

A REVISED INTERCHANGE STANDARD FOR THE EFTPOS SYSTEM

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A Revised Interchange Standard for the EFTPOS System

1. Introduction

The Payments System Board has held long-standing concerns about the competitive effects of different interchange fees and governance arrangements in the EFTPOS and scheme debit systems. Initially, it addressed these concerns by regulating to narrow the interchange fee differential between the two systems. But in its review of the card payment reforms, completed in September 2008, the Board indicated that it intended to further address its concerns by either removing regulation on both systems or, in the event regulation was maintained, making the regulations consistent. The adoption of the former option was contingent on the Board forming a view that governance arrangements and market structures were such that vigorous competition between the systems could be generated and maintained.

In August 2009, the Board decided to defer its decision on future regulation, and maintain the existing regulations so that it could gather more information on the likely evolution of the competitive landscape. A significant factor in this decision was that the new governance arrangements for the EFTPOS system had only recently been established and had not had sufficient time to demonstrate their effectiveness. But this deferral meant that the difference in regulatory treatment of the debit systems would remain for the time being and, in particular, that EFTPOS interchange fees would remain more tightly constrained than scheme debit interchange fees. The Board was of the view that this could limit the extent to which the newly established EFTPOS scheme could compete with the scheme debit systems prior to any final decision on the regulatory landscape. It therefore decided to consult on the possibility of changing the regulation of EFTPOS interchange fees to be consistent with that applying to scheme debit.

This document sets out the Board's analysis and conclusions on this issue. Section 2 sets out the Payments System Board's mandate and objectives. Section 3 discusses the background to the current interchange regulations on debit cards and the reason why the Board decided to consider a change to the EFTPOS interchange Standard. Section 4 sets out the proposed EFTPOS interchange Standard and Section 5 summarises the consultation. Section 6 sets out the options considered by the Board and its assessment of the options. Section 7 concludes.

2. The Payments System Board's Mandate and Objectives

The Payments System 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 the Payments System Board at the Reserve Bank with the responsibility and powers to promote greater competition,

¹ *Financial System Inquiry (1997), Final Report, March.*

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*. The Act 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 Reserve 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 reforms to the debit card systems are those set out in the *Payment Systems (Regulation) Act 1998*. Under this Act, the Bank has the power to designate payment systems and to set standards and access regimes in designated systems. The Act also sets out the matters that the Bank must take into account when using these powers, including the desirability of payment systems: being financially safe for use by participants, efficient and competitive; and not materially causing or contributing to increased risk to the financial system.

3. Background

The Australian debit card systems

Two types of debit card systems operate in Australia to allow cardholders to make purchases with funds drawn from a deposit account. The EFTPOS system allows cardholders to swipe their card through a terminal at the point of sale and verify the transaction using a personal identification number (PIN). EFTPOS payments are processed through bilateral links between customers' and merchants' financial institutions, with each link governed by one of the many bilateral agreements between financial institutions. It is common practice for financial institutions to issue cards providing EFTPOS and ATM access when deposit accounts are established. As a result EFTPOS cards are ubiquitous. EFTPOS is currently the dominant debit card system in Australia, accounting for 85 per cent of debit card payments in 2008/09.

Scheme debit systems can be used to make payments at point-of-sale terminals, using either signature or (since June 2008) PIN verification, but can also be used remotely (for example, over the internet or the telephone) by quoting the card number and other details. Payments are processed via the networks of the international card schemes. Visa Debit cards have been offered in Australia for many years. Debit MasterCard was launched in Australia in 2005. Like EFTPOS cards, scheme debit cards are issued by financial institutions. They carry branding of both the issuing institution and the scheme. In recent years scheme debit has been actively promoted, including by the major banks, resulting in rapid growth in its use. In the year to the September quarter of 2009, scheme debit transactions increased by 37 per cent.

In nearly all cases scheme debit cards are multi-function, providing point-of-sale access to the cardholder's funds via the EFTPOS system as well as through the scheme. 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 case through the relevant international scheme.

