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**REVIEW OF RETAIL PAYMENTS REGULATION: ISSUES PAPER**

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We would like to thank the Reserve Bank of Australia (the Bank) for its continued oversight and involvement in the regulation of payment systems in Australia. Since 2003, with the first regulation around developing access regimes and setting interchange caps, through to the most recent amendments in 2016 where companion cards were designated, we believe that the Bank has managed to set regulation that balances merchant benefit and card network benefit. As a reflection of this we now have a market where card usage is at some of the highest levels globally and merchant acceptance of cards is strong across all levels from micro merchants to very large organisations.

We applaud the constant drive to improve on the regulations and feel that this is one of the reasons that Australia is seen as a global leader in payments regulation.

About this response;

The Grant Thornton Payments Advisory practice is led by Dhun Karai and Stuart Haughey who both have many years of experience working in the Australian payments industry. We work predominantly with merchants helping them to negotiate banking and merchant acquiring arrangements as and when their existing contracts expire. To best serve our clients we maintain a strong knowledge about all aspects of the payments market in Australia and internationally including pricing and fee structures, technology capabilities, new entrants, industry participants and global payment trends.

Whilst this submission has been drafted by Grant Thornton it is a reflection of the needs of all of the merchants both ASX listed, large, mid-tier and small businesses that we have dealt with in recent years. In addition, we have worked with a number of our retail clients across groceries, QSR's, general merchandise, department stores, shopping centres, retail outlets, telecommunications, roadways,

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entertainment, hospitality, sporting organisations, education/universities etc that have all reviewed the document and support the positions expressed within.

Submission summary;

As you will read through our submission we touch on a number of topics that can be summarised as follows:

- We support amending the regulations in line with the Banks recent regulatory trends including; further reductions on interchange, a continued focus on the importance of system availability, resilience and continued transparency around costs for merchants.
- On a number of topics we are suggesting patience to allow the market to better understand and adjust to the most recent changes. These topics include surcharging and least cost routing.
- We believe that the payments market is at a turning point where regulation of card based systems alone will not be sufficient. With the rise of mobile devices and new business models emerging we propose clearer definitions around payments to allow for more relevant, adaptable and appropriate regulation into the future.

Strategic Issues for Review;

- **The future role of cash in the economy** - Mid-tier and large merchants are well aware of the declining usage of cash in the Australian economy. Merchants have seen and been tracking the trends in recent years as electronic card transactions increase. Merchants do not believe that this trend is likely to change but will move in the next decade to a long tail of reducing cash usage. For most merchants there is still enough cash in the economy to continuing to accept cash as a form of payment and this is unlikely to change in the short to medium term. Merchants would request a reasonable level of engagement and education for both businesses and consumers regarding any significant changes to cash in the Australian market.

A side effect of the impact of reducing cash transactions is that many merchants feel the impact of increased overall cost of accepting electronic payments and hence continued regulatory support, especially around interchange fees, would be welcomed. The other issue is the increasing reliance on the electronic systems places even greater focus on the need for these systems to be resilient. scalable and available 24x7.

- **The future of cheques in the economy** - Merchants see cheques as being on a similar trajectory as cash though much further advanced in terms of their decline. We are certainly in the long tail of the reduction of cheque usage and acceptance. For many merchants, especially those with lower transaction values, cheques have largely been removed from their receivables business process though this has largely been a reflection of declining requirement from customers to want to pay with cheques, as opposed to businesses actively seeking to reduce them.

Merchants generally believe that cheques will eventually be formally removed from the payments landscape. Merchants would request a reasonable level of engagement and education for both businesses and consumers regarding any significant changes to cheques in the Australian market.

