Australian Payments
Clearing Association

Submission to the Senate Standing Committee on Economics Inquiry into Competition within the Australian banking sector

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About this document

This is the submission of the Australian Payments Clearing Association to the Senate Economics Committee Inquiry into Competition within the Australian banking sector. If required, the Chief Executive Officer of the Association can appear before the Committee to respond to any additional questions.

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The Association has no objection to publication of its submission.

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Table of Contents

1. Executive Summary

APCA's submission concerns competition, change and innovation in Australian payments services, particularly customer mobility in transaction accounts. APCA's strategic orientation is strongly towards the promotion of competition as the best means to ensure that payment services deliver what Australian citizens and businesses need over the long term.

Australian non-cash payment services are diverse, competitive and heavily used by Australian consumers and businesses: Australians made an average of 286 non-cash payments each in the year to June 2010.[1] There have been extensive and ongoing industry efforts to enhance competition, access and innovation, together with public policy oversight by the Payments System Board. The Australian economy is relatively well-served by a competitive Australian payments system, and the necessary industry commitment and public policy oversight exists to ensure that this continues.

Based on local data on account "churn" and overseas comparisons as well as RBA analysis of deposit account competition, there is substantial and effective competition in transactional banking services. If the challenges of switching transaction accounts are a barrier to competition, they are not a strong one – millions of Australians change provider every year.

That said, reducing barriers to switching is desirable in itself, in that it enhances the utility of the payments system. APCA's members and others in the payments industry have made efforts to do so in recent years, and continue to work on relevant initiatives. In an environment where switching is active and there is clear evidence of effective, indeed increasing, competition, structural and systemic change solely to ease account switching is hard to justify, but non-systemic measures have been taken, and others could be explored. In addition, systemic changes that are aimed at long-term enhancement of the payments system are an opportunity to enhance customer mobility along the way.

APCA will continue to work with the payments industry and public policymakers to identify opportunities in this area.

2. The Inquiry, and APCA's role

The Australian Payments Clearing Association Limited (APCA) is pleased to make this submission to the Inquiry of the Senate Economics Committee into competition within the Australian banking sector.

The inquiry's terms of reference have similarities with those of previous Parliamentary inquiries, notably the 2008 House Standing Committee on Economics Inquiry into competition in the banking and non-banking sectors. APCA made submissions and appeared before that inquiry, and refers

[1] Payments System Board Annual Report 2010, Reserve Bank of Australia, p8. This figure does not include a range of payment instruments not tracked by RBA, including online payment systems and closed loop instruments.

the Committee to the submissions, proceedings and report of the earlier inquiry as a useful starting point.

The terms of reference of the present inquiry focus on competition, change and innovation in Australian banking services and banking products. As the industry association for Australian payments, APCA is concerned with a particular aspect of this: products and services that facilitate payments. This submission will present data and policy analysis exploring:

- Competition, innovation and access in Australian payment services, particularly transactional accounts and payment cards (Inquiry terms of reference (a), (d), (h) and (k));
- Customer mobility in transactional banking together with overseas comparisons (terms of reference (e) and (k)); and
- Some strategies that have been suggested to enhance competition in payment services (terms of reference (j)).

APCA's strategic orientation is strongly towards the promotion of competition as the best means to ensure that payment services deliver what Australian citizens and businesses need from their payments infrastructure over the long term. In this context, APCA provides an industry venue and framework for payment system policy, self-regulation and coordinated change management. Its core purpose is to improve the safety, reliability, equity, convenience and efficiency of the Australian payments system. Membership is open to payment service providers, regardless of institutional form.

3. Competition, innovation and access in Australian payments

Australian non-cash payment services are diverse, competitive and heavily used by Australian consumers and businesses: Australians made an average of 286 non-cash payments each in the year to June 2010.[2] The major categories are:

- Financial institution transaction accounts, which can be used in conjunction with the following payment instruments:
    - cheques;
    - direct debit payments initiated electronically by a biller and drawn from the account,
    - direct credit payments initiated by the account holder by telephone, internet or online business banking package; and
    - BPAY payments initiated by the account holder by telephone or internet;

