1 Margaret St
Sydney NSW 2000

GPO Box 4720
Sydney NSW 2001

TEL (02) 8299 9000
FAX (02) 8299 9600

21 March 2018

Competition in the Australian Financial System
The Productivity Commission
Level 12
530 Collins Street
Melbourne VIC 3000
Via email to financial.system@pc.gov.au

Dear Sir/Madam,

Re: Submission in regard to the Productivity Commission Draft Report:
- Competition in the Australian Financial System

Cuscal Limited (Cuscal) appreciates the opportunity to respond to the Productivity Commission's Draft Report on *Competition in the Australian Financial System.* We welcome the report and the interest it has created in the industry.

Cuscal is an end-to-end payments provider that services more than 100 established and challenger brand clients within Australia's financial system and payments landscape, including the majority of the mutual banking sector. We are an Authorised Deposit Taking Institution and hold an Australian Financial Services Licence.

Our services include card scheme sponsorship, card issuing, card production services, merchant acquiring, ATM fleet management, digital and mobile banking platforms, and access to the New Payments Platform (NPP). We also act as settlement agent for many of our clients through our Exchange Settlement Account with the Reserve Bank of Australia (RBA). We process approximately 16% of Australia's electronic transactions.

We are at the forefront of payments innovation and we are investing for future development. As a founding participant and one of the primary architects of the NPP, we enabled 30 of our clients (40 brands) to participate in this important payments innovation on Day One, which is greater than 50% of the total number of participants. We are also an industry leader in the implementation of digital wallets including Apple Pay and Google Pay, having enabled nearly 40 of our clients with this technology.

Cuscal also works closely with small and large fintech companies seeking access to the Australian payments ecosystem and has enabled the connectivity of companies such as Square, who is providing innovative products and business models and improved customer outcomes.

We are experienced in developing API's for our clients, and we are compliant with Payment Card Industry's Data Security Standards (PCI-DSS). The secure handling and transmission of customer financial transactional data is therefore core to our business. Innovation and the introduction of competition in the sector is of high importance to us, our clients and the Fintech partners who we support.

Cuscal supports an industry environment which encourages competition, stability and innovation, but one that does not place unreasonable cost burdens on the industry. In this context, we are providing comments on four recommendations contained in Chapter 10 of the Commission's Draft Report "*The Payments System*", namely:

- Draft Recommendation 10.2 – Making the ePayments Code Mandatory
- Draft Recommendation 10.3 – Ban card interchange fees
- Draft Recommendation 10.4 – Merchant choice of default network routing
- Draft Recommendation 10.5 – Access regime for the New Payments Platform

General Comments

Before addressing each of the abovementioned recommendations in turn, we would like to provide commentary on two overarching assumptions that appear to be embedded in the Commission's analysis of the Australian payments system. We believe that the assumptions have not fully considered all aspects, including:

1. "Cash costs nothing"

   There appears to be an assumption in the report commentary that merchants (and consumers) incur no cost when accepting cash for payment, and that the cost for a merchant to accept payment via a card can therefore be compared to a zero cost base. In fact, it has always cost merchants to accept a payment in whatever form it is proffered, even dating to the 1970's and before when many local merchants chose to provide their regular customers with free monthly account credit (and some still do so today) – a facility that has effectively been replaced by credit card accounts, which are available to all customers.

   In terms of accepting cash, the merchant incurs a variety of costs, including:
   - The provision of safe, secure storage of cash on-site;
   - Losses due to theft and/or the security systems to avoid such losses (and potential personal injury to staff);
   - Losses due to staff pilferage;
   - Losses (and gains) due to incorrect change being given;
   - Losses due to counterfeit currency;
   - Cost and time (often not accounted for) to reconcile/count the cash and take it to the bank.

   The major Australian retailers fully understand the cost of accepting cash, as, amongst other things, the size of their operations require the use and significant cost of armoured car cash transportation. Hence their interest and investment to move to electronic payments, primarily by card. Additionally, a cash based financial system increases the Anti-Money Laundering and Counter Terrorist Financing risk and the potential for tax avoidance.

