

EFTPOS INDUSTRY APPLICANTS' GROUP

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Ms Jennifer McNeill
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Dear Ms McNeill

Applications for Authorisation A30224 and A30225 in relation to EFTPOS interchange fees

1 Background

1.1 General

We refer to the Commission's letters of 24 September and 2 October 2003 enclosing a further 27 public responses to the Commission's draft determination dated 8 August 2003 and the pre-determination conference held on 1 September 2003.

The Applicants have reviewed those submissions and believe that the issues raised in them have all been extensively addressed in previous submissions by the Applicants. The Applicants do not intend to repeat those arguments.

1.2 Continued areas of confusion

Of concern to the Applicants, however, is that some of key issues continue to be confused by some of the interested parties. This letter seeks to clarify the following issues:

- effect on competition;
- pass through of costs; and
- transparency.

1.3 *Key areas of support*

The Applicants also wish to highlight the support given by some of their most vocal opponents, to certain of their key submissions, namely:

- separation of interchange fees from access reform; and
- existence of competition in issuing and acquiring.

2 **Effect on Competition**

2.1 *Deemed substantial lessening of competition*

Caltex argues (at 4.2) that:

"... price fixing is deemed by the Trade Practices Act to substantially lessen competition, so that the Commission's conclusion is right in law as well as fact..."

Caltex has misunderstood the test for the granting of an authorisation as the test involves the actual effect on competition, not any deemed effect.

Section 88 of the *Trade Practices Act* also empowers the Commission to authorise conduct even if it is anticompetitive, provided that the Commission determines that there are public benefits outweighing the anticompetitive detriment from that conduct.

In the present matter, the Applicants have made submissions why the proposed agreement in the present case is not anticompetitive at all and why there is a net public benefit.

2.2 *Future changes to interchange fees*

Concerns are raised that the proposed interchange price fixing arrangements require 75% of all parties to agree to any change, whereas there is no such constraint in bilateral negotiations.

Caltex attributes (at 3.2) high existing barriers to entry to the bilateral network architecture and its large number of links, rather than to negotiating the various bilateral agreements, which it rather simplistically states (at 4.1(a)), "flow from the nature of the network".

The Applicants disagree. Supposing an issuer and acquirer were to agree that an interchange fee should be altered, it is likely that each party would then wish to refer to all other counterparties to their bilateral agreements, before implementing such a

change. Practically speaking, this would require a series of negotiations between the relevant counterparties, each on a bilateral basis. In practice, therefore, there are constraints to a change in interchange fees in bilateral negotiations.

By way of comparison, the proposed agreement provides a mechanism for interchange fees to be altered if there is support for doing so. A 75% majority is likely to be less difficult to achieve than to obtain a change to the existing bilateral agreements. The only delay will be in obtaining an authorisation for any new interchange fee.

It is also important to note that this clause has been included in order to protect against potential adverse effects on investment and to facilitate any essential and exceptional change rather than as a mechanism for arbitrary alterations.

Additionally, in no way does it constrain the ability of merchants and acquirers to negotiate and renegotiate their own arrangements from time to time or to employ differential pricing.

3 Pass through of costs

- 3.1 Caltex and others continue to assert that the combination of likely increases to retail prices (in order to recoup increased merchant service charges paid to acquirers), and incomplete pass through of savings from issuers to cardholders will result in a net public detriment (at 5.2).
- 3.2 Ultimately, all costs of EFTPOS are borne by consumers (not necessarily just card holders). The Applicants have sought to limit those costs by exposing the fees to greater competition than at present. By reducing the interchange fees to zero, the remaining fees (namely, fees to cardholders and fees to merchants) are exposed respectively to competition between issuers and competition between acquirers. This competition will ensure that there is a pass through of at least some of the savings to issuers (whether the pass through is in the form of lower fees or some other aspect of an improved price/service/quality bundle provided to cardholders).
- 3.3 The Applicants also refute the allegation made in certain retailers' submissions that this analysis constitutes a "watered down" commitment to passing through any cost savings.
- 3.4 It is also interesting to note, that as the Australian Retailers' Association points out (at 4.1), the net flow of interchange fees is quite small. Accordingly, any amount to be recovered by acquirers from the loss of interchange fee revenue should be correspondingly small and, therefore, should have little impact on merchants and even less on the overall value of retail trade.
- 3.5 The continuing argument as to the pass through of costs also obscures one of the key issues, asserted by both the Applicants and the Reserve Bank of Australia, namely that

there are public benefits to be reaped from a greater use of EFTPOS, regardless of the relative (and private) costs and benefits to specific parties.

