Australian Newsagents' FEDERATION LTD

New multi-lateral EFTPOS interchange fee model issues

Background to the increased EFTPOS Fees

- The big banks, along with Coles and Woolworths as members of EFTPOS Payments Australia Limited (EPAL) have decided on a new fee regime for EFTPOS. The new fee is an increase of 10 cents per EFTPOS transaction in interchange fee and of 1 cent in scheme fee. For transactions under $15 in value the interchange fee increase is five cents.

- Assuming a merchant pays currently 10 cents per EFTPOS transaction, nothing for an EFTPOS transaction with cash-out and that the acquiring bank passes through the fee increases the result would be:

Scenario	Old fee regime	New few regime	Cost increase
EFTPOS Purchase Transaction >$15	-5c interchange fee 15c acquiring fee **10c** merchant service fee	+5c interchange fee +1c EPAL scheme fee 15c acquiring fee **21c** merchant service fee	The Merchant Service Fee increases by 110% from 10 cents to 21 cents per transaction
EFTPOS Purchase Transaction <$15	-5c interchange fee 15c acquiring fee **10c** merchant service fee	+0c interchange fee +1c EPAL scheme fee 15c acquiring fee **16c** merchant service fee	The Merchant Service Fee increases by 60% from 10 cents to 16 cents per transaction
EFTPOS Purchase with Cash-out	-20c interchange fee 20c acquiring fee **0c** merchant service fee	-15c interchange fee +1c EPAL scheme fee 20c acquiring fee **6c** merchant service fee	The Merchant Service Fee increases by 6 cents from being free

- In the old model, all retailers including Woolworths, Coles, Harvey Norman and more than 300,000 small businesses were treated equally with respect to EFTPOS transactions. Card issuing banks paid a 4 to 5 cent rebate to the acquiring banks to assist in subsidising the merchant community to deploy and maintain the 700,000 EFTPOS terminals and to encourage uptake of Australia's highly successful EFTPOS debit card system.

- In the new model, big banks will slap an extra 10 cents interchange fee and 1-cent EPAL scheme fee increase (total approximately 11c) on the merchant community's EFTPOS transactions starting 1 October 2011.

- Through a transitional arrangement Woolworths and Coles as self-acquirers can be exempted as they may maintain the bilateral agreements they have with the big issuing banks.

- The threat to all other merchants is that to provide revenues to the banks, they will be slugged with higher merchant service fees on EFTPOS.

- EPAL, argues that, "the new multi-lateral model gives EPAL and its Members the confidence and funding necessary to invest in EFTPOS enhancements such as chip technology for state-of-the-art security, contactless payments that are quick and convenient, mobile and online payments." The fees are needed to invest into EFTPOS so that it can compete against Visa and MasterCard and not die like Bankcard.

- The issue then is who has to carry the burden of the investment. Banks as well as Woolworths and Coles are in the enviable position to continue to receive up to 5 cents per transaction to fund their central system EFTPOS technology upgrade and to support their bottom line.

- However 325,000 merchants with 700,000 terminals, from Harvey Norman to the corner store, will have to worry about and pay new interchange fees to fund the upgrades to their in-store EFTPOS technology. Their terminals have to be upgraded and/or swapped out to accept EFTPOS EMV (chip) and contact-less cards. Additionally they will have to motivate and pay their software vendors to integrate new EFTPOS functionality into their point of sale software or web sites.

- Recent suggestions that banks might absorb the interchange fee are beside the point and naive. It is unlikely the big bank issuing side raises fees and big bank acquiring side absorbs the same fees.... they could have resolved that with an internal accounting entry.

- The interchange fee is the problem, because it is not exposed to competition. No retailer or association can negotiate the interchange fee with his bank. The new EPAL regime is all about raising bank fees.

- Merchants will now suffer a significant competitive disadvantage compared to Woolworths and Coles. Cardholders will ultimately pay with higher prices through less competition.

- The Diagram below demonstrates the change in flows of funds under the new model between Issuing and acquiring banks. It demonstrates how funds are now flowing away from the Acquiring, merchant side of the transaction to the Issuing banks and EPAL.