- **The future of the direct entry system in the economy** - Similarly to the Bank's comments on the direct entry system, merchants see the current system as low cost, efficient and robust. Whilst there have been questions about competing systems like NPP, there are as yet limited compelling use cases for these systems in the day to day running of many of our merchants. We would suggest that rather than any mandated migration, the products are left to compete on their own merits and the competitive market will determine which system is used for which payments based on the needs of the payer and the payee and the various costs of processing transactions.
- **Capabilities around and management of automated and recurring payments** - Recurring payments play an important part in the payments landscape, especially for service providers such as utilities and insurance companies. Whilst the underlying transaction processing and settlement capabilities are mature and work effectively, the more customer facing aspects of engaging with the recurring payments system can be inefficient and cause friction for customers. These points of interaction seem to have worsened in recent years with an increasing focus on the security of payment card details through PCI compliance. Many of these processes, to both on-board a new recurring payment and to amend or terminate an existing recurring payment, are very manual and can involve multiple hand offs of data between merchants, banks and transaction processors. The processes are also time-consuming and attract the majority of consumer complaints.

Merchants would welcome further industry discussion on possible solutions for improving the recurring payments process.

- **The impact of new technologies and new entrants** - It is our view that much of the new technology deployed in recent years has been customer facing, largely made possible by improvements in mobile devices and "apps". We have provided an extensive response in question 9 below to how we see mobile phones impacting the payments market and refer to that as part of our response to this discussion topic.

Beyond mobile driven changes we see certain challenges in the acquiring market for back office and transaction processing services. The current acquiring systems for many of the larger acquirers are legacy technology, inflexible, often hard coded with minimal work arounds. This means that new products and services are hard to develop and slow to come to market.

The more agile, cloud-based, customer experience and innovation driven global platforms have started to make inroads into the market though usually at much higher costs to merchants. We do not believe that there is a suitable regulatory model to compel innovation, but rather that over time the market will determine which features are important and at what price points, and that providers will need to deploy the relevant tools to meet those needs.

- **Closed loop and stored value payments systems and their role in the payments system** - In recent years we have seen a rapid rise in the use of closed loop and stored value payment systems. The products meet a number of specific market needs such as gifting of funds or separating funds for self-use or budgeting purposes. In terms of a payment mechanism, from a customer perspective, these products operate largely like any other card based payment. The card is taken to a participating merchant and is read by the PINpad at the point of sale. From a merchant perspective these cards also operate much like any other payment type.

The difference between these products and more traditional card products is in the issuing of the product and the level of cardholder protection available should there be issues with the card issuer.

Given the structure of these products the historical regulation has been focussed on the cardholder protection aspects of the product and has been delivered by consumer focussed regulators. Many of these regulators do not have a national remit and as such we have ended up with state based standards.

The challenge in this is that many of the larger card programs in this category are issued by national retailers meaning that complying with state based regulations is complex and time consuming. These regulations can also change from time to time meaning that entire programs need to be amended constantly to remain compliant. Whilst the consumer protections have increased with past interventions, the implementation complexity has also increased.

We believe that there is a strong case for a consolidated, national focus, rather than the current varied state based regulations, to the benefit of many stakeholders including merchants and consumers.

- **The resilience of the payments system** – Resilience and availability of the payments systems is in some ways their most critical feature. Regardless of how much a transaction costs, or how long the settlement might take, if the system is unavailable it adds no value to the merchant. In fact despite having the best retailing systems in the world to manage stock selection and levels, pricing and store experience etc. if at the end of all of those chains the customer is unable to pay for their goods then their value is lost. The merchant community firmly believes that payment systems availability and resilience, should be the continued primary focus of the firms and people that operate these systems.

Merchants support the Bank's suggestion for a standard set of metrics that can be tracked and reported on by the banks and the merchant acquiring institutions. As with other elements of the Bank's regulatory approach we believe that transparency alone bring benefits to the network.