Public policy concerns

A critical difference between the EFTPOS and scheme debit systems is the operation of interchange fees. In line with the bilateral nature of the EFTPOS system, EFTPOS interchange fees are bilaterally negotiated and paid by card issuers to transaction acquirers. Scheme debit interchange fees, in contrast, are centrally set by the scheme operator and flow from the acquirer to the issuer. This difference was discussed by the Reserve Bank and the Australian Competition and Consumer Commission (ACCC) in *Debit and Credit Card Schemes in Australia: A Study of Interchange Fees and Access* (the Joint Study), published in October 2000. At the time of the Joint Study, EFTPOS interchange fees averaged around 20 cents per transaction, flowing to the acquirer, while Visa Debit interchange fees were around 0.95 per cent of the transaction value, flowing to the issuer – the same as credit card interchange fees. The Joint Study noted the significantly different interchange fees in the two systems, concluding that there did not seem to be a convincing case for an interchange fee in either direction in the case of the EFTPOS system and that there was no case for applying credit card interchange fees to debit cards.

The Board's main concerns with interchange fees in the EFTPOS and scheme debit systems at this time were that they were subject to limited competition and that the large discrepancy between fees provided issuers with an incentive to promote scheme debit (or credit), even though the resource costs of those systems were higher than for the EFTPOS system. Interchange fees in the scheme debit systems were set in the same way as for credit cards. In these systems, there was limited competitive pressure from merchants for lower interchange fees while cardholders were quite sensitive to the relative prices they faced for using different payment mechanisms. Competitive pressures therefore tended to raise interchange fees above efficient levels.² Similarly, normal competitive pressures did not act on EFTPOS interchange fees – once the bilateral fees were set, it was very difficult, if not impossible, to renegotiate them.

The end result was that, due to the limited competitive pressure and the history of the two types of systems, the difference in interchange fees was entrenched. This meant that prices to cardholders did not reflect the relative resource costs of the different systems. As a consequence, there was potential for the higher-cost systems to grow at the expense of the lower-cost EFTPOS system and for merchants' payment costs to rise, along with the overall level of goods and services prices in Australia. 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.

Regulatory response

While the industry was initially willing to address the Board's concerns about EFTPOS interchange fees, a self-regulatory solution proved impossible and the Bank ultimately regulated to address

² See *Reserve Bank of Australia (2005), Reform of the EFTPOS and Visa Debit Systems in Australia: A Consultation Document, February, pp19-26.*

the difference in EFTPOS and scheme debit interchange fees.³ A standard was introduced to constrain EFTPOS interchange fees for purchase transactions to between 4 and 5 cents paid to the acquirer. Unlike other interchange fee caps determined by the Bank, a cap and floor were established for EFTPOS interchange fees reflecting concerns that, in a system relying on bilateral negotiation, unfavourable interchange fees could be used by incumbents as a means of restricting new entrants' access to the system. At the same time, the Bank set a standard on Visa Debit interchange fees, capping the weighted-average interchange fee at 12 cents per transaction paid to the issuer. MasterCard provided a voluntary undertaking to adhere to the Visa Debit Standard in respect of its debit card system. These changes meant that for a \$100 transaction the differential between EFTPOS and scheme debit interchange fees was reduced by around 58 cents – from around 75 cents to 17 cents. The fall from prior to the credit card interchange Standard was even greater, at around 98 cents.⁴

While the reduction in the interchange fee differential addressed the Board's concerns to some extent, the Board remained of the view that, as long as a differential remained, there may have been an incentive for issuers to promote scheme debit, not on its merits, but on the basis of the more favourable interchange fees. The relative competitive positions of the EFTPOS and scheme debit systems were therefore revisited during the recent review of the Board's payments system reforms. At the conclusion of the Review, the Payments System Board indicated that it would be prepared to remove explicit credit and debit card interchange fee regulation if the industry took sufficient steps to improve the competitive environment.

Some of the key elements the Board identified as providing such an improved environment were related to the EFTPOS system's capacity to compete with the schemes by actively developing and marketing its products and setting previously inflexible interchange fees in a way that best advantaged the system. Central to this was the formation of an EFTPOS scheme with the ability to make decisions about the system. With improved governance and the removal of interchange restrictions, the Board was of the view that the EFTPOS system would be placed on a level playing field with scheme debit and would be in a much improved position to compete effectively.

If improvements to the competitive environment proved not to be achievable, the Board expressed a preference for further lowering interchange fees and applying a common treatment to both EFTPOS and the scheme debit systems. It concluded after consultation that this common regime would constrain interchange fees in the EFTPOS and scheme debit systems to between five cents paid to the issuer and five cents paid to the acquirer.

