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BY EMAIL

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Financial Services Unit
Australian Competition & Consumer Commission
Level 20
175 Pitt Street
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Dear Sir / Madam

Australian Competition and Consumer Commission (ACCC) Inquiry into the Supply of Foreign Currency Conversion Services – Submission – PUBLIC VERSION

1. Introduction and summary

- 1.1 FEXCO Merchant Services (**FEXCO**) appreciates the opportunity to participate in the ACCC's Foreign Currency Conversion Services Inquiry (**Inquiry**), and this is a response to the Issues Paper seeking input from suppliers of foreign currency conversion services.
- 1.2 Our comments focus on three key points which cut across each of the four broad themes identified by the ACCC for the Inquiry. The points arise from the services FEXCO provides, in particular dynamic currency conversion (**DCC**) which is an acquiring service and Issuer Currency Optimisation (**ICO**) which is a new issuing service.
- 1.3 FEXCO plays an important role in the competitive landscape including by providing foreign currency conversion services which are ultimately used by Australian consumers to make purchases, including those travelling overseas with cards issued by Australian card issuers. In particular, DCC offers competition at the overseas point of sale, ATM or eCommerce site by giving a choice for the Australian card holder of an alternative FX conversion service to that provided by their issuing banks and the payment card schemes.

1.4 In short:

- (a) DCC services provided by FEXCO to overseas merchants and card acquirers offer enhanced choice, transparency, comparability, certainty and convenience to Australian cardholders. FEXCO considers that an analogous standard of transparency should also apply to standard payment card scheme FX conversions (which do not disclose the applicable exchange rate at the time of transaction, nor the applicable margin or the amount of fees charged by card issuers). We recommend the ACCC consider carefully the developing European regulatory approach towards transparency on cross-border transactions and currency conversion charges. This is outlined in more detail in section 4 below.
- (b) The ACCC should challenge the basis of the imposition of excessive and non-transparent international transaction fees by Australian card issuers on Australian card holders even when DCC has been applied on the card acquisition side overseas (so there is no FX conversion service provided by the card issuer / card scheme operator). This is outlined in more detail in section 5 below.
- (c) There would also be strong pro-competitive benefits if the card schemes were not permitted to impose restrictions on multi-currency settlement by card issuers in Australia. An apparent restriction by card schemes is having an anticompetitive effect by preventing FEXCO's provision of an innovative ICO service to card issuers in Australia which would give those institutions choice and allow them to circumvent the use of card scheme conversion services for the benefit of their Australian card holders. This is outlined in more detail in sections 3.8 and 6 below.

1.5 This submission contains redacted confidential information in respect of the business, commercial and financial affairs of FEXCO.

2. Background – FEXCO and the card schemes

- 2.1 FEXCO is a significant provider of foreign currency services for payment card transactions, introducing the world's first DCC service in 1996.
- 2.2 Globally, FEXCO provides its FX Services to forty four card acquiring banks and ten large merchants. Merchants include hotel chains and airlines located in twenty nine countries, including countries such as the United Kingdom, Sweden, Germany, UAE, China, Hong Kong, Japan and South Africa.
- 2.3 In Australia, FEXCO currently provides FX Services to **[begin FEXCO confidential]**

[end FEXCO confidential].
- 2.4 FEXCO plays a significant role in the competitive landscape for FX conversion services, both globally and in Australia, by providing alternative foreign currency conversion services to consumers. Globally, FEXCO offers DCC services ultimately used by Australian cardholders purchasing goods and services overseas. In Australia, FEXCO offers DCC services to Australian merchants and card acquirers which facilitate sales by them to overseas consumers wishing to purchase goods and services in Australia.

