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Australian Competition & Consumer Commission
Level 5 / 1 William Street Perth 6000
Via Email: connie.wu@accc.gov.au

Proposed amalgamation of BPAY, eftpos and NPPA – into NewCo.

Dear Connie,

Thanks for your letter asking for further information regarding the impact of the proposed amalgamation on the fees small business people pay for digital banking services. You asked two questions, and in summary COSBOA would say;

In the implementation of LCR. The Merger will decrease LCR access.

- There is no agreement on the facts of the LCR implementation
- The profit motivation of the banks will not change, so implementing a less profitable initiative, like LCR remains highly unlikely
- The merger will further exacerbate the lack of focus on the needs of small business
- The merger will also remove the competition that has seen progress on small business needs
- Small Business is highly sceptical of reassurance that benefits will trickle down, LCR is evidence that this doesn't happen.
- The increasing complexity of navigating banking products and services, and the banking industry itself, will be exacerbated by the merger, and again not create clarity and improved services for small business.

On the merger's impact on incentives to direct business to the ICS

- Long term and high value deals done suggest this will continue
- A web of incentives exist that are difficult to untagle and lucrative
- Attempts to reduce fees, have reaulted in increased fees, including fees to ICS
- The complexity has created a whole industry of consultants, meaning any savings in fees is soked up by consulting fees to achieve the savings, with a net neutral effect
- The proposed merger is not the only pathway to removing competition to ICS, removing incentives would also help and the banks have been unwilling/unable to do that. We see the competition argument as a furphy to justify increasing market power.
- It is unlikely that vested interest will magically disappear in a merged entity under the proposed management structure.

COSBOA does not have the resources that the banks and retailers have to call upon in making these submissions. What we do represent is our member's real experinces on the ground running small businesses in Australia. We have attached details of our perspective, to this letter.

The real question is….

The question is not will banks continue to incenticse ICS, or will LCR implementation be impacted, but what will be most profitable for the shareholders of the ICA as it becomes NewCo and does their accumulated power contravene section 50 of the Competition and Consumer Act 2010?

One look at the shareholdres, is enough to realise this is a considerable concentration of already powerful and dominant companies. COSBOA contends that over time, competition in the financial services of payments would be significantly reduced by this merger, under the definition of the law.

Yours sincerely,

Peter Strong
Chief Executive Officer
Council of Small Business Organisations Australia (COSBOA)

ABOUT COSBOA The Council of Small Business Organisations Australia (COSBOA) is the national peak body representing the interests of small business. Collectively, COSBOA's members represent an estimated 1.3 million of the 2.5 million small and family businesses that operate in Australia.

Small and medium sized enterprises (SMEs) are major contributors to the Australian economy. SMEs employ 68% of Australia's workforce. In GDP terms SMEs together contribute 56% of value added. For this reason, small and medium businesses will be the key partners with Government in re-building the Australian economy.

1. Could you please clarify the extent to which the concerns you have raised about LCR might apply regardless of the proposed amalgamation, and whether – and if so how – the proposed amalgamation would increase those concerns. More specifically, how would the proposed amalgamation change the incentives of the banks (and separately, NewCo) with regards to the implementation of LCR?

More simply, will this merger impact (increase or decrease) the banks motivation to implement LCR above the current level (which has been glacial)? Without a crystal ball, COSBOA relies on past evidence. And the short answer is we believe the merger will decrease the implementation of LCR. The reasons are provided below.

No agreement on facts

We have raised this issue with the Australian Banking Association, the individual banks and the Applicant's Industry Committee Administration (ICA) with whom we consult regularly. They have assured us that the introduction of LCR would be improved. They have sent us statistics of current implementation, which we have queried as their version of LCR implementation differs with our experience. We are waiting on answers and have been informed the Australian Banking Association is gathering information. While there is no agreement on the facts of the current implementation of LCR, the debate on whether the proposed merger would benefit LCR Implementation is difficult. For more information, see attachments Contested LCR Implementation and Least Cost Routing Case Studies.

Profit motivation remains unchanged

A merged entitity will still have profit as it's main purpose. Reducing costs for small business, or passing on productivity gains from the merger, just like implementing LCR, is less profitable for the banks. Why would a merged entity sans competitive pressures between banks, products and services, be more motivated to adopt a less profitable initiative? This isn't logical or likely.

