Cuscal's Submission to the Financial Systems Inquiry

31 March 2014

Cuscal
Partners for Success

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Introduction and recommendations

Cuscal is a world-class end-to-end payments leader, which provides more than 100 established and challenger brand clients with access to Australia's financial system and payments landscape.

Our unique combination of ADI-licensing, deep regulatory and scheme relationships, as well as payments knowledge and technology, is unmatched in the Australian marketplace. Australian-owned, we employ more than 300 people located at our Sydney headquarters.

We welcome the opportunity to submit our analysis of some of the issues the Financial System Inquiry is focusing on in its endeavour to lay out a 'blue print' for the financial system over the next decade.

As a unique end-to-end payments leader that facilitates transactional banking and payments to a variety of different clients including banks, mutual sector organisations, airlines and government bodies, Cuscal is in a unique position to contribute analysis of how trends and innovation is impacting developments in payments – one of the key issues stated in the Financial Systems Inquiry's Terms of Reference.

In this submission, we will articulate the following interdependent points, which we believe are not only in the best interests of Australia's financial system, but also Australia's consumers:

1. **Why Australia's financial services regulatory framework must be applied to new 'technology focused' players entering the payments space.**
2. **For Australia, through its current regulatory framework, to lead an international conversation about a global approach to payments, including an international acceptance of standards and recourse.**
3. **Why the industry must resolve itself to uphold and ensure transparency of the costs associated with payments (from both a consumer and institutional perspective) to safeguard and promote better consumer awareness.**
4. **That participants and regulators within the current regulatory framework consider new 'payment types' now being used to facilitate the exchange of goods and services.**
5. **That the current regulatory framework is enhanced to include real consequences to ensure dominant players cannot unfairly influence or stem the flow of payments innovation and availability in Australia.**

The payments landscape

Cuscal empowers its clients to compete in the Australian financial services industry by providing end-to-end access to: EFT switching services; payments schemes; card schemes; inter-institutional settlement arrangements; and Australia's second largest ATM network, rediATM.

A systematically important element of the daily flow of payments transactions, Cuscal's impact on the Australian financial services landscape includes:

- Processing more than 1.4 million transactions per day for 2.6 million holders of eftpos, scheme debit, credit and prepaid cards via our in-house switching and payments platform.
- 122 million direct entry transactions, 115,000 RTGS transactions and 21.8 million BPay transactions in FY12/13.
- Providing more than 100 financial institutions and their eight million cardholders with access to cash via 3,000 rediATMs nationwide.
- Monitoring more than 1.7 million cards through our Vigil fraud bureau service, which has saved more than $38 million of potential fraud losses since it was launched in December 2010. Vigil's clients consistently experience around two gross basis points of loss compared to turnover, one of the lowest fraud rates in the industry.
- Bringing Virgin Australia's Velocity Global Wallet Travel Card to market, Australia's first multi-currency paid program marketed by an airline.
- Being Australia's largest Visa Debit Issuer by sales volume, processing $8.5bn in Visa transactions in FY12/13 across our issuance base of two million cards. We were the first to issue Visa Debit PayWave in Australia, and one of the first to rollout the new NFC pay tag.
- Recently, Cuscal announced the pilot of Australia's first trial incorporating NFC functionality on Visa cards into compatible mobile phones using Host Card Emulation technology, which is one of the first such trials in the world.

On top of our robust product infrastructure, which spans the entirety of the existing Australian financial market, Cuscal is supporting the future of Australian banking and payments through continual innovation and industry leadership. Our financial credentials are evidenced by our A+ financial rating. We are also playing a leading role alongside Australia's regulators and largest banks to roll out faster payments in Australia by 2016 as a founding member of the Real Time Payments Committee (now the New Payments Platform).

It goes without saying Cuscal would not be achieving such success without the backing and the protection offered by Australia's sound domestic financial services regulatory framework that has enabled consumers to place their trust in payments in Australia.

The Australian public today simply expects payments mechanisms in this country to be secure, reliable, efficient and fast, as well as innovative and leading edge. This is thanks to the sound regulatory framework based on a co-regulatory approach between regulators and participators, guided by the principles of balancing competition against effective coordination.

In fact, Cuscal supports the Australian Payments Clearing Association's belief (as outlined in its Financial Systems Inquiry Submission) that the current regulatory structure for payments has worked well and that radical surgery of payments regulation is unnecessary[1].

