APC Consultation Response

Australia Productivity Commission

March 2018

cmspi

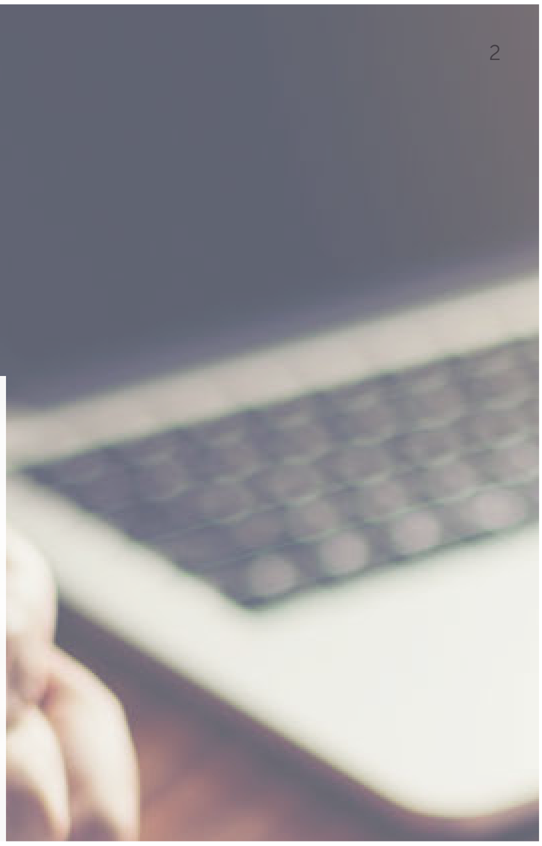
INTRODUCTION TO CMSPI

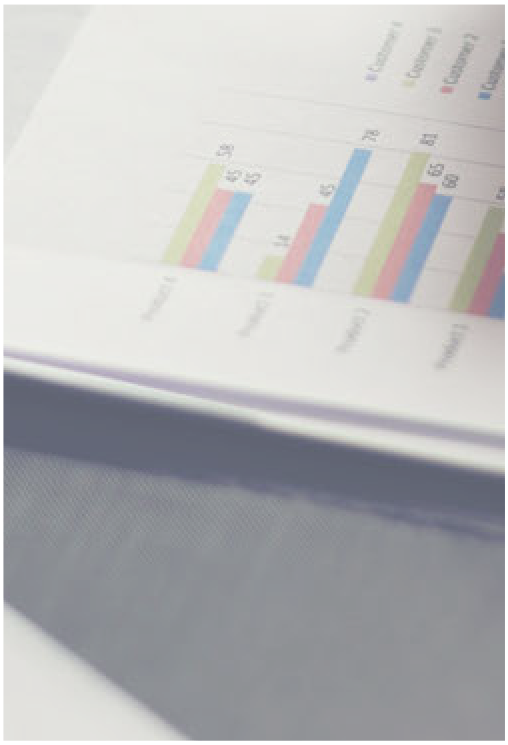
CMSPI is an international, independent payments consultancy that has worked with hundreds of leading merchants to develop optimal payments strategies.

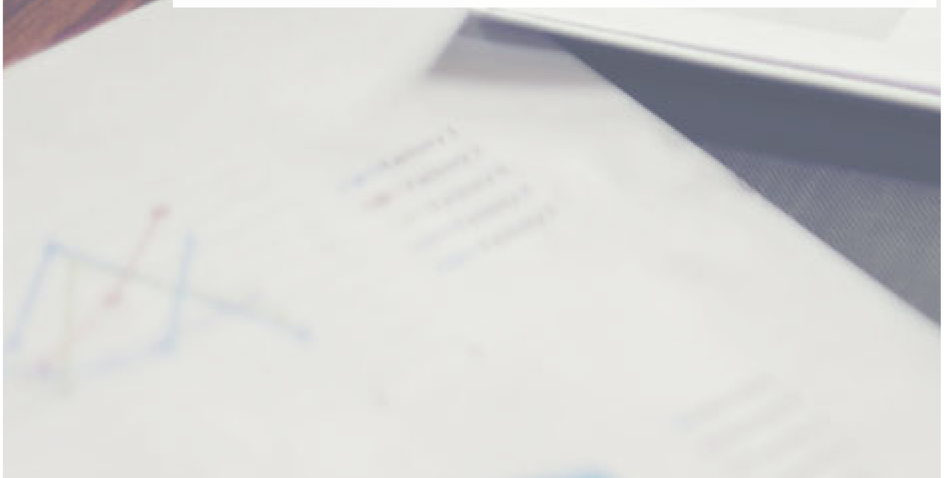
We have offices in the Europe (UK), Singapore and U.S. and work across all areas of global consumer payments.

