Review of Retail Payments Regulation: Issues Paper

November 2019

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1. Introduction

1.1 Background to this Review

Following the 1996–97 Wallis Inquiry, the Reserve Bank of Australia (the Bank) was given new regulatory powers with respect to the payments system and a new Board, the Payments System Board (the Board), was created to oversee the exercise of those powers. The Bank's powers are to be directed towards 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. In the early 2000s, the Bank introduced some reforms to credit and then debit card systems. These reforms have subsequently been reviewed periodically, with the most recent wide-ranging review taking place over 2015–16.

Card payments are now the most frequently used payment method in Australia. In 2018/19, Australians made 10 billion debit and credit card payments for a total value of $678 billion. This equates to an average of 395 payments per year and $26,800 for each Australian resident. Cards are increasingly being used for smaller value transactions where consumers once used to mainly use cash, with the average value of card transactions falling from $103 in 2009 to $66 in 2019.

Most of the costs of card payments are paid initially as merchant service fees by merchants, who then in turn will pass those costs on to consumers, either directly (through surcharges) or indirectly (through pricing of goods and services generally). In 2018/19, total merchant fees on card payments in Australia were $4.3 billion.

Two recent inquiries – one by the Productivity Commission, another by the Black Economy Taskforce (BETF) – made some recommendations relevant to the Bank's payments regulations. More generally, developments in technology, new entrants and innovation in payments have altered the retail payments landscape. In response to these developments, the Bank is undertaking a holistic review of the regulatory framework for card payments.

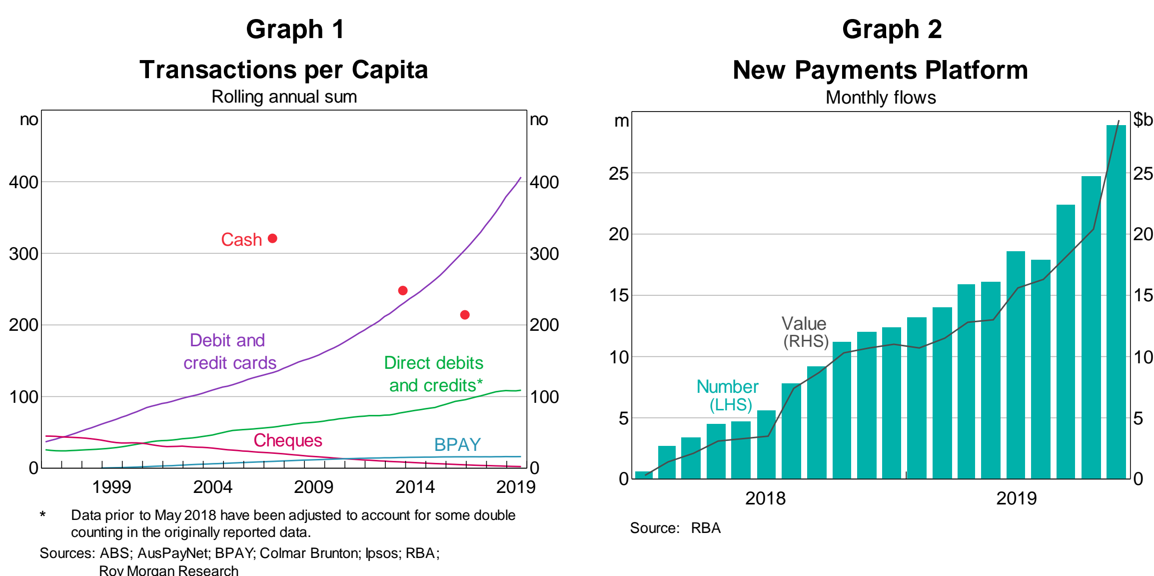
This Issues Paper is the first stage in the review process. It summarises relevant developments since 2015–16 and identifies some potential issues for the review. Key questions for stakeholders are included in Section 3 and collated in the Appendix. While some of the issues identified are directly relevant to the Bank's card payments regulation, the review is intended to be broader-ranging and to consider whether there are any gaps in the payments system that should be addressed, as well as whether there are any regulatory issues arising outside of the narrower topic of card payments. Stakeholders are encouraged to provide written submissions on these issues, and to raise any other payments issues that they think the Bank should consider as part of this review.

The Bank will review written submissions received and will endeavour to meet with stakeholders to discuss their submissions in more detail. If it emerges that in the Board's view a consultation on policy actions is in the public interest, the Bank will release a follow-up paper with detailed proposals for reform.

2. Developments in Retail Payments

2.1 The Payments Landscape

Over the past two decades, the Australian retail payments system has moved from one where the dominant payment methods were cash and cheques to one where electronic payment methods are near-ubiquitous. In particular, there has been strong growth in the use of card payments, as well as in the use of the direct entry system and BPAY (Graph 1). The use of the New Payments Platform (NPP) has also increased markedly since its launch in February 2018 (Graph 2).



Over recent years, new technologies have had a significant impact on the payments market. The widespread adoption of mobile phones has seen the launch of digital wallets like Apple Pay, Samsung Pay and Android Pay, and a consortium of banks in Australia have established a real-time payments application called 'Beem It'. 'Buy now, pay later' (BNPL) services have also emerged, with very strong recent growth in their use. These innovations have all generally relied on existing payment rails for clearing and settlement of transactions – i.e. supplementing existing card payment methods with new features, channels or business models.

While they have not been widely used to make payments, the emergence of crypto-tokens has caused policymakers to review their potential implications. These include recent proposals for so-called 'global stablecoins', which are currently being assessed by policymakers in many countries and in international groups such as the Financial Stability Board and the Financial Action Task Force. A number of central banks have also been considering policy issues relating to the possible issuance of central bank digital currencies (CBDC). Among these have been the People's Bank of China, which has periodically indicated that it is considering CBDC issues, and Sweden's Riksbank, which has been assessing the case for an 'e-krona' in light of a rapid reduction in the use and holding of cash.

The role of cash in Australia has not declined to the extent observed in Sweden. Unlike in Sweden where cash outstanding is declining, in Australia it has continued to rise and as a share of GDP is as high as it has been in many decades. But the 2016 iteration of the Bank's triennial Consumer

Payments Survey (CPS) showed that cash was used in 37 per cent of the number of transactions, down from around 70 per cent in the 2007 survey (Graph 1). The Bank conducted another CPS during October 2019 and expects to publish the results in the first half of 2020. This will provide an update on the day-to-day use of cash and of how the use of other payment methods is changing. A number of jurisdictions have given some consideration to the impacts of declines in the use of cash and whether there are any policy issues that arise in relation to access to cash, in particular for groups in society that rely on it more heavily. The Bank will continue to monitor issues relating to access to cash.

As part of a longer-term trend, more payments are taking place online or remotely compared with face-to-face. In part, this reflects the way that purchasing habits have changed, with more shopping taking place online. Another contributing factor is the growth of online subscription services and in-app payments (e.g. where payment details are provided once and then stored – typically in tokenised form – for future use).

Other countries have seen a rise in mobile payments using quick-response (QR) code technology. To date, the most prominent use case for QR code payments in Australia has been a growing number of retailers using them to facilitate payments from tourists from China, where take-up of QR-code based mobile payments has been extensive. While the number of use cases is growing, the limited use of QR code payments in Australia to date largely reflects the very wide use of card payments and near-ubiquity of payment terminals that accept contactless payments using near-field communication (NFC) technology.

2.2 The Bank's Regulations and the 2015–16 Review

Under the *Payment Systems (Regulation) Act 1998* (PSRA), the Bank can designate payment systems, and establish standards and access regimes for designated systems. To date, the Bank has designated nine card payment systems:

- the Mastercard and Visa credit card systems and the American Express companion card system
- the eftpos, Debit Mastercard and Visa Debit systems
- the eftpos, Mastercard and Visa prepaid card systems.

The Bank has determined three standards under the PSRA. Two of these regulate interchange fees and net payments to card issuers (one relating to credit card systems, the other relating to debit and prepaid card systems). A third standard applies to all nine designated systems and regulates certain aspects relating to merchant pricing, precluding card schemes from applying 'no-surcharge' rules. Some background on interchange fees and surcharging is set out in 'Box A: Interchange Fees and Surcharging: Key Concepts'.

The Bank has also established access regimes under the PSRA applying to the designated Mastercard and Visa credit card systems. These require those systems to have in place transparent eligibility and assessment criteria for scheme membership and to report information about membership and applications to the Bank. These criteria should not discriminate between entities or classes of entity,

except to the extent reasonably required to assess and address the risks arising to the scheme or its participants, merchants or cardholders.[1]

Over 2015–16, the Bank conducted a comprehensive review of the regulatory framework for card payments, guided by the Board's mandate to promote competition and efficiency in the payments system. This Review concluded in May 2016 with the release of a conclusions paper and the publication of new surcharging and interchange standards.[2]

The revised surcharging standard, which sought to address issues around excessive surcharging, took effect for large merchants in September 2016 and for small merchants in September 2017. The standard preserves the right of merchants to surcharge but ensures that consumers using payment cards from designated systems cannot be surcharged in excess of a merchant's cost of acceptance for that card system. Additionally, from June 2017, acquirers and payment facilitators have been required to provide merchants with easy-to-understand information on the cost of acceptance for each designated scheme that would help them in decisions regarding surcharging. These reforms work in conjunction with legislation passed by the Government in 2016 that banned excessive surcharges and provided the Australian Competition and Consumer Commission (ACCC) with enforcement powers.

Following discussions with the Bank, several schemes that were not formally captured by the Bank's new standard modified their surcharging rules in line with the Bank's standard. American Express and Diners Club updated their undertakings to the Bank in relation to 'no-surcharge' rules, while UnionPay International provided new undertakings to the Bank. PayPal removed its 'no-surcharge' rule in Australia and introduced provisions in its merchant terms and conditions aimed at preventing merchants from surcharging above their costs of acceptance.

The revised interchange standards came into effect in July 2017. Under these standards, the weighted-average interchange fee benchmark for debit cards was reduced from 12 cents to 8 cents, and applies jointly to debit and prepaid cards in each designated scheme. The weighted-average benchmark for credit cards was maintained at 0.50 per cent. These weighted-average benchmarks are now supplemented by ceilings on individual interchange rates: 0.80 per cent for credit; and 15 cents, or 0.20 per cent if the interchange fee is specified in percentage terms, for debit and prepaid. To prevent interchange fees drifting upwards in the manner that they have previously, compliance with the benchmark is now assessed quarterly, based on transactions in the preceding four quarters, rather than every three years.

The interchange standards also included new provisions relating to 'net compensation'. To prevent circumvention of the interchange fee caps and benchmarks, the standards contain a requirement that issuers may not receive 'net compensation' from a scheme in relation to card transactions. This requirement is intended to limit the possibility that schemes may use payments and other incentives to issuers (funded by higher scheme fees on acquirers) to effectively replicate interchange fee payments. In 2018–19, the Bank conducted a consultation on the operation of the net compensation provisions and made some changes aimed at clarifying and improving their operation.

1 The Board has also determined an access regime applying to the ATM system and most recently reviewed this at its August 2019 meeting. Members agreed that while the policy case for an access regime may not be as strong as when it was introduced a decade ago, it could still serve a useful purpose in promoting fair access to the ATM industry. In particular, it could help promote the evolution of the industry in a way that supports the efficient and sustainable provision of ATM services across the country. Having taken account of the views of stakeholders, the Board agreed to retain the ATM access regime in its current form, with another review to take place in 2–3 years.

