12 July 2019

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

By email: pysubmissions@rba.gov.au

Dear Sir/Madam,

RBA Review of Retail Payments Regulation – Consultation Paper (May 2021).

Attached please find ACAPMA's submission to the Reserve Bank of Australia's Review of Retail Payments Regulation Consultation Paper of May 2021.

As the national peak body representing the Australian Fuel Retail Industry – an industry that processes around 608M transactions per year- the *Australasian Convenience and Petroleum Marketers Association* (ACAPMA) has a strong interest in the operation of Australia's Retail payment System.

A general discussion on the significance of retail payments to the Australian fuel retail industry is presented in Section 3 of our submission. Section 4 provides some general observations in respect of the RBA Consultation paper, while Section 5 specifically addresses the draft changes foreshadowed to the *Payment Systems Regulation (1988).*

In summary, ACAPMA does not support the recommendations that have been made in the Consultation Paper. Our opposition is premised in the belief that the proposed amendments ultimately constitute a weakening of the retail payments system – one that could potentially increase the cost of merchant fees paid by Australia's fuel retail industry (and its' customers) by a further $116M in the future.

ACAPMA's position in respect of the measures canvassed in the Consultation paper is three-fold and can be summarised as follows:

1. Opposition to any significant reduction in the requirement for *Dual Network Debit Cards* (DNDCs), other than a small carve out for Neo Banks to accommodate market entry for a maximum period of two years.

2. Proposes modification of the *Payment Systems Regulation Act (1988)* to stipulate immediate introduction of Least Cost Routing (LCR) functionality for all debit card payments in the ***in-person*** environment in Australia, such that all payment terminals *default* to the least cost gateway.

3. Proposes modification of the *Payment Systems Regulation Act (1988)* to stipulate a timetable for the introduction of LCR for all payments in the ***online, mobile and digital environments***, with a requirement for such functionality to be in place by 30 June 2022.

ACAPMA firmly believes that the above changes are essential to protect all small businesses from the adverse consequences of any failure of the RBA to ensure that sufficient competitive tension is maintained in the Australian payments market.

Thank you for the opportunity to provide feedback on this Consultation. Should you require clarification of any aspect of our submission, please contact me via email (markm@acapma.com.au) or by mobile (0447 444 011).

Yours sincerely,

Mark McKenzie
Chief Executive Officer

EVENTS ADVOCACY EMPLOYMENT TRAINING INFORMATION

Submission to the Reserve Bank of Australia

Review of Retail Payments Regulation
(Consultation Paper of May 2021)

July 2021

ACAPMA
The Voice of Petrol Convenience

ACAPMA
Australasian Convenience and Petroleum Marketers Association

1. Introduction

This paper constitutes a submission by the *Australasian Convenience and Petroleum Marketers Association (ACAPMA)* to the May 2021 Consultation Paper prepared by the Reserve Bank of Australia's Payments Systems Board of the Review of the Australian Retail Payments Regulation. This consultation paper *(See* Review of Retail Payments Regulation - Consultation Paper - May 2021 (rba.gov.au)) contains a series of preliminary conclusions and supporting draft standards that are proposed for inclusion in an amendment of the *Payment Systems Regulation (1998) Act* later this year.

This submission provides a narrative on the preliminary conclusions of the Payment Systems Board, as considered from the perspective of Australia's more than 2000 fuel retailing businesses – ranging from international subsidiaries of global fuel companies to single site fuel retail businesses.

Further, the discussion presented in this submission is grounded in more than five years of advocacy on the need for changes to be made to the operation of the Australian Payments Regulation to reduce the rising cost of merchant fee transactions in a market that is both complicated and opaque, when considered from a service users perspective (i.e. Australian fuel retail businesses).

2. About ACAPMA

The Australasian Convenience and Petroleum Marketers Association (ACAPMA) is the national peak body representing the interests of the petroleum distribution/wholesaling and the petrol-convenience retail industry. These two industry sectors generate annual revenues of around $74B and employ an estimated 58,200 Australians.

