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24 December 2020

Secretariat - Payments System Review
The Treasury
Langton Crescent
PARKES ACT 2600
Via PaymentsReview@treasury.gov.au

Dear Secretariat,

Thank you for the opportunity to comment on the Australian Payment's System Review. Small business relies on the payments system and has welcomed recent efficiencies and new products that make it easier and less expensive to do business. COSBOA has also seen payments systems that make it much more expensive to do business, more difficult to understand the costs and nearly impossible to choose competitive products.

The world of digital payment systems has been rapidly transformed. Small business is traditionally adaptive and innovative, driving technology adoption over the last 30 years. With technological efficiencies, the expectation of lower priced payment services has however not been realised. Any savings made are often kept by those offering the services. We have seen an increased market power of banks even when innovative products are available. Case studies are attached.

We welcome a review of the payment systems; the regulatory frame works and organisational structures around them. In this submission we have

1. Proposed principles for changes to the Payment's System
2. Presented case studies that demonstrate the small business experience
3. Answered the Consultation Questions from the Payment System Review Issues Paper

This Payment's System Review comes at a time when a merger of EFTPOS, NNP and BPAY as NewCo is being promoted as stronger, unified, less costly, more innovative, efficient, and able to compete with multinational payment platforms. COSBOA believes the proposed Governance structure of the proposed NewCo is messy. The Chair, Robert Milliner says NewCo is a unified and strong response to the entry of global payment companies in Australia and will unlock, "incredible value." The obvious question is for whom? COSBOA's view is that this is about protection of profits rather than the development of competition to the benefit of consumers and small businesses. In an environment which clearly does need restructuring, NewCo is a smokescreen for a monopoly. It is a distraction from what Australian regulators should be focused on, a system that serves consumers and businesses.

We are available for further discussion at your convenience.

Yours sincerely,

Castaly Haddon - Policy COSBOA

## Principles

We recommend the following principles.

- The payments system regulatory architecture should prioritise the interests of merchants and consumers in terms of payments policy, legislation, regulator decisions and industry self-regulation.
- Merchants must have a a say in all relevant payments policy, regulatory and industry advisory bodies.
- The legislative and regulatory regimes and the regulators administering them must consider core principles that will deliver the best outcomes for merchants and consumers, in terms of both prices and functionality.
- These core principles should focus on competition, innovation and investment, choice, transparency, and timely and effective action to prevent/stop behaviour that is contrary to the interests of merchants as end users.
- Competition must be encouraged at all levels of the payments system: including competition through multiple payments platforms (e.g domestic and international card schemes), competition between payments rails (e.g. between cards and accounts), and competition in products, services and applications on top of the payments rails (e.g. by fintech as well as traditional providers).
- As merchants pay the transaction costs at point of sale, they should have the highest priority in choosing their preferred payments scheme to reduce transaction costs and access the functionality best suited to their businesses.
- To enable maximum merchant choice, point of sale and digital payments systems should accept dual network debit cards and merchants should be able to rout transactions through the lowest cost scheme.
- The regulatory architecture must give merchants full transparency in terms of their payment costs, with pricing information provided in a way that is understandable and enables merchants to make informed decisions about the choices available to them. This contrasts with the current complex and opaque disclosure of transaction costs.
- The regulatory regime must require regulators to respond rapidly and decisively, both in terms of proactively enabling access to new digital payments solutions and defying any attempts to prevent or delay the introduction of competitive payment offerings that would reduce merchant transaction costs or provide small businesses with access to enhancements in digital payments functionality.
- The regulatory architecture should ensure there is a level playing field between large and small businesses in terms of payment choices, terms and functionality. A good example of where this hasn't happened is least cost routing which has been made available to select larger businesses but not to their small business competitors. This cannot be allowed to occur in the digital environment.
- The regulatory architecture should ensure that fintechs who want to introduce smart payments apps for merchants on existing payments platforms are able to access those platforms on fair commercial terms and are not deterred by unreasonable rules or technical constraints.
- Regulatory decisions should be publicly announced and explained in plain English so that merchants can understand how these decisions impact their businesses.
- The regulatory architecture must provide clarity regarding regulatory responsibilities and ensure that regulators work together with a thorough understanding of payments technologies and the needs of small businesses.

## Case Studies

# Least Cost Routing (LCR)

Since 2017 COSBOA and the Fairer Merchants Fees Alliance have been advocating for Least Cost Routing. This would allow merchants to choose the least cost route for tap and go transactions made with a customer's dual network debit card.

