**Re : Proposed amalgamation of BPAY Group Holding Pty Ltd, BPAY Group Pty Ltd, BPAY Pty Ltd (together, BPAY), eftpos Payments Australia Limited and NPP Australia Limited**

Statement by Cuscal Limited in support of application for authorisation

Signed by: Kieran McKenna, Chief Risk Officer of Cuscal Limited

Date: 16 March 2021

**This document contains confidential information which is indicated as follows:**

**[Confidential to Cuscal]**

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## A. INTRODUCTION

1 This document has been prepared in support of the application by Industry Committee Administration Pty Ltd for authorisation on behalf of the shareholders of BPAY Group Holding Pty Ltd, the members of eftpos Payments Australia Limited (**eftpos**) and the shareholders of NPP Australia Limited (**NPPA**) who were members of Industry Committee (**IC**) at all relevant times, and by NewCo once it is incorporated, to acquire shares in NewCo and for NewCo to acquire shares in each of BPAY Group Pty Ltd and BPAY Pty Ltd, eftpos and NPPA.

2 Exhibited with this statement are two documents marked **Exhibit KM-1**.

## B. SUMMARY

3 The Reserve Bank of Australia's Review of Retail Payments Regulation: Issues Paper was published in November 2019. After this, the NPPA Board took steps to canvass stakeholder and shareholder views on whether the three industry-owned Australian payments companies would benefit from amalgamation.

4 Cuscal Limited (**Cuscal**) was receptive to these engagements and joined the IC tasked to assess whether an amalgamation served the objects of BPAY, eftpos and NPPA, having regard to the interests of their respective shareholders, stakeholders and the public interest.

5 Cuscal voted in favour of the proposed amalgamation and the reasons for this support can be summarised as follows:

(a) the amalgamation should ensure a viable domestic payments platform that will enable the three entities to better compete against the international schemes (Visa and Mastercard) and the large technology companies (including Apple and Google). Each of the international schemes have expanded beyond traditional card companies, and the large technology companies are increasingly offering digital payments products, and so they are each fast becoming significant players in the broader payments industry. A strong domestic alternative to the international schemes and large technology companies is good for competition, industry pricing and services for Australian business and consumers;

(b) the amalgamation will result in enhanced industry co-ordination and an integrated products roadmap providing clarity to the industry, in particular smaller retailers and companies, enabling new innovations to be brought to market more frequently and quickly. The ongoing commitment to the current roadmaps of each of BPAY, eftpos and NPPA provides clarity in relation to existing strategies and also to future development;

(c) the amalgamation will improve the ease at which products are brought to market – increased efficiency to market enables Cuscal (and other providers) to provide a more efficient service to its clients, which will assist ongoing competition in the market;

(d) improved governance and risk management associated with a simplified NewCo governance structure;

(e) the proposed structure and unified roadmap will also enable NewCo to ensure that developments and innovation are designed to achieve critical mass. Ubiquity and network effects are critical to providing efficient and cost-effective payments services; and

(f) dealing with one entity as opposed to three is more efficient and provides greater clarity and easier co-ordination for industry participants. Simplification of compliance and a common integrated purpose will make it easier and quicker for products to be up and running in the marketplace.

## C. CUSCAL LIMITED

6 Cuscal is an authorised deposit-taking institution (**ADI**) and the largest independent provider of payments solutions for the Australian financial services sector. Cuscal is rated A+ by S&P ratings.

7 Cuscal is an unlisted public company that, amongst other things, enables financial institutions, payment service providers and businesses to integrate payment services into their products and payment processes.

8 As the holder of numerous licenses (ADI, AFSL, ACL etc), Cuscal is one of only five players who offer full end to end payments connectivity - the others being the major Australian banks.

9 Cuscal is essentially a business-to-business (**B2B**) service provider who partners with mutuals, banks, FinTechs and corporates who provide payment services to their customers.

10 Cuscal largely consists of the following Cash Generating Units (**CGU**):

(a) **(Corporate)** The Corporate CGU covers Cuscal's investment and treasury activities; including the funding of those activities. The Corporate CGU also manages the investment of Cuscal's surplus capital.

(b) **(Payments)** Payments is the main CGU, which covers the processing, and clearing and settlement of financial transactions on behalf of clients, generally for their customers. Payments includes Cuscal's card issuance activities, fraud monitoring, industry compliance, data analytics and Cuscal's switching activities.

11 Cuscal is also the creator and solitary founding shareholder in 86 400. It presently owns approximately 51% of 86 400.

## D. IMPACT ON SMALLER RETAILERS

12 Cuscal understands that Australia's two largest retailers, Woolworths and Coles, are supportive of the amalgamation.

13 For the reasons that follow, Cuscal is of the view that the amalgamation will also have a positive impact on smaller retailers and will not result in either smaller retailers or small business being any worse off. Rather, the amalgamation under NewCo, will lead to increased certainty and availability of product and pricing for these players, improved clarity and improved ease of engagement.

14 From a retailer's perspective, operating in the payments ecosystem at the lowest cost with stable technology is critical. Smaller retailers and end consumers are ultimately after simple, smart functionality and are not particularly conscious about how a card or payment application interacts with a terminal – the end objective is to make a transaction (be it in person or online) low cost, fast and easy.

15 Apart from being very price conscious, smaller retailers rely on real time processing and same day payments, as this cash flow is critical to their day to day business. The integrated roadmap for NewCo will help deliver extra options and innovations to support their business.

16 The amalgamation will accelerate the implementation of initiatives which will expand payment options and price competition, which will greatly benefit smaller retailers. For instance, if the consolidation proposal proceeds the new entity has already agreed the delivery of "eftpos online", through agreeing to a roadmap of future services. This initiative has been brought forward in its planning and will provide retailers (and merchants) with an industrial alternative to other online payment mechanisms, thereby providing a lower cost online payment option.

17 Importantly the amalgamation will strengthen the three not for profit entities by bringing together common shareholder capital, resources and better industry co-ordination. The combined entity will enable the three brands to deliver more market services and faster, which provides enhanced functionality for the retailer. Greater choice of functionality creates price competition for services and processing. By way of example and as mentioned above, the new entity has already locked in the delivery of eftpos online, which will provide retailers with access to lower cost online payment options. Once implemented, this functionality will provide a viable market leading alternative (for the retailer and consumer) to the current scheme and big tech options that exist today for online payments.

## E. FUTURE OF THE PAYMENTS INDUSTRY

*General perspective of the likely future industry*

18 Australia is amongst the leading countries for adoption and innovation of digital payments.[1]

19 The payments industry is increasingly digital and mobile. Technology will continue to develop for the benefit of the end user – the manner in which consumers make a payment will be controlled by them through their device or application and will be agnostic of the terminal, website or platform at the point of transaction.

20 The market and consumers have moved rapidly towards mobile devices as the new way of payments, with the mobile device and digital wallets becoming the intelligent payment control centre.

21 The consumer will ultimately decide how they wish to pay and it is incumbent on the domestic payments industry to ensure Australian consumers have choice and competition around doing so. The consumer should not hesitate when they go to pay for goods – they should be able to simply choose the best form of payment with best benefits for them. The consumer is looking for the lowest price, and the retailer is looking for uniform acceptance at the right price.

22 In terms of the three entities in the amalgamation, it is unlikely that the large common shareholders will continue to be willing to invest future capital requirements across each of the three entities, to enable them to keep pace with ongoing change. Bringing the entities together will better coordinate pricing and the capital required in a more efficient coordinated structure.

23 The present governance structure involves three separate Boards, each with their own strategies. Over the long run, each entity has been predominantly funded by the big four banks and (in some instances) a broader group of smaller shareholders or members. Each of the three entities are funded to run at a break even or slight profit and are reliant on revenue from their product offerings to provide for general working capital and short term development. The current funding regime generally requires capital contributions by all shareholders for significant product developments – on occasions (for various reasons) there have been some reticence by some shareholders to contribute or mobilise to support various product initiatives. This misalignment creates delay which results in efficiencies in the allocation of resources and project timelines and, on occasions slows industry progress.

24 By way of reference, in a speech titled “A Payments System for the Digital Economy - December 2019”, the RBA Governor commented on industry inertia and misalignment as follows:

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[1] See **Tab 1** of **Exhibit KM-1** titled Consumer payment behaviour in Australia – Reserve Bank of Australia bulletin – March 2020.