The Association is first and foremost an employer organisation that is formally recognised under Australian law as the industrial advocate for fuel marketing and fuel distribution businesses. First established in 1976, the Association started operations as the Australian Petroleum Agents and Distributors Association (APADA) and subsequently changed its name to ACAPMA in 2007. The name change was accompanied by a change in the Association's Constitution to incorporate national representation of fuel retailers.

Today, the Association directly represents 95% of fuel distributors/wholesalers in the country and directly and indirectly (via franchisees and distributor-owned retailers) around 5200 of the 7100 service stations (i.e. 73%) operating in Australia.

The scope of ACAPMA's membership extends from 'refinery gate' through to the forecourt of Australia's national network of service stations and petrol convenience outlets – including fuel wholesale, fuel distributors, fuel retailers, petroleum equipment suppliers and petroleum service providers.

ACAPMA's member businesses range from Australian-owned subsidiaries of international companies, to large Australian-owned businesses, to independently owned mid-cap Australian companies, and small single retail site family-owned businesses.

Given the diversity of our membership base, ACAPMA strives to assemble an aggregate whole-of-market perspective on key public policy and market regulation - with a view to providing policymakers and regulators with meaningful industry insights that are directly relevant to issues under consideration.

Given the wide variance in the market propositions (and market presence) of individual market participants, ACAPMA's aggregate whole-of-market perspective should not be taken as necessarily being representative of the position of any individual fuel retailer. It is therefore possible that one or more of ACAPMA's members may have an individual enterprise position that varies from the one presented in this paper.

3. Significant of retail payments to the fuel retail industry

The Australian Fuel retail industry comprises more than 2500 businesses operating an estimated 7080 retail sites across Australia, with the vast majority of these businesses being small to medium business.

These businesses sell an estimated 31 billion litres of fuel (i.e. petrol and diesel) to private households and businesses each year. An approximation of the profile of these transactions (based on FY20) is provided in the table below:

Market descriptor	Petrol	Diesel
Annual volume sold through retail outlets in Australia	16.5B litres	15.2B litres
Average volume per transaction	47 litres	85 litres
Total no. of transactions per year	340M	176M
Estimated transaction value	$59	$116
Estimated number of electronic transactions per year (excludes cash and accounts)	204.3M	105.9M

Note: Data utilised in this table has been extracted from the *Australian Petroleum Statistics* data sets produced by the Australian Federal Government (Australian Petroleum Statistics | energy.gov.au) and information derived from ACAPMA's *Monitor of Fuel Consumer Attitudes* research series.

As evidenced by the above, Australian fuel retailers are large users of electronic payment services with an estimated 310M transactions processed each year – approximately 70% of which are debit transactions. As a consequence, fuel retail businesses (and their customers) are heavily exposed to the Australian electronic payments market and are vulnerable to deficiencies in market competition.

During 2017, fuel retailers reported a significant escalation in merchant fee costs and sought assistance from ACAPMA in seeking to better understand the drivers of this increase. ACAPMA's investigations revealed that the costs had 'quietly' increased as a result of 'tap and go' technology (see The silent debit transaction rort - ACAPMAg - The voice of downstream petroleum).

Further investigations revealed that debit transactions costs had increased markedly for processing these transactions via the international credit card gateways – and Australia's major banks had been complicit in routing payments via these gateways instead of the cheaper Eftpos network (which, at the time, did not have 'tap and go' functionality).

Individual investigations of the cost increases amongst a select number of retailers revealed that the cost of debit transactions increased three-fold as a result of: (a) Eftpos's inability to provide a competitive offering to 'tap and go' technology at the time and (b) the opaque nature of merchant fee offerings provided by banks to retailers.

Had these costs been replicated across all electronic payments, the cost to fuel retailers – and ultimately passed through to motorists in the form of higher fuel costs – could have been in the vicinity of $69M per year.

