

20 March 2018

Competition in Australia's Financial System Inquiry
Productivity Commission
GPO Box 1428
CANBERRA CITY ACT 2601

Peter Harris AO, Chairman

RE: Competition in the Australian Financial System

Australian Payments Network (AusPayNet) welcomes the opportunity to respond to the Draft Report of the Productivity Commission (PC) *Inquiry into Competition in the Australian Financial System* (the Draft Report). We have focused our submission on those areas that relate to payments and the payments system.

We welcome the recognition by the PC that “there is scope for competition to occur both *within* and *between* payment methods.”¹ It is important that the Australian Financial System balances competition and stability. AusPayNet brings together stakeholders to improve the Australian payments system by promoting competition and innovation, delivering efficiency and controlling system risk. The payments system operates within a ‘co-regulation’ model,⁵ with the “presumption in favour of self-regulation”⁶ which is noted in the Explanatory Memorandum to the *Payment Systems (Regulation) Act* (the Act). The Act places primary responsibility for payments system regulation with the Payment Systems Board (PSB) and the Reserve Bank of Australia (RBA). The Australian Competition and Consumer Commission (ACCC) retains responsibility for competition and access regulation in a payments system “unless the RBA imposes an Access Regime or sets standards for it”.⁷

The promotion of competition in the payments system is a key part of the mandate of the PSB. The PSB is required to exercise its responsibilities in a way that best contributes to - controlling risk in the financial system, promoting the efficiency of the payments system and promoting competition in the market for payment services, consistent with the overall stability of the financial system.⁸

¹ PC Draft Report, p274

⁵ PC Draft Report, p504

⁶ PC Draft Report, p505

⁷ PC Draft Report, p505

⁸ RBA Submission to PC Inquiry, Competition in the Financial System, Sep 2017, p30

AusPayNet considers that the current regulatory model for payments, and the associated roles and responsibilities, have served, and continue to, serve, the Australian market well and should be retained.

AusPayNet Membership & Role

AusPayNet (formerly known as APCA) was established in 1992 as an industry group with the aim of self-regulating the payments industry. APCA changed its name to AusPayNet in 2017.

Membership of AusPayNet is open to participants in, and operators of, Australian payment systems which are recognised as meeting a set of criteria specific for each category of membership. Categories of membership are (i) Appointing members; (ii) Electing members; and (iii) Operator members.

There are currently over 120 members of AusPayNet which include:

- a) Financial Institutions, including the major banks and other Authorised Deposit-taking Institutions (ADIs) including credit unions and building societies;
- b) the Reserve Bank of Australia; and
- c) Operators or administrators of Australian payment systems including BPAY, Austraclear, Visa, Mastercard, American Express, eftpos Payments Australia Ltd (EPAL) and PayPal.

AusPayNet's responsibilities include:

- controlling and managing risk in the Australian payments system;
- co-ordinating the operation of effective payment systems through facilitating industry collaboration, self-regulation and system-wide standards; and
- developing industry policies and rules for the regulation of payment systems (also known as clearing systems) relating to cheques; direct entry (i.e. direct debit/credit); cards and accepting devices (i.e. cards used for in-store purchases at Point of Sale (POS) terminals, ATMs, or phone/internet purchases); high value payments (eg. between financial institutions); and the distribution of cash in Australia.

AusPayNet, through the Issuers and Acquirers Community, develops, implements and operates standards, policies and procedures to promote the efficiency, security and integrity of Australian card payments. The standards include minimum security standards and interoperability standards to support how card payments are used throughout Australia. AusPayNet develops its rules and processes (including minimum standards for PIN entry devices) to meet best practice based upon international and domestic standards developed by, for example, the International Standards Organisation (ISO) and Standards Australia.

Card payments and Commercial off the Shelf Devices

Given AusPayNet's role, it is necessary to draw to the PC's attention a factual inaccuracy in the Draft Report:

"The rules and standards (such as the security of PIN handling) for Australia's domestic debit card scheme, eftpos, are developed by the industry body, Australian Payments Network (AusPayNet). That AusPayNet, made up of industry participants, is responsible for determining the eligibility of new financial institutions to join the eftpos scheme, inevitably raises the potential for incumbents to block or create barriers to new competitors."⁹

eftpos Payments Australia Ltd (EPAL) has been responsible since it was established in 2009 for all decisions in relation to the eftpos scheme, including membership, participation, compliance, processing and the implementation of fees.

