**Commonwealth** Bank

Commonwealth Bank of Australia
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# RESPONSE TO REVIEW OF RETAIL PAYMENTS REGULATION – ISSUES PAPER

The Commonwealth Bank (CBA) welcomes the opportunity to participate in the Review of Retail Payments Regulation. A review is timely given technological developments and changes in payments trends that warrant re-appraisal of the existing regulatory framework. With regard to the specific policy areas identified in the Issues Paper, CBA places particular emphasis on our positions in relation to further interchange regulation, digital wallets and the need for competitive neutrality of regulation.

In general, decisions to introduce new regulation should be guided by a number of broad principles. CBA supports measures that create competitive neutrality and a fair market. Regulatory design needs to be forward looking and technologically neutral to accommodate future innovation. While payments reforms in other jurisdictions can be a useful guide for domestic regulatory reform, it is important to differentiate the Australian payments system in order to understand whether overseas legislation is applicable or relevant to the Australian context. Unnecessary or inefficient regulation should be avoided and, consistent with the RBA's approach to payments regulation, should only be contemplated when the industry is unable to address a public interest concern. Indeed, we encourage the RBA to consider removing regulations which have served their purpose and offer little prospect of additional benefits, given the burden associated with monitoring and reporting on compliance. Finally, it is important that consumer outcomes are the primary consideration when pursuing efficiency in the payments system.

## Developments in retail payments

Since the previous wide ranging review of the payments system in 2015-16, the payments landscape has undergone substantial transformation as a result of technological developments, innovation, new entrants and regulation that has been accompanied by changing consumer payment behaviours and expectations.

<u>CBA</u>
CBA understands the responsibilities of being Australia's largest payment provider. We have continued to lead and innovate in payments with a number of achievements since the previous review including:

- Significant progress in roll out of the NPP, with CBA accounting for the largest proportion of payments received and as of December 2019, third highest payments sent via NPP
- Expanded the access to digital wallets for retail and business customers
- Delivered next generation point of sale terminals
- Led the development and launch of BeemIt
- Issuing bonds for the World Bank utilising blockchain technology
- Wiise – empowering SMEs by combining accounting, payroll and banking
- Supported Transport for NSW to roll out contactless open loop payment on all public transport modes and continuing to support other states.

These initiatives demonstrate the proactive approach we take to delivering better outcomes for all of our stakeholders.

Regulatory reform

As the RBA has summarised in the Issues Paper, a number of regulations have been introduced since the previous Review, including the interchange standards in 2015-16, revised interchange standards in 2017 and the review of net compensation provisions in 2018-19.

The formation of the Australian Payments Council in 2015 has facilitated the industry working together with the RBA to achieve a number of additional policy objectives including a plan for the decline of cheques, a framework to address card not present fraud and digital identity. The industry has also collaborated to respond to RBA policy objectives with the development of the NPP and least cost routing (LCR).

These factors in combination have led to significant shifts in the market, which should inform any new regulatory reform.

**Consultation 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?**

**The future role of cash, cheques and DE**

Cash

CBA supports the RBA's view that the progression towards a less-cash society is a positive development that brings benefits of reduced cost, increased efficiency and choice, and an opportunity to better manage payments fraud and financial crime more generally. However, as the RBA Governor has previously noted, this transition is occurring relatively quickly and organically.

The Australian Payments Council's new strategic agenda will focus on proactive measures to ensure that the payment system continues to be inclusive and accessible as Australians shift towards digital payments. As well as actively managing the transition to 'less cash', it will be important to ensure that customers who prefer to use cash continue to be able to do so. At this stage, cash remains widely accepted and continues to be available via ATMs, bank branches, Bank @ Post and cash out @ POS.

Cheques

CBA supports the work of AusPayNet to manage the decline of cheques through collaboration with impacted stakeholders. We expect the AusPayNet industry consultation on the 'Future State of Australian Payment Systems' will provide a transition plan with a definitive end date for the retirement of cheques as a payment method. CBA considers that retirement of cheques over the period of 2025 to 2030 is an achievable aim. The reduction in cheque use has reached the point where processing cheques is now very expensive, whilst numerous alternative payment methods exist that are safe, efficient and increasingly accessible. The industry will need the support and the public endorsement of the RBA and relevant government agencies to progress this necessary step in modernising the Australian payments system.