The more likely outcome is that NewCo will focus on whatever is most profitable. Small business people, busy running their businesses, don't have time to understand the complexity, their individual small voulmes reduce their bargaining power, and dispersed power across millions of business, are likely to be considered "low hanging fruit" or easy pickings for NewCo's immediate profitability.

Loss of small business focus

The NewCo merged entity, if approved, will have a large shareholders and responsibilities. Reducing costs for small business will not be a focus. Since 2015 eftpos has built market share and profitability differentiating itself in a competitive market by offering merchant's lower fees and agile new technology options. Competition existed. The present proposal will significantly soften that competition. COSBOA is concerned the small business focus will languish as larger goals are pursued.

It is clear that the bank's progress on payment systems has been slower than international comparisons, and does need to be addressed urgently. Larger entities run by the banks, like NPP have floundered in the same marketplace where eftpos has, by being competitive, grown. COSBOA submit the larger the entity, the more unlikely small business will benefit.

For example, bank influence on eftpos between 2010 and 2015 saw virtually no progress on LCR. New more risk tolerant leadership in a competitive ecosystem has seen good progress. This progress is at risk, based on past experience, if the banks interests are centralised and more influential, as proposed in this merger.

Eftpos as a NFP drives profit into development of its products and services. NewCo has no such guarantee. There is no proof that a larger merged entity will be any more successful at competing with the ICS than the individual stakeholders and a very large risk that it will remove healthy competition and innovative developments in this space.

The myth of shared benefits from productivity gains

Our experience is that the benefits to be gained by the banks will not transfer as reduced costs to small businesses despite reasurrances. This is trickle down economics 101, largely dismissed by those who have studied its impact.

Our first submission sought to gain a commitment to real benefits flowing from the merger, as per ICA's commitment.

> **What does this mean for small business?**
>
> Amalgamation will aim to deliver substantial and tangible benefits to small businesses, including:
>
> - **Applying downward pressure on payment costs:** A unified domestic payments entity will foster low-cost real-time account to account and eftpos debit card form factor payments and seek to bring average merchant fees down further. [1]

At present **the merger appears with an unacceptable level of risk and uncertainty that small business will experience a reduction of choice and increased costs in digital banking services,** an extension and exacerbation of the current situation.

COSBOA is concerned that the progress on LCR made by the Fairer Merchant's Fees Aliance and other organisations like eftpos will falter, not thrive, under the merger. As such small business people remain highly sceptical that the benefits will be shared. If such benefits do exist, COSBOA , as per our submission of 16 April, would ask for a commitment to a real reduction (rather thanthe vauge "seek to bring average costs down further") and monitoring of these efforts with remedies in place to address small business banking costs.

Lost in complexity

The banks have made getting LCR increasingly complicated to understand and navigate. Some bank's do provide information on how to "opt-in" like the CBA[2], which provides examples of fees with and without LCR. Other banks, like Westpac[3], started to reach out to some merchants from December 2020. In keeping with keeping it complicated, Westpac decided to adopt a different name to LCR, using Merchant Choice Routing (MCR). LCR is a good example of the complexity small business people face when they deal with the payment's system. See example below.

There's also an issue of the internal complexity (attachment) of the industry, which will increase with another entity. Much of this complexity is self-regulated and this self-regulation has seen numerous recent failures.

This complexity is unlikely to become simpler, at least to the small business owner who only sees the user interfacce of the banking and payments systems. COSBOA views the merger as increasing complexity and therefore decreasing the implementation of LCR.

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[1] December 2020 Robert Milliner ICA letter to COSBOA
[2] CBA Information on Least Cost routing
[3] Westpac Info on Merchant Choice Routing

2. We note that your submission indicates that the banks may currently have an incentive to favour processing of dual-network debit card payments via VISA and Mastercard instead of eftpos. If this is the case, how would the proposed amalgamation affect those incentives?

The irony of the deals done.

In 2015 NAB announced a 10-year deal with Visa to work together on technology. [4] This deal included switching all NAB cards to Visa and developing new payment products. The deal, which would have included incentives and payments to the bank (we heard in the vicinity of $10M), is like others that Australian banks have struck with the International Card Schemes (ICS's).

These deals are not transparent and evidence of conflicted interests amongst the banks. The banks complain that the ICS are impacting their business, while at the same time taking their money to promote the ICS. We understand the payment by ICS to the Australian banks is predicated upon the banks reaching certain value targets. This is a strong incentive for Australian banks to favour the ICS.