*"Further Progress Needed*

*The progress across these various fronts means that there is a positive story to be told about innovation in Australia's payments system. At the same time, though, there are still some significant gaps and areas in our payments system that need addressing and where progress would support the digital economy in Australia. I would like to talk about four of these.*

*NPP*

*The first of these is further industry work to realise the full potential of the NPP, including its datarich capabilities. The NPP infrastructure can help make electronic invoicing commonplace and help invoices be paid on time. It can also support significant improvement in business processes, as more data moves with the payment. Real-time settlement and posting of funds also enables some types of delivery-versus-payment, so that the seller can confirm receipt of funds and be confident in delivering goods or services to the buyer. The layered architecture of the system was designed to promote competition and innovation in the development of new overlay services. Notwithstanding this, one of the consequences of the slower than-promised rollout of the NPP by some of the major banks is that there has been less effort than expected on developing innovative functionality.*

*Payment systems are networks, and participants need to know that others will be ready to receive payments and use the network. Some banks have been reluctant to commit time and funding to support the development of new functionality given that others have been slow to roll out their 'day 1' functionality. The slow rollout has also reduced the incentive for fintechs and others to develop new ideas. So we have not yet benefited from the full network effects. The Payments System Board considered this issue as part of its industry consultation on NPP access and functionality, conducted with the ACCC earlier this year. As part of that review we recommended that NPPA – the industry-owned company formed to establish and operate the NPP – publish a roadmap and timeline for the additional functionality that it has agreed to develop. The inaugural roadmap was published in October (2019) and NPPA also introduced a 'mandatory compliance framework'. Under this compliance framework, NPPA can designate core capabilities that NPP participants must support within a specified period of time, with penalties for non-compliance. This is a welcome development."*

25 A unified strategy (with improved independence) will rally investment and commitment behind an integrated roadmap. Importantly this momentum will be aided by the right balance provided through a revised governance model.

26 Cuscal therefore considers the amalgamation as the most expedient way to set up the industry to continually address the pace of change and innovation, requirements for capital and to ensure retailers and consumers continue to benefit from fast optionality around ways to pay.

27 NewCo will also be an important stakeholder and coordinator across the industry and Government to assist with future payment functionality for Open Banking as part of the Consumer Data Right.

*Implementation of prescribed services*

28 It is critical for FinTechs and small business (including smaller retailers) to connect easily into the payments ecosystem, and central to this principle is the publication of roadmaps.

29 The Implementation Agreement entered into by the three payment schemes and commitment to the current roadmaps of each entity neatly ties together activities of the three entities, enabling the industry to make plans with greater clarity and certainty. Simply put, it allows the industry to align and better coordinate behind innovation of retail and consumer driven services.

30 Given the requirements for further and ongoing capital, Cuscal is of the view that absent the current amalgamation, the prescribed services would likely still be rolled out, but at a much slower pace and uncoordinated to an agreed timeline. On occasions the Reserve Bank of Australia (**RBA**) has had to intervene in the market to encourage faster rollout and adoption of various product initiatives – some of these issues were set out most recently in the Address by Philip Lowe, RBA Governor, to the Australian Payments Network.

31 In terms of ensuring the industry progresses at pace, the Governor commented that:

> *"In promoting innovation we have employed a mix of strategies. We have used a combination of:*
>
> *i. suasion and pressure on industry participants to do better*
>
> *ii. regulation to promote competition and access*
>
> *iii. using our position to help overcome co-ordination problems, which can act as a barrier to innovation in a network with many participants*
>
> *iv. helping the industry establish benchmarks that can be aspired to collectively.*
>
> *I will leave it to others to judge the success of this mix of strategies. But from my vantage point, Australians enjoy an efficient and dynamic payments system. There are still gaps that need addressing, but by global standards we have done pretty well. Australians were early and rapid adopters of tap-and-go payments and increasingly are using digital wallets. We have a very good fast payments system, which after a slow start, is seeing continuing strong volume growth. And there is a roadmap for the development of new payment capabilities*

*using this fast payments infrastructure."*[2]

32 It is beneficial for the industry (and consumers) to have an agreed set of services and agreed implementation dates – the amalgamation will assist in achieving this advancement.

*Dual network debit cards*

33 In its current review of Retail Payments Regulation, the RBA has asked for industry feedback on single network debit cards. The RBA is aware that many industry participants who run smaller card portfolios are incurring increased costs and lower revenue, due to the introduction of the RBA Net Compensation legislation and the industry compliance and operational costs of running two schemes on a debit card.

34 **[Confidential to Cuscal]**.

35 The onset of Open Banking and the Consumer Data Right will (in the near future) have payments and payments functionality at the front and centre of the consumer experience. Without the infrastructure, industry co-ordination and scale that NewCo brings to the table the industry runs the risk of falling beyond payment industry developments such as Know your Payee, Digital ID and QR code orchestration.

## F. POTENTIAL DETRIMENTS FOR THEM FROM THE PROPOSED AMALGAMATION

36 Cuscal sees very little downside with the amalgamation.

37 However, Cuscal understands that broadly two areas of concerns regarding the amalgamation have been raised.

(a) First, that it leads to a concentration of power; and

(b) Second, that it will cost small business and smaller retailers more.

38 Cuscal has considered these concerns and the detail behind them.

39 Considering the benefits of the amalgamation of same or better pricing, more connected roadmaps and enhanced industry and regulatory co-ordination, Cuscal quickly became comfortable with the amalgamation.

40 A large part of this comfort is derived from the stringent NewCo governance arrangements in place.

41 In particular, the new structure does not enhance the concentration of power by the major

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[2] See **Tab 2** of **Exhibit KM1** for an address by Governor Phillip Lowe to the Australian Payments Network dated 7 December 2020.

Australian banks or two larger retailers, instead it provides less power in the hands of major market players.

42 A single board will represent a broader range of payment stakeholders. The four major banks and two major retailers will move from a majority of votes (at eftpos and BPAY today), to six from 13 seats on the NewCo Board. The Chair and three of the other 13 NewCo Directors will be independent.

43 Participants in the Australian payments industry such as Cuscal want to bring new payments technology to market as quickly and cost consciously as possible and the current structure of three separate entities hampers this. Across the industry, Cuscal sits on over 70 industry boards, committees and working groups. The current structure of three separate boards across the three payment schemes often results in triple application of everything Cuscal does in maintaining and bringing payments functionality to market. As referred to above, the current structure makes decision making more complex and leads to delay in the implementation of new technology. Cuscal sees great benefit around the simplification and strengthening of the Governance model, agreed common purpose with integrated roadmaps, backed by broad regulatory engagement.

44 In relation to the issue of costs for smaller retailers, it is important to note that;

(a) competition amongst merchant platforms providing technology and processing services to small retailers is already intense. The entrance of a number of small and larger providers has generally solved this cost line for retailers.

(b) A retailers prime concern is transaction costs. NewCo will create the third player in the market to create price tension and increased functionality.

(c) The prevailing services and features from the three entities (for example, least cost routing by eftpos) will be maintained and expanded upon. The introduction of new functionality will be pre-agreed by NewCo and added to the integrated roadmap. This managed co-ordination is not possible under the existing individual entity arrangements, as each entity has a general duty of care to their respective shareholders and stakeholders.

## G. POTENTIAL BENEFITS FOR THEM FROM THE PROPOSED AMALGAMATION

*Alternative to Visa and Mastercard*

45 Cuscal considers that it is critical to have a viable and sustainable domestic alternative to the international card schemes (in particular Visa and Mastercard) in the marketplace.

46 Similar to IGA and Aldi in the supermarket market sector in relation to Coles and Woolworths,

it is important to have a strong third player. The existence of a third player in the market assists with competition and keeping prices down and delivering service and functionality. The purpose of the amalgamation is to provide a reasonable domestic alternative proposition to the international schemes.

*Improved functionality*

47 As previously mentioned, with the 3 schemes under NewCo, the amalgamation will increase the delivery and timing of collective functionality, through a more coordinated approach.

*Quicker to market*

48 The amalgamation and specifically, the commitment to roadmaps and future integrated roadmaps, will enable industry participants to innovate with more certainty and clarity and ensure products are brought to market quicker. Clarity of strategy and development paths enables the industry to develop product with greater certainty, which leads to improved competition.