Direct Entry

In the long term, the direct entry system should be retired as part of a broader rationalisation of payment systems over the period of 2025 to 2030. CBA supports AusPayNet's industry consultation on 'A Future State for Australian Payments Systems' to co-ordinate industry activity to reach this target. For the NPP to be a viable alternative to direct entry, particularly for bulk corporate payments, the costs of processing and settlement will need to become comparable to direct entry costs.

**System resilience**

CBA will continue to support the work of the RBA and industry in developing a standard set of operational performance statistics for individual institutions that is accurate, meaningful and does not undermine confidence in the payments system. System resilience is the responsibility of all participants in the payments ecosystem, including new entrants that rely on the existing infrastructure.

Regardless of its longer term future, direct entry remains an efficient and cost effective payments rail. CBA is therefore supportive of initiatives that are being undertaken by the industry to build resilience into the system - such as review of the current Community of Interest Network (COIN) that provides alternative network services and connectivity between payments participants.

However, a regulatory framework anchored around payments alone will be inadequate to build system resilience. The reliance of the payments industry on infrastructure such as telecommunications, water and electricity should not be understated. CBA considers the focus of the Australian Payments Council's current strategic agenda on the continuous identification, management and reduction of risks to payments system resilience will be essential for reliable electronic payment services.

**Automated and recurring payments (including direct debits)**

CBA agrees that cancellation or redirection of direct debit and other automated payment arrangements is not always straightforward. Customers view recurring payments via direct debit and recurring credit card payments as a similar service, even though these payment arrangements relate to parts of different clearing streams.

From a card schemes perspective, the International Card Systems already enable automated billing updates. In the future, tokenisation, while primarily a security measure, will offer a longer term solution for greater customer control over recurring payments.

However identification of recurring direct debits via Direct Entry continues to be challenging. Given the limited future of the Direct Entry system in the long-term, the industry should be cautious of overinvestment in capabilities around life cycle management of automated and recurring payments for direct debits. As reliance on Direct Debit is expected to reduce as payments progressively move over to the NPP, CBA considers that building this capability as part of the NPP Consent and Mandate service would be preferable to adding further complexity to BECS. The NPP Consent and Mandate service will give customers more control over how they establish, maintain and cancel recurring payments.

**The impact of new technologies and new entrants**

New market entrants and emerging business models have contributed to today's highly competitive financial services sector with numerous diverse providers that include traditional financial institutions, neo-banks, fintech start- ups and a growing range of global technology businesses. CBA believes there are opportunities for both banks and new entrants to partner and deliver innovative experiences for consumers. We have numerous examples of mutually beneficial collaboration with the FinTech community such as our partnerships with Whitecoat, Klarna and Wiise. Through these we have brought, and will continue to bring benefits more quickly to our customers.

Some new competitors take advantage of business models that are not subject to the same level of regulatory oversight as traditional business models. Based on international experience it is likely that many of these may consider expanding and differentiating the services they offer in the future. Any new risk and associated cost imposed upon the payments system is borne by its existing users and participants. Regulators must be vigilant in managing the risks introduced to the payments system by new and innovative payment offerings. Emerging products and services also need to be supported by appropriate consumer protection measures to prevent poor customer outcomes deterring widespread adoption of new and innovative solutions.

As a network industry, the reliability and sustainability of the payments system requires the involvement and collaboration of all participants. CBA supports AusPayNet's attempts to accommodate new participants in the payments system by offering tiered membership options. The payments landscape is becoming more diverse with a range of new participants utilising an increasingly burdened payments infrastructure. The industry will need to continue to develop tailored solutions to ensure the proportionate contribution by new entrants to help support the resilience, security and maintenance of the payments infrastructure that they use.

**Domestic schemes & frameworks**

While CBA recognises the potential efficiency gains from consolidation, efficiency should not be at the expense of consumer benefit, competition and innovation. CBA believes that the domestic schemes all have their individual place in the payment ecosystem. The existing arrangements encourage competition to facilitate differentiated customer propositions.

