

29 April 2005

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Please reply to:
Robert Slocombe
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Dear Dr Veale,

Re: Reform of EFTPOS and Visa Debit Systems

I refer to the Reserve Bank of Australia's press release dated 24 February 2005, seeking submissions in response to the gazetted draft standards for the EFTPOS and Visa Debit systems.

St.George is an issuer of proprietary EFTPOS cards and Visa branded debit cards with more than two million cards on issue to our customers under the St.George and BankSA brands. We are also a large acquirer of EFTPOS and Visa Debit transactions issued by St.George and other institutions. The benefits of providing customer choice with payment products is becoming more evident over time, with an increasing proportion of our customers choosing to use Visa Debit via channels that are not available to those customers with a proprietary debit product.

St.George has also enjoyed being an active participant in payment systems reform and we welcome this opportunity to comment on the Bank's draft standards.

General methodology

As St.George has stated in previous submissions, we believe that it is appropriate to apply a consistent interchange methodology across all card based payment products with the distinctions between credit cards, scheme debit cards, and EFTPOS debit cards recognised in the resulting interchange calculation. The calculation must be based on sound economic principles that are transparent and defensible, and that utilise appropriate issuer and/or acquirer cost data.

The draft standards and supporting consultation document identify and discuss a number of options available to the Bank in setting interchange levels for EFTPOS and Visa Debit. In particular the option of setting an absolute level of difference between the two payment systems is the Bank's preferred approach¹. The Bank also concedes that if these standards are adopted different interchange standards apply in the credit card, Visa Debit, and EFTPOS payment systems².

While we are encouraged that the Bank would prefer a common methodology, and is considering a further review in 2007, the additional uncertainty about future interchange levels may result in issuers incenting their customers to convert their current scheme debit

¹ Reform of the EFTPOS and Visa Debit Payment Systems in Australia, February 2005 - Paragraph 2.5(iv) 'Narrow the Differential' at pp29

² pp31

card into a credit card. Our own analysis has indicated significant numbers of Visa Debit customers would be eligible for a credit product and could switch due to pricing or other signals.

Differential model

By using a target measure of an absolute level of difference between EFTPOS and Visa Debit interchange, a model is created that distorts the true economic drivers in issuing and acquiring debit products. This is exacerbated when the cost base used in the interchange calculations is from a different payment system and does not reflect the true costs of the participants. Further, no explanation has been provided in either the consultation document or the standards for the removal of fraud and fraud mitigation costs from the Visa Debit interchange standard. Rather, it appears that inclusion of fraud costs would result in an interchange level deemed too high by the Bank.

The Bank has identified that it is concerned that interchange levels that reflect the actual costs of current issuers alone could result in larger issuers being attracted to issue the product³. Surely the risk of larger institutions issuing the product has *lessened* over time as Visa Debit interchange rates have reduced in line with credit card rates. Further, with a short 3-year review period, the interchange levels could be reset at that time to include the cost data of larger issuers who potentially bring additional scale benefits.

Flat fee interchange

The consultation document identifies that a flat fee interchange for Visa Debit is preferred as the costs of processing and authorisation are “*unrelated to the size of the transaction*”⁴.

While this may be the case, the mechanics of the calculation in Standard No. 4 use the relative sizes of debit and credit card transactions to determine the interchange fee. In particular paragraph 11(a) of the standard identifies that the cost base is calculated using the *value* of credit card transactions rather than the *volume*. A weighted average cost percentage is then multiplied by the average debit card transaction arriving at the ultimate benchmark. As debit card transactions are on average for a smaller amount than credit card transactions, the benchmark understates by a few cents the costs of processing and authorisation.

The more appropriate measure would be for a unit cost to be calculated by dividing the costs of processing and authorisation by the total number of credit card transactions. This amount should then be applied as the benchmark for debit card transactions.

Honour all cards and surcharging

St.George has long maintained that the Honour All Cards rule should be retained in the Australian market as it promotes rather than suppresses competition. As a number of issuers and schemes have noted in prior submissions, the rule:

- Ensures new market participants benefit from the scale of the established network, removing barriers to entry;
- Does not prohibit merchants from accepting other payment methods; and,
- Promotes confidence in the payments system through guaranteed card acceptance and merchant payment.

Irrespective of the final outcome on the Honour All Cards rule, we agree with the Bank that the ‘honour all issuers’ aspect of the rule is vital as it ensures acquirers cannot exclude particular issuers

³ pp36

⁴ pp36

While the Bank has previously commented that merchants have limited ability to recover costs incurred by compliance with the Honour All Cards rule, St.George maintains that the introduction of surcharging will broadly mitigate this concern. However, in the spirit of interchange reform, the surcharging standard should ensure that any surcharge levied by a merchant reflects the economic cost of accepting that card and is fully disclosed to customers at the time of transaction. Further the surcharging standard should ensure that retailers and other merchants offering competing payment systems cannot use surcharging as a method to recruit consumers to their own product.

Product differentiation

St.George supports the Bank recommendation that the Visa Debit product is clearly identified at the point of sale. As you are aware St.George has unique BIN identifiers for our scheme debit portfolios, and we will be introducing a new range of card designs that include a separate 'Debit' identifier further differentiating between our credit cards, scheme cards, and proprietary debit cards.

Conclusion

St.George supports the introduction of reduced interchange for EFTPOS transactions and a modified credit card standard for scheme debit transactions. However, it is vital that aspects of the standards are amended prior to implementation. The use of a differential model for determining EFTPOS and Visa Debit interchange levels does not include all relevant economic factors. In addition, the mathematical calculation used to determine the Visa Debit benchmark requires further consideration.

We look forward to further discussions with the Reserve Bank on the issues raised in this letter. The outcome of these deliberations has significant impact on both St.George and our customers and we welcome a timely resolution of any outstanding items.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Robert Slocombe', followed by a long horizontal line extending to the right.

Robert Slocombe

Head of Deposits & Electronic Channels