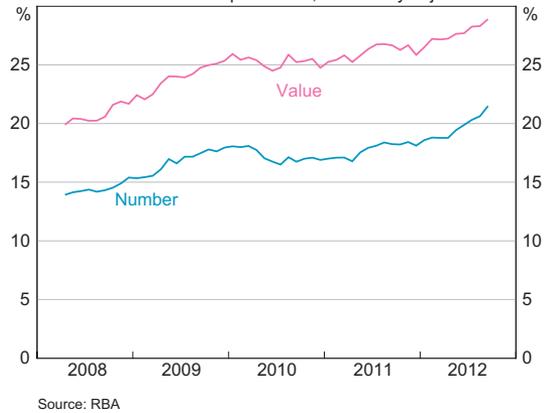
10 Some of the higher cost for the international schemes reflects additional functionality, such as online and overseas use. For more detail on relative costs, see Schwartz C, J Fabo, O Bailey and L Carter (2008), 'Payment Costs in Australia', in *Payments System Review Conference*, proceedings of a conference held by the Reserve Bank of Australia and the Melbourne Business School, Sydney, pp 88–138. Available at <<http://www.rba.gov.au/payments-system/resources/publications/payments-au/paymts-sys-rev-conf/2007/7-payment-costs.pdf>>.

Graph 1
Interchange Fees on a \$100 Payment
After the 2006 Reforms*
 Excluding GST



* The post-reform data show the benchmark for each system
 Source: RBA

Graph 2
MasterCard and Visa Debit Cards
 Share of debit card purchases, seasonally adjusted



Source: RBA

and \$0.05 paid to the acquirer) and those set on a common multilateral basis by ePAL, which are subject to a weighted-average cap of \$0.12 paid to the issuer – the same cap as in the Visa Debit interchange fees Standard.

Under this benchmark for multilateral interchange fees in the EFTPOS system, ePAL has a degree of flexibility to set different interchange fees for different transaction types, in line with other debit card schemes. For instance, it may choose to set interchange fees above \$0.12 on some transactions and below \$0.12 for others, so long as the transaction-weighted average of all multilaterally set interchange fees remains below the cap. However, the multilateral interchange fees set by ePAL are currently all well below the benchmark (Table 1). EFTPOS transactions in the highest interchange fee category currently attract \$0.05 payable to the issuer, and some transactions (purchases under \$15, charity payments and Medicare rebates) do not attract any interchange fees; interchange fees on transactions with a cash-out component remain payable to the acquirer, at \$0.14. ePAL also recently introduced a 'differential' interchange rate of between \$0.00 and \$0.05 payable to the issuer for purchases, and a differential cash-out rate of between \$0.14 and \$0.23, payable to the acquirer, for merchants meeting certain criteria set by ePAL. By contrast, the Debit MasterCard and Visa Debit schemes have a number of interchange fee categories – some set in *ad valorem* terms – which yield more than \$0.12 per transaction and rely on lower interchange rates in other categories to comply with the benchmark.

3.2 Access Framework

The Bank imposed the *Access Regime for the EFTPOS System* (Access Regime) in 2006 to complement the industry's *EFTPOS Access Code* (Access Code).¹¹ The Access Code, which was developed as a response to concerns on access to the EFTPOS system for new participants, is administered by EFTPOS Access Australia Limited. It sets out procedures for new entrants to negotiate and implement bilateral connections with existing EFTPOS participants by providing time frames for agreement on access terms and a dispute resolution mechanism for agreements not finalised within those time frames. The Bank's Access Regime adds two elements to this framework – it places a cap on the amount that an existing participant can charge an entrant to establish a new connection and places restrictions on the interchange fee terms that existing EFTPOS participants can offer new participants ('no-discrimination' provisions).

11 The Access Code is available at <[http://www.eftposaccess.com.au/public/eftpos01.nsf/live/IntroductoryGuide/\\$File/IntroductoryGuide.pdf](http://www.eftposaccess.com.au/public/eftpos01.nsf/live/IntroductoryGuide/$File/IntroductoryGuide.pdf)>.

The cap on connection charges prevents existing participants from charging unreasonably high connection fees, which may discourage new entrants. The cap is based on a survey of the cost of establishing a connection, and is currently set at \$87 776.

The Access Regime's 'no-discrimination' provisions prevent existing EFTPOS participants from using negotiations over interchange fees to frustrate access. These provisions require existing EFTPOS participants to offer interchange fee terms to new participants – whether an acquirer or an issuer – that are no less favourable than terms agreed with other existing participants. Because these provisions were written at a time when interchange fees in the EFTPOS system flowed only from issuers to acquirers, they specifically require that existing issuers offer prospective acquirers an interchange fee no less than the lowest fee paid to an existing acquirer, and prevent existing acquirers from demanding from prospective issuers an interchange fee greater than the highest fee they receive from an existing issuer.

ePAL currently plays a coordinating role in admitting new members to its multilateral interchange fee arrangements, with its *EFTPOS Scheme Rules* (Scheme Rules) setting out requirements for membership and obligations to admit applicants meeting those requirements.¹² Prospective participants still need to reach bilateral agreements on connections with existing participants in the system. ePAL's Scheme Rules do not currently place explicit obligations on members to facilitate direct technical access for prospective entrants as these provisions are contained in the Access Code and Access Regime.

3.3 Governance Arrangements and Recent Industry Developments

As noted above, the current regulatory framework for the EFTPOS system was put in place at a time when the governance of the system was based largely on bilateral agreements that determined interchange fees and connection arrangements between participants. While certain operational procedures and general standards for the exchange of EFTPOS (and ATM) transactions were set collectively by the Australian Payments Clearing Association (APCA), there was no central body responsible for promoting the use of EFTPOS, making strategic decisions about the system, or adjusting pricing to better compete with other card payment systems.¹³ Such a bilateral governance structure made it difficult for the EFTPOS system to adapt to changing technology and demands of end users, and to compete effectively with the international scheme debit systems.

The Board noted these concerns in its 2007/08 review of the payments system reforms and encouraged the industry to establish an EFTPOS scheme that could promote and make decisions in the interests of the EFTPOS system as a whole.¹⁴ In the Board's view, a scheme would be best placed to strike a balance between the interests of issuers, acquirers, merchants and cardholders, and would contribute to a more competitive environment for debit cards. The industry's response was the establishment of ePAL in April 2009.

ePAL is owned and funded by 14 member institutions (including two large merchants). ePAL has responsibility for managing and promoting the EFTPOS system on a commercial basis, and operates independently of its owners. Reflecting this, ePAL's Board (the highest decision-making body of the scheme) has three independent directors (including the chairman) in addition to the managing director and eight directors nominated by members. Like other company boards, ePAL's Board has duties and obligations under the law as well as the

12 The Scheme Rules are available at <<http://www.eftposaustralia.com.au/corporate/resources/scheme-rules>>. This Regulation Impact Statement uses 'member' and 'membership' with specific reference to ePAL members. In other contexts it uses the more general term 'participant'.

13 The operational procedures and general standards are set out in APCA's Consumer Electronic Clearing System (CECS) Manual and Regulations.

14 Reserve Bank of Australia (2008), *Reform of Australia's Payments System: Conclusions of the 2007/08 Review*, September. Available at <<http://www.rba.gov.au/payments-system/reforms/review-card-reforms/review-0708-conclusions/index.html>>.

Table 1: Multilateral Debit Card Interchange Fees^(a)
November 2012, dollars (unless otherwise specified) excluding GST

	EFTPOS	MasterCard	Visa
Electronic POS/ consumer electronic	0.045	0.060	0.080
Consumer standard	–	0.120	0.200%
Commercial/business/ corporate	–	0.910%	0.850%
Premium/platinum	–	0.500%	0.400%
Differential/strategic merchant	0.000 to 0.045	0.032 or 0.036	0.020 to 0.600
Contactless ^(b)	–	0.050	–
Government/utility	–	0.070	0.060
Service station/ petroleum	–	0.070	0.060
Supermarket	–	–	0.060
Education	–	–	0.060
Insurance	–	–	0.060
Transit	–	–	0.060
Low-value/ Micropayment ^(c)	0.000	0.004	–
Charity	0.000	0.000	0.000
Medicare Easyclaim refund	0.000	–	–
Recurring payments	–	0.100	0.060
Quick/express payments	–	0.060	–
Cash-out ^(d)	–0.136	–0.159	–
Differential cash-out ^(d)	–0.136 to –0.227	–	–
Secure Code merchant UCAF	–	0.080	–
Secure Code full UCAF	–	0.100	–
Benchmark	0.120	0.120	0.120

(a) Positive fees indicate those paid to the issuer; negative fees indicate those paid to the acquirer

(b) MasterCard *PayPass* purchases equal to or below \$60

(c) Purchases equal to or below \$15 for MasterCard and below \$15 for EFTPOS

(d) Applies to EFTPOS transactions with a cash-out component (including a combined cash-out/purchase transaction) and to MasterCard purchases with cash-out

Sources: ePAL website; MasterCard website; Visa website

company's constitution. ePAL has adopted a set of principles for interchange fee setting aimed at promoting use, issuance and acceptance of EFTPOS. It aims to achieve competitive net costs for both issuance and acceptance, and to review its interchange fee regime at regular intervals (at least annually). The principles are published on its website, as are the currently applying interchange fees.

Since its inception, ePAL has put in place scheme rules to regulate the activities of its members, covering some aspects of access, interchange fees, and technical operation and security rules; it has also taken an active role in promoting the use of EFTPOS. One strategic decision made by ePAL was to introduce a multilateral interchange fee schedule from October 2011. As discussed above, this schedule reverses the direction of interchange fees from previous bilateral arrangements on most purchase transactions such that a fee is now payable from the acquirer to the issuer – the same direction (but not magnitude) as in the international scheme debit systems. However, the multilateral interchange fee schedule does not currently apply to all EFTPOS transactions. For ePAL members choosing not to opt in to the schedule, existing bilateral agreements remain in place until they expire or are terminated. ePAL members may also bilaterally agree, under the Scheme Rules, to an interchange fee that is different from the multilateral schedule. Additionally, there remain participants in the current EFTPOS system that are not members of ePAL; these participants are not directly bound by ePAL's Scheme Rules, including its multilateral interchange fee schedule.¹⁵

Alongside these developments in governance arrangements, there have been significant changes to the underlying architecture of the EFTPOS system. The industry, with encouragement from the Bank, has worked since 2009 on migrating the exchange of messages in bilateral payment systems to the COIN, a central 'network cloud'. The COIN removes the need for participants to establish physical bilateral links to every other participant for messaging; instead, participants can establish a single physical connection to the COIN. By simplifying the physical connection process, the COIN has the potential to reduce the cost and shorten the time frames involved for new EFTPOS entrants to establish connections to existing participants.