"Sources close to negotiations between banks and Apple over the introduction Apple Pay say Visa has been taking advantage of Apple's attempts to take a cut of the $2 billion in merchant fees banks in Australia get every year for issuing Visa and MasterCard." [4]

The Australian Payment's network is increasingly complex, see attachment. This complexity works against the interests of small business and regulators as numerous commissions and inquiries have found.

The web of incentives

The Merchant Service Fee (MSF) at the heart of the LCR dispute illustrates small business people's concerns about incentives. COSBOA has looked at the Merchant Service fee (MSF) charged when a customer uses a cashless tap and go transaction. These fees are not simple and COSBOA does not have the resouces to understand them fully. The MSF has three components and creates a complex and unreguated web of rebates and subsidies across and between banks and ICS.

1.Interchange fee

Flows from Acquiring Service to issuing bank and set by the Schemes (Visa/Mastercard/Eftpos) as a wholesale fee which range from $0.04c to $0.35c providing in some cases, a margin of $0.29c. This is a very lucrative margin. These fees vary depending on the volumes, values, sector and size of the merchant's transactions and are skewed against small business who pay the higher rates.

2.Scheme Fee

Set by Schemes, it is secret and variable, depending on transaction size, it is a % of transaction plus a fixed fee. Most merchants "discover" what it is after they pay it. There is no regulation and these fees can be directed by the "schemes" to the bank, to incentise the bank to promote a certain ICS. i.e. if Visa collects 2c it can choose to send it to Xbank, to incentive the bank to favor VISA. This fee defies data rights as the consumer has no way to understand, chose or know what they will pay, and this particularly applies to small businesses. It is not transparent nor fair.

3.Bank Margin

Varies from bank to bank, no regulatory formula, RBA has threatened to regulate and the banks responded (ancedotally) saying they would send three truckloads of information on how it works. NAB hired a consultant who spent three months investigating the bank margin fee structure in NAB and walked away without delivering. Embedded in legacy systems and lost understanding, therefore difficult to change and understand.

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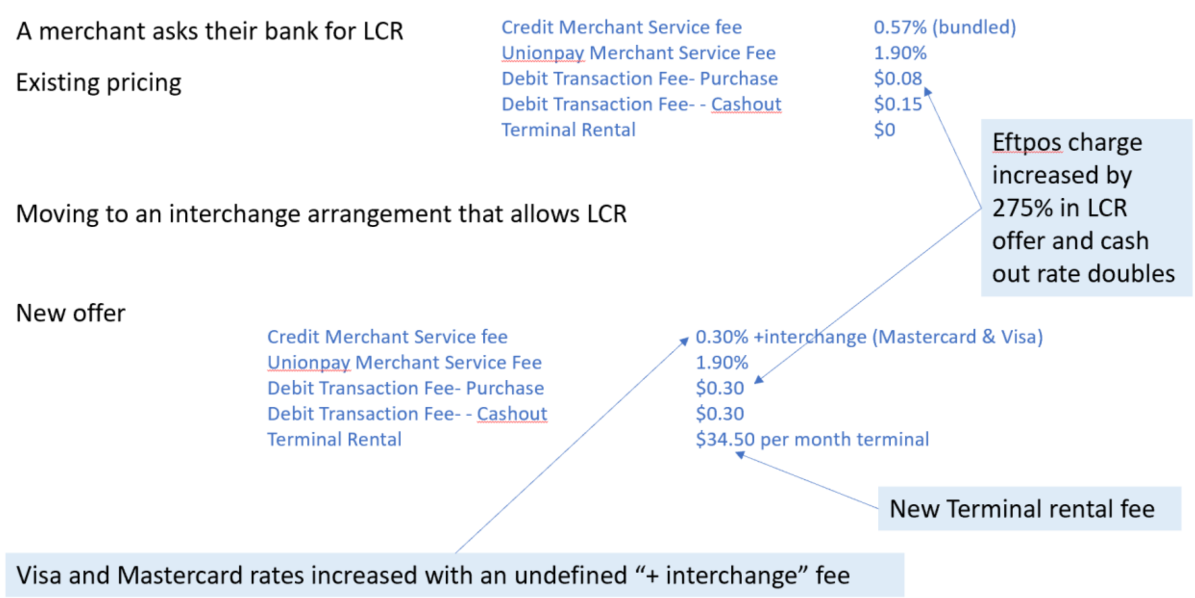
[4] https://www.afr.com/companies/financial-services/nab-does-10year-deal-with-visa-amid-banks-apple-battle-20151101-gknv91

Futher fees are often “bundled” into the merchant’s payment service, increasing the complexity and decreasing the merchants ability to understand and find competitive services. See example below.