ACAPMA's 2017 investigation prompted the Association to join forces with the Master Grocers Association of Australia (MGAA) and the Council of Small Business Organisations of Australia (COSBOA), to advocate for greater transparency in merchant fee arrangements and the introduction of Least Cost Routing (or LCR).

Over the next 3 years, ACAPMA (and its' partners) were successful in raising awareness of the concerns surrounding merchant fees and securing the support of Eftpos to encourage the banks to introduce a simplified form of LCR.

Of most relevance to this merger, ACAPMA learned that the temporary 'loss' of Eftpos in the marketplace (due to a technology barrier) resulted in reduction in the intensity of market competition that, coupled with the opaque nature of merchant fee services, significantly increased the costs of processing card payments in Australia.

It therefore follows that the continued unencumbered operation of Eftpos – a uniquely Australian payment service provider that stands independent of the two international card payment services – is essential to the maintenance of competitive tension in the Australian payment services market.

Further, any weakening of Eftpos's position in the Australian electronic transaction services market exposes Australia's fuel retail businesses (and their customers) to the adverse consequences of a duopoly of international payment services providers (i.e. Visa and Mastercard) and risks the quiet and steady increasing of fees for electronic services in a market that is both opaque and complex.

4. General comments

ACAPMA's specific commentary on the May 2021 *Consultation Paper* on retail payments industry is founded on a series of guiding insights about the opaque and oligopolistic nature of the current merchant service market in Australia. The current nature of this market carries significant contingent risk for all Australian businesses (and their consumers) and therefore the payment systems regulation should take all reasonable steps to neutralise this risk.

4.1. Australia's fuel retailers currently pay around $116M in merchant fees but potentially stand to reduce this cost by $35M with the meaningful introduction of LCR. Conversely, the wholesale reduction of LCR (and/or the loss of the domestic provider of merchant services) could result in the fuel industry paying an estimate $332M in merchant fees – with consequent flow on impacts to Australian households and businesses in the form of upward pressure on fuel prices.

The nation's fuel retailers process an estimated 608M fuel transactions per year, with just over half of these transactions being debit transactions (i.e. 310M). The cost of processing these debit transactions is conservatively estimated to be around $116.M per year (i.e. excluding convenience sales).

Noting the UK experience arising from the loss of the domestic payments provider in 2018 (https://www.bbc.com/news/business-54606252), any failure of the RBA to effectively manage the retail payments market in the future (and the consequent loss of Eftpos) could see a worst-case scenario that doubles the cost of merchant fees to $332M.

The quantum of this risk – and its consequent impact on fuel input costs for Australian businesses and households – is sufficient to warrant the adoption of a *precautionary approach* in respect of the Australian retail payments market.

4.2. The operation of the merchant service market is complex and opaque, creating unnecessary vulnerability of Australian businesses to escalating merchant fees.

The most challenging aspect of the current merchant service market is the varied architecture of the current merchant services offerings provided in the market. These offerings are complex, apply tiered cost structures that don't allow ready comparison of the cost of competing services, and are often conflated with the provision of other financial services to the merchant.

This lack of structure, and a general lack of transparency of charges and interchange costs (levied between the card provider and the issuing bank), makes it virtually impossible for merchants to compare the cost of competing offerings – and indeed, in many instances, difficult to calculate the true costs of electronic transactions paid by the business.

The extent of this business confusion is evidenced by work completed by a business survey completed by RFI Research (Refer Attachment A) which shows that there is considerable business confusion about the relative costs of the different payment gateways on their business (see Figure A). While some of this variance can be explained by differences in the architecture of specific merchant fee products, the high percentage of "*I am not sure*" in the '*Unaware of MCR category'* is particularly concerning.