EPAL has chosen to follow, and requires its members to meet, AusPayNet's security rules and standards determining which terminals and devices are approved for use on the eftpos scheme.

AusPayNet is not responsible for determining the eligibility of new financial institutions to join the eftpos scheme as implied in the Draft Report. This inaccurate understanding leads to the PC making the following observation:

"First, relatively new acquirer Square has not been approved by AusPayNet to accept eftpos transactions because of stated security concerns, since Square captures PINs through smartphones rather than a physical keypad (Eyers 2017; Gluyas 2016; Gray 2017). To date, Square is capable of accepting cards from Visa, MasterCard and American Express, but remains unable to accept eftpos transactions (Square 2018)."¹⁰

The Square solution involves entry of PINs on commercial off the shelf (COTS) devices (i.e. smartphones). At the present time, such entry of PINs on COTS devices has not been approved under any security standard anywhere in the world. The Square solution has been operating in the Australian payments market under a pilot program conducted by the international card schemes. This program runs on the basis that there are waivers of current rules of the relevant card schemes (which are based on current international standards), while new standards are being developed.

International security standards for point of sale devices fall under the remit of the PCI Security Standards Council. Until earlier this year there was no international PCI security

⁹ PC Draft Report, p280-281

¹⁰ PC Draft Report, p281

standard available against which entry of PINs on COTS devices could be assessed. PCI released security requirements for Software-based PIN entry on COTS (SPOC) in January this year and test requirements for SPOC at the end of February. PCI is currently developing a program for the assessment of SPOC solutions and this is expected to be available in May/June 2018, at which point the security of such solutions – including the Square solution – can be assessed globally, including in Australia.

Interchange Card Fees

Draft Recommendation 10.3 – Ban Interchange Card Fees

The Payments System Board should introduce a ban on card payment interchange fees by mid-2019. Any remaining fees should be directly related to the costs of operating the system. Such fees should be made transparent and published.¹¹

Responsibility for reviewing and determining interchange policy should remain with the PSB. The PSB regularly reviews interchange and periodically undertakes detailed examination and consultation.

The PSB conducted a review of card payment interchange fees in 2015 and 2016, including examination of the level of interchange fees and competitive neutrality, i.e. ‘the implications of regulation applying to some card schemes but not to others’ - ultimately deciding not to proceed with the removal of interchange.¹² Instead, the Review maintained the weighted-average credit benchmark of 0.50% and introduced a number of other reforms – including a reduction in the weighted-average debit interchange fee benchmark, and changes to compliance monitoring (moving from three-yearly to quarterly monitoring).¹³

Issuers and card schemes have invested heavily in innovation, including contactless cards and in growing their networks. As the PC recognises “this ubiquity is convenient for customers and merchants.”¹⁴ This investment and ongoing associated costs have to be recouped. Interchange fees provide an efficient way of managing and allocating these costs. Interchange fees allow issuers to recover reasonable costs incurred in issuing and authorising cards, covering interest free days, and fraud detection and control. Without a revenue stream from interchange fees there may be less incentive to introduce or invest in innovative technologies,

¹¹ PC Draft Report, p299

¹² RBA, Review of Card Payments Regulation, Conclusions Paper, <https://www.rba.gov.au/payments-and-infrastructure/review-of-card-payments-regulation/pdf/review-of-card-payments-regulation-conclusions-paper-2016-05.pdf>, p12

¹³ RBA, Review of Card Payments Regulation, Conclusions Paper, <https://www.rba.gov.au/payments-and-infrastructure/review-of-card-payments-regulation/pdf/review-of-card-payments-regulation-conclusions-paper-2016-05.pdf>, p23

¹⁴ PC Draft Report, p279

which in turn, could negatively impact competition. Further, as the Draft Report notes,¹⁵ the 2014 Financial System Inquiry (the Murray Report) considered banning interchange fees altogether, but decided not to proceed on the basis of high transitional costs in doing so.¹⁶

International experience has shown that interchange fee reform can have unintended consequences, as business models shift to recover costs from other areas. Sharp interchange reductions in the United States (US) resulted in a shift of costs onto individual customers.¹⁷

AusPayNet does not support the recommendation to ban on card payment interchange fees. Given the promotion of competition in the payments system is a key part of the mandate of the PSB, interchange fees should be left to the PSB and RBA to determine as part of their ongoing roles and responsibilities.

