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Dr John Veale
Head of Payments Policy
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Dear Dr Veale

REFORM OF CARD PAYMENT SYSTEMS

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

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

Guiding Principles

The Commonwealth Bank has been an active supporter of reform in relation to EFTPOS including, chairing the EFTPOS Industry Working Group and leading its work in application for and support of authorisation for zero EFTPOS interchange fees. The Commonwealth Bank has also been an active participant in the Australian Payments Clearing Association Limited (**APCA**) EFTPOS access reform project. Each of these initiatives adopts a voluntary reform path, a path which in the view of the Commonwealth Bank is preferable for participants and in the public interest.

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

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

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

The industry has actively led and continues to participate in voluntary reform initiatives in relation to EFTPOS. Co-operative arrangements subjected to the test for authorisation under the TPA are tested through a rigorous public process to determine whether they satisfy an overall public benefit test. Furthermore, this process conducted by the ACCC is subject to a full merits review by the Australian Competition Tribunal (**Tribunal**). While in the case of the zero interchange fee authorisation application the Tribunal decision handed down on 25 May 2004 set aside the authorisation, in the Commonwealth Bank's view the procedure was in the public interest: subjecting the public benefit questions to judicial merits review.

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

Public Interest

In the Commonwealth Bank's view alternative regulatory approaches and voluntary arrangements have not been exhausted in respect of EFTPOS reform. The APCA EFTPOS access project is continuing to its specified timetable making constructive progress involving a broad range of participants and parties with a range of interests in respect to access reform including major retailer groups. The Reserve Bank is monitoring that progress closely and the industry is conscious of the need to achieve constructive reform in a short time frame. This reform proposal may be resolved by voluntary co-operative industry arrangement and then implemented within a TPA regulatory framework subject to the appropriate consultation processes.

In respect to the Tribunal decision to set aside the ACCC authorisation of zero interchange fees, it is more difficult to identify further avenues for voluntary reform. As an applicant for authorisation, the Commonwealth Bank publicly supported the move to zero interchange fees both before the ACCC and the Tribunal. The Tribunal found that there would be real public detriment and saw little public benefit in allowing the change to come about. This may be an area where the exercise of the Reserve Bank reserve powers will be warranted, if the Reserve Bank considers it to be in the public interest.

If so, retention of an interchange fee structure, providing future flexibility to address investment incentives, cost / benefit imbalances, or to fund significant one-off industry developments should be considered.

Scope of Potential Designation

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

The infrastructure supporting the proprietary EFTPOS networks broadly comprises:

- several networks of terminals provided to Merchants to facilitate obtaining a Cardholder's card and PIN information;
- internal Acquirer and Issuer switches; and
- telecommunications switching infrastructure to facilitate communications links between the Acquiring and Issuing participants in each transaction.

The majority of this infrastructure is, separately, owned and operated by six Network Principals (including the Commonwealth Bank). Other significant network infrastructure operators include Merchant Principals that operate Private EFTPOS Terminal Networks. This infrastructure has multiple uses, for EFTPOS transactions, ATM transactions, some credit card transactions, charge card transactions, value added services provided to merchants, and electronic funds transfers at point of banking. This broad base of infrastructure, combined with such a multitude of applications, clearly does not provide a sound basis for designation.

The proprietary EFTPOS networks are supported by bilateral interchange agreements, which include standards concerning clearing, settlement and interchange fee arrangements. These arrangements support the set of EFTPOS transactions – EFTPOS Withdrawal Transaction (including sales, sales / cash-out and cash out only), EFTPOS Reversal Transaction and EFTPOS Declined Transaction. In the event that the Reserve Bank considers a designation with respect to EFTPOS to be in the public interest, it is this set of transaction types which will need to form the scope of regulatory attention.

Bearing these issues in mind, in the event that the Reserve Bank considers a designation with respect to EFTPOS to be in the public interest, the Reserve Bank will need to be mindful of the unintended consequences of broad regulation with respect to future investment and innovation.

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

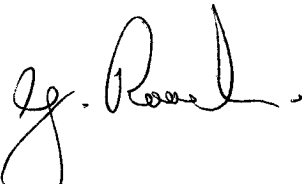
Commonwealth Bank position

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

- EFTPOS reform should be pursued as far as possible through voluntary industry reform and the co-regulatory structure envisaged under the PSRA;
- the APCA process has not been exhausted as a means of EFTPOS access reform;
- in respect to zero interchange, other avenues may have been exhausted; and
- in the event the Reserve Bank considers designation in the public interest, it is difficult to determine the scope of designation of a system that provides a useful basis for EFTPOS reform.

We note that the Reserve Bank intends providing the opportunity for discussion with parties lodging submissions in regard to reform of card payment systems. The Commonwealth Bank will continue to be an active participant in industry initiatives relating to EFTPOS reforms and would be happy to meet with the Reserve Bank in its consultation process in respect to designation, and to this end we request you contact the writer at the above address, or Stuart Woodward (phone 9312-7523) to arrange such discussions.

Regards


pp. Bruce Munro
Executive General Manager