We know big business has the power and volume to negotiate. For example, the NAB’s flat 1.15% compares poorly with big merchants processing more than $10M, paying half this fee, 0.6%. These fees work against small business. This is a an example of how the financial institutions have worked, understandably, for their own interest, to increase their profitability in league with the ICSs. COSBOA strongly argues there is a place for the regulator here to make sure competition can exists and market power does not accumulate further to those already with considerable influence.

Ask for less and get charged more…

A further example, around incentives, again from LCR, is when a merchant asks for LCR, the banks simply add fees to make the choice no longer financially attractive.



The terminal fee was for a pre-existing terminal, not a new one. Regarding terminals, there’s about 55,000 CBA Albert terminals embedded in Australia businesses, the majority of them small businesses, that do not have LCR capability. These were launched in Australia in 2015 with antipated 3 million users.

The example again shows the depth of inter-connected relationships and transactions between banks and the ICS’s. For COSBOA, unpicking this complexity is not possible within our resources.

To avoid fees, pay more fees

The complexity of navigating these fees and legacy outdated infrastructure, has now created a new consulting service[5], and small business people can hire someone to negotiate on their behalf. These services typically save merchants from 20 – 40% of their fees.

The irony being, to avoid paying hefty bank fees, small business must pay more fees, to consultants, to work through the complexity. The ICA argue that the merger will reduce complexity, and we disagree based on the evidence.

[5] Merchant Pricing Hub, Consulting services for small business to navigate bank fees

Unite to conquor is the only possibility
There's an assumption that the this merger is the only pathway for banks to compete with the ICSs.

"The lack of coordination between the domestic payment streams in the deployment of new technologies and services is slowing down the rate of innovation, primarily within the large number of financial institutions that need to change their internal systems to integrate these new developments within their own banking infrastructure."[6]

The bank's "lack of co-ordination" could possibly be solved by better co-operation. The banks regularly sign contracts with technology partners, often for large amounts and long term investments.[7] This proposal removes competition on the basis that co-operation is not possible. COSBOA does not accept this underlying tenent. It is a furphy to justify increasing market power.

Australia has a reputation of tecnology innovation. Before NPP the banks were working together on MaMBO. Disunity amongst the banks, saw the RBA intervene to create the New Payment's Platform. Such disunity, has contributed to the bank's malaise in terms of being competitive, and must still be navigated within NewCo. NewCo will not have a clearer purpose, it will most likely have the impact of internalising many competing interests and losing focus. It is unrealistic to claim vested interests will magically disapear in a merged entity under the currently proposed management structure.

The ACCC question is how would the amalgamation impact these incentives? Given these are long term deals, we expect the amalgamation will not impact these incentives or behaviour until a home-grow and more profitable alternative emerges. We expect, at the current rate of change, for that to take several years. Australian's use of credit cards is decreasing as alternatives become available and this change will happen gradually.

The real question is….
The question is not will banks continue to incenticse ICS, but what will be most profitable for the shareholders of the ICA as it becomes NewCo and does their accumulated power contravene section 50 of the Competition and Consumer Act 2010?

One look at the shareholdres, is enough to realise this is a considerable concentration of already powerful and dominant companies. COSBOA contends that over time, competition in the financial services of payments would be significantly reduced by this merger, under the definition of the law.

[6] Para14, pg. 7 Expert Industry Opinion, Lance Sinclair Blockley March 2021
[7] https://www.itnews.com.au/news/commonwealth-bank-quietly-rolls-over-telstras-1bn-10-year-deal-519967

Attachment - Contested LCR implementation

ICA Analysis and COSBOA queries

Least Cost Routing (LCR)

The rollout of LCR is unaffected by this proposal.
LCR rollout is accelerating and has been offered to nearly all merchants.
However, supporting its take-up by small business remains a work-in-progress.