Merchant Routing

Draft Recommendation 10.4– Merchant Choice of Default Network Routing

Merchants should be given the ability to choose the default network to route contactless transactions for dual-network cards. As the technology is readily available, this option should be offered from 1 January 2019 at the latest.

The Payments System Board should require that neither a scheme, nor any of its participants (including issuers and/or acquirers), can prevent merchants from setting (or asking their acquirers to set) the default route.¹⁸

We support the position that merchant routing should be an option available to merchants. We share the view of the PSB, that industry participants are best placed to solve this particular issue, which is “preferable to regulation”²¹. AusPayNet agrees that the ultimate choice of how any payment should be processed should be made by the consumer. This is consistent with the view of the RBA²² and the House of Representatives Standing Committee on Economics *Review of the Four Major Banks*.²³

¹⁵ PC Draft Report, p299

¹⁶ Financial Services Inquiry, p174

¹⁷ The Durbin Amendment explained <https://www.nerdwallet.com/blog/banking/durbin-amendment-explained/>

¹⁸ PC Draft Report, p303

²¹ Media Release: Payment Systems Board Update: November 2017, <https://www.rba.gov.au/media-releases/2017/mr-17-24.html>

²² RBA speech, Merchant Payment Costs and Least-cost Routing, <https://www.rba.gov.au/speeches/2017/sp-so-2017-12-13.html>

²³ Review of the Four Major Banks (Third Report) House of Representatives Standing Committee on Economics, p7

As the Draft Report recognises, “there are many ways that people and businesses can pay each other”.²⁴ Network costs are dependent on a number of factors including the size of the transaction and the pricing policy of the network; it is not always the case that one network will be less expensive than another.²⁵ For example, RBA Payment Statistics for the December quarter 2017 indicate the weighted average merchant fee for an international debit transaction is 0.59%, compared to the domestic scheme fee of 18c.²⁶ For an average contactless debit transaction valued at \$30, domestic and international schemes are therefore comparable in cost. Merchants may also want to make a choice based on commercial factors other than simply cost.

AusPayNet also agrees that merchant routing should continue to be addressed via the PSB.

Purchased Payment Facilities

Draft Recommendation 10.1 – Review Regulation of Purchased Payment Facilities

“The Australian Prudential Regulation Authority should, either itself or outsourced elsewhere, design a tiered prudential regime for Purchased Payment Facilities to reduce barriers to growth.

- Purchased Payment Facilities with total stored value below \$50 million and individual holdings of no more than \$500 would not face prudential regulation.
- The lower prudential tier would maintain the current 100% liquidity ratio requirement but reduce other prudential requirements to lower compliance costs.
- The higher prudential tier would reduce liquidity requirements but strengthen other prudential requirements.

These reforms should be implemented no later than mid-2019.”²⁷

AusPayNet has previously noted that the regulatory regime that has emerged to cover purchased payment facilities (PPFs) is inconsistent, complex and does not adequately incorporate new entrants.²⁸ AusPayNet agrees with the need for clarity in this area. Given that payments is a network industry, the current lack of clarity raises concerns around systemic risk and liability. This includes the question of who ultimately bears liability should a new entrant fail, and how to protect funds that customers hold in PPFs.

