Australian Retailers
ASSOCIATION

Financial System Inquiry

THE AUSTRALIAN RETAILERS ASSOCIATION

SUBMISSION

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Australian Retailers Association

- Voice of the Retail Industry

For over 110 years, the Australian Retailers Association (ARA) has been the peak industry body in Australia's $265 billion retail sector which employs over 1.2 million people. As an incorporated employer body under the Fair Work (Registered Organisations) Act 2009 and with a range of member services including employment relations, policy development, advocacy and education, the ARA promotes and protects over 5500 independent and national retailers throughout Australia.

The ARA provides leadership and solutions to improve the long-term viability, productivity and visibility of the retail industry by proactively dealing with government, media and other regulatory bodies on behalf of our members. ARA members comprise a diversity of sizes and types of retailers reflecting the profile of the retail industry, ranging from large national chain retailers to one-person operators throughout the nation.

OVERVIEW

Retailers in Australia are facing a difficult operating environment. In the last ten years, the structure of the retail sector has shifted and evolved as a result of globalisation, advances in the digital economy and changes to business practice policies (such as employment, changes to card payments). In addition, the retail sector has experienced various economic environments with the Global Financial Crisis and fluctuating Australian dollar having a significant effect on the performance of the industry. The ARA offers support, information, and representation to around 5500 retailers across the nation, and works closely with Governments, The Reserve Bank of Australia (RBA) and other industry participants to ensure the long-term viability and position of the retail sector as a leading contributor to Australia's economy.

The ARA and its members have a strong vision for the retail industry – based on well regulated markets and growth, productive and innovative businesses, responsible collective initiative supported by Government where appropriate but removing regulatory burden where possible and appropriate.

We are committed to promoting retail as a viable and exciting career choice for people of all ages with particular emphasis on young people, and to retaining and developing the highest standards of practice within individuals and groups at all levels of our industry while advocating and assisting members to deal with new technologies and a changing trading environment.

We are focused on providing members with the information, knowledge and skills necessary to operate more effectively in all areas of card payments as well as assisting our members as and when new payment methods roll out into the issuing and acquiring market, in what is an increasingly competitive retail environment exposed to international competition.

Our members range from small sole operator enterprises to medium, large, independent, chain and franchise stores of all types and sizes. Over 80 percent of our membership consists of businesses ranging from one to five stores with most of that number employing less than 200 staff.

ARA membership and retailers in general have experienced significant cost pressures through international competition, reduced margins, falling growth and wages costs well above our international competitors. The ARA along with the Australian Merchant Payments Forum represents the interests of merchants within the important payments sector of the economy. It is critical that the perspective of merchants is considered in addition to those of schemes, issuers, acquirers and cardholders. Merchants make significant investments in payments infrastructure and are essential components of the payments system. The Reserve Bank of Australia (RBA) has been a global leader in reform of payments systems, particularly card payments systems, but Australia is now beginning to fall behind other jurisdictions and around the world, both in scope of reforms and in the quantum of some reforms.

The RBA has traditionally been a reluctant regulator, and this has seen some areas of payments now causing merchants costs that have been thrust on them due to an unforseen shift of costs that, in the merchant's opinion, they should not have had to bear. It is therefore the view of the ARA, and the merchants that it represents, that although the current government is removing unwanted red tape, there are areas within payments and card processing that will require the existing regulation to be broadened and enhanced to ensure that future processing costs will not have unintended consequences of putting higher and more processing costs onto the merchant. Merchants however believe that innovation in cards and payments is essential and should be properly supported by appropriate governance and regulatory structure. Innovation should not be mandated on to merchants without prior consultation. Mandated innovations are of particular concern to merchants as these are generally compulsory, and frequently have been forced on merchants either without merchant involvement in the process at all or without sufficient consultation.

EXECUTIVE SUMMARY

ARA POSITION

- Retail changes are required in relation to co-branded or companion cards issued by financial institutions.
- All schemes need to be brought under regulation, not just the four party schemes that are currently regulated.
- Merchants should have the choice of routing for all payment transactions including, but not limited to, AMEX, Scheme Debit and contactless transactions.
- As internet transactions increase (currently at 6% of total retail – expected to grow to 12% of retail sales by 2020) and technology changes rapidly from cards to mobile devices to new POS equipment, merchants will need to invest heavily in new technology (both hardware and software). Therefore, any costs to merchants need to be controlled; otherwise the merchant will continue to pay for the technology as well as face increased costs from both new payment schemes and new innovations by existing schemes.
- As bricks and mortar retailers move to PIN on credit (August 2014 onward) there will be necessity for increased security in the online area as fraud will shift from bricks and mortar retailing to the online retail space.
- Retail trading conditions are currently improving but unfortunately these increases are not being seen across all sectors of the retail industry. Retailers are still struggling from the post GFC and are unable to accept costs of innovation and increases in Merchant Service Fees (MSF) that they have been experiencing from new entrants into the payment space.