- 2.5 DCC providers like FEXCO are in direct competition with the card schemes in the supply of currency conversion services.
- 2.6 For more than 20 years, card schemes (Visa and MasterCard) and their issuing banks have generated billions of international transaction fees and currency conversion fees from consumers for cross-border credit card, debit card and ATM transactions (**cross-border transactions**). Traditionally, the back-office currency conversions supplied by card schemes for these transactions – the processes by which card schemes convert the merchant's local currency to the cardholder's home currency – have been provided by default without notice to the consumer and at FX rates that are determined by the card schemes for single currency debit/credit/prepaid cards. Even today, the exchange rates applied by card schemes and the fees applied by card issuers in cross-border transactions are undisclosed to consumers at the point-of-sale (**POS**), ATMs or eCommerce sites at the time of the transaction.
- 2.7 DCC service providers like FEXCO are viewed as a serious threat by the card schemes, because DCC (and ICO) disintermediates any need for the back-office currency conversion services provided by the incumbent card schemes and endangers the associated revenue streams (cross-border transaction fees represent 20–30% gross revenue for Visa and MasterCard). Where historically, the card issuer and card scheme may have benefited from standard conversions, in DCC-converted transactions the alternative margin from the transfer is instead shared between the DCC provider, the merchant and the card acquirer. In essence, DCC empowers card holders and shifts the margins towards the 'real economy', away from card schemes like Visa and MasterCard, to merchants. We estimate that today, DCC services account for approximately 5% of cross-border transactions globally.
- 2.8 In response to the threat of DCC, card schemes have over time initiated various strategies to block competition from DCC to their own back-office currency conversion services, engaging in conduct such as unfair pricing and regulatory controls. As the ACCC is aware, in 2015, Visa paid penalties of \$18 million for engaging in anti-competitive conduct for restricting the expansion of DCC as a result of the ACCC's enforcement proceedings. We note also that the EU Competition regulator, DG Competition, is currently conducting an investigation into foreclosure practices by card schemes in DCC.¹ FEXCO also currently has complaints on foot with the Hong Kong Competition Commission and the Japanese Fair Trade Commission in relation to similar issues.

3. Background - currency conversion services

- 3.1 Currency conversion services for cross-border transactions are comprised of processing services that convert the currency of the international merchant to the domestic currency of the cardholder to effectuate a payment transaction. There are three principal ways in which currency conversion services may be performed for cross-border transactions:
- (a) scheme currency conversion (standard currency conversion);
 - (b) DCC; and
 - (c) ICO.
- 3.2 We set out below the key elements of a standard currency conversion transaction as compared to a DCC- or ICO-converted transaction. This is important in identifying the distinctions in the service offerings and where margins are moving.

¹ DG Competition – Case AT.40085 – Foreclosure practices in DCC.

Standard currency conversion / non-DCC or ICO

- 3.3 In the traditional, incumbent card scheme model of standard currency conversion when an Australian card holder uses their card overseas to pay for something they are charged in the merchant's local currency. After the purchase, to determine the card holder billing amount (the amount the card holder will be billed prior to any additional fees) and the settlement amount (the amount the card issuer is expected to settle the card scheme) Visa or Mastercard converts the merchant's currency to Australian dollars. That amount—plus any international transaction fees typically applied by the Australian issuing bank—appears on the Australian consumer's card statement. Neither the currency-conversion rate nor any fees associated with the currency conversion are disclosed to the Australian consumer at the point of sale (or ATM / eCommerce site). The Australian consumer has no knowledge of the final amount of the purchase until the transaction posts to his or her account, and even then, the disclosure of the fees on the statement may be confusing.
- 3.4 The currency conversion profits for the scheme participants are typically comprised of:
- (a) an exchange rate set and charged by the card scheme. As there is a time delay between the time of authorisation (when the transaction is done) and the time of settlement (when transactions are cleared by the card schemes to card issuers), the card scheme applies an exchange rate that may be different from that which applied when the Australian card holder made the purchase and is generally not as competitive as a spot interbank rate; and
 - (b) an international transaction fee, which for most payment cards issued in Australia typically is around 3% – 3.5%, charged by the Australian card issuer to cover the cost of processing international transactions through the card schemes.

Dynamic currency conversion

- 3.5 DCC allows Australian card holders traveling abroad to pay for purchases in Australian dollars at the point of sale and at the time of the transaction. A DCC enabled merchant still prices its products in its local currency, but the merchant provides the Australian cardholder with the transparent choice to pay for the purchase in either the merchant's local currency or Australian dollars. With DCC, nothing is hidden from the consumer. The currency-conversion calculation is performed in real time at the point of sale, and the exchange rate is disclosed to the consumer.
- 3.6 If the consumer chooses to pay in Australian dollars, the merchant's acquiring bank or the DCC provider, acting as a third-party processor, submits the transaction to Visa or Mastercard with no back-office conversion required by the scheme. On the other hand, if the consumer chooses to pay in the merchant's currency, the credit or debit transaction is submitted and converted through Visa or Mastercard's default back-office process, as described above.
- 3.7 For DCC the currency conversion profits are typically shared three ways between the card acquirer, the merchant and the DCC provider. In the DCC world, card schemes and issuers lose out on the currency conversion revenue and international fees they traditionally enjoy.

Issuer Currency Optimisation

3.8 FEXCO offers a new ICO service which it would like to bring to the market in Australia. ICO is an issuing service that is designed to bring control of the FX conversion directly to the issuer for cross border transactions either as a result of Australian travel or overseas spend at foreign merchants in non AUD currency. The service allows card issuers to achieve a more optimal multi-currency settlement structure with the card schemes to mitigate settlement FX risk and to also be fully in control of the FX rate that is applied to cardholder accounts for customer billing. In doing so, greater transparency can be delivered to the Australian card holder.