This choice became an issue when merchants noticed an inexplicable increase in their merchant fees charged to debit transactions. These transactions where being routed through expensive international networks. Merchants saw fees in some cases double and triple. The fees are not transparent or easy to calculate, often being bundled with other services, tied to volumes and values, with a complex fee structure, which further obscures the cost. Lower cost options are available but are not automatically enabled. The infrastructure they ran on wasn't readily available from the banks who provided the merchant machines to process payments. Numerous calls for action were resisted by the banks who were making money from these transactions, infrastructure and deals.

It took Industry and Association advocacy to get attention, and even then, progress was glacial. The task of understanding fee structures was so difficult, it spawned a new service industry to help business people understand, benchmark and shortlist different service providers. In the meantime, a handful of major Government reviews, also recommended LCR, including the RBA which estimated banks were gouging $500m in tap and go fees as recently as February 2020.

In 2019 some banks began offering LCR, with conditions attached that impacted the LCR capabilities. More obstruction. The RBA noted that even with some movement, small businesses were paying significantly higher costs (>33% - 50%) in merchant fees than larger businesses.

How much could a business save by Least Cost Routing?

- An independent supermarket with an average basket size of $44 could save $26,391 per annum* on the cost of debit transactions.
- An independent petrol station with an average ticket size of $44 could save $13,196 per annum* on the cost of debit transactions.
- An independent newsagent with an average ticket size of $36 per annum could save $3,167 per annum* on the cost of debit transactions.

*Source: RBA Statistical Tables, March 2020

It took a pandemic in 2020 for the banks to move, and even now only 6% of debit transactions are LCR, so there's a long way to go.

- Westpac, CBA and NAB all rolling out variations of LCR.
- Westpac proactively switching 55,000 terminals to LCR, saying 37,000 small businesses will have lower debit transaction processing costs.
- CBA has written to 50,000 customers, plus launched advertising campaign, and is pledging to do more.
- NAB's LCR has flat rate of 1.15 per cent.

The NAB's flat 1.15% compares poorly with big merchants processing more than $10M, paying half this fee, 0.6%.

Least Cost Routing has been a story of big banks collaborating and gouging fees from small businesses. Providing no transparency and obstructing change, even when alternatives existed.
At the end of 2020, the worst year since the Great Depression for small business, banks have done little but lip service to address LCR.

EFTPOS has led LCR progress, providing a competitive choice for merchants. That role is now in jeopardy, with the announcement of the merger of EFTPOS, NPP and BPAY. It is inconceivable, based on experience, that a mega entity of big banks and retail giants will guarantee a competitive environment for new players, innovative less expensive products and services or pay any heed to regulators. This new mega entity, has demonstrated convincingly that it views the role of small business as a free, eat as much as you want, buffet.

## Buy Now Pay Later

While small businesses were fighting fees between 1 – 3%, a new innovative product came into the market, which made small businesses feel much better about those fees. Buy Now Pay Later charges merchants between 3 – 7%.

Buy Now Pay Later (BNPL) the modern version of lay-buy, without the wait, is targeted at young people wary of credit card debt who can have it now without interest, by entering a payment plan for a specific purchase. The scheme is growing, largely unregulated and earned almost $400 million mostly from small business in 2018-19 and by all accounts this has increased in 2019-20. ASIC recently looked at  the schemes and issued a report, read it here. This report focused on the services offered and the customers, and largely ignored the merchants in the middle, who pay between 3-7% of the transaction.  COSBOA is surveying the “missing middle,” the merchants who use and pay for BNPL and whose voice has been absent from meaningful discussions around regulating this new “fin-tech”.

BNPL supports it’s fees claiming it is a marketing service however, for the majority of small businesses using the service, there  is no way of calculating this marketing value. Worse, it collects the small businesses customer’s data. A huge resource that it can, and is, monetising. BNPL pits the consumer’s desire (for free credit) against the merchant’s desire (and fear of missing out “FOMO”) for a sale and takes a fee from the resulting transaction. Of course the merchant is under no compulsion to offer BNPL. However the lure of free credit will tempt the most loyal customer.

Unlike credit card fees, the merchant is prohibited from on charging (surcharing) the fee. BNPL claims it is an innovative FinTech and there’s good evidence it is consuming market share of the traditional credit card market.  For the consumer 0% interest, compared to 10- 15% on a credit card, spread over fortnightly payments, that align with wages, is a good deal and a manageable way to stay in control of debt. However Choice and other consumer groups have raised concerns about the nature of unregulated debt facilities like BNPL and the late fees they charge. However the merchant fees dwarf the late fee revenues.

COSBOA, does not support BNPL being self regulated. COSBOA has also called for BNPL to be treated in the same way as other forms of credit at point of sale, allowing merchants to place a surcharge on BNPL transactions.