However, the payments landscape is evolving fast, driven by significant developments in advances in technology both in terms of consumer devices and back-end banking technology. The payment mechanisms available today differ significantly to those offered in 1997, the time of the Wallis Inquiry.

Table 1.

Evolution of payments in Australia

Payment types available in 1997	Payment types available in 2014
Cash	Cash
Cheque	Cheque (phasing out)
Credit card	Credit card
Debit card	Debit card
Direct Entry	Prepaid Card (reloadable)
	Gift cards
	Direct Entry
	BPAY
	e-Wallets (e.g. PayPal)
	Contactless (Near Field Communications)
	Crypto-currencies (e.g. Bitcoin)
	Closed loop (e.g. Starbucks card, McDonalds app)
	Coupons
	Rewards schemes

At the same time online retailing is driving up the use of online and mobile payments, with the NAB's Online Retail Sale Index for the 12 months to June 2013 showing Australians spent $13.9 billion online, 6.2 per cent of total retail spending.

[1] APCA Submission to the Financial Systems Inquiry, March 2014, Recommendation 1, page 4

However, we believe the industry and regulators have the ability to continue to maintain and enhance the current landscape as long as it adapts to the challenges and opportunities presented by these new payment mechanisms.

Payments proliferation

The proliferation of different ways to make payments is providing consumers more choice than ever before. However, consumers' understanding or knowledge of how these new forms of payments work is low.

There is the risk than many consumers may choose a payment mechanism based on an assumption that they are still protected in the same manner of a more 'traditional payment' method.

An example of this is the increase in 'account aggregating' services that provide an online interface between a merchant and a consumer, facilitating payments from the customer's transaction accounts. However, many of these aggregators, including aggregation services provided by some of Australia's largest banks, are breaching industry guidelines by requesting customers to input their internet banking log-in details via a portal, not their financial institutions actual website, something referred to as 'screen scraping'.

It is not clear who would wear liability for fraudulent or incorrect transactions conducted because of information breaches arising from these services. It is likely, however, that consumers will lose the benefit of the protection of the ePayments Code because of their actions.

A specific example incorporating screen scraping and Australia's largest online portals goes even further, and highlights the complexity as well as regulatory arbitrage. In this example, some of Australia's largest companies attempt to comply with one regulator's guidelines while arguably encouraging conduct which undermines a Code administered by another.

Australia's largest airlines and hotel and accommodation providers encourage payment for their goods and services using a service, which facilitates a Direct Credit "push payment" service via an internet banking solution. These organisations comply with the component pricing provisions of Australia's consumer laws by advertising headline pricing (for airfares etc), on the basis that these can be avoided using this "push payment" service (as opposed to paying $8.50 - $12.50 in additional credit card surcharging per fare per passenger). However, in using the service, consumers must disclose their internet banking password to an unknown party (as regulated by ASIC's ePayments code order), which effectively causes them to be exposed to liability for fraudulent or incorrect electronic transactions.

It goes without saying that more payment services mean more competition, which is only a good thing for Australian consumers and the Australian economy. Cuscal is certainly not seeking regulation to slow down or burden new entrants to the Australian payments landscape.

We face the very real risk, however, of the erosion of consumer trust in payments, due to negative interactions with payments providers who fall outside the current regulatory framework. There is a risk that some new entrants, particularly those using new technologies, may not behave to the same standards set by long-standing industry participants or some notable new players who work within the same regulatory framework.

If this happens, we will essentially undo the excellent work of a regulatory framework that has to date supported a robust and trusted payments ecosystem across Australia and allowed Australian consumers to expect stability, security and reliability.

Recommendation one:

Australia's financial services regulatory framework must be applied to new 'technology focused' players entering the payments space

Globalisation of payments

Running parallel to the availability of different payments types in the domestic market place is the expansion of international trade, which is being accelerated by the ease of global travel and the increasing availability of online shopping.

In the year to June 2012, Australians made a record eight million overseas trips, 80 per cent of these trips as tourists. According to the Australian Bureau of Statistics the number of overseas trips made by Australians has increased by 57 per cent in the past five years. Buoyed by a record high Australian dollar, people are buying more than ever on these overseas trips.

For those opting to stay home, more people than ever before are flexing their international buying power via online mechanisms. The Australian Bureau of Statistics estimated Australians imported $6.23 billion on goods worth less $1,000 in FY11/12, most of which was considered to be purchased via online sites, versus estimates of $4.55 billion spent at domestic online retailers during the same period[2].