4. Consumer outcomes would be better with enhanced cost transparency

4.1 DCC is a foreign currency service that provides cardholders with a choice of paying in their home currency or in the merchant's local currency. If the consumer declines DCC, the card schemes' back-office conversion services are used by default, and the conversion rate and associated costs are not disclosed at the time of the transaction. If the consumer chooses DCC, the currency conversion rate is fully disclosed at the POS / ATM / eCommerce site before the consumer consummates the transaction.

4.2 DCC is a completely voluntary, premium service which is pro-competitive because it provides:

- (a) Greater consumer choice and convenience – DCC enhances consumer choice by offering consumers a payment currency alternative in a clear and neutral manner, providing cardholders with the optionality to pay in their home currency instead of the local currency of where they are making their purchase. In the DCC world, consumers are offered the freedom to choose whether to pay in the local currency or their home currency. Consumers have the convenience of understanding exactly how much they are spending in their home currency before initiating the transaction;
- (b) Enhanced transparency, comparability and certainty – DCC is currently the only segment of the currency conversion market that provides full transparency and certainty, as the cardholder is provided with the exact transaction amount, with full visibility over the exchange rate and margin applied at the time of transaction. Transparency on the applicable exchange rate and the total amount of fees of a currency conversion transaction is of paramount importance to ensure an adequate level of consumer protection. Consumers are only able to make an informed choice if the total transaction cost is known prior to the initiation of the payment service; and
- (c) Price competition – DCC provides consumers with price competition in the supply of currency conversion services for cross-border transactions. In the incumbent scenario, consumers are not provided with the choice of currency conversion, and seldom have knowledge what currency conversion services are being applied.

4.3 Consistent with the ACCC's terms of reference, FEXCO believe that increasing transparency across the FX industry is crucial to improving consumers' ability to compare the pricing of different currency conversion services offerings.

- 4.4 FEXCO believes competition would be improved if the same level of transparency which applies to DCC services is applied to all currency conversion services, particularly scheme based conversion services. Only with full comparability between DCC and non-DCC will consumers be able to make a properly informed decision with complete information. That is, exchange rates and all total fees, charges and mark-ups charged by providers of currency conversion services, including card schemes and card issuers, should be required to be disclosed in a meaningful and effective manner at the time of transaction. Under the current regime, consumers are 'left in the dark', with the only disclosure in relation to the applicable exchange rate or amount of fees charged at the time of transaction sitting obscurely in the terms and conditions (scheme rules) which are provided with the card.
- 4.5 The European Commission is currently considering amending its cross-border regulations to improve transparency in relation to cross-border payments in the European Union and currency conversion charges.² We believe there is significant merit to the European regulatory approach towards currency conversion services and commend the proposal for the ACCC's consideration.
- 4.6 The proposed amendments would require enhanced transparency in the costs of both DCC and non-DCC be displayed at the POS. Payment service providers would be required to inform consumers of the full cost of currency conversion services prior to the initiation of a payment transaction, including:
- (a) the foreign exchange rate applied;
 - (b) the wholesale exchange rate; and
 - (c) the total amount of all charges applicable to the transaction,
- before the consumer can make a selection.
- 4.7 We encourage the ACCC to engage with card issuers and card schemes to determine the feasibility of analogous disclosure requirements for non-DCC providers in Australia. FEXCO acknowledges that there are technical difficulties to indicating the applicable exchange rate for non-DCC transactions at the time of operation. Unlike DCC, the exchange rate is not applied at the time of transaction and the overall cost applied by a card issuer is comprised of a number of elements beyond a typical percentage-based fee. This does not, however, preclude card schemes from being held accountable to analogous standards of transparency that are required for DCC transactions.
- 4.8 Moving forward, a potential 'half-way house' may be for example to include additional disclosure requirements at the POS which brings to the consumer's attention, the fact that with non-DCC transactions, the foreign exchange rate will be determined after completion of the transaction and is subject to additional card issuer fees.
- 4.9 This approach will improve transparency and comparability and may indeed generate significant savings for consumers, while the revenues of some payment service providers may decrease. Further, this approach will ensure that currency conversion costs are not able to be used by card schemes and card issuers to compensate for reduced revenues through increased, non-transparent margins on international transactions fees, as these costs are not usually understood by consumers.

² COM(2018) 163: Proposal amending Regulation (EC) No 924/2009 as regards certain charges on cross-border payments in the Union and currency conversion charges (<<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2018:163:FIN>>).

