

# Submission to Treasury's Payments System Review: Issues Paper

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Thank you for the opportunity to comment on Treasury's Review of the Payments System. The purpose of this submission is to suggest some possible improvement to the regulatory architecture, based on my experience working as a policy director at the Australian Bankers' Association and subsequently as a consultant to banks and various payment schemes.

The stated aim of the Treasury's review is to ensure the regulatory architecture of the Australian payments system remains fit-for-purpose and is capable of supporting continued innovation for the benefit of consumers, businesses and the broader economy.

In general, the regulatory architecture works reasonably well and Australian consumers and businesses have reasonable options for making purchases and conducting transfers.

The main area of concern is in the length of time it takes for industry-wide initiatives to be implemented and made effective. Industry-wide commitment to and coordination of investment is difficult in payments infrastructure, both here and overseas. The suggestions below are aimed at improving the speed of decision making, but also discusses some wider issues.

## Greater role for ministerial intervention to secure industry commitments

In 1996, the Australian Treasurer and the Reserve Bank Governor exchanged letters regarding the independence of the Reserve Bank with respect to monetary policy. The purpose was to free the Reserve Bank of Australia (RBA) to take politically unpopular decisions if necessary, such as increasing interest rates near elections. The latest agreed statement was published on 19 September 2016<sup>1</sup>.

With the RBA also the primary regulator of the payments system, it is often assumed the degree of independence extends to payments policy as well. Independence is a concept in monetary policy implementation, but not payments policy. The latest statement does suggest that RBA independence also relates for financial stability issues and lists the payments system under that heading. However, there are aspects of payments policy that go beyond financial safety issues, such as competition and efficiency.

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<sup>1</sup> <https://www.rba.gov.au/monetary-policy/framework/stmt-conduct-mp-7-2016-09-19.html>

While it is important for Government not to ‘pick winners’ and to remain ‘technology neutral’ as far as possible, there are circumstances when ministerial interventions maybe useful in helping overcome coordination and investment problems in banks, particularly if individual banks are unnecessarily delaying decisions, perhaps due to undisclosed commercial objectives.

Earlier and forceful ministerial intervention would have been useful in encouraging banks to address the gaps in Australian payments identified by the RBA in its review of payment innovation in 2012. Some of these gaps are still not addressed. More forceful ministerial intervention would have also been useful in getting card payment acquirers to enable least cost routing (LCR) in wake of the significant shift to contactless payments and could help support the continued issuance of dual network debit cards (DNDCs) across all banks.

Ministerial intervention is also useful where broader national interest considerations are needed and beyond the scope of the regulator. This issue seems relevant with the buy now pay later (BNPL) industry and surcharging.

BNPL providers compete against credit cards, so the principle of a level playing field should ideally apply. Merchants should be free to surcharge consumers for using either product.

But Australia has a relatively underdeveloped technology sector compared to many countries and the BNPL are some of our most innovative tech companies, so there is probably a case of giving BNPL firms some regulatory relief from normal surcharging rules. However, it is better for a minister to make this judgement rather than for the RBA. The RBA’s position should be more concerned with ensuring a level playing field and being technology neutral, especially since it is also a participant in a number of payment systems.

A simple way to achieve this might be to insert a new paragraph into the independence statement agreed by the RBA Governor and Treasurer. The paragraph could (a) confirm RBA independence does not encompass payments policy, particularly with respect to efficiency and competition, and (b) there are occasions when ministerial intervention would be useful in helping resolve investment coordination problems or other important outcomes.

### Increased focus on innovation – ‘dynamic efficiency’ to be given more weighting

A key objective of the Treasury review is to ensure the regulatory system supports innovation in the payments system. Under the PSRA, the Payments Systems Board (PSB) is responsible for determining the Reserve Bank’s payments system policy and, in doing so, promote the ‘efficiency’ of the payments system, amongst other objectives.

The term ‘efficiency’ does encompass a concept that is useful in giving direction towards decisions that promote innovation. This concept is explained well in a publication from the Commonwealth Parliamentary Library:

*Economists usually distinguish between three types of efficiency: allocative efficiency; productive efficiency; and dynamic efficiency. The first two of these are static concepts being concerned with how much can be produced from a given stock of resources at a certain point in time. The third is a dynamic concept and concerned with pushing out the production possibility frontier and giving the community access to more and better goods and services over time...*

*Dynamic efficiency – involves improving allocative and productive efficiency over time. This can mean developing new or better products and finding better ways of producing goods and services. Learning, investment and innovation are key elements of dynamic efficiency and central to the ability of an organisation, industry or economy to adjust to changing circumstances.<sup>2</sup>*

In order to improve incentives for innovation in the regulatory architecture, it would be useful to elevate the importance of ‘dynamic efficiency’ in PSB decisions. A first step could be a publication explaining these efficiency concepts with respect to payments, and for the PSB to explain how in practice dynamic efficiency can be given more weight.

A similar exercise could be undertaken by other agencies involved in payments, including AusPayNet and the Australian Payments Council (APC).

An alternative approach would be to actually insert the word ‘innovation’ into the formal objectives of regulators involved in payments regulation.