2 See Reserve Bank of Australia (2016a).

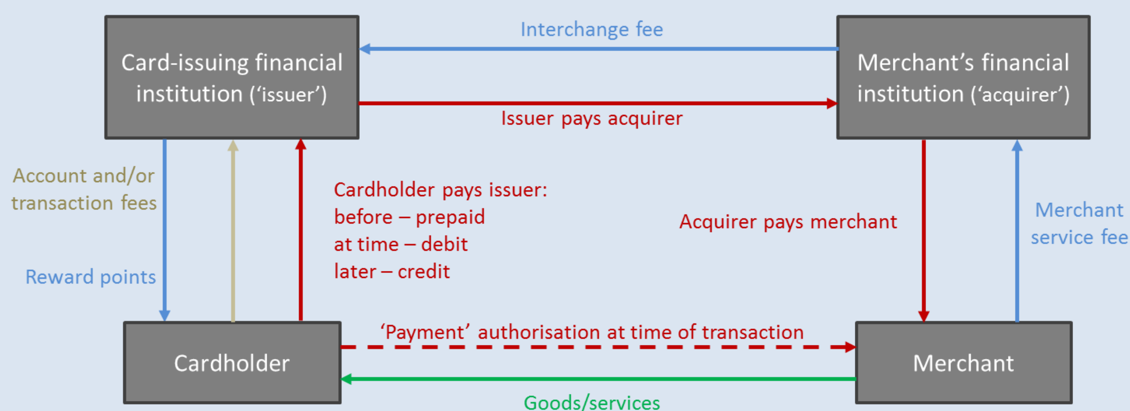
Box A: Interchange Fees and Surcharging: Key Concepts

Interchange fees

An interchange fee is a fee charged by the financial institution on one side of a payment transaction to the financial institution on the other side of the transaction. They are most commonly seen in card transactions, although can arise in other payment methods.

A typical card transaction (Figure 1) involves four parties – the cardholder, the cardholder's financial institution (the issuer), the merchant and the merchant's financial institution (the acquirer). For most card transactions, the interchange fee is paid by the acquirer to the issuer. Interchange fees can have important implications for the prevalence and acceptance of different cards as well as the relative costs faced by consumers and merchants. In contrast to normal markets for goods and services, competition in payment card networks can actually drive fees higher.

Figure 1: Stylised Flows in a Card Transaction



Financial institutions typically charge fees to their customers for payment services. Cardholders are charged by their financial institution in a variety of ways. This typically includes monthly account-keeping fees for debit cards and annual fees for credit cards plus interest on borrowings that are not repaid by a specified due date.

Merchants receiving payments are also typically charged by their financial institutions. The fees paid by merchants usually depend on the payment method. For card payments, merchants are usually charged a 'merchant service fee' for every card payment they accept. Some merchants are also charged a fee by their financial institution to rent a terminal to accept cards.

In contrast, interchange fees are paid between financial institutions and are present in many, but not all, card systems. Interchange fees are often not transparent; cardholders and merchants do not typically see them. But they have an impact on the fees that cardholders and merchants pay.

When a card payment is made, interchange fees are paid by the merchant's financial institution to the cardholder's financial institution. This has two effects. First, the merchant's financial institution will charge the merchant for the cost of providing it with the acceptance service plus the fee that it must pay to the card issuer (the interchange fee). The higher the interchange fee the merchant's financial institution must pay, the more the merchant will have to pay to accept a card payment. Second, since the card issuer is receiving a fee from the merchant's financial institution every time its card is used, it does not need to charge its customer – the cardholder – as much. The higher the interchange fee, therefore, the less the cardholder has to pay. In effect, the merchant is meeting some of the card issuer's costs which can then be used to subsidise the cardholder. Indeed, with rewards programs, the cardholder may actually be paid to use his/her card for transactions and competition tends to involve offering incentives for a consumer to hold and use a particular network's cards. A network that increases the interchange fee paid by the merchant's financial institution to the cardholder's financial institution enables the latter to pay more generous incentives, and can increase use of its cards.

However, the competitive response from other networks is typically to increase interchange rates.

That is, competition in well-established payment card networks can lead to the counterintuitive result of *increasing* the price of payment services to merchants (and thereby leading to higher retail prices for consumers). This phenomenon has been most clearly observed in the US credit card market, which has not been subject to any regulation. Prior to the Bank's reforms this had also occurred to an extent in the Australian credit card market, with average interchange rates in the MasterCard and Visa systems tending to rise.

When one compares the incentives for cardholders and merchants and for their financial institutions the implications of the interchange flows described above are clear. Other things equal – in particular assuming no regulatory intervention and no surcharging by merchants to offset the differences in their costs – cardholders will have a preference to use a card from a network where larger interchange payments flow to the card-issuing financial institution, while merchants will prefer to receive cards from a network with lower interchange fees (or fees flowing in the opposite direction). In circumstances where multiple card networks are widely accepted by merchants (as in Australia and many other developed countries), the consumer typically decides which means of payment is tendered and used in a transaction. Given this, financial institutions will have an incentive to issue cards from networks where interchange fees flow from the merchant's financial institution to the cardholder's financial institution, and competition may lead networks to increase the size of such fees. The generosity of cardholder rewards programs will rise, as will the cost of payments to merchants.

Interchange fees may be appropriate in some circumstances, particularly in the establishment of new systems where they may be necessary to rebalance costs between the sides of the market and ensure that both sides of a market have an incentive to participate. However, the major card schemes are mature systems, and regulators in many countries have reached the judgement that their cards are 'must take' methods of payments – that is, that merchants have little choice but to accept their cards. In practice, with interchange fees being used to incentivise issuers to issue cards from a particular scheme and cardholders to use that card, the tendency has been for competition between mature card schemes to drive up interchange fees and costs to merchants, with adverse effects on the efficiency of the payments system.

Since the early 2000s, the Bank has had in place weighted-average interchange fee benchmarks to constrain the potential for interchange fees to distort efficient payment choices and to underpin a fall in the overall resource cost of payments. Further reforms following the 2015-16 Review imposed maximum caps on interchange fees, as a way of addressing some large differences that had emerged between interchange fees that were being paid by small merchants and the lower 'strategic' rates applying to larger merchants

Surcharging

Merchants face a range of costs when they accept payments. In some cases, merchants might wish to charge a different price to a consumer depending on what type of payment method they use. A surcharge on a particular payment type or types helps the merchant send a signal to a customer that some payment methods are more or less costly for them. Card schemes in the 1990s in Australia had in place 'no-surcharge' rules that prevented merchants from doing this. The effect of this was that customers using low-cost payment methods were effectively cross-subsidising the payment choices of customers who elected to pay with high-cost cards.

The Bank's initial reforms required card schemes to remove these 'no-surcharge' rules, enabling merchants to pass on the cost of card transactions if they wished, resulting in improvements in price signals to cardholders. The right of merchants to surcharge for expensive payment methods is important for payments system efficiency and helps to hold down the cost of goods and services to consumers generally.

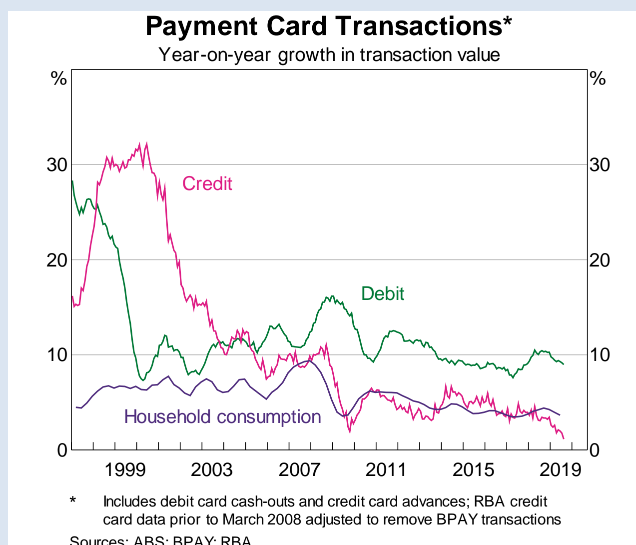
While most merchants tended to either not take up the option of surcharging, or applied surcharges at percentage rates that reflected their acceptance costs, some concerns emerged about possible cases of excessive surcharging by some merchants, and a tendency towards the 'blending' of surcharges for

higher- and lower-cost schemes. In response, new powers were given to the ACCC in 2016 to investigate and take action against excessive surcharges, and this was supported by the Bank defining the concept of a 'permitted cost of acceptance' in its surcharging standard, in terms of the merchant's average cost of acceptance for each scheme. Merchants are provided with annual and monthly information by their financial institutions so that they are readily able to calculate their cost of acceptance.

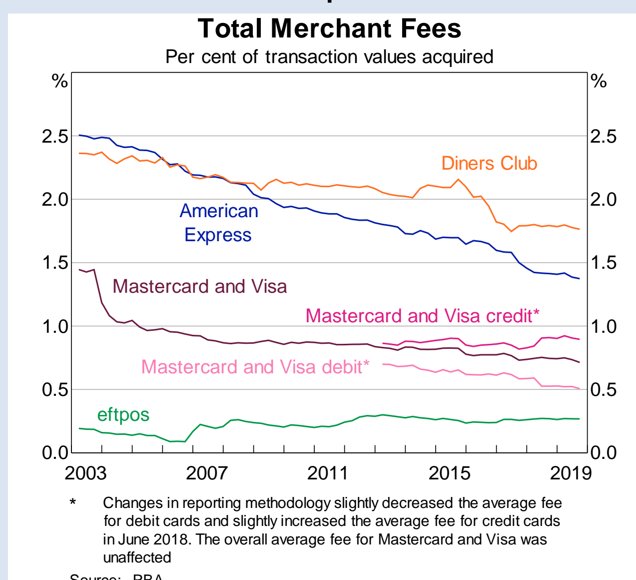
The effects of reform in Australia

Card payments have continued to grow strongly in Australia since the initial implementation of the Bank's reforms in 2003 (Graph 3). Furthermore, data on merchant service fees indicate that interchange fee regulation and surcharging have led to overall lower costs for merchants in accepting card payments (Graph 4). Australia now has a relatively low-cost payments system by international standards, most notably compared with the United States (Graph 5).[3]

Graph 3

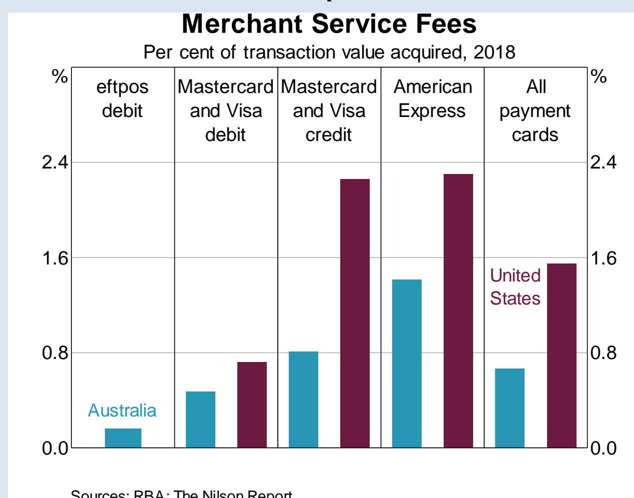


Graph 4



3 See also Stewart *et al* (2014).

Graph 5



2.3 Other Recent Regulatory Developments

Since the 2015–16 Review, the Bank has been involved in a number of other regulatory activities in relation to retail payments systems:

- In late 2016, the Bank undertook a public consultation in response to concerns about possible restrictions on the ability of card issuers and mobile wallet providers to provision both networks on dual-network debit cards (DNDCs) for use by cardholders. Such restrictions could have the effect of reducing competition and efficiency in the payments system. Following discussion with industry participants through the consultation process, the Bank received commitments from relevant participants addressing its concerns (see Section 3.2.1).
- In 2018–19, the Bank, with input and assistance from the ACCC, consulted on the functionality of, and access to, the NPP, concluding with a report in June 2019. The report found that the NPP was enabling payments functionality consistent with its aims of addressing key gaps in the payments system. However, the report noted the slow and uneven roll-out of NPP services by some of the major banks, and identified that this had likely affected the development of new functionality and contributed to stakeholder concerns about access to the NPP. The report made a number of recommendations aimed at promoting the timely roll-out of NPP services and development of new functionality, as well as some recommendations on access issues, balancing the potential competition benefits from more open access against the need to maintain safety and security in a real-time payments platform. NPP Australia has responded to the recommendations arising from the report and has published a roadmap of plans to extend the NPP's capabilities, including the development of messaging to support third-party payment initiation and a 'mandated payments service' to support recurring and debit-like payments.
- The Bank has chaired a working group of the Council of Financial Regulators (CFR) that has been reviewing Australia's regulatory framework for stored-value facilities (SVFs). SVFs encompass a range of facilities in which prepaid funds can be used to make payments. In October 2019, the CFR provided a report to the Treasurer, recommending the streamlining of regulatory responsibilities and providing greater flexibility in the regime.