We do support the work of AusPayNet in establishing a working group that can consider all scheme priorities (domestic and international) and seek alignment where possible. The objectives of AusPayNet's Payments Review Committee are to manage the strategy and roadmap resulting from AusPayNet's Consultation on the 'Future State of Australia's Payment Systems'; and manage the development of functionality and governance across Australia's payment systems, to ensure efficiency and interoperability, for the benefit, and in the best interests, of end users.

**Regulatory technology**

CBA sees opportunity in driving and implementing regulatory technology ('RegTech') to streamline meeting our compliance obligations and ensure better customer outcomes. The use of RegTech will help prevent the recurrence of large remediation programs and help restore trust in the financial industry.

**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?**

AusPayNet's self-regulatory model, supported by strategic direction from the Australian Payments Council and market mechanisms is working well to provide an innovative and consumer-focused payments landscape. Industry already has self-regulatory initiatives underway to manage payment clearing systems in the medium-to-long term on a number of the areas identified in the Issues Paper.

Regulatory arbitrage can be minimised by ensuring that payments regulation is competitively neutral and creates a level playing field. Domestic self-regulation is undermined when global participants (for example acquirers) do not adhere to AusPayNet standards or device certification.

In addition to the above, the ongoing disparity between bank issued four-party credit cards and those issued by three-party schemes such as American Express continues to hamper CBA's ability to effectively compete in important segments such as business and commercial customers and affluent consumers. The most recent interchange regulations which cap individual interchange rates for programs which are typically more expensive to maintain has led to a reduction in competition in the aforementioned segments, and should be reconsidered in this Review.

**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?**

It has been publicised that other central banks have started to assess the viability of digitising the fiat currency, particularly as the private sector (eg Libra) aims to move into this space. CBA requests the RBA to actively consider the steps required to ensure Australia is not left behind. CBA supports proactive measures to create the necessary conditions for the eventual proliferation of an eAUD and we are committed to working with the RBA and industry in relation to this emerging issue.

**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?**

The introduction of LCR has been effective in placing pressure on interchange fees to reduce costs of card acceptance for merchants, eliminating the need for any further regulatory intervention. The implementation of LCR functionality by industry participants (including CBA) in response to the RBA's concerns provides a positive example of the successful achievement of policy outcomes without resorting to regulatory action.

CBA's solution: Merchant Choice Routing

The CBA solution to Least Cost Routing (LCR) is called Merchant Choice Routing (MCR) and allows the Merchant to choose settings suited to their individual business circumstances. In general, all customers currently have the option of MCR as they either have an enabled device with MCR as a default, or if they don't, CBA will upgrade to an MCR enabled device at no cost when requested by a merchant.

We have published information about the availability of MCR (including on the Commbank website https://www.commbank.com.au/business/merchant-services/merchant-choice-routing.html) and intend to take further steps to raise awareness of this offering. At this stage a small proportion of merchants have taken up MCR, with interest predominantly from larger merchants.

In light of recent publicity[1] relating to unexpected consumer charges arising from LCR, the RBA should consider regulatory solutions to enhance consumer awareness of LCR and its potential implications, and ensure that consumers understand they have a choice as to how their transaction is routed, and how they can exercise that choice.

CBA has reservations regarding the Payment System Board's concerns that the needs of smaller merchants are not being met. In CBA's experience, customer research has consistently demonstrated that small merchants prefer the convenience of bundled plans or rates that remove ambiguity and simplify the process. This is reflected in the popularity of CBA's Simple Merchant Plan.

> Simple Merchant Plan
> CBA's Simple Merchant Plan provides customers with an EFTPOS terminal, transaction value and a settlement account with no monthly account keeping fee. This plan offers value for money and is the simplest plan available in the market.
>
> The Simple Merchant Plan has been in place for 4 years and allows a merchant to use a facility at a fixed monthly cost inclusive of terminal rental, business transaction account and card turnover. The resounding popularity of this solution is due to its simplicity and alignment with other offerings such as mobile phone plans.

In addition, while CBA acknowledges the benefits of MCR to merchants, it should be recognised that the development and implementation of MCR has meant that other planned innovations that may have benefitted smaller to medium sized merchants have had to be deferred. It should also be noted that with the anticipated proliferation of digital wallet acceptance over time, the effectiveness of MCR will reduce as consumers can set the default for the contactless mobile token.

