

Strategic Review of Innovation in the Payments System: Issues for Consideration

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ANZ Submission to the
Reserve Bank of Australia



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INTRODUCTION

Payment systems, products and services in Australia have evolved substantially over time in response to the changing needs and preferences of consumers, and through the availability of new technologies. In parallel, the shift towards electronic payments and the proliferation of new payment channels has introduced new challenges to the integrity and security of our payments system, which has in turn driven further innovation.

Payment flows are also increasingly crossing borders, and any evaluation of innovation in the Australian context must contemplate the implications of this trend on domestic payment systems.

Innovation in any industry thrives where there are returns available to participants who are prepared to take the investment risk. When considering and judging innovation in the context of the payments system, it is therefore important to balance the value created for consumers with the impact on the stability, efficiency and security of the system, and also with the commercial viability for providers of payment solutions.

INNOVATION IN THE AUSTRALIAN PAYMENTS SYSTEM

The most common form of recent innovation in payments has been innovation that has leveraged or built on existing payment systems and infrastructure. There are many examples of proprietary innovations (for example, ANZ goMoney and PayPal), which have responded to a gap in the market, or evolving customer needs. Such innovation typically delivers competitive advantage without the need for widespread market adoption to be successful for both consumers and the innovator.

The second form of innovation is co-operative, where benefits are clear, but broad market adoption is required for benefits to be realised by participants (for example, BPAY and EMV).

The ongoing successful introduction of new payment products and services indicates that from an innovation perspective, the Australian payments system is fundamentally healthy:

- Competition is driving the development of new products and services, where customer needs or other commercial incentives exist
- New entrants are successfully entering the market with new payment solutions
- Where innovation supports non-competitive issues such as the security of the payments system, or there is a commercially-viable market opportunity that requires co-operation to deliver benefits, the industry collaborates.

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Where innovation has required significant change to payments system infrastructure and processes, co-operation is more challenging and at times requires external leadership or intervention. This can be because near-term financial benefits are uncertain due to difficulty in accurately estimating consumer adoption, but where significant investment is required up front. It can also be because the economic benefits of innovation accrue to parties other than those required to fund development of the enabling infrastructure and processes.

Therefore a common view and set of priorities across the industry is essential to ensure that the payments system infrastructure continues to evolve to support the development of products and services to meet future customer needs.

DEVELOPING AN INDUSTRY ROADMAP FOR INNOVATION

Not since the mid-1990s, when the Australian RTGS system was introduced, has the industry worked together closely with the RBA to determine the key payments system developments required to meet the emerging needs of the market. ANZ considers it timely that the industry comes together to agree a roadmap to deliver the fundamental changes to payments system infrastructure and processes that are required to underpin future innovation that cannot be accommodated by what is in place today.

To facilitate this, ANZ proposes that a new senior industry payments body is established which is mandated to define and to govern the implementation of a roadmap for payments system innovation. While some very effective industry organisations operate in the payments industry today, there is currently no single broad-based organisation with a membership that represents all system participants and, in the case of payment services providers, with representatives who are empowered to commit the resources of the organisations that they represent.

The RBA can play an important role in both facilitating co-operation to determine the roadmap, and in ensuring industry progress against implementation of the roadmap (which may require specific policy interventions or mandates).

Enabling the industry to discuss and alter pricing mechanisms can help to align the interests of the participants. A roadmap will also support a holistic view of the impact of innovation, to ensure that incremental value is created in the system, rather than driving only the redistribution of current value. Learning from successful innovations in other markets will be key – Australia is a relatively modest market in terms of size, and therefore has a commensurate capacity for investment and change.

In addition to the development of a roadmap, ANZ proposes the development of 'common operating standards' for the Australian market that provide a framework for the various domestic and international payments schemes to operate under. The objectives of this framework would include optimising interoperability for domestic & cross-border payments services, and minimising duplication.

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There are many valuable and successful innovations introduced via the card payment schemes that create value for consumers both locally and cross-border, and for the industry. It is important that Australia continues to keep pace with the rest of the world with such evolution and innovation, as well as evolving its domestic payment capabilities.

INNOVATION PRIORITIES

The areas that ANZ regards as priorities for inclusion in a payments innovation roadmap are:

- Transmission of data with payments to facilitate a greater degree of automation and straight-through-processing of transactions, and to support further innovation in both business-to-consumer and in person-to-person payment products and services
- Providing customers with the option of improved timeliness of payments. This could include payment confirmation messages, the speed of funds availability or completion of settlement, and up-to-date balances. Any improvement in speed needs to be able to be traded-off by the customer against other value drivers, such as revocability and fraud management
- Adoption of ISO 20022 compliant payment messaging standards for new payment systems, and potentially for existing payment systems over time. This will establish a flexible platform for innovation, including interoperability between payment systems globally
- Active management of the decline of legacy payment systems such as cheques and cash, including through the adoption of pricing mechanisms where appropriate. This must be done in the context of continuing to meet the needs of the Australian public
- The global context: it is increasingly difficult to consider payments and innovation in Australia without giving strong regard to the increasing globalisation of payments. Payment flows into and out of Australia are growing quickly (between 10–20% per annum over the last 10 years). This is giving rise to consumer and wholesale demand for more sophisticated cross-border payment capabilities to facilitate migrant remittances, internet purchases, supply-chain billing and foreign investment flows. Central Banks are also expanding the scope and mandate of domestic automated clearing houses to support various countries' aspirations to become a 'Regional Financial Centre'. Therefore integration with more payment systems and schemes in other geographies, in particular in Asia, needs to form part of this roadmap.

Delivery of such changes to payment systems may be possible through the enhancement of current payment systems.