2. "Most credit cards earn rewards"

   The Draft Report tends to infer that the vast majority of credit cards are associated with rewards programs of some form (e.g. airline or retailer loyalty programs, bank proprietary reward programs, cash back, etc.), and therefore the card payment acceptance costs being incurred by merchants only exist to fund extraneous benefits given to consumers by card issuers. In fact, over 55% of the 15.3 million consumer credit card accounts in Australia have no association with any rewards programs, comprising of low rate, fee free and standard credit cards.

   It is true that consumers who hold rewards related credit cards tend to have a higher annual spend on the card than those with no rewards, but nonetheless about 8.4 million Australian consumer credit card account holders without associated rewards are simply using them as payment and/or borrowing devices.

Draft Recommendation 10.2 – Making the ePayments Code Mandatory

Cuscal supports the Commission's Draft Recommendation and agrees that mandating the ePayments Code for any entity that intends to send or receive electronic payments would provide more certainty to all users of the payments system.

We would note that the current version of the ePayments Code has been effective from March 2016. Given the speed of change in technology, regulations and consumer expectations, there will be a need for regular and relatively frequent reviews of the Code, in order to ensure it remains up to date.

Draft Recommendation 10.3 – Ban Card Interchange Fees

We would disagree with the implication in the Draft Report that the RBA has not sufficiently addressed the issue of interchange fees on payment card transactions. Through its interventions in 2003, the RBA made Australia the first jurisdiction in the world where the interchange fees of the Visa and MasterCard schemes were regulated, which subsequently led to many other regulators in overseas jurisdictions taking action in this area. Figure 10.10 in the Draft Report shows that this initial action by the RBA had an immediate and beneficial impact on the cost of payment card acceptance by merchants in Australia.

In the case of credit cards, in 2003 the RBA originally took a cost based approach to interchange, specifically defining those costs incurred by the card issuer that should be balanced in the network, including fraud and fraud prevention, authorising transactions, processing transactions, and funding the interest free period.

Following its original study with the ACCC, which led to the 2003 intervention, the RBA has conducted a series of regular studies into the payment card market, including the level of interchange fees, with each review leading to tighter and tighter controls. Indeed the last such study led to the current set of Standards, which only came into effect on 1 July 2017 and whose impacts are still filtering through to consumers some eight months later. The inclusion of the American Express companion cards and the capping of credit card interchange at 0.8% (whereas some card transactions had had a rate of 2+% previously) have had significant impacts on consumers, merchants and the financial services industry.

The removal of all interchange by mid-2019 would negatively impact over 15 million credit card account holders and over 40 million debit card holders (with just about every Australian adult having one), at a time when the new regulatory regime will be only two years old. These consumers are likely to be charged higher fees (including transaction account fees, linked to debit cards) and more stringent terms by card issuers, as the balancing payment of interchange will have been removed.

Cuscal would also like to note that the removal of all interchange on payment cards would have a disproportionately negative impact on the smaller financial institutions that it services, who all issue debit cards. These smaller, challenger players in financial services do not have the economies of scale of the major banks, and therefore suffer a lower level of profitability on their card programs. The removal of the interchange revenue stream from these small card portfolios is likely to tip them into a loss position unless countervailing fee increases are enacted, which will make these organisations even less competitive in regard to the major banks. One of the overarching goals of the Commission's Report is to enable more competition in the Australian market. We believe without this revenue stream, this recommendation will have the opposite effect, removing the commercial viability of card provision from the smaller players and any new entrants in market. In addition, the smaller financial institutions do not have the resources to meet the suggested timeline, given the significant volume of compliance changes already being imposed on the financial services sector.