5. As well as enhancing disclosure, the ACCC should review the basis of international transaction fees charged by Australian card issuers when DCC has been applied overseas at point of sale / ATM / eCommerce site

- 5.1 As outlined above, the growth of DCC services (where the transaction currency and the issuer settlement currency match as a result of the service being applied on the acquiring side outside Australia) has to a degree undermined the revenue card schemes would have traditionally expected to derive from the provision of currency conversion services on cross-border transactions. This has no doubt placed some pressure on card schemes, which has in turn flowed to other scheme participants, particularly card issuers. This has produced a situation in Australia where card issuers are continuing to charge so-called 'international transaction fees' to their card holders at a level unjustified by the incremental cost to the card issuer arising from the international nature of the transaction when DCC has been applied at POS.
- 5.2 FEXCO understands that card schemes typically charge Australian card issuers approximately 1% fee for processing an international transaction of their card holder through the card scheme network. This scheme fee applies regardless of whether DCC is applied. In turn, with few exceptions Australian card issuers currently charge cardholders approximately **3–3.5%** as an 'international transaction fee' for those cross-border transactions. This international transaction fee is charged even for DCC-converted transactions, despite no currency conversion service having been provided by the card scheme or the card issuer to the card holder (i.e. the DCC provider provides the currency conversion services).
- 5.3 To be clear, in DCC-converted transactions, the only additional aspect of service which is being provided by Australian card issuers to their card holders for an international transaction is the provision of the facility through the card scheme which allows the cardholder to use the Australian card overseas. For this service, Australian cardholders are typically being charged a **3–3.5%** international transaction fee. However, if card schemes charge card issuers a 1% fee for processing international transactions, in effect card issuers are charging cardholders more than three times the cost for international transactions even when DCC has removed the need for the card issuer to provide a currency conversion service to its card holder.
- 5.4 FEXCO believes the imposition of international transaction fees by Australian card issuers is excessive, unjustified and unfairly increases the cost of DCC for consumers. While DCC providers must charge margin for providing currency conversion services to maintain the efficacy of their operating model, Australian card holders are effectively paying twice when Australian card issuers subsequently charge an additional excessive international transaction fee.

6. There would be strong pro-competitive benefits if the card schemes permitted multi-currency settlement for card issuers in Australia

- 6.1 The Issuer Currency Optimisation (ICO) service is a new currency optimisation service offered by FEXCO.
- 6.2 Unlike DCC, the currency conversion takes place later in the transaction process, by the card issuer rather than the merchant (through its card acquirer). Importantly the ICO service would still obviate the need for the card scheme to conduct FX conversion process for supported card scheme settlement currencies – for example, with the Australian card holder making an international transaction denominated in the merchant's local currency and that passing through the card scheme infrastructure to be settled by the Australian card issuer in the

original merchant currency, where that is a supported card scheme settlement currency, using the ICO facility provided by FEXCO.

- 6.3 In Australia, multi-currency settlement is supported at a transaction currency level for card acquirers by the schemes. However, multi-currency settlement at a transaction currency level is apparently restricted by card schemes for Australian card issuers. From a card issuer perspective, multi-currency settlement to match the original transaction currency at a transaction level is apparently no longer permitted by Mastercard unless the issued card is a multi-currency debit/prepaid card. Mastercard used to support settlement at transaction level but settlement specifications were changed in April 2018. Single currency debit/credit cards form the bulk of cards carried by Australian card holders and used abroad.
- 6.4 So far as FEXCO is aware, Visa may also not allow transaction level settlement to be done by Australian card issuers according to the original transaction currency unless the issued card is a multi-currency debit/prepaid card.
- 6.5 FEXCO believes the apparent restriction on multi-currency settlement at a transaction currency level by Australian card issuers by the card schemes across widely used single currency debit and credit cards is another example of the history of strategic steps by the card schemes to minimise competition to their own FX conversion services.
- 6.6 FEXCO considers that it would be pro-competitive if Australian card issuers could settle international transactions conducted by their single currency card holders through card schemes in the currency which is matched to the original transaction currency, so that card issuers can manage their own foreign exchange requirements where possible. This has the potential to provide an improved service for cardholders as card issuers would have direct control of the exchange rate used to fund settlement and therefore allow issuing banks to compete to deliver better outcomes to the card holder including improved transparency.

Please do not hesitate to contact us if you have any questions. Please contact [REDACTED] on [REDACTED] or by email at [REDACTED] if you would like to arrange such a discussion.

Yours faithfully

[REDACTED]
Managing Director
for and on behalf of
FEXCO Merchant Services Unlimited Company