4 Transparency

- 4.1 The Applicants are concerned that a number of the interested parties continue to misunderstand the point at which transparency occurs, namely at the level of fees to cardholders and fees to merchants, not at the level of retail prices to consumers.¹

Interchange fees operate between issuers and acquirers, where it is alleged that the fees are not transparent. It is a shift away from the relative invisibility of inter-bank payments into the more public and transparent spheres of merchant/acquirer, issuer/cardholder that the proposed arrangements seek to effect. In these spheres, the fees will be transparent to merchants and to cardholders and will be exposed to competitive forces.

5 Key areas of support

5.1 Separation of reform of interchange fees and access

Almost unanimous support was received at the predetermination conference for the view that interchange fees and access were, and should be, treated as separate issues.

The Applicants derive additional comfort from written support in the most recent round of submissions, from three vocal opponents to the Applications, namely Caltex (at 3.1), Australian Retailers' Association (section 3) and Transaction Resources.

The Australian Retailers' Association indeed, go so far as to criticise the Commission's focus on access, making the point (which the Applicants strongly endorse):

"...As the Commission itself has noted, it must reach its decision based solely on the merits of the Application before it, and specifically:

"...the Commission's role is not to design for others business arrangements that can be authorised, nor insist on optimum arrangements before granting authorisation..."

¹ "Central to credit card reforms outlined by the RBA was transparency and correct price signals to consumers. If zero EFTPOS interchange fees were to be imposed, retailers would build these additional costs into the prices of goods and services. As with credit cards, fees would be hidden in the prices of goods and services, with all consumers regardless of the payment type used, paying these hidden costs. CML therefore agrees with the ACCC in that correct price signals may not be readily observable by consumers if zero EFTPOS interchange fees were implemented." (Coles Myer dated September 2003, at paragraph (i)); and "All retailers, big and small, will be required to pay higher bank fees for EFTPOS transactions. These higher costs will in turn be passed on to all consumers through higher prices for goods and services". (Mitre 10 dated 17 September 2003 et al)

With this in mind, the following statement can only be seen as speculative, and not relevant to the current Application:

"However, the Commission considers that, in the event that suitable access reform was to be introduced the proposed Agreement is more likely to be in the net public benefit."

Accordingly, the Applicants submit that Commission should not consider access reform in reassessing these Applications.

5.2 *Competition in the market for card issuing*

The Applicants have always submitted that they consider that the market for card issuing is currently competitive, and support for this statement is given by the Australian Retailers Association which states (at 4.4):

"The issuing market share for debit cards for the four major banks has fallen from 80% to 70% over the past 3 years..."

The Australian Retailers' Association also explicitly states (at 4.1) that the effect of a reduction in interchange fees on smaller issuing institutions will be unequivocal:

"The big winners from zero interchange fees on EFTPOS would be the smaller EFTPOS card issuers who either do not acquire at all, or who have only a very small share of EFTPOS acquiring. Most of the credit unions and building societies would be in this group of winners."

5.3 *Competition in the market for acquiring*

In the market for acquiring, the key submissions appear to be at odds with each other.

Both the Australian Retailers' Association and Caltex appear to give some support to the Applicants' submission that there is an effective level of competition in the market for acquiring or, at least in the case of Australian Retailers' Association, that such competition is not likely to be affected by the removal of the interchange fee, i.e. that the level of interchange fees is irrelevant to the degree of competition in acquiring (at 4.4):

"Regarding competition in acquiring, the ARA believes that this is an issue related to access, not the interchange fee. The removal of the current barriers will allow new entrants as well as the existing small institutions to compete on a more equal basis with the large incumbent acquirers."

Caltex is more explicit, stating (at 4.1(c)):

"Caltex agrees there is considerable competition between acquirers for merchants..."

and (at 4.4 and 4.5):

"Arrangements between acquirers and merchants have not been static for years...the applicants have recognised that there is considerable competition in this market [in which acquirers compete for merchants]..."

It is interesting to note however, that (at paragraph (e)), Coles Myer disagrees with the Australian Retailers' Association that merchant acquiring is effectively competitive:

"CML does not agree with the Applicants' statement that merchant acquiring is effectively competitive and that price increases to merchants will be limited."

6 Conclusion

As the Applicants have previously submitted, the Commission's draft determination should be reversed as the benefits to the public from the proposed agreement will outweigh the detriments. This is a view which is shared by a number of the interested parties, including the Reserve Bank, the Australian Consumers' Association and Financial Services Consumer Policy Centre.

Yours sincerely

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