Card schemes have invested heavily in innovation, for example contactless card payments. This innovation has resulted in significant convenience and benefit to both the consumer and merchant. This investment and the ongoing associated costs need to be recouped. Interchange fees provide an efficient way of managing and allocating these costs. Interchange enable issuers to not only drive innovation resulting in better consumer and merchant products and services, they also recover reasonable costs incurred in issuing and authorising cards, including; fraud monitoring, authorising and processing transactions and funding the interest free period.

Cuscal supports a simplified approach to interchange fees, to drive transparency and better understanding for consumers and merchants, for example move from the current 'blended' merchant service fee to 'interchange plus' pricing. This will provide pricing transparency to the merchant and enable them to price appropriately based on the individual routes selected, such as applying or not applying a surcharge for credit or debit transactions. Interchange plus has been in practice extensively in the UK and the EU regions for some time.

Cuscal believes that the recent round of changes implemented in 2017 need to continue to be absorbed in the market. Responsibility for reviewing and determining interchange rates and policy should remain with the RBA's Payments System Board (PSB) to determine as part of their ongoing regulation of the Australian payments system.

Draft Recommendation 10.4 – Merchant choice of default network routing

Cuscal believes that the actions of the PSB on delivering least cost merchant routing in the Australian market are already taking effect: to our knowledge, at least two merchant acquirer financial institutions have been developing solutions, with one launching its 'Tap & Save' terminals to the market last week. This will provide the necessary impetus for the other major acquirers to offer the option to their own merchants, which they have already indicated they will.

An unintended consequence of enforcing least cost merchant routing in the Australian market could be the end of the issuance of multi-network debit cards, with financial institutions moving to issue pure Visa/MasterCard debit cards (with no EFTPOS functionality) and/or pure EFTPOS debit cards (as issued today by some institutions). This could be a loss of convenience for consumers, who might now have to carry two cards instead of one, and could lead to a reduction in EFTPOS card usage. This latter impact occurring because of the enhanced functionality of Visa/MasterCard debit cards, which can be used both on the internet and overseas, whereas EFTPOS cannot. Indeed the uptake of Visa/MasterCard debit usage amongst younger age groups (many of whom are choosing to avoid credit cards) has been very strong due to the ability to purchase online and when travelling abroad.

Cuscal supports the concept that least cost routing should be an option available to merchants, but it should not be mandated. The choice of contactless multi-network debit card routing by merchants effectively disempowers consumers from themselves making a choice of payment scheme for contactless debit; indeed some form of standardised signage at POS should probably be deployed by merchants using least cost or "smart" routing, so that consumers remain informed. The PSB remains the appropriate body to oversee and progress this work.

Draft Recommendation 10.5 – Access regime for the New Payments Platform

Cuscal is proud to be one of the financial institutions that created the NPP and an enabler for competition. Cuscal connected more than half of the organisations to the NPP on 'Day One' – 40 retail banking brands connected to the NPP via Cuscal.

The introduction of the NPP provides the technical infrastructure to provide innovative and reliable real-time payment solutions. However, we believe that, having only launched the NPP publicly on 13 February 2018, it is too early to begin developing a regulatory regime around the NPP. The RBA resides on the New Payments Platform Australia Board, and is best placed to determine the Access regime regulation. It is important to allow the new platform to grow and build confidence. In addition, the significant opportunities for enhanced payments functionality are likely to occur only once services such as "Request To Pay" and payment/request with documentation go live, which is probably in 2019.

Given the significant financial investments that NPP participants have made both to create the NPP infrastructure and to build the integration interfaces within each of their own core banking systems, fees will need to be charged to each organisation (including the participants themselves) using the services - with the RBA in a position to monitor how these are being set by NPPA. However, all participants are keen to see large transaction volumes coming through the system, which should lead to lower average cost per transaction, potentially making it more affordable and attractive for smaller entrants. This will not be achieved if pricing is not competitive with alternative payment methods available in the market.

We trust this submission has assisted the Productivity Commission's considerations. If we can be of further assistance, please contact myself
or alternatively Melanie Pulis, Senior Manager of Compliance

Yours sincerely,

Kieran McKenna
Chief Risk Officer.