3.4 A New EFTPOS Designation

In response to these changes in the EFTPOS system, the Board announced in September 2011 that it would undertake a review of the regulatory framework for the system. The aim of the review has been to identify whether regulation is still required and, if so, to ensure that the framework continues to meet the objectives of promoting effective competition, improving efficiency in the payments system as a whole, and providing fair access to new participants.

As a formal step in this review, the Bank issued a consultation document on the designation of the EFTPOS system in March 2012.¹⁶ This was judged to be necessary before a consultation on the entirety of the regulatory framework for the EFTPOS system could be undertaken, since the original designation no longer clearly defined the EFTPOS system, given the changes to governance arrangements and APCA rules (which were relied on to determine the scope of the original designation). After taking into account views expressed during

¹⁵ In other words, these entities are participants in the EFTPOS system as designated in 2004, but do not participate in the EFTPOS system as designated in 2012 (see Section 3.4).

¹⁶ Designation in itself has no effect on a payment system. It is a formal step the Bank must take before it can exercise its powers under the Act. For more detail on the EFTPOS designation consultation, see Reserve Bank of Australia (2012), *Review of the Regulatory Framework for the EFTPOS System: Consultation on Designation*, March. Available at <<http://www.rba.gov.au/publications/consultations/201203-replacing-eftpos-designation/index.html>>.

consultation, the Board decided in May 2012 to revoke the original designation (*Designation No 2 of 2004*) and impose a new designation of the EFTPOS system (*Designation No 1 of 2012*) based on ePAL's Scheme Rules.¹⁷

In the Board's view, it is in the public interest to align the definition of the EFTPOS system with the current rules and governance structure for the system. Revoking the original designation and imposing a new one with a scope that keeps pace with industry developments removes any uncertainty regarding the scope of the system and the status of participants. The Board decided that a 'narrow' designation based on ePAL's Scheme Rules – compared with a designation encompassing transactions outside the Scheme Rules – provides the clearest definition of the EFTPOS system. It considered that giving regulatory recognition to the central governing role that ePAL has now undertaken is the best way to promote competition between debit card schemes for two key reasons. First, defining the EFTPOS system this way is consistent with the regulatory treatment of the Visa Debit system in terms of designation. Second, this would support ePAL's ability to manage aspects of access or pricing that are regulated by the Bank, in a way that will support competition. The new designation of the EFTPOS system is set out in Attachment 1.

It should be noted that, despite the form of the 2012 designation, proprietary debit transactions may still occur outside ePAL's Scheme Rules. However, any regulation that might be imposed by the Bank on the new designated system would not apply to those transactions.¹⁸

As a technical matter in relation to timing, in May 2012 the Board determined that the original designation should remain in place until final implementation of the broader EFTPOS regulatory framework in order to avoid a period without any EFTPOS regulation in force (given that the existing interchange fees Standard and Access Regime refer to the 2004 designation). It should also be noted that because a new designation is in place, any new regulatory framework for the EFTPOS system would need to be put in place through new regulatory instruments (instead of varying the existing Standard and Access Regime).

17 For a more detailed discussion on the Board's EFTPOS designation decision, see Reserve Bank of Australia (2012), *Review of the Regulatory Framework for the EFTPOS System: Consultation on Options for Reform*, June. Available at <<http://www.rba.gov.au/publications/consultations/201206-rev-reg-frmwrk-eftpos-sys/index.html>>.

18 For instance, while any bilateral agreement made between two ePAL members as provided for and defined in ePAL's Scheme Rules would form part of the new designated system and be subject to the Bank's regulation, arrangements made outside of the Scheme Rules would not.

4. The Current Issue

4.1 Objectives for the Current Review of the Regulatory Framework

In line with the Board's mandate and the Bank's specific powers, the current review is aimed at ensuring that the regulatory framework for the EFTPOS system continues to meet its original objectives in light of recent industry developments. Aspects of competition that may be relevant in card systems include rewards, incentives and rebates offered to cardholders by issuers, and service levels, incentives and rebates offered by acquirers to merchants. First, the framework should promote competition between EFTPOS and other debit card systems by at least ensuring that the Bank's regulations are not unduly more onerous on one debit system than another. Second, any regulations on the EFTPOS system should improve efficiency in the payments system as a whole by facilitating more appropriate price signals to participants in, and end users of, the different systems, thereby improving the allocation of resources. A third and related objective is fair access for new EFTPOS participants, which should encourage competition both within the EFTPOS system and between various payment systems. As discussed in Section 3 above, these original objectives may no longer be met by the existing framework because of recent changes to governance and architecture.

The Bank's objectives in promoting competition and efficiency involve a number of key concepts:

- Competition in terms of access to the EFTPOS network, with the objective of promoting competitive behaviour among existing participants and enabling the emergence of new participants, thereby potentially driving innovation, expanding choice and reducing costs. More effective competition between participants may enhance the quality (e.g. additional functionality) and availability (e.g. a wider range of acceptance locations) of the EFTPOS network.
- Competition in terms of ensuring a 'level playing field' from a regulatory perspective for competing networks, namely EFTPOS and the international debit schemes. The Bank's approach here is designed to ensure that for interchange fee setting, given the development of multilateral arrangements and management thereof via a scheme, EFTPOS should be under similar regulatory requirements to those that apply to the international schemes, and can then compete with them in that context on equal terms.
- Efficiency in terms of pricing that is more reflective of relative resource costs. This is in line with the Bank's actions to improve cardholder and merchant information and choice, and consistent with the approach established in the 2000 Joint Study.¹⁹

As discussed in Section 3, the current regulatory framework for the EFTPOS system was put in place at a time when governance was based largely on bilateral agreements on interchange fees and connection arrangements. Such a framework may no longer be appropriate given recent industry developments. In particular, there have been significant implications for the operation of the current regulatory framework from

¹⁹ See Reserve Bank of Australia and Australian Competition and Consumer Commission (2000).

the establishment of ePAL, its decision to establish a multilateral interchange fee schedule that reverses the direction of interchange fee flow for most EFTPOS transactions, and the industry's migration to the COIN. The Bank's interchange fees Standard and the access framework are discussed in this context below.

4.2 Interchange Fees

The focus of the Bank's regulation of interchange fees has been on promoting effective competition *between payment systems*. As noted in Box A, schemes may compete with higher interchange fees to give issuers an incentive to issue and promote their card, and an incentive for cardholders to use the card, particularly when the card is widely accepted. Competition may therefore drive interchange fees up, potentially resulting in pricing to end users (across different payment methods) that is not reflective of relative resource costs. In this context, competition driving fees up may lead to higher merchant service fees, passed on to consumers in the form of higher prices.

For these reasons, the Bank imposed a cap – \$0.12 flowing to the issuer – on the weighted average of interchange fees in the Visa Debit system.²⁰ A similar cap was introduced for the EFTPOS system after the formation of ePAL, allowing ePAL the freedom to set its multilateral interchange schedule in response to competitive pressures from other payment systems within the same regulatory constraint as that applying to other debit card schemes. ePAL's capacity to set interchange fees has, however, been further constrained by regulations that were put in place before its formation and that may no longer be appropriate. In particular, a minority of interchange fees in the EFTPOS system (those that are agreed bilaterally) have been constrained by the Bank's regulation to between \$0.04 and \$0.05, payable to the acquirer – a level that is very different to any fees on ePAL's multilateral schedule.²¹ This has the potential to inhibit ePAL's capacity to compete with other payment systems.

The Bank's existing interchange regulations for the EFTPOS system, therefore, have the potential to distort behaviour over time and undermine ePAL's capacity to set interchange fees in the interest of the EFTPOS system. The regulatory constraints on the setting of interchange fees by ePAL are now more restrictive than for the other schemes. This is largely a result of the existing EFTPOS interchange regulations having been put in place before significant changes in the EFTPOS system (as described above) had occurred. The Bank is therefore seeking to update its regulatory framework for the EFTPOS system so that it remains appropriate, having regard to the existing regulation of the other debit card schemes.

4.3 Access Framework

The Bank's regulation of access has been focused on competition *among payment system participants*, in most cases financial institutions. As with the interchange fees Standard, the existing access framework – comprising the industry's Access Code and the Bank's Access Regime – may no longer be appropriate as the nature of some of the access issues faced by potential new entrants has changed with the shift towards a multilateral EFTPOS system. In particular, the existing access framework was designed to deal with factors inhibiting access

20 MasterCard provided a written undertaking to meet the same benchmark for the Debit MasterCard system.

21 It should be noted that when the Bank amended the interchange fees Standard in 2009 to allow for multilateral interchange fees to be introduced in the EFTPOS system, its decision to leave in place the floor-and-cap approach for bilateral interchange fees – that is, to not harmonise regulation of multilateral and bilateral interchange fees – was intended to be a transitional measure, aimed at reducing the likelihood of disruptive bilateral fee negotiations ahead of the expected move by industry to a multilateral interchange fee schedule. See Reserve Bank of Australia (2009), *A Revised Interchange Standard for the EFTPOS System*, November. Available at <<http://www.rba.gov.au/payments-system/reforms/debit-card-systems/rev-inter-stand-eftpos/index.html>>.

in a system based on bilateral arrangements, which no longer fully characterise the EFTPOS system. The Bank is therefore seeking to update the framework to ensure that its regulations remain appropriate in the changing circumstances.

The economic rationale for intervention in this area reflected the barriers to entry imposed on potential new participants seeking a direct connection to the network, as a result of having to establish separate bilateral connections with each other participant, rather than a single multilateral connection. The bilateral connection requirement presented a significant barrier to entry as a potential participant needed to engage and negotiate with each incumbent separately. Hence, any one existing participant could effectively veto entry by refusing to establish a connection to a prospective participant that otherwise met the connection criteria, or by setting terms (including interchange fees) that would make the new entrant uncompetitive.

Because a new entrant to the system has to negotiate with individual incumbent participants for access on reasonable terms, the Access Code and Access Regime set out some requirements for negotiations over the cost of connection, interchange fees and reasonable timeliness to complete the process, in the context of a system characterised by bilateral agreements. With the prospect of a move to multilateral arrangements, the complexity of multiple bilateral arrangements may no longer be a concern, rendering some elements of the existing regulatory framework no longer appropriate for several reasons.

First, the introduction of the multilateral interchange fee schedule has made ambiguous the interpretation – and potentially relevance – of the Access Regime’s no-discrimination provisions, which must be addressed for regulatory certainty. Second, the multilateral schedule has potentially rendered redundant one of the rationales for having no-discrimination provisions – namely to ensure that incumbents cannot use negotiations over (bilateral) interchange fees to frustrate access for new entrants. Third, the industry’s migration to the COIN has meant that connection costs for a new entrant may have fallen; accordingly, the existing provisions on costs may no longer be appropriate. Finally, there is now a central body capable of governing access arrangements in the EFTPOS system, raising the possibility that the Bank’s regulations on access may no longer be required, particularly given that scheme-governed payment systems are typically regulated by membership requirements set out in the rules of the central scheme.²² The Access Regime was designed for the previous bilateral arrangements, where there was no central coordination of the EFTPOS system. Now that there is central coordination of EFTPOS, the Bank thinks that it is worth considering whether explicit regulation by the Bank is still required. This is consistent with the Board’s standard approach of using its powers as ‘reserve’ powers, only intervening when it considers it necessary.