*Stability and risk management*

49 A primary benefit from the amalgamation will be increased industry co-ordination, increased use of uniform messaging standards and better risk management around data for fraud and cyber management. A uniform approach to data will assist financial crime prevention, regulatory oversight and development of industry regulation.

*Increased commercial and technical access*

50 It is likely that the amalgamation will enhance co-ordination over Know your Payee, Digital ID and QR code technologies, which will be beneficial for merchants and consumers in the long-run.

51 Smaller players and providers in the industry need simple and easy access to products developed across the industry. Ubiquity and functionality should not be unavailable or overpriced for sectors of the market.

52 The ability for the industry to agree common interfaces and technology standards is derived from broad industry engagement and co-ordination – this is where NewCo will be able to steer new technologies and standards to make sure that they are accessible and reasonably priced for smaller players.

53 The recent announcement by eftpos (“eftpos launches advisory committee to give FinTech a

voice – FinTech Australia")[3] is a case in point. This initiative is focused on eftpos engaging with the Fintech community around the eftpos digital roadmap, with a particular focus on the eftpos digital roadmap and API programs. This initiative would be most likely be expanded under NewCo to include NPPA and BPAY.

## H. DEAL RATIONALE

*General*

54 Traditionally the large banks in Australia have funded (and in various ways directed) the pace and type of innovation in the domestic payments market. This has served the industry and participants well in many respects, however the pace of change and the co-ordination of change and investment in the industry needs to be enhanced to further enable competition and industry efficiencies.

55 As outlined, the Governance structure for NewCo simplifies and reduces control, so that a greater degree of independence is delivered in the oversight and direction of the amalgamated entities.

*Cuscal*

56 Cuscal is looking for simplicity – simplicity benefits clients and the marketplace generally. The amalgamation will provide for a simplified industry approach which in turn improves associated time and costs benefits for retailers and consumers.

57 How businesses and consumers obtain efficient and safe access to payments, and improved functionality, are the crucial questions - Cuscal is of the view that the amalgamation will lead to clarity around these questions, which will lead to improved investment and better outcomes for the industry and consumer.

58 The creation of Newco will also assist in improved management and co-ordination of technology and project resources in the industry. These resources are not unlimited and are increasingly expensive in periods of increased industry project activity.

## I. COUNTERFACTUAL

59 If the amalgamation does not proceed, the current (slower) pace of innovation within the payments industry will remain.

60 The ability of unlicenced large technology companies to move deeper into the domestic payments industry will accelerate. This will not create competition but actually impede it.

[3] See **Tab 3** of **Exhibit KM1** for an eftpos press release dated February 23, 2021 - "eftpos launches advisory committee to give FinTech a voice – FinTech Australia".

61 Cuscal is of the view that each of the schemes bring with them varying, complementary capabilities. If each are related to NewCo, this will make end product and future innovations better for consumers - more tailored, efficient and cheaper.

Signed on behalf of Cuscal Limited by:

[redacted]______________________

| | |
|---|---|
| Name | Kieran McKenna, Chief Risk Officer of Cuscal Limited |
| Date | 16 March 2021 |

TAB 1: Exhibit KM-1

# Consumer Payment Behaviour in Australia

James Caddy, Luc Delaney, Chay Fisher and Clare Noone[*]

Photo: Carolyn Hebbard – Getty Images

## Abstract

The Reserve Bank's 2019 Consumer Payments Survey has provided further evidence that Australian consumers are increasingly preferring to use electronic payment methods. Many people now tap their cards, or sometimes phones, for small purchases rather than paying in cash. Consumers also have an increasing range of options available for making everyday payments. Despite this, cash still accounts for a significant share of lower-value payments and a material proportion of the population continues to make many of their payments in cash.

## Introduction

The Bank undertook its fifth comprehensive survey of consumer payments in October and November 2019.[1] Participants in the Consumer Payments Survey (CPS) recorded details about every transaction they made in a week and provided extra information on their payment preferences and attitudes in a post-survey questionnaire.[2] The way in which Australians are making payments is changing and new payment methods are emerging, often enabled by mobile technology. Accordingly, the 2019 CPS asked participants to report more information than previously on their use of newer electronic payment methods and channels, as well as in-depth information on their use of and attitudes towards cash. Around 1,100 people participated in the survey, recording around 13,500 consumer payments (see Box A: Details of the CPS).

The CPS showed that Australians are continuing to switch to electronic payment methods in preference to cash and confirmed that personal cheques are seldom used for consumer payments (see Box B: The Decline of Cheques). In 2019, debit cards were the most commonly used means of payment, overtaking cash as the single most

**Table 1: Consumer Payment Methods[(a)]**
Share of number of payments, per cent

| | 2007 | 2010 | 2013 | 2016 | 2019 |
|---|---|---|---|---|---|
| Cash | 69 | 62 | 47 | 37 | 27 |
| Cards | 26 | 31 | 43 | 52 | 63 |
| *– Debit* | *15* | *22* | *24* | *30* | *44* |
| *– Credit and charge cards* | *11* | *9* | *19* | *22* | *19* |
| BPAY | 2 | 3 | 3 | 2 | 2 |
| Internet/phone banking | n/a | 2 | 2 | 1 | 3 |
| PayPal | n/a | 1 | 3 | 3 | 2 |
| Cheque | 1 | 1 | 0.4 | 0.2 | 0.2 |
| Other[(b)] | 1 | 1 | 2 | 4 | 2 |

(a) Excluding payments over $9,999
(b) 'Other' methods include prepaid, gift and welfare cards, bank cheques, money orders, 'buy now, pay later' and Cabcharge
Sources: RBA calculations, based on data from Colmar Brunton, Ipsos and Roy Morgan Research

frequently used payment method (Table 1).[3] Although the share of payments made in cash continued to fall, cash was still used for over one quarter of consumer payments and some people continue to rely heavily on cash in their daily lives.

This article sets out the main findings of the 2019 CPS, focussing on consumers' use of cash, cards and other electronic payment methods and channels.[4]

## Cash

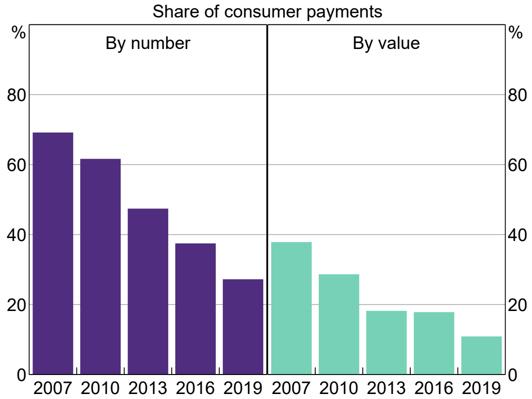
The 2019 CPS provided further evidence of the decline in the transactional use of cash – 27 per cent of all consumer payments were made with cash in 2019, compared with 37 per cent in 2016 and 69 per cent in 2007 (Graph 1, left panel).[5] When measured by the value of consumer payments (rather than the number), the share of cash payments fell to around 10 per cent, from just under 40 per cent in 2007 (Graph 1, right panel).

While consumers in all broad demographic groups are using cash less frequently than they did in the past, the shift to electronic payment methods has been most pronounced among younger Australians (Graph 2, left panel). Survey respondents aged under 40 used cash for less than 15 per cent of their payments in 2019, roughly half the share reported by participants in this age group in 2016.

Despite these changing payment preferences, some members of the community continue to make a material share of their payments in cash. While participants aged 65 and over use cash less frequently than they used to, consumers in this demographic still made over half of their payments in cash in 2019. Lower-income households also tend to pay in cash more often than households in higher income groups (Graph 2, right panel).

Among all survey participants, around 15 per cent of respondents used cash for over 80 per cent of their in-person payments in 2019 and about 10 per cent used cash for *all* of their in-person transactions over the week (compared with

**Graph 1**
**Cash Payments**
Share of consumer payments




Source: RBA calculations, based on data from Colmar Brunton, Ipsos and Roy Morgan Research

12½ per cent of all respondents in 2013 and 2016) (Graph 3). At the other end of the scale, the CPS indicates that an increasing share of Australian consumers do not use cash at all in a typical week; around a third of consumers did not record *any* cash payments in the 2019 survey, compared with 18 per cent in 2016.

