19 February 2020

Tony Richards

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Reserve Bank of Australia

GPO Box 3947

Sydney NSW 2001

Via email to pysubmissions@rba.gov.au

Cc Chris Thompson, David Emery (by email).

Dear Tony,

**Re: Cuscal response to the Review of Retail Payments Regulation: Issues Paper**

**Background**

Cuscal Limited (Cuscal) appreciates the opportunity to respond to the above consultation paper issued by the Reserve Bank of Australia (RBA).

Cuscal is an end-to-end payments provider that services more than 100 established and challenger brand clients within Australia's financial system and payments landscape, including the majority of the mutual banking sector. We are an Authorised Deposit-taking Institution (ADI) and also hold an Australian Financial Services Licence and Australian Credit Licence. We are the founder and owner of 86400 [www.86400.com.au](http://www.86400.com.au), the new fully licenced digital bank.

The services that we provide to our client institutions include: card scheme sponsorship, card issuing, card production services, card payment acquiring, digital and mobile banking platforms, and access to the New Payments Platform (NPP), Direct Entry (BECS) and BPAY. We also act as settlement agent for many of our clients through our Exchange Settlement Account with the RBA. We process approximately 16% of Australia’s electronic transactions.

In addition to established and new financial institutions, Cuscal works closely with small and large fintech and “paytech” companies seeking access to the Australian payments ecosystem. We enable their market connectivity so they can focus on providing innovative products, business models, and drive improved customer outcomes.

For further information on services Cuscal provides, please refer to our website at [www.cuscalpayments.com.au](http://www.cuscalpayments.com.au).

Our responses in this submission have been structured in line with the proposals raised in the Issues Paper.

**Our response to the “Questions for Stakeholders”**

**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?**

There are a number of areas in which Cuscal feels a regulatory or consolidated industry response may be warranted. Some of these are areas raised in the Issues Paper, some are additional areas of focus or concern raised by Cuscal. These are, in brief:

1. Consumer choice for routing processing: With the increasing use of digital wallets and the onset of Consumer Data Right (CDR), it is likely the consumer will be able to choose which payment rail a transaction is routed through to minimise cost/maximise their benefit. The industry should prepare for this eventuality.
2. Set regular review periods for regulatory codes and standards: for example, the ePayments Code and other regulatory codes or standards should be reviewed to set timetables or timeframes, rather than on an ad hoc or reactive basis. This will require cross industry coordination, including with other regulators.
3. Consistency in regulation and enforcement: New entrants should abide by the same rules as existing participants. There are benefits in providing initial concessions or exemptions, but these should be time and volume bound. This is crucial for the security of data, transactions and consumer assets.
4. Reporting of statistics: Regular reporting of statistics needs to be clarified, streamlined, and simplified, especially where there is duplication between what is reported to regulators and which products or facilities must be reported.
5. The resiliency and reliability of payment system infrastructure: this remains a focus area for all involved, including both prevailing infrastructure and the increasing move to cloud-based systems. As consumers and businesses increasingly rely on electronic payments, there is a need to ensure that the systems are modern, resilient, cost-effective and safe.
6. Enhanced fraud reporting and the use of fraud and financial crime data: Cuscal would like to see increased sharing of real-time fraud and crime data amongst ADIs - beyond the AUSTRAC Fintel Alliance. Reducing fraud costs is a clear consumer and industry benefit.
7. Legacy systems and products (such as direct entry) are becoming older due to the pace of innovation and are therefore unlikely to attract dedicated investment. It is Cuscal’s view focus needs to be on how existing payment volumes can be moved to electronic or digital means; for example, the use of digital cheques for large value consumer payments.
8. The decline in use of cash: It is Cuscal’s view that there will always be some ongoing need for cash which should be protected. As has been foreshadowed in the UK and Sweden, it may be necessary to legislate for the protection of access to cash if competitive or market forces will not. The regulatory regime around surcharging card payments assumes that there is no cost associated with the acceptance of cash, and, as such, encourages its continued use, which is a high cost payment method for society. Cuscal believes the RBA should review whether surcharging for low cost debit payments should be discouraged or banned, as it is in Europe.
9. Open Banking and the Consumer Data Right: The industry needs to consider the potential disruption and opportunities of these new archetypes to the payments landscape and what the open banking “payments ecosystem” may look like. A review group of industry participants should be formed to consider this, perhaps led by the Australian Payments Network (APN).

