

6 September 2021

Least Cost Routing Implementation Framework must be actioned

This document proposes a framework to promote discussion on the immediate implementation of a meaningful LCR mechanism in Australia.

SYNOPSIS

COSBOA has been advocating for changes to Australia's payment system to protect merchants from the rising cost of card transaction fees for over 5 years. A call to mandate least cost routing (LCR) and maintain dual network debit cards has been at the heart of this advocacy and has resulted in modest and largely ineffective action by the Reserve Bank of Australia (RBA) the principal regulator of the payments system.

On 1 September 2021, the Federal Treasurer (The Hon. Josh Frydenberg MP) announced that he had written to the RBA's Payment Service Board (PSB) urging that LCR be mandated for all payment forms (i.e., in person, online and mobile) and that dual network debit cards be fully maintained.

COSBOA welcomes the Federal Treasurer's intervention but notes that this is merely the start of a very important conversation in respect of how and when LCR will be mandated for debit card payments in Australia. **In effect, the Treasurer's announcement marks the commencement of the discussion on implementation of an LCR mandate for merchant payments in Australia.**

Having participated in the LCR conversation for more than 5 years, COSBOA is keen to ensure the Treasurer's request is not undermined by continued delays and obfuscation from banks and the international card schemes. This concern is justified given the behaviour of the major financial actors in the national payments ecosystem over recent years. As recently as this week the Australian Banking Association has written to the ACCC claiming LCR is available to 95% of businesses, a disingenuous claim considering the Treasurer's action.

The release this month of the Treasury "Payments System Review, From System to Ecosystem" places consumer and business needs as recommendation #1. Its emphasis on considering small business needs in policy design and implementation is welcomed.

The Treasurer's announcement must now be followed with an implementation framework that sets out a **clear pathway and timing** for mandating LCR for all payment methods i.e. in-person, online and mobile.

KEY THEMES

COSBOA's position on LCR implementation encompasses the following key themes:

1. **There is an urgent need to reduce the rising cost of card transactions for all Australian small businesses and therefore implementation timeframes should be realistically aggressive.**
 - Debit card costs for most businesses have more than doubled over the past 5 years. While some of this can be attributed to the rising use of debit cards over cash by consumers, such an assertion ignores the fact that unit costs for transactions have increased markedly over the same period. Such an increase is counterintuitive given that increased usage of payment infrastructure should have delivered scale efficiencies that would normally preclude these increases.
 - The ever-growing use of debit cards and the escalation of digital payments (online and mobile) means that LCR must be pursued as a matter of priority if SMEs are to be protected from unfettered increases in essential merchant services fees.
2. **There is a need to agree on firm timelines for the implementation of LCR for all payment forms (i.e. in-person, online, and mobile).**
3. **LCR for in-person card payments via point of sale should be mandated no later than 31 March 2022 with provision for compulsory three-month reviews. The cost comparison of payment gateways (or routes) should be developed solely around comparison of the wholesale costs to the acquirer.**
 - COSBOA notes that the functionality for card LCR (i.e. in-person payment via a POS) is already well underway and could be made available for all in-person payments within the next 6 months.
 - While COSBOA would like to see dynamic routing (as occurs in the USA) we note advice from the banks that such a mechanism would be costly given the constraints imposed by legacy information systems. Conversely, we firmly believe that the current binary or dumb routing that has been introduced is unsatisfactory. It is suggested that LCR should be mandated and reviewed by the merchant services provider at three-month intervals in accordance with RBA statutory reporting obligations of card issuers.
 - Noting the potential for cost comparisons to be gamed through the manipulation of interchange and scheme fees, COSBOA believes that the parameter for comparison of routes should be developed around the wholesale cost to the acquirer.
4. **LCR for online or e-commerce payments should be mandated no later than 1 September 2022, taking account of work already in hand and the programmed roll-out of secure LCR functionality commencing 1 November 2021.**

- COSBOA is aware that the roll-out of LCR capability for online functionality (i.e. mapped against the progress being made by the domestic payment services provider eftpos) is on track to commence on 1 November 2021 for low-risk payments, with scheduled completion by 1 May 2022 for all but extreme high-risk payments. Within this context, and allowing time for adoption by card issuers, it would appear reasonable to set a deadline of 1 September 2022 for mandating LCR for online payments.
- 5. LCR for mobile payments is currently subject to uncertainty, depending on whether Australia chooses to follow the European or USA approach. On balance, the less complex European approach is preferred, and a target of 1 January 2023 should be set for mandating LCR for all mobile payments in Australia.**
- COSBOA notes that LCR for mobile payments has already been mandated in some European countries in response to EU regulations. This approach utilises a dual token approach with the majority of focus on payments made by Apple mobile platforms.
 - COSBOA also notes that the USA has introduced LCR for mobile payments via the use of a ‘universal’ token, but the implementation cost of this approach appears to be substantially higher than the European alternative.
 - Noting that the majority of digital wallet users in Australia use Apple Pay, it would seem prudent and reasonable to follow the same implementation path as the EU for provision of LCR functionality for mobile payments. Such an approach would allow LCR to be mandated (for all Apple payments in the first instance) from 1 January 2023.
- 6. Given the Treasurer’s statement on LCR, and the apparent difficulty of setting a meaningful undertaking in respect of the proposed payments merger being considered by the ACCC, there would appear to be a strong case for deferring the merger until such time as LCR is introduced for all payment methods, or requiring that a timetable for LCR be made binding on the applicants for the Payment Australia merger.**
- COSBOA notes that the applicants, the Industry Committee Administration Pty Ltd (ICA) for the payment systems merger currently being considered by the ACCC, might suggest that the Treasurer’s recent announcement removes the risk of delays to LCR. In the absence of a regulatory timeframe being set down prior to the merger, COSBOA believes that the merger should either:
 - a) Be delayed until LCR is implemented in all payment forms in accordance with the timelines outlined in this document, or
 - b) Be advanced based on a binding undertaking being provided by the applicants to introduce LCR for all payment forms within the timeframes outlined above.

In conclusion, it would be COSBOA’s expectation that legislation ensuring these measures are implemented be introduced to the Australian Parliament in the year 2021.

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