The shift away from cash has occurred for transactions of all sizes, including for lower-value payments as consumers increasingly prefer to use contactless cards to 'tap and go' for these purchases (see below). This trend continued in the latest survey, with the share of transactions of $10 or less made in cash falling by 18 percentage points since 2016. Cards are now used more often than cash for all payments over $5. Nonetheless, cash still accounts for a significant share of small transactions: about 45 per cent of payments of $10 or less (Graph 4).

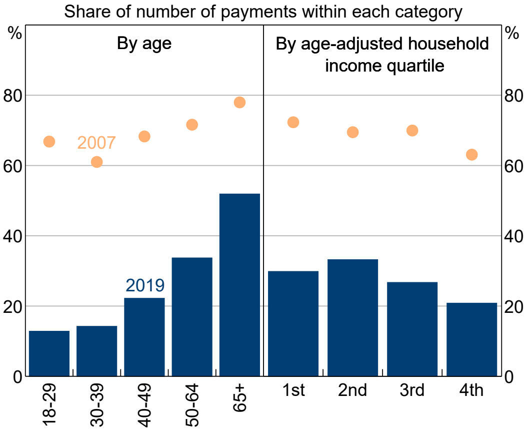
People continue to use cash for two broad reasons: personal preference and merchant acceptance. When asked about the most important reason for paying in cash, around a third of respondents in 2019 cited factors relating to merchant acceptance, fees and pricing (Graph 5). Some respondents also indicated a preference for using cash for small transactions (around 20 per cent), as well as to assist in budgeting or as a means to spend using their own (rather than borrowed) funds (around 15 per cent). Not surprisingly, respondents who used cash relatively frequently (for more than 80 per cent of their in-person payments) tended to cite factors relating to a preference for using cash over other payment methods. For example, nearly half of frequent cash users reported that budgeting and a preference for using their own funds were their most important reasons for using cash. In contrast, people who used cash less often commonly cited merchant acceptance as the most important reason they used cash, which could suggest that they paid in cash only when other payment options were unavailable.

As the transactional use of cash has continued to decline, so too has the value of cash that respondents held in their wallets or purses. The median value of such holdings was $45 in 2019, which was $10 less than in 2013. In the 2019 survey, around a quarter of people held no cash at all in their wallet; the equivalent figure was 8 per cent in

## Graph 2

### Cash Payments

Share of number of payments within each category

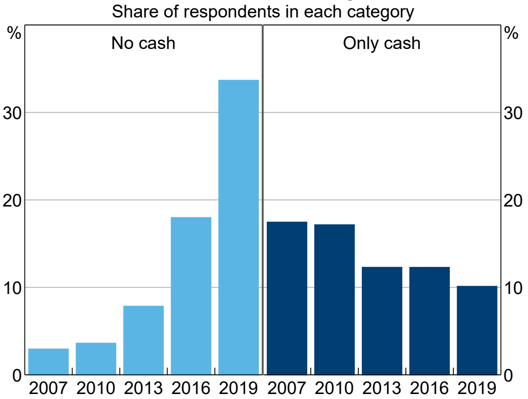



Source: RBA calculations, based on data from Roy Morgan Research

## Graph 3

### Point-of-sale Cash Payments

Share of respondents in each category

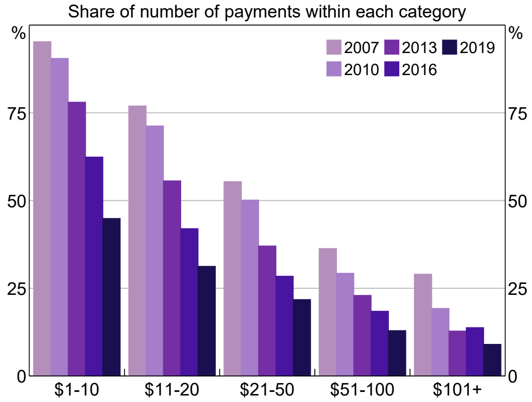



Source: RBA calculations, based on data from Colmar Brunton, Ipsos and Roy Morgan Research

## Graph 4

### Cash Payments by Size

Share of number of payments within each category




Source: RBA calculations, based on data from Colmar Brunton, Ipsos and Roy Morgan Research

2013. Respondents were also asked if they held cash outside their wallet, with nearly 40 per cent reporting that they did so. Aside from making everyday payments, the most common reason cited for holding cash was for precautionary purposes (Graph 6). People also cited budgeting and issues relating to the convenience and accessibility of cash as important reasons for holding it.

## Payment Cards

As Australian consumers pay in cash less frequently, they are often instead using cards for their purchases. This trend continued in the latest CPS, with the share of payments made using credit and debit cards combined increasing by around 10 percentage points between 2016 and 2019, to 63 per cent of consumer payments (Table 1).

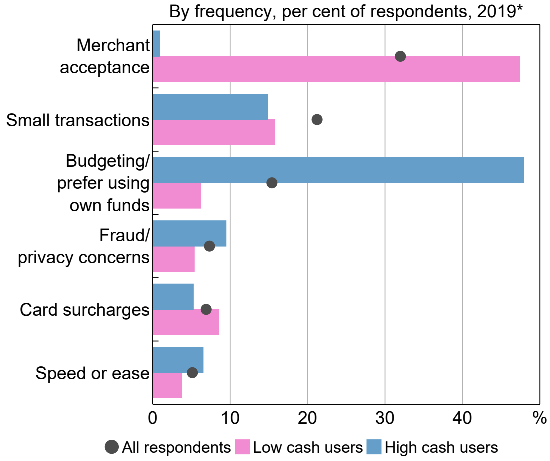
The recent increase in the frequency of card payments relative to other payment methods has been largely because cards are being used more often to make payments in-person at the point-of-sale.[6] While consumers are using cards more frequently for payments of all sizes, growth in the use of cards – particularly debit cards – was strongest for lower-value transactions (Graph 7). This ongoing shift to cards for relatively small purchases has been facilitated by the adoption of contactless functionality by consumers and merchants; around half of all in-person payments were made by 'tapping' a debit or credit card on a card terminal in 2019 (Graph 8, left panel). A further 5 per cent of in-person payments were made by tapping or waving a smartphone or other payment-enabled mobile device (e.g. watch) in front of a card terminal rather than using a physical (plastic) card. Overall, 83 per cent of point-of-sale card transactions were contactless, initiated by tapping a card or mobile device (Graph 8, right panel).

While mobile device 'tap and go' payments still account for a relatively small share of consumer payments, the use of mobile payments has grown over the past three years. In 2019, around 10 per cent of respondents made at least one mobile payment during the week of the survey, which is over twice the share of respondents that made at least one such payment in 2016.[7] The

**Graph 5**

**Most Important Reason for Using Cash**

By frequency, per cent of respondents, 2019*



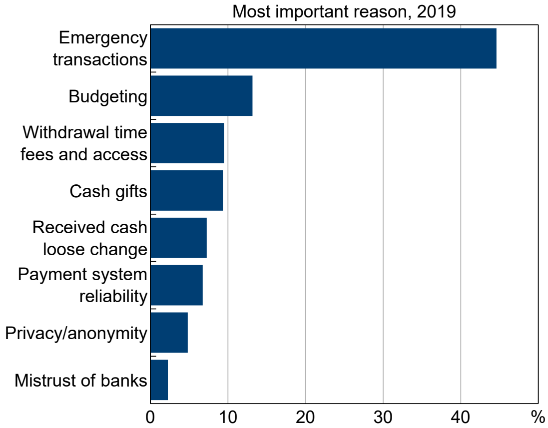

* Frequency based on share of point-of-sale payments in cash (low: <20 per cent, high ≥80 per cent)

Source: RBA calculations, based on data from Roy Morgan Research

**Graph 6**

**Why Hold Cash Outside of Wallet?**

Most important reason, 2019

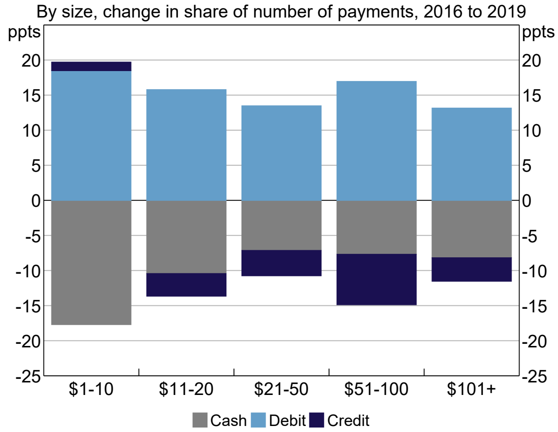



Source: RBA calculations, based on data from Roy Morgan Research

**Graph 7**

**Change in Point-of-sale Payments**

By size, change in share of number of payments, 2016 to 2019




Source: RBA calculations, based on data from Ipsos and Roy Morgan Research adoption of mobile payments is consistent with the increased availability of this payment option and with consumers' greater awareness of the ability to make mobile payments. At the time of the 2016 survey, the ability to make mobile payments was still a relatively new feature of the retail payment system whereas it is now a more common product offering across card issuers. The growth in contactless mobile device payments has been driven by increased use among consumers aged under 40; almost one in five people in this age group recorded at least one contactless mobile payment during the week of the 2019 survey (Graph 9).