It would also be helpful to consider whether a lead regulator for CDR (including Open Banking, Consent Management and Digital ID) should be considered. With a lead regulator a greater focus can be placed on consumer education, which would assist these new and developing channels. In addition, given that CDR and open banking will eventually introduce payment capability, the timeline for compliance and compete needs to be more closely coordinated in the industry. To that end, it pleasing to note the ACCC has recently consulted on adjusting timelines for smaller ADI participants.

1. Consumer education and costs disclosure: It is Cuscal’s view there needs to be further coordinated industry action on consumer education and payment costs disclosure. For example, greater, and near-time, notice of fraud and scams, and card use and harm minimisation techniques. Additionally, with merchant surcharging and costs of acceptance, not only transparency of costs, but disclosure of unforeseen ramifications of least-cost routing, for example chargeback recourse or insurance forgone or limited.
2. Market power imbalances: For example, the ability of card and payment schemes to mandate product changes (often disguised as compliance changes) which create significant regulatory and cost burdens that participants do not have the ability to opt out of.
3. Greater transparency of RBA intentions and awareness of strategy: Cuscal feels there would be benefit in the RBA undertaking broader consultation and engagement with respect to its regulatory actions. For example, increased promotion of their strategic regulatory and policy roadmap, and greater engagement with industry, such as periodically attending or presenting at meetings of industry bodies or forums, such as the eftpos, BPAY or APN Board meetings, as an adjunct to the roles it fulfils for NPPA.
4. Domestic scheme consolidation: Cuscal has direct or indirect membership of APN, NPPA, BPAY and eftpos. Cuscal would support an investigation of the efficiency, competition and resilience benefits that might be gained from consolidating and/or cross-pollinating the activities of APN, NPPA, BPAY and eftpos into one entity (eg. “Payments Australia”).
5. Timing alignment of scheme technical releases: There is no alignment between the biannual mandate and technical releases of domestic schemes with those of their international counterparts. For example, Visa and Mastercard are generally aligned with each other due to their global releases, however eftpos, NPP and BPAY have their own change implementation schedules. This creates a substantial compliance cost and resource burden across the industry due to different “go live” dates. A staged alignment of scheme releases would provide significant benefit to the 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?**

Further to the areas specified above in Question 1 (where regulatory gaps may need to be addressed), Cuscal would also identify the buy now, pay later (BNPL) sector as an area where regulation is insufficient or inconsistently applied, in which case it may cause adverse regulatory outcomes. We are pleased this has been identified as an area of concern in the Issues Paper, though suggest earlier action by regulators in this regard would have been welcome. Our further thoughts on this issue are detailed in the respective question below.

A secondary area of concern in terms of market distortion or regulatory arbitrage are the discrepancies in card scheme rules, particularly the absence of uniformity in definitions of common terms, products, participants and so on. For example, there are distinct inconsistencies in the classification of marketplaces between schemes, which can cause differing impacts on merchants, issuers and end consumers. It is Cuscal’s view it could be beneficial to develop standardised terms and classifications that must be used across card schemes wherever possible, especially where such terms affect the application of scheme rules, interpretation of regulation, participant pricing or consumer outcomes.

**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?**

Cuscal believes a substantial barrier to innovation in the retail payments market is the significant costs of compliance, including technology costs, not just in terms of legislation or regulation but also the numerous network, system and scheme rules. This makes innovation and development difficult for established players, but also can be an insurmountable barrier for new entrants or small institutions, which inhibits and stifles competition.

An additional restriction on competition, in Cuscal’s view, is the construct of the net compensation standards. One of the key factors in ensuring there has been competition in the card market has been the payment of incentives to help establish new players. We believe the move to disallow the net payment of incentives severely curtails the ability of new entrants to become established in the market, as their initial start-up volumes (and hence scheme fees paid) will never meet the initial incentives paid to entice their entry into the market. Incentives from schemes do not simply replace interchange fees for issuers: they fund innovation and subsidise the sizable upfront costs of new market entrants. We also believe that further review of the definitions of receipts and payments for net compensation needs to be undertaken in the near future.