These issues are discussed in more detail below.

4.3.1 Access Regime

4.3.1.1 *No-discrimination provisions*

The no-discrimination provisions of the current Access Regime are aimed at ensuring that a new entrant has access to interchange fees that are in line with those available to existing participants. As noted above, when these provisions were put in place, interchange fees were regulated to flow from the issuer to the acquirer – as had been the case prior to the regulation of the EFTPOS system. The reversal in the direction of interchange fee flow for most EFTPOS transactions after ePAL put in place its multilateral interchange fee schedule has made the no-discrimination provisions difficult to interpret. In particular, the current Access Regime specifies:

²² In the case of the MasterCard and Visa schemes, the Bank imposed access regimes designed, in part, to relax previously restrictive membership requirements in their scheme rules.

No discrimination

18. An acquirer or self-acquirer who becomes a participant in the EFTPOS system for the first time, on or after 13 September 2006, is for three years entitled to receive an interchange fee from an issuer with whom it has an Access Agreement no less than the lowest interchange fee payable by that issuer to an existing acquirer or self-acquirer.
19. An issuer who becomes a participant in the EFTPOS system for the first time, on or after 13 September 2006, is for three years not required to pay an acquirer or self-acquirer with whom it has an Access Agreement an interchange fee greater than the highest interchange fee payable by an existing issuer to that acquirer or self-acquirer.

Contrary to the original intent of these provisions, paragraph 18 could now be interpreted as requiring that new acquirers (including self-acquirers) *receive* an interchange fee, whereas acquirers subject to ePAL's multilateral fee schedule now *pay* interchange fees. The provisions may therefore now have the unintended effect of enabling new acquirers to receive substantially more favourable treatment than incumbents. The terms 'no less than the lowest' and 'greater than the highest' are also more difficult to interpret now that interchange fees can flow in either direction; indeed, the existing interchange fees Standard considers a fee paid to the acquirer to be a negative interchange fee, so 'less than' could be considered to mean a larger negative number – the opposite of what was intended in the Access Regime.

A more important issue is whether there remains a need for provisions of this type when multilateral fees have been adopted by the industry. The fact that new entrants are now able to access multilateral interchange fees (which apply equally to all participants) may be sufficient to prevent existing participants from using negotiations over interchange fees to frustrate entry – the original concern underlying the existing no-discrimination provisions.

4.3.1.2 Connection charges

The existing cap (which reflects the 'access charge benchmark') on the amount an existing participant can charge a new entrant to establish a connection under the Access Regime is based on a cost survey undertaken by APCA in 2004, under the old (bilateral) technical connection arrangements.²³ Since that time, the industry has migrated to the COIN for the exchange of messages in the EFTPOS system, which has the potential to reduce the cost to existing EFTPOS participants of establishing connections to new entrants. The COIN reduced the number of physical network connections in the system (from one for each pair of direct participants, to one from each direct participant to the COIN). A new market entrant would thus face reduced physical connection costs (but would still face the costs of establishing logical connectivity with each participant); if the Access Regime were to be retained, the connection cap could be reduced accordingly.

One issue that has arisen from the change in architecture is whether there is a case for a new access regime to provide for an earlier recalculation of the access charge benchmark – the next recalculation date under the provisions of the current Access Regime is January 2014. A more fundamental issue to consider is whether the provisions on connection charges are indeed necessary, should suitable arrangements to limit the cost of access be put in place by ePAL or an industry body.

²³ The lowest estimated cost of those surveyed for providing a direct connection was adopted as the benchmark.

4.3.2 Access Code

A second element of existing access arrangements is the industry Access Code, which governs the procedure for new entrants to negotiate and implement bilateral connections with existing EFTPOS participants. Although the Bank does not play any direct role in the operation of the industry's Access Code, the effectiveness of industry access arrangements are relevant in determining whether regulation of access arrangements is required at all and, if so, what form this may take. The current Access Code relates to the 'EFTPOS system designated by the RBA'; its scope may therefore be affected by the Bank's new designation. In line with the discussion in the preceding section, a further consideration is whether EFTPOS Access Australia Limited remains the most appropriate body to administer the Access Code and to govern access to the EFTPOS system now that ePAL has been established.

5. Options for the Future Regulation of the EFTPOS System

A number of options for the future regulation of the EFTPOS system are presented below, in line with the structure of the existing regulatory framework. These include options for an interchange fees standard, and for no-discrimination and connection cap provisions of an access regime. It should be noted, however, that some combinations of the options are not feasible. For instance, should the Board decide that it is appropriate to eliminate bilateral interchange fees within ePAL, it would not be possible to entitle a new entrant to establish a bilateral fee arrangement under new no-discrimination provisions in an access regime.

5.1 Interchange Fees Standard

The Board has identified five broad options to address issues concerning the current regulation of interchange fees in the EFTPOS system.

- *Option 1: Leaving the current form of regulation unchanged*

The new interchange fees standard would be substantively the same as the current Standard in this option, with minor adjustments to clarify the application of multilateral or bilateral interchange fee benchmarks where this is ambiguous.

- *Option 2: Imposing a bilateral interchange fee benchmark that is closer to the benchmark for multilateral interchange fees*

The current regulation of interchange fees could be changed to bring the bilateral interchange fee benchmark closer to the multilateral interchange fee benchmark. An example would be to constrain bilateral interchange fees between \$0.05 paid to the issuer and \$0.05 paid to the acquirer.²⁴

- *Option 3: Placing bilateral and multilateral interchange fees under a common benchmark*

This option would bring the regulation of bilateral interchange fees into line with that of multilateral interchange fees, with both subject to a benchmark of \$0.12, payable to the issuer. The cap and floor on fees paid by the issuer to the acquirer would be removed. As discussed in Section 6 below, some distinction would need to be retained between bilateral and multilateral interchange fees under this option because of the practical difficulty for both ePAL and participants in meeting a weighted-average benchmark for bilateral interchange fees. In the Bank's view, a solution would be for *all* bilateral interchange fees to be subject to a \$0.12 cap, and multilateral fees to be subject to a weighted-average benchmark of \$0.12.

²⁴ This option was considered by the Board in its 2007/08 review of the payments system reforms.

- *Option 4: Eliminating bilateral interchange fees in the designated system by preventing the payment of any interchange fee other than a multilateral interchange fee set by ePAL*

Under this option, a new interchange fees standard would prevent the payment of any interchange fee in the designated EFTPOS system other than a multilateral fee set by ePAL. The multilateral interchange fee benchmark could remain the same as the existing Standard, currently \$0.12 paid to the issuer. It should be noted that it would still be possible under this option for parties to agree to exchange debit transactions at a bilaterally negotiated fee outside the designated system.

- *Option 5: Revoking the interchange fees Standard without imposing a new standard in its place*

The final option is to revoke the existing interchange fees Standard without imposing a new one in its place. This would allow ePAL to determine the appropriate level of interchange fees in the EFTPOS system without having to meet a regulatory benchmark, and would remove the current floor and cap for bilateral interchange fees.

5.2 Access Regime

As noted above, the existing Access Regime has two main elements: the no-discrimination provisions and the cap on connection charges. Options for each of these elements were considered during the consultation process and evaluated below.²⁵ More generally, the Bank also sought views on the broader issue of whether it would be appropriate to continue to have an access regime in light of the recent changes to the industry's governance.

5.2.1 No-discrimination provisions

The Board has identified two main options for the no-discrimination provisions.

- *Option 1: Imposing no-discrimination provisions that are workable under new interchange fee arrangements*

A new access regime could impose no-discrimination provisions that give effect to the intent of similar provisions in the existing Access Regime. This would involve altering the wording of the existing no-discrimination provisions so as to clarify their operation in an environment in which interchange fees can potentially flow to either the acquirer or the issuer. Given that new entrants can now access multilateral interchange fees through ePAL, the no-discrimination provisions under this option would apply only to bilateral interchange fees and would entitle a new entrant to establish a bilateral fee. Specifically, a new acquirer seeking to establish a bilateral agreement with an issuer would, for a specified period (e.g. three years, as provided for in the existing Access Regime), be entitled to a bilateral interchange fee no less favourable than the least favourable (to the acquirer) bilateral agreement that the issuer has with an existing acquirer or self-acquirer. A new issuer establishing a bilateral agreement with an acquirer would, for a specified period, be entitled to a bilateral interchange fee no less favourable than the least favourable (to the issuer) bilateral agreement that the acquirer has with an existing issuer. Such a provision would only be meaningful when there are bilateral agreements in the system.

²⁵ For this Regulation Impact Statement, the Access Regime options that correspond to the status quo are encapsulated in Option 1 for both the treatment of the no-discrimination provisions and the provisions on connection costs. These options are as close as practicable to retaining the current EFTPOS regulatory regime, given the Board's decision on a new designation for the EFTPOS system.

- *Option 2: Omitting the provisions*

Another option is to omit the no-discrimination provisions from any new access regime, since new entrants are already able to rely on the multilateral interchange fee schedule set by ePAL to access the system on the same terms as other participants.

5.2.2 Connection charges

Three options in relation to connection charges were considered during the consultation process.

- *Option 1: Put in place an access charge benchmark that is the same as that provided for in the current Access Regime*

Under this option, the access charge benchmark provisions under the existing Access Regime would be replicated in a new access regime. That is, a benchmark of \$87 776 would be imposed for a period, with a new access benchmark applying from January 2014 based on a survey of connection costs conducted during 2013 (which should reflect the industry's migration to the COIN).

- *Option 2: Provide for an earlier recalculation of the access charge benchmark*

The recalculation of the access charge benchmark under any new access regime could be brought forward, using the same methodology as in the existing Access Regime to estimate actual connection costs in order to calculate the benchmark.

- *Option 3: Remove regulation of the cost of connection*

The Board could consider removing regulation of the cost of connection if it were satisfied that appropriate arrangements to limit connection costs would be put in place by ePAL or an appropriate industry body.

6. Draft Standard and Access Regime

The Act requires the Bank to publish any proposed standards or access regimes for public consultation. Given that the Bank has imposed a new designation on the EFTPOS system, any future regulation of interchange fees or access arrangements would need to be put in place via a new interchange fees standard and access regime that apply to the EFTPOS system as defined in the 2012 designation. Accordingly, the Bank published a consultation document on 12 June 2012 – *Review of the Regulatory Framework for the EFTPOS System: Consultation on Options for Reform* – that sets out the options discussed above to address issues concerning the existing regulation of interchange fees and access arrangements. The document also details the Board’s decision on the new EFTPOS designation following an earlier consultation.²⁶

Although some of the options discussed in the June 2012 consultation document do not involve the imposition of a new interchange fees standard or access regime, the document nonetheless contained a draft Standard and Access Regime based on some options outlined by the Board. The starting points for both draft instruments were the provisions of the existing interchange fees Standard and Access Regime.