3 *An industry proposal to reduce interchange fees in the EFTPOS system to zero was approved by the ACCC in 2003 but it was subsequently challenged by a group of merchants in the Australian Competition Tribunal and the decision was overturned. With little prospect remaining of an industry-initiated solution, the Bank, after reviewing the Tribunal decision and undertaking public consultation, designated the EFTPOS system in September 2004 with a view to establishing lower interchange fees via a standard under the Payment Systems (Regulation) Act. After delays related to further legal action and the development of an industry access code for the EFTPOS system, the EFTPOS interchange fee 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. See Reserve Bank of Australia (2006), Reform of the EFTPOS and Visa Debit Systems in Australia: Final Reforms and Regulation Impact Statement, April, for more details of the process leading up to the regulation of the EFTPOS and scheme debit systems.*

4 *Since scheme debit interchange fees were initially the same as those for credit cards, scheme debit interchange fees were lowered from around 0.95 per cent to around 0.55 per cent in November 2003 as a result of the introduction of the credit card interchange Standard.*

The current issue

The Board considered the future of interchange regulation at its August 2009 meeting. It concluded that progress on improving the competitive environment was not sufficient to provide it with confidence that interchange fees would not rise if interchange regulation were removed. Nonetheless, in recognition of the progress that had been made by the industry, including the formation of an EFTPOS scheme, the Board decided that it would not be appropriate at that time to lower interchange fees further. Instead, the Board decided to defer consideration of any further reduction in interchange fees. It indicated that it would keep matters under review, and would be prepared to re-open consideration of the regulations in light of industry developments.⁵

A consequence of that decision was that, in the absence of any other action by the Bank, the different regulatory standards applying to the EFTPOS system and the scheme debit systems would continue, to the potential detriment of the efficiency of the payments system. In particular, under the current regulatory regimes, the EFTPOS system is more constrained in its ability to set interchange fees than are the scheme debit systems. While the EFTPOS system continued to operate as a series of bilateral relationships this may not have mattered, as it was not possible for the system as a whole to set interchange fees in its best interests. But with the formation of the EFTPOS scheme earlier this year, there is the possibility of more active competition between the two types of debit card systems. While EFTPOS Payments Australia Limited (EPAL) is not yet fully operational, its formation provides the potential for more active promotion of the system and for decisions to be made about interchange fees in the interests of the system. But without some flexibility in setting its interchange fees, EPAL's ability to compete is likely to be hampered.

Leaving EFTPOS interchange regulation unchanged until the Board made a final decision about the future of interchange regulation more generally was an option. However, it was the Board's view that there could be material market changes resulting from the disparate regulatory treatment during this transitional period that might affect the ultimate competitive outcome, regardless of any final decision that was made. It was also the Board's view that providing decision-making flexibility was important during the formative stages of the EFTPOS scheme to facilitate its growth and allow it to demonstrate the competitive pressure it could bring to the market. For this reason, the Board indicated that it was considering amending the interchange Standard for the EFTPOS system to make it consistent with the Visa Debit interchange Standard and invited submissions on the proposal.⁶ This amended EFTPOS interchange Standard would remain in force until such time that the Board made a final decision on interchange regulation.

4. Proposed Changes to the EFTPOS Interchange Standard

The Bank published a draft Standard for EFTPOS interchange fees with its 22 September 2009 media release.⁷

⁵ Reserve Bank of Australia (2009), Media Release No. 2009-18, 'Payments System Reform', 26 August (www.rba.gov.au/MediaReleases/2009/mr-09-18.html).

⁶ Reserve Bank of Australia (2009), Media Release No. 2009-20, 'Payments System Issues', 22 September (www.rba.gov.au/MediaReleases/2009/mr-09-20.html).

⁷ The draft Standard was gazetted on 24 September 2009.

The draft Standard largely replicated the effect of the Visa Debit interchange Standard for the EFTPOS system. It set the benchmark for EFTPOS interchange fees as the benchmark applying to the Visa Debit system under the Visa Debit interchange Standard. The Visa Debit benchmark is published on the Bank's website.