Many of Cuscal’s clients are smaller card issuers, these clients suffer a disproportionate cost per cardholder to support dual-network debit cards (DNDC), due to the need to comply with the mandates of both schemes which requires a significant investment from each organisation, as well as Cuscal itself. For example, eftpos is seeking to mandate the development and deployment of many functionalities that duplicate what is already available via the international schemes, with the issuer forced to make the investment to remain compliant. Whilst our clients’ new neobank competitors appear able to issue single-network debit cards (SNDC) without the cost impost of dual network, which creates an unfair advantage in attracting customers.

Cuscal does not agree with the concept of differential interchange between dual-network and single-network debit cards, and would consider the RBA’s suggestion of a “Durbin” approach that permitted the issuance of SNDCs by smaller issuing institutions far more preferable.

Similarly, a reduction in interchange rates has a disproportionate impact on smaller card issuers compared to other banks that can absorb the revenue decline by their ability to amortise costs across large customer portfolios and/or offset issuing and acquiring portfolios to avoid passing on costs to consumers.

Larger merchants have benefited from lower interchange benchmarks by negotiating strategic merchant rates. Meanwhile, larger issuers have proven more able to arbitrage interchange via offering premium or commercial cards that attract the highest returns from smaller merchants. One potential policy response might be to simplify or remove interchange hierarchies used by the card payment networks to eliminate the opportunities to arbitrage interchange.

Cuscal’s small clients rely on a reasonable level of interchange revenue to support the various debit and credit card propositions that they provide to their customer bases. As interchange falls, at the same time as the average transaction value declines, our clients’ costs exceed revenue on a per transaction basis.

Any further reduction in interchange rates is likely to force smaller issuers to lift their fees on accounts associated with card transactions, as they are less able to absorb the financial loss that lower rates would inflict. This would have the unintended consequence of reducing competition in retail banking. Downward changes should be fact-based decisions, utilising current statistics and research, in a holistic manner taking into account all stakeholders.

**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 benefits to merchants of least-cost routing are well established. However, as foreshadowed in Question 1 above, Cuscal would like to see greater consideration of the impact on consumers. For example, whether the least-cost or merchant choice is actually the cheapest option for the consumer; or whether there are other impacts such as chargeback recourse or insurances that may be forgone or limited.

In terms of the additional regulatory actions posited in the Issuers Paper, Cuscal does not think it necessary for acquirers to explicitly offer all merchants the option of LCR for dual-network debit card transactions. However, in the interest of fairness and transparency, and to promote competition where possible, Cuscal would support a requirement that schemes publish their criteria for the setting of any preferred or strategic interchange fees, and that the setting of such fees should be prohibited from being influenced by acceptance decisions relating to other payment systems.

**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?**

Yes, developments in technology will change the need for continued issuance of dual network debit cards. The further uptake of mobile and digital platforms will diminish the need for DNDCs. Cuscal does not necessarily view such a trend as a negative requiring regulatory rectification; for one, Cuscal is acutely aware of the continued cost of compliance of multiple networks on card issuers (as noted above), not to mention issues with mobile provisioning and tokenisation. Cuscal does not support the idea of mandating compulsory DNDCs issuance, nor further capping interchange to achieve the same means.

**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?**

Cuscal is in favour of policies that safely and logically reduce the initial barriers to entry and encourage innovation in the acquiring market, noting that costs of acceptance for merchants (although having declined significantly) and compliance burdens for acquirers both remain high. Cuscal is generally supportive of improved transparency in financial dealings, and it would be the same with any requirement for merchants to be given more accurate representation of their fees (for example breaking down total fees into the components attributable to interchange fees, scheme fees and acquirer margins, as suggested).

However, whether this needs to be enforced via regulation (as opposed to ordinary commercial pressure or imperatives) should be considered. We note the aims of the RBA Standard No. 3 of 2016, and its success in both allowing merchants to have a better understanding of their costs, while also restricting their ability to over-surcharge consumers. A placement of further regulatory requirements in this area should be cautiously approached. Nonetheless, the value in facilitating merchants’ ability to compare and switch acquirers is noted. It should also be acknowledged that competitive pressure from new entrants upon the major acquirers appears to have encouraged them to adopt “interchange +” pricing and to move away from blended or bundled rates, with this construct achieved without direct regulatory direction.