These statistics are being driven by the obvious benefits of online shopping such as convenience, price comparison and the infinite choice of a global market place.

The preferred method of payment for overseas and international online transaction is still credit cards (54 per cent of transactions.) However e-wallets such as PayPal are increasing in popularity.

[2] http://www.abc.net.au/news/2013-08-19/data-gap-skewing-picture-of-australian-retail-spending/4896828

At the same time, incidences of online fraud are also increasing. Data from the Australian Payments Clearing Association show card-not-present fraud (CNP) accounts for the bulk of fraud on Australian issued cards. Between 2012 and 2013, CNP fraud increase 5 per cent to $198.9 million, against a reported increase in online shopping of 14 per cent.

Other implications of the globalisation of payments include ensuring consumers are receiving fair value of the goods and services they have paid for from global merchants. In a domestic market consumers are protected by Australian Consumer Laws that set out consumer rights through a range of guarantees. These include consumers' rights to a repair, replacement or refund, as well as compensation for damages and loss, or replacement of faulty goods.

However, these domestic consumer law guarantees do not extend into an international marketplace. Currently, in the absence of domestic consumer guarantees (which would not be available ordinarily to Australians for overseas purchases), Australians are protected against insolvency of the seller or non-delivery of goods by the seller, by chargeback rights which are provided to them by the card scheme they use to purchase goods with (generally international credit card schemes such as Visa or Mastercard), or where purchases are funded directly from an account through an alternative ecommerce channel such as PayPal, by a buyer protection program.

The availability of such mechanisms to protect issuers are either: a) funded via merchant service fees which are increasingly under pressure, or b) merchants decide voluntarily to "make good" any losses because the alternative would be to lose their merchant status and ability to accept payments for goods sold.

These sorts of "discretionary" purchaser protections, which are outside domestic law are increasingly expected by consumers, particularly for international transactions. It is not clear to Cuscal, however, that they can be sustained in an environment of:

a. Increasing divergence away from established schemes (such as Visa, Mastercard, and PayPal) towards niche schemes which are cheaper, smaller, and more technologically driven as opposed to network driven, and therefore may have less leverage over merchant communities.

b. In a future real time environment, may be funded by accounts via fixed fee or "free", which are therefore unable to provide a revenue stream against which to "make good" failed transactions.

It is critical that the industry and Government continue to educate consumers regarding the risks associated with purchasing goods outside of domestic boundaries, particularly using non-traditional payment methods. While the banking and payments landscape provides reasonably large amount of consumer protections already over and above those available from domestic consumer law, the extent to which these will be available in the future via different payment arrangements, including real-time payment arrangements, is unclear.

The industry's focus to introduce faster payments will bring about the benefits and speed of real time payments. However, this also means money will have the ability to move even more quickly, including potentially out of the country, from known accounts to unknown accounts via two or three "hops" increasing the risk of undetected fraud.

Australia is a mature landscape within which the industry and Government can and does architect rules within systems to promote consumer confidence. Additionally, Australian jurisdictions also monitor payments for tax and other legislative purposes such as money laundering. In an environment of strong and increasing overseas e-commerce transactions, however, including growth in non-traditional payment mechanisms, consideration needs to be given to what protections are desirable or realistic for inter-country transactions.

Recommendation two:

For Australia to lead an international conversation about a global approach to payments regulation – an international acceptance of standards and recourse

Consumer awareness and the cost of payments

As mentioned previously, Australia's approach to regulation of the financial system has resulted in a high level of consumer trust. It may be argued that there is now such a level of trust that many Australian consumers have little awareness of what happens behind the scenes when payments are made, or how much they are paying for that service.

The Reserve Bank of Australia conducted a survey in 2007 about the costs of payments in Australia. This work, which is currently being refreshed, seeks to "provide comprehensive estimates of the underlying resource costs associated with different methods of payment. The study does not attempt to measure the benefits associated with various payment methods, nor the profitability of institutions providing payment services"[3]. However, even in this study, there is comparatively little analysis of the end cost of payments to Australian households, the levels of awareness or understanding that Australians have about their monthly or annual cost of payments. Nor is there any research about the extent to which levels of awareness of relative costs (including benefits) are driving or influencing payment choices.

[3] RBA Payments Costs in Australia, November 2007, page 3.

In other areas of the financial services industry, there are various indexes or comparison mechanisms that consumers use to track or compare the cost of financial services. To date these have mostly focused on interest rates or account fees.