Reflecting the Board’s preliminary views, a key element in the Draft Standard is that it places multilateral and bilateral interchange fee regulation on an equal footing, with both being subject to a \$0.12 benchmark payable to the issuer. Such a provision would effectively remove the existing regulatory requirement for bilateral interchange fees in the EFTPOS system to flow to the acquirer and be constrained between \$0.04 and \$0.05. As discussed above, it should be noted that it is not possible to be entirely consistent in the regulatory treatment of bilateral and multilateral interchange fees because it is not workable to ensure that a *weighted average* of bilateral interchange fees complies with a specific benchmark. This is because bilateral fees negotiated between participants under ePAL’s Scheme Rules would not be directly under ePAL’s control, and no single participant operating on these bilateral fees would be in a position to manage the weighted average into line with the cap. Accordingly, under the Draft Standard, *each* bilateral interchange fee would be required to be below the \$0.12 cap.

Although the consultation included the possibility that the Board might consider all elements of the current Access Regime to be no longer necessary – for instance, if it were to be satisfied that a suitable and appropriate access framework had been provided by the industry – the Draft Access Regime was included in the June 2012 consultation document as an option for interested parties to consider. The draft incorporates possible wording for new no-discrimination provisions that are workable under the current interchange fee arrangements in the EFTPOS system, and an updated access charge benchmark provision that reflects the cost of establishing a connection to the system via the COIN. The no-discrimination provisions in the Draft Access Regime would apply only to bilateral interchange fees and would entitle a new entrant to establish a bilateral fee no less

²⁶ The consultation document on designation was published on 9 March 2012. See Reserve Bank of Australia (2012), *Review of the Regulatory Framework for the EFTPOS System: Consultation on Designation*, March. Available at <<http://www.rba.gov.au/publications/consultations/201203-replacing-eftpos-designation/index.html>>.

favourable than the least favourable (to the new entrant) arrangement that the incumbent acquirer/issuer counterpart has with an existing participant. The updated access charge benchmark provision in the Draft Access Regime would have the effect of providing for an earlier recalculation of the benchmark than provided for in the existing Access Regime, potentially allowing prospective participants to benefit sooner from the cost savings arising from the adoption of the COIN.

7. The Consultation Process

Under section 28(2) of the Act, the Bank must invite submissions on a proposed determination of a standard and a proposed imposition of an access regime, and consider those submissions before taking action. Accordingly, the review of the regulatory framework for the EFTPOS system has involved extensive consultation with interested parties. As noted above, the Bank invited submissions on two separate consultation documents relating to the regulatory framework for the EFTPOS system: the first consulting on the definition of the EFTPOS system to be adopted in a new designation; and the second on the future regulatory framework for the EFTPOS system. The views expressed on the first consultation paper were summarised in detail in the June 2012 consultation document. This Section focuses on the views expressed in the recent round of consultation on the Draft Standard and Draft Access Regime.

The June 2012 consultation document requested submissions from interested parties by 31 July. The Bank received nine submissions in total from financial institutions, industry bodies, payments service providers, ePAL, a sole-acquirer and a merchant. The Bank invited those making submissions to meet with Bank staff.

The Bank invited comment on a number of issues relating to the regulatory framework for the EFTPOS system – the EFTPOS interchange fees Standard, the access framework (including the Access Regime and the industry Access Code), and the necessity and form of any arrangements that may be put in place to facilitate transition to the new governance and regulatory framework. The views expressed on each of these issues are discussed below.

7.1 Interchange Fees Standard

The majority of submissions supported the Bank continuing to regulate interchange fees in some form, generally by placing bilateral and multilateral interchange fees under a common benchmark.

The Bank proposed five options for the future regulation of interchange fees in the EFTPOS system (see Section 5). There were diverging views expressed by industry. Nonetheless, nearly all submissions considered that continued regulation of interchange fees in the EFTPOS system remains appropriate. For example, in its submission, ePAL commented that ‘continued regulation of interchange fees related to the EFTPOS system, in a manner which is consistent with the regulation of the other designated systems, is required and will promote competition and efficiency in the payment industry’.

Around half of the submissions received indicated their primary support for placing bilateral and multilateral interchange fees under a common benchmark (Option 3). The reasons for supporting this option were relatively consistent across submissions: the regulatory treatment of bilateral interchange fees should be brought into line with ePAL’s multilateral interchange fees now that the majority of ePAL members have adopted the multilateral interchange fee schedule; it provides certainty and clarity for payments system participants; it is in the long-term interests of ePAL members; and it promotes competition between schemes.

Several submissions supported the elimination of bilateral interchange fees by preventing the payment of any interchange fee other than a multilateral interchange fee set by ePAL (Option 4). These submissions argued that Option 4 supports fair access to the EFTPOS system. For instance, one submission argued that 'competitive neutrality' cannot be achieved in the EFTPOS system where dominant participants are able to maintain bilateral arrangements that deliver a competitive advantage over other stakeholders. With this in mind, it suggested that the alternative regulatory options, which allow bilaterally negotiated interchange fees to continue, do not pass the public interest test. This submission also argued that the EFTPOS system will always be at a disadvantage to the debit systems of the international schemes if issuers are required to pay, rather than earn, interchange fees.

One submission from a sole-acquirer argued that, of the alternatives presented, only leaving the current regulation unchanged (Option 1) supports the sole-acquirer model. It argued that under ePAL's multilateral interchange fee regime, sole-acquirers are fully exposed to the loss of interchange fees. It further commented that other participants with an issuing business are able to cross-subsidise the costs they face from their acquiring business, putting sole-acquirers at a significant disadvantage. Consequently, for the sole-acquirer model to be sustainable, the submission suggested that the interchange fee model needs to be cost based and that sole-acquirers should have such costs paid by the users of the payment system. The submission argued that, should Option 1 not be implemented, the Bank should amend the interchange fees Standard to require that ePAL set its multilateral interchange fee regime so that for any transaction acquired by a sole-acquirer, the interchange fee must be paid by the issuer. The submission argued that such an arrangement would, among other benefits, balance out interchange fee costs across all participants, be simple and transparent, and encourage participants to invest in innovation.

By contrast, APCA expressed a desire for the interchange fees Standard to be revoked without imposing a new standard in its place (Option 5). APCA argued that because there is evidence that market forces are operating efficiently on both the issuing and acquiring sides of the market, it is not obvious that regulatory support is required to regulate interchange fees for any of the debit schemes.

7.2 Access Framework

There were varying views about the relevance and proposed form of the Access Regime, with some submissions arguing that it should be revoked while others argued that at least one of the provisions should be retained. Of those submissions that commented, all noted that the industry Access Code could now be adopted within ePAL's scheme rules.

7.2.1 Access Regime

7.2.1.1 *No-discrimination provisions*

Nearly all submissions supported omitting the no-discrimination provisions from the Access Regime (Option 2). Most submissions commented that the no-discrimination provisions are no longer relevant as new participants in the EFTPOS system can adopt the multilateral interchange fee schedule. In its submission, ePAL argued that no-discrimination provisions are unnecessary because, in light of their declining prevalence, the existence of bilaterally negotiated fees will not place competitive constraints on new entrants. APCA also commented that if new participants can establish bilateral arrangements that are more favourable than those available to existing participants, it may be difficult for ePAL to promote the interests of all stakeholders, and so was supportive of omitting these provisions.

One submission supported retaining no-discrimination provisions that are workable under new interchange fee arrangements (Option 1). It argued that, depending on the Bank's decision regarding the regulation of interchange fees, the inclusion of no-discrimination provisions may be vital to protect fair access for sole-acquirers.

7.2.1.2 Connection charges

There were a range of views regarding the treatment of connection charges under the Access Regime. A number of those submissions that supported the omission of no-discrimination provisions from the Access Regime also supported the removal of regulation of the cost of connection (Option 3). These submissions generally commented that access charge regulation is unnecessary as ePAL now has the commercial incentive to establish scheme rules in relation to connectivity. Indeed, in its submission, ePAL noted that if the Bank revoked its regulation of connection costs, ePAL would include provisions dealing with the establishment of connections in its scheme rules.

A number of other submissions indicated their support for an access charge benchmark that is the same as that provided for in the current Access Regime (Option 1). These submissions generally suggested that there is little to be gained from recalculating the benchmark early. One submission from a payments service provider suggested that the current benchmark does not seem to be a barrier to new entrants.

By contrast, a sole-acquirer supported Option 2 – provision for an earlier recalculation of the access charge benchmark. It commented that migration to the COIN has simplified connection efforts and lowered access costs significantly, and so new participants should be able to benefit sooner from any cost savings.

7.2.2 Access Code

As noted above, of the small number of submissions that commented, all supported ePAL taking over the management of the Access Code. A submission from a payments service provider noted, however, that any participant wishing to exchange debit transactions not subject to ePAL's scheme rules should not automatically have a right to establish a connection under the conditions of this Code. One bank also indicated its support for ePAL exploring further opportunities to enhance its access and membership-related rules as a demonstration of ePAL's commitment to a sustainable access framework.

7.2.3 Transitional arrangements

Around half of the submissions commented on the need and form of any arrangements that may be put in place to facilitate transition to the new governance and regulatory framework. Only one suggested that transitional arrangements may be necessary. It argued that a significant transition time would be required to allow such entities as sole-acquirers to adjust to the new regulatory framework.

The remaining submissions commented that there is no compelling evidence to suggest that it is necessary to put transitional arrangements in place. For example, APCA queried the scope of any likely disruption to participants given the broad membership of and participation in the ePAL scheme. One financial institution also suggested that by the time the final regulatory framework is determined, market adjustments to any regulatory changes in the EFTPOS system will be largely complete, especially if a suitable implementation period is given.

8. Evaluation and Impact Analysis

In making a decision on whether to determine standards to be complied with by participants in a designated payment system under section 18 of the Act, the Bank must consider whether determining the standards is in the public interest. Similarly, in imposing an access regime under section 12 of the Act, the Bank must consider it appropriate, having regard to:

- (a) whether imposing the access regime would be in the public interest; and
- (b) the interests of the current participants in the system; and
- (c) the interests of people who, in the future, may want access to the system; and
- (d) any other matters the Reserve Bank considers relevant.

The Bank may also revoke an existing access regime under section 15 of the Act if it considers it is appropriate, having regard to the same factors.

Section 8 of the Act states that in determining whether a particular action is in the public interest, the Bank is to have regard to the desirability of payment systems:

- (a) being (in its opinion):
 - (i) financially safe for use by participants; and
 - (ii) efficient; and
 - (iii) competitive; and
- (b) not (in its opinion) materially causing or contributing to increased risk to the financial system.

The Bank may have regard to other matters that it considers are relevant, but is not required to do so.