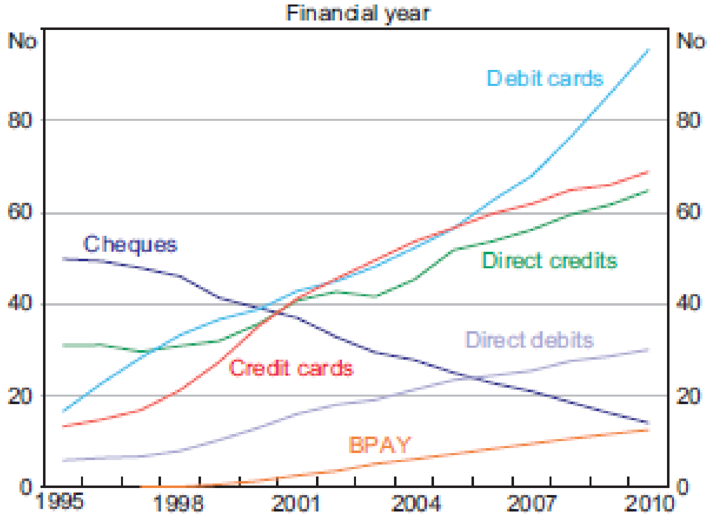
[2] Payments System Board Annual Report 2010, Reserve Bank of Australia, p8. This figure does not include a range of payment instruments not tracked by RBA, including online payment systems and closed loop instruments.

- Debit cards, that link to one or more transaction accounts;
- Credit cards that link to a financial institution credit account (Visa, MasterCard and recently American Express);
- Credit cards that link to a charge account with the card scheme or other provider, such as American Express, Diners Club and JCB;
- “Open loop” pre-paid cards (Visa and MasterCard) that link to a balance maintained with the card issuer;
- Online payment systems such as PayPal, Paymate or POLi that link to an account maintained with the provider; and
- Specialist “closed loop” payment services of many varieties, including store credit.

The following graph provides an overview of relative usage of payment instruments, as well as trend changes over time:[3]

Non-cash Payments per Capita*

Financial year



* Apart from BPAY, data from 2002 onwards are based on the RBA's Retail Payments Statistics; data for earlier years come from APCA and the RBA, and have been adjusted for differences between these sources and the Retail Payments Statistics

Sources: ABS; APCA; BPAY; RBA

The distinguishing characteristic of payment services amongst the broader category of banking services is their networked nature. That is, some coordination is required amongst payments service providers to ensure that payments move efficiently between them, even as they compete to

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[3] Id. at p9.

provide payment services to their customers. In Australia, payments infrastructure is largely owned, maintained and developed privately - by large and small financial institutions, major retailers, specialist payments service providers, and payment scheme operators such as Visa, MasterCard, BPAY and PayPal.

The need for coordination amongst competitors in the supply of critical economic infrastructure has led to extensive policy oversight of payment services, including competition, innovation and access in payments. Since 1998, the Reserve Bank of Australia's Payments System Board has carried out this function. Like APCA, the PSB has a strong focus on promotion of competition as the best means of achieving efficiency and innovation in payments over the long term. The 2010 PSB Annual Report provides a summary of industry efforts to enhance competition, innovation and access (pp21 -25). Major developments identified in that Report include:

- The formation by APCA in 2009 of EFTPOS Payments Australia Limited as the business development vehicle for the EFTPOS system as a competitor with international card payments schemes;

- The commitment of major banks to support MAMBO, a new system to be operated by BPAY. This will provide, among other things, a new option for online payments alongside cards, internet "pay anyone" services through financial institutions and direct services such as PayPal, Paymate and POLi;

- A new Common Payments Network being introduced by APCA and its members during 2011, which combined with other access improvements APCA is undertaking will enhance access arrangements for competitors in payment services.

More detail on these initiatives can be provided as required.

On the question of innovation in payment services, in 2009 the industry undertook its own substantial review of Australian and global payments innovation through the Australian Payment Forum, which consists of senior stakeholders across the payments system. The results are public – see www.australianpaymentsforum.com.au. The PSB is currently undertaking a public policy inquiry into innovation in the payments system, and to assist the PSB, the Australian Payments Forum met on 22 November 2010 to further explore opportunities for payments system innovation. The communiqué from the meeting will be published shortly.

In global comparisons, Australia's system generally scores well as relatively open, efficient and automated. For example, a 2009 study by Edgar Dunn & Co. commissioned for the Australian Payments Forum, concluded that Australian consumers were "well served in payment systems by international standards."[4] A 2009 McKinsey Global Payments Map placed Australia high by global standards in terms of use of electronic payments and card usage.[5]

[4] Card Payments Forum Communiqué, 27 March 2009.

[5] McKinsey on Payments, No.4 2009.

Based on these resources, APCA's submission to the inquiry is that in the area of APCA's expertise - payments services – there is already substantial effective competition, together with ongoing industry effort to further enhance competition, innovation and access. Moreover, through the PSB there is transparent public policy oversight of these issues. The result is that the Australian economy is relatively well-served by the Australian payments system, and that the necessary industry commitment and public policy oversight exists to ensure that this continues.