THE SUBMISSION
REGULATION OF ALL SCHEMES

The Reserve Bank Act (1959) and the RBA's Payment System Board (PSB) must ensure that within its limitation of power, it must exercise its powers to ensure that in the opinion of the board it will contribute to control risk within the financial system, promote competition in the market for payment systems and ensure consistency within the overall stability of the financial payment system.

In 2004 the RBA decided to regulate both Visa and MasterCard (regulation of four party schemes), however, as American Express and Diners Club were three party schemes, they did not fall under the same regulation. The regulation was in relation to interchange and pricing, and as such has caused a change in the payments landscape, bringing unintended consequences to the payments system in Australia with major changes to the card payment landscape.

As both Visa and MasterCard were regulated under the four party schemes, merchants were able to process transactions via their acquirer with a fair and reasonable Merchant Service Fee (MSF) and merchants essentially decided if they would/would not accept payments via American Express (AMEX) and Diners. Many merchants declined to accept AMEX and Diners as the MSF was often four to five times the rate of Visa and MasterCard. With increased issuing of co-branded or companion cards it is difficult for retailers not to accept these cards as consumers expect retailers to accept most card payment types.

The ARA does not believe that at present, under the current regulation of the Australian Payment System, there is a level playing field, and we strongly believe that not all payment providers are treated equally by the Australian regulatory system, which should encourage and promote an efficient competitive market for payment transactions.

Under the Payment System Regulation (Act) 1998 the RBA has power to designate payment systems and has the ability to set and enforce standards and access for designated payment systems. As noted above, in 2001 the RBA designated/regulated the four party schemes, being both MasterCard and Visa, however they chose not to regulate the three party schemes of both AMEX and diners Club which were left out of the regulatory environment.

The ARA has completed anecdotal research with its members, and the results have shown that depending upon the type of retailer involved, they will change the type of payment method used - from cash to tap and go to charge cards, however, the one consistent result was that there has been a far increased usage of three party scheme cards in all retailers where these cards are accepted.

In 2003 following on from the regulation of the four party schemes, AMEX entered into arrangements with the major commercial banks to issue co-branded or companion cards. These co-branded or companion cards are issued alongside existing Visa or MasterCard credit cards products. As these cards have a much higher MSF than both Visa and MasterCard, which AMEX charges and the retailer pays for, it provides the issuing bank an incentive to issues these cards alongside the co-branded or companion cards, therefore allowing these cards to provide greater reward points for spending particularly when compared to the Visa or MasterCard product.

In the view of the ARA, these co-branded or companion cards are now being issued as a four party scheme card and must be regulated and designated under the <50 basis cap as a four party scheme card - the same way as Visa and MasterCard are regulated and designated under a four party payment scheme.

When researching for this submission – the ARA has spoken anecdotally with retailers and we have been advised that use of American Express cards has increased from approximately 13% to 18% over the last four years. The ARA is prepared to conduct a full survey of members to provide a more comprehensive view on card use, please advise us if you would like the ARA to look into developing a thorough member survey.

Via AMEX global network services (GNS) the issuing banks in Australia are highly incentivised to issue these co-branded or companion cards and now act as an acquirer for these cards. The ARA understands that currently these companion or co-branded cards represent more than 35% of the AMEX market globally (refer to American Express Company 2011 Annual report). The companion or co-branded cards are extremely strong in Australia and may well represent more than the 35% of the Australian AMEX market. The ARA believes that as new payments systems are developed, particularly as new entrants develop new technology in the digital technology and internet payment space these cards will give undue pressure to merchants, unless they are regulated by the RBA. The regulation should encompass interchange fees/MSF that can be charged to merchants, and these new schemes must be regulated to ensure that there is a competitive market place consistent with the overall stability of the financial system, as well as ensure merchants do not suffer from unintended consequences in the payment transaction space. Many of the new entrants in the payments area are neither price regulated nor are there regulations restricting it from having a “no surcharge” rule.

Due to the competitive nature of retail and due to the increased volume of co-branded or companion bank issued cards, merchants are unable to refuse acceptance of these cards, as the major merchants accept these cards. For the independent SME retailer as well as the major chains, any impediment or barrier to the consumer by trying to steer the consumer away from using these co-branded or companion cards will result in the consumer remembering the experience, and when next purchasing, they will look to a merchant that doesn’t steer by surcharging and accepts their preferred method of payment.

