

Proposed Merger Between Armaguard and Prosegur

Submission to ACCC consultation on Proposed Undertaking

April 2023

Introduction

The Reserve Bank of Australia (the Reserve Bank) has prepared this submission to the Australian Competition and Consumer Commission (ACCC) in response to the Proposed Undertaking and the Response to Statement of Preliminary Views (the Response) provided by Armaguard and Prosegur (the Applicants) to the ACCC and released publicly on 21 March 2023.¹

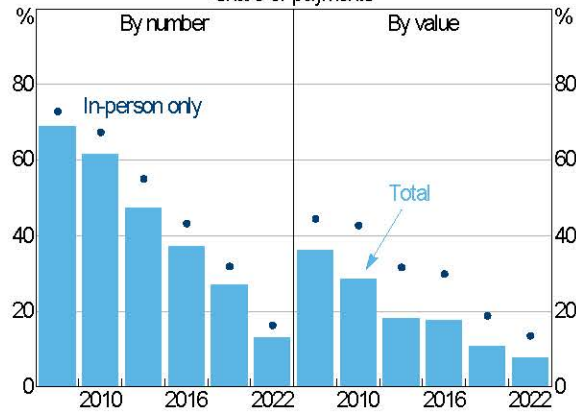
The Reserve Bank is the sole issuer of banknotes in Australia and has responsibilities under the *Payment Systems (Regulation) Act 1998* (Cth) (PSRA). This submission provides a perspective on the Proposed Undertaking, the impact of exit of one or more of the Applicants and the regulation of payment systems in Australia.

The Proposed Undertaking

In considering the merits of the Proposed Undertaking the Reserve Bank recognises that, to assist Australians to continue to have good access to cash, the banknote distribution system needs to remain effective, efficient, sustainable and resilient in the face of ongoing declines in cash usage. As outlined in the Submission by the Reserve Bank on the proposed merger (the Previous Submission), it is the Reserve Bank's assessment that some form of change is required to reduce the excess capacity that currently exists in the banknote distribution system to ensure it is both viable and able to withstand further expected structural declines in transactional cash usage.² The Reserve Bank conducted its latest Consumer Payments Survey in late 2022 (historical data from earlier surveys was included in the Previous Submission). It shows a further, significant step-down in cash usage compared to three years ago (Graph 1). These data suggest that the pressures facing the banknote distribution industry, driven by the declining use of cash as a means of payment, show no signs of easing.

1 Armaguard and Prosegur (2023), 'Submission to the ACCC - Response to the Statement of Preliminary Views: Application for Merger Authorisation by Linfox Armaguard Pty Ltd and Prosegur Australia Holdings Pty Ltd', 9 March.
2 See Reserve Bank of Australia (2022), '[Proposed Merger between Armaguard and Prosegur](#)', October.

Graph 1
Cash Payments
Share of payments



Source: RBA calculations, based on data from Colmar Brunton, Ipsos and Roy Morgan Research.

The Reserve Bank also noted in its Previous Submission that the proposed transaction is one option that may achieve a more viable industry structure and the appropriate path forward will depend on a range of factors, including how various concerns arising from increased concentration can be addressed. It is also important to avoid any significant, abrupt and/or prolonged reduction in the timely availability of good quality banknotes across the country. The Reserve Bank continues to hold the view, as stated in its Previous Submission, that it is in the national interest that the industry be put on a more sustainable footing. If this is not done, access to and availability of cash will decline, damaging the efficiency of the economy, particularly in regional Australia.

The Reserve Bank acknowledges that the intent of the Proposed Undertaking is to address competition issues that could potentially arise from the proposed transaction. At the same time, the Reserve Bank notes that there are some issues with aspects of the Proposed Undertaking, which have the potential to affect the efficiency of the banknote distribution system over time (outlined further below). However, we acknowledge that these issues need to be weighed up against the prospect of a disorderly exit of one, or both, of the Applicants. In the Reserve Bank’s view, it is likely that such an exit would affect the ability of Australians to have good access to cash, at least for a period, and this is most likely to be experienced in regional areas.

It may be possible to adapt the Proposed Undertaking in a way that reduces the potential for inefficiencies in banknote distribution system to occur over the medium term. For example, one approach could be for the undertaking to be limited in its duration, which could provide some stability to the sector while it adjusts to the lower cash volume environment and mitigates the risk of (disorderly) exit of one of the Applicants.