In the past five years, a range of other jurisdictions have undertaken reforms to aspects of their retail payments regulation; these are summarised in 'Box B: Retail Payments Reforms in Other Jurisdictions'.

Box B: Retail Payments Reforms in Other Jurisdictions

Since the 2015–16 Review, a range of developments in retail payments regulation have occurred in other jurisdictions. These included some new reforms as well as changes to existing regulations. Much of the regulatory focus has been on interchange fees and surcharging rules in card payment systems, although some countries have also begun to consider issues such as competition in acquiring and mobile wallets.

In the case of interchange fees and merchant service fees, tables compiled by the Federal Reserve Bank of Kansas City list 44 jurisdictions as having undertaken action or initiated investigations to date (Hayashi and Maniff 2019). Of these, 18 jurisdictions have taken regulatory action within the past four years.

Where countries have initiated retail payments regulation, this has mostly been to establish rules for interchange fees in credit and/or debit card systems. Some have taken an approach similar to the Bank's reforms that were introduced in the early 2000s and which aimed to promote competition and efficiency in the payments system. A number of jurisdictions have referenced the Australian reforms as influencing their approach.

The European Union (EU) brought a comprehensive package of regulatory reforms for retail payments into effect in December 2015, aiming to create a single EU market for card payments. Under these reforms, interchange fees have been capped at 0.3 per cent for credit card transactions and 0.2 per cent for debit cards. The EC argued that these caps were consistent with the 'merchant indifference test' and would promote competition by giving consumers greater choice of payment methods and service providers.[4] Three-party schemes and commercial cards are exempted from the regulation, on the basis that they do not compete directly with retail payment instruments.[5] A review by the European Commission (EC) of the impact and appropriateness of the interchange fee regulation is expected to conclude in mid-2020.

The EU interchange fee rules apply in all countries within the European Economic Area (EEA). However, member states are provided with some scope for national discretion. For example, the United Kingdom decided to apply a weighted-average fee cap of 0.2 per cent for domestic debit card transactions, rather than the 0.2 per cent per-transaction cap. The UK government considered that percentage-based caps would result in higher interchange fees for many UK merchants, since the majority of fees for debit card payments in the UK are capped at a fixed value amount.

A 2018 amendment to the EU interchange fee regulation requires the structural and legal separation of payment card schemes and processing entities. This is intended to enhance competition by reducing the disadvantage faced by independent payment processing entities. Following the new legislation, Visa Europe has split its scheme and processing entities into separate business units.

More recently, the EC has obtained legally binding commitments from Mastercard and Visa regarding inter-regional interchange fees. Under these commitments, the interchange fees on card-present transactions made in the EEA using consumer debit and credit cards issued outside the EEA will also be capped at 0.2 and 0.3 per cent of transaction value, respectively. Caps of 1.15 per cent for debit and 1.50 per cent for credit card payments will apply for online transactions. The commitments, which will come into effect in December 2019, were intended to avoid 'anti-competitively increased prices for European retailers accepting payments from cards issued outside the EEA', which 'in turn lead to higher prices for consumer goods and services'.[6]

4 The merchant indifference test is the proposition that interchange fees be set at a level that results in a cost of card acceptance that makes the typical merchant indifferent between accepting a card payment and other widely used forms of payment. For further details, see Rochet and Tirole (2011) and European Commission (2013).

5 Three-party scheme cards issued through a licensee, agent or co-branding partner are not exempt from the regulation.

6 See European Commission (2019).

In Canada, Mastercard and Visa voluntarily reduced their weighted-average interchange fees for all credit and debit cards in 2015 under the *Code of Conduct for the Credit and Debit Card Industry in Canada*. Following further discussions with the Department of Finance, the major card networks have committed to reduce the average annual interchange rates by an additional 10 basis points to 1.4 per cent on all cards. This will take effect in 2020 for a period of five years. American Express has separately also agreed to support the objectives of the Code of Conduct through bilateral rate agreements with third-party issuers and transparent merchant service fees.

In recent years, 'no-surcharge' and 'honour-all-cards' rules have also come under increased scrutiny by central banks and other authorities. The Federal Reserve Bank of Kansas City lists 37 jurisdictions as having taken action in relation to surcharges and discounts. Surcharging is permitted in some countries, including Canada and the United States, though it is generally subject to caps associated with consumer protection rights. In contrast, some jurisdictions have prohibited surcharging, either with a policy aim of increasing price certainty and comparability for consumers (such as in the EU and the UK) or to promote the use of card payments (as in India).

The EU banned surcharging on payment methods whose interchange fees are capped under regulation as part of the revised Payment Services Directive (PSD2), which came into force in 2018. According to the EC, regulated interchange fees are capped at a sufficiently low level that surcharging is no longer justified. The UK has extended the ban on surcharging to all non-commercial payment methods, including cards issued by three-party schemes, PayPal and digital wallets. This was intended to level the playing field between payment instruments and increase price transparency for consumers.

In contrast, Visa and Mastercard modified their no-surcharge rules in Canada following a class action settlement with Canadian merchants. Merchants are now allowed to levy surcharges under certain circumstances, although maximum surcharge caps and disclosure requirements apply.

In addition, some regulators have considered policy issues arising from mobile wallets. While, the PSD2 in Europe and the Canadian Code of Conduct have to date mainly focused on consumer privacy and data protection aspects of mobile wallets, the UK has begun to also consider competition issues. The UK Payment Systems Regulator (PSR) conducted an industry consultation to better understand the contactless mobile payments sector and examine the impact of Apple's restriction on access to the NFC chip in Apple devices, which impinges on the ability of other providers to install their own applications for contactless mobile payments. In 2018, the PSR concluded that there had not yet been any damage to innovation that required regulatory action, but said it intended to keep the mobile payment sector under observation.[7] In September 2019, the EC initiated an informal investigation into Apple's NFC restriction, seeking information from market participants about any potential anti-competitive behaviour and abusive conduct. Competition issues involving Apple Pay have also arisen in Switzerland.

The PSR is also undertaking a review of card-acquiring services, and in particular whether the changes in interchange and scheme fees in the UK have flowed through to the payment costs faced by merchants. A report on the interim conclusions is expected to be published in Q1 2020.

7 See Payment Systems Regulator (2018).

3. Issues for the Review

3.1 Strategic Issues in the Retail Payments System

During 2010–12, the Board conducted a Strategic Review of Innovation in the Payments System. The Review sought to identify areas in which innovation in the Australian payments system might be improved through more effective cooperation between stakeholders and regulators and to identify possible gaps in the Australian payments system that might need to be filled over the medium term. The outcomes from this Review included the implementation of same-day settlement for direct entry transactions, the formation of the Australian Payments Council, and the development of the NPP.

Among the gaps identified were the ability of end-users of the payments system to:

- make real-time payments
- send more complete remittance information with payments
- address payments in a relatively simple way
- make and receive payments outside normal business hours.

These particular gaps were addressed by the implementation of the NPP, although certain functionality gaps remain for some end-users, reflecting delays in the roll-out of NPP services by some banks. As noted in Section 2.3, the Bank, in collaboration with the ACCC, consulted on functionality and access issues with the NPP during 2018–19.

Drawing on the experience of the 2010–12 Review, the Board considers that it would be useful for the current review to provide an opportunity for stakeholders to identify whether there are further functionality gaps in the retail payments system or broader strategic issues that should be addressed, either in this review or independently of it.[8] Without limiting responses by stakeholders, these could include:

- the future role of cash. A significant proportion of the population still rely heavily on cash for their daily payment needs. Furthermore, demand for Australia’s banknotes is strong and growing, and the evidence suggests it is mostly geared toward legitimate (if non transactional) uses.[9] Accordingly, cash is likely to play a significant role in the economy for some time to come, which underlines the need for the Bank to invest in keeping banknotes secure from counterfeiting. However, the declining role of cash in household and business transactions is likely to raise some important public policy questions over the next few years. One such issue may relate to maintaining adequate access to cash in the event of a significant contraction in the ATM network or in the provision of other cash services. The Bank invites stakeholders’ views on any particular cash-related issues relevant to this review.

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8 The industry association Australian Payments Network (AusPayNet) is currently undertaking an industry consultation on the future state of Australian payments; the outcomes of that consultation may be relevant to the broader landscape issues raised in this paper.

9 See Wakefield and Finlay (2019).

- the future of the cheques system. Given the continuing decline in the use of cheques, and the fixed costs involved in the operation of any payment system, it is likely that it will be appropriate at some point for the industry to wind up the cheque system, as long as suitable alternative payment methods are available.
- the future of the direct entry system. Current direct entry arrangements are low-cost, efficient, widely used, and volumes continue to grow (in contrast to the cheques system). However, at some point it may be appropriate to consider whether the enhanced functionality of more modern arrangements (such as the NPP) offer benefits that would justify migration of remaining payments going through the direct entry system. Such a migration will not be under consideration as part of this review, but the Bank would be interested in industry views on the longer-term strategic issues that might arise here.
- capabilities around and management of automated and recurring payments, in particular arrangements for management of direct debits. End-users have periodically noted to the Bank that cancellation or redirection of direct debit and other automated payment arrangements is not always straightforward.
- the impact of new technologies and new entrants. In general, regulation should aim to be technology-neutral and not prevent competition emerging from new players. In some cases, actions taken by regulators may encourage developments in technology (such as support for industry-led initiatives to reduce fraud), or promote access by new entrants (such as establishing access regimes for ATM and card systems). The Bank would be interested in stakeholder views on whether there are aspects of current regulation that should be modified or re-examined in the light of new technology, new players or new business models.
- closed-loop systems and stored-value systems and the role that they play in the payments system, including where they access card or other payment rails, and where they establish their own processes and/or infrastructure. Noting that the Council of Financial Regulators has recently reported to the Government with recommendations regarding stored-value facilities, the Bank would be interested in stakeholder views on regulatory or policy issues arising from closed-loop and other types of stored-value systems, including on whether there are potential approaches to licensing and regulation of non-financial institution payments service providers that would be in the public interest.
- the resilience of the retail payments system. The Board has noted evidence of an increase in retail payment disruptions and stressed the importance of having reliable electronic payment services, especially given the declining use of cash. It endorsed the Bank working with the industry and the Australian Prudential Regulation Authority to develop a standard set of operational performance statistics to be disclosed by individual institutions.
- the increasing importance of cross-border payments, which are typically slower, more costly and more opaque than domestic payments. Retail payments are increasingly crossing borders – for example, businesses providing services to foreign clients or buying supplies from abroad, and individuals sending money overseas or making online purchases from foreign retailers. Some of the additional costs and processing time may partly reflect the additional risks and complexities that need to be managed, but it may be useful to consider whether there are specific efficiency or competition issues that could be addressed.
- the roles played by the range of domestic-focused schemes and frameworks in Australia. As well as the cooperative frameworks managed by AusPayNet for a range of clearing streams and the real-time payments infrastructure managed by NPP Australia, there are domestic schemes for bill

payments (BPAY) and debit card transactions (eftpos). There has been a tendency for consolidation of domestic arrangements in some other countries; for example, in the UK, Pay.UK has been established to manage a range of domestic systems and schemes that have been brought together in the New Payments Architecture. The Board invites views from stakeholders on any challenges posed by the various domestic schemes and frameworks in Australia and any changes or consolidation that might be worth considering.

