

11 July 2013

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By email to: pysubmissions@rba.gov.au

Dear Tony

RE: CONSULTATION ON PAYMENT CARD ACCESS REGIMES

We refer to your media release dated 28 May 2013 announcing the Reserve Bank of Australia's (RBA) consultation on Payment Card Access Regimes and the invitation to make a submission outlining our feedback on the proposed changes.

In considering the proposed changes outlined in the consultation document, there are two key aspects that need to be assessed when looking at whether regulation should be amended or revoked, these being risk and competition. These two factors are often in conflict to each other given that managing risk and ensuring the payments system is secure may result in a more restrictive payments system that limits competition through barriers to entry and stifles product innovation, if risks are perceived as too high.

Having said this, risk and competition must coexist in order to ensure there is a vibrant payments system that promotes competition through the entry of new participants and the development of new product innovations whilst always taking into consideration whether any changes introduce new risks into the system.

Of greatest importance is the need to ensure there is integrity in the payments system so that industry participants have sufficient protection against financial losses and there remains confidence by consumers that the system is safe, reliable and trustworthy.

The current regulatory framework has been successful in achieving the right balance between risk and competition. With the formation of a new type of ADI (SCCI), regulatory oversight by APRA has ensured that new entrants must be financially sound, maintain minimum levels of capital, have appropriate governance structures in place and appropriate risk management practices.

In consideration of the three options presented by the Bank, we make the following comments.

OPTION 1 - Vary the Access Regime

In the discussion paper under this option the RBA consider using alternative regulatory regimes such as the Australian Credit Licence to determine access to the card schemes. Such a regime could in theory be used for credit card activities and you could also add the Australian Financial Services Licence as a regime for dealing with debit and prepaid card access. However both these regimes, which are managed by ASIC, are designed to protect the consumer, rather than the payment system and as such are not designed to manage the risks the RBA are trying resolve.

The discussion paper notes the different risks that different parts of the schemes produce. We believe it is worthwhile detailing these in greater depth to understand why the alternative supervisory schemes are not appropriate, at least without substantial modification.

1. Credit Card Issuing Risk

In terms of the payment system, issuers are net payers in the payment system and therefore impose credit risk on every acquiring institution in the event the issuer fails. Therefore it is imperative that each acquiring institution has confidence that issuers will not fail in order to continue to universally acquire all scheme card transactions. To provide this confidence, acquirers must be satisfied that issuers have, at all times, sufficient capital, liquidity and credit risk management in place to meet their settlement obligations. These are the cornerstones of the prudential supervision provided by APRA. The ASIC schemes by contrast have a minimum requirement regime that does not account for the size of any settlement risk imposed on the payment system and is largely managed by self audit rather than ongoing direct supervision.

Credit card issuers must also be able to manage the fraud risk that is imposed upon them. Recent compromises of acquiring terminals in Australia have placed extremely high fraud losses on many Australian card issuers. Issuers must have sufficient capital to sustain such losses as they can't be passed back to the cardholder.

2. Debit Card Issuing Risk

Issuing debit cards places the same issuing risk on the payment system as credit card issuing as described above. The difference is that the Issuing Institution does not carry credit risk for which it needs to hold capital but retains cardholders' funds (deposits) which require protection.

Traditionally debit cards have attached to an ADI savings account. Under the current access regimes a number of new entrants have issued prepaid cards and the system regulators have responded accordingly to ensure sufficient mechanisms are in place to protect cardholders from any loss. This includes APRA supervision of Purchased Payment Facility Providers, Financial Services Licence regime managed by ASIC and a number of exemptions for small low value programs, typically exempt on public policy grounds.

This regulation relies on an ADI being the "Holder of Stored Value" under s.22 of the Payment Systems (Regulation) Act 1998. By doing so it ensures not only are cardholders' funds protected but that payment system is assured an ADI is taking responsibility to honour all cardholder payments in the payments system.

3. Acquiring Risk

Acquirers are typically net receivers of funds and as such it may appear that they introduce little settlement risk into the payment system. However, as noted in the discussion paper, acquirers must be able to manage the risks their merchants place on the payment systems which includes merchant fraud and chargeback risks. These risks can be considerable as demonstrated by the high profile Ansett failure which resulted in the acquiring bank having to refund cardholders any payments made for forward purchased flights that were subsequently cancelled. Each acquirer must be able to absorb the impacts of a merchant failure and to ensure the payment systems and issuers are not exposed to such risks. Therefore acquirers must be supervised to ensure they are not taking on merchant risk that is larger than they can prudently manage.

The schemes, in response to the losses caused by data system breaches on issuers, have mandated significant penalties on acquirers whose merchants do not meet minimum security standards, which can include absorbing any resulting fraud loss. Acquires must have sufficient capital to meet these risks should they be realised and be prudential managed to ensure they are managing their merchant's appropriately. Whilst the card schemes supervise that members are managing their merchants, they do not supervise the capital management strategies of acquiring institutions as they have relied on their ADI status and APRA to do this. If acquirers are not supervised by APRA then some form of supervision will be required.