[REDACTED]

Aspects of the Proposed Undertaking that the Reserve Bank considers could potentially be adapted in order to help address efficiency and sustainability issues include:

- the in-perpetuity nature of the Proposed Undertaking. This approach provides no scope to review or adjust the pricing model or service levels over time. Given the pace of change in the industry, this will likely pose challenges for both the merged entity (MergeCo) and the industry more generally to adapt to the declining demand for transactional cash. For example, for MergeCo to

remain efficient and sustainable in the face of declining cash usage, it may need to adjust its service levels, particularly in terms of the capacity/number/location of depots. In addition, the fixed nature of the Proposed Undertaking could impede MergeCo's ability to respond to actions of other participants in the banknote distribution system or, conversely, the ability of other participants to adjust their own business strategies. Those participants include: the Reserve Bank, with respect to its wholesale banknote distribution arrangements; the existing customers of MergeCo; potential new customers of MergeCo; potential new banknote distribution participants; and the government, in the form of any new regulatory arrangements.

- the proposed pricing model. This model seeks to protect the revenue base of the merged entity and therefore contribute to the sustainability of the industry. However, there are risks that the cost-plus nature of the pricing model may not adequately incentivise MergeCo to find efficiency savings in its operations moving forward.
- the complexity of the pricing model. This complexity of the pricing model could impede transparency and make it challenging to measure or enforce adherence to the proposed arrangements. The model also contains subjective elements, such as revenue forecasts, but does not specify a mechanism by which these elements would be independently tested or challenged. While there are measures in place to ensure existing customers are protected from unreasonable price increases for the remaining term of their existing contracts, any consequences of a lack of transparency and too much complexity become more amplified as these contracts expire and customers transition to the new arrangement.

In relation to the compliance reporting in the Proposed Undertaking, the degree of the Reserve Bank's proposed involvement in this process requires clarification. There are references in the Applicants' Submission to the proposed reporting regime that imply MergeCo would report to the Reserve Bank (for example, Annexure A- Section 9), whereas the detail in the explanatory text and the Proposed Undertaking appears to limit this to 'the ACCC *may* disclose [the compliance report] to the RBA' (Annexure B paragraph 4.44). In any event, it is the ACCC alone that has the discretion to make an application to the courts if MergeCo breaches the terms of the Proposed Undertaking – the Reserve Bank has no ability to do so.³ Further, it is difficult to see how the mechanism 'allows for effective operation, oversight and enforcement of the Proposed Undertaking'. The Reserve Bank understands that the compliance report will only assess MergeCo's compliance with the terms of the Proposed Undertaking, as opposed to whether it facilitates the evolution that is required to make the industry sustainable.

The Reserve Bank considers that, should adjustments be made to the Proposed Undertaking to address these issues, an additional round of broad public consultation on the impact of the changes would be necessary.

Potential for exit

Regarding the impact of the exit of one or both of the major cash-in-transit (CIT) providers from the market, we reiterate the points made in the Previous Submission. That is, if either of the Applicants were to stop supplying CIT services, there would be a reduction in industry capacity and the customers of the exiting CIT company would need to transition to another provider. In this situation, access to and the availability of cash would most likely decline (at least for a period), which would damage the

³ See Section 87B *Competition and Consumer Act* 2010 (Cth).

efficiency of the economy, and this is likely to be particularly so in regional Australia. The extent and duration of a disruption to CIT services – and so the likelihood of avoiding the impact of a disorderly exit – would depend on the exact circumstances known only at the time of exit. One key factor is the length of the notice period provided by the exiting CIT company to its customers; more time would better enable, at least for certain customers, the time to transition to another supplier of CIT services (which, for wholesale banknote distribution, would likely involve transitioning to the remaining Applicant). Other factors potentially relevant to whether the exit was orderly or disorderly include:

- the nature of any relevant contractual terms between the exiting CIT company and its customers
- the wind-up process that is put in place to manage the exit by the CIT company and its outcomes
- the ability of other CIT providers to provide services to the customers of the exited CIT company, both immediately and following the wind-up of the exited CIT company
- the business continuity plans/arrangements of the CIT company's customers, how quickly they can be mobilised and how effective they are in this particular context in transitioning to a new supplier.