In addition to questions of resilience, merchants have questions about the current performance of fall back limits or store and forward (SAF) transactions. In traditional mag stripe or chip based transactions the cards were encoded with an agreed dollar value (floor limit) under which the transaction would be processed in an outage situation to improve the customer experience during such outages. It is the experience of merchants that with the rollout of contactless cards, issuers have set the fall back limit on contactless transactions to zero, effectively removing their ability to function during an outage. The impact of this change is that where there used to be a balanced, customer focussed tool for reducing the impact of system outages this has been effectively removed by the card issuers, with little consultation with other system stakeholders. The severity of systems outages is now greater and more widely felt by merchants and consumers. Merchants would request the Bank to consider this issue as part of its overall thinking on system resiliency issues and consider appropriate steps.

- **The increasing importance of cross-border payments** - Whilst we agree with the Bank's comments about the increasing importance of cross border payments for retail businesses we do not believe that there is any regulatory need in this space at the moment.

One major issue for Australian merchants with overseas presence is the lack of any Australian headquartered acquirer offering cross border acquiring platforms or facilities. It is a key reason we see global acquirers like Fiserv/First Data, Adyen and WorldPay etc. gaining market share despite often having higher costs.

- **The roles played by the domestic focussed schemes and frameworks in Australia** - It is our view that the various frameworks and domestic schemes operate reasonably well in the market. Except for AusPayNet, each scheme focusses on a single payment technology or product. We understand how each of these schemes evolved as the technology was initially developed and deployed with the scheme then moving to a more business as usual focus on running each of the technologies or products.

There could be an argument to rationalise all of the payment schemes into one body, probably AusPayNet however this would present some challenges that need to be overcome. AusPayNet

maintains oversight of a number of clearing systems and whilst it has a mature structure that could likely be expanded to include other products as new streams, there are gaps in its traditional scope that would need to be addressed. The product specific schemes take care of their own rule setting, membership approval, dispute resolution, some operations etc. as well as their own commercial needs including price setting and product development. AusPayNet have not traditionally been price setters nor product developers and as such these capabilities would need to be added to their existing scope to allow them to completely run the domestic schemes.

Whilst the required changes and consolidation could happen it is also worth questioning the benefit of consolidating the schemes into a single body. We believe that there would only be limited benefit given that for most schemes the overhead cost of running the scheme makes up a small percentage of the total transaction cost for each scheme and as such the benefits would be limited. Merchants currently have limited visibility of the structure of the various schemes and networks, depending upon their acquirer to provide the various schemes or network acceptance capabilities.

- **Opportunities for the use of RegTech in the Bank’s regulatory regime** – Most of the Bank’s regulations apply directly to financial institutions and card networks rather than directly to merchants. As a result merchants have a limited need to engage directly with the Bank either using RegTech or any other system. We assume that well selected and implemented technology systems will benefit all stakeholders of those systems and will leave it with those stakeholders to comment on the potential use of RegTech by the Bank.
- **The possible issuance of an electronic form of banknotes** – We note the Bank’s interest in this capability. Merchants today are far more focussed on the current and emerging payment systems available to them rather than trying to understand longer term technologies and as such we have no well-defined views to communicate on this topic at this time.
- **Regulatory impacts from the prospective issuance of ‘global stablecoins’** - We note the Banks interest in this capability. Merchants today are far more focussed on the current and emerging payment systems available to them rather than trying to understand longer term technologies and as such we have no well-defined views to communicate on this topic at this time.

Questions;

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| <p><b>1. What major or prospective developments in the broader payments industry are relevant to this review? Specifically, are there any gaps in functionality available to end users or any shortcomings in industry governance or operating agreements that require regulation of</b></p> | <p>Merchants believe that the regulating of card payments is now mature. Previous regulatory interventions have delivered a world leading payments ecosystem where new products are delivered to market by reputable providers at reasonable prices for the benefit of both consumers and merchants. Card transactions have grown as functionality has increased and the consumer experience has improved.</p> <p>There are however some points that prove frustrating for merchants to have to deal with in the current payments ecosystem;</p> |
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**coordinated industry  
action?**