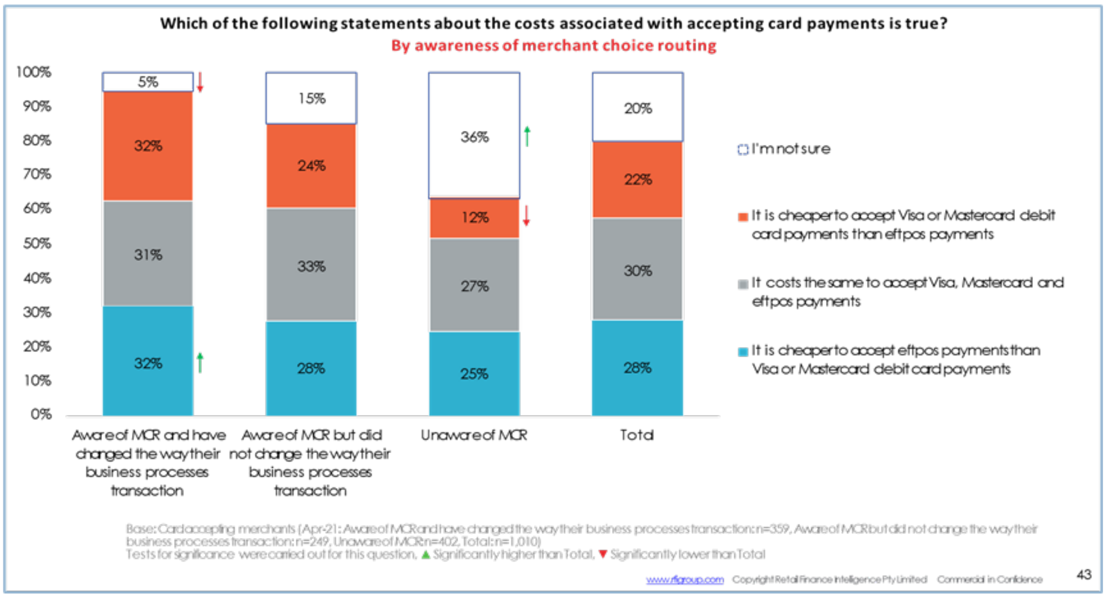


Figure A: *Level of understanding of the relative costs of different payment gateways amongst Australian businesses (RFI Research, April 2021).*

4.3. The competitive tension in the Australian merchant services market is not sufficient to ensure fair pricing of merchant service offerings to Australian retailers, particularly for smaller businesses (i.e. less than $10M turnover).

The RFI research also reveals that the majority of businesses with annual turnovers of less than $10M per year don't wholly agree that the transaction fees paid by their business are 'Fair' (See Figure B). Most importantly, this category accounts for around 96% of all businesses operating in the Australian economy.

Interestingly, a business owner's perception of the unfairness of charges increases as the annual turnover of the enterprise decreases. It is strongly suggested that this trend demonstrates the combined effect of a lack of internal capacity of smaller businesses to interrogate complex products, and the vulnerability of small market players to paying higher transactions rates given their lack of market leverage with merchant service suppliers (i.e. relative to larger businesses).