The Bank has considered the public interest in its evaluation of the various options and, in relation to the options relating to the access regime, the interests of current and prospective participants to the EFTPOS system. At the same time, the Bank has considered the potential effects each of the options may have on individual users and providers of payment services, including:

- the institutions that are participants in the EFTPOS system under either designation
- merchants that accept EFTPOS cards
- EFTPOS cardholders
- consumers and the community as a whole.

The Bank has also taken into account the views expressed by various parties during the consultation process. The following discussion sets out the Bank's evaluation of the main options considered in relation to an interchange fees standard and an access regime for the EFTPOS system under the 2012 designation.

8.1 Interchange Fees Standard

The options in relation to the interchange fees standard are:

1. leaving the current form of regulation unchanged;
2. imposing a bilateral interchange fee benchmark that is closer to the benchmark for multilateral interchange fees;
3. placing bilateral and multilateral interchange fees under a common benchmark;
4. eliminating bilateral interchange fees in the designated system by preventing the payment of any interchange fee other than a multilateral interchange fee set by ePAL; or
5. revoking the interchange fees Standard without imposing a new standard in its place.

In large part, evaluation of these options relies on anticipated effects on competition in the debit card market.

For a card system to be successful it must be accepted by merchants and held and used by consumers. Where cards are widely accepted, as is the case for EFTPOS, Debit MasterCard and Visa Debit, the choice of payment method may be significantly influenced by the card issuer, which may influence both the cards held by the consumer and the card presented or system selected at the point of sale. This may in turn be influenced by the level of interchange fees received (or paid) by the issuer. As an example in point, reflecting the higher interchange fees (to the issuer) on debit products of the international schemes, a number of banks have in recent years replaced customers' proprietary debit/ATM cards with international scheme debit cards that also have EFTPOS functionality, often with instructions suggesting that the customer push the 'credit' button at the point of sale so that the transaction is routed through the international scheme.

The market share of international scheme debit cards has been increasing over recent years, despite one major retailer declining acceptance for a period. The market share of the international schemes has increased from 20.6 per cent of the value of debit card purchases as at September 2008 to 28.9 per cent by September 2012.

The history of the Bank's regulation of EFTPOS interchange fees has reflected a concern that significantly different interchange fees between it and the international schemes, and individual participants' lack of incentives to manage EFTPOS interchange fees in the interest of the EFTPOS system, has impeded its ability to compete. This may be counter to the public interest, in particular because the resource costs of the EFTPOS system are estimated to be lower than those of the international schemes.²⁷

The establishment of ePAL and a multilateral fee schedule means that there is now much greater capacity for the EFTPOS system to compete effectively with the international schemes. The Bank believes that it is appropriate for ePAL to determine how that competition best occurs – for instance how it balances the need to appeal to merchants, issuers and cardholders. At present, the regulatory restrictions on bilaterally negotiated interchange fees place a constraint on ePAL's capacity to compete with the international schemes, which are not subject to similar constraints. Options 1 to 5 present different approaches to removing those restrictions.

An assessment of the options is largely on the basis of the extent to which each option will promote effective competition, which in turn should lead to a better allocation of resources (including through greater adoption of a lower resource cost payment method) and a more efficient payments system overall. It is not possible

²⁷ In 2007, the Bank estimated that the resource costs incurred by financial institutions for an average EFTPOS transaction was 0.37 per cent of the transaction value, compared with 0.58 per cent for an average debit transaction made through an international scheme – see Schwartz *et al* (2008). It should be noted that changes since these estimates were made in 2007, including the establishment of ePAL and the COIN, may have altered these relative costs.

to explicitly quantify these effects, which will reflect a number of factors, including: the degree to which participants either move to the multilateral interchange fee schedule or adopt bilateral interchange fees more aligned to ePAL's interests; the extent to which changes to interchange fees are passed through to pricing to merchants; and the effect on issuers' promotion of EFTPOS and, as a result, use by cardholders.

The establishment of ePAL and its greater capacity to compete with the international schemes may also drive dynamic efficiencies via innovation – both in terms of ePAL's own actions and the competitive response of the international schemes. These dynamic effects are difficult to estimate, but the scope for innovation through coordinated action is arguably greater than in circumstances where dispersed bilateral arrangements render system improvements problematic; indeed, the Bank's recent *Strategic Review of Innovation* focuses on the difficulties of industry coordination in various aspects of the payments system which are characterised by bilateral linkages and arrangements.²⁸

With this background, the following discusses options for EFTPOS interchange regulation.

Option 1: Leaving the current form of regulation unchanged

Current regulation constrains bilateral interchange fees to a range of \$0.04 to \$0.05 paid to the acquirer while multilateral interchange fees on most transactions flow in the other direction. In the short term, this situation confers a competitive advantage to any acquirer that is able to maintain a bilateral fee agreement. In its start-up phase, the ability to maintain bilaterally negotiated fees at the current regulated level may have made it easier for ePAL to maintain membership, given the potential for some players to seek bilateral agreements outside the ePAL framework. However, with the exception of the fact that it represents the status quo, it is hard to identify specific benefits for Option 1. In particular, it constrains ePAL's ability to set interchange fees in the best interests of the system and accordingly may reduce the efficiency of the payments system, as discussed above.

Relative to the other options that retain bilateral fees, Option 1 is the most constraining in that it restricts interchange fees to a tight range that is significantly different from the current multilateral rates. This provides a strong incentive for acquirers that have bilateral agreements to seek to maintain them, but also an incentive for issuers to resist and to seek to terminate contracts, resulting in some potential for disputes, with outcomes dependent on the bargaining positions of the parties involved. In addition, should ePAL seek to manage bilateral fees through its rules, it has very little scope to do so under this option.

A risk of Option 1 is that the constraints on ePAL are sufficient over time to render a domestic debit scheme uncompetitive. This could reduce the number of debit schemes in Australia from three to two, with potential implications for the degree of competition in the Australian payments system.

It should be noted that the original motivation for the current cap-and-floor regulation of bilateral fees – namely, to allow new entrants to access the system at interchange rates similar to those of the existing participants – has largely been addressed by the establishment of a multilateral interchange schedule and its adoption by most EFTPOS participants. In line with this, little support for Option 1 was expressed during the consultation process.

On balance, Option 1 does not appear to be in the public interest as it continues an uneven playing field and constrains ePAL's capacity to promote the EFTPOS system in a way that would be expected to benefit competition and efficiency in the payments system.

²⁸ See <<http://www.rba.gov.au/payments-system/reforms/strategic-review-innovation/index.html>>.

Option 2: Imposing a bilateral interchange fee benchmark that is closer to the benchmark for multilateral interchange fees

This option would seek to address concerns that bilateral fees are currently tightly constrained to a level that is very different to multilateral fees. It would potentially allow greater freedom in setting bilateral fees, without going as far as placing them on the same regulatory footing as multilateral fees and international scheme debit fees. For instance, bilateral fees might be allowed within a range from \$0.05 cents paid to the acquirer, to \$0.05 cents paid to the issuer.²⁹ This would make it more likely that two parties could agree to a bilateral interchange fee because the fee could be set closer to the fee that is available to all parties via the multilateral schedule. Therefore, while this option might increase the probability of the negotiation of bilateral fees (which are outside ePAL's direct control), those fees are more likely to be influenced by the level of multilateral fees determined by ePAL. Equally, should ePAL choose to apply limits on bilateral fees through its rules, this option would provide it with more flexibility to do so in a way that allows it to promote the system than under Option 1. This option is therefore likely to improve ePAL's capacity to compete.

Nonetheless, ePAL's ability to determine pricing in the best interest of the EFTPOS system would continue to be more constrained by the Bank's regulations than that of the other debit schemes (i.e. it would fail to ensure a 'level playing field'); while bilateral fees might be influenced by the level of multilateral fees or by rules set by ePAL, they could not be moved outside the regulatory constraints. This option would entail a level of regulatory inconsistency, without, in the Bank's view, a sound justification for such inconsistency. A benefit of this option would be that interchange fees flowing to the acquirer would also be subject to a cap, although the risks entailed by the lack of a cap on fees in this direction are negligible.³⁰

The Bank sees this option as superior to Option 1.

Option 3: Placing bilateral and multilateral interchange fees under a common benchmark

The key benefit of putting in place a common benchmark for the regulation of bilateral and multilateral interchange fees in the EFTPOS system is that it would harmonise, in form, the regulation of interchange fees across all three debit card systems. This would place ePAL on a similar regulatory footing to the other debit schemes and encourage competition within the same regulatory framework. This therefore offers the benefits of Option 2 (allowing ePAL to have greater influence over bilateral fees), but allows this to occur over a wider range of interchange fees – capped at the same level as all other domestic debit interchange fees. Option 3 therefore provides ePAL with more freedom to compete than either Option 1 or 2 and received broad support from those making submissions during consultation. At the same time, interchange fees in all debit card systems would continue to be capped, which is appropriate given the potential for competition to result in rising interchange fees over time. To the extent that this option entails movement in bilateral interchange fee flows, there would be a transfer from acquirers to issuers, which, if passed through, would entail benefits to cardholders and costs to merchants. The likely magnitude of these costs is expected to be small, however (see below), and likely to be outweighed by the benefits of regulatory consistency and scope for competition between schemes.

29 This was suggested in the conclusions of the 2007/08 review of the card payment reforms.

30 In theory, the removal of the cap and floor on fees paid to the acquirer could allow for unlimited interchange fees to be paid from issuer to acquirer. The Bank considers this to be highly unlikely, noting that it is inconsistent with international experience and experience with the other debit schemes operating in Australia; to the extent that large interchange fees were to be instituted, they would be likely to be explicitly passed on by issuers to customers via transaction or account fees, with the result that cardholders would no longer use EFTPOS but substitute other methods, such as scheme debit.

On balance, the Bank's view is that Option 3 would be in the public interest and would fulfil the objectives outlined in Sections 2 and 4.

Option 4: Eliminating bilateral interchange fees in the designated system by preventing the payment of any interchange fee other than a multilateral interchange fee set by ePAL

Eliminating bilateral interchange fees within the designated EFTPOS system by regulation would force all participants that are ePAL members onto the multilateral fee schedule established by ePAL. This would provide ePAL with more direct control over interchange fees within the regulated system than would be the case under Options 1 to 3, increasing ePAL's capacity to compete with the international scheme debit systems (other things being equal). Currently, a small number of participants have been able to retain bilateral agreements, with interchange fees therefore regulated to flow in the opposite direction to the scheme's multilateral schedule. Those parties would be forced to adopt the multilateral schedule if they wished to continue to participate in the designated system. Support for this approach was expressed by several parties during consultation, with those parties noting that there had already been a prolonged effort to bring participants into ePAL's multilateral fee schedule and/or ePAL membership. A benefit of this option would thus be the fact that the Bank was providing greater regulatory certainty over the removal of bilateral arrangements.