We would also caution that while there is merit in easing access to the market for acquirers, the bar should not be set so low that rogue, undesirable or poorly funded operators are given entrance, which could undermine the security, reliability and reputation of the payments ecosystem.

**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?**

Cuscal is in favour of greater transparency in scheme fees. Schemes fees are complex, convoluted and at times impenetrable, with hundreds of individual fees charged. We would support policies that promote clarity and reform in this regard.

Once again, smaller participants, without the resources dedicated to managing scheme costs that the major banks and retailers have, are susceptible to being exploited and are less able to negotiate better pricing and rebates.

Cuscal would support having more simplicity and transparency in the scheme fees that are paid to all of the different payment streams that it handles, as it is currently a complex and complicated area in which to understand one’s costs. As detailed in Question 2 above, uniformity in fee definitions and classifications between schemes would also be beneficial, especially with respect to net compensation calculations.

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

Cuscal would support further work on facilitating access to schemes, especially for non-ADI applicants. In our experience, such applicants can face onerous information and compliance requirements that can also result in significant consultancy, advisory and outsourcing costs, which may narrow viability for start-up or less-established entities, which in turn limits competition in the market.

**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?**

The benefits, particularly consumer convenience, of mobile and digital payments in Australia are well established. As detailed in the Issues Paper and above, the continued uptake in mobile and digital card products will naturally result in a decline in demand for physical card issuance. It is established this may impact the opportunities for least-cost routing by merchants.

Cuscal agrees that broadening third-party access to near field communication (NFC) functionality (with appropriate security) could promote competition and efficiency by enabling financial institutions and technology players to develop their own apps and wallet products for use on certain devices or with certain software.

Cuscal also has concerns around the costs of access to digital wallets, as well as information and compliance requirements for approval. This can be especially prohibitive for smaller ADIs and non-ADI participants.

With respect to QR-code use, Cuscal does not presently foresee any future demand for QR-code based payments amongst its client base.

**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?**

No, Cuscal disagrees with the assertions that interchange fees should be lowered or removed altogether.

Interchange is an important revenue stream for new and small issuers in the market, which promotes competition. If interchange was further lowered or removed, it would be no longer viable for new issuers to enter the market and may lead to existing small issuers becoming uncompetitive (due to the need for higher consumer fees). Interchange revenue is also used by established players to fund innovation, which could stall or evaporate if revenue was further limited. Interchange revenue can also be used by issuers to offset the continued rises in scheme fees.

Cuscal believes greater consideration of the issuing side of interchange needs to be regarded, rather than simply striving for the best deal for merchants (who have benefited from significant cost reductions already): without issuers, there would be no card market. As previously noted, this is particularly pertinent for smaller issuers, who may be hit hardest by reductions in interchange. We note that small banks and credit unions were exempt from the Durbin Amendment restricting interchange in the US for this very reason. We also believe it fallacious to assume any benefit provided to a merchant will necessarily be passed on as a benefit to consumers.

With respect to the frequent resets of interchange fee levels, whilst an additional compliance burden, Cuscal accepts this is a regulatory prerogative. Nonetheless, we would be in favour of less frequent resets, for example, annually rather than quarterly. Increased flexibility in billing systems may alleviate the problems some participants, particularly acquirers, may have with the frequent resets in pricing.

**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?**

It would clearly be beneficial to merchants in the Australian market to place a cap on inter-regional interchange fees. This could provide fairness and consistency, not just with Australian-issued cards, but with caps in other jurisdictions, such as the EU. However, such a cap may result in adverse effects, such as reduced merchant sales in Australia (or increased use of cash), if foreign issuers are sufficiently disincentivised by the lower interchange on offer to take steps to limit card use inter-regionally.

International transactions can also carry a higher risk, as local authentication methods may not be the same as domestic (for example, PIN use). Additionally, in most cases Australian merchants are paid same-day or next-day for their international card transactions, before the acquirer receives payment from the scheme. As higher-risk transactions, it is logical that the fees on transactions of foreign-issued cards should be higher.

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

It would seem fair to place equivalent caps on three-party card schemes, for example, a cap on merchant service fees. However, it is Cuscal’s view that such systems already have an advantage of not presently having caps on fees and this has not led to any perverse market distortion - indeed the merchant service fees on American Express cards has dropped more than that on Visa or Mastercard. Revenue caps could, however, stifle competition by restricting the ability of new three-party systems to enter the market, or for established players to increase their market share.