The method by which the draft Standard constrained interchange fees relative to the benchmark varied according to whether interchange fees were bilateral (agreed directly between two participants) or multilateral (applying to any participants in the system in the absence of a bilateral agreement). For multilateral interchange fees, the draft Standard mirrored the requirements of the Visa Debit interchange Standard. On specified compliance dates the weighted average of multilateral interchange fees was required to be no higher than the benchmark. The weighted average was to be calculated by dividing the total interchange revenue that would have been payable had the interchange fees on the compliance dates applied to the transactions processed in the preceding financial year. This would be expressed as cents per transaction. Compliance dates were to be on a specified date each third year or on the date when any multilateral fees were introduced, varied or removed.

For any bilateral interchange fees that remained in the EFTPOS system, the above methodology was unlikely to be workable. The decentralised nature of the bilateral fees would significantly complicate the calculation of a weighted average, but more importantly, no single entity would have control over those fees in a way that would allow them to be adjusted to bring the weighted average into line with the benchmark. For this reason, the draft Standard simply prevented any bilateral fee from exceeding the benchmark, a similar approach to the existing EFTPOS interchange Standard.

One additional element that had to be accommodated by the draft Standard was the possibility that interchange fees could flow either from the acquirer to the issuer or from the issuer to the acquirer – or indeed that interchange fees might be zero. While, at least conceptually, Visa Debit interchange fees could flow from the issuer to the acquirer (and the Visa Debit interchange Standard does not prevent it), in practice this has not occurred and was not contemplated in the drafting of the Visa Debit interchange Standard. In contrast, the draft Standard for EFTPOS interchange fees explicitly contemplated interchange fees that could flow in either direction. It achieved this by defining interchange fees that flow from acquirers to issuers as positive numbers and those that flow from issuers to acquirers as negative numbers. The draft Standard therefore allowed interchange fees to flow to the acquirer because a 'negative' fee would by definition be lower than the 'positive' benchmark. One implication was that cash-out arrangements, some of which involve the payment of around 20 cents to the acquirer, would be consistent with the draft Standard. As such, there would be no need for an exemption for cash-out transactions and none was included.

Finally, the draft Standard imposed two obligations in relation to transparency of EFTPOS interchange fees. EPAL was required to publish any multilateral interchange fees for the EFTPOS system on its website or make them available in some other way. Acquirers or self-acquirers with bilateral interchange fees in place were required to report to the Reserve Bank once a year on the range of interchange fees received over the preceding year. The Bank would then publish the industry range.

5. Consultation

The Bank called for submissions from interested parties in its media release of 22 September 2009. In total, 16 submissions were received, 13 of these by the deadline of 23 October 2009. The submissions were from banks, retailers, industry associations, card scheme operators, specialist financial institutions and an industry analyst. All parties who made submissions were provided with an opportunity to discuss their submission and the submissions of others with the Bank.

Opinion about the appropriate course of action was divided between the submissions, with some supporting the changes and others opposing them. There were five main themes explored in the submissions: whether EFTPOS needed interchange fee flexibility to compete with the scheme debit systems; the distinction between card-present and card-not-present transactions; how to deal with bilateral arrangements; the implications for access; and the implications of these changes being transitional. These are discussed in turn below.

Does EFTPOS need the flexibility to compete?

A number of submissions argued that it was appropriate to put EFTPOS on the same regulatory footing as the scheme debit systems and, indeed, that this flexibility was necessary if EFTPOS was to compete with these systems. A number of these submissions argued that the proposed change ensured competitive neutrality and, as such, was appropriate. Some submissions further argued that interchange fees in the EFTPOS system needed to flow from acquirers to issuers, the same as for scheme debit cards, for EFTPOS to compete effectively. Two submissions argued for a floor on interchange fees as well as the proposed cap to ensure that interchange flowed from acquirers to issuers.

Two submissions, however, argued that providing interchange fee flexibility was inappropriate because the nature of competition in card payment systems was flawed and led to inappropriately high levels of interchange fees. One of these submissions suggested that, if regulatory change was to occur, EFTPOS interchange fees should be limited to a range from 5 cents paid to the issuer to 5 cents paid to the acquirer, a proposal that the Board had already identified as a possible final outcome. A number of submissions argued that the systems are different and therefore different interchange fees, and potentially regulation, may be appropriate. Some argued that a better way to ensure competitive neutrality would be to change the existing scheme debit interchange regulations to match the EFTPOS interchange regulations.