CBA cautions that the desire to maximise merchant savings needs to be balanced against consumer outcomes. LCR effectively removes consumer choice and transparency by overriding cardholder preference and limits customer access to the potential benefits offered by card schemes such as travel insurance and extended warranties.

Further, the Issues Paper states that the three schemes offer similar protections to cardholders in relation to fraudulent and disputed transactions. The EFTPOS centralised disputes and chargeback rules introduced in 2017 are relatively comparable to the card schemes with regards to card present transactions. However the EFTPOS chargeback process is largely untested in the ecommerce environment which is associated with higher fraud levels and chargebacks.

**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?**

CBA considers that dual-network debit cards should continue to be widely available. There are sufficient incentives in the market to continue issuing multi network cards and supporting the migration of their

[1] https://mozo.com.au/debit-cards/articles/shop-at-coles-you-could-now-be-charged-when-you-tap-and-go

functionality into tokenised mobile wallet environments. Unless the above conditions materially change, there is no case for further policy intervention.

**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?**

From CBA's perspective, merchant acquiring is an inherently high risk business that is operating in an increasingly competitive market, evidenced by the addition of 10 new acquirers in the past 10 years. Traditional acquirers are facing low margins, an increasing cost base, a high cost of maintaining infrastructure and competition from new entrants who are able to leverage the existing payments infrastructure without the equivalent regulatory obligations.

**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?**

In principle, CBA considers that fee transparency may be a positive feature of a payments system when disclosure is meaningful, useful and does not increase regulatory burden. However, based on the attempts in Europe to increase card payment transparency, such measures may not achieve the intended policy objectives. The European Commission introduced rules in 2015 and 2016 that aimed to increase transparency of payment costs with debit or credit cards to retailers and consumers and to allow them to make efficient choices.

From a technical point of view, the European Commission rules have been difficult to implement by acquirers. In many cases, implementation by acquirers has taken much longer than anticipated and even now, many of the larger merchants continue to lack the systems to check the validity of the new data that they receive. Smaller merchants appear to have preferred the simplicity of a single unit or ad valorem fee per transaction, and many have elected to opt out under the rules.

Additionally, the roll out of least cost routing, interchange and surcharging regulations, and the entry of 10 new acquirers into the market have combined to materially reduce acceptance costs for merchants and eliminates the need for additional regulation. Additional reporting obligations on fees in this context will be expensive, onerous and unlikely to provide any further benefits to consumers or smaller merchants.

**Q8: Are the existing access regimes working effectively?**

CBA considers that the existing access regimes are working effectively as demonstrated by the entry of a number of new acquirers and ADI issuers into the Australian market over the past decade. As recommended in the Conclusions Paper of the NPP Functionality and Access Consultation, CBA agrees that a review of access arrangements in 2021 would be appropriate.

**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?**

CBA considers that commercial models imposed on Australian issuers that create exclusivity for third party mobile wallets on particular mobile devices and restrictions on pass-through of the third party mobile wallet provider fees have the potential to introduce uncapped and unwarranted costs into the payments ecosystem.

The commercial model and practices employed by some mobile wallet providers (for example intercepting card on file transactions and routing through their own digital wallet - which incurs an additional charge to the issuer) are significantly increasing payment costs.

CBA believes a broadening in third-party access to NFC functionality (with appropriate security) would have clear benefits for competition and efficiency by enabling providers to install their own applications for contactless mobile payments. We welcome the international scrutiny of restrictions on NFC access that is occurring in Europe.

**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?**

Australia is a global leader in payments despite having amongst the lowest interchange rates internationally. While the major card schemes may be considered ‘mature systems’, they continue to innovate and evolve to meet the needs of consumers and the changing payments ecosystem. Therefore, CBA considers that the current level of interchange provides the absolute minimum revenue stream required to incentivise ongoing innovation, promote competition and fund fraud mitigation initiatives and losses.

The RBA should also consider establishing an interchange fee floor as a mechanism to ensure that smaller schemes, which may not be able to sustain a prolonged “race to the bottom” continue to remain viable. An interchange floor on individual interchange rates, particularly for debit cards, could also work to reverse the current phenomenon, which has seen large merchants enjoy interchange fees well below the weighted average, at the expense of smaller merchants.