Two points should be noted, however. First, ePAL could potentially prevent the payment of bilateral interchange fees via its own rules, but has chosen not to do so. In this sense, Option 4 would constrain ePAL's freedom to choose how to deal with interchange fees. Second, preventing bilateral fees within the EFTPOS system would not prevent a party with bargaining power from negotiating bilaterally to exchange debit transactions outside the EFTPOS system at an unregulated interchange fee. This would be the only means to agree on a bilateral interchange fee under this option. Therefore, in some circumstances this option might hinder ePAL's capacity to compete, rather than enhance it. It can be argued that decisions about whether to eliminate bilateral interchange fees are most appropriately left to ePAL as it seeks to balance the elements that impact on its competitive position.

It should also be noted that Option 4 represents a prescriptive approach generally, and a more prescriptive regulatory approach than the Bank has taken for the international debit card schemes (whose scheme rules allow for bilateral interchange fees to be negotiated).

On balance, the Bank is of the view that Option 4 is inferior to Option 3, in that it unnecessarily limits ePAL's choice to manage interchange fees in the best interests of the system; in particular, ePAL itself has the power to prevent bilateral interchange fees among its members if it chooses to do so.

Option 5: Revoking the interchange fees Standard without imposing a new standard in its place

This option would remove all regulatory constraints on interchange fees (both bilateral and multilateral) in the EFTPOS system. It recognises the fact that EFTPOS multilateral fees are currently set well within the regulated cap of \$0.12. The Bank is conscious that ePAL's business is still evolving and that its interchange fee schedule and transaction mix might change over time; ePAL might, for instance, choose to set higher interchange fees on some transaction types in the future given that it is still developing functionality for the EFTPOS system. The Bank is also conscious of the tendency for competition between card schemes in some circumstances to drive interchange fees higher over time. Accordingly, this approach might provide ePAL with a competitive advantage over the other debit schemes in the longer term, potentially resulting in inefficient use of the payments system. This option was supported by one respondent in submissions, but this respondent also

noted that for reasons of regulatory consistency other options could be assessed. A specific cost of this option is that removal of regulation here means that there is not a 'level playing field' in regulatory terms for debit card networks in Australia. ePAL would gain a potential competitive advantage over the other debit card schemes, which would be a benefit accruing narrowly to it, but at the expense of regulatory consistency and thus effective competition.

The Bank remains of the view that this option would not be in the public interest, and that consistent regulation of debit card schemes would be likely to promote more competitive and efficient outcomes than a system in which the other debit schemes were regulated but ePAL was unregulated in relation to interchange fees.

8.1.1 The case of sole-acquirers

There has been some focus during consultation on sole-acquirers – those who provide third-party acquiring services, but do not issue cards. Most participants in the EFTPOS system are both issuers and acquirers, which means that they both pay and receive interchange fees and have greater freedom to decide how a change in interchange fees is reflected to both merchants and cardholders. A sole-acquirer on the other hand has little choice but to either absorb a change in interchange fees in margins or pass the full fee change through to its merchant customers.

Currently only one sole-acquirer, Tyro, operates in the EFTPOS system.³¹ It argues that, because sole-acquirers are fully exposed to any change in interchange fees, the regulatory regime should provide them with more favourable interchange arrangements. This could occur, for instance, by requiring ePAL to establish fees that flow towards sole-acquirers for the transactions that they acquire and towards the issuer for other transactions. Alternatively, Tyro suggests that a no-discrimination clause could provide for a sole-acquirer to receive the same interchange fees as self-acquirers. Finally, Tyro argues for a long transition period if all interchange fees were to be subject to a \$0.12 cap (interchange Option 3).

While the Bank recognises the unique challenges of the sole-acquirer model, it does not believe there to be a case for different regulatory treatment of different categories of participant. The adoption of multilateral interchange fees in the EFTPOS system has the benefit of allowing new entrants to access the system on the same terms as existing players. While this does not guarantee the success of any particular business model, it provides a transparent and level playing field on interchange fees. To attempt to address other perceived shortcomings in the competitive environment through regulating interchange rates differently for some participants would create distortions that may ultimately undermine competition and reduce ePAL's capacity to promote the interests of the system. It should be noted that the Bank's proposed approach to regulating EFTPOS interchange fees would allow ePAL to set interchange fees that flow towards acquirers (or a category of acquirer) if it considered it to be in the best interests of the system to do so.

The Bank recognises that the timing of the flow-through of shifts in interchange fees to merchant service fees charged by issuer-acquirers could affect the competitive position of sole-acquirers in the short term. Nonetheless, by the time the new EFTPOS interchange fees standard comes into effect, ePAL's multilateral interchange fee structure will have been in effect for all members for more than a year. The Bank does not believe there to be a case for any further transitional arrangements.

8.1.2 Effect on business and consumers

As noted above, the Board's mandate under the *Reserve Bank Act 1959* is to determine the Bank's payments system policy so as to best contribute to: controlling risk in the financial system; promoting the efficiency of the

31 Two merchant self-acquirers also operate, but do not offer payment services to third parties.

payments system; and promoting competition in the market for payment services, consistent with the overall stability of the financial system. This does not necessarily mean minimising costs to end users of a particular payment system in the short run. Indeed, in some cases increasing prices to a class of end users of a particular payment method may be part of the process of improving price signals, which will ultimately result in more efficient choices by end users and a more efficient payments system overall.

Options 1 to 5 above contemplate ways of regulating EFTPOS interchange fees. In the short run, Option 1 (the status quo) will result in little change in interchange fees, while Option 4 will guarantee a reversal in the direction of interchange fees for those parties that currently remain on bilateral interchange fees within the designated system (although it is possible that this would occur in any event). Options 2, 3 and 5 ease constraints on bilateral interchange fees, but it is not possible to predict how bilateral interchange fees might change as a response. These options are directed at placing greater control in the hands of ePAL, which it is expected to use in the best interests of the EFTPOS system.

In the short term, where changes in the regulation of bilateral interchange fees lead to a shift in those fees in favour of the issuer, fees faced by merchants and cardholders may be affected. This would depend on a number of factors. One is the degree to which acquirers choose to pass changes in interchange fees through to merchants. In turn, merchants may choose to: absorb part of the increase in costs; pass it on to all consumers via an adjustment to the general pricing of goods or services; or pass it on only to EFTPOS cardholders via a surcharge. However, it is also possible that EFTPOS issuers might choose to adjust their pricing to cardholders to reflect changes in interchange fees, offsetting the impact on consumers from changes in merchant prices. For instance, issuers might reduce account fees or provide other benefits to cardholders, such as reward points.

The intent of the regulatory changes proposed in this paper is to provide ePAL with the capacity to compete with the international schemes on an equal footing. In the longer term, payment choices are likely to be more efficient and the resource cost of the payments system lower than otherwise as a result. From the perspective of merchants, this could be expected to be reflected in lower costs, including through greater use than otherwise of a lower resource cost payment method. These benefits could be expected to be passed on, at least in part, to consumers.

Given that any changes that arise from these reforms simply affect existing pricing structures, no additional compliance costs for merchants would be expected.

8.1.3 Quantifying effects

The changes described in this Regulation Impact Statement are principally about updating the EFTPOS regulatory framework to take into account changed institutional arrangements. Quantifying the impact of these explicitly is difficult. In the absence of a cap, the tendency of interchange fees is to increase, as outlined in the general background in Box A. Where a cap is in place, the impact of fee changes underneath this cap are likely to be small compared with previous debit card reforms undertaken by the Bank (see below). *In extremis*, failure to update regulatory arrangements might mean that the EFTPOS system is unable to compete effectively with the international schemes, and it is likely that the closure of the EFTPOS scheme would represent a negative outcome for the Australian payments system. Estimates of the resource costs of the competing systems are based on figures from 2007, and do not take into account changes in payment costs that have occurred in the last five years – and so should be used with caution. Nevertheless, at the time those cost estimates were made, the EFTPOS system was characterised by lower overall costs than other debit schemes – and thus a wholesale migration of payments from the former to the latter would entail an increase in resource costs of payments to the Australian economy (separate from any other impacts of going from three competing debit networks

to two). Based on the previous estimates, this wholesale migration would entail additional resource costs for financial institutions of some \$43.5 million per month, much of which would presumably be ultimately passed on to the consumer.³²

Indirectly, the scope of the effects of price movements underneath the interchange fee cap can be compared to previous reforms undertaken by the Bank in debit card regulation. Although in theory the remaining bilateral fees could move from the current \$0.04 to \$0.05 cents to the acquirer, to \$0.12 cents to the issuer, the actual movements are likely to be much smaller. Indeed, to the extent that migration to multilateral fees has occurred or is occurring as a result of changes instituted by ePAL and independent of changes in the regulatory framework, movements in *bilateral* fees may in effect not occur as a result of the recommended option. To the extent that any movement does occur in the average interchange fee, it is likely to be in the order of cents or, indeed, fractions of a cent. A one cent change for an average-sized EFTPOS transaction represents around 0.019 per cent of the transaction value, or 1.9 basis points. Compared with the change in interchange fees that resulted from the Bank's determination of the Visa Debt interchange fees Standard (0.95 per cent of the transaction value to \$0.12 per transaction, or around 80 basis points), the one cent movement underneath the cap is one-fortieth of the effect. In other words, the estimated direct impacts of the Bank's changes are likely to be small, especially relative to previous reforms.

8.2 Access Regime

The consultation paper discusses the approach to both the no-discrimination and access charge cap elements of the existing Access Regime, with a view to determining the form of a potential new access regime applying to the newly designated EFTPOS system. Should the Board decide that all the elements of the current Access Regime are no longer necessary (subject to the Board being satisfied with the industry's access arrangements), there might not be a need to put in place a new access regime.

8.2.1 No-discrimination provisions

The consultation paper presented two options in respect of no-discrimination provisions. Option 1 was to include the provisions in a form workable under the new interchange fee arrangements; Option 2 was to omit these provisions in any new access regime.

As discussed above, the existing no-discrimination provisions were intended to help new entrants gain access to the EFTPOS system on bilateral terms consistent with existing participants. The practical effect of no-discrimination provisions workable under new interchange fee arrangements would depend on the prevalence of bilateral agreements in the system. It should be noted that any new access regime would apply only to the system governed by the ePAL's Scheme Rules.

In general, multilateral interchange fees are considered to be access friendly in that they allow new entrants to access the system on the same fee terms as existing participants. Therefore no-discrimination provisions have no effect where only multilateral fees apply. However, if most participants have adopted bilateral fees with one another, no-discrimination provisions could place a new entrant on comparable terms to most existing

³² This uses resource costs estimated on a per-transaction basis from Schwartz *et al* (2008), and assumes that the same *volume* of EFTPOS purchases passes through the debit systems of the international card schemes. An alternative method is to use resource costs estimated as a share of transaction value (estimated for an average-sized transaction in each payment system), and to assume that the same *value* of EFTPOS purchases passes through the international scheme debit systems. The difference between the two estimates reflects the fact that EFTPOS transactions have a lower average transaction size than other debit card transactions. The 'value' method estimates an increase in resource costs of \$20.3 million per month, should all EFTPOS transactions be processed through the international schemes.

participants. On the other hand, if most participants have adopted a multilateral fee schedule, with only a small number of participants on bilateral interchange fees, the provisions could give a new entrant a fee advantage over the majority of participants. This in turn could provide new entrants with an incentive to adopt bilateral rather than multilateral interchange fees, reducing ePAL's capacity to set interchange fees in the interests of promoting the system. It should be noted that the no-discrimination provisions in the existing Access Regime were intended to give a new entrant a right to a fee that is no less favourable than the least favourable currently provided by an incumbent under existing agreements. It was not the intent to place a new entrant on more favourable arrangements than any incumbents.