- The least cost routing implementation has been inconsistent across different acquirers making like for like comparison difficult to complete. Especially when considering a different acquirer it is difficult to accurately estimate the benefits of least cost routing across providers.
  - The New Payments Platform (NPP) has been successfully delivered in its most basic form and has a limited number of services now available as overlays on it. Merchants are keen to see if there are any opportunities for any B2C services to be built that may add value in some markets yet this seems to be very difficult to achieve so we would like to see this analysis fast tracked if possible.
  - The ability for acquirers to offer new payment types can be slow and frustrating at times. When a new payment provider enters the market, such as AliPay, some acquirers seem to offer this to their merchants fairly quickly whilst other can take 12 months or more to bring a product to market. These delays can prove frustrating for merchants and customers alike who are looking to access market leading technologies. Alternatively, some merchants decide to integrate the new payment types through separate aggregators or providers which then increases their operational complexity, cost of implementation and cost of doing business.
  - The non-transaction processing services offered by acquirers which are starting to become more and more valuable to merchants also seem to have lagged in their development. As merchants do more and more with data throughout their business there is a growing need to add payment data into their overall understanding of the customer. The ability to access this data can often be difficult or costly or not even possible. Rather than offering web based, real time portals, many acquirers are still offering batch file exchanges. Settlement still does not happen on weekends or public holidays and even on week days it can be a day or two behind when the transaction has occurred.
  - The tokenisation solutions, developed largely to resolve PCI compliance issues, are now starting to be handcuffs for merchants if they choose to change acquirers. Tokens are calculated by an acquirers systems and are specific only to that acquirer. When a merchant considers switching acquirers they have to deal with having all of their online customers re-entering their card data into the new acquirers system. This process can be concerning for customers who may believe that a breach has occurred and adds another point of friction into a checkout experience that is trying to minimise lost shopping carts. For in-store transactions the change of acquirer means a new set of tokens which will not align to the merchants existing customer profiles therefore breaking their ability to know the customer and tailor merchant experiences to their needs. In both cases the operational impact of having to migrate tokens between acquirers is significant, not only for merchants, but also for customers as well. Merchants would like to see a system for token transportability established before tokens become the next method of impacting competition in the payments market.
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Beyond the current issues listed above, we are also conscious of the changing nature of the retail payments landscape. In recent years we have seen the introduction of new payment networks, new payments products and new payment providers. We are conscious of the need for the regulations to be flexible as the industry changes and to ensure that all types of retail payments are treated equally. We suggest that the Bank should consider broadening and redefining its scope of oversight to better include all retail payments. Some payments tools will be card based others will be mobile based, some will be 4 party scheme supported, others will be 3 party scheme supported, some payments will be card present, others will be card not present.

A clearly defined, flexible regulatory framework allows existing players to maintain compliance, provides consumers (end users) with comfort about their protection and allows new entrants to understand the rules before they enter the market with products. In further sections we have proposed a regulatory framework that we believe would be beneficial for the industry for the Bank's consideration.

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| <p><b>2. Are there aspects of retail payments regulation that lead to market distortions or that create opportunities for regulatory arbitrage? What options should be considered to prevent this? Are there any gaps in the regulatory regime that need to be addressed or any elements where regulation is no longer required?</b></p> | <p>We do not believe that there are gaps in the current regulatory framework that lead to market distortions or that allow for regulatory arbitrage. In our opinion the current regulatory framework is mature and well considered for the environment which it serves. The challenge as we have mentioned is in adapting the current regulatory framework to suit the changing retail payment landscape and its future needs.</p>   |
| <p><b>3. Are there barriers to innovation and/or competition that may affect the costs of or provision of electronic payments and should be addressed in this review?</b></p>  | <p>Overall we do not believe that there are structural barriers to innovation or competition that could be resolved via regulation. In terms of innovation the legacy platforms and technology of the domestic acquirers are increasingly becoming pain points for merchants. Globally, we see merchant self-service for on boarding, account servicing, data reporting and MIS yet these capabilities seem a long way from being available in the market here. We do see global acquirers bring this type of technology to market so believe that competitive forces will over time force the larger acquirers to update their systems to meet the developing merchant needs.</p> |
| <p><b>4. How do stakeholders assess the functioning to date of least cost routing of contactless debit card</b></p>  | <p>In our view having worked across a large number of merchants and their acquiring partners the implementation of least cost routing has highlighted a number of areas that may be worth the Bank considering;</p>  |
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**payments? Do additional steps need to be taken regarding LCR to enhance competition and efficiency in the debit card market?**