4. Customer mobility in transactional banking

The ease of moving between providers of banking services is clearly relevant in considering competition in the provision of such services. However, linkages across different kinds of services should be carefully considered before any general conclusions are drawn – the dynamics of customer mobility in lending products are likely to be different from those applying to transactional banking, to which APCA's submissions are limited.

Since early 2009, APCA has been collecting data on customer mobility in financial institution transaction accounts. There are three main sources:

- records of use of APCA's account switching package, which seeks to assist consumers to identify and transfer standing payment arrangements when they change provider;
- data from APCA members on account openings and closings, regardless of whether the switching package is used; and
- survey data on account switching reported by consumers.

Usage of the switching package has been low, as has already been publicly reported. In the year to September 2010, 2541 lists of regular payment arrangements were issued to consumers at their request. However, it would be inaccurate to conclude from this that switching activity is low, since the switching service is a minimum default service: consumers need not use it, and financial institutions may have other more extensive services for consumers seeking to switch.

To get a better idea of switching activity, data on openings and closings of personal bank accounts can be used to infer a personal account "churn" rate. In the year to September 2010 there were 4.43 million new accounts opened by personal customers, and 2.7 million accounts closed. These numbers must be adjusted downwards to exclude account activity not related to switching. For this purpose, we have used the birth rate, death rate and net migration rate as reported by the Australian Bureau of Statistics. We have also conservatively assumed an average of openings and closings as an approximation for churn from one account to another.[6] This yields an annual account churn of approximately 3.5 million accounts. This suggests a churn rate of more than 10% of total personal transaction accounts as recorded by the Reserve Bank (32.3 million as at September 2010).

[6] It is a common practice to switch providers by opening a new account, but leaving the old account dormant, rather than closing it. This, along with economic growth, may explain the consistent disparity between openings and closings.

Consumer survey results suggest roughly comparable churn rates. Retail Financial Intelligence, a market survey company, conducts regular surveys of consumer views of banking products. Their July 2010 consumer survey (N = 2,015, statistically significant for the Australian population) indicated that 24% of respondents had switched account provider at least once in the last 5 years, of which 5% had done so two or more times. The survey also found that 14% of respondents would consider switching accounts in the next 6 months. Over the last two years, RFI have tested this result in four surveys and found it to be consistent: between 24% and 29% of consumers report having switched their transaction account at least once in the preceding 5 years.

Some overseas data is available to provide context. In 2009, the European Commission published a Flash Eurobarometer No.243 on consumers' views of switching service providers across a range of consumer services in the European Union. The survey found that on average 11% of retail banking customers changed products every **two** years, suggesting a rate somewhat lower than Australia's. Rates for current accounts (9%) were lower than for mortgage loans (13%).

Further support for the proposition that there is significant and effective competition in transactional banking services can be derived from RBA analysis of deposit rate competition. The RBA has shown that, in contrast with previous eras, nearly all personal transactional banking services now pay a competitive deposit rate, and has concluded that this in itself is evidence of competition.[7] Further, the RBA finds that since deregulation in the 1980's there has been a progressive increase in the strength of deposit account competition, and that as a consequence of the global financial crisis the intensity of competition for retail deposit funds has stepped up even further. Although the most intense competition is to be found in term deposits and other specialised deposit accounts, rather than in transaction banking, the RBA observes that the same general trend is present across the board, and that deposit rates on transaction accounts have followed the trend higher as financial institutions compete for consumers' business and funds.

The conclusion appears to be that there is substantial and effective competition in transactional banking services, and that the widely held assumption that Australians find it "too hard" to change their provider is not borne out by the evidence. If the challenges of switching transaction accounts are a barrier to competition, they are not a strong one – millions of Australians change provider every year. That said, reducing barriers to switching is desirable in itself, in that it enhances the utility of the payments system. APCA's members and others in the payments industry have made efforts to do so in recent years, and continue to work on relevant initiatives. The next section explores what has been done, and what might be done in the future.

5. Possible strategies to ease account switching

Initiatives to further ease barriers to switching and thereby enhance competition in transactional banking may be desirable, but need to be approached with caution. Notwithstanding the benefits such initiatives may provide to consumers, structural or systemic changes to the payments system aimed solely at enhancing customer mobility are unlikely to deliver consumer benefit worth the systemic cost. Quite apart from the expense and risk of making changes to systems that handle

[7] The material attributed to RBA in this paragraph is drawn from "Competition in the Deposit Market", Speech by Dr Malcolm Edey, Assistant Governor (Financial System), RBA, 19 May 2010, available at www.rba.gov.au.

tens of millions of transactions per day, such proposals by definition will involve substantial change, cost and inconvenience for those intended to benefit: consumers and businesses. In an environment where switching is active and there is clear evidence of effective, indeed increasing, competition, this seems hard to justify.

