

# EFTPOS Designation

## APCA Submission



April 2012

## **About This Document**

This paper sets out APCA's response to the RBA's consultation paper '*Review of the Regulatory Framework for the eftpos System: Consultation on Designation*'.

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## EFTPOS DESIGNATION

### 1. Introduction

#### 1.1 Description of Submission

This is APCA's response to the RBA's consultation paper '*Review of the Regulatory Framework for the eftpos System: Consultation on Designation*' issued in March 2012.

The RBA has sought feedback on the scope of designation of the eftpos system required to support future regulation of the system. The RBA has indicated that this is a preliminary consultation and that the issue of the regulatory requirements of the eftpos system following designation will be the subject of a further consultation.

We have addressed the RBA's request in relation to the scope of designation below and then deal with an alternative approach to regulating on a market-wide basis at Section 3.

A description of the elements of the current eftpos framework, APCA's role in this and how this has changed with the establishment of EFTPOS Payments Australia Limited (EPAL) is set out in the Schedule as background information.

#### 1.2 Change of Environment

The eftpos environment has changed significantly since the 2004 designation, with the introduction of the EPAL scheme and associated changes to the CECS rules, referenced within that designation. The development of the Community of Interest Network (COIN) has contributed to ease of physical access to the network.

It is clear that the regulatory framework for the eftpos system now requires adjustment to take account of this new environment.

### 2. Designation

#### 2.1 Power to Designate

The power to designate arises when it is in the public interest to regulate a payment system, although the RBA need not have determined the form of such regulation in taking the view that regulation is required.

Whereas we appreciate that this consultation is a preliminary to further engagement in respect of the regulatory requirements of the system, APCA believes that it is difficult to address the issue of designation in isolation from a consideration of whether it is in the public interest to regulate a payment system and what the objectives of this would be.

Below we consider the designation of the EPAL system, followed by the designation of the broader eftpos system (Options 1 and 2 in the RBA's consultation paper).

## 2.2 Designation of EPAL

### ***Public Interest***

The threshold question is whether it is in the public interest to designate and regulate the EPAL system. Even though this is characterised as a review of the existing designation, we consider that it is still important to address the public interest objectives anew.

Under the PSRA, the public interest in the designation and regulation of payments systems relates to financial safety, efficiency, competitiveness and not causing increased risk in the financial system.

As a starting point, we have considered the public interest originally addressed by the designation of the eftpos system and whether regulatory support is still necessary to meet these objectives.

### ***Original designation***

Through its 2004 designation of the eftpos system and the subsequent imposition of the Access Regime and Standards (together with the industry-developed Access Code), the PSB was addressing the public interest in promoting pricing efficiency and competition (through improved access arrangements) in the market for payment services as a whole.

### ***Pricing Efficiency***

Under the original designation, the PSB sought to achieve pricing efficiency by restraining the level of interchange fees and introducing non-discrimination provisions to ensure that new entrants had an opportunity to participate on no less favourable terms than available to other participants - through the EFTPOS Interchange Fee Standard and the non-discrimination provisions of the Access Regime.

With the introduction of the EPAL scheme, the debit card market now has three competing debit schemes, each of which has established its own interchange pricing arrangements to compete with each other. Participants have the opportunity to opt into market-based multi-lateral fee arrangements set by the schemes.

Arguably this addresses this public interest concern in relation to pricing efficiency and regulation is no longer required to support this. We note however that in its media release of 2 September 2011, the PSB stated that *'The provisions of the interchange fees Standard dealing with multilateral interchange fees came into force in January 2010, with the express intention of allowing ePAL to determine multilateral fees, subject to the same cap as the scheme debit systems. These provisions will not be considered as part of the current review.'*

To the extent that the PSB wishes to maintain the multi-lateral fee standard, then designation is required to support this.

### ***Access***

Access to the system relates to physical and logical connectivity and the commercial terms applicable to access.

Under the original designation, the PSB sought to facilitate more open access to the system through the Access Regime and industry-developed Access Code, which taken as a whole provided a framework for physical and logical connectivity.

The eftpos system is now accessible to new entrants through the commercial and operating conditions established by EPAL. Further the availability of the COIN facilitates and simplifies physical access to the network.

Whereas these changes have gone a good way in meeting the PSB's public interest concerns in relation to improved access, they do not fully deal with all access issues. Logical connectivity continues to be provided by virtue of the EFTPOS Access Code (the industry code administered by APCA) and is negotiated on a bilateral basis. The RBA Access Regime provides a regulatory cap for the charge that may be levied for such access.

APCA believes that this access regime (the RBA Access Regime and EFTPOS Access Code) is no longer required. EPAL has the commercial incentive to establish scheme rules in relation to logical connectivity that facilitate access and we are currently discussing this with EPAL.

### ***Continuing Need for Designation***

Designation of EPAL would enable the RBA to continue to support the intent of the joint regime adopted by the industry and the regulator to enable access. The continuing need for such designation and regulation could be reviewed, with a view to removing this, once an alternative approach to access is established, most logically under EPAL's scheme rules.

In any event, designation would be necessary to support a continuation of the multi-lateral pricing regime, to the extent that regulatory support remains necessary to achieve pricing efficiency.

## **2.3 Broader Scope of Designation**

The next question is whether it is in the public interest to designate and regulate bilateral arrangements outside of the three debit schemes.