- Implementation approaches are inconsistent across acquirers and whilst this could create competitive differences between providers in our experience it has largely just caused confusion amongst merchants about how the system works and the outcome that it delivers.
- Financial benefits of least cost routing to merchants can be difficult to calculate with an incumbent acquirer, let alone with a potential new acquirer, hence the decision to move acquirers for reduced pricing is clouded by least cost routing ambiguity.
- Activation of least cost routing is largely driven by merchant requests only and not by proactive selling from the acquirers.
- Account structures at some smaller institutions that cap the number of free eftpos transactions continue to drive poor customer experiences when least cost routing is deployed by merchants. Whilst this may be resolved over time by competitive pressure either through consumers changing issuing banks or issuing banks removing the thresholds in the meantime it is merchants that feel the pain at the checkout.

One suggestion that we do think would be beneficial is regulating that merchants must “opt out” of least cost routing when they sign their merchant acquiring agreement. This would mean that least cost routing is the default at all acquirers and a merchant must make an informed decision about electing to have it disabled at the time of signing their agreement. We believe that this change would have the dual benefit of increasing the knowledge of least cost routing in the market as well as forcing acquirers to discuss least cost routing with merchants and therefore raising awareness of the technology and the benefits that it provides. We have seen this regulatory approach successfully applied in other markets such as in the USA and believe that it would work in Australia as well.

**5. Have recent prospective developments in technology changed the case for promoting the continued issuance of dual-network debit cards? What policy actions might need to be needed to promote competition and efficiency in an environment where single-network cards were more prominent? Alternatively, would it be desirable to mandate that all debit cards issued enable at least two competing networks?**

We have observed in recent times the closing of the pricing gap between eftpos and the international schemes. For merchants the cost of payments is a key decider in relation to eftpos versus international scheme acceptance. Dual debit network issuance in our market allows merchants to make informed decisions in relation to payment hierarchies. Thus at a minimum, merchants must have the ability to select their preferred network with minimal customer confusion and issuer backlash.

Globally, we are seeing a growing momentum towards understanding the importance of domestic debit networks. In the EU (PEPSI), Canada, India, China and the Middle East, these recent developments are in light of domestic payments being considered through a national interest lens.

We believe that the Australian market could soon mirror the growth of QR codes and other digital payment form factors, in which case the issuance of



physical cards will be replaced thus reducing the focus on single and dual network cards.

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**6. Is there a case for further policy action to enhance competition in the provision of acquiring services to merchants? If so, what form could this action take?**

Current acquiring services are closely bundled with transactional banking and debt services, especially for SME's. The competitive landscape amongst the major acquirers has limited technology or functionality differentiation which negates the high cost of migration.

One area we do see differentiation between larger and smaller acquirers is the time it takes to settle funds to merchants. Large acquirers who are direct network participants and have large issuing books have the ability to provide next day settlement of funds, and same-day settlement from their own cards. Small acquirers often have to wait for multiple settlement steps to happen resulting in merchants not being able to receive their funds for two or more days after the transaction is completed. Where speed of settlement is important to merchants, this structural advantage encourages merchants to prefer the larger acquirers.

We believe that the deployment of new cloud-based, agile technology and services into the market by technology driven organisations and global platforms will provide stronger competition to current incumbents.