However, there are non-systemic measures that have been taken, and others could be explored. In addition, systemic changes that are aimed at long-term enhancement of the payments system are also an opportunity to enhance customer mobility along the way. The rest of this section canvasses the possibilities.

5.1 Better assistance to consumers

When APCA last assessed this issue in 2007, the conclusion was reached that the best option of those examined was to increase awareness of switching options and provide facilities to assist consumers who found it difficult. Following a public consultation exercise in late 2007 and discussions involving the Treasury, the Australian Bankers' Association, Abacus and APCA, this led to the Account Switching Facilitation Package in November 2008. The Package's purpose is to make changing accounts more convenient for those consumers who found it difficult due to regular payment arrangements attached to their transaction accounts. Full details of the Package can be found on APCA's website.[8]

The package caters both for consumers who would like to "do it themselves" and those who would like their incoming financial institutions to assist then. The existence of the package has been widely reported,[9] although as mentioned above usage of the optional "regular arrangements" listing feature has been low, and only a fraction of total account changing activity.

In Europe, where recent data suggests less account switching activity than in Australia, the European Commission decided to implement a consumer awareness and facilitation package with marked similarities to the Australian approach. [10]

As a further measure to assist customers in the area of card-based accounts, APCA worked with Visa, MasterCard, American Express, Diners Club and financial institutions to introduce a number of initiatives in December 2009 to bring consistency to scheme card account switching. These initiatives include standardisation of approaches to regular payment arrangements and retention of card details, plus a cardholder pack including FAQs and template forms, to assist consumers that have regular payment arrangements on their scheme cards.

APCA continues to promote consumer awareness through the electronic and print media.

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[8] http://www.apca.com.au/Public/apca01_live.nsf/WebPageDisplay/ACCTSW_MadeEasy?OpenDocument

[9] For example, Annette Sampson, "Everyday fees slashed" The Age, 27 October 2010.
http://www.theage.com.au/money/investing/everyday-fees-slashed-20101026-171mk.html

[10] Memo 09/402, September 2009, European Commission, pages 8-9.

5.2 Customer addressing in payment services

Most systemic approaches to easing account switching focus on payment addressing: if a bank account number is used as the destination for a payment (as occurs in direct credit and direct debit), then this could be construed as an impediment to account switching because account numbers are provider-specific, and must change if an account holder switches providers.

However, a structural challenge is that there is no universal addressing system in the competitive payments marketplace. Account numbers are used for direct entry payments (33% of non-cash retail payments[11]), and have been a focus of industry efforts to facilitate switching. But nearly two thirds of non-cash retail payments do not use the account number for addressing purposes. Instead, they use card numbers formatted and allocated by competing card schemes (57.5%) and unique references such as the BPAY identifier (4.4%) and the PayPal account number (volume unknown).

As the payments system evolves, competition amongst competing instrument providers is intensifying, and new payments services are in development.[12] For example, the major banks and BPAY are working on an online, deposit account-based payment system with the project name of "MAMBO" which would support payments in a wide range of online contexts. It is understood that the new system will not use account numbers for addressing. Such innovative developments are an excellent opportunity to further enhance the ease of account switching as the system is designed.

In such an environment, it would be a mistake to equate the account number with a mobile phone number, as some commentators have done. The sole purpose of a mobile phone number is universal personal addressing, but that is not the function of a bank account number. Even if account numbers were fully portable amongst providers, this would not improve addressing arrangements for most payments; separate, additional arrangements would need to be made for other identifiers, particularly card account numbers. Since these identifiers have been competitively developed by a range of different payment schemes over many years, the complexity, cost and risk to the payment system would be impossible to justify.

Instead, if further easing of barriers to switching can be shown to have materially beneficial impacts on competition (which in APCA's submission is doubtful, given the analysis above), then each payment system needs to be examined separately to identify where the barriers are. Moreover, the evolution of the payments system, in common with all other consumer service networks, is towards greater competition amongst suppliers leading to long-term benefits for system users. An attempt to force an artificial addressing constraint to support account switching would tend to dampen this competitive evolution.

[11] Volume data drawn from the Payments System Board Annual Report 2010, RBA, at p9. RBA does not provide data on PayPal or other commercial payment methods.

[12] For a general description see "Competition and Cooperation in Retail Payments" PSB Annual Report 2010 at p21ff.

6. Conclusion

APCA believes that based on available evidence, there is substantial and effective competition in transactional banking. There are opportunities to enhance account switching both to improve customer convenience and to enhance competition, but structural or systemic changes solely for this purpose are not justifiable on a cost/benefit basis.

APCA will continue to work with the payments industry and public policymakers to identify opportunities in this area.