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

Cuscal remains concerned about the intent and impact of net compensation provisions. Cuscal acknowledges the regulatory aim of attempting to ensure caps on interchange fees are not circumvented by the payment of excessive incentives. However, it is Cuscal’s view the net compensation provisions can have a counter-intuitive effect on competition. As detailed in Question 2 above, incentives from schemes are used by new entrants to become established in the market to offset the initial costs of compliance and marketing in particular, as well as scheme fees paid. Incentives can also be provided by schemes to co-fund or subsidise innovation and technological development in both established players and new entrants.

Cuscal would also posit greater consideration needs to be placed on existing arrangements in the development and enforcement of net compensation provisions. It can be unreasonable for new standards to be applied in the present day, to long-term arrangements made up to 5 or 10 years prior, when there was no contemplation of such limitations; perhaps a grandfathering approach to existing arrangements could be considered.

With respect to the proposition that a corresponding obligation to comply with the net compensation standards be placed on the schemes, Cuscal supports this as a fair and natural conclusion.

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

If the net compensation regime must continue, Cuscal would support the allocation of more explicit remedial powers to the RBA, particularly the express ability to dismiss marginal or trivial breaches, or to issue corrective orders. We note these should not be retrospectively applied where agreements were entered into prior to the legislation coming into force.

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

Cuscal agrees that the merchant surcharging framework is working well; however, it does currently assume that there is no cost to the acceptance of cash. Considerations such as risk and security expenses, as well as bank fees contribute to the cost of cash. This needs to be considered in any comparison of merchant costs, especially of cash versus electronic or digital methods. Hence, as noted above, Cuscal believes the RBA should consider whether surcharging for low cost debit payments should be discouraged or banned, as it is in Europe.

Cuscal would not object to the approval of differential surcharging as proposed (for example, foreign versus domestic cards; standard versus premium cards), so long as surcharges continue to adequately correspond to the actual differentials in cost of acceptance.

**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?**

Cuscal understands the benefit that appropriate BNPL services can provide, especially to younger consumers who may otherwise have difficulty in obtaining short-term, lower-value credit. However, it is this very demographic that is most vulnerable to exploitative or unconscionable practices. Cuscal also believes BNPL services have proliferated in the Australian retail market to such an extent in the past 2-3 years that they are now absolutely considered as essential for most medium-to-large or established retailers, such that not offering them would place a merchant at a competitive disadvantage.

Accordingly, it is Cuscal’s view that timely regulatory action is required in this regard; not just in terms of protection of consumers, but also in terms of ensuring fairness and consistency with the regulation of other payment methods: such as the ability of merchants to surcharge fairly to cover costs of acceptance, and for ensuring abidance with anti-money laundering and counter-terrorism financing obligations.

In addition, it has been reported that the highest level of rejections on debit card transactions for some Cuscal clients comes from the merchant accounts of BNPL providers, further indicating the vulnerability of some of the consumer users of such schemes.

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

Cuscal acknowledges the deficiency in remedial powers afforded to the RBA compared with other financial regulators. It would be a natural assumption that if the RBA has the power to enact standards or access regimes, it should also be able to establish and enforce corresponding penalties or actions for breaches of such. Cuscal agrees that the current size of potential fines available for the RBA to impose are inadequate and likely to be viewed as ineffective in deterrence. An increase in the quantum of fines available to the RBA would be supported. Cuscal also agrees a broader range of remedial actions should be available to the RBA, including the ability to accept court-enforceable undertakings from payment participants.

In general, Cuscal would agree that if the RBA is to take a more standards or rule-based regulatory role, its deterrent, remedial and enforcement abilities should at least be consistent with other Australian financial regulators. Further engagement with industry, government and other regulators on the types and extent of powers would be required, considering the gravity of such a change. However, it would be important to note such powers, if enacted, should not be retrospectively applied.

In closing, we trust that our above responses will assist the RBA in formulating a holistic review of the regulatory framework for card payments, and we look forward to meeting with you to discuss our submission.

If we can be of any further assistance in the interim, please feel free to contact me at kmckenna@cuscal.com.au or (02) 8299 9000.

Yours sincerely,



**Kieran McKenna**

Chief Risk Officer