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**7. Is there a case for greater transparency in scheme fee arrangements, including their effect on payments costs? If so, what form should this take?**

With interchange fees regulated making them transparent and well understood, the next area that causes confusion for merchants is the calculation and setting of scheme fees. As many acquirers move to "direct" or "interchange plus plus" pricing merchants are seeing charges on their invoices for "scheme fees". The issue for the merchant remains with the underlying calculation of these fees and how they can budget for and or manage these fees.

We understand that scheme fees are complex with different fees applying to different types of transactions depending on the type of card used. We hear of hundreds of different fee types existing in the market. This feels like the approach that we previously had to interchange fees prior to regulatory intervention.

We understand that different banks are able to negotiate different scheme fee rates depending on the size of their issuing or acquiring businesses. The effect of this is that smaller acquirers that already have less transactions over which to spread their fixed costs are further penalised by having higher scheme fees making them less competitive in the market.

We propose that the Bank implements a transparency regime that we believe would assist merchants to understand scheme fees with the potential for direct fee intervention also an opportunity in future. Accordingly, acquirers should be required to disclose their average scheme fee charged for a period, we suggest

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quarterly. This could work in a similar fashion to how schemes publish their interchange rates.

Future regulation could include setting standards for calculation and setting caps for maximum scheme fees as per current interchange regulations.

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**8. Are the existing access regimes working effectively?**

It is our belief that the existing access regimes are working effectively for those that wish to access them. Direct system access is not regularly required by merchants and as such there is limited need by our clients for these types of regimes.

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**9. What are the implications of the growing importance of mobile devices and digital platforms for the retail payments system in Australia? Are there issues that arise for the Bank's regulatory regime for card payments or that are relevant to competition, efficiency and risk?**

The implications of mobile devices on the payments market are starting to take shape and they are presenting an interesting challenge to the current industry and regulatory structure. Traditionally retail payments were completed using either cash or a payment card (the payment card could be associated to either a three party scheme or a four party scheme). All of the industry and regulatory focus was on these models and products.

The first stage of mobile disruption in payments largely just emulated the card details into a mobile device but still looked and felt to the industry and regulators just like any traditional card payment. Providers of these types of services include ApplePay, Google Pay and Samsung Pay etc. There was the ability to introduce some enhanced fraud detection, card detail security and convenience for the customer but all of the transaction processing and funds settlement operated in largely the same way as they always had. The Bank's regulatory framework handled these developments fairly well and kept the balance between the various needs to all of the systems stakeholders.

The next phase of mobile devices and digital platforms looks like it is going to be facilitating the development and deployment of services that operate largely as three party schemes to facilitate payments between merchants and consumers. Whilst these services are already attracting strong customer usage, because they are not card based they fall outside of the current regulatory framework despite the fact that they have nearly all of the same characteristics of card based schemes that are currently regulated.

We believe that there is an opportunity for the Bank to change its regulatory framework from being more rule based where specific participants or products are "designated" and then regulated to a more principle based one where a set of characteristics are grouped to define a product or service and then the relevant regulation applied to all products in that family.

By definition when moving to a principles based system there is likely to be an increase in the scope of activities and payment types that the Bank will now be regulating. The same principles can however still be applied whereby costs are reasonably controlled, transparency is maintained, competition is enhanced and

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efficiency is promoted. This would benefit all stakeholders in the payments ecosystem.

The risk of not amending the current rules based approach is that regulation gets harder and harder to manage over time and it is easier for specific products or services to fall between the rules, therefore giving them a competitive advantage over those that are regulated.

We encourage the Bank to consider its regulatory framework and ensure that it continues to deliver world leading regulation of retail payments.

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**10. Is there a case for further lowering of the credit or debit interchange benchmarks or any change in the way they are applied?**

We believe that the structure that is in place for the regulation of interchange is practical and seems to be working and therefore we do not propose any change to that model.