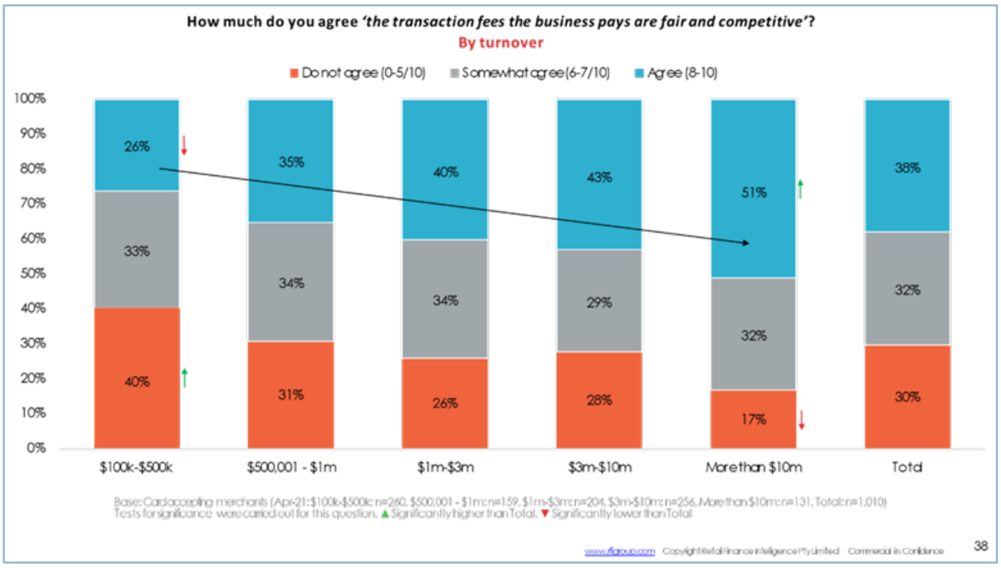


Figure B: *Business owner satisfaction with the fair and competitive nature decreases in proportion to the annual turnover of the enterprise (RFI Research, April 2021).*

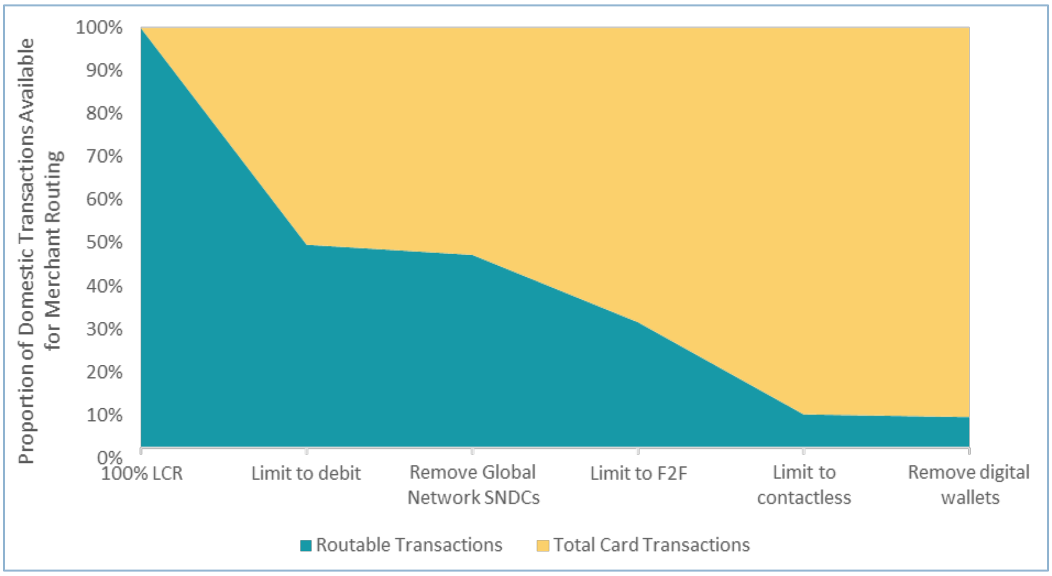
4.4. The rapidly evolving nature of the electronic payments landscape suggests that any failure to maximise LCR will substantially increase merchant fees for Australian businesses. Measures must be put in place for all digital forms now, to avoid making the same mistakes of the past in terms of retailers being vulnerable to the unfettered market power of the global card providers in the delivery of electronic debit transactions.

The merchant fee landscape is constantly being shaped by changes in consumer behaviour and payment technologies.