The ARA believes that there is currently an unequal playing field. The new entrants into the payment system are able to decide their own pricing model and they are able to choose if they wish to allow surcharging by the merchant, however, both of the schemes Visa and MasterCard are regulated to ensure that merchants rightfully are not charged more than a reasonable MSF. It is therefore only right that all participants in the payments system must be treated fairly and equally. Regulations need to be broadened to include both three party schemes (AMEX and Diners) and the existing regulated four party schemes (Visa and MasterCard) as well as new and developing entrants into the payment space.

Merchants should have the choice of routing co-branded or companion cards directly to the issuing bank instead of AMEX. For all practicable purposes, these companion cards are the same as the original Visa or MasterCard, and are linked to the same account and issued by the issuers on their own card platforms - they do not require any processing or routing via AMEX. Routing via AMAEX only adds costs and generates an additional revenue stream for card issuers and AMEX and additional points to the cardholder, without any value add to the payment functionally or process. If AMEX wants to have information on the purchasing of the co-branded or companion cards, then the issuers should send a file with the detail to AMEX at AMEX's own cost.

FUNDING OF INNOVATION IN PAYMENTS

Merchants are concerned about the costs associated with innovation. An example of innovation costs being when eftpos introduced the new interchange fees - retailers understand in the case of eftpos that the changes were necessary to ensure that eftpos remained as a true low cost scheme to compete with the existing card schemes. According to eftpos, the increased scheme fees were introduced to allow issuers to invest in new innovations, such as contactless cards, and although this change is laudable it should also be noted that moves to contactless cards requires investment by merchants in both new equipment at POS and that new interchange fees mean that merchants, unlike the issuing bank, have less money to invest in a process which will now cost them more. As technology changes rapidly from cards to mobile devices to new POS equipment, merchants will need to invest heavily in new technology, both hardware and software. Therefore, any costs to merchants need to be controlled. The ARA believes this is why structural changes need to be made to prevent the mandating of higher costs on merchants without reasonable consultation with the wider merchant community.

TRANSACTION ROUTING

Merchants have for many years accepted many types of cards that are introduced into the payments market place, invariably the cost of acceptance is one that is "thrust upon" them rather than consultation with the merchant to establish if they are prepared or willing to accept these costs. An example where costs to merchants have been "forced" upon them include merchant service fees on scheme debit cards which could be routed either via the eftpos network (pressing savings) or via the Visa and MasterCard scheme network by pressing the credit button. Some merchants, particularly in the high discretionary spend, would prefer that the consumer pressed the saving button where the transaction MSF would be in the area of 7c to 14c per transaction. Equally for a merchant with low value and a high number of large volume transactions, the merchant may prefer to have the credit button pressed, as the MSF may well be at a more acceptable level.

Following on from the lead of Woolworths, who via owning their own switch simply turned off the ability for a customer to use the credit button when a scheme debit card was presented, a number of merchants have informed the ARA that they had been advised by their merchant acquirer that the acquirer is unable or unwilling to program the terminal to turn off the credit button so that the transaction is routed via the eftpos network.

As an example: A merchant sells goods on an average ticket price of $85:00 who has an eftpos fee of 14c per transaction including GST using the savings button. If the same merchant processes a sale via the Visa or MasterCard scheme, and the MSF for the scheme fee is 0.79 inc GST, the MSF for the transaction is

.67C (this is the rate that the ARA has negotiated for its members). Obviously this merchant would prefer to have all Visa and MasterCard transactions routed via the eftpos network.

Consider as another example a merchant who has low value average transactions of $10.25 per transaction - if the same MSF applied as above then this merchant would pay .14c per transaction using the eftpos network, however if that transaction was routed via the Visa or MasterCard scheme (pressing the credit button) that transaction would cost the merchant 0.08c per transaction.

The ARA believes that all acquiring banks should allow all merchants to decide if they wish to route transactions via a particular scheme route. In fact, the ARA via the Australian Merchant Payments Forum in a submission to the RBA in May 2011 (5.1) made reference to unbundling of card schemes and branding from the network, process, clearing and settlement activities would increase competition and innovation by encouraging new entrants into the Australian payments market.

Merchants should have a choice of routing for all payment transactions, including but not limited to the option of routing American Express (AMEX) companion cards issued by banks directly to the issuing bank instead of AMEX. For all practical purposes, these companion cards are the same as the original Visa or MasterCard and linked to the same account and are issued by the issuers on their own card platforms and do not require any processing or routing via AMEX. Routing via AMEX only adds costs and generates an additional revenue stream for card issuers and additional points to the cardholder without any value added to the payment functionally or process.