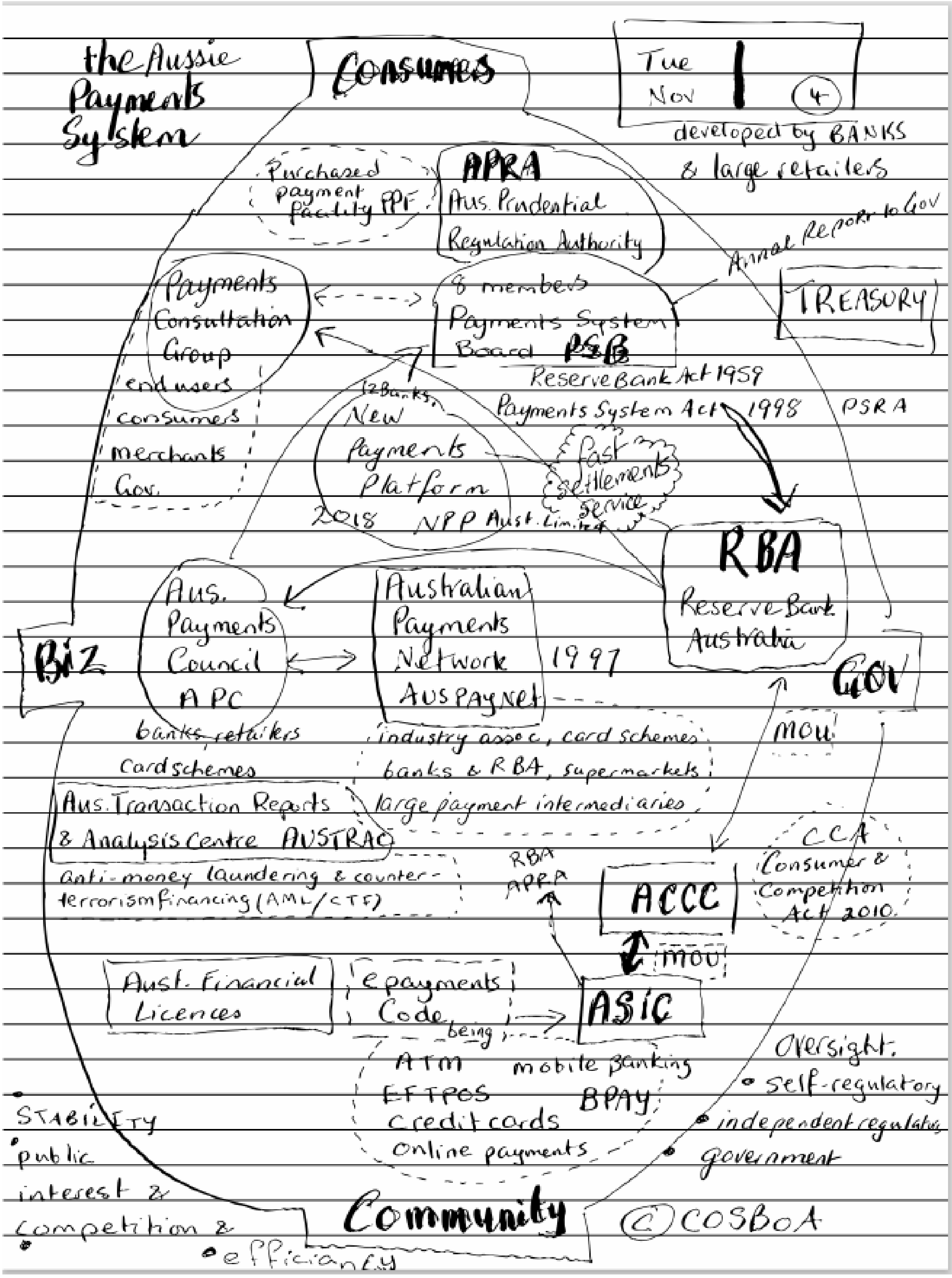
- We collected data from six of the largest organisations providing merchant services, who collectively service the majority of the market or merchant base in Australia.
- Together, these organisations have made available or offered some form of LCR to >90% of their merchants.
- The approach taken to offering LCR to merchants varies; increasingly they are auto-enrolled, or proactively contacted.
- Depending on the organisation, take-up is as high as close to 1 in 3 merchants or ~20% overall.
- In addition, up to 20% of merchants in some organisations are on some kind of bundled pricing plan, where the mix of cards used does not influence the cost of accepting cards (i.e. there is no benefit to the merchant in moving to LCR).
- Feedback suggests that work to extend LCR continues to accelerate.
- The RBA's Review of Retail Payments Regulation will continue to focus on this.