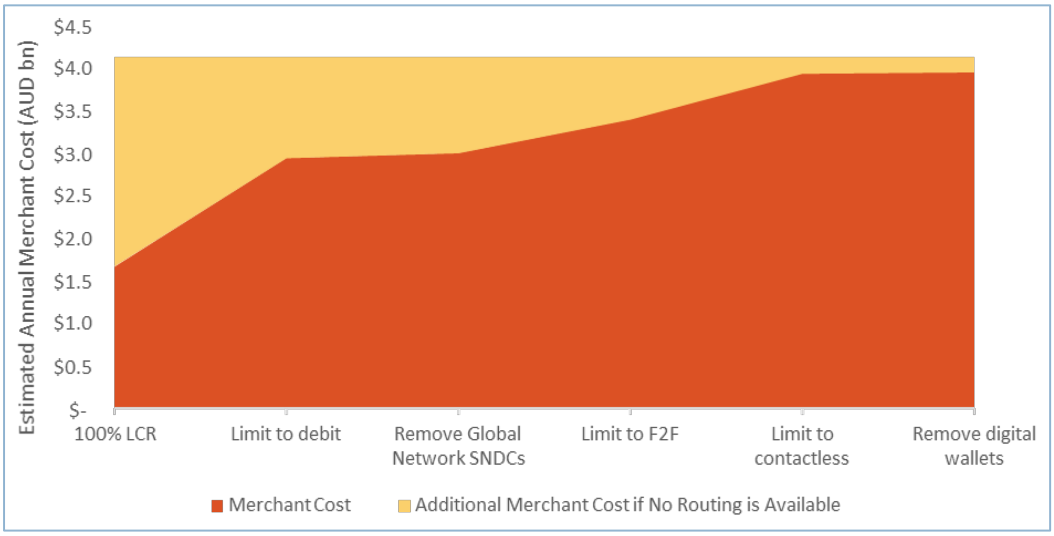
Under the current regulatory settings where LCR is not mandatory, current and future market developments are likely to reduce the proportion of merchant fee payments that are available to LCR to just 10% of all payments (See Figure C).

Any failure to ensure that new technology payment forms accommodate LCR in Australia will decrease market competition in favour of the higher cost card gateways. Research completed by CMPSI in June 2021 (Refer Attachment B) estimates that the cost of this loss of LCR functionality could increase merchant fees for Australian businesses to around $4.16B per year (See Figure D).

A $4.16B annual merchant fee cost represents an additional and unnecessary premium paid to merchant services provider that is $2.31B higher than it would otherwise be, if all transactions were routed via LCR. Such a cost constitutes a significant drag on the Australian Retail Industry that is of such significance as the threaten the future viability of Australia's increasingly globally exposed retailers.



<u>Figure C</u>: *Under the current market paradigm, the propensity to route transactions on a least cost basis decreases as digital transactions increase (CMPSI, June 2021).*



4.5. The past 'soft approach' of encouraging market participants to introduce LCR has failed, largely as a result of the key actors in Australia's merchant fee ecosystem (i.e. the Banks) being wholly conflicted in respect of lowering their fees for the provisions of merchant services.

Less than 8% of electronic transactions (by value) are currently capable of being routed to the least cost gateway (See Attachment #2). This is despite a national conversation on the need for same being in existence for more than 5 years, including an open acknowledgement of the value of this mechanism (as a foil against higher fees in the future) being openly acknowledged in the RBA's *Consultation Paper*.

While the major banks have introduced a *simplistic* form of least cost routing two years ago, this voluntary action has had minimal effect with the proportion of customers that have chosen LCR being less than 1 in 10 (Anecdotal feedback from fuel retail businesses suggests that those who chose to explore this option generally backed out of the process due to advice being provided by the bank about a possible increase in fees levied on other business products).

It is strongly suggested that the failure of the voluntary approach of the major banks was largely predictable. That is, it is not in the financial interests of Australia's major banks to introduce LCR given that it the widespread utilisation of same would substantially lessen annual income derived from the higher cost international card gateways.

4.6. Maintenance of Australia's dual rail system for the processing of debit payments (incorporating a powerful domestic payments platform) is essential. Such a mechanism, when coupled with meaningful Least Cost Routing (LCR) provides the <u>only realistic</u> mechanism for reducing the current vulnerability of Australian retailers to unjustified increases in merchant fees in the future.

