

31 January 2020

Head of Payments Policy
Reserve Bank of Australia
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SYDNEY NSW 2001

Email: pysubmission@rba.gov.au

Dear Sir/Madam,

Review of Retail Payments Regulation – Issues Paper

Reference is made to your invitation to provide comments in regard to the discussion presented in the above Issues Paper circulated for stakeholder comment in November 2019. Below please find COSBOA's submission to this Paper.

1. About this submission

COSBOA notes that the RBA Issues Paper canvasses stakeholder opinions in relation to 17 specific questions about the architecture and operation of retail payments in Australia. The detailed and largely technical nature of many of the questions posed in this paper is such that COSBOA has neither the mandate nor the technical expertise to respond in a meaningful way.

That said, COSBOA's members remain concerned about the operation of the retail payments system in Australia. These concerns incorporate elements from number of the stakeholder questions posed in the Issues Paper and can be broadly summarised as follows:

- a) Inadequacy of current 'binary' LCR Technology
- b) Poor security of online (i.e. 'card-not-present') retail transactions.

This submission discusses these two issues and includes perspectives on how they might be resolved in the future.

2. Background

COSBOA is a federation of industry associations that work collaboratively to address issues of concern to Australian small businesses. Unlike other business organisations that advance representation of small business on a geographic basis, COSBOA's advocacy positions are advanced on the basis of issues that are seen as a priority across multiple industry segments. These segments include grocery retailing, hair and beauty, pharmacy, lotteries and newsagents, meat industry retailing, and fuel retailing – a number of these process a large number of low volume retail transactions.

In late 2017, COSBOA's member associations were being petitioned by their own small business members to investigate a significant escalation in merchant fees. Investigation of this issue led to the identification of a significant escalation in the cost of debit transactions and the realisation that this increase had occurred in tandem with a growth in contactless card payments. This increase had been largely insidious and occurred without any prior notification to retailers from Australia's major banks.

As COSBOA's knowledge of this issue improved, liaison with payment industry participants (and the Reserve Bank of Australia) suggested that the resolution of this issue likely lay in the introduction of Least Cost Routing (LCR) – and so COSBOA began lobbying for the introduction of a requirement for this functionality in all major retail payment systems via regulation.

In early 2018, the Australian banking and card industry responded to this issue by committing to the introduction of LCR functionality within 12 months. At the same time, key stakeholders discussed options for making the system more transparent to ensure that retailers – particularly small retailers – were better able to compare the merchant payment system offerings of different financial institutions to minimise the ongoing cost of debit transactions.

During 2019, Australia's major banks progressively introduced LCR functionality to their retail payment systems. Unfortunately, the sophistication of these systems was relatively limited with the retailer being required to choose a single gateway (e.g. Mastercard/Visa or EFTPOS) for the processing of *all* ALL transactions.

Small business experience with this 'Binary LCR' technology has been poor since its introduction owing to the difficulty of determining which gateway represented the lowest *overall* cost for debit transactions. This difficulty was due to both the lack of transparency of debit transaction costs (i.e. use of blended rates for debit transactions) and a lack of knowledge of payment architectures (e.g. a knowledge of the proportion of payments received at different value thresholds).

One of the benefits of the focus on debit payments, however, was the temporary introduction of a competitive tension in debit payment offerings which has seen most of the major retail payment system providers discount their debit transaction costs. Unfortunately, the use of blended payments has resulted in some of these reductions in 'wholesale' costs not being passed through to merchants by major financial institutions.

In recent months, COSBOA has explored opportunities to increase the transparency of debit payment systems but has been confounded by the complexity of the existing retail payments system. The complexity and variance in current offerings mean it is simply not possible for small business owners – who have limited capacity and time to thoroughly interrogate different retail payment offerings – to make an informed decision about the retail payment offering that is best suited to their business.

The issue is further complicated by the fact that few retailers – whether large or small – have the capacity to analyse their retail payments in the detailed manner needed to determine the optimum *level of fit* with the architecture of a retail payment system offering.

During the course of our investigation of the debit payment issue in recent years, COSBOA has also become aware of an issue concerning the lack of security in online (i.e. card-not-present) retail transactions. The inadequacy of the current system means that, unlike card-present transactions, retailers are now bearing the cost of online card payment fraud.