Queries in relation to LCR slide from the Industry Committee.

- You say LCR is unaffected by the amalgamation. Given the offering and take up of LCR has been so slow, what commitment can you make to accelerate LCR, set targets, and guarantee that LCR is proactively available to all merchants, in online/mobile channels as well as POS?
- You say that collectively the organisations LCR has been offered to up to 90% of merchants. What does this mean? If that is the case, why is the take up so low?
- What percentage of overall transactions are least cost routed? We are told it is less than 10% and for some of Australia's largest banks, it is significantly lower than 10%.
- You say 20% of merchants have taken up LCR and another 20% do not benefit from LCR due to bundled offerings. What about the other 60%?
- You say that organisations have 20% of their customers on LCR. What does that mean? Do 20% of small business merchants have LCR, if not what is the estimated percentage?
- Is it true that you cannot access LCR on Albert terminals? How many Albert terminals are there and when will this be addressed?

Attachment – The Australian Payment's System

A small business perspective of the system.



Attachment - Least Cost Routing (LCR) for Small Business

Since 2017 COSBOA and the Fairer Merchants Fees Alliance have been advocating for Least Cost Routing. This would allow merchants to choose the least cost route for tap and go transactions made with a customer's dual network debit card.

This choice became an issue when merchants noticed an inexplicable increase in their merchant fees charged to debit transactions. These transactions were being routed through expensive international networks. Merchants saw fees in some cases double and triple. The fees are not transparent or easy to calculate, often being bundled with other services, tied to volumes and values, with a complex fee structure, which further obscures the cost. Lower cost options are available but are not automatically enabled. The infrastructure they ran on was not readily available from the banks who provided the merchant machines to process payments. Numerous calls for action were resisted by the banks who were making money from these transactions, infrastructure, and deals.

It took Industry and Association advocacy to get attention, and even then, progress was glacial. The task of understanding fee structures was so difficult, it spawned a new service industry to help business people understand, benchmark and shortlist different service providers. In the meantime, a handful of major Government reviews, also recommended LCR, including the RBA which estimated banks were gouging $500m in tap and go fees as recently as February 2020.

In 2019 some banks began offering LCR, with conditions attached that impacted the LCR capabilities. More obstruction. The RBA noted that even with some movement, small businesses were paying significantly higher costs (>33% - 50%) in merchant fees than larger businesses.
How much could a business save by Least Cost Routing?

- An independent supermarket with an average basket size of $44 could save $26,391 per annum* on the cost of debit transactions.
- An independent petrol station with an average ticket size of $44 could save $13,196 per annum* on the cost of debit transactions.
- An independent newsagent with an average ticket size of $36 per annum could save $3,167 per annum* on the cost of debit transactions.

*Source: RBA Statistical Tables, March 2020

It took a pandemic in 2020 for the banks to move, and even now only 6% of debit transactions are LCR, so there is a long way to go.

- Westpac, CBA and NAB all rolling out variations of LCR.
- Westpac proactively switching 55,000 terminals to LCR, saying 37,000 small businesses will have lower debit transaction processing costs.
- CBA has written to 50,000 customers, plus launched advertising campaign, and is pledging to do more.
- NAB's LCR has flat rate of 1.15 per cent.

The NAB's flat 1.15% compares poorly with big merchants processing more than $10M, paying half this fee, 0.6%. Least Cost Routing has been a story of big banks collaborating and gouging fees from small businesses. Providing no transparency and obstructing change, even when alternatives existed. At the end of 2020, the worst year since the Great Depression for small business, banks have done little but lip service to address LCR.

EFTPOS has led LCR progress, providing a competitive choice for merchants. That role is now in jeopardy, with the announcement of the merger of EFTPOS, NPP and BPAY. It is inconceivable, based on experience, that a mega entity of big banks and retail giants will guarantee a competitive environment for new players, innovative less expensive products and services or pay any heed to regulators. This new mega entity, has demonstrated convincingly that it views the role of small business as a free, eat as much as you want, buffet.