



Abacus
Australian Mutuals

Association of Building Societies and Credit Unions

9 September 2011

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

By email: pysubmissions@rba.gov.au

Dear Dr Kent

Strategic Review of Innovation in the Payments System

Abacus – Australian Mutuals appreciates the opportunity to comment on the RBA's June 2011 consultation paper on innovation in the payments system.

Abacus represents the customer-owned banking sector: credit unions, building societies and mutual banks. The mutual banking sector has 4.5 million customers and provides important competition and choice in retail banking. (For more information go to www.abacus.org.au)

As demonstrated by our sector's market leading customer satisfaction ratings, mutuals focus on service, value and convenience for consumers. Mutual banking institutions provide their members with a wide range of payments products and services, ranging from cheques to contactless debit cards and mobile banking.

Mutuals' record of innovation in payments includes installing Australia's first ATM and being 20 years ahead of the major banks in issuing Visa Debit cards.

Abacus believes there is scope to improve the environment for innovation in the Australian payments system.

The RBA can play an important role by:

- promoting greater transparency and accountability from the payments system's dominant participants;
- pursuing improved capacity and governance of APCA;
- avoiding counter-productive intervention.

Please find attached our 29 July 2011 submission to APCA on the role of cheque use in Australia.

Transparency & Accountability

Like the wider financial services sector, the Australian payments system is dominated by the four major banks. The major banks are the key participants in the payments clearing systems administered by APCA. The major banks own BPAY and, along with the two biggest retailers, are influential participants in the EFTPOS, Visa and MasterCard schemes.

The major banks and the big retailers can veto or retard improvements in the payments system when it suits their narrow commercial interests. Examples include entrenched resistance by big retailers to reform of EFTPOS interchange fee arrangements, collapse of the MAMBO project, and stalling of initiatives to enhance the direct entry system. The RBA could do more to identify and publicly expose the real barriers to progress by monitoring and publicly reporting on these initiatives and making the participants publicly accountable for their decisions.

Abacus recommends that the RBA publish information and analysis about the reasons why innovative proposals are stalling or failing. What competitive and commercial tensions have halted MAMBO, denying consumers a better payments option? What is stopping adoption of pro-competitive multilateral interchange fees in the EFTPOS system?

It is important that the RBA as payments system regulator representing the wider public interest is active and vigilant in revealing how Australia's highly concentrated banking industry is affecting competition and choice in consumer payments.

APCA governance

The current governance structure for the payments industry could be improved.

APCA's role and powers are limited and, as the RBA's consultation paper notes, there is a perception that the needs of end-users for new product offerings are not taken into account sufficiently.

Abacus supports reform of the governance arrangements, with due care not to diminish the hard-won position the mutual banking sector has achieved in the current framework.

Mutual banking institutions are represented around the APCA table through their settlement and clearing providers: Cuscal, Indue and ASL. These positions, ranging from the APCA board membership to seats on various APCA committees and working groups, were not easily gained and reflect the significant role of credit unions and building societies in the payments system.

"Whilst the Australian payments system does appear to have some evidence of innovation, competition and efficiency within the existing model, it is apparent that some aspects of the governance of the payments system are flawed and lack flexibility," says an Abacus member ADI. "Examples of this would include APCA voting arrangements which do not reflect stakeholder views accurately with voting rights currently being allocated on payment volume within the industry alone. There is evidence that this particular model can stall innovation for the whole domestic payments system based on the voting of one to two institutions due to costs or legacy technology."

Abacus recommends that the RBA set a timetable for reform of APCA governance arrangements to:

- promote dynamism and decision-making capacity;
- broaden representation of stakeholders; and
- reduce the dominance of the major banks.

Relevantly, the governance framework proposed in Canada's current Payments System Review features an industry Self-Governing Organisation (SGO).