As has already been discussed, the industry has been shifting away from bilateral agreements under the ePAL scheme, with most participants now having opted-in to its multilateral fee schedule.³³ Therefore imposing no-discrimination provisions of the type outlined in the Draft Access Regime would place prospective participants – particularly acquirers – on more favourable terms than most existing participants. Option 1 could therefore create a distortion in the market for EFTPOS issuing and acquiring services, constraining the ability of the EFTPOS system to compete with other debit systems. In the absence of no-discrimination provisions, a new entrant would be able to access the EFTPOS system at the multilateral rates, on equivalent terms to most existing participants. In light of this, almost all parties that made a submission supported omitting the provisions.

While currently the multilateral fee schedule applies in most cases, it would technically be possible for widespread bilateral interchange arrangements to re-emerge within the ePAL scheme, rendering access on fair terms an issue for new entrants once more. However, in the Bank's assessment this is unlikely, given that the 'losing' party in a move from ePAL's multilateral schedule to a bilateral agreement would have little incentive to enter into such an agreement. Moreover, should this situation arise in the absence of no-discrimination provisions, the Bank would be at liberty to consider the merits of reimposing one.

In summary, the recent establishment and widespread adoption of multilateral interchange fees within the EFTPOS system means that new entrants can access the system on similar terms to most existing members, meeting the intent of the provisions of the existing Access Regime without requiring regulation of this form. No-discrimination provisions therefore no longer play an appropriate role in that they could force incumbents to adopt bilateral interchange fees with new participants that, other things equal, place a new entrant at a competitive advantage to most incumbents. Indeed, to the extent that no-discrimination provisions would provide new entrants with a right and potentially an incentive to establish bilateral interchange fees, they would make ePAL's task of managing interchange fees in the interests of the system more difficult. The Bank therefore believes that omitting the no-discrimination provisions would be in the interests of competition and efficiency in the payments system.

8.2.2 Connection charges

Consultation on connection charges focused on two broad issues – whether the existing cap on connection charges should be replicated in a new Access Regime for the EFTPOS system and, if that were the case, whether the existing timetable for recalculation of the cap should be brought forward from the current timetable. Options 1 and 2 set out approaches to the timing of recalculation of the cap. Option 3 considers the case for removing the connection charge cap.

³³ The remaining bilateral fees among ePAL members relate to self-acquirers, which potentially now have a greater incentive to adopt multilateral rates given ePAL's introduction of a 'differential' interchange fee category for qualifying merchants.

Options 1 and 2: Retention of an access charge benchmark

In the absence of a suitable Access Regime being put in place by ePAL, there would be benefits in retaining a connection cap to ensure that the cost of connection is not used by incumbent participants to frustrate entry. However, in circumstances where there is a suitable regime in place, the retention of an access charge benchmark may represent unnecessary and costly additional regulation.

The Bank has considered two options for the timing of the recalculation of an access charge benchmark, were such a benchmark to be retained in any new access regime (see discussion under Option 3 below). Option 1 would retain the current arrangements for recalculation, with a new benchmark applying from January 2014. Option 2 would bring forward the benchmark recalculation.

As noted previously, the current cap on the amount that an existing participant can charge a new entrant to establish a connection under the current Access Regime is based on a cost survey undertaken in 2004, before the COIN was established. Since the COIN has reduced the cost of the physical component of establishing bilateral connections to the other EFTPOS participants, the key advantage to Option 2 – that is, to bring forward the recalculation of the benchmark from January 2014 – is that it would allow new entrants to benefit sooner from any cost savings that have arisen from the adoption of the COIN. This could potentially make it more cost effective for prospective participants to access the EFTPOS system during that period.

However, the scope to implement Option 2 may be limited by the fact that estimates of actual connection costs (taken over the preceding four years) are to be provided 4½ months before the new cap is due to apply under the current methodology. Given that any new access regime is unlikely to be put in place until the end of 2012 or early 2013 at the earliest, this would leave existing participants in the EFTPOS system little time to gather the relevant data, and the period of potential savings to prospective participants would be relatively short. There might also be additional costs that would be incurred by participants in bringing the recalculation forward.

Given its limited additional benefits to potential new entrants and the practical difficulties in implementing Option 2, the Bank's view on balance is that the public interest would best be served by maintaining the current timetable for recalculation of the benchmark.

Potential costs of Option 1 include the risk that the benchmark is higher than necessary, which could result in higher costs for potential entrants than either a recalculated benchmark under Option 2 or Option 3 (under suitable industry arrangements). Both Option 1 and Option 2 also potentially constrain ePAL's ability to promote its growth and act in the best interests of the system. The benefit of Option 1 is that it constrains connection costs in circumstances where a recalculation or new industry arrangements might produce a higher benchmark – but as above, this is unlikely given the advent of the COIN.

Option 3: Removing regulation of the cost of connection

The establishment of ePAL has significantly changed the dynamics of access to the EFTPOS system. Whereas under the previous solely bilateral arrangements individual participants had no incentive to assist the access of potential competitors, it is now in ePAL's interests – acting to the benefit of the system – to promote membership. As discussed above, the Bank has concluded that the no-discrimination provisions of the Access Regime are no longer in the public interest. Under the circumstances it is appropriate to consider whether a cap on connection costs imposed through regulation remains the best approach. Given that the connection cost cap is closely linked to the industry Access Code, a related question is whether an Access Code administered by a separate company (EFTPOS Access Australia Limited) remains appropriate.

Under the current access framework, removing the regulation of the cost of connection under Option 3 might result in entry to the system being frustrated by incumbent participants levying a higher than necessary charge for a new entrant to connect. The formation of ePAL has not at this stage removed the need for those bilateral connections to be made. However, to the extent that the costs of connection were kept to a reasonable level by industry-based arrangements, there would be no need for restrictions to be imposed via an access regime. Indeed, the Bank imposed the access charge cap only when it became evident that the industry would not do so via the Access Code.

The Bank shares the view expressed by many parties during the consultation process that access to the EFTPOS system would best be governed by ePAL. Under the current bilateral connection technology, this would ideally include a connection cost cap and the elements of the industry Access Code. It should be noted, however, that the view was expressed during consultation that facilitating technical access under the current Access Code is unnecessarily cumbersome, and that prospective participants seeking access under the Code have been few. It was noted that technical access may be frustrated by an unwillingness to engage on the part of some incumbent participants, particularly with regard to coordination with internal project schedules. The Bank believes that these concerns should be taken into account in any future access arrangements, whether they continue to be administered by EFTPOS Access Australia Limited or are managed by ePAL.

Looking ahead, technological development may provide scope to place EFTPOS connectivity on a more consistent regulatory footing with the international schemes. As access costs are not regulated for the international schemes, a consistent approach may be appropriate for EFTPOS under these circumstances.

In summary, if the industry is able to put in place arrangements that satisfactorily control the cost of access to the EFTPOS system, there will be no public interest case for continuing to impose a regulated cap. This is the Bank's preferred option, but the Bank would only be in a position to pursue it if it were satisfied that industry access arrangements were sufficient. The Bank's proposed approach is that the omission of the current connection cost cap in any new access regime (or omitting an access regime altogether) would be subject to satisfactory access arrangements that appropriately control connection costs being put in place by the industry.

8.2.3 Effects on business and consumers

Similar to the impact of the changes to interchange fee arrangements on business and consumers, analysis of the impact of changes to access requires some assumptions about dynamic effects. In a scenario where ePAL establishes a suitable access framework, there may be greater scope for competition in issuing and acquiring markets, bringing greater choice to consumers and small business merchants and reducing card acceptance costs. There may also be some efficiency improvements in centralising access arrangements in a single entity. Again, however, the effect of this greater competition is difficult to quantify. The overall impact on total resource costs is also difficult to judge; however, debit card systems are generally lower in resource costs than a number of other payment methods. Therefore, to the extent that there is a move away from higher resource cost methods towards debit cards, or from higher resource cost debit cards towards EFTPOS, there are likely to be net benefits in the form of lower total resource costs.

9. Recommended Options

9.1 Interchange Fees

On balance, the Bank's view is that placing multilateral and bilateral interchange fee regulation on an equal footing – that is, a common benchmark – would be the most effective approach to regulating EFTPOS interchange fees in the public interest. Accordingly, the Bank considers capping bilateral interchange fees in the EFTPOS system at the same level as the Visa Debit system (currently \$0.12 paid to the issuer) to be the most effective way to implement this.³⁴ Given that bilateral interchange fees are not under ePAL's direct control, the cap would apply to each bilateral interchange fee; that is, it would not apply to a weighted average of interchange fees as is the case with multilateral EFTPOS interchange fees.

This approach would remove the existing constraint that forces bilateral interchanges fees to remain significantly different from multilateral fees. It would provide ePAL with greater capacity to manage interchange fees in the way that it considers to best benefit the interests of the EFTPOS system. This may include ePAL itself constraining or eliminating bilateral fees if it considers it appropriate to do so. Importantly, the approach would place all three debit card schemes operating in Australia on an equivalent regulatory footing in respect of interchange fees, allowing EFTPOS to compete more effectively and promoting greater efficiency in the payments system generally.

9.2 Access Regime

In the Bank's assessment, there is a case to omit both the no-discrimination and the connection charge elements from any new access regime, subject to an appropriate access framework being put in place by ePAL. The Bank believes that this would best balance the public interest, the interests of current EFTPOS participants, and the interests of prospective participants of the system.

The aim of the current no-discrimination provisions is to facilitate competition in the provision of EFTPOS services by enabling new entrants to access similar interchange fee arrangements to more established players. ePAL's multilateral interchange fee arrangements are consistent with this intention, since incumbent participants in the designated system are prevented from using the level of interchange fees to frustrate access for new entrants. As most incumbent participants have already opted-in to the multilateral interchange fee schedule, a new entrant will be able to access the system on equivalent terms to other third-party payment providers in the system.

More generally, the Bank has formed the view that EFTPOS access issues may be best handled by ePAL as the governing scheme. This is likely to be more efficient and involve lower compliance costs for participants than the current approach, which imposes access obligations on participants via the Bank's Access Regime, the

³⁴ Interchange fees paid to the acquirer would not be capped.

industry's Access Code and ePAL's Scheme Rules. In this context, the Bank assesses it to be in the public interest and the interests of current and prospective participants to omit both the no-discrimination provisions and the connection charge cap, therefore removing the need for an access regime, subject to ePAL putting in place a satisfactory access framework. Such a regulatory approach would be consistent with that taken for the other debit schemes in the context of restrictions on connection charges and pricing for access purposes.