There should be an understanding of how much individuals and/or households spend when making their daily payments transactions through the various different payment options such as:

- Cash
- ATMs
- In branch
- BPay
- Debit cards
- Credit cards
- EFTPOS
- Mobile banking
- PayPal
- Reward scheme transactions

As well as measuring the quantitative results of payments behaviours, any study should look at qualitative evidence such as:

- What drives consumers' preference to different payment types?
- Levels of awareness regarding the cost of payments
- How much of a factor costs plays when it comes to choosing payment methods

Cuscal believes that there is merit in further exploring the end costs paid for each of the key payments streams by consumers, thereby enabling comparison of the consumer costs of payments to the resource costs associated with providing different methods of payment.

It can be argued that tracking these two elements (cost to consumers versus cost to institutions/providers) will be an effective tool in measuring the overall efficiency of the payments system.

Recommendation three:

An industry code to uphold and ensure transparency of the costs associated with payments (from both a consumer and institutional perspective) to safeguard and promote better consumer awareness

Broadening the definition of payment types

The definition of a payment is fast evolving from obvious displays of monetary exchange to other ways of transferring 'value' between two parties. What we used to perceive as having 'monetary value' is radically evolving.

Digital currency

The 'Bitcoin' has spearheaded the introduction of digital currency. Traded from one person's digital wallet to another to buy physical products and services, Bitcoins can be bought or sold on the open market at the going average rate, plus a fee that goes to the owner of the exchange. Increasingly, Bitcoin ATMs are being set up where users can trade cash for Bitcoins for a fee.

The obvious benefits of the Bitcoin are making small online payments in a cheap and easy manner, compared to online credit card transactions that can attract fees between 2.5% - 5%.

However, the payment network and the currency are not created, controlled or regulated by a central body. While this lack of centralised control is applauded by many online purists, it's this lack of regulation and the anonymous nature of transactions that lead many observers to express concern about the success of what seems to be the first real experience in digital currency.

At the same time, Bitcoin's lack of fixed value makes it nearly impossible to measure its true value against the products and services it is being used to purchase.

Regulators in many countries are unsure how to approach the Bitcoin, with many simply issuing warnings for consumers to either stay away or wear the risk themselves. However, the speed in which Bitcoin is being taking up suggests many consumers are not heeding such warnings. At the end of August 2013, the value of all Bitcoins in circulation exceeded more than AUD $1.6b.

Cuscal believes that the current co-regulatory approach to payments system regulation works well, and that a fundamental component of this is the ability of the RBA as payments system regulator to use its designation powers under the Payments Systems Regulation Act as an ultimate lever to shape regulatory outcomes. To this end, Cuscal supports the recommendation made by APCA in its submission to the Financial Systems Inquiry that "the RBA's jurisdictional reach under the PSRA should be reviewed to ensure that it provides an effective "backstop" for co-regulation notwithstanding increasing technological diversity and increasing marketisation of payment systems and networks[4]."

Loyalty schemes

Loyalty schemes operate by rewarding customer buying behaviour with points that can be cashed in at a later date in the exchange of goods and services.

With more customers viewing loyalty schemes as 'tradeable value' the risk of collapse of schemes is a credible concern. At the same time, it is up to the company controlling the loyalty scheme to decide the value of points against the redeemable products and services.

Since the collapse of Ansett, where many frequent flyers lost many years work of points accumulated by travel or expenditure on linked credit cards, there have been some changes made to the ways in which these and similar programs are structured. In some cases, trusts have been created which hold "value" ascribed to frequent flyer points and which are expensed as flights are redeemed, however these developments have not been uniform or comprehensive.

Social media exchanges

Social media has revolutionised both personal and business interaction. While the business world still tries to harness the power of social media, many have quickly realised the power of 'likes', 'favourites' , 'retweets' or 'reviews' via social networking sites like Facebook, Twitter and TripAdvisor.

So much so, shady organisations or 'click farms' have emerged, selling 'likes' or followers, charging for each fake follower. However, the value of social media exchanges are linked directly to authenticity and trust, which is why many paid-for followers are quickly uncovered and shunned.

It is this trust and authenticity that can also quickly lead to the demise of an organisation's reputation in the face or harsh criticism. However, speed and potential anonymity of social media makes it difficult to control the power of the keyboard, especially when it comes to dishing out unfair assessments or reviews.

If these broader forms of payments are considered part of the future payments landscape, how can we as an industry help users of social media to see the true value of social media exchanges in an effort to manage potential reputations losses of unfair social media exchanges?