We suggest that consideration of the following issues should be included in any review:

²⁴ PC Draft Report, p274

²⁵ RBA speech, Merchant Payment Costs and Least-cost Routing, <https://www.rba.gov.au/speeches/2017/sp-so-2017-12-13.html>

²⁶ Table C3 <https://www.rba.gov.au/payments-and-infrastructure/resources/statistics/payments-data.html>

²⁷ PC Draft Report, p289

²⁸ APCA Submission to the Financial System Inquiry Interim Report, <http://www.apca.com.au/docs/2014-submissions/submission-to-the-financial-system-inquiry-interim-report.pdf> p10

- Appropriate safeguards to protect consumer funds. PPFs should be required to become signatories to the ePayments Code;
- The establishment of clearly defined lines of regulator responsibility;
- The need for ongoing or semi-regular assessments of the regime, to take into account evolving business models and offerings.

AusPayNet would welcome the opportunity to work with the RBA and APRA on the proposal for a tiered regime for PPFs.

The ePayments Code

Mandating the ePayments Code

Draft Recommendation 10.2 – Making the ePayments Code Mandatory

“The Australian Securities and Investments Commission should amend the ePayments Code to make subscription to the code mandatory for any entity that intends to send or receive electronic payments.”²⁹

AusPayNet supports mandating the ePayments Code for any entity that intends to send or receive electronic payments. The ePayments Code has not been substantially reviewed for more than five years and urgently requires review, in order to bring it up to date with developments in technology and new payment operating models.

AusPayNet would welcome the opportunity to collaborate and assist ASIC, and others as required in undertaking this review, and in making appropriate changes to the ePayments Code.

Liability under the ePayments Code

Information Request 10.1 – How Should Liability for Unauthorised Transactions be Shared?

“What would be the costs and benefits of different ways that liability for unauthorised transactions under the ePayments Code may be shared between financial institutions and third parties, including participation in financial dispute resolution schemes? This includes the feasibility of having Code subscribers provide unique access details to third parties approved by customers.

We are also interested in stakeholder views about whether the new Open Banking policy (once implemented) could be relied upon as a better alternative for secure, shared access.”³⁰

²⁹ PC Draft Report, p290

³⁰ PC Draft Report, p292

A core issue within the current ePayments Code is the clarification of liability where a customer knowingly provides account logon details to a third-party, which facilitates an activity commonly referred to as 'screen-scraping'. This activity was been described in the Open Banking Review as "risky, unstable and costly".³¹ The PC notes it may leave the customer liable for unauthorised transactions initiated by the third party, and this "has led to uncertainty among consumers about whether they are protected."³²

AusPayNet considers that data should be shared through a secure mechanism, such as through the proposed open banking regime, rather than via sharing of passwords and logins. Sharing data in a framework which has clear operating standards, including liability allocation, would provide better security for consumers and remove the need to share login details. It is worth noting that the proposed open banking framework aims to "make the practice [of screen-scraping] redundant by facilitating a more efficient data transfer mechanism".³³

Account-Switching

Draft Finding 13.2 – Tick and Flick has not Been Effective

"The 'tick and flick' account switching facility has not been effective at facilitating bank account switching for customers due to low awareness about the reform and delays in actioning a switch. The low cost of retaining duplicate transaction accounts may also be a factor that reduces the importance of facilities such as tick and flick."³⁷

As the PC recognised during the public hearing process, 'tick and flick' is unlikely to be as relevant to consumers today as it may once have been perceived to be.³⁸ It is important to differentiate between account switching, and account-number portability (ANP), as they are not one and the same thing.

In 2011, the Australian Government commissioned an inquiry to assess the viability of ANP. The inquiry's final report, *Banking Services: Switching Arrangements*,³⁹ found that a move to full ANP was likely to be high cost, with little clear benefit. The UK Competition and Markets Authority (CMA), also considered ANP but decided not to progress the issue as it would

³¹ Treasury, Final Report of the Review into Open Banking, p72

³² PC Draft Report, p290

³³ Treasury, Final Report of the *Review into Open Banking*, <https://static.treasury.gov.au/uploads/sites/1/2018/02/Review-into-Open-Banking-For-web-1.pdf>, px, 83-84

³⁷ PC Draft Report, p393

³⁸ Public Hearing, Sydney 28 March 2018

³⁹ Australian Government, *Banking Services: Switching Arrangements*, https://banking.treasury.gov.au/content/reports/switching/downloads/switchingarrangements_aug2011.pdf

involve substantial changes to the payments systems and estimated the costs to be £2-10 billion”.⁴⁰