Network Interchange Flows **Old Model (estimate) $Million (M)**	**Network Interchange Flows** **New Model $Million (M)**
Issuing bank **Acquiring bank**	**Issuing bank** **Acquiring bank**
1.2 billion purchases at -4 to -5c rebate = **$48M – $60M** →	1.2 billion purchases at +5c fee = **$60M** **$108M - $120M** **(turnaround compared to old model)** ←
400 million cash out transactions at -20c per transaction = **$80M** →	400 million cash out transactions at -15c per transaction = **$60M** **$20M (turnaround compared to old model)** →
Low Value - 400 million purchases at -4c to -5c rebate = **$16M - 20M** →	Low Value – No Transfer 400 million purchases at 0c fee = **$0M** **$16M - $20M (turnaround compared to old model)**
EPAL Scheme Fee **$0**	**EPAL Scheme Fee** +1c per transaction fee for issuing bank and acquiring bank each **+$40M (compared to old model)** ←
Issuing bank **EPAL** **Acquiring bank**	**Issuing bank** **EPAL** **Acquiring bank**
- $144M to -$160M **$0** **+ $144M to +$160M** →	**Differences compared to old model** **+ $144M to +$160M** **+$40M** **- $184M to -$200M** ←

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<u>**Responses to EPAL statements on this issue:**</u>

'The new fee model is necessary to guarantee the future of EFTPOS as a low-cost payment alternative to Visa and MasterCard for small business.'

- *Since when has increasing a fee made it more competitive? It is only making it more competitive in relation to which payment system may provide issuing banks with the most fees, not which payment system provides merchants and customers the most competitive cost effective option?*
- *The question of the new fee model should not be about the competition of EFTPOS with Visa and MasterCard, but should be about competition between EFTPOS providers to provide the best value product and service to merchants and customers.*

'The bulk of investment in new EFTPOS functionality has to be made by EPAL and card issuers.'

- *There are about 325,000 merchants with 700,000 terminals. Who will fund the upgrades that are required? If the answer is the Acquirer, then the next question is who will fund the acquirer? We will provide the funds but under the new model most of the funds are flowing back to the issuer.*
- *We understand that EPAL and card issuers bear a cost in providing EFTPOS services and improved functionality – But the investment cost of delivering EFTPOS is substantially on the acquiring side.*

'It will underpin investment in enhancements to EFTPOS functionality, without which EFTPOS could go the way of Bankcard and disappear.'

- *Merchants through the new fee will pay for the investment. There is no transparency or clear line of sight though to the level of investment required or over what period it is justifiably required, leaving this open to providing issuing banks with a significant increase in bank fees.*
- *If EFTPOS provides value and service, merchants will demand it.*

'EFTPOS transactions will remain only a small proportion of merchant's total transaction costs.'

- *The relatively low cost of EFTPOS when compared with Visa and MasterCard bears no relevance to the issue that EFTPOS fees could be lower and have been lower.*
- *If EFTPOS provides value and service, merchants will preference it.*

‘The new fee model ensures EFTPOS will continue to be competitive against Visa and MasterCard.’

- *EFTPOS is already a competitive payments system – It will not be made more competitive by allowing EFTPOS providers to determine the interchange (or wholesale) price between themselves.*

- *EFTPOS should compete with Visa and MasterCard on the strength of the price and service of each EFTPOS provider – Not by preventing EFTPOS providers from facing competitive pressures.*

- *EPAL seems to be forgetting that making EFTPOS competitive can also be making it most attractive to merchants who will then “prefer” EFTPOS and ensure its longevity.*

‘As self-acquirers Coles & Woolworths have invested tens of millions of dollars in infrastructure to process payments under existing bilateral arrangements’

- *Yes, Coles & Woolworths have done this and as self-acquirers have probably received an excellent return on their investment as they are entitled. This does not change the fact that they will now receive an additional market advantage not shared by most other retailers over and above the extra margin they receive for their investment to be self-acquirers.*

<u>**General Points on interchange fees**</u>

- Multi-lateral interchange agreement (new model) is when all participants* pay the same interchange. Increase or decrease is not subject to competitive forces, but is mandated by the administrator of the multilateral i.e. EPAL. **Coles & Woolworths as self-acquirers can opt out of this.*

- Bi-lateral interchange agreements (old model) are set between two parties and have specific terms and pricing as agreed only between the two parties. It’s harder to increase an interchange price in the market with a large number of bi-laterals.

- The EPAL regime allows the big banks to move to multi-lateral EFTPOS interchange agreements and fees. It in effect fixes the price of EFTPOS transactions at a point approximately 10c per transaction higher than the current interchange fee.

- The capability exists for bilateral arrangements still to be maintained between EFTPOS acquirers and issuers, but these are unlikely to survive for too long.