The distinction between card-present and card-not-present transactions

One submission noted that EFTPOS does not currently compete with scheme debit systems in card-not-present environments. It argued that in the card-present environment EFTPOS was currently very strong and, indeed, enjoying increased usage relative to scheme debit. This submission suggested that, given this distinction, there did not need to be any change to the regulatory environment for card-present transactions. It noted that, for card-present transactions, scheme debit transactions were below the 12 cent weighted-average cap. It was suggested that any increased flexibility in EFTPOS interchange setting should be targeted at card-not-present transactions where EFTPOS does not currently compete.

Another submission suggested that since EFTPOS does not compete for online transactions, setting the interchange fee cap for EFTPOS the same as for scheme debit would give EFTPOS a competitive advantage in card-present environments. The international schemes typically set interchange fees for card-not-present transactions higher than both card-present transactions and the regulated cap. The greater the proportion of card-not-present transactions within a system, therefore, the lower card-present interchange fees would need to be to comply with the cap. It was argued that this would allow the EFTPOS scheme to set interchange fees for card-present transactions higher than the equivalent fees in the scheme debit systems.

Treatment of bilateral arrangements

A number of submissions highlighted potential problems with the operation of bilateral arrangements under the proposed regime. Some observations also reflected a view that future arrangements in the industry are more likely to be multilateral, with bilateral arrangements being phased out. Two submissions suggested that existing bilateral arrangements could be grandfathered at their current levels and only multilateral interchange fees be given the greater flexibility allowed by the proposed Standard. One submission raised concerns that, to the extent that arrangements in the EFTPOS system remained bilaterally based, the system would be at a disadvantage because of the more restrictive regulation of bilateral interchange fees that has been proposed – namely a hard cap compared with a weighted-average cap. There was a general (although not unanimous) view in submissions and subsequent discussions that the regulatory changes should, to the extent possible, encourage a move to multilateral interchange fees, although they differed on the most appropriate way to achieve this.

Implications for access

Submissions were mixed on whether the proposed changes would adversely affect access to the system. Some submissions suggested that access was a relatively minor problem and that EPAL could now work to further reduce any access problems to the system. A number of submissions, however, acknowledged that an easing of the existing constraints on bilateral interchange fees could create additional difficulties for access seekers and that, in general, multilateral interchange fees are more access-friendly than bilateral arrangements. One submission noted that competition would be stronger if more parties were able to freely access the system. It was argued that, while access remained difficult, greater flexibility of interchange fees would not necessarily result in a more competitive outcome and that it would therefore be preferable to keep the current constraints on interchange fees until such time as access problems were dealt with. During discussions, some parties suggested that this may merely be a theoretical problem and that it was unlikely that any industry participants would expend effort on renegotiating bilateral interchange fees, with the attendant access concerns, given that the EFTPOS system is likely to move to multilateral interchange fees.

Implications of these changes being transitional

A number of submissions argued that the likely life of these transitional arrangements, when combined with the amount of time required to change existing interchange fee arrangements, means that there is a danger that the final regulatory outcome will be in place before any meaningful renegotiation can take place. That is, that either no changes will actually occur in the

time available or that renegotiation costs will be incurred twice for a minimal interim benefit. These submissions therefore argued for leaving regulation unchanged because the likely benefits of change would not outweigh the costs over the limited lifetime of the new regulations. One submission argued that any changes to interchange fees in the proposed transitional phase might simply be reversed if the Bank were ultimately to move to a regime of lower, regulated interchange fees instead of deregulation. Many submissions supported the changes only to the extent that they were transitional and expressed a preference for different long-term arrangements.

A number of other issues were raised in submissions that are not discussed here. Of note, however, was that a number of submissions raised questions about the treatment of cash-out transactions. This is considered in the analysis of the options, below. The submissions can be found on the Reserve Bank's website (www.rba.gov.au/PaymentsSystem/Reforms/DebitCardSystemsAus/submissions_received.html).

6. The Options

Reflecting the feedback received in the consultation process, the Board considered three options.

Option 1: The status quo

Under this option, the Board would leave the regulatory regime unchanged. Interchange fees on EFTPOS purchases would be required to be between 4 and 5 cents paid to the acquirer and transactions with a cash-out component would be unregulated.

Option 2: A new standard for multilateral and bilateral EFTPOS interchange fees

Under this option, the standard implemented would be as set out in Section 4. The weighted average of any multilateral interchange fees set by the EFTPOS system would be required to be below a cap set by reference to the cap on scheme debit interchange fees, currently 12 cents per transaction paid to the issuer. Any bilateral interchange fees would also be required to be below this cap.