Competition policy objectives have been met by the existence of a well-functioning competitive debit card market, with three commercial schemes operating in this space. As discussed above, this provides pricing efficiency and access arrangements.

It is unclear what public interest would be served by regulation to ensure a framework for access and commercial terms in debit cards outside of this market. This is not to suggest that it would not be possible to undertake eftpos business outside of the schemes – this is a commercial matter for participants. Rather, we do not consider that those participants wishing to enter into arrangements outside of the market-based terms available under the schemes should be subject to any specific regulation.

On this basis we consider that the scope of the designation should be restricted to EPAL and its rules ie not extend to bilateral arrangements outside of the schemes. This is consistent with Option 1 presented in the RBA consultation paper.

Having said this, we consider what is more important is not whether or not the bilateral arrangements are regulated, but that any such regulation achieves consistent pro-competitive outcomes across the debit market. We accept that this is a matter for further consideration in forthcoming consultation.

Additionally, as the RBA points out, there would be issues with the definition of a broader eftpos system for designation, since it would no longer be appropriate to designate by reference to any CECS requirements.

## **3. Longer Term Approach**

In the longer term, APCA considers that there may be a better approach to achieving efficiency and competitiveness between payment systems than by designating individual payment systems – that is to regulate the marketplace rather than each system.

What may be required is an approach to regulation of payment systems in a market segment with the objective of achieving a consistent pro-competitive regulatory outcome. Take for example, the possibility of a new scheme wishing to engage in debit business in Australia. In order to ensure an open competitive framework, it may be necessary to regulate to prevent other schemes from establishing hurdles to market access in their own rules. Currently this would be achieved by designating the new scheme and then regulating across all relevant schemes to achieve the outcome. A market-based approach would enable regulation to be made that applies across a specific payments market segment.

It is not obvious whether or not the current legislation provides the opportunity for such a market-wide approach - the jurisdiction of the PSRA is in respect of 'payment systems'. This has been applied up to now to designate schemes operated or administered by a single entity rather than to designate and regulate aspects of an interoperable but distinct payments system such as the card payment system<sup>1</sup>.

APCA has proposed a solution to this issue in the submission it made to in respect of reform to the PSRA<sup>2</sup>. This submission proposes that a self-regulatory body (APCA) could develop a common regulatory framework applicable across aspects of a number of payment systems in a market segment. The regulation would be market specific rather than scheme specific and would have the flexibility and responsiveness to changes in market circumstances inherent in self-regulation.

APCA is proposing legislative change to provide an additional power to the RBA under the PSRA to complement its existing power to designate and regulate. This would enable RBA to approve such an industry-developed framework or 'Code' applicable to a particular segment of the payments industry, providing regulator support to industry self-regulation without the need to designate.

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<sup>1</sup> This would be defined by reference to interoperable acceptance of cards in a linked terminal network.

<sup>2</sup> Proposal to Amend Payment Systems (Regulation) Act 1998, October 2011, provided to RBA;

## Schedule

We summarise below the elements of the eftpos regulatory framework, APCA's role in this and how this has changed with the introduction of the EPAL scheme.

### **CECS rules and EPAL scheme**

APCA administers the CECS rules which up until recently (January 2011) had provided the framework for participation in the eftpos system.

The creation of EPAL has established a mechanism for participation in the eftpos system, through a multi-lateral scheme, which provides the operational and commercial framework. It remains possible to continue to establish bilateral eftpos connections outside of the EPAL scheme, although these are no longer regulated through the CECS rules, which were amended in January 2011 to remove those elements of regulation that had been assumed by the EPAL scheme rules (subject to some transitional arrangements).

The CECS rules now focus on the ATM system with some residual requirements that relate also to the eftpos system, given transitional requirements from the scheme to manage such matters as device security certifications until such time as EPAL acquires its own capacity in this area.

### **Access Code**

APCA administers the EFTPOS Access Code on behalf of Eftpos Access Australia Limited, a company owned by industry participants and established in 2006 to meet the RBA's access concerns. The Code enables new entrants to seek access to the eftpos system from existing participants on standard terms within a specific time-frame and complements the Access Regime imposed by the RBA that deals with access charges. The Code supports both physical and logical connectivity.

### **RBA Access Regime**

The EFTPOS system was designated as a payment system in September 2004 under the *Payment Systems (Regulation) Act 1998*. The EFTPOS Access Regime came into effect May 2006. The primary focus of the Regime is an Access Charge benchmark calculation applicable to applications for access under the Access Code.

Additionally the regime includes non-discrimination provisions that ensure that new entrants may participate for a period on terms no less favourable than those available to existing participants.

### **EFTPOS Interchange Fee Standard**

The RBA determined a revised EFTPOS interchange fee standard in November 2009. This is a dual standard comprised of: a bilateral EFTPOS interchange fee of between 4 cents and 5 cents per transaction (not including cash-outs) paid to an acquirer; and a multilateral EFTPOS interchange fee benchmark consistent with the benchmark applying to the Visa Debit system as published on RBA website (currently 12 cents to the issuer).

### **COIN**

The creation of the COIN administered by APCA, has provided a simple way in which to achieve physical connectivity with other COIN members to support participation in the eftpos system. It does not however facilitate logical connectivity which must still be managed at the bilateral level.