A discussion of these two issues is presented below for RBA consideration within the context of the current review of the Retail Payment Regulation.

3. Inadequacy of current 'Binary LCR' technology (Issue 1)

The LCR functionality that has been introduced in recent months requires the retailer to make a choice between EFTPOS and VISA/Mastercard gateways for *all* debit transactions. Differences in the structure of retail payment fees (i.e. variance in rates according to the quantum and volume of transactions) coupled with the use of blended rates has created a level of complexity in debit payment architecture that simply cannot be successfully navigated by retailers.

While some banks (e.g. Westpac) have provided helpline facilities to support informed retailer choices, small business experience with these services has been poor as retailers have neither the necessary detailed knowledge of their payment history nor the capacity to conduct the payment cost analysis needed to make an informed choice.

As a consequence, COSBOA believes that the 'binary' (or 'Dumb') LCR technology that has been introduced by all but a select few payment system providers does not provide retailers with the capacity to select the least cost payment gateway for debit transactions.

While some stakeholders have suggested that this issue might be resolved by the harmonisation of cost structures, this would only partially address the current barriers as it does not address the retailer knowledge issue described above. Even if it was possible to address this issue, the use of a fixed setting for all payments means that the retailer must stay on top of changes in the retail transaction costs offered by the various providers in the market.

COSBOA believes that this issue would best be addressed by introducing a regulatory requirement for retail payment systems to support 'dynamic' LCR whereby the system uses algorithms that operate in real time to select the least cost payment route for each debit transaction processed by a retailer. The advantage of this approach is that it resolves the retailer knowledge issue and introduces an ongoing competitive tension in the merchant fees market.

Some COSBOA members have also suggested requiring payment system providers to report to merchants more transparently on the breakup of costs included in their fees so that they are better able to compare their options and make an informed choice. This would include interchange, scheme fees, issuer fees and margins. However, as noted in section 2 of this submission, the complexity of the current payment system makes this difficult. Such information would need to be communicated to retailers in a way that is thorough and transparent yet still easy for them to understand. This should not be a substitute for dynamic LCR, which COSBOA maintains is the best solution.

4. Security of 'digital' retail transactions (Issue 2).

COSBOA notes the changing policy stance of the Australian Government in respect of cybersecurity in recent years. Against this background, significant growth in digital retail payments (i.e. card-not-present) has not been accompanied by a commensurate increase in the security of online credit card payments.

This deficiency means that card-not-present fraud costs have grown to nearly \$500M per year in Australia (refer to <https://auspaynet.com.au/sites/default/files/2019->

[08/AustralianPaymentCardFraud2019_0.pdf](#)). Unfortunately, and unlike retail payments where the card is present, this cost is being shouldered by Australian retailers directly.

While the rate of growth in this type of fraud has slowed in recent years, the total quantum of loss continues to grow and is placing Australian retailers at a significant competitive disadvantage in an increasingly digitalised global retail market.

COSBOA believes that there is an opportunity for the retail regulation to be amended to stipulate a requirement for retail payment systems to utilise 'token' technology. To avoid a repeat of the competitive distortion created by the switch to contactless card payment, it is strongly recommended that this functionality be developed as a generic platform (for use by all retail card payment systems).

5. Implementation considerations

COSBOA notes that the proposed technological solutions proposed for each of the issues discussed above carry a significant cost burden, with the potential for these costs to ultimately be passed through to retailers in the form of higher card transaction costs.

It is suggested, however, that there are significant public good benefits that arise from both of these opportunities which would justify the use of public funds (either as a co-contribution with industry or wholly funded) to develop this technology in tandem with a change in relevant provisions of the Australian Payment Regulation once this functionality is available to the market. These public good benefits include an increased competitive tension in the retail payments market and improved international competitiveness of Australian retailers.

6. Summary

COSBOA welcomes the opportunity to provide feedback on the RBA Issues Paper relating to the review of the Retail Payments Regulation.

While not equipped to address all of the questions posed in the Issues Paper, COSBOA believes that there is a need to adapt the existing regulation (enabled by improvements in retail payment technology) to stipulate a requirement for all payment system providers to adopt dynamic LCR and improve the security of online (i.e. card-not-present) payments made to Australian retailers

Should you require clarification of any of the issue discussed above, please contact me on 0433 644 097.

Yours sincerely,



Peter Strong
CEO, COSBOA