The Bank is also mindful that the issues surrounding access – and thus any need for specific access regulations – could change considerably if the architecture of the EFTPOS system were to change as part of ePAL's strategy to promote the scheme.

10. Implementation and Review

As discussed in Section 3, while an interchange fees Standard and Access Regime are currently in place for the EFTPOS system under the 2004 designation, the regulatory framework for the newly designated EFTPOS system (designated in June 2012, based on ePAL's Scheme Rules) requires new instruments to be put in place. With new regulation in place, the original Standard, Access Regime and designation could then be removed. While the Bank is of the view that an access regime is no longer required if ePAL can put in place satisfactory access arrangements, it is not in a position to remove the existing Access Regime until that condition has been met. On the other hand, placing bilateral EFTPOS interchange fees on the same footing as multilateral EFTPOS fees under a new interchange fees standard is not contingent on those access arrangements. The Board has therefore approved implementation of the new EFTPOS interchange fees Standard, which will come into effect on 1 July 2013. The Board has also approved the removal of the original EFTPOS interchange fees Standard, applying to the original 2004 EFTPOS designation, on the same date.

The new interchange fees Standard is set out in Attachment 2. It is substantively the same as the Draft Standard in the June 2012 consultation document, with some minor changes to wording to ensure regulatory consistency with the other debit schemes. In addition, a transparency provision has been added to ensure that ePAL certifies in writing every year that multilateral interchange fees in the system complied with the Standard.

The Bank encourages ePAL to put in place a new access framework in a timely manner. At a minimum, the framework should give consideration to issues such as: limits on connection costs; minimum service level requirements; the establishment of full connections within a set time frame; dispute resolution processes; criteria for access; and obligations of participants to exchange, clear and settle EFTPOS transactions. It will be important to this approach that all parties have confidence in ePAL to govern access in a fair and objective manner, although in general it could be expected to be in a scheme's interest to encourage participation in the system. Any changes in EFTPOS network architecture would be considered by the Bank in determining the suitability of access arrangements.

Until the new access framework is in place, the Bank expects participants to continue good faith negotiations on such matters as access and pricing, and to abide by the current access framework as a minimum in granting access. The Bank does not consider that any additional transitional arrangements are required.

The Board will consider and monitor the effect of the new regulatory framework on an ongoing basis and will respond, consistent with its obligations under the Act, if it deems further action to be appropriate.

Attachment 1

Designation

Designation No 1 of 2012

The RESERVE BANK OF AUSTRALIA designates as a payment system pursuant to section 11(1) of the *Payment Systems (Regulation) Act 1998* the debit card payment system operated within Australia known as the EFTPOS system.

The EFTPOS system is the electronic funds transfer system governed by the EFTPOS Scheme Rules promulgated under the constitution of EFTPOS Payments Australia Limited and any schedule, document, specification or rule published by EFTPOS Payments Australia Limited pursuant to those EFTPOS Scheme Rules.

Attachment 2

Standard

Interchange Fees in the EFTPOS System

Objective

The objective of this Standard is to ensure that the setting of interchange fees in the designated EFTPOS payment system promotes:

- (i) efficiency; and
- (ii) competition

in the Australian payments system.

Commencement date

1. This Standard comes into force on 1 July 2013 and is current as at that date.

Application

2. This Standard is determined under Section 18 of the *Payment Systems (Regulation) Act 1998*.
3. This Standard applies to the payment system operated within Australia known as the EFTPOS system, which was designated as a payment system on 12 June 2012 and is referred to in this Standard as the EFTPOS system.
4. In this Standard:
 - ‘Bilateral Agreement’ has the meaning given in the EFTPOS Scheme Rules and also includes any other agreement permitted under the EFTPOS Scheme Rules between two or more Members to pay or receive interchange fees that vary from those specified by the Company as payable between Members;
 - a ‘bilateral interchange fee’ is an interchange fee that is agreed between two or more Members under a Bilateral Agreement for payment solely between those Members in relation to EFTPOS Transactions;
 - ‘Company’ means EFTPOS Payments Australia Limited (ABN 37 136 180 366);
 - ‘EFTPOS Acquirer’ has the same meaning as in the EFTPOS Scheme Rules;
 - ‘EFTPOS Interchange Activity’ has the same meaning as in the EFTPOS Scheme Rules;
 - ‘EFTPOS Issuer’ has the same meaning as in the EFTPOS Scheme Rules;
 - ‘EFTPOS Scheme Rules’ are the rules promulgated under the constitution of the Company and any schedule, document, specification or rule published by the Company pursuant to those rules;

'EFTPOS Transaction' has the same meaning as in the EFTPOS Scheme Rules but excludes credits, refunds, reversals and chargebacks;

'financial year' is a 12-month period ending 30 June;

an 'interchange fee' is a wholesale fee payable between an EFTPOS Issuer and an EFTPOS Acquirer or Self Acquirer, directly or indirectly, in relation to an EFTPOS Transaction in the EFTPOS system;

'Member' means a member of the Company;

a 'multilateral interchange fee' is an interchange fee that is determined by the Company to apply to EFTPOS Transactions between Members unless a Bilateral Agreement is in place and applies;

a 'Self Acquirer' has the same meaning as in the EFTPOS Scheme Rules;

terms defined in the *Payment Systems (Regulation) Act 1998* have the same meaning in this Standard.

5. The Company and each Member must do all things necessary on its part to ensure compliance with this Standard.
6. If any part of this Standard is invalid, the Standard is ineffective only to the extent of such part without invalidating the remaining parts of this Standard.
7. This Standard is to be interpreted:
 - in accordance with its objective; and
 - by looking beyond form to substance.

Interchange fee

8. For the purposes of this Standard, an interchange fee paid from an EFTPOS Acquirer to an EFTPOS Issuer is to be expressed as a positive number and an interchange fee paid from an EFTPOS Issuer to an EFTPOS Acquirer is to be expressed as a negative number.

Bilateral interchange fees

9. A bilateral interchange fee (excluding GST) that is paid on any EFTPOS Transaction in Australia must not exceed the bilateral interchange fee benchmark set out in paragraph 10 below.

Bilateral interchange fee benchmark

10. The bilateral interchange fee benchmark for the EFTPOS system at any time will be the same as the benchmark applying to the Visa Debit system at that time under the Standard *The Setting of Interchange Fees in the Visa Debit Payment System* and published on the Reserve Bank of Australia's website.
11. The bilateral interchange fee benchmark may be re-calculated in accordance with the Standard *The Setting of Interchange Fees in the Visa Debit Payment System*.

Multilateral interchange fees

12. On each of the dates specified in paragraph 13, the weighted average of multilateral interchange fees implemented in the EFTPOS system in Australia (excluding GST) must not exceed the multilateral interchange fee benchmark set out in paragraph 15 below.
13. For the purposes of paragraph 12, the dates are:
 - (i) 1 November of every third year after 2012; and
 - (ii) the date any multilateral interchange fee is introduced, varied or removed in the EFTPOS system.
14. For the purposes of paragraph 12, the weighted average of multilateral interchange fees is to be expressed as a number of cents per EFTPOS Transaction. It is to be calculated by dividing the total interchange revenue that would have been payable had the interchange fees implemented on the dates specified in paragraph 13 been applicable in the previous financial year, by the number of EFTPOS Transactions in that year.

Multilateral interchange fee benchmark

15. The multilateral interchange fee benchmark for the EFTPOS system at any time will be the same as the benchmark applying to the Visa Debit system at that time under the Standard *The Setting of Interchange Fees in the Visa Debit Payment System* and published on the Reserve Bank of Australia's website.
16. The multilateral interchange fee benchmark may be re-calculated in accordance with the Standard *The Setting of Interchange Fees in the Visa Debit Payment System*.

Transparency

17. The Company must publish any multilateral interchange fees applying to EFTPOS Transactions on its website or otherwise make these fees publicly available.
18. The Company must certify in writing to the Reserve Bank of Australia, on or before 30 November each year, that interchange fees in the EFTPOS system complied with this Standard over the prior 12 months ending 31 October.
19. Any EFTPOS Acquirer or Self Acquirer that is a party to a Bilateral Agreement must report to the Reserve Bank of Australia by 1 November each year the range of bilateral interchange fees it received or paid in the previous financial year. The Reserve Bank of Australia may publish the industry range of bilateral interchange fees on its website.

Glossary

Term	Definition
ACCC	Australian Competition and Consumer Commission. A Commonwealth statutory authority responsible for ensuring compliance with the <i>Competition and Consumer Act 2010</i> (formerly the <i>Trade Practices Act 1974</i>) and the provisions of the Conduct Code. The Commission's consumer protection work complements that of state and territory consumer affairs agencies.
Acquirer	An institution that provides a merchant with facilities to accept card payments, accounts to the merchant for the proceeds and clears and settles the resulting obligations with card issuers.
APCA	Australian Payments Clearing Association Limited. A public company owned by banks, building societies and credit unions which has specific accountability for key parts of the Australian payments system, particularly payments clearing operations.
CECS	Consumer Electronic Clearing System. CECS is a system managed by APCA.
COIN	Community of Interest Network. The COIN is a 'network cloud', or virtual private network, established by the industry in 2010 to simplify the exchange of messages for approved low-value payment systems by allowing each participant to connect to all other participants in the system using a single physical connection, instead of a connection to every other participant.
Debit card	A debit card is a card that enables the holder to access funds in a deposit account at an authorised deposit-taking institution.
EFTPOS	A domestic debit card system managed by EFTPOS Payments Australia Limited (ePAL) that makes use of processing infrastructure owned and operated by domestic financial institutions. Prior to the establishment of ePAL, the EFTPOS system was characterised by bilateral interchange agreements and did not have a centralised governing body to make strategic decisions for the system.
ePAL	EFTPOS Payments Australia Limited. ePAL is a company established in 2009 to centrally manage the EFTPOS system, and is owned by its 14 members.
Interchange fee	A fee paid by the acquirer to the issuer, or vice versa, when a cardholder undertakes a transaction.
Issuer	An institution that provides its customers with debit or credit cards.
Merchant service fee	A per-transaction or <i>ad valorem</i> fee paid by a merchant to its acquirer when a cardholder undertakes a transaction.
Payments System Board	The Payments System Board (the Board) was established in 1998 within the Reserve Bank of Australia (the Bank). The Board is responsible for determining the Bank's payments system policy so as to best contribute to: controlling risk in the financial system; promoting the efficiency of the payments system; and promoting competition in the market for payment services, consistent with the overall stability of the financial system. Powers to carry out the Board's policies are vested in the Bank.
Self-acquirer	A merchant that sends or receives payment instructions directly to or from issuers rather than through an acquirer and takes on the responsibilities usually undertaken by an acquirer.
Sole-acquirer	An acquirer that is not also an issuer.