Cards are being used more frequently at all broad types of businesses, including in sectors where cash has traditionally been used for a high share of transactions. For example, participants in the 2019 CPS used cards for around 60 per cent of purchases at (non-supermarket) food retailers – which includes small food stores, cafes, restaurants and pubs/bars – displacing cash as the most common means of payment at these businesses for the first time.[8]

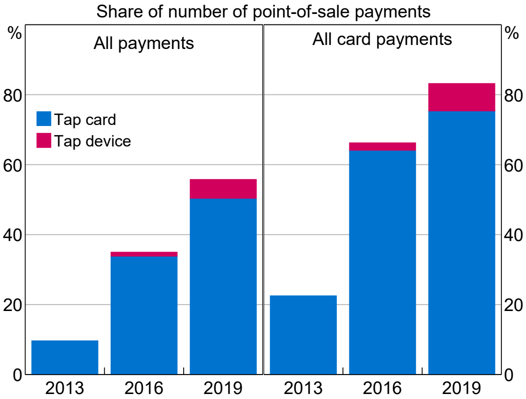
When choosing to pay with a card, Australian consumers are increasingly using debit cards – which allow people to make payments from funds in their deposit account – rather than credit cards. Debit cards were used for nearly 45 per cent of consumer payments (by number) in 2019, an increase of around 15 percentage points from three years earlier. Credit cards accounted for 19 per cent of consumer payments in 2019, which was a slightly lower share than in the 2016 survey (Table 1).[9]

The use of debit cards grew among survey participants of all ages between 2016 and 2019, although younger people tend to use debit cards the most intensively; respondents aged under 40 made around two thirds of their in-person payments with a debit card, compared with 36 per cent for consumers in older age groups (Graph 10). Debit cards are also becoming an increasingly popular way of making online purchases, accounting for around 30 per cent of these payments in 2019, compared with 23 per cent in 2016 (see below).

**Graph 8**

**Contactless Card Payments**

Share of number of point-of-sale payments

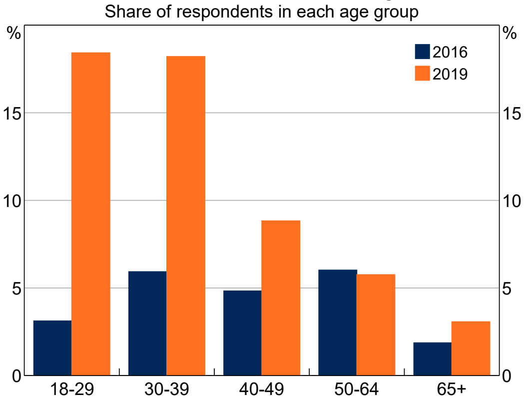



Source: RBA calculations, based on data from Colmar Brunton, Ipsos and Roy Morgan Research

**Graph 9**

**Use of Contactless Mobile Payments***

Share of respondents in each age group



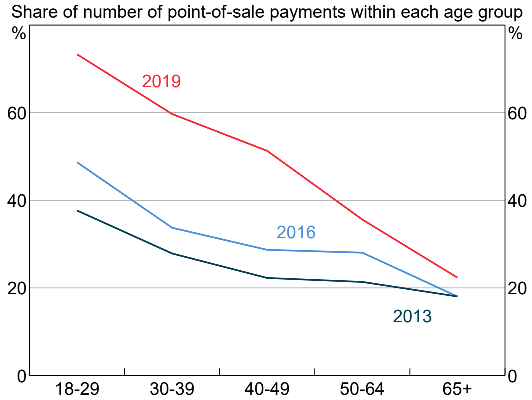

* Used at least once in the diary week

Source: RBA calculations, based on data from Ipsos and Roy Morgan Research

**Graph 10**

**Debit Card Payments**

Share of number of point-of-sale payments within each age group




Source: RBA calculations, based on data from Colmar Brunton, Ipsos and Roy Morgan Research

**Table 2: Online Payments**

Share of number of consumer payments, per cent

| | 2007 | 2010 | 2013 | 2016 | 2019 |
|---|---|---|---|---|---|
| Debit card | 0.3 | 1 | 2 | 3 | 4 |
| Credit card | 1 | 1 | 3 | 3 | 2 |
| BPAY/Internet banking | 2 | 4 | 5 | 4 | 4 |
| Other[(a)] | 0.4 | 1 | 3 | 4 | 2 |
| Total | 3 | 7 | 13 | 13 | 13 |
| *Mobile/app share of online* | n/a | n/a | 6 | 20 | 40 |

(a) 'Other' methods include Paypal, prepaid, gift and welfare cards and 'buy now, pay later' services

Sources: RBA calculations based on data from Colmar Brunton, Ipsos and Roy Morgan Research

## Online Payments

A long-run trend in retail payments is an increase in the share of transactions that occur online rather than in-person, consistent with growth in e-commerce. As in previous surveys, participants in the 2019 CPS were asked to record the details of every consumer payment that they initiated online during the week of the survey.

Around 55 per cent of respondents made at least one online payment in 2019, which was about the same as in 2016 but double the share of people surveyed in 2007. When measured by the number of transactions, the share of payments made online was 13 per cent, which was a similar share as in the previous two surveys but roughly four times the online share recorded in 2007 (Table 2). It has become increasingly common for these payments to be made using mobile apps, with 40 per cent of online payments initiated through apps rather than 'traditional' web browsers (e.g. Chrome or Safari) in 2019.

Many respondents also reported that they had used debit or credit card details that had previously been stored on a computer, device or within an app to make an online payment (as opposed to filling in their card details at the checkout stage of the transaction). This includes, among other things, choosing to auto fill stored payment credentials when shopping online, and payments made via apps in which the payment is embedded and occurs in the background at the time of a transaction (e.g. transport ride-sharing apps). Around 45 per cent of survey participants had used stored payment details for an online payment in the past year. This is consistent with a trend towards payments becoming more seamless from the perspective of consumers.

While the online share of payments shown in Table 2 has been fairly stable in recent years, these figures do not include participants' automatic payment arrangements, such as household bills (e.g. electricity or subscription services) paid by direct debit, and recurring 'pay anyone' transactions via online banking. These arrangements are set up ahead of the payment occurring and are recorded separately in a post-diary questionnaire. This allows participants to review their bank statements when recording information on these payments. The share of total weekly spending made automatically – rather than initiated during the week of the CPS – has been steadily increasing over recent years, to 9 per cent of the number of total transactions (Graph 11, left panel). When measured by the value of weekly spending, around one fifth of all payments were made automatically in 2019 (Graph 11, right panel). The growth in automatic payments largely reflects the changing way people pay their bills and, to a lesser extent, make debt repayments. Around half of all household bill payments in 2019 were made automatically, which is more than double the share in 2013. This shift towards automatic payments for certain transactions is another way in which payments are becoming more seamless.

## New Payment Methods

The way in which Australian consumers make payments is being shaped by a number of related influences. Among other things, these include the emergence of different payment channels, the use of mobile technology and the introduction of innovative products and services.[10]

Over the past few years, a number of alternative means of payment have emerged or attracted greater attention. These include (among others): buy now, pay later (BNPL) services that enable consumers to obtain goods and services immediately and make subsequent payments in a series of interest-free instalments; the ability to make in-app payments using stored card details; 'cryptocurrencies'; and the ability to make real-time account-to-account bank transfers using PayIDs via the New Payments Platform. To gauge awareness and use of these methods, the CPS asked respondents whether they had heard of a number of 'alternative' ways of making payments and also whether they had used them at least once in the past 12 months (Graph 12).