## Consultation Questions

1. Does the regulatory architecture appropriately facilitate the development of an overall vision, strategy and principles for the Australian payments system?

No, it is too complex. Designed prior to digital agility it's been patched and added to, increasing complexity and duplication, rather than restructured to deal with today's digital flow of finances. It also lacks small business representation.

2. How should our regulatory architecture be designed in order to balance the management of risk and efficiency in the payment system with the need for effectiveness for end-users?

Prioritise end-user needs, including merchants. They also require the regulatory architecture to manage risk and efficiency. The current system starts with the banks and regulators needs, legacy software, existing (not fit for purpose) software, regulatory legacies, transition challenges, etc. This convolutes and diverts the focus and design of regulatory architecture away for the outcome, safe effective payment systems for consumers and businesses.

3. What is the appropriate balance between self-regulation, formal regulation and government policy to ensure the payment system continues to work in the best interests of end-users?

The appropriate balance protects the interests of consumers and merchants against larger participants who unchecked, are driven by profit making. Their preferred route is by securing market power. If fees are excessively high, the appropriate balance is absent. Self-regulation, while preferred by many, has a poor track record in achieving the appropriate balance. Good Government regulation acts to mitigate the tensions between allowing competition and encouraging innovation. The result is a landscape with many different beneficial products, with diverse ownership and competitive fees.

4. Are there gaps (or duplication) in the current architecture that need addressing to ensure the system continues to work in the best interests of end-users?

There is a lack of small business experience in the design of the current architecture which leaves it often unsuitable. This leaves space for innovation, which we have seen. It also leaves room for exploitation, also currently present.

5. How should the regulatory architecture be designed to best facilitate the coordination of participants and regulators to meet the requirements of end-users?

Streamline the current regulatory environment. Understand and prioritise end-user requirements. Recognise where vested and powerful interests may divert or divest the interests of end-users. See case studies for real examples.

6. What are the required features of a future regulatory architecture to ensure it is well-placed to meet the needs of end-users in relation to emerging innovations in the payments system such as those discussed above? Are changes needed to existing structures, roles and mandates involved in the governance of the system?

Needs to be more communication between regulatory entities when it comes to NPP. There is the issue with Payment Reference Numbers not being consistent throughout the industry. If you cannot reconcile Payment Reference Numbers, people need to manually intervene which defeats the purpose of having fast payments in the first place.

It needs to **embrace change** (innovation) and **protect end users** concurrently. Regulator architecture must recognise the unfair power held by some participants and **balance their needs** with end-users. **Competition** is necessary, however not when it destroys the ability for competition. An important aspect is **transparency**. The fees earned from the product should be transparent to the end user, even if they are not paying them.

7. What regulatory architecture is needed to provide support and clarity for businesses – particularly new entrants – to invest and innovate in our payments system?

Protection for end-users and **certainty** around this, provides a **stable environment for innovation**.

8. How can the regulatory architecture enable participants in the payments system to make better use of data to improve cross-border payments and other payments that benefit end-users?

NA

9. Given rapid changes to the system, what need is there for education for end-users (including consumers and businesses) about payments and who should provide that education?

With the NPP and fast payments, enthusiasm has waned slightly as the industry realised if there is a fraudulent actor in this process, there is no time buffer to prevent a fraudulent fast transfer out of a person's account. It is near impossible for banks to unwind these transactions.

It is also more secure to validate ABNs linked to a bank account through NPP. Also the ability that it could start to reduce payment times to small businesses.

10. How does Australia's regulatory architecture compare with that of other jurisdictions, particularly as it relates to the encouragement of innovation and competition?

NA

11. Are there are lessons from international experiences that can improve Australia's regulatory architecture to ensure it responds effectively to new developments in the future for the benefit of end-users?

NA

COSBOA COUNCIL OF SMALL BUSINESS ORGANISATIONS AUSTRALIA

The Council of Small Business Organisations Australia (COSBOA) is the national peak body representing the interests of small business. Collectively, COSBOA's members represent an estimated 1.3 million of the 2.5 million small and family businesses that operate in Australia.

COSBOA is the big voice for small businesses people since 1977. As a collaboration of peak organisations, we promote small business with independent, tenacious advocacy to powerful decision-makers to get a better deal for millions of small businesses people and a better economy for all Australian people.

Small and medium sized enterprises (SMEs) are major contributors to the Australian economy. SMEs employ 68% of Australia's workforce. In GDP terms SMEs together contribute 56% of value added. For this reason, small and medium businesses will be the key partners with Government in re-building the Australian economy.