- whether there are opportunities for the use of regulatory technology ('regtech') in the Bank's regulatory regime, including whether compliance obligations can be streamlined or made more efficient by the use of regtech.
- possible issuance of an electronic form of banknotes (an eAUD or CBDC for household use). The Bank, like most other central banks, does not consider that there is currently a strong case for this, though it will continue to monitor and review relevant developments. The Board is interested in stakeholder views on CBDC and the issues that it raises, including: whether there would be demand for such an instrument given the electronic payment services already available to households; the extent to which it might contribute to a more resilient or competitive payment system; possible effects on financial stability and financial intermediation; and the implications for the current review.
- whether there are any policy issues particularly relevant to this review that arise from the prospective issuance of 'global stablecoins'. The Bank notes that Bank staff are engaging closely with other Australian regulators and agencies on this topic, and are also participating in international groups that are examining potential regulatory and policy issues.

Q1: What major recent or prospective developments in the broader payments industry are particularly relevant to this review? More specifically, are there any gaps in functionality available to end users or any shortcomings in industry governance or operating arrangements that require regulation or coordinated industry action?

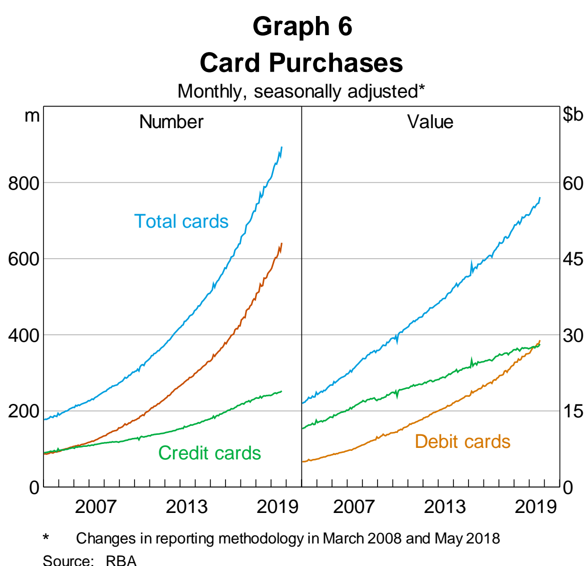
Q2: Are there aspects of retail payments regulation that lead to market distortions or that create opportunities for regulatory arbitrage? If so, what options should be considered as a means of addressing these? Are there gaps in the regulatory regime that need to be addressed or any elements where regulation is no longer required?

Q3: Are there barriers to innovation and/or competition that may affect the costs of or provision of electronic payments and should be addressed in this review?

3.2 Competition in the Cards Market

3.2.1 Dual-network debit cards and least-cost routing

As Australians have shifted away from cash and cheques, card payments have grown rapidly. Most of the rapid growth in card payments has occurred in debit cards (Graph 6), and the debit card has emerged as the most frequently used payment method in Australia. Over recent years, the Board has considered a number of issues relating to competition in the debit card market, most notably around dual-network debit cards (DNDCs).[10]



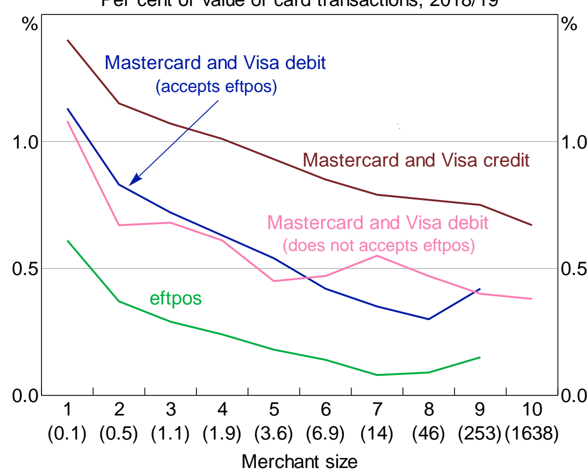
Around 90 per cent of debit cards issued in Australia are DNDCs, which allow a domestic point-of-sale payment to be processed via either eftpos or one of the other debit schemes (Debit Mastercard or Visa Debit); to date, however, online or foreign transactions have only been feasible via an international scheme. A payment made using a DNDC typically draws on the same deposit account regardless of which debit card scheme processes the transaction. The three schemes also offer similar protections to the cardholder in relation to fraudulent and disputed transactions. However, from a merchant's perspective, the cost of accepting a debit card payment can vary depending on which of the three networks processes the transaction. For most merchants, payments via eftpos can be significantly cheaper for them to accept than payments via the international schemes (Graph 4 and Graph 7).[11]

10 The Bank is also aware of an issue involving DNDCs, in particular involving purchases at Australian retailers using Chinese-issued cards which enable transactions to be processed by either the UnionPay network or by Visa or Mastercard. Some Australian merchants have suggested that the use of the UnionPay network would result in lower costs for both the Australian merchant and the foreign cardholder but that they have not been provided with the capability to process transactions in this way.

11 Graph 7 shows the average costs of acceptance for a sample of almost 672,000 merchant accounts, divided into deciles based on the value of annual card transactions. Each decile contains 10 per cent of total transaction values. The size of some merchants in the sample may be understated since individual locations within chains or franchises may receive separate statements. The absence of observations for eftpos for the tenth decile suggests that all of the 31 merchant accounts in this group are billers or online-only merchants (with a single merchant account).

Graph 7

Average Cost of Acceptance by Merchant Size*



* Merchants ranked in value deciles, with average annual value of card transactions ($m) in parentheses

Sources: Acquirers; RBA

When a cardholder inserts their DNDC into a terminal to make a payment, they are asked to select the debit card scheme to process the transaction (for example, by pressing CHQ or SAV for eftpos and CR for Debit Mastercard or Visa Debit). By contrast, if the cardholder makes a contactless ('tap-and-go') payment, the default is for the transaction to be automatically routed to the network which has been programmed as the default network by the issuing financial institution. Until around 2016, contactless payments were only available through the two international networks, which completed their rollout of contactless cards around 2012, and those networks were the default. However, with ePAL having completed its rollout of contactless functionality, contactless payments can now also go through the eftpos network.[12] This raises the possibility of least-cost routing (LCR), whereby merchants might choose to route contactless transactions via whichever of the two networks on the card costs them less to accept. This can help merchants reduce their payment costs, and also increases competitive pressure between the debit schemes, with greater incentives for them to lower their fees.[13]

The Bank has supported the issuance of DNDCs because they are convenient for users and can contribute to competition and efficiency in the payments system. In particular, they enable competition between networks at the point of sale, facilitating both consumer and merchant choice. Merchants have also favoured the continued issuance of DNDCs because they can help hold down payment costs if they allow the possibility of steering consumers to use a less expensive network. Recently, given that eftpos is a significantly lower-cost network on average, many merchants have expressed interest in getting access to LCR, to reverse the increase in payment costs that occurred with the shift to contactless transactions and the international schemes. The issuance of DNDCs and the provision of LCR functionality have also been supported in reports by the BETF and the Productivity Commission, and in the Government's responses to those reports.

However, over the past decade, disputes have arisen regularly between schemes regarding DNDCs. For example, over 2010–13, disputes arose over a number of issues including: international scheme rules that required the provision of commercially sensitive data about one network to a competitor network; the imposition of fees by one network on another network's transactions; and the

12 The domestic eftpos payment scheme (or network) is governed by eftpos Australia Payments Limited (ePAL).

13 LCR functionality can be made available to merchants by acquirers incorporating it in their terminals, often through a remote software update. Regardless of whether a merchant uses LCR, cardholders would still have the option to select a particular debit network by inserting their card in the terminal and making a selection rather than tapping.

placement of network brands on cards. Fresh disputes arose in 2016 as ePAL was seeking to have some of its issuers begin provisioning and tokenising DNDCs in mobile wallets to enable mobile payments. More recently, there have been concerns about the potential for international schemes to discourage merchants from adopting LCR by increasing the interchange fees that apply to a merchant's credit card transactions if it implemented LCR for debit card transactions.

For financial institutions, there may not be strong incentives for the continued issuance of DNDCs and the provision of LCR. For card issuers, there may be incentives to negotiate exclusive single-network contracts with a scheme that offers higher average interchange fees and large upfront financial incentives. In addition, issuers may wish to avoid the extra costs associated with supporting a second network on a card, especially as new technologies lead to a rapid pace of change in card issuance. For example, some smaller issuers have recently indicated to the Bank that it is costly for them to maintain two networks on their debit cards and to carry out largely duplicative activities such as regular upgrades of cards to the standards of both schemes (for example, in chip compliance) and investment to enable both scheme networks in mobile wallets. Indeed, when issuers have introduced new functionality – such as enabling Apple Pay for cardholders – they have often done so first for an international scheme, with no firm plans for also enabling eftpos.

As payment costs rose with the strong growth in tap-and-go payments through the middle of this decade, merchant groups were actively calling on acquirers to provide LCR. However, the industry only began to consider providing LCR following pressure from the Bank and from the review of Australia's four major banks by the House of Representatives Standing Committee on Economics in 2017.[14] While a few smaller acquirers began offering LCR in 2018, progress by the major banks and other acquirers was slower, with the four major banks launching their LCR functionality only between March and July 2019. There are some key differences in the LCR capabilities offered by different acquirers, with some not yet offering a version that maximises merchant savings by enabling routing based on transaction size and payment network. In addition, for some acquirers, LCR is not yet available on all the payment terminals they support. Perhaps most importantly, some of the major banks are currently only offering LCR for merchants – typically larger ones – which are on interchange-plus pricing contracts. None of the major banks has taken advantage of the ability to implement LCR 'in the background' as a way to offer improved pricing for smaller and medium-sized merchants on 'simple merchant plans'.[15]

As LCR functionality has been gradually rolled out, schemes have responded with lower interchange rates for merchants that might be considering adopting LCR (Graph 8). However, there are several factors which may be limiting the overall downward pressure on merchant payment costs. First, lower interchange rates for some debit card transactions have been accompanied by increases in rates on other types of cards and/or transactions, in some cases for segments of the market where LCR is not an option. Second, the Bank has continued to hear concerns that merchants may lose access to favourable strategic rates on credit transactions if they adopt LCR for debit transactions. Third, there appears to have been only limited competitive response in the form of lower scheme fees (discussed below), which also affect payment costs to merchants and where the international schemes appear to remain more expensive than eftpos.

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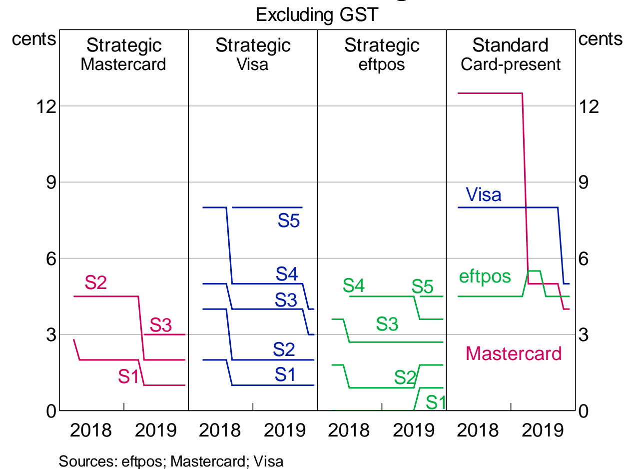
14 See House of Representatives Standing Committee on Economics (2017) and Reserve Bank of Australia (2017).

