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About CMSPI

CMSPI is a global leader in retail payments consulting. Our expert team works to empower the retail community with insights, expertise, benchmarking, and analysis to drive value in their payments supply chain. This consultation response was constructed by CMSPI's market-leading '***Insights Team'***, which is made up of economists, data and statistical experts, and experienced payments professionals. We have structured our response to reflect the key areas of the consultation document in which CMSPI can offer unique insights.

CMSPI Response to the Parliamentary Joint Committee on Corporations and Financial Services

CMSPI welcomes the Parliamentary Joint Committee's inquiry into mobile payment and digital wallet financial services. It also recognizes the globally influential work of the Reserve Bank of Australia in limiting merchant acceptance fees through legislation and the promotion of competition. In our work with merchants across Australia and globally, CMSPI observes that the rise of digital wallets can have significant impacts in both areas. Our response therefore considers firstly the impacts of digital wallets on merchant routing choice, and then the fees associated with these solutions. With digital wallets already constituting 24% of Australian ecommerce expenditure (and 8% of in-store expenditure) in 2020[1], we believe it is crucial that the benefits of card fee regulation are preserved for merchants as these solutions grow.

1 – Merchant routing choice

As Australia's two most popular digital wallets[2], CMSPI's response focuses on Apple Pay and Google Pay. Both are card-backed wallets and therefore generate specific concerns for Australian merchants with respect to routing choice.

When a consumer makes a payment with Apple Pay in Australia, it is often routed by default down Visa or Mastercard's network even where an alternative network is available. To instead use the domestic Eftpos scheme, which is often the cost-efficient option for merchants, the consumer must follow a number of steps within the app to make Eftpos their default network.[3] Customers only have an incentive to do so if there is an explicit cost associated with using the network that is more expensive for the merchant. Unlike in a number of other jurisdictions, Australian legislation allows merchants to mitigate this cost through surcharging. However, in 2019 just 4% of transactions in Australia attracted a

[1] Worldpay Global Payments Report 2021
[2] http://www.roymorgan.com/findings/8408-digital-payment-solutions-march-2020-202005120625
[3] https://support.apple.com/en-us/HT209137

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surcharge. [4] Studies on surcharging from other regions suggest that this is the result of greater competition amongst retailers; Jonker (2011), for example, finds that merchants with monopoly power are more able to surcharge than those facing competition.[5] The 4% surcharging figure therefore implies strong competition within the Australian retail sector. This is unlike the dynamics we typically observe in the payments industry, where high barriers to entry often produce markets that are dominated by a few players. Even though surcharging is legal, the RBA's Consumer Payments Survey finds that 25% of respondents would avoid a merchant altogether when faced with a surcharge. This suggests that handing routing choice to consumers, as card-backed digital wallets do, distorts the pricing mechanism and therefore limits competition on merchant fees.

The RBA has so far made great strides in ensuring that routing choice lies with the merchant for other forms of payment. Contactless transactions are a notable example of this. Figure 1 illustrates the effect of the Productivity Commission's 2017 announcement that they would consider regulation if merchants were not allowed choice over the routing of their contactless transactions.[6] The notable reduction in average fees from the global card networks in 2017 illustrates the effect of competitive pressure driven by allowing merchants to choose between the Eftpos and international networks. It is these gains that could be lost if contactless digital wallets are allowed to grow with default routing as the norm.

[4] Reserve Bank of Australia (2020). Consumer Payment Behaviour in Australia: Evidence from the 2019 Consumer Payments Survey. https://www.rba.gov.au/publications/rdp/2020/2020-06/full.html

[5] Jonker, N. (2011). 'Card acceptance and surcharging: the role of costs and competition'. De Nederlandsche Bank. Working Paper No. 300 (May).