The UK Current Account Switch Service (CASS), which the review cited in Box 13.3, does not implement full ANP but provides a service to assist customers switch banks. Despite heavy investments by the UK banking industry both in build and significant ongoing advertising, the introduction of CASS had “little impact on switching levels”.⁴¹

Instead of opting for a simple metric of account-switching volumes, a better metric may be accounts opened and closed. As noted in the Draft Report 50-70% of Australians interact with more than one bank,⁴² meaning that some consumers may in fact ‘switch’ without closing old accounts. AusPayNet collects statistics on transaction accounts (defined as savings and cheque accounts) opened and closed on a monthly basis. Over the past two years, the number of accounts opened per month has exceeded accounts closed.

Recent research recommends that future action should address customer pain points across the breadth of the customer journey.⁴³ This may include:

- Better product comparison tools, enabled through open data, to improve consumer education and understanding of their options within a market. This will improve consumer’s decision-making process about the choice to switch.
- Simplified account opening procedures. Digital identity, and shared KYC, will simplify the account-opening process.

Importantly, the payments industry is progressing work on both of these initiatives.

⁴⁰ CMA Retail Banking Market Investigation, Final Report, 9 August 2016, p xii
<https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf>

⁴¹ University of Bristol, *Personal Current Account Switching*, <https://www.bristol.ac.uk/media-library/sites/geography/pfrc/pfrc1604-personal-current-account-switching-report.pdf>, pviii

⁴² PC Draft Report, p6

⁴³ Available at: Bacs, Current Account Research Papers, <https://www.bacs.co.uk/Resources/FactsAndFigures/Pages/ConsumerEngagementInTheCurrentAccountMarket.aspx>

Batch Settlement Process

The following extract is taken from the Draft Report:

Box 10.4 – What happens to bank transfers over the weekend?

“Assume you make a bank transfer on Saturday — the ‘initiation date’. Most financial institutions tend to calculate daily interest for a customer’s account based on the closing account balance at the end of the day. Therefore, you forfeit the daily interest attributable to the transfer amount. Then, the general practice is for financial institutions to lodge the clearing and settlement instructions on the next available business day, being the following Monday — the ‘payment date’. Once the payment is settled on Monday, the recipient receives the funds in the account, and daily interest is payable on the transferred amount.

There is no regulatory obligation on the sender or recipient’s institution to provide interest to the funds sender or recipient from the initiation date. We were advised that this is a matter for the terms and conditions of individual products at each financial institution. This process can end up costing the sender and/or recipient in interest forgone on the transfer and result in a windfall gain for the financial institution — the sender’s institution can still earn interest on these funds, for example in short-term money markets at a rate akin to the Reserve Bank of Australia cash rate. The Commission estimates that this gain to financial institutions is likely to be small.⁴⁴”

The practice whereby the interest benefit of funds is not available to the sender or recipient does not exist in Australia. Therefore, the suggestion that customers forgo interest and financial institutions somehow gain is incorrect.

Payment clearing is governed by a set of rules that bind all Australian banking organisations. Under those rules, each payment that moves from one bank to another has an ‘as at’ date – that is, an agreed payment date. This is usually the day when an automated ‘clearing message’ goes from payer bank to payee bank to let them know about the payment, notwithstanding that the transfer of funds might happen later. In line with this, banks give the payer the benefit of any interest until the ‘as at’ date, and the payee gets the benefit from that date, so there is no gap in interest, however long the payment actually takes to process. Many electronic payments in Australia now get processed in full inside a single day, as long as the paying bank gets the direction from the payer early enough on a business day. NPP will further reduce the amount of time taken for a payment between the sender and recipient. Nevertheless, there will still be an ‘as at’ date, so either the payer or the payee is always getting the interest benefit of the funds.

⁴⁴ PC Draft Report, p306

AusPayNet would welcome further discussions with the Productivity Commission on any of the issues raised in our submission as it seeks to finalise the Report.

Yours sincerely

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