15 A typical simple merchant plan has a fixed monthly fee which covers a certain value of transactions (for example, around $30 for up to around $1,500 of transactions, or $60 for up to $3,000) within a month, with the merchant then paying a fixed percentage fee (often around 1.5 per cent) for any additional transactions. Such plans typically do not differentiate between debit or credit card transactions or between transactions of different schemes. That is, a merchant will be paying the same percentage rate for transactions that may have very different costs (in terms of interchange and scheme fees) to the acquirer.

Graph 8
Debit Card Interchange Rates



The Bank has made a number of interventions over the past decade or so that serve as background for the two consultation questions at the end of this section:

- In August 2013, the Board accepted undertakings from the three debit networks that were intended to safeguard the rights of Australian issuers to maintain existing dual-network arrangements in the contactless environment.[16] The three networks committed: to work constructively to allow issuers to include applications from two networks on the same card and chip; not to prevent merchants from exercising choice in the networks they accept, in both the contact and contactless environments; and not to prevent merchants from exercising their own transaction routing priorities when there are two contactless debit applications on one card.
- In 2016–17, the Bank undertook a public consultation in response to concerns about possible restrictions on the ability of card issuers and mobile wallet providers to enable both networks on DNDCs for use on a mobile device.[17] Following discussion with industry, the Bank received commitments from the relevant parties that they would not take any steps that would prevent the use of both networks on DNDCs in mobile wallets. These commitments were shared with industry participants, with the expectation that they should facilitate greater choice and convenience in the payment options available to card holders through mobile devices and improve the ability of merchants to encourage the use of lower-cost payment methods.
- During 2017–18, the Board considered the case for mandating LCR, given the slow pace of industry progress in providing LCR functionality. In May 2018, with commitments made by the major acquirers, the Board determined that a standard was not required, but asked the staff to closely monitor developments. The Board has also stressed that the benefits to competition from LCR should not be prevented by issuers removing networks from DNDCs. In addition, given concerns from some merchants that the international card schemes might respond to a merchant's decision to implement LCR for debit card transactions by increasing the interchange fees that apply to that merchant's credit card transactions, the Bank sought assurances from the three schemes that they would not respond to LCR in ways that would limit competitive pressure in the debit card market. The Bank has been monitoring developments in this regard.

16 See Reserve Bank of Australia (2013).
17 See Reserve Bank of Australia (2016b).

For this review, the Bank is interested in stakeholder views on some particular issues regarding DNDCs and LCR.

First, the Bank is interested in views on the availability and functioning of LCR to date. The Bank notes that LCR is bringing down payment costs for some types of merchants and transactions, but that payment costs for other merchants may have risen as schemes have increased some interchange fees. The Bank also notes that acquirers typically have not taken advantage of the potential cost savings from LCR to offer more competitive 'simple merchant plans' to their smaller merchants (e.g. offering a greater value of transactions for a fixed monthly payment, or a lower monthly payment for a fixed value of transactions). This raises the question of whether additional, possibly regulatory, actions might be warranted regarding LCR to enhance competition in the debit card market. Options could potentially include consideration of measures such as requiring that acquirers explicitly offer all merchants the option of LCR for DNDC transactions and that schemes publish explicit criteria for any preferred or strategic interchange fees and that any such criteria not be related to acceptance decisions relating to other payment systems.

Second, the Bank is interested in views on some broader issues regarding DNDCs. The DNDC, which enables the possibility of the merchant being able to choose the routing of a transaction, is an attractive payment instrument from a competition and efficiency perspective. Looking ahead, however, 'cards' seem increasingly likely to be electronic payment credentials that are pushed out electronically to digital devices such as phones and wearables, as opposed to pieces of plastic that are mailed out in the post. The functionality offered by a card will no longer be largely fixed for the several years between issuance of physical cards, but will be able to be changed regularly reflecting innovation by schemes, issuers, mobile phone operators and others. Policy interventions to encourage dual-network provisioning in this world will likely become more challenging and disputes such as have occurred over contactless payments, mobile provisioning and tokenisation are likely to be frequent.

If incentives offered by the international schemes to issuers were to lead to the issuance of single-network international scheme cards, LCR would no longer be feasible on these cards, and the decline in the market share of eftpos seen over the past decade would likely continue. With less prospect of LCR, it is likely that there would be an increase in payment costs to merchants. In such an environment where single-network debit cards were becoming the main type of card issued, the Bank would likely need to assess the impact on competition and efficiency in the debit card system.

One possible policy response to any upward pressure on payment costs would be a reconsideration of the level of the interchange benchmark for debit cards. An alternative could be to set separate interchange fee benchmarks for single-network cards and DNDCs. Issuers might be incentivised to issue DNDCs if the interchange cap for transactions on DNDCs with full functionality to enable LCR were higher than for single-network card transactions. Another possibility might be regulatory actions to facilitate the entry of new schemes that could compete more aggressively to be the low-cost scheme on DNDCs. This might include consideration of the effect of the current long-term exclusivity arrangements between issuers and international schemes, which may hinder the entrance of competitor schemes. Alternatively, to the extent that the slow roll-out of LCR reflects the lukewarm support for eftpos from its members, it may be worth considering whether the governance of ePAL needs to be strengthened.

Another policy option might be explicit regulatory action regarding the issuance of DNDCs. For example, the approach taken in the 'Durbin amendment' in the United States obliges all issuers with over US$10 billion in assets to have two unaffiliated networks on a debit card, to enable merchant choice of routing. Such an approach would support LCR, and could help maintain downward pressure

on interchange and scheme fees. To be effective, however, it might have to be supported by regulation covering online and mobile payments (e.g. where card credentials are tokenised) that ensured that both networks remained accessible to merchants as the industry shifts away from physical cards to digital credentials. Consideration of regulation would also have to address the role of BINs in DNDC transactions.[18] There would also have to be consideration of the current issuance of eftpos-only ('proprietary') cards, which the international schemes have objected to.[19] The Bank notes that there appears to be limited evidence available as to how effective the Durbin amendment has been in facilitating LCR, especially as regards some of the challenges posed by mobile and remote payments, tokenisation, etc.

Q4: How do stakeholders assess the functioning to date of least-cost routing (LCR) of contactless debit card payments? Do additional steps need to be taken regarding LCR to enhance competition and efficiency in the debit card market?

Q5: Have recent and prospective developments in technology changed the case for promoting the continued issuance of dual-network debit cards? What policy actions might be needed to promote competition and efficiency in an environment where single-network cards were more prominent? Alternatively, would it be desirable to mandate (or incentivise through interchange caps) that all debit cards issued enable at least two unaffiliated/competing networks?

3.2.2 Competition in card acquiring

The reforms implemented by the Bank and the ACCC as part of the 2015–16 Review have served to improve the information available to merchants about their payment costs. Acquirers and payment facilitators are now required to provide merchants with monthly and annual statements that clearly set out their average cost of acceptance for each of the card payment systems regulated by the Bank. This greater transparency of payment costs should make it easier for merchants to seek quotes from other providers and to negotiate with their existing acquirers. Greater competition in the acquiring market should exert downward pressure on payment costs, and consequently the prices paid by households for goods and services.

While market forces are likely to result in competition for the payment flows of large merchants, the Board has on a number of occasions noted its concerns about whether the needs of smaller merchants are being sufficiently met by acquirers. This concern has been reinforced by the recent experience with LCR. For example, as discussed above, the Bank is not aware of any evidence that any of the major banks have yet taken advantage of LCR to offer lower-cost payment plans to smaller merchants.

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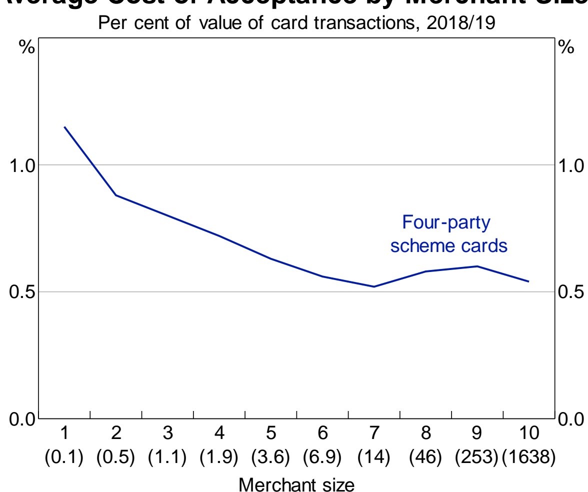
18 The BIN or Bank Identification Number (sometimes also referred to as an Issuer Identification Number or IIN) on a DNDC is the initial 6 digits of the (typically) 16-digit card number or Primary Account Number (PAN). Allocation of BINs and keeping a register of this allocation is done by the American Bankers Association. The BIN can be used to identify the financial institution issuing the card and the scheme it is issued under. To date, DNDCs have carried a single BIN and PAN that has enabled transactions via two schemes; the international schemes have, however, sometimes asserted rights over DNDCs where the BIN has been allocated to them. Looking forward, it may be feasible for DNDCs to have dual PANs, which might reduce the scope for disputes between schemes; indeed, it is noteworthy that when DNDCs are tokenised by different schemes, two tokens are created. However, requiring the industry to move to dual BIN and PAN arrangements would likely require additional investment by issuers and acquirers, including potentially modifying the way in which LCR is undertaken.

19 The international schemes argue that the continued issuance of eftpos-only cards, which do not facilitate LCR, represents an undue advantage for ePAL. It would of course be possible for there to be issuance of cards with eftpos as first-priority network and an international scheme as the second-priority network for domestic use. The Bank would be interested in information as to whether there are any international scheme rules or policies that would prevent or discourage this option.

Data collected by the Bank provide confirmation that smaller merchants tend to pay significantly higher merchant service fees than larger merchants (Graph 9). In 2018/19, the average cost of acceptance for four-party scheme cards was around 1.5 per cent for merchants with annual card transactions of less than $100,000 (over 40 per cent of all merchants), and 0.9 per cent for merchants with annual transactions of between $100,000 and $1 million. In contrast, merchants with annual card transactions of more than $10 million faced average acceptance costs of less than 0.6 per cent.



* Merchants ranked in value deciles, with average annual value of card transactions ($m) in parentheses

Sources: Acquirers; RBA

Interchange fees may account for part of the differences in merchant service fees. Larger merchants are more likely to benefit from favourable strategic rates or particular industry rates. However, the effect of interchange rates on average merchant service fees is likely to be smaller than it was prior to the regulatory changes in the 2015–16 Review, which had the effect of significantly lowering the gaps between the strategic rates offered to large merchants and the high interchange rates on premium and corporate cards that fell disproportionately on smaller merchants.

Rather, the higher cost of acquiring services for small firms is likely to be more a reflection of the costs and margins charged by acquirers than of the interchange (or scheme fee) component set by card schemes. To some extent, this may be justified by economies of scale and the fact that the fixed costs of providing services to a small merchant will be spread over a smaller volume of transactions. However, the pricing of simple merchant plans offered by the major banks suggests that some other factors may also be involved. The marginal cost of additional transactions in these plans is typically around 1.5 per cent, well above the likely marginal cost of interchange and scheme fees, and implying a margin much larger than that typically paid by merchants on interchange-plus contracts. The Bank will be gathering further information around fee and margin arrangements as part of this review.