Our team of analysts and consultants use benchmarking data, proprietary software, and over 25 years' of accumulated market intelligence to calculate the complex, underlying charging structures behind the fees merchants pay.

We have a unique visibility into the fees merchants pay globally to accept card payments







Our consultation response will cover two areas of the APC's consultation – interchange fees and co-badging.

Interchange

Multilateral Interchange Fees (MIFs) are fixed, non-negotiable charges that comprise the majority of the Merchant Service Charge (MSC).

Analysis by CMSPI suggests:

- Debit and credit card issuers generate sufficient income from overdraft fees and interest payments respectively to ensure they would remain willing to encourage consumer card use in the absence of interchange fees. For a typical UK card issuer, interchange only consisted 10-15% of total debit and credit card issuer income prior to interchange regulation in 2015[1].

Moreover, there is limited evidence to suggest that the lowering or removal of interchange would result in a large-scale removal of cardholder reward schemes.

This suggests that interchange fees do not increase the output of the card system.

- Visa and Mastercard's Australian businesses would survive the removal of interchange fees as there would be little incentive for issuers to migrate to alternative card schemes in the absence of interchange fees.
- Interchange fees are a significant multi-billion-dollar per annum burden to merchants, many of whom are small and medium sized enterprises (SMEs) with very small profit margins.
- A number of local debit schemes including Interac (Canada), Dankort (Denmark) and BankAxept (Norway) have zero interchange but high card volumes.
- The consultation suggests that any fees that do exist need to be related to the cost of operating the system. Economies of scale within card issuing means that at the very least, interchange caps should be lowered to reflect lower costs, as they were in 2016.

On the basis of the above, we do not feel that the removal of interchange fees would have a detrimental impact on the card system in Australia. Therefore, we strongly support the Australia Productivity Commission's (APC) decision to recommend interchange fees are removed in Australia.

Co-Badging

Even if interchange was abolished, there can be significant cost differentials for merchants between card schemes through either direct scheme fee costs, or through differential costings from acquiring banks that can prevail from scheme-acquirer relationships.

Co-badging can be highly effective. In the United States, the "no network exclusivity clause" of the Durbin amendment to the Dodd-Frank Wall Street Reform Act has mandated that at least two unaffiliated networks are included on each debit card. The scheme competition emerging from dynamic merchant-led routing has put downward pressure on both unregulated interchange and scheme fees and generated significant savings for merchants.

[1]Please note that UK debit card interchange fees were relatively similar to Australian interchange fees prior to regulation, while credit card interchange fees (at around 1% on double average) were roughly Australian credit card interchange fees.

Co-Badging (Cont.)

However, to make these benefits work it is important that routing choices sit with merchants rather than consumers. From a consumer perspective, card schemes are homogeneous with no difference in terms of speed, security or cost. Therefore, there are no benefits to providing consumers with routing choices (for contactless or any other authentication method), and doing so only serves to restrict competition within the card scheme market.

As the APC's analysis suggests, restricting merchants from setting default routing options on contactless transactions jeopardises the survival of the local card scheme (EFTPOS) as contactless volumes continue to thrive in Australia.

There are further considerations. In Europe, Article 8 of the European Commission's Interchange Fee Regulation (IFR) states[2]:

"Payees shall retain the option of installing automatic mechanisms in the equipment used at the point of sale which make a priority selection of a particular payment brand or payment application but payees shall not prevent the payer from overriding such an automatic priority selection made by the payee in its equipment for the categories of cards or related payment instruments accepted by the payee."

This essentially means that consumers should be provided the ultimate choice of which card scheme to route card transactions through.

Following the introduction of Article 8 in June 2016, there have been a number of practical issues associated with its implementation for contactless transactions particularly with the requirement for two-taps to allow consumers routing choices. Indeed, nearly two years since Article 8 became active, there are still issues with necessitating the two-tap functionality in Europe.

In summary, we strongly support the APC's proposal to give merchants routing control of contactless transactions.

[2]https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.2015.123.01.0001.01.ENG

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