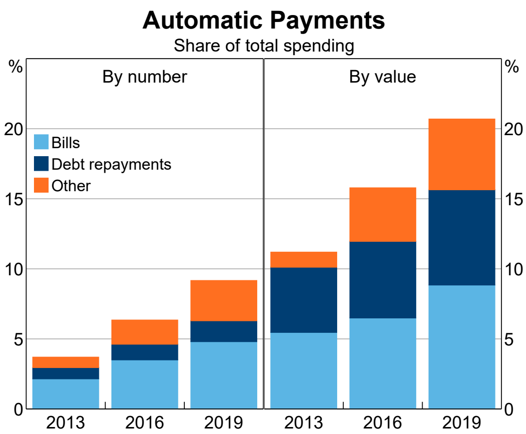
In terms of awareness, a majority of respondents had heard of several of the newer means of payment, with awareness highest for BNPL services and the ability to make tap and go payments using devices such as mobile phones and various types of 'wearables'. Although many respondents had heard of 'cryptocurrencies', very few had used a cryptocurrency such as Bitcoin to actually make a consumer payment over the past year (indeed, less than one per cent had done so). In contrast, around one third of consumers reported that they had made an in-app mobile payment, with tap-and-go mobile device payments and BNPL the next most frequently used 'alternative' payment methods. While consumers have a broader range of options with which to make their payments, it is worth noting that many of these newer services ultimately use existing card networks to facilitate the payment (e.g. via stored card details).

## Conclusion

The way in which Australian consumers make their everyday payments is continuing to change. The Bank's 2019 CPS showed a continuation of the trend decline in the use of cash for consumer payments as many people now prefer to use electronic payment methods, such as cards, for even small purchases. The majority of in-person payments are now initiated by tapping a card with contactless functionality on a terminal, and consumers are also using mobile phones and other devices to make 'tap and go' payments more often than they were three years ago. People are also making more of their online payments using mobile devices and using stored payment credentials.

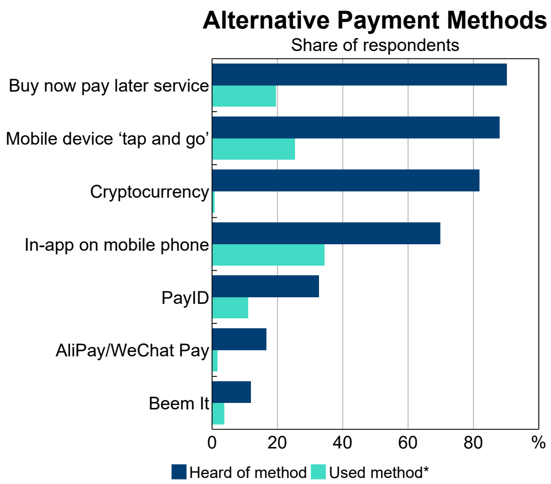
The growing importance of electronic payments highlights the need to make sure that electronic payments are low-cost, secure and resilient to operational disruptions. In this regard, the Bank is conducting a review of retail payments regulation

**Graph 11**




Source: RBA calculations, based on data from Colmar Brunton, Ipsos and Roy Morgan Research

**Graph 12**




* In the last 12 months

Source: RBA calculations, based on data from Roy Morgan Research in 2020 which will consider a range of issues relating to competition, efficiency and the safety of retail payments.[11] The CPS is an important source of information on a number of aspects of this review.

The CPS is also one of the main sources of information on the use of cash and cheques in the economy. While cash is used less frequently than in the past, it is still widely held for precautionary purposes and some members of the community continue to rely very heavily on it in their daily lives. Older Australians, for example, continue to make a significant share of their payments in cash, although survey participants in this demographic are also making increasing use of electronic payment methods over time. It will be important to consider the needs of people who prefer to pay in cash or continue to write cheques, and/or who do not have access to electronic payment options in the broader transition to electronic payments.

## Box A: Details of the Survey

The fieldwork for the 2019 Consumer Payments Survey was conducted by the research firm Roy Morgan Research on behalf of the Bank in October and November 2019. The survey consisted of three parts: a pre-diary questionnaire about the demographic characteristics of respondents; a seven-day payments diary; and a post-survey questionnaire focussing on respondents' payment preferences and attitudes. To encourage participation and engagement with the survey, respondents received a gift card on completion of the three components.

The survey was delivered online for most respondents but to ensure the sample was broadly representative of the Australian population, participants without internet access were recruited by telephone to complete a paper-based survey. The overall response rate was good, resulting in a final sample of just over 1,100 respondents. These participants made a total of around 13,500 consumer payments and around 1,500 automatic payments in their seven-day diary periods.

In addition to internet access, recruitment targets for age, sex, household income, credit card ownership and location (i.e. capital city or regional area) were set so that the sample would be reasonably representative of the Australian population. To account for different response rates across the various demographic categories, the Bank weighted the responses so that the final sample aligned with Australian Bureau of Statistics and HILDA population benchmarks.[12]

## Footnotes

[*] James Caddy, Luc Delaney and Chay Fisher are from Payments Policy Department; Clare Noone is from International Department, having worked on the survey when she was in Payments Policy Department. Cameron Dark and Ed Tellez from Payments Policy Department also made significant contributions to the survey.

[1] The Bank has conducted Consumer Payments Surveys every three years since 2007. For information on previous surveys see Emery, West and Massey (2008); Bagnall, Chong and Smith (2011); Ossolinski, Lam and Emery (2014); Doyle, Fisher, Tellez and Yadav (2017a and 2017b).

[2] Roy Morgan Research conducted the 2019 CPS on behalf of the Bank.

[3] In the 2016 CPS, debit and credit cards combined were used more frequently than cash.

[4] A detailed report and additional data will be published later in 2020.

[5] For previous discussions of the use of cash in the economy see, for example, Davies, Doyle, Fisher and Nightingale (2016) and Meredith, Kenney and Hatzvi (2014).

[6] As discussed below, the share of online payments was stable in 2019 and cards were used for a similar proportion of these payments as in the 2016 survey.

[7] People who had made one or more contactless mobile device payments over the week of the survey made 45 per cent of their in-person payments using this method.

[8] In 2007, cash was used for almost 90 per cent of purchases at (non-supermarket) food retailers.

[9] Growth in the use of debit cards relative to credit cards is consistent with aggregate data from the Bank's Retail Payments Statistics, which show that growth in debit card transactions has outpaced that in credit cards since the mid 2000s.

[10] See, for example, Bullock (2018).

[11] See Reserve Bank of Australia (2019).

[12] This paper uses unit record data from the Household, Income and Labour Dynamics in Australia (HILDA) Survey. The HILDA Project was initiated and is funded by the Australian Government Department of Social Services (DSS) and is managed by the Melbourne Institute of Applied Economic and Social Research (Melbourne Institute). The findings and views reported in this paper, however, are those of the author and should not be attributed to either DSS or the Melbourne Institute.

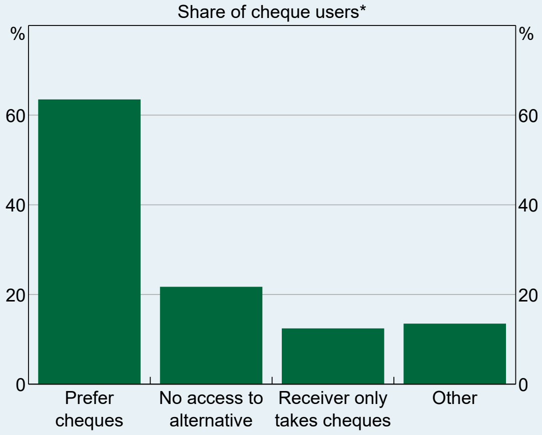
[13] See, for example, Lowe (2019).