“At the heart of the Governance Framework lies the assumption that most problems in the payments system can be addressed by participants,” Canada’s Review discussion paper says. “For this to happen, players need a collaborative forum to work together to make the system more efficient, as well as provision for collective action to resolve divisive issues. To this end, the Governance Framework encourages the creation of an SGO to include all payment players, who would work to develop and enforce codes of conduct and manage the integration of new technologies. The SGO would involve mandatory membership for industry participants, while allowing for voluntary membership for consumers and merchants. The SGO would be self-funded and self-governed. The SGO’s mandate might include development of standards in emerging technologies (mobile payments, digital identification and authentication), as well as establishing codes of conduct for business practices. Industry members should show leadership in this endeavour. For that reason, decisions about the SGO’s organization, agenda and operation should be left to the SGO, and have been omitted from the Governance Framework.”

Counter-productive intervention

Direct regulatory intervention can have a chilling effect on innovation.

The RBA’s intervention to modify the Honour All Cards (HAC) rule in the Visa and MasterCard schemes enabled a dominant merchant to refuse to accept scheme debit while continuing to accept scheme credit.

Woolworths’ decision to refuse to allow shoppers to make purchases with scheme debit demonstrates how powerful entities can cherry-pick regulatory interventions to suit their narrow commercial interests.

Woolworths has a long record of resisting pro-competitive reforms to interchange fee arrangements for EFTPOS debit but seized the opportunity provided by regulatory intervention to ban scheme debit and deny consumers choice about how they pay for purchases.

This decision disproportionately affected members of mutuals. Credit unions and building societies were the earliest adopters and strongest supporters of scheme debit because of the product’s superior functionality compared to proprietary debit. Until recently, major banks preferred to offer their customers credit cards or proprietary debit rather than scheme debit.

The RBA’s change to the HAC rule was unnecessary given the earlier abolition of the ‘no surcharge rule’ and has resulted in reduced consumer choice and reduced incentive for card issuers to offer new products.

Increasing the power of entrenched powerful interests to block payment products is no way to promote innovation.

Security & consumer confidence

One of the most important factors in promoting innovation in payments is reassuring users about security and reliability.

Many Abacus member ADIs are extremely concerned about a recent widespread fraud episode due to a credit card data compromise at a series of independent merchants. In this case the fraud is due to the failure of the merchants and their banks to upgrade terminal security to the required level.

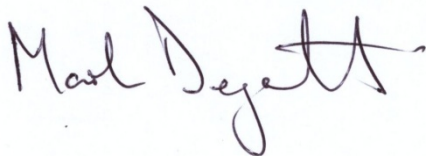
The scale and the velocity of this fraud incident are significant, imposing considerable costs on affected card issuers. Cardholders are protected from loss from fraud but their confidence is shaken by the experience and they suffer the inconvenience of having their card cancelled and re-issued.

Card payments networks involve five parties: the scheme, card issuers, card acquirers, merchants and cardholders. The allocation of responsibilities, incentives and liabilities in relation to security is critical to promoting confidence in the system. This fraud case exemplifies a breakdown in the system, with consequences for trust and confidence in the system by key stakeholders.

Incidents that erode trust and confidence in existing payments products are damaging for payments innovation.

Thank you for the opportunity to contribute to this review. Please don't hesitate to contact me on 02 8299 9053 or Luke Lawler on 02 6232 6666 to discuss any aspect of this submission.

Yours sincerely,

A handwritten signature in black ink that reads "Mark Degotardi". The signature is written in a cursive style with a prominent loop at the end of the last name.

MARK DEGOTARDI
Head of Public Affairs



Abacus
Australian Mutuals

Association of Building Societies and Credit Unions

29 July 2011

Mr Arun Kendall
Industry Policy
Australian Payments Clearing Association
Level 6, 14 Martin Place
Sydney NSW 2000

Sent via: consultation@apca.com.au

Dear Mr Kendall

Public Consultation of the Role of Cheque Use in Australia

Thank you for the opportunity to comment on the Australian Payments Clearing Association's review of cheque use in Australia.