This suggests there may be some impediments to competition in the acquiring market for smaller merchants. One of these impediments may be the relatively higher barriers to switching faced by smaller merchants. The costs of searching for and switching to an alternative payment facilitator, for example, are more likely to outweigh the benefits for a merchant with low transaction volumes. This would be compounded if acquiring services for small merchants are bundled into broader business banking packages. Smaller merchants may be less familiar with some of the technical aspects of payments, and have fewer resources available to help understand the complexities of interchange fees, scheme fees and the like. More broadly, smaller merchants may have less negotiating power in

relationships with their acquirers, and may be less likely to choose, or be offered, plans that would minimise their payment costs.

Impediments to competition in the acquiring market may also arise if there are barriers to entry or expansion. Since the modification of the access regimes for the international schemes in January 2015, a number of new acquirers have become participants in the card schemes. However, the acquiring market continues to be dominated by a small number of large institutions, with the four major banks acquiring more than 90 per cent of the value of four-party card transactions. New entrants offering innovative technology could also face barriers to entry, for example if there were problems in the process for certifying 'non-standard' card acceptance products for use in the Australian market.[20]

The Bank is interested in stakeholder views regarding the degree of competition in the acquiring market and any possible policy action that could address shortcomings in competition. This may include consideration of policies that: reduce barriers to entry and innovation in the acquiring market; further enhance the transparency of merchant payment costs (for example breaking down total fees into the components attributable to interchange fees, scheme fees and acquirer margins); and otherwise facilitate merchants' ability to compare and switch acquirers. Similar issues are currently being considered by the UK PSR in its review of card acquiring services.

Q6: Is there a case for further policy action to enhance competition in the provision of acquiring services to merchants? If so, what form could this action take?

3.2.3 Scheme fees

Scheme fees are per-transaction fees payable by both acquirers and issuers to card schemes for services that they provide. Scheme fees, like interchange fees, directly affect costs faced by merchants in accepting card payments. However, while schemes publish their schedules of interchange fees, there is far less transparency around scheme fees. The Bank understands that the international schemes have schedules of hundreds, if not thousands, of individual fees but these are not published. The fee schedules are usually a combination of global and domestic fees. Listed fee schedules may be subject to bank-specific rebates or discounts to encourage card issuance and exclusivity arrangements.

The Bank has previously considered issues relating to greater transparency of scheme fees. The 2007-08 Review raised the prospect that the level of scheme fees be made available to all merchants as a means of increasing competitive tension in merchant service fee pricing. In particular, merchants that wished to would be able to back out acquirer margins using scheme and interchange fees, and rely on this information to negotiate for lower merchant costs from their acquirers. Following that Review, the Bank considered some possible mechanisms for scheme fee transparency, but did not proceed with specific regulatory action.

It may be timely to revisit the issue of scheme fee transparency as part of this review. With the declining use of cash and cheques, card payments represent an increasing share of household payments. In addition, information from some stakeholders suggests that scheme fees on acquirers and issuers have been growing over time and represent an increasing proportion of merchant service

20 AusPayNet has engaged with industry via its Issuers and Acquirers Community, aiming to provide a more effective process for adoption of card acceptance solutions that use different technology. See Australian Payments Network (2019).

fees. Accordingly, the Bank invites stakeholder views as to whether it would be in the public interest to have greater transparency over scheme fees. There could be a number of potential benefits to greater transparency including:

- greater transparency to merchants on this significant component of payment costs, which may enable more informed negotiations with acquirers and more informed decisions on transaction routing
- greater transparency to the Bank regarding possible circumvention of interchange regulation through payments to issuers
- information that may be relevant to understanding the degree of competition in electronic payments.

Q7: Is there a case for greater transparency in scheme fee arrangements, including their effect on payment costs? If so, what form should this take?

3.2.4 Access regimes

In 2015, the Bank varied the access regimes initially imposed in 2004 on the Mastercard and Visa credit card schemes. These variations provided greater flexibility for the card schemes to broaden membership beyond existing participants. The variations required the schemes to publish transparent eligibility and assessment criteria, the maximum time they will take to assess an application, and also obliged the schemes to report information about membership approvals and applications to the Bank.

The revised access regimes appear to be working effectively. Both schemes have admitted new participants in each year since the 2015 variations came into effect, and have met their publication and reporting requirements. Where processing of applications has in some cases been outside of the timeframes published on schemes' websites, this has been attributed to applicants sometimes taking additional time to provide information in relation to scheme assessment criteria. The Bank has received very few complaints from would-be participants regarding delays in access applications, but would be interested in hearing the views of stakeholders.

Q8: Are the existing access regimes working effectively?

3.2.5 Digital wallets and mobile payment applications

In recent years, technology firms including Apple, Google and Samsung have launched digital wallets for use in their respective mobile platforms. These digital wallets store electronic representations of payment cards, tokenised to protect the card number, that can be used to make contactless payments at the point-of-sale using the communication capabilities of the mobile device. Payments are processed using the card scheme network the payment card was issued under. While not all card issuers in the Australian market currently support each digital wallet, many card issuers, including some smaller banks, credit unions and building societies support one or more digital wallets.

Mobile platforms and handset manufacturers may have rules relating to access to different aspects of the functionality in their devices. Google's Android has supported third-party use of NFC functionality, including for payment applications, since 2013. By contrast, until recently (for example, to allow NFC capability for scanning ePassport data), Apple prevented third-party use of NFC functionality in the iPhone, and it still does not provide access for third parties to create their own payment applications

that directly use NFC functionality. In July 2016, this was the subject of an application to the ACCC by three of the major banks and one other bank. In particular, the four banks sought authorisation to negotiate collectively with Apple regarding access to the iPhone's embedded NFC controller and the Apple App Store, in order to provide their own digital wallets with embedded access to the NFC without relying on Apple Pay. In March 2017, the ACCC denied the application on the basis that the likely benefits from providing banks with access to the iPhone's NFC functionality did not outweigh the likely detriments.[21] At the time of the ACCC decision, only one of the four major banks and a number of smaller institutions using an aggregator had enabled their cardholders to use Apple Pay; currently more than 80 financial institutions, including three of the four major banks, have enabled Apple Pay.

Given the growing importance of mobile devices and digital wallets in card transactions, the Bank would be interested in receiving information from stakeholders on the additional functionality and benefits provided, as well as the costs involved. The Bank would also be interested in stakeholder views on any issues related to access to such platforms. In particular, this could include views on whether new entrants have appropriate access to digital wallets and if a broadening in third-party access to NFC functionality (with appropriate security) could have benefits for competition and efficiency in the market for digital wallets (this issue is reportedly also being given some consideration in Europe – see 'Box B: Retail Payments Reforms in Other Jurisdictions').

Another type of digital wallet technology that has emerged in other jurisdictions, but has to date not gained widespread use in Australia, is QR-code based payment technology. The most prominent cases are Alipay and WeChat Pay, the Chinese mobile payment applications that have gained a large share of the payments market in China. These companies have been able to fill gaps in the Chinese market, capitalising on their large user networks – in online, retail and social messaging channels – and making use of QR code technology to make payments more convenient. In China, QR codes have provided a cost-effective way for merchants to accept electronic payments in an environment where many of them were previously unable to do so, largely because of a lack of access to card payment terminals.

NPP Australia, the operator of the NPP, Australia's fast retail payments system, has recently published a QR code standard for use of QR codes on the NPP. This standard is based on the global EMVCo QR code specification and, while not mandatory, is aimed at standardising NPP QR code payments and promoting interoperability. Additionally, the payments industry association AusPayNet is currently considering incorporating the EMVCo QR code specification (or aspects of it) into the industry rules that govern participation in various clearing streams in Australia, such as cards and the bulk electronic clearing system. AusPayNet is also investigating industry appetite to create a single QR code interface, similar to the Singapore QR Code developed by the Monetary Authority of Singapore.

While these types of mobile payment applications are not widely used in Australia, the Bank understands that there are now a number of merchants accepting QR-code based payments. The Bank would be interested in receiving information from stakeholders about the current extent of their use, any future proposed adoption of QR-code based payments, and any potential policy issues they raise.

Q9: What are the implications of the growing importance of mobile devices and digital platforms for the retail payments system in Australia? Are there issues that arise for the Bank's regulatory regime for card payments or that are relevant to competition, efficiency and risk?

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21 See Bendigo and Adelaide Bank & Ors (2016).

3.3 Interchange and Net Compensation Regulation

3.3.1 Interchange fees

Two recent Government-commissioned reports have made recommendations in relation to interchange fees. The final report of the BETF recommended that the Bank should consider whether there are further actions that it could take to put downward pressure on interchange fees.[22] The BETF considered that there was little justification for the imposition of significant interchange fees in mature card systems, and suggested that the Bank consider overseas experience, in particular the EU reforms that set hard interchange caps for both debit and credit card consumer transactions. More recently, in its 2018 Inquiry into Competition in the Australian Financial System, the Productivity Commission recommended that the Bank should completely ban interchange fees (see 'Box C: 2018 Productivity Commission Recommendations').[23]

Box C: 2018 Productivity Commission Recommendations

The final report of the Productivity Commission's Inquiry into Competition in the Australian Financial System made two recommendations relating to interchange fees:

> **Recommendation 17.1**: The Payments System Board should introduce a ban on card payment interchange fees. Any other fees should be made transparent and published.
>
> **Recommendation 17.2**: The ACCC, with input from the Payments System Board, should investigate:
>
> - whether current or recommended interchange fee regulation favours three-party card schemes and, if such a distortion exists, whether it is significant enough to require further regulatory intervention; and
> - if further regulatory intervention is desirable, the nature of such intervention, including, but not limited to, the possibility of regulating merchant service fees as an adjunct to the interchange fee ban.

The Commission's recommendations on interchange fees focused on the cost of payments and possible ways of getting consumers to take account of (or internalise) the cost of different payment instruments in their choice of payment methods.

Different payment methods have different costs – for example credit cards are more expensive (both in total resource costs and in the cost to merchants) than debit cards, and other forms of electronic payments (BPAY or direct entry) may be lower cost than debit cards. However, the Commission noted that consumers rarely directly face the full cost of their decision to use a particular type of card, which can distort their choice of payment method towards cards. Most merchants feel obliged to accept the widely used card schemes because if they do not, they might lose business to competitors who do accept them. The Commission argued that this resulted in an imbalance which gives card schemes and card issuers the opportunity and incentive to grow the network by competing on the value to cardholders – such as rewards – rather than the costs to merchants. It argued that schemes set interchange fees to subsidise issuers providing benefits to cardholders, with the effect of raising the cost of payments to merchants. It noted that merchants could offset this by surcharging those who pay with cards, but most merchants do not feel able to do so because of competitive pressure. As a result, merchants pass on the cost of interchange to all customers through higher product prices, creating a cross-subsidy from those who pay with low-cost payment methods to those who pay with

22 See Recommendation 3.3, Black Economy Taskforce (2017).

23 See Recommendation 17.1, Productivity Commission (2018).

higher-cost payment methods such as credit cards that offer rewards.

The Commission argued that for mature card systems there is little justification for schemes to have centrally-set interchange fees to rebalance the costs and benefits of cardholders and issuers on one side of the market and merchants and acquirers on the other. It noted that removing interchange fees would not prevent issuers and acquirers from passing on their costs to their consumer and merchant customers. For example, cardholders receiving the benefits of rewards and interest-free credit could pay issuers for these benefits. Merchants would continue (as currently) to pay their acquirers for transaction processing, terminal rental, etc.

The Commission argued that there would be a number of benefits from setting interchange fees to zero. These would include a more transparent and efficient payments system, where cardholders faced price signals associated with their payment choices. There would be more discipline on card issuers and schemes to focus on the cost of their transactions, and a reduction in the focus on rewards and other incentives to subsidise card payments. Merchant service fees for card payments would fall and it was likely that there would be a reduction in costs of the payments system overall. The Commission expressed scepticism regarding claims that a reduction in interchange fees would result in a reduction in innovation in card payments and that it would not result in lower prices of goods and services to consumers.