Option 3: A new standard for multilateral EFTPOS interchange fees, with regulation of bilateral fees unchanged

Under this option, bilateral arrangements would be grandfathered and remain subject to the current range of 4 to 5 cents paid to the acquirer for purchase transactions. Any multilateral interchange fees would be subject to a cap on the weighted average at the same level as currently applies to scheme debit transactions. This option is based on suggestions made during the consultation process and is designed to address concerns raised about the difficulty of renegotiating bilateral interchange agreements during a transitional period and the access problems that might also ensue from the wider permissible range of bilateral interchange fees.

Assessment

The Board is of the view that the first option would not promote competition and efficiency in the payments system and would hinder the ability of the EFTPOS system to compete with

the scheme debit systems. If the status quo were maintained, the recently established EFTPOS scheme would have no flexibility in setting its interchange fees. This would mean that the current interchange fee for purchases would remain between 4 and 5 cents paid to the acquirer. But it might also mean that any interchange fees introduced for new types of transactions would be similarly constrained. The ability to set interchange fees in the best interests of the scheme is an important part of a scheme's competitive strategy. While this may not have been practical prior to the creation of the EFTPOS scheme, the new governance structure now makes such decisions possible. Furthermore, if the status quo were maintained, the scheme debit systems would have a strong incentive to use their more flexible regulatory arrangements to their competitive advantage. In these circumstances, the growth of the systems is likely to continue to be determined in part by the interchange differential, rather than on the basis of the merits of the systems. This would not be in the interests of the efficiency of the payments system.

Options 2 and 3 both have an advantage over Option 1 in that they provide the EFTPOS scheme with the same flexibility as the scheme debit systems in setting interchange fees. Therefore, they both overcome the main disadvantage of Option 1 – the inability of the EFTPOS scheme to compete effectively with the scheme debit systems. The difference between the options is the treatment of bilateral interchange fees.

The advantage of Option 2 over Option 3 is that it attempts, as far as possible, to impose a consistent treatment on all EFTPOS interchange fees, whether bilateral or multilateral. It is not possible to be entirely consistent because, as discussed in Section 4, it would not be possible to ensure a weighted average of bilateral fees complied with the Standard. But broadly, under this option, the industry would be free to set bilateral or multilateral interchange fees with as much flexibility as is currently provided to scheme debit systems. The disadvantage of Option 2 is that, because these are largely interim arrangements, any renegotiation of bilateral interchange fees making use of this greater flexibility might not be in the interests of efficiency. Not only might it be costly for the industry, but it may also divert participants from the more important task of developing a competitive strategy for the EFTPOS system. Option 3 eliminates this risk by leaving the regulation of bilateral interchange fees unchanged.

Option 3 has a further advantage over Option 2 in that it provides much greater protection of the principle of non-discriminatory access. The retention of a cap and floor on bilaterally negotiated interchange fees will limit the ability of incumbents to offer unfavourable interchange fees to new entrants. Multilateral interchange fees have the inherent advantage that they are access friendly because they offer the same interchange fees to all participants. Under Option 3, therefore, participants would be able to agree to an interchange fee outside the 4 to 5 cent range only if it is a multilateral fee.

On balance, the Board is of the view that Option 3 will best achieve its objectives. It will put the regulation of multilateral interchange fees in the EFTPOS and scheme debit systems on a consistent basis but at the same time ensure that participants do not expend resources in costly bilateral renegotiations that may result in access difficulties being exacerbated. Furthermore, the Board is of the view that since this is a transitional arrangement, changes necessary to improve the competitive landscape should be implemented in a way that avoids unnecessary disruption.

Under the preferred option, existing bilateral cash-out interchange fees would remain unregulated. Multilateral cash-out transactions would, however, be subject to the same treatment as any other interchange fee – they would be included in the calculation of the weighted-average interchange fee along with all other interchange fees. There would, however, be no requirement that cash-out interchange fees be set at the same level as purchase transactions.

While the two types of debit systems would be subject to equivalent regulation of multilateral interchange fees under this option, this does not imply that interchange fees in the different systems should be the same. Furthermore, it does not dictate how the greater freedom to set interchange fees should be used by the EFTPOS scheme. This will be a decision for EPAL, based on its judgements about the best commercial strategy. Indeed, it would be possible for EPAL to decide to set a multilateral interchange fee for purchases at the current level. There are, however, potentially many other strategies it might consider, each providing different incentives for issuers and merchants to support the system. In the Board's view, providing the EFTPOS scheme with the same flexibility as scheme debit would leave competition between the systems no worse off and would provide significant potential for it to be improved.