Abacus – Australian Mutuals is the industry association for Australia's mutual banking institutions: credit unions and mutual building societies. Abacus represents 101 credit unions and 8 mutual building societies. Some 4.5 million Australians are members of a mutual banking institution

Credit unions and mutual building societies provide a full range of retail banking services, including cheque books. All credit unions and mutual building societies are Authorised Deposit-taking Institutions regulated by the Australian Prudential Regulation Authority and are licensed and subject to the requirements of the National Consumer Credit Protection Act, including the responsible lending requirements.

Abacus recommendation

Abacus supports the retention and use of cheques as a payment option until such time as cheaper alternatives with the same utility and functionality are as widely available.

Current cheque users

Data cited in APCA's consultation paper indicates a decline of nearly 37 per cent in the use of cheques in Australia between 2006 and 2010.

This trend is also reflected in a recent sample of a cross-section of Abacus member ADIs. Three quarters of those surveyed said only a third or fewer of their customers were regular cheque users. Two-thirds of our member sample indicated that cheque volumes were decreasing over time.

Older customers and people living and doing business in rural and remote Australia represent the most active cheque users in the mutual banking sector. Generally, these people are aware of other payment methods, however they are less likely to adopt other payment options.

In general terms, these customers are less likely to adopt new electronic payment methods because of limited internet access and a lack of computer skills. Feedback from Abacus members suggests these customers consider internet or phone banking payment methods to be less 'safe' than cheques.

People living in rural and remote areas have access to less reliable telephone and internet services. This restricts the use of electronic banking in many instances. In this context, cheques are seen as a reliable payment option for personal and business banking in the bush.

Many mutuals have indicated they intend to engage with these customers in an effort to raise better awareness of electronic payment options.

Benefits of cheques

The mutual sector has a proud record of implementing innovative banking services and products in Australia. For example, credit union 'firsts' include the introduction of the twenty four hour ATM (1977), the first international VISA ATM withdrawal in the world (1984) and telephone-activated home banking services.¹

Notwithstanding the advances in electronic banking in recent years, cheques have unique features that cannot be easily replicated by other payment methods.

As noted in the RBA's strategic review of innovation in the payments system (June 2011), these features include:

- physical, face to face, instant exchange of payments;
- unlimited additional data that can be attached to a cheque;
- payments can be made when only limited information is known about the payee; and
- signatory oversight of all outward payments provides additional security.

Abacus believes these features will need to be available in other payment methods, before cheque use is phased out in Australia.

Cost of cheques

We note APCA's data indicates the average cost of cheques for consumers, merchants and financial institutions was \$7.69 compared to \$1.21 for credit cards, \$0.67 for EFTPOS and \$0.55 for cash in 2007.

In the aforementioned survey, cheque use was generally considered a high cost payment method by many in the mutual banking sector. In response, some mutuals have established fee structures to help cover some costs related to providing a cheque service for their customers. Fees and charges may be applicable to the provision of cheque books, cheque deposits and withdrawals, and other cheque related services.

Whilst cheque use continues in Australia, cheque providers reserve the right to price this service according to their own commercial and other considerations. In this context, some mutuals may continue to subsidise the cost of cheques, while other mutuals may seek to recover more of the costs of providing this service to customers.

Abacus acknowledges that the decline in cheque use is adding to unit costs but the trend of rising unit costs could be slowed by initiatives such as the use and exchange of electronic images of cheques. The cost of investing in such initiatives to prolong the use of cheques

¹ Gary Lewis: 'People Before Profit', 1996

would have to be considered against the prospect of universal availability of cheaper alternatives.

Conclusion

Mutuals will continue to provide cheques to ensure their customers have access to, and choice of all payment options. Abacus does not support at this time any proposal to phase out the use and acceptance of cheques.

Abacus supports further work on:

- educating the community about alternatives to cheques;
- enhancing alternatives; and
- removing barriers to using alternatives.

Please contact Jim Aliferis on 02 8299 9033 or jaliferis@abacus.org.au to discuss any aspect of this submission.

Yours sincerely

A handwritten signature in black ink that reads "Mark Degotardi". The signature is written in a cursive, slightly slanted style.

MARK DEGOTARDI
Head of Public Affairs