In light of the desired outcomes of interchange regulation, it remains unclear whether the cost-savings for retailers from reduction in interchange fees have in fact been passed on to consumers through lower retail prices. Many factors influence retail prices: the specific retail sector and its margin structure; the size of the merchant; acceptance of different payment instruments; and economic developments. Additionally, interchange is only one driver of the price of payment services and should not be viewed in isolation. Equal consideration should be given to other unregulated costs that are being introduced into the payment system by newer services such Buy Now Pay Later, digital wallets and AMEX.

A European Central Bank market consultation in 2017 indicated that merchant prices did not decrease in response to interchange fee regulation. The review study planned by the European Commission for 2020 may provide more insight to guide future interchange reform.

The underlying rationale for the regulation of interchange should be revisited in light of changing consumer behaviour. As card payments are now the most frequently used payment method for retail transactions in Australia, concerns regarding cross-subsidisation by those who pay with supposedly low-cost payment methods may no longer be relevant.

**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?**

CBA does not believe there is a strong rationale for regulating international interchange fees, particularly given the lack of lower cost alternatives available to consumers visiting Australia.

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

CBA supports a general principle of competitive neutrality of regulatory outcomes. Unless the RBA is convinced that keeping the three party schemes relatively unregulated is not distorting market outcomes, it will need to act to ensure competitive neutrality. CBA is committed to assisting with the development of any regulatory frameworks proposed by the RBA.

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

CBA considers that the provision is working effectively.

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

As the variations of the net compensation provisions only came into effect in July 2019 it may be premature to consider enforcement mechanisms in the absence of evidence of breaches that indicate the need for enforcement.

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

Surcharging can improve efficiency of the payments system when it provides appropriate price signals to consumers by accurately reflecting the cost incurred by merchants. However, surcharging has a number of limitations including the impact on customer satisfaction and discouragement of adoption of electronic payments.

The European Union banned surcharging on payment methods whose interchange fees are capped under its regulation as part of the revised Payment Services Directive (PSD2), which came into force in 2018. According to the European Commission, regulated interchange fees are capped at a sufficiently low level that surcharging is no longer justified. We encourage the RBA to consider adopting a similar approach.

**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?**

CBA would encourage the RBA to ensure there is competitive neutrality of regulatory outcomes, to products and providers operating in the same market. Accordingly, a consistent approach should be adopted for the payment component of Buy Now Pay Later offerings in relation to surcharging rules.

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

As the Issues Paper observes, compliance with the RBA's standards and access regimes is generally observed effectively by schemes, and payments system participants and industry participants are usually willing to provide data and information to the RBA without it having to resort to use of its formal information gathering powers under section 26 of the *Payment Systems (Regulation) Act 1998*. CBA notes that we have made proactive efforts to ensure effective information sharing, including voluntarily providing monthly updates to the RBA on our progress with the NPP, MCR and other initiatives of interest to the RBA.

In view of the RBA's presumption in favour of self-regulation by the industry, and the Government's Regulator Performance Framework objective to reduce the cost of unnecessary or inefficient regulation, it does not appear that strengthened regulatory powers and enforcement mechanisms are needed at this stage. The industry solutions that have been developed in response to the RBA's policy objectives to date confirms this view. The Explanatory Memorandum for the *Payment Systems (Regulation) Bill 1998* made clear that the intent of the legislators was for the Bank's regulatory powers to be used sparingly.

We acknowledge the RBA's concerns regarding the complexity of the net compensation provisions. However, there is a need to ensure regulation is proportionate to the regulatory risk being managed. As the variations of the net compensation provisions only came into effect in July 2019 it may be premature to consider enforcement mechanisms in the absence of evidence of breaches occurring.

The policy objectives that have been achieved to date suggest that the current regulatory model is working well. In order to maintain an efficient, reliable and competitive payments system it will be essential to reduce complexity and enable innovation. The Australian payments industry is facing unprecedented demands including major projects such as the NPP and SWIFT ISO20022 migration, in addition to the need to enhance and modernise operations to keep pace with new technological advances and maintain resilience in the face of increasing demands on our technology platforms. Collaboration and co-operation across industry and with regulators will be necessary to agree on realistic implementation timeframes, and to facilitate appropriate planning and sequencing of multiple technological changes.