However, the Commission noted some consequences of a ban on interchange fees. It noted that the Bank would have to monitor payments between card schemes and banks to ensure that these were not used to replicate the effect of an interchange payment between issuing and acquiring banks. It also noted the possibility that a ban would result in an advantage to three-party schemes, which are not subject to interchange regulation. Accordingly, it recommended that the ACCC and the Bank should study the impact on competitive neutrality of three-party schemes to determine whether additional regulation was required, including the possibility of regulation of the merchant service fees charged by three-party card schemes.

One possible consequence of further lowering the interchange fee benchmarks would be that it could provide a competitive advantage to three-party schemes, which are not subject to interchange fee regulation and may therefore have more scope to offer rewards to cardholders to incentivise take-up and use of their cards, funded by higher merchant fees. If this were the case, then it is possible that any near-term lowering of payment costs from a reduction in the weighted-average benchmark for credit card transactions could be offset in the longer-term by a shift towards more expensive three-party cards. However, the Bank notes that the indirect effects on three-party merchant service fees of earlier regulatory changes involving interchange fees and surcharging appear to have been at least as large as the more direct effects on merchant service fees on four-party credit transactions (Graph 4). This suggests that there have been competitive constraints on the ability of three-party schemes to expand their market share at the expense of the four-party schemes that are subject to interchange regulation. Moreover, to the extent three-party schemes were able to obtain a competitive advantage from a further lowering of the credit card interchange benchmark, there may be regulatory responses the Bank could consider to improve the efficiency of the payments system. One option, as suggested by the Productivity Commission, would be for the Bank to regulate merchant service fees charged by the three-party schemes. The Bank would be interested in stakeholder views on the effects a further reduction in interchange fees on credit cards might have on competition between three- and four-party schemes, and what regulatory options might be considered to address this.

In addition to the issues outlined above, stakeholders may also wish to comment on other issues relating to interchange fees, including the following:

- The effects of the changes to interchange regulation stemming from the 2015–16 Review. The most noteworthy changes include the reduction in the weighted-average debit benchmark from 12 cents to 8 cents per transaction, and the imposition of caps on individual interchange fees (80 basis points for credit and 15 cents or 20 basis points for debit).
- Developments in debit interchange strategies in response to LCR, in particular in relation to the strategies of the international schemes, which have traditionally set their schedules to keep weighted-average interchange fees close to the benchmark; by contrast, average interchange fees in the eftpos system have (since 2012) always been well below the benchmark. For the international schemes, recent reductions in interchange fees for some categories have typically been accompanied by increases in other categories, implying increases in payment costs for some merchants.
- Implications of the ongoing fall in the average value of card transactions, especially for debit. The average transaction value for debit cards is now around $48, down from $69 in 2009 and $56 at the time that the Board took the decision to lower the weighted-average benchmark for debit and prepaid from 12 cents to 8 cents. For some low-value debit transactions that are subject to cents-based interchange fees, the interchange fee payable on a debit transaction may be significantly higher than if a credit card had been used.
- The issuance of premium international scheme debit cards, which represent a small but growing share of transaction volumes. These cards may provide benefits such as cashback or fee-free foreign transactions. They are more expensive for merchants given that interchange fees for these cards are set at the maximum level permitted by the standard. Where these cards provide certain additional benefits to cardholders when used in one network rather than another, cardholders may not be indifferent as to the routing of their transactions; stakeholders are invited to comment whether it should be for merchants to disclose the use of LCR or for issuers of these cards to advise their cardholders to make proactive choices regarding network selection.
- Issues regarding compliance with the weighted-average benchmarks. Following the 2015–16 Review, the compliance cycle is now quarterly, as opposed to three-yearly (or whenever schemes undertook a voluntary reset). When the Bank was consulting on this change in 2016, the international schemes argued that frequent resets of their interchange schedules were costly for the industry to implement. While the international schemes have the option of setting interchange fee schedules conservatively to avoid exceeding the benchmark and limit the frequency of mandatory resets, they have not done so; resets for credit card interchange fees have been required at almost every compliance date. The Bank is interested in views from merchants, acquirers and issuers as to the cost of these frequent resets of interchange fee schedules and on any alternative approaches that might involve lower costs but would be effective in keeping interchange rates from drifting above the benchmarks.
- On a technical matter, reversals, credits, and chargebacks are currently excluded from the definition of transactions for the purposes of the interchange standards. An alternative approach would be to define transactions as net of reversals, credits and chargebacks. At the margin, this would slightly lower the overall level of interchange fees permissible under the Bank's standards. The Bank notes that there is now a wider range of transaction types that are processed as credits or reversals and would be interested in views of stakeholders as to the costs and benefits of alternative approaches to the definition of transactions.

Finally, the Bank is interested in views on whether interchange regulation should be extended to foreign-issued cards used to make payments in Australia. Interchange fees on transactions on foreign-issued cards are significantly higher than those on domestic cards. There are currently no restrictions on the interchange fees levied on these transactions, and schemes are not required to publish inter-regional interchange fee schedules. Payments made using foreign-issued cards at Australian merchants as a share of card payments – both in person and online – have increased over the past decade. In the 2015–16 Review, the Board decided not to bring transactions on foreign-issued cards into the regulatory framework, but indicated that it would continue to watch developments in this area. As noted earlier, in 2019, the EU accepted legally binding commitments from Mastercard and Visa to reduce their inter-regional interchange fees to or below caps set by the EC,[24] to refrain from circumventing the caps, and to publish inter-regional interchange fees. It is estimated that the voluntary commitments by the schemes would reduce interchange fees on foreign-issued cards used in the EEA by 40 per cent on average.

Q10: Is there a case for a further lowering of the credit or debit interchange benchmarks or any change in the way they are applied?

Q11: Should regulation of interchange be extended to inter-regional interchange fees (i.e. interchange fees applying to transactions in Australia using foreign-issued cards)? What is the typical cost of transactions on foreign-issued cards, and how much of this is attributable to interchange fees?

Q12: Is there a case for applying regulation to three-party card systems? What form could this take?

3.3.2 Net compensation

In 2018–19, the Bank conducted a limited-scope review of the interchange standards, focusing on clarifying and improving the operation of the net compensation provisions. The resulting variations that came into effect on 1 July appear to be broadly operating as intended, and the Bank is not proposing to revisit these issues in detail in this review. However, the Bank would welcome stakeholder views on other issues related to compliance with the net compensation provision.

The interchange standards prohibit issuers from receiving net compensation from a scheme, but do not prohibit schemes from paying net compensation to its issuers. Thus, the substantive obligation to comply with the net compensation provision rests with issuers. While the schemes have not objected to providing certifications of their compliance with the net compensation provision to date, the absence of a substantive obligation on schemes may limit the enforcement options in relation to any breaches of the provision. This raises the possibility of schemes offering large incentives to potential issuers to enter into an issuing agreement without consequence to the scheme should these incentives amount to net compensation. The Bank is therefore interested in stakeholder views on whether a substantive obligation regarding net compensation should also be imposed on schemes.

24 The caps set for card-present transactions are the same as those for intra-regional transactions, while the schemes were afforded a higher cap for card-not-present transactions.

The Bank is also interested in stakeholder views regarding what actions the Bank should take, or should have the power to take, following any breach of the net compensation provision (under current legislation or through a change to legislation). Issuers and schemes report on their net compensation position soon after the end of each financial year. In the event of a breach, options might include:

- for marginal breaches, no action if this was justified on materiality grounds
- issuance of a direction requiring a true-up/true-down of the excess compensation (effectively, a repayment of the amount by the issuer to the scheme or downward adjustment to an accrued entitlement of the issuer)
- issuance of a direction that has the effect of lowering the net compensation threshold in the following year by the amount of the breach
- a reduction in the interchange benchmark for a future period (say, by expressing the amount of the previous year's breach as a percentage of relevant transaction values and reducing the benchmark by some multiple of the resulting number of basis points) – the reduction in the benchmark could potentially be applied just to the relevant issuer or to a scheme broadly (i.e. across all issuers in that scheme)
- acceptance of a voluntary undertaking from an issuer to take actions addressing the breach
- sanctions as discussed in section 3.5.

A relevant consideration in relation to some of these options is whether they may effectively reward a scheme for a breach. This might be the case with a requirement to 'undo' the breach by repayment or adjustment to an accrued entitlement or lowering the effective net compensation threshold.

Q13: Is the revised net compensation provision in the interchange standards working effectively?

Q14: What enforcement mechanisms would strengthen observance of the net compensation provision?

3.4 Surcharging

The revised surcharging framework put in place following the 2015–16 Review preserved the right of merchants to surcharge for more expensive payment methods but required surcharges in designated card systems to be more closely linked to the cost of acceptance.[25] It was also accompanied by changes to the *Competition and Consumer Act 2010* that provided the ACCC with investigation and enforcement powers to take action in cases where merchants might be surcharging excessively.[26]

As a result of these changes, there have been a few significant enforcement actions taken by the ACCC. In addition, the revised framework has required reductions in surcharges by some prominent large merchants where there had previously been concerns about surcharging practices. For example, the two large domestic airlines had previously imposed fixed-dollar surcharges on domestic airfares. While these amounts may not have been excessive in terms of the overall amount of revenue raised, they were clearly above the airlines' cost of acceptance for lower-value fares. Following the 2015–16

25 Following discussions with the Bank, several payment schemes that are not formally captured by the Bank's surcharging standard – American Express, Diners Club, UnionPay and PayPal – agreed to modify their surcharging rules in a manner consistent with the standard.

26 See Dark et al (2018).

Review, the airlines changed their surcharges to be percentage-based. Furthermore, as the cost of card acceptance has fallen for the airlines, no doubt partly reflecting the changes to interchange regulation in the 2015–16 Review, the airlines have further reduced their surcharges. For example, in September 2016 Qantas replaced its fixed-dollar surcharges of $7 for credit cards and $2.50 for debit cards with a 1.3 per cent surcharge for credit/charge cards and a 0.6 per cent surcharge for debit/prepaid cards, with caps of $11 for domestic and trans-Tasman flights and $70 for international flights. Since then, it has reduced these percentage rates to 1.03 per cent for credit cards and 0.36 per cent for debit cards. The result has been a very significant reduction in the surcharges applying to lower-value air fares.

While the Bank's preliminary assessment is that the revised surcharging framework has been functioning well, the Bank invites stakeholders' views, including on any possible modifications. In addition, the Bank is interested in stakeholder views on two specific issues.

First, the Bank is aware of a few merchants that are applying differential surcharges for cards within a system, though this is not explicitly contemplated in the surcharging standard. In particular, they are applying different surcharges to domestic- and foreign-issued four-party credit cards, in line with the (significantly different) acceptance costs of the two types of cards. The Bank's view is that this is consistent with the intent of the standard, providing that the surcharge rates are each set no higher than the respective costs of acceptance. In addition, the Bank is aware of merchants that are interested in surcharging standard and premium four-party credit cards differently. The Bank is interested in stakeholder views as to whether it would be desirable to explicitly provide for the possibility of such differential surcharging, subject to no excessive surcharging for any type of transactions.

Second, the Bank would be interested in stakeholders providing information regarding the observance of the requirement in Clause 6.3 of the surcharging standard, relating to the provision of BIN lists by schemes or acquirers allowing for the electronic identification of different card types. In particular, as payment cards are tokenised for digital payments, the Bank considers it is important that merchants continue to have access to information on tokenised BINs so they will have the ability to identify whether a card is a credit, debit or prepaid card. Without such lists of BINs, merchants that choose to surcharge could be at risk of ACCC enforcement action due to inaccurate information about the card type.