Overseas examples of merchant routing options occur in Europe (via SEPA for Cards and Payments Services Directive – PSD). Transaction routing choices guaranteed to the merchant under the Durbin amendment which prevents a scheme from mandating that a network is used for authorising, clearing or settling a debit card transaction.

Ownership of BINs is also an issue affecting routing. For contactless cards with multiple applications (e.g. eftpos and scheme debit applications on a single piece of plastic) the routing choice is determined by the BIN, which is typically "owned" by the international card schemes (Visa and MasterCard). This potentially prevents merchants from choosing to route these transactions over the lowest cost network. It also prevents consumers from choosing whether they wish to process the transaction as an eftpos transaction or as a scheme debit transaction.

Internet Payments Security

Over the past three to five years it has been well documented by the ARA that there has been and will continue to be a large growth in "online or internet transactions." The volume and the value of transactions on the internet have been growing rapidly and although transactions currently sit at 6% of total retail, it is expected that by 2020 (in six years) this figure will sit at approximately 12% of all retail transactions. As we move from August 2014 onwards to the removal of signatures at card present transactions, and as fraudulent transactions become more difficult in a card present transaction, the level of fraud in the online environment is a concern to the merchant community. This will drive up continuing innovation as the industry seeks cost effective solutions. These solutions could take many possible forms including biometrics, low cost PIN pads with wireless or USB connections to personal computers and other forms of Two Factor Authentication.

Evolving personal authentication methods should ideally be portable from one form of payment application to another, as the wide variety of different technologies and the increasing number of passwords and codes that need to be remembered by individuals actually represent a threat to security as they are invariably written down somewhere and can therefore be intercepted. Merchants expect this area to evolve rapidly over the next few years.

Internet Card Not Present (CNP) transactions are levied at a higher fee by card schemes and this is justified by higher CNP fraud levels. In many cases, no payment guarantee is given in exchange for the higher interchange fee and all fraud is charged straight back to the merchant. Where this is the case, the issuer fraud risk is very low as the merchant is accepting most (if not all) of the risk and therefore these merchants should in fact receive a lower interchange or MSF.

The EMV chip card has the potential to allow internet payments to be classified as Card Present Transactions, where the card holder's computer is equipped with a chip card reader. In this situation, the card and the card reader can exchange secure messages to establish that they are both legitimate devices and that the card is in fact present during the transaction. The ARA believes these transactions should attract the lowest Card Present interchange rate, and believes that this would encourage more investment in low cost chip card readers for personal computers and mobile devices.

RETAIL TRADING CONDITIONS

Retail trading conditions are currently within a context of historically difficult trading conditions with flat or low retail trading growth. Although in the last five months retail seems to be showing signs of improvement, unfortunately the positive signs are not across all sectors and industries within retail. The SME sector of the retail industry continues to struggle, along with sectors such as department stores and in particular discretionary spend in retail.

Consumer confidence remains in the doldrums by any measure, personal savings in these conditions are still at record levels as consumers brace for the perceived worse. Sales growth, where it has happened, has been minimal. We have seen recent significant deflation in consumer prices such as electronics being driven by deflationary pressure and overseas competition.

Retail trade viability in 2014 is directly related to many factors in the current economy. Increased costs to retailers impacts on the capacity for the retail industry to remain competitive and the industry is seeing more closures and greater unemployment within the sector.

CONCLUSION

The retail industry's submission has outlined the difficult trading environment existing for the retail sector. Most small to medium retailers are those that suffer and in most cases, they are charged the highest MSF to compete in the card payments space.

The retail industry:

- Makes a significant contribution to the overall state of the national economy;
- Employs more people in Australia than any other private sector industry;
- Employs more juniors than any other private sector industry;
- There are 141,000 retail merchants in Australia with the majority of those retailers (85% or more) are SME retailers with fewer than ten retail outlets;
- Retailers suffer a higher disproportionate effect in relation to MSF than other industries due to the high volume of use of cards used for payment in the retail industry;
- Retail is on a low to negative growth period during this time of low consumer confidence and low business confidence in the services sector

The ARA urges the Financial Systems Inquiry to review the cost structure of the payments industry. We believe that the effect of co-branded cards, the routing of scheme debit cards and the current and future fraud cost on the retail sector has and is continuing to have a large impact on costs that retailers are forced to accept. We also believe that the financial institutions are gaining from these costs charged to the retail industry.

Kind regards,

Russell Zimmerman
Executive Director
Australian Retailers Association

Please note: In 2004 Russell Zimmerman was appointed as Chair of the Australian Merchant Payments System (AMPF). The AMPF works with the major retailers including Coles, Woolworths, Australia Post, BP and Caltex, Reject Shop and the 5,500 members of ARA.