### Bank revenue from payments and the Australian Payments Council

One reason it can take banks so long to agree on common payment system infrastructure investments is the difficulty in establishing a commercial business case, especially when so little revenue is earned from the payments system. Of particular note is the low fees paid by households and individuals for deposit accounts and payment transaction services.

Due to various factors, including reputational concerns, consumers now typically pay nothing (directly at least) for using the payment systems. Some examples are:

- ATM withdrawals through bank-owned ATMs are now free;
- Internet banking is free;
- Direct entry (DE) pay anyone transactions are free;
- BPAY transactions are free;
- Osko transactions are free;
- Beem It transactions are free;
- Per-transaction debit fees, common in the 1990s, are no longer charged;
- Cheque books are free with many accounts, despite the very high resource costs associated with cheques;
- Account service fees have largely gone, except for credit cards; and
- Most transactions undertaken in branches are free.

According to the RBA’s annual household fee survey, the aggregate amount of fees paid on household deposit accounts in Australia is less today in dollar terms than it was twenty years ago, despite more than a doubling in the aggregate household deposit base. Most of the growth in bank

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<sup>2</sup>

[https://www.apc.gov.au/About\\_Parliament/Parliamentary\\_Departments/Parliamentary\\_Library/FlagPost/2014/March/Dynamic-Efficiency](https://www.apc.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/FlagPost/2014/March/Dynamic-Efficiency)

revenue from payments in the last two decades has come from businesses and merchant customers, in the form of merchant services fees (MSFs).

There needs to be a rebalancing, households and consumers need to pay more for payment services. Arguably, merchants and businesses should be paying less.

The banks do make income on the margin between household deposits and lending rates, but the level of deposit balances held by households relates more to the need for liquidity and low risk investment options, not directly related to payments system functionality. So it is hard to argue that payment investments will lead to higher deposit levels.

If customers are paying for payments, it is easier for fintechs and competitor banks to create services and products to share in that revenue, and easier to get customers to pay a bit more for enhanced services. However, if the prevailing price is zero, creating a business case for investment or innovation is considerably harder.

The Australian Payments Council (APC) could play a useful role here. In addition to producing its payments roadmap, it should also consider ways of encouraging a user-pays payments culture and work out ways to foster this culture. Without the prospect of securing a return on investment (ROI), expecting banks to invest in common payments infrastructure is like pushing against a string.

### Proposed merger of domestic payment scheme - raises important issues

Recently an Industry Committee (IC) organised by the NPP<sup>3</sup> Australia (NPPA) recommended the merger of three domestic payment schemes, eftpos, BPAY and the NPP. The idea is to combine the infrastructure under one board to help rationalise and coordinate investment priorities.

An important backdrop to this is complaints by major banks to regulators that they are having to invest in the same technology across multiple schemes, thereby unnecessarily wasting resources.

The merger raises important considerations. Firstly, the merged scheme will in effect create a domestic monopoly and, as such, will attract considerable regulatory and public scrutiny as to the competition implications. In a recent speech, the RBA Governor said he wanted to see the constitution of a merged entity has a strong public interest focus.

To address public interest concerns over major bank dominance of the scheme, there might end up being a board constituted with a wide set of community representatives. In the UK, a new consolidated industry scheme known as Pay.UK has only one bank board member on its eleven-member board. Pay.UK was identified as a potential model for Australia.

However, the risk with a large and diverse board is that it can become unwieldy and inefficient, with the potential result of decision making becoming more difficult and delayed.

On the other hand, if banks dominate the new scheme, either through board representation or through constitutional rules, then another concern arises - the future of eftpos.

Eftpos poses something of a dilemma for banks. Business customers are big supporters of eftpos; in-part because acceptance fees for eftpos debit transactions are typically lower than Visa and Mastercard. The flipside is that banks earn relatively less revenue from eftpos transactions.

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<sup>3</sup> New Payments Platform

Under a merged entity, the risk for business and merchants is that the banks will orchestrate a shifting of eftpos income towards subsidising the NPP rollout. This reprioritisation of investment maybe supported by the RBA because the central bank has an ownership and reputation stake in the NPP.

Merchants will likely need strong representation on the merged entity board to safeguard eftpos' investment needs and growth, particularly if banks end up dominating the new scheme governance. The details of the proposed merger will be released as part of an authorisation application to the ACCC to be lodged in March 2021.

### Regulation of stored-value facilities – further simplification possible?

The Council of Financial Regulators (CoFR) has published the conclusions of a review into the regulation of stored-value facilities (SVFs) in Australia<sup>4</sup>. The review makes eleven recommendations. A key recommendation is that the RBA no longer has a role in regulation SVFs.

While the report simplifies the current regulatory approach, there may be further scope for simplification and better accountability.

Both APRA and ASIC are given responsibility for regulating and licencing SVRs, with the primary regulator determined by the amount of risk inherent in the business model, including an assessment as to whether the facility held a significant amount of money (over \$1000) for long periods (greater than 31 days).