[4] APCA Submission to the Financial Systems Inquiry, March 2014, Recommendation 5, page 4

How does recent work by the ACCC in seeking to manage and regulate the treatment of online reviews and star ratings[5] align with the increasing likelihood that these social media "likes", or "retweets" increasingly form a kind of currency which have value as a form of economic exchange?

Given the long future time horizon anticipated to be covered by this Inquiry, and the growth that we have seen in alternative currencies recently, Cuscal believes it is worth considering the similarities, differences, and boundaries between sovereign currencies like the Australian dollar; newer boutique currencies such as Bitcoin, and well-established, commonly used and ubiquitous "currencies" such as frequent flyer points which would underpin or explain differences in approach as to how they should be regulated (or not) as a payment system?

Recommendation four:

That the current regulatory framework is evolved to consider and include new 'payment types' now being used to facilitate the exchange of goods and services

Safeguarding payments competition

Is lack of competition preventing or slowing down payments innovation in Australia?

In 2010, a major Australian supermarket blocked the 'credit' option for users of Visa Debit. This option was only reinstated after considerable negotiation creating a commercially favourable outcome for that supermarket.

Major Australian retailers have the ability to control and influence not only the adoption of new forms of payments, but also the cost of using them. In the same way, major banks as the predominant holders of capital to invest in new payments technology, and gatekeepers to large customer bases to trial these new forms of payment, also play a dominating role.

Meanwhile at the other end of the payments chain, creators of devices like Apple or Samsung have the ability to influence payment mechanism by the design and updates of their devices. An example of this influence is the resistance of Apple to include otherwise widely available NFC technology within their mobile devices, or the role of handset manufacturers and or mobile network operators in seeking to extract rent from other payment system providers in managing the use of credentials on specific handsets. This means some payment methods have restricted use across handsets.

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[5] www.accc.gov.au/business/advertising-promoting-your-business/managing-online-reviews

It can be argued that these developments should be left to the marketplace to decide; that consumers will ultimately vote with their feet and prefer devices or operators which deliver them connectivity and functionality via open approaches.

The interaction and vigorous competition between equally powerful opposing forces is not, in and of itself, good for Australian consumers.

The actions of these dominant players and participants (or participants who refuse to participate) in the payment system should not be allowed to go unremarked or unchecked. Indeed, they should also be subject to scrutiny according to existing competition law. Similarly, industry self-regulatory frameworks should be able to set standards and establish a common playing field, where it is in the public interest to do so.

In this landscape, we see the need for a regulatory framework that not only sets out codes of practices for all players to support innovation in the payments chain, but also delivers very real consequences for adverse action. Especially when blockages are against the best interest of consumers and their access to modern and affordable payments technology.

Recommendation five:

That current regulatory framework is enhanced to include real consequences to ensure dominant players cannot unfairly influence or stem the flow of payments innovation and availability in Australia

Conclusion

Cuscal is committed to playing a critical role as the payments landscape continues to evolve. Adopting a philosophy of partnering and never competing with clients, Cuscal is the 'brand behind the brand' to many organisations that require safe, innovative payment options or cost-effective transactional banking services.

By empowering challenger organisations in this way, Cuscal stimulates competition within Australia's banking sector and payments environment, and promotes new, innovative forms of payments in Australia.

It is our ambition to position ourselves as a 'launch pad' for new forms of payments, whether borne out of Australia or internationally. However, we strongly believe for this to happen the current regulatory framework must evolve to meet the new and varied realities of today's modern payments landscape.

However, this change need not be radical, reiterating our belief that the approach to regulation since 1997 has been successful as a key driver of the financial system's current good health.

Our recommendations are about supporting a parallel evolution to meet the changing payments landscape. Evolving the regulatory framework:

1. to extend its focus to new 'technology focused' players that are quickly entering the payments space;
2. to lead an international conversation with view to creating a global approach to payments, which could include an international acceptance of standards and recourse;
3. to facilitate industry agreement to an approach that ensures the transparency of the costs associated with payments (from both a consumer and institutional perspective) to safeguard and promote better consumer awareness;
4. to consider new 'payments' types now being used to facilitate the exchange of goods and services; and
5. to deliver real consequences to dominant players who attempt to unfairly influence the flow of payments innovation and availability in this country.

A competitive, innovative and robust payments landscape is in the best interests of Australian consumers, business and the economy.

We strongly support the ongoing work of the Financial System Inquiry and would welcome any further opportunities to contribute.