Any reduction of the dual rail mechanism for processing of electronic payments reduces the capacity of merchants to choose LCR in the future and makes these businesses hostage to the higher cost international card gateways. Similarly, any failure to advance regulatory settings that protect the operation of a market effective domestic payments provider risks a reduction in market competition and a loss of payment services choice, with consequent upward price pressures on merchant fees levied on Australian businesses in the future.

While small and non-traditional banks have argued that the provision of Dual Network Debit Cards (DNDCs) represent a higher cost than Single Network Debit Cards (SNDCs) it is strongly suggested that this is not an issue of implementation costs (But rather, an opportunity cost arising from the lesser fees earned by splitting transactions between the higher cost international card gateway and the lower cost Eftpos gateway) Within this context, it is interesting to note that all of the banks that operate SNDCs – or are proposing to do so – are proposing to utilise the higher cost international card gateways over the lower cost Eftpos gateway)

4.7. Mandating LCR as a default for the processing of all debit payments – irrespective of payment form (i.e. physical, online, mobile and digital wallet) – is now required to create the competitive tension needed to protect Australian businesses from large and unjustified escalation of merchant fees in the future.

The complex and opaque nature of merchant fee service offerings is such that there does not appear to be any reasonable mechanism for introducing a benchmark indicator (e.g.

such as the use of the 'Comparison Rate' for home loans) that might be used by Australian businesses to readily ascertain which of the available merchant fee products delivers the best value. Further, it is not reasonable to suggest that Australia's banks – with their inevitable commercial conflict – can reasonably be expected to 'voluntarily' direct their customers away from the international card gateways that deliver them higher interchange revenues than the least cost route for merchants.

Rather, there would appear to be a strong case for the mandating LCR as a default position for all debit transactions (in all payment forms) and a requirement for all card issuers to provide DNDCs.

Such action is considered a relatively straightforward regulatory intervention that puts the onus on the higher card gateways to sell the benefits of these gateways to merchants as an alternative to the default setting.

Such an approach does not involve the introduction of the 'band aid' cost fixing mechanisms that are proposed in the RBA Consultation paper – mechanisms that have not been fully modelled and risk unintended adverse consequences for merchants.

5. Specific comments

The following comments are provided in respect of the draft standards presented in the discussion paper.

5.1 Proposal for only the major banks to issue DNDCs (for all relevant payment forms) while excusing non major banks from this requirement.

This proposal is openly opposed on the basis that it further reduces the potential for payments to be routed via the least cost gateway. ACAPMA estimates that the proposal will result in a loss of the potential to route around 20% of all debit transactions to the lower cost gateway, potentially imposing additional merchant fee costs on fuel retailers of up to $23M per year).

For reasons of maintaining and enhancing competitive tension in an oligopolistic payment services market, any concession in respect of DNDCs risks a lessening of market competition with obvious and material detriment to *all* Australian retail businesses.

The implicit suggestion in this recommendation that smaller banks are only able to offer debit services on a commercial basis, where they are permitted to levy higher charges on retailers than other market competitors, is an inequitable and deeply flawed proposition.

It is strongly suggested that this proposed measure should solely be provided as a market entry concession to ‘Neo Banks’, with the concession expiring after a maximum period of two years.

5.2 Establishment of a lower interchange cap for SNDC transactions than for DNDC, to discourage wholesale use of SNDCs.

This measure is only necessary if the flawed Standard cited in 5.1 above is progressed. Removal of this first Standard, as suggested above, would remove the need for this measure to be advanced.

5.3 Statement of expectation – as opposed to explicit regulatory requirement – to offer and promote LCR functionality to merchants operating in the ‘in-person’ environment.

Arguably, this is the policy position that has been informally pursued by the RBA over the past four years in the wake of numerous parliamentary citations and strident advocacy by organisations representing Australia’s retail businesses.

The fact that this approach has failed to catalyse the growth of LCR (i.e. currently less than 8% of transactions by value have the potential to be routed) over this time, strongly suggests that continuing the current approach will not deliver increased LCR outcomes.

Further, and given the inherent commercial conflict of interest that exists among the card issuing banks, there is no reason to believe that such a strategy will be effective in the future.