It would be simpler if just one agency had the primary responsibility and could set standards according to risk, including being able to exempt the SVF from any standard. APRA seems better placed as the main concern with SVFs is that they are competing with deposit-taking institutions. APRA is the supervisor responsible for protecting deposits.

Giving the full responsibility to APRA would make it simpler for SVF providers, their first step is to contact APRA. Having one agency undertake the risk assessment would reduce duplication and allow for a more coherent risk assessment. This would help accountability.

Rec. 10 of the CoFR report is for a 'designation' power to be given to APRA to enable it to identify and regulate a SVF where its business structure does not fit into existing criteria for regulation. Rather than developing a new designation power, the existing power within the PSRA could serve this purpose. If needed, the RBA could designate a SVF and set as a standard, with the standard being that the designated SVF needs to operate with an APRA licence. After the designation and setting of the standard, the RBA would have no further supervisory role.

### AusPayNet could be more transparent - publish meeting minutes?

A number of submissions to recent inquiries have identified AusPayNet processes as potentially blocking new entry into aspects of the payments system.

A specific issue is whether AusPayNet members are too slow in approving non-standard payment acquiring equipment. The concern is that this may be undermining acquirer competition. This market is concentrated and dominated by the big four banks. Another issue raised is that because

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<sup>4</sup> <https://www.cfr.gov.au/publications/policy-statements-and-other-reports/2020/regulation-of-stored-value-facilities-in-australia/pdf/report.pdf>

AusPayNet participation is voluntary, inconsistencies can arise that can impact on competition, such as the adoption of common standards with respect to fraud and payment terminals.

One idea to help address concerns is to require AusPayNet to operate with more transparency. Pay.UK is a self-regulatory body set up in the UK in 2018. It operates with a high transparency model. The organisation publishes board minutes, and minutes of its advisory councils. This may be a good model for AusPayNet in order to identify problems with its operations and give stakeholders greater confidence in its integrity.

### The ACCC's decision regarding access to Apple's near field communicator (NFC)

In 2017, the ACCC refused an application by four banks, including three major banks, to collectively bargain with Apple over access to its iPhone NFC. Access would enable the banks to provide their own digital wallets that could facilitate contactless payments at point of sale, and other services needing the NFC. Without third-party access, all contactless payments must be done through the Apple Pay wallet.

The ACCC's final decision accepted that access to the iPhone NFC would increase competition in mobile payment services, yet refused the application. The reasoning by the ACCC seemed uncharacteristically weak. It said, for example, that if the banks gained access to the NFC it would impact on Apple's competitive position versus Google.

Apple and Google are the largest companies in the world. The ACCC granting authority for four banks to collectively bargain will not have any impact on the relative competition between these companies. The other two arguments published were equally weak.

There is a question as to how this issue is going to be resolved, with the aim of giving consumers the prospect of using an alternative payments app to that of Apple Pay on the iPhone. This is especially important given the large increase in phone payments in recent years.<sup>5</sup> Apple's restriction to the NFC has resulted in the European Commission (EC) launching a trade practices investigation<sup>6</sup>. The RBA Governor has said the Payments Systems Board (PSB) does not have the power to designate Apple and force access to the NFC.<sup>7</sup>

The Government should consider amending the PSRA to give the PSB the capacity to designate Apple. The Apple iPhone is clearly a critical platform for current and future payments, and securing access to this platform to assist innovation should be a priority. A level playing field requires that this platform to be subjected to similar access principles as those imposed on card schemes: eftpos, Mastercard, and Visa. The major banks developed a payment app called Beem It. The users of this app should be enabled to make payments at point-of-sale using Apple's NFC.

A second approach to be conducted in tandem is for access to be pursued through political channels, using Australia's strong relationship with US administrations.

### Direct access to the NPP - fintechs need to change expectations

Fintechs and their representative organisations have been using government inquiries to criticise the access arrangement for the NPP. The Productivity Commission has also raised concerns and has

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<sup>5</sup> <https://ibsintelligence.com/ibsi-news/cba-digital-wallet-transactions-soar-during-covid-19-in-australia/>

<sup>6</sup> [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_20\\_1075](https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1075)

<sup>7</sup> <http://brrmedia-assets.s3.amazonaws.com/audio/5360e7bd-0e74-4db3-9b15-d05b6962a39d.mp3>

recommended implementing a formal access regime. The ACCC and RBA undertook a review of the NPP operation and access arrangements, publishing their conclusions in June 2019.

There is a problem in that many fintechs have unrealistic expectations about becoming direct participants. The NPP is a real-time payments service that therefore involves real-time fraud. The resources needed to maintain the operational integrity of the system is significant.

One of the reasons fintechs are strongly supported by government is that they are risk taking and innovative. But organisations faced with material risks in their business model is not the optimal business to be operating at the core of payments infrastructure, particularly real-time payments. What is needed is very stable entities with deep pockets and experienced staff.

There is a need for Government and regulators to be clearer with fintechs that they should not expect to get direct connection to the NPP and are almost certainly wasting resources by building a business model around direct connection. Fintechs are better off focussed on building products and services using indirect connection, as are most existing banks and credit unions.

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