We do believe that further reductions in interchange for both credit and debit products are possible without structurally changing the market. Taking a lead from recent EU interchange fee regulation we believe that the Bank could lower the weighted average for credit cards to 0.30% and the cap on credit card interchange to 0.50%. For debit and prepaid cards we believe that the Bank should lower the weighted average to \$0.06 per transaction and the interchange cap to \$0.12 per transaction.

In terms of how these standards are applied, we would suggest, that they be in line with our broader suggestion about clarifying industry definitions, that these rates be applied to fees that operate like interchange despite what it may be named in any four party payment model.

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**11. Should regulation of interchange be extended to inter-regional interchange fees? What is the typical cost of transactions on foreign-issued cards, and how much of this is attributable to interchange fees?**

We believe that it is appropriate for foreign cards to have the interchange regulated however understand that the cost of processing these cards is different to the processing of domestic issued cards and as such suggest that perhaps a slightly different regulatory approach is needed.

Whilst the charging of an international assessment fee seems reasonable to cover the costs associated with maintaining the global networks required to support international transaction processing perhaps capping the combined cost of the international assessment fee and interchange would provide merchants with a known upper cost for these transactions. This could then be used by merchants to budget for the cost of international card acceptance each month.

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**12. Is there a case for applying regulation to three party cards systems? What form could this take?**

Merchants fundamentally believe that despite the structural differences in some of the products customers see them as largely interchangeable due to the fact that they perform the same function of permitting a purchase at a merchant. As a result we believe that regulation should largely treat these products in the same manner.

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The current regulation of three party card schemes requires them to report their average merchant service fee quarterly in line with the obligation on the four party schemes. Three party card schemes are also prevented from prohibiting surcharging in their merchant contracts.

We propose amending the regulation of three party scheme as follows:

- Extending the scope of the regulation of three party card schemes to include all three party payment tools.
- Defining three party payment tools as all payment tools that facilitate a payment between a merchant and a customer through a third party provider. The definition could also include some characteristics of three party tools such as they have a direct relationship with the merchant including setting rates and pricing, they settle funds directly with the merchant, they sign up customers directly onto their platforms. This definition would effectively capture all current three party card schemes such as American Express and Diners Club as well as the international, non-card based payment schemes such as WeChat or AliPay as well as emerging payment facilities such as Buy-now-pay-later tools. Our aim is that by regulating the characteristics of a payment system rather than the consumer tool used by the payment system, it will allow for an equitable set of rules that does not advantage new entrants at significantly higher cost to merchants over legacy providers due to the use of new technology.
- Including the newly regulated entities into the existing average fee reporting regime.
- Consider the possibility of introducing caps on merchant fees. One model we would suggest is to have a structure where the cap for any individual provider would be a fixed multiple of their reported average fee. So for example if a provider had a reported average fee of 2.4% and the regulated cap was 200% of the average then their maximum fee would be 4.8%. The appeal of this structure is that as larger, more powerful merchants negotiate improved rates over time, as they no doubt will, then smaller, less powerful merchants will not be competitively any worse off.

The aim of this approach is to better define three party merchant payment providers, equally regulate them starting with increasing transparency around pricing and caps on fees, effectively for smaller merchants.

Over time the Bank may elect to regulate some or all of the three party tools merchant services fee but having this transparency should allow for better decisions to be made on behalf of all stakeholders.

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**13. Is the revised net compensation provision in the interchange standards working effectively?**

Merchants have very little visibility of the application of this standard. We do not have any data or evidence to suggest that the current net compensation provision is not working as intended.