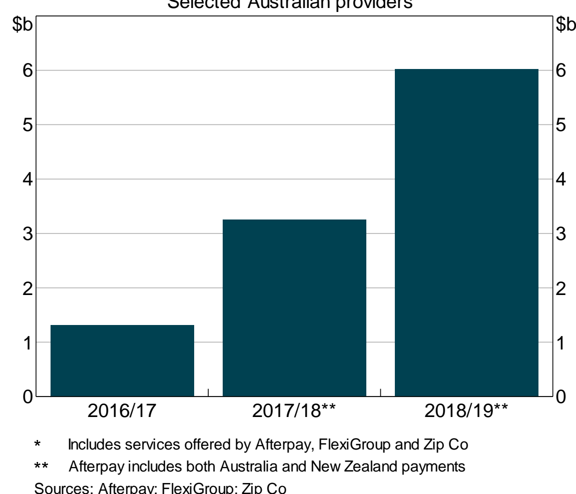
The Bank is also interested in stakeholder views regarding the growth in the use of buy-now, pay-later (BNPL) services. These are services in which customers are able to purchase goods or services but defer payment via low- or zero-interest instalments to the BNPL provider, typically over 1–2 months. While arrangements vary, some of the prominent BNPL providers have models whereby the service is 'free' for consumers if payments are made on time, with merchants charged a relatively high per-transaction fee for accepting the payment. Customers typically make instalment payments to the BNPL provider using a debit or credit card.

These services have become widely accepted by merchants in a number of retail segments, both online and in person. Data from several large BNPL providers indicates that the value of BNPL transactions has grown considerably in the past few years (Graph 10). The number of providers and products in the BNPL sector has also expanded during this period.

Graph 10

BNPL Payments Processed

Selected Australian providers*



* Includes services offered by Afterpay, FlexiGroup and Zip Co
** Afterpay includes both Australia and New Zealand payments
Sources: Afterpay; FlexiGroup; Zip Co

From a consumer perspective, the popularity of BNPL services may relate to their convenience and availability as a potentially lower-cost form of consumer credit. There are indications that BNPL services are used more intensively by certain segments of the population, particularly younger people, who may not have a credit card. For merchants, it has been argued that BNPL services may facilitate increased sales as well as provide additional benefits – for example, as merchants are paid upfront by the BNPL provider, they do not bear the risk of fraud or customer non-payment.

Stakeholders such as smaller businesses have observed that the cost of accepting BNPL payments – in terms of the fees paid by the merchant to the provider – is often in the range of 3–6 per cent and is generally higher than the cost of accepting other electronic payment methods such as cards. Most BNPL providers also have rules that prevent merchants from levying a surcharge on the customer to recover those fees.[27] This may increase the overall cost of accepting payments for merchants that feel compelled to offer BNPL services as a payment option for competitive reasons, but are unable to recoup the merchant fees from the customers that directly benefit from the service.

The Bank has long been of the view that the right to apply a surcharge on more expensive payment methods plays an important role in signalling the costs of different ways of making payments to consumers. If a business chooses to apply a surcharge to recover the cost of accepting more expensive payment methods, it is able to encourage customers to consider making the payment using a cheaper option. The possibility that a consumer may choose to pay with a lower-cost option when presented with a surcharge also helps put competitive pressure on the pricing policies of payment providers, indirectly lowering merchants' payments costs. By helping keep merchants' costs down, the right to apply a surcharge means that businesses can offer a lower total price for goods and services to all of their customers.

27 An example of a merchant that does apply a surcharge on BNPL payments is Jetstar, which applies a payment surcharge of 1.5 per cent on Afterpay transactions. Similarly, Tigerair applies a fee of 1.25 per cent of transaction value plus 15 cents for customers using Zip Pay.

The Bank is interested in stakeholder views on the no-surcharge rules of some BNPL providers. An issue for the Bank is that, unlike card schemes, BNPL providers typically have no-surcharge rules to prevent merchants from recovering the cost of acceptance from consumers via a surcharge.[28] Accordingly, merchants that accept both cards and BNPL payments are permitted to apply a surcharge to recover the cost of accepting a traditional card payment but are unable to recoup the cost of accepting a more expensive BNPL payment funded by a provider that may receive its repayments through a debit or credit card. The Bank notes in this regard that it would take a negative view of any arrangements where a currently regulated card scheme used a BNPL structure to try to re-establish no-surcharge rules.

Stakeholders may wish to provide information on some of the following questions:

- How do merchants and other stakeholders view the benefits and services that BNPL models provide?
- How do the costs of payments received through BNPL services compare with the cost of traditional card payments?
- Has the recent entry of additional BNPL providers influenced merchant fees for BNPL services?
- Do all BNPL providers have binding no-surcharge rules or are merchants able to negotiate on these?
- Are some BNPL services viewed as 'must take' payment methods for particular market segments or transaction types; that is, do merchants feel that they cannot refuse to accept BNPL for fear of losing business?

Q15: Is the surcharging framework working well? Are there any changes that should be considered?

Q16: Is there a case for policymakers to require that BNPL providers remove any no-surcharge rules, consistent with earlier actions in regard to card systems that applied such rules?

3.5 Regulation and Enforcement

Compliance with the Bank's standards and access regimes is generally effectively observed by schemes and payments system participants (e.g. interchange schedule resets occur within the time required where a scheme is above an interchange benchmark). Industry participants are also usually willing to provide data and information to the Bank without it having to resort to use of its formal information gathering powers under section 26 of the PSRA. However, the net compensation provisions – which are more complex than some other aspects of the Bank's standards – have led the Bank to give some recent consideration to what powers it would have available in the event of a significant breach of a standard or access regime.

Where the Bank considers that a participant in a designated system has failed to comply with an access regime or standard, the Bank has a power under section 21 of the PSRA to give a direction to the participant to take or refrain from specified action as the Bank considers appropriate having

28 The issue of surcharges for BNPL transactions was briefly referenced in Australian Securities and Investments Commission (2018): 'Given existing surcharges for some credit card transactions, merchants may in the future seek to introduce surcharges for buy now pay later arrangements. The implications of this would need to be considered.' ASIC noted that the BNPL providers focused on in its report are not regulated under the *National Consumer Credit Protection Act 2009*, as they either do not charge consumers for providing the credit, or they only include charges for credit that amount to an upfront fee or a periodic fee that is fixed and is less than specified amounts.

regard to the failure to comply with the standard. Any direction must be consistent with any applicable regulation prescribed by the Bank (e.g. any other part of a relevant standard or access regime). The Bank may impose a timeframe by or within which a direction is to be complied with. If a participant fails to comply with, or otherwise contravenes the direction, then it commits an offence, and is subject to a penalty of 50 penalty units (currently equivalent to around $10,500) per day until the failure is remedied or the direction is revoked.[29] The penalty for failing to comply with a direction is substantially lower than for offences under other legislation relating to the financial sector[30] – and potentially means that the deterrence effect of the Bank's powers here is limited. This raises the question as to whether it might be desirable for the Bank to be given some additional regulatory powers or mechanisms:

- For example, whether the Bank should be able to establish and enforce penalties or remedial actions under, or for failure to comply with, a standard or access regime, rather than relying solely on a directions power and sanctions for failure to comply with a direction.
- Whether the size of potential fines under the PSRA should be increased.
- Whether other mechanisms should be available to the Bank to provide a broader range of effective regulatory tools, e.g. the ability to accept court-enforceable undertakings from payment system participants, including system administrators.

Q17: Are there potential enhancements to the Bank's regulatory powers and enforcement mechanisms that could improve the effectiveness of retail payments regulation?

3.5.1 American Express Companion Card designation

The American Express Companion Card system was designated in October 2015, and Standards No.1 and No.3 of 2016 apply to it. As a result of the net compensation provisions, the four major banks have elected to cease offering companion cards. The Bank expects to revoke this designation in light of the cessation of these arrangements.

29 For bodies corporate, a court may impose a fine of up to five times this amount (i.e. up to $52,500).

30 For example, contraventions of Part IV of the *Competition and Consumer Act 2010*, which deals with anti-competitive practices, can lead to a penalty for a corporation that is the greater of: $10 million; three times the value that is 'reasonably attributable' to the benefit obtained as a result of the breach; or 10 per cent of the corporation's annual turnover in the 12 months preceding the breach.

4. Next Steps

The Board is seeking views from interested parties on the issues raised in this Paper. Written submissions on the issues discussed in Section 3 should be provided by no later than 31 January 2020, and should be sent to:

Head of Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001

or

pysubmissions@rba.gov.au

The Board also invites stakeholders to raise other issues relevant to the payments system for inclusion in the review. The Bank will consider any other issues raised by stakeholders and will determine whether these should fall within the scope of the review. The Bank expects to publish a follow-up paper in mid 2020.

Submissions provided by email should be in a separate document, in Word or equivalent format. Submissions in PDF format must be accompanied by a version in an accessible format such as .rtf or .doc.

All submissions will be published on the Bank's website, unless it is specifically requested that the Bank treat the whole or any part of a submission as confidential. In the normal course of events, those making submissions will be provided with an opportunity to discuss their submission with the Bank.

Privacy

Unless requested otherwise, published submissions will include contact details and any other personal information contained in those documents. For information about the Bank's collection of personal information and approach to privacy, please refer to the Personal Information Collection Notice for Website Visitors and the Bank's Privacy Policy.

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Appendix A: Questions for Stakeholders

The Bank is seeking submissions on the issues discussed in this paper, including stakeholder views on some or all the following specific questions.

Q1: What major recent or prospective developments in the broader payments industry are particularly relevant to this review? More specifically, are there any gaps in functionality available to end users or any shortcomings in industry governance or operating arrangements that require regulation or coordinated industry action?

Q2: Are there aspects of retail payments regulation that lead to market distortions or that create opportunities for regulatory arbitrage? If so, what options should be considered as a means of addressing these? Are there gaps in the regulatory regime that need to be addressed or any elements where regulation is no longer required?

Q3: Are there barriers to innovation and/or competition that may affect the costs of or provision of electronic payments and should be addressed in this review?

Q4: How do stakeholders assess the functioning to date of least-cost routing (LCR) of contactless debit card payments? Do additional steps need to be taken regarding LCR to enhance competition and efficiency in the debit card market?

Q5: Have recent and prospective developments in technology changed the case for promoting the continued issuance of dual-network debit cards? What policy actions might be needed to promote competition and efficiency in an environment where single-network cards were more prominent? Alternatively, would it be desirable to mandate (or incentivise through interchange caps) that all debit cards issued enable at least two unaffiliated/competing networks?

Q6: Is there a case for further policy action to enhance competition in the provision of acquiring services to merchants? If so, what form could this action take?

Q7: Is there a case for greater transparency in scheme fee arrangements, including their effect on payment costs? If so, what form should this take?

Q8: Are the existing access regimes working effectively?

Q9: What are the implications of the growing importance of mobile devices and digital platforms for the retail payments system in Australia? Are there issues that arise for the Bank's regulatory regime for card payments or that are relevant to competition, efficiency and risk?

Q10: Is there a case for a further lowering of the credit or debit interchange benchmarks or any change in the way they are applied?

Q11: Should regulation of interchange be extended to inter-regional interchange fees (i.e. interchange fees applying to transactions in Australia using foreign-issued cards)? What is the typical cost of transactions on foreign-issued cards, and how much of this is attributable to interchange fees?

Q12: Is there a case for applying regulation to three-party card systems? What form could this take?

Q13: Is the revised net compensation provision in the interchange standards working effectively?

Q14: What enforcement mechanisms would strengthen observance of the net compensation provision?

Q15: Is the surcharging framework working well? Are there any changes that should be considered?

Q16: Is there a case for policymakers to require that BNPL providers remove any no-surcharge rules, consistent with earlier actions in regard to card systems that applied such rules?

Q17: Are there potential enhancements to the Bank's regulatory powers and enforcement mechanisms that could improve the effectiveness of retail payments regulation?