[6] Available at: https://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/FourMajorBanksReview3/Report

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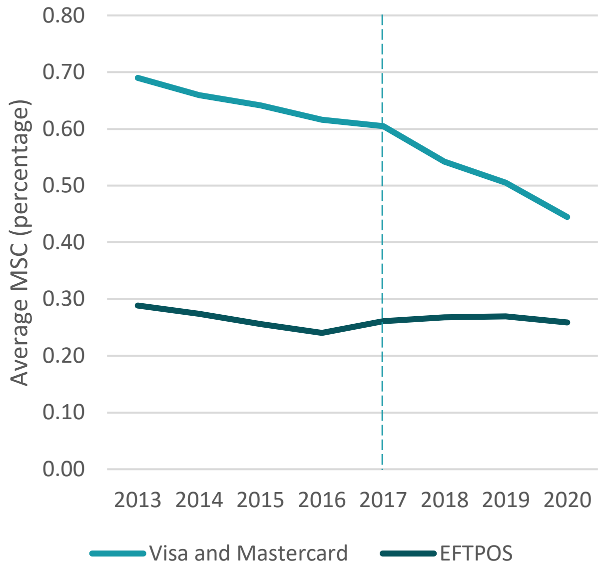

Figure 1. Average merchant service charge by network.[7]

2 – Fees

Routing choice is so pivotal in the digital wallets space primarily because it places downward pressure on fees. From CMSPI's experience, merchants accepting digital wallets often incur fees that are significantly higher than those for traditional card payments. This is increasingly a concern for Australian merchants, particularly in the area of Buy Now Pay Later (BNPL). Many BNPL providers in Australia are shifting towards the face-to-face environment by issuing cards that can be used from within a customer's Apple or Google Pay wallet.[8][9] CMSPI has had reports that some such providers, on top of the Merchant Service Charge paid by merchants to accept card payments, are requiring that retailers pay an additional fee – often multiple times the regulated interchange rate - and enter into a bilateral agreement.[10] This form of bilateral agreement presents a direct threat to Australian interchange fee regulation. If providers can act as de facto issuers but charge fees significantly above

[7] CMSPI estimates and analysis from RBA data.
[8] https://www.afr.com/companies/financial-services/zip-strikes-in-store-deal-with-visa-apple-google-20201020-p566qt
[9] Afterpay. https://help.afterpay.com/hc/en-au/articles/900003733466-Afterpay-Card-Launching-in-Australia-in-2021
[10] CMSPI data

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the regulated caps, then the historical success of the RBA in limiting merchant fees could be eroded, especially with BNPL growth of 79% between FY2017-18 and FY 2018-19.[11]

Conclusion

The rise of digital wallets comes with a number of potential benefits, particularly in terms of customer experience and promoting innovation. The pandemic also appears to have quickened the pace of their adoption, with CBA figures suggesting that the number of digital wallet transactions increased by 90% between March 2020 and March 2021.[12] However, from CMSPI's experience working with merchants globally, greater use of digital wallets also presents concerns. The first relates to routing choice. For merchants faced with a competitive retail environment, the ability to pass on the costs associated with certain payment methods by surcharging is limited. In the case of card-backed wallets, this translates into a situation wherein the international card networks are favoured over Eftpos by default – to the detriment of merchants' costs, usage of the domestic network, and wider industry competition. It is therefore crucial that merchant routing rights are preserved for the use of digital wallets, just as they have been for conventional card transactions.

The second issue concerns fees, an area in which Australian regulators have been historically proactive in protecting merchants and their consumers. Not only do digital wallets often attract higher headline rates, but the mobile wallet space is increasingly attracting suppliers who traditionally did not perform an issuing function. CMSPI is aware of some such providers potentially acting outside of interchange fee regulation in requiring bilateral agreements with merchants that attract fees above interchange caps.[13] As such, it is important that the rise of digital wallets is approached with caution; although there are many benefits of their growing role in the Australian payments landscape, providers must not be allowed to violate the protections afforded to merchants by regulation in the process. CMSPI therefore believes that fintechs entering the in-store environment ought not to be treated differently from their legacy issuer counterparts, and must be required to operate within the bounds of existing regulation.

[11] Australian Securities & Investments Commission (2020). *Buy now pay later: An industry update.* Report 672.
[12] https://www.finextra.com/newsarticle/38081/digital-wallets-poised-to-overtake-contactless-cards-as-instore-payment-of-choice-in-australia?utm_medium=newsflash&utm_source=2021-5-19&member=86967
[13] CMSPI data

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