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- 14. What enforcement mechanisms would strengthen observance of the net compensation provision?**
- As per the question above with very little visibility of the current provision and its effectiveness we also have no position on the best way to strengthen this provision or its enforcement.
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- 15. Is the surcharging framework working well? Are there any changes that should be considered?**
- Overall we believe that the surcharging framework seems to be working well. The regulations and obligations are clear and the increased data provided by acquirers to merchants makes it reasonably simple to calculate the appropriate surcharge amount to be applied. In cases where surcharges have been applied incorrectly enforcement action has been undertaken and we believe that framework is also working to protect consumers and the integrity of merchants that apply surcharges correctly.
- At this stage we would suggest not making any further changes to the surcharging framework. We believe that a longer period of stability under the current arrangement will allow for increased compliance, and continued developing of merchant knowledge and confidence from consumers regarding the changes.
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- 16. Is there a case for policymakers to require that BNPL providers remove any no-surcharge rules, consistent with earlier actions in regard to card systems that applied such rules?**
- We believe that BNPL providers do need to permit surcharging as part of their contracts. These permissions have been in place now for a number of years in Australia for other payment systems and we believe it only reasonable that merchants should be able to use surcharging as a price signal to customers who elect to use these types of services.
- Whilst we have outlined in response to other questions how we believe that a change in the regulatory framework could better encapsulate three party payment providers and how they might then be regulated, we are aware that BNPL providers may remain outside of a revised scope.
- Specifically, in terms of BNPL firms and surcharging we would suggest that the following alternate model could be workable;
- BNPL programs would be mandated to separate out their payment costs from their network services costs in their contracts and when invoicing merchants.
  - Merchants should not be prevented from surcharging the payment costs component of their BNPL provider fees.
  - Payment costs would include the costs of processing the payment to the underlying funding vehicle as well as the BNPL providers cost of credit.
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- Network Services costs would include all other costs incurred by the BNPL provider in offering the service excluding the payment costs.

The reason we have suggested this approach is that the BNPL providers currently provide marketing and sales promotions services in terms of opening up their customer base to the merchant to access in an attempt to drive additional sales. By separating out the payment costs from the network services costs the merchant can then effectively make two decisions when signing a contract with a BNPL provider. We see the scenarios as follows;

- If the BNPL providers payment costs are in line with the merchants other payment costs and network services costs are reasonable for the marketing services compared to the merchants existing promotional costs then they would elect to proceed without needing to surcharge.
- If the BNPL providers payment costs were higher than the merchants existing payment costs but the network services costs were in line with the merchants existing promotional costs then they may choose to offer the BNPL service and to surcharge the payment costs.
- If the BNPL providers payment costs were higher than the merchants existing payments costs and the network services costs are higher than the merchants existing promotional costs then they may elect not to offer the BNPL service.

We believe that this approach would clarify what fees are being paid for what service and allow easier decision making for the merchant when considering the BNPL services. The price transparency of the payment costs will pressure BNPL provider to manage these costs to remain competitive with other forms of payment. Overall BNPL costs may actually be able to be increased by the BNPL providers when their network costs are compared to other promotional costs experience by merchants.

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

As we have discussed in response to a number of previous questions we believe that the Bank could make two key changes to its scope and regulatory framework. We believe that the change to a broader focus on all retail payments as opposed to simply card payments and creating updated product definitions would allow for a more flexible and suitable framework in the long term.

We also strongly recommend that the Bank extends its scope of oversight to also include the operations of gift cards and gift vouchers. Again these products act as payment tools to facilitate purchases for consumers at merchants. Whilst gift cards and vouchers have some different characteristics to traditional payment products they operate in largely the same manner. At present their regulation is managed by a variety of state and national bodies, most of whom have no other visibility of payments products, and as such compliance for merchants with a national footprint of stores is difficult to maintain. The Bank bringing gift cards into their remit would allow for a

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singular view of all payment types to be maintained as well as national standards to be implemented to benefit both merchants and consumers.

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We would again like to thank the Bank for its continued interest and oversight into retail payments in Australia. We hope that the positions we have stated in this document are clear and assist your consideration of any further regulations in this space. Should you wish to discuss our comments with us or with any of the merchants named below please let us know.

We look forward to working with the Bank through this process of reviewing retail payments in Australia.

Kind Regards,



Dhun Karai

Partner



Stuart Haughey

Principal