## Box B: The Decline of Cheques

The 2019 Consumer Payments Survey provided further evidence of the long-term decline in the cheque system, with personal cheques seldom used for consumer payments. Cheques accounted for only 0.2 per cent of the payments made during the week of the survey, a similar rate to that recorded in 2016. As in previous surveys, cheque use was concentrated among older Australians; all of the cheque payments made in the 2019 survey were made by respondents over 50, with 80 per cent of these made by those aged over 65. Personal cheques were often used for relatively large consumer expenditures such as household bills and services.

Because cheques are used so infrequently, it will be appropriate at some point to wind up the cheque system.[13] In this context, it is important that alternative payment methods are available and accessible for those who rely on cheques. For people who continue to use cheques, the majority indicated that this reflected a preference to use cheques for some payments, although smaller shares reported that they had no access to an alternative means of payment or that the receiver only took cheques (Graph B1).

**Graph B1**
**Reasons for Cheque Use**
Share of cheque users*




* Made a personal cheque payment in the last 12 months; respondent could choose more than one response

Source: RBA calculations, based on data from Roy Morgan Research

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TAB 2: Exhibit KM-1

RESERVE BANK OF AUSTRALIA

Speech

# Innovation and Regulation in the Australian Payments System

**Philip Lowe** [*]
Governor

**Address to the Australian Payments Network**
Online – 7 December 2020

## Introduction

Thank you for the invitation to join you today. It is very good to see the tradition of AusPayNet's annual summit continue, even if it is taking a different form this year.

As we all know, the world of payments has become an area of excitement: it brings together two things that people have a fascination with – money and technology. The pace of change is rapid and the payments landscape is complex and evolving quickly. New technologies are creating new ways of moving money around and new business models are emerging. There are also new players, including the big techs and the fintechs. And blockchain and distributed-ledger technologies are opening up new possibilities. This innovation is raising many issues for both the payments industry and for regulators.

This morning I would like to discuss some of these issues and their implications for the regulatory framework. I will then discuss some of the Payments System Board's preliminary views from its Review of Retail Payments Regulation.

## Innovation

The Payments System Board has a long standing interest in promoting innovation in the Australian payments system. Those of you who have followed our work over the years will recall that back in June 2012 the Board released a report titled 'Strategic Review of Innovation in the Payments System'.

In promoting innovation we have employed a mix of strategies. We have used a combination of:

i. suasion and pressure on industry participants to do better
ii. regulation to promote competition and access
iii. using our position to help overcome coordination problems, which can act as a barrier to innovation in a network with many participants
iv. helping the industry establish benchmarks that can be aspired to collectively.

I will leave it to others to judge the success of this mix of strategies. But from my vantage point, Australians enjoy an efficient and dynamic payments system. There are still gaps that need addressing, but by global standards we have done pretty well. Australians were early and rapid adopters of tap-and-go payments and increasingly are using digital wallets. We have a very good fast payments system, which after a slow start, is seeing continuing strong volume growth. And there is a roadmap for the development of new payment capabilities using this fast payments infrastructure. I would though like to draw your attention to two areas where we would like to see more progress.

The first is the move to electronic invoicing and the ability to link e-invoices to payments as a way to improve the efficiency of business processes. The second is improvements to the speed, cost and transparency of cross-border retail payments and international money transfers. We are looking forward to progress on both fronts.

Against the backdrop of this generally positive picture, the Payments System Board recognises that the structure of payment systems is changing. In some cases it is now better to think of a payments ecosystem, rather than a payments system. In this ecosystem, the payment chains can be longer and there are more entities involved and new technologies used. This more complex and dynamic environment is opening up new opportunities for innovation as well as new competition issues to consider.

One of the factors driving innovation is the increasing interest of technology-focused businesses in payments. These businesses include the fintechs and the large multinational technology companies, often known as the 'big techs'. They are a source of innovation and are playing a role in the development of digital wallets. These wallets are being used more frequently and I expect this trend has a long way to go. Another trend is the increasing use of payments within an app. Big techs are playing important roles on both fronts.

This influence of the big techs is perhaps most evident in China, with Ant Group (owners of Alipay) and Tencent (WeChat Pay) having developed new payments infrastructure that has led to fundamental changes in how retail payments are made in China.

In Australia and many other countries, Google, Apple, Facebook and Amazon are increasingly incorporating payments functionality into their service offerings. Mobile wallets such as Apple Pay and Google Pay are the most prominent examples of this in Australia. In some other countries the big techs are also offering person-to-person transfers and consumer credit products. Facebook also announced its Libra project.

The Apple Pay and Google Pay wallets illustrate some of the new and complex issues that are arising. These wallets are clearly valued by consumers and they will reduce industry-wide fraud costs through the use of biometric authentication (e.g. fingerprint or facial recognition). The tokenisation of the customer's card number is also a step forward. So these wallets are a good innovation. At the same time, though, they are raising new competition issues.

One of these relates to the restriction that Apple, unlike Google, places on access to the near-field communication (NFC) technology on its devices. Many argue that this restriction limits the ability of other wallet providers to compete on these devices and that this could increase costs. This issue has recently attracted the attention of policymakers in several countries. For example, in 2019 the German parliament passed a law requiring device manufacturers to provide third parties with access to technologies (such as NFC) that support payments services. And the European Commission announced in June that it would commence a formal antitrust investigation into Apple's restriction of third-party NFC access on the iOS platform and in September announced that it will also consider legislation on third-party access. This issue has also been raised in submissions to our review of payments system regulation, and we are watching developments in Europe and elsewhere closely.

Another issue being raised by these wallets is the value of information and data, and again we observe Google and Apple taking different approaches. Google states that it may collect information on transactions made using Google Pay, which can be used as part of providing or marketing other Google services to users. In contrast, Apple states that it does not collect transaction information that can be tied back to an individual Apple Pay user. There are also different approaches to charging transaction fees. Apple charges a fee to issuers when a transaction is made with the Apple Wallet but a similar fee is not charged by Google when transactions are made with Google Pay. It is certainly possible that these different approaches to the use of data on the one hand and access and fees on the other are linked. So there are issues to consider here too.

Beyond the issues raised by digital wallets, there are other competition issues raised by the involvement of the big tech companies in payments.

These companies are mostly platform businesses that facilitate interactions between different types of users of their platform. They have very large user bases, benefiting from strong network effects that can make it hard for competitors. Data analysis is part of their DNA and they have become increasingly effective at commercialising the value of data they collect and analyse. Providing additional services, such as payments, also reduces the need for users to 'leave' the platform. So there are complex issues to be worked through here. One of these is the terms of access to the platform and whether the platform requires that payments be processed by the platform's own payment system.

One specific issue that is raised by both digital wallets and the big techs is the nature of the protections that apply to any funds held within any new payment systems, and outside the formal banking sector. For confidence in the system and for the protection of individuals and businesses it is important that strong arrangements are in place.

In this regard, I welcome the Government's announcement that it will accept the Council of Financial Regulators' proposed reforms of regulatory arrangements for so-called stored-value facilities. Under the proposals, APRA and ASIC will be the primary regulators, with requirements tailored to the nature of the facility. It would be possible, for example, to 'designate' a provider of a stored-value facility as being subject to APRA prudential supervision on the basis of financial safety considerations. This could become relevant if the technology companies were to launch new payment and other products that held significant customer funds.

Internationally, this and related issues came to prominence following Facebook's announcement that it was developing a global stablecoin (originally called Libra, but recently rebranded as Diem). Since the original announcement, the Libra Association (now the Diem Association) has also announced plans to launch some single-currency stablecoins intended for use in consumer digital wallets. In April, the Association applied to FINMA (the Swiss financial regulator) for a payment system licence.

This initiative has raised concerns from governments and regulators in many jurisdictions regarding a wide range of issues including consumer protection, financial stability, money laundering and privacy. The Swiss authorities have established a regulatory college to coordinate with other countries. The RBA is participating in this college on behalf of Australia's Council of Financial Regulators. FINMA has indicated that Diem will be subject to the principle of 'same risks, same rules' – that is, if Diem poses bank-like risks it will be subject to bank-like regulatory requirements. It remains to be seen how this and other similar initiatives progress.

As I said at the outset, the world of payments is becoming more complex and raising new issues for industry participants and regulators to deal with. This means that it is timely to consider how the payments system should be regulated and the Payments System Board welcomes the Government's review of the regulatory architecture.