Payment system regulation

The Applicants submit that 'it would be open to the RBA to designate the Australian Cash Distribution and Exchange System (ACDES) as a payment system (or alternatively, as [a]n integral and inseparable part of the cash payment system)' (paragraph 152).

The Reserve Bank has the power under the PSRA to designate 'payment systems' as being subject to its regulation and then to impose standards and/or access regimes on 'participants' in those designated payment systems, if it is in the 'public interest' to do so (i.e. by promoting competition, efficiency and financial safety, as defined in the PSRA). 'Payment system' is defined in the PSRA to mean 'a funds transfer system that facilitates the circulation of money, and includes any instruments and procedures that relate to the system'. The Explanatory Memorandum for the PSRA refers to a payment system as one that 'covers the system of payment instruments (cash, cheques, smart cards among others), their delivery, the exchange or clearance of payment messages, *and* the final settlement of value *between intermediaries providing payment services*' (emphasis added) and indicates that the definition of payment system is 'not meant to refer merely to bilateral transactions, or mechanisms established for them'.⁴

ACDES provides rules for the exchange and distribution of wholesale cash between ACDES participants (ANZ, CBA, Westpac and NAB – the Applicants are not ACDES participants). The ACDES arrangements are intended to 'facilitate the distribution of cash to the general community ... to ensure there is an adequate supply of cash to meet demand'.⁵ At its core, it is a series of bilateral agreements (not

⁴ *Payment Systems (Regulation) Bill 1998*, Explanatory Memorandum, pp 3 and 17.

⁵ See 'Objects and Scope of ACDES', Regulations for Australian Cash Distribution and Exchange System Framework, p. 16. Available at <<https://www.auspaynet.com.au/sites/default/files/2023-01/ACDES%20Regulations%20-%20Version%20E015%20-%20Effective%201%20January%202023.pdf>>.

necessarily on consistent terms) between each of the ACDES participants to govern the exchange of an asset (i.e. wholesale cash). The ACDES participants are also not, in this context, providing payment services. Accordingly, the Reserve Bank does not consider the ACDES arrangements to be within the scope of its powers under the PSRA.

It is unclear whether the Applicants are continuing to suggest that the regulation of the ‘cash distribution system’ in Australia – that is, the physical transportation of banknotes on behalf of the owner of those banknotes between different locations in Australia and associated cash processing and quality sorting processes – is within the scope of the Reserve Bank’s powers under the PSRA. As noted in the Previous Submission, the Reserve Bank’s view that these activities are not within the scope of its powers under the PSRA. To the extent that the references in the Applicants’ Response to the ability of the Reserve Bank to regulate ‘CIT services’ and ‘the CIT industry’ indicate that the Applicants do not agree with this view, the Reserve Bank repeats the comments in its Previous Submission.

The Reserve Bank also notes the Applicants’ reference to a proposed ministerial designation power as outlined in the Treasury consultation on ‘A Strategic Plan for the Payments System in Australia’ (Strategic Plan Consultation).⁶ The Applicants speculate that this ministerial power could be broad enough to include ‘the critical infrastructure which supports Australia’s payment system (including CIT service providers comprising the ACDES)’ (paragraph 159). The Reserve Bank notes that, as indicated above, the ACDES does not comprise the Applicants or other providers of CIT services. The Reserve Bank understands that the proposed ministerial designation power is to be used to ‘address payment issues outside the scope of the Reserve Bank of Australia’s (RBA) public interest power’ (p. 18, Strategic Plan Consultation). The scope of any such power will ultimately be determined by the government, following public consultation, and the legislative process. In that regard, the scope and timing are uncertain. The Strategic Plan Consultation also notes the proposed Strategic Plan ‘could articulate principles that will inform the Government’s response to providing consumers with adequate access to cash’. Whether regulatory reforms or interventions are needed, or are even appropriate, to ensure the Australian public has good access to cash is ultimately a matter for the government, though it is not inconceivable that regulatory change could occur in the future.

Reserve Bank of Australia
6 April 2023

6 See Treasury (2022), ‘Developing a Strategic Plan for the Payments System’, December. Available at <<https://treasury.gov.au/sites/default/files/2022-12/c2022-343663-final.pdf>>