5.4 Statement of expectation – as opposed to explicit regulatory requirement – that the financial industry would follow a set of principles regarding LCR in the 'online' environment.

Noting the failure of the 'soft coercive' approach to work within the 'in person' environment, and mindful of the banks having the very same commercial conflict of interest in promoting LCR in the *online* environment as they do in the *in-person* environment, this approach is unlikely to be successful – and will in fact, cede greater market power to the higher cost international card gateways.

It is strongly suggested that the RBA's stance in respect of this recommendation amounts to 'gambling with the financial interests of the nation's merchants', as any failure of the RBA to drive penetration of LCR in the rapidly growing 'online and digital' environment risks nearly doubling the cost of annual merchant fees to an estimated $4.16B per year (Refer Attachment B).

It is understood that the major market participants are proposing that the implementation of LCR for the online and digital environment (including mobiles) be delayed due to the cost of implementation for the EftPos system (i.e. such functionality is already available on the higher cost card gateways).

Such an observation, however, is not supported by the facts given that much of the work required to provide the necessary online functionality for Eftpos has largely been completed to support market availability from November 2021 (see https://www.eftposaustralia.com.au/sites/default/files/2021-03/eftpos-Product-Roadmap-2021.pdf).

5.5 Prohibition of tying conduct involving debit and credit products.

ACAPMA is supportive of this policy standard but suggests it would be an unnecessary market intervention if the RBA was to adopt to an approach that involved mandating of DNDCs and LCR for all retail payments (in all payment forms).

6 Summary

Australian fuel retailers are large users of electronic payment services with an estimated 310M transactions processed each year – approximately 70% of which are debit transactions. The costs of processing debit card transactions alone are estimated to be in the vicinity of $116M per year.

Consequently, Australia's fuel retail businesses (and their customers) are heavily exposed to the Australian electronic payments market - and are vulnerable to deficiencies in market competition. The widespread availability of *Dual Network Debit Cards* (DNDCs) and *Least Cost Routing* (LCR) are considered to be critical to maintaining a competitive pressure on merchant fees in the future.

The RBA Consultation Paper openly acknowledges the vital importance of LCR for maintaining a positive competitive tension on the merchant services market. Despite this, the Consultation Paper fails to advance any meaningful draft standards to address same.

In fact, the draft standards proposed in the paper will have the likely adverse effect of weakening competition by reducing the proportion of transactions that can be routed in the future – and by failing to make LCR compulsory for all debit transactions. The proposal to excuse card issuers other than the four major banks from providing Dual Network Debit Cards (DNDCs), for example, could result in the fuel industry (and its' customers) paying an extra $23M per year in merchant fees.

ACAPMA does not support the recommendations that have been made in the Consultation Paper. This opposition is premised in the belief that the proposed amendments ultimately constitute a weakening of the retail payments system that could potentially increase the cost of merchant fees paid by Australia's fuel retail industry (and its' customers) by $116M in the future. Specifically, ACAPMA:

4. Opposes any significant reduction in the requirement for *Dual Network Debit Cards* (DNDCs), other than a small carve out for Neo Banks to accommodate market entry for a maximum period of two years.

5. Seeks modification of the *Payment Systems Regulation Act (1988)* to stipulate immediate introduction of Least Cost Routing (LCR) functionality for all debit card payments in the ***in-person*** environment in Australia such that all payment terminals default to the least cost gateway.

6. Seeks modification of the *Payment Systems Regulation Act (1988)* to stipulate a timetable for the introduction of LCR for all payments in the ***online, mobile and digital environments***, with a requirement for such functionality to be in place by 30 June 2022.

ACAPMA firmly believes that the above changes are essential to protect all small businesses from the adverse consequences of a failure of the RBA to ensure that sufficient competitive tension is maintained in the Australian payments market.

7 Further information

Further information about this submission can be obtained by contacting the Chief Executive Officer, Mark McKenzie using any of the below details:

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