While the Board is easing the regulation on EFTPOS interchange fees somewhat during this transitional period, it is not leaving fees unconstrained. The Board is conscious of the tendency for competition between payment systems to result in rising interchange fees. The Board will be monitoring the development of EPAL's strategy, and in particular its approach on interchange fees, for evidence that it can exert downward competitive pressure on interchange fees in the scheme debit systems.

One final issue that arose during consultation, but was not directly related to the current proposal, was how any transition from bilateral to multilateral fees would be managed. Concerns were expressed about both the detriment that might occur if participants were forced off bilateral arrangements to less favourable multilateral arrangements, and the detriment that might occur to the growth of the system if bilateral arrangements continued indefinitely. While the Board acknowledges that this is an important question, it is hopeful that the industry will be able to negotiate this transition in a manner that takes account of the interests of all participants. For the time being, the Board is prepared to give the industry the opportunity to do so. The Board is supportive of the efforts of EPAL to simplify and improve the governance and operation of the EFTPOS system, including through the setting of multilateral interchange fees, but notes that nothing in the amended Standard requires any changes to existing bilateral interchange agreements.

7. Conclusion

The Board has decided that it is in the public interest to amend the EFTPOS interchange fee Standard such that any multilateral interchange fees set by EFTPOS Payments Australia Limited are subject to the same weighted-average cap as applies to the scheme debit systems. Bilateral interchange fees will continue to be regulated as they are now.

The new Standard differs from the draft Standard discussed in Section 4. It incorporates those elements of the draft Standard relating to the setting of multilateral interchange fees, while retaining the elements of the existing Standard that relate to the setting of bilateral interchange fees. A copy of the new Standard is attached. It will come into force on 1 January 2010.

Standard

The Setting of 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.

Amended and restated standard

1. This Standard is an amended and restated Standard of that gazetted on 27 April 2006 and amended on 8 December 2008.

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 9 September 2004 and referred to below as the EFTPOS system.

4. In this Standard:

an ‘acquirer’ is a participant in the EFTPOS system that provides services to a merchant to allow that merchant to accept a debit card;

a ‘bilateral interchange fee’ is an interchange fee that is agreed between two participants in the EFTPOS system for payment solely between those participants in relation to EFTPOS transactions;

‘cash out’ means the provision of cash to a cardholder by a merchant, as a result of a debit card transaction at the merchant;

‘debit card’ means a card issued by a participant in the EFTPOS system that allows the cardholder to make payments to merchants for goods or services and/or obtain cash out using the EFTPOS system by accessing a deposit account held at an authorised deposit-taking institution;

‘debit card transaction’ or ‘transaction’ means a transaction in Australia using the EFTPOS system;

‘financial year’ is the 12-month period ending 30 June;

an ‘interchange fee’ is a wholesale fee payable between an issuer and an acquirer or self-acquirer, directly or indirectly, in relation to a debit card transaction in the EFTPOS system;

an ‘issuer’ is a participant in the EFTPOS system that issues debit cards to its customers;

‘merchant’ means a merchant in Australia that accepts a debit card for payment for goods or services and/or that provides cash out;

a ‘multilateral interchange fee’ is an interchange fee that is determined by EFTPOS Payments Australia Limited to apply to transactions in the EFTPOS system between members of that system in the absence of a bilateral interchange fee agreement;

‘nominated EFTPOS acquirers’ are those acquirers and self-acquirers determined by the Reserve Bank of Australia, selected in order of their share of the number of transactions, who comprise the minimum number of such acquirers or self-acquirers required to account for at least 90 per cent of the number of transactions acquired in the EFTPOS system in the ‘reference year’;

‘reference year’ is the financial year prior to the relevant year;

‘relevant year’ is the financial year in which the bilateral interchange fee benchmark is calculated;

a ‘self-acquirer’ is a participant in the EFTPOS system that is a merchant that sends transactions directly to issuers rather than through an acquirer and takes on the responsibilities usually undertaken by an acquirer;

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

5. Each participant in the EFTPOS system 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.
8. This amended and restated Standard comes into force on 1 January 2010.