Both issuers and acquirers place settlement risk on the payments system and its participants. These systems rely on each participant having confidence in each other and every participant being able to meet their respective obligations. That confidence is only obtained from each participant knowing that every other participant is under a strong prudential oversight regime. This has been recognised to date by the RBA implementing a regime that either places an institution under direct APRA supervision or imposes the need for a non-ADI issuer to use an ADI (which is under APRA supervision) as the settlement counterparty. These protections have been in place for many years and have demonstrated themselves to be an effective process for managing these risks.

Option 2 - Revoke the Access Regime: Using the Schemes to Manage Settlement Risk

The discussion paper suggests that rather than using APRA to manage non-ADI members and the risks they introduce into the payments schemes, that the schemes themselves be entrusted with this responsibility under transparent guidelines. In essence it is outsourcing prudential management away from APRA to the card schemes.

Both MasterCard and Visa have now transformed from mutual organisations run by their members with a strong focus on member protection to publicly listed companies, which by their very nature, places a much greater focus on corporate profitability and return on investment that is not present to the same extent in a mutual organisation. The potential for a conflict between growth and profitability versus prudent risk management has increased with the increased focus on profitability/growth. If the RBA intends to outsource this responsibility to the schemes then they will need to ensure that this potential conflict of interest is appropriately managed.

As the discussion paper alludes to, the creation of a second prudential supervisor may create "regulatory arbitrage" and an uneven playing field with potential and existing participants moving to whichever system is the least intrusive and inexpensive.

As Australia already has a strong and independent prudential regulator, it seems unnecessary or undesirable to create a second non-independent prudential regulator by outsourcing this activity back to the card schemes.

Option 3 - Maintain the Status Quo

If the status quo is enabling innovation, growth and competition with appropriate risk management then this would be an appropriate outcome.

One of the drivers of the discussion paper is the suggested desire of potential entrants issuing virtual cards not proceeding because of the costs of the current regulatory regime.

Although there may be a perception by the Bank that the current framework is restrictive to new entrants, given there have been limited examples of new entrants that have gone through the process of applying for an SCCI license, there are ways for new entrants to bring their products to market without the need to become an ADI.

The Purchased Payment Facility Providers can partner with an ADI (as the holder of stored value) and card scheme member and issuer to distribute a product. Many gift and prepaid card programs are distributed in this way.

New entrants also have the option of seeking a BIN sponsorship arrangement through an existing scheme member, thereby removing the need to deal directly with the schemes as a member and take on regulatory requirements that may be challenging to meet. There are already examples of new entrants in the Australian market who have done so through a BIN sponsor and who have been able to provide innovative products, ideas and technologies that have led to a more competitive landscape.

The BIN sponsor has the primary obligation for settlement with the schemes and as such, there is limited additional risk introduced into the system by new entrants issuing through a BIN sponsorship arrangement. In regards to the sponsoring member, they will manage their own risk position by establishing appropriate collateral arrangements to ensure that the financial obligation they assume on behalf of the sponsored issuer is appropriately covered.

The new entrants alluded to in the discussion paper that wish to issue virtualised cards can do so under the current framework, without the need to become an ADI, by using an existing member to sponsor and underwrite the settlement risk.

Further the current regime ensures that in the Australian marketplace consumers will remain protected as the issuer/acquirer will have an Australian presence and be prudentially supervised. Under option two, the card schemes may well enable offshore entities to issue cards in the Australian market without any real presence in Australia which would introduce an entire new set of risks to be managed in terms of consumer protection and payments system security.

Thus under the current framework, we believe there is an environment that strikes a good balance between risk and competition and on this basis the Access Regimes should remain in force. The question then becomes, should they be amended or stay the same. With some evidence to suggest that widening the criteria for being a direct participant is appropriate, we would only support this for a small number of cases.

Preferred Option – Option 1: Vary the Access Regime

Of the three policy options offered by the Bank, our preference is for Option 1.

We do not believe it is appropriate for the Bank to outsource the prudential supervision for payment system entrants to offshore publicly-listed companies. The current regime has allowed significant innovation in card products and payment system innovation without the introduction of undue risk to either consumers or the payment system participants.

This is not to say that the current system can't be modified to remove unnecessary regulation of low risk programs. In doing so, the RBA needs to be mindful that:

1. a small acquirer by acting for an inappropriate merchant can impose significant risk on the payment system; and
2. a small issuer by loading a large amount of value onto cards or suffering a significant fraud event can also impose significant risk on the payment system.

Rather than revoking the access regimes, we consider the better approach is to tailor the existing regime to balance the risk a new entrant brings to the payments system with the need for competition. This will ensure a consistency in the framework and a level playing field.

In conclusion, we thank you for the opportunity to comment on your consultation document and look forward to the opportunity to discuss our submission with the Bank. In the meantime, if you have any questions, feel free to give me a call on 07 3258 4248.

Yours faithfully



Michael Swannell
Executive Manager - Payments