The legislation governing the Reserve Bank's regulatory responsibilities was put in place over 20 years ago. This legislation gives the Bank specific powers in relation to payment systems and participants in those systems. While the powers are quite broad, in practice the Bank has the ability to regulate only a fairly limited range of entities. As I mentioned earlier, these regulatory powers have been used in conjunction with our ability to persuade and to help solve coordination problems in networks. As part of the Government's review it is worth considering what the right balance is here and whether the regulatory arrangements could be modified to better address the complexities of our modern payments ecosystem.

## An update on the Review of Retail Payments Regulation

At the same time that we have been considering these broad issues, the Payments System Board has been conducting its periodic Review of Retail Payments Regulation in Australia. This review was temporarily put on hold during the pandemic but has now restarted. I would like to use this opportunity to provide you with a sense of our thinking on three important issues:

1. interchange fee regulation
2. dual-network debit cards and least-cost routing

3. ‘buy now, pay later’ (BNPL) no-surcharge rules.

I want to stress that we have not yet reached any final conclusions and the Bank's staff will be meeting with industry participants over the next few months to discuss these and other issues. If, at the conclusion of the review, we are to make changes to the standards it is our intention to consult on these by mid 2021.

## Interchange fee regulation

The Board's view is that interchange fees should generally be as low as possible, especially in mature payments systems. While these fees might arguably play a role in establishing new payment methods, once a payment system is well established these fees increase the cost of payments for merchants and they can distort payment choices. So the direction of change in these fees over the medium term should be down, and not up.

Having said that, at the current point in time the Board does not see a strong case for a significant revision of the interchange framework in Australia.

The current interchange standards have been in effect for only 3½ years and submissions to the review did not point to strong arguments for major changes. The standards appear to be working well and frequent regulatory change can carry costs. It is also relevant that the average level of interchange rates in Australia is quite low by international standards, particularly the 8 cents benchmark for debit card payments. Credit card interchange fees are also lower than in most countries. One exception is the lower credit card interchange fees in Europe. The Board is watching the European experience closely and expects that, over time, a stronger case will emerge for lower credit card interchange fees in Australia.

There is one aspect of the interchange regulations where the Board is considering a change as part of the review – that is the cap on the fees that can be applied to any particular category within a scheme's schedule of debit card interchange fees. Currently a 20 basis point cap applies when a fee is expressed in percentage terms and a cap of 15 cents applies when the fee is expressed in terms of cents. The Board sees a case to lower this 15 cents cap.

This case has emerged as there has been an increasing tendency for interchange fees on transactions to be set at the 15 cents cap, particularly on transactions that are less at risk of being routed to another scheme. At the same time, the international schemes are setting much lower strategic rates for some merchants, particularly larger ones, in response to least-cost routing. This is resulting in large differences in interchange fees being paid on similar transactions, with unreasonably high interchange fees on some low-value transactions, especially at smaller merchants. For example, a 15 cent interchange fee on a $5 transaction is equivalent to an interchange rate of 300 basis points, which is far higher than would apply to that transaction if a credit card had been used. Over the coming months, Bank staff will be seeking further information from the industry on this issue as the Board considers a lower cap.

## Dual-network debit cards and least-cost routing

The second issue is dual-network debit cards and least-cost routing.

The Board has long held the position that merchants should have the freedom and the capability to route debit card transactions through the lower-cost network. The Government and a wide range of stakeholders have a similar view. It is understandable why: this choice promotes competition and helps keep downward pressure on the cost of goods and services for consumers.

Over recent years, the Board has discussed the right balance between regulation and suasion to achieve this outcome. Its judgement has been that the best approach was for the industry itself to support least-cost routing, pushed along by pressure from the RBA. While progress has been slower than we would have liked, the slow progress by the major banks did create competitive openings for other players, which led to some innovation. The major banks now also all offer least-cost routing, with some making it the default offering for small and medium-sized businesses. So there has been significant progress. The Board is not convinced that a better outcome would have been achieved through regulation.

The concept of least-cost routing is most applicable when a physical card is used and where that card has two networks on it. One recent trend that we have observed is that some issuers have sought to move away from dual-network debit cards to issue single-network cards, with no eftpos functionality. This may be partly in response to financial incentives from the international schemes and possibly the additional costs to issuers from supporting two networks on a card.

Notwithstanding this trend, the Board's view is that it is in the public interest for dual-network cards to continue and to be the main form of debit card issued in Australia. It is also important that acquirers and other payment providers offer or support least-cost routing and that the schemes do not act in a way that inappropriately discourages merchants from adopting least-cost routing.

The Board is again considering the best balance between regulation and suasion to achieve these outcomes. Consistent with its earlier approach, its preference is for the industry to deliver these outcomes without regulation. To help achieve this, the Board is considering setting out some formal expectations in this area. If these expectations are not met, the Board would then consider regulation.

To be clear, the Board sees a strong case for all larger issuers of debit cards to issue cards with two networks on them. At the same time, it recognises that there can be additional costs of supporting two networks, which can make it harder for new entrants and small institutions to be competitive. So it may not be appropriate to expect very small issuers to issue such cards. Over the months ahead, the Bank will be consulting with small authorised deposit-taking institutions and the schemes to get a clearer picture of the costs and their implications for determining any regulatory expectations.

The Board also expects that in the point-of-sale or 'device-present' environment all acquirers should provide merchants with the ability to implement least-cost routing for contactless transactions, possibly on an 'opt-out' basis.

In the online or ‘device-not-present’ environment, it is not yet clear how least-cost routing should operate and what expectations on its provision might be appropriate. In this environment, there is scope for consumers to make more active choices, there are various technical challenges to least-cost routing and there can be more providers in the payments chain. So the idea of how least-cost routing might apply in the online world will be explored by the Bank's staff over coming months.

## Buy now, pay later no-surcharge rules

The third issue that I'd like to cover is the no-surcharge rules of buy now, pay later providers.

The Board's long standing view is that the right of merchants to apply a surcharge promotes payments system competition and keeps downward pressure on payments costs for businesses. This is especially so when merchants consider that it is near essential to take a particular payment method for them to be competitive.

The Board also recognises that it is possible that no-surcharge rules can play a role in the development of new payment methods. While new payment methods can be developed without them, these rules can, under some circumstances, make it easier to build up a network and thereby promote innovation and entry.

The Board's preliminary view is that the BNPL operators in Australia have not yet reached the point where it is clear that the costs arising from the no-surcharge rule outweigh the potential benefits in terms of innovation. So consistent with its philosophy of only regulating when it is clear that doing so is in the public interest, the Board is unlikely to conclude that the BNPL operators should be required to remove their no-surcharge rules right now.

Even the largest BNPL providers still account for a small proportion of total consumer payments in Australia, notwithstanding their rapid growth. New business models are also emerging, including some that facilitate payments using virtual cards issued under the designated card schemes that are subject to the existing surcharging framework. In addition, the increasing array of BNPL providers is resulting in competitive pressure that could put downward pressure on merchant costs.

The Board expects that over time a public policy case is likely to emerge for the removal of the no-surcharge rules in at least some BNPL arrangements. Some of the BNPL operators are growing rapidly and becoming widely adopted by merchants, particularly in certain sectors. As part of the Bank's ongoing consideration of this issue, Bank staff will be discussing with industry participants possible criteria or thresholds for determining when no-surcharge rules should no longer be allowed.

If the point is reached where the Board's view is that the public interest would be served by the removal of a no-surcharge rule, the Board's preference would be to reach a voluntary agreement with the relevant provider. This would be similar to the approach adopted with American Express and PayPal. In the event that this were not possible, the Bank would discuss with the Australian Government the best way to address the issue. More broadly, as I discussed above, the current Treasury review of the regulatory architecture provides an opportunity to look holistically at this issue and whether the existing legislation and regulatory provisions could be amended to better reflect our modern and dynamic payments ecosystems.

## Conclusion

So that is a quick review of some of the issues that the Payments System Board and the RBA staff have been focusing on recently. It is clear that payments is an increasingly exciting area and that significant innovation is occurring. This presents opportunities to deliver improved services to end users of the payments system as well as raising new questions for policymakers. The Bank very much appreciates the ongoing engagement we have with the industry as we jointly work towards better outcomes for the Australian community.

Thank you.

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## Endnotes

[*] I would like to thank my colleagues in Payments Policy Department for assistance in the preparation of this talk.