Bilateral interchange fees

9. A bilateral interchange fee paid on any transaction, other than a transaction which includes a cash out component, must be paid to the acquirer and be no more than the bilateral interchange fee benchmark applying in accordance with paragraph 15 and no less than the minimum fee specified in paragraph 16.

Bilateral interchange fee benchmark

10. The interchange fee benchmark for bilateral interchange fees in the EFTPOS system is to be calculated by the Reserve Bank of Australia as follows:
 - (i) for each of the nominated EFTPOS acquirers, the aggregate value of its eligible costs in the reference year is to be divided by the number of its debit card transactions in the reference year. The outcome is to be expressed as a number of cents per transaction;
 - (ii) the interchange fee benchmark is to be calculated by the Reserve Bank of Australia as the aggregate value of eligible costs in the reference year of the three nominated EFTPOS acquirers with the lowest outcome as calculated in paragraph 10(i), divided by the aggregate number of transactions undertaken by the same three nominated EFTPOS acquirers in the reference year. The result is to be expressed as a number of cents per transaction, rounded to the nearest cent.
11. Eligible costs are those directly related to processing and switching EFTPOS transactions incurred by an acquirer or self-acquirer when performing the business responsibilities usually undertaken by an acquirer.
12. Data on eligible costs must be drawn from accounting records of the nominated EFTPOS acquirers, prepared in accordance with generally accepted accounting principles and Australian equivalents to International Financial Reporting Standards.
13. The data required to conduct the calculation in paragraph 10 must be provided by each nominated EFTPOS acquirer to the Reserve Bank of Australia, or its agent, by 15 August in the relevant year.
14. The Reserve Bank of Australia, or its agent, will review the data to determine if the costs included are eligible costs and the Reserve Bank of Australia will use the eligible costs to calculate the bilateral interchange fee benchmark in accordance with paragraph 10.
15. The Reserve Bank of Australia will publish the bilateral interchange fee benchmark for the EFTPOS system by 15 September in the relevant year, and, subject to paragraph 19, this benchmark will apply for three years from 1 November in the relevant year.
16. The minimum fee determined for the purposes of paragraph 9 is 80 per cent of the applicable bilateral interchange fee benchmark.

Initial and subsequent bilateral interchange fee benchmarks

17. For the initial bilateral interchange fee benchmark for the EFTPOS system the relevant year is the financial year 2006/07.
18. The bilateral interchange fee benchmark for the EFTPOS system is next to be re-calculated in the financial year 2012/13 and every three years thereafter. The requirement to re-calculate the bilateral interchange fee benchmark in 2009/10 was waived by the Reserve Bank in December 2008.
19. The Reserve Bank of Australia may at any time, by notification on its website, waive or suspend the requirement to re-calculate the bilateral interchange fee benchmark, in which case the benchmark in force at that time will continue to apply.

Multilateral interchange fees

20. On each of the dates specified in paragraph 21, 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 24 below.
21. For the purposes of paragraph 20, the dates are:
 - (i) 1 November of every third year after 2009; and
 - (ii) the date any multilateral interchange fee is introduced, varied or removed in the EFTPOS system.
22. For the purposes of paragraph 20, the weighted average of multilateral interchange fees is to be expressed as a number of cents per 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 21 been applicable in the previous financial year, by the number of transactions in that year.
23. For the purposes of this standard, multilateral interchange fees paid from acquirers to issuers are to be expressed as positive numbers and multilateral interchange fees paid from issuers to acquirers are to be expressed as negative numbers.

Multilateral interchange fee benchmark

24. The multilateral interchange fee benchmark for the EFTPOS system will be the same as the benchmark applying to the Visa Debit system, as varied from time to time, and which is published on the Reserve Bank's website.
25. The Reserve Bank of Australia may at any time, by notification on its website, waive or suspend the requirement to re-calculate the multilateral interchange fee benchmark, in which case the multilateral interchange fee benchmark in force at that time will continue to apply.

Transparency

26. EFTPOS Payments Australia Limited must publish any multilateral interchange fees applying to EFTPOS transactions on its website or otherwise make these fees publicly available.
27. Each acquirer and self-acquirer with a bilateral interchange agreement in the EFTPOS system must report to the Reserve Bank of Australia by 1 November each year the range of bilateral interchange fees it received in the previous financial year. The Reserve Bank of Australia will publish the industry range of bilateral interchange fees on its website.