An alternative could be the development of a new 'sixth' payments clearing and settlement system that enables the transmission of data while improving timeliness of payments. Parties could 'opt in' to this new system when convenient and appropriate, rather than all (or a majority) of industry participants being required to invest in upgrading existing payment systems simultaneously. Consideration would need to be given to the source of funding to establish new systems that follow an 'opt in' model.

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Implementing a centralised clearing and settlement infrastructure or 'hub' to facilitate connectivity and accessibility could enhance overall industry efficiency and payment service availability – the concept of 'plug in once, and then play according to the rules'.

ANZ welcomes the opportunity to explore all options, and is experienced in operating in different payments system environments across many countries.

BENEFITS OF AN INDUSTRY ROADMAP FOR INNOVATION

The benefits of an innovation roadmap include:

- Ensuring that the focus of innovation is on developing capabilities for which customer demand can be clearly evidenced
- Assisting in achieving the necessary network effect by providing an orderly way for providers to participate, including facilitating access for participants who lack scale
- Ensuring that there is an appropriate alignment of interest to drive widespread adoption
- Providing certainty to participants to support investment and resource planning cycles, and minimising duplicate and redundant investments
- And thereby supporting user take-up of innovation initiatives.

TAKING A BALANCED APPROACH

The payments system is an essential infrastructure and survives on trust. Therefore payments system innovation, including extracting efficiencies, should be balanced against our principal obligation to maintain user confidence in our payments system by ensuring integrity, stability and security.

The consequences of recent payment fraud incidents and system outages serve to reinforce the importance of security and stability in the payment system. Maintaining the integrity of the payments system, through strong governance, standards and consistent supervision of the introduction of new products, services and parties to the system, is critical.

The industry's ability to implement innovative initiatives is also stretched by the substantial resources required to comply with recent competition, consumer credit and other regulatory reforms. Investment capacity is further constrained by impacts on revenue streams as a result of some of these regulatory changes.

Innovation can add further layers of complexity to existing system infrastructure. Careful consideration must be given to the additional risks that may be introduced by implementing the innovation roadmap in parallel with mandated regulatory change, payment scheme upgrades and the industry's 'normal' level of system enhancement and development.

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CONCLUSION

Trends identified in the RBA's *2010 Consumer Payments Use Study* demonstrate that consumer needs and preferences are continuing to change. In response, new products and services are regularly introduced into the market, and these are predominantly built on existing payments system infrastructure.

It is timely for the industry to review this infrastructure and the associated operating processes to determine whether either enhancements or new payment systems are required to support the innovation required to meet future consumer needs. Such innovation will need to consider the impact on the stability, efficiency and security of the payments system overall, as well as the commercial viability for industry participants.

Formation of a senior payments governance body that represents the needs of payments system participants, together with leadership from the RBA, will enable the development of an industry roadmap for payments innovation.

The **ATTACHMENT** provides a summary of ANZ's position on each of the issues raised in the *Consultation Paper*.

ANZ would be pleased to provide any further information about this submission as required and can be contacted as follows:

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1. THE DECLINE OF TRADITIONAL PAYMENT METHODS

1.1 The Decline of Cheques

ANZ supports APCA's work on managing the decline of cheques in Australia. However, the industry must continue to be responsive to the needs of the Australian public. Decline can be managed through agreement to an industry roadmap, implementing pricing changes to better reflect costs to shape cheque usage, and setting a target end-date when appropriate. It is important that Government, as a significant user of cheques, plays a leadership role in managing this decline.

In the short-term, managing the cost of cheques through processing efficiencies may be achieved by, for example:

- Replacing the APCA requirement to exchange physical cheques with the ability to exchange images of cheques. To derive sufficient benefit, images of cheques would need to be captured at the place of deposit (if not sooner). This would eliminate the need for cheques to be couriered from branches to processing centres, and subsequently designated exchange points, each business day (which today is the greatest cost component of cheque processing).
- Exchanging cheques less frequently, for example, every other business day, to reduce courier costs. However, in doing this, cheque clearing times would in some instances be extended by one business day. As cheques are typically used for non-urgent payments, customers may be comfortable with this change – but consultation would be required. This initiative could be implemented relatively quickly, and at a much lower cost than adopting cheque imaging.
- Introducing a pricing model that would better reflect the distribution of costs associated with cheques, while providing better signals to users, would be a logical move. Today, for a payer, cheques are an inexpensive, if not free, payment method. The majority of costs are absorbed by the payee's financial institution (e.g. courier/processing costs). This model will become unsustainable at some point as cheque volumes decrease.

It is important that any change is carefully considered and agreed by key industry stakeholders to ensure that customer needs continue to be met.

1.2 Cash Replacement

ANZ supports development of an industry agenda to manage the decline in cash usage, building on the industry's investment in contactless payment technology. In other markets where cash usage has declined more rapidly as a result of the introduction of contactless payment mechanisms and, in some cases, electronic purses, a transit proposition has typically been key to driving consumer adoption. ANZ welcomes views on how the RBA can assist the industry in progressing this given the proliferation of different contactless payment applications that have been adopted by State transport authorities across Australia.

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2. THE ENVIRONMENT FOR INNOVATION IN THE AUSTRALIAN PAYMENTS SYSTEM

The body of this submission outlines ANZ's views on the environment for innovation. Further comments on key focus areas are provided below.

2.1 Industry Governance and Decision-Making

The relatively small size of the Australian market necessarily means that there is limited opportunity to invest in both upgrading and enhancing current payment systems, and in implementing innovative payments offerings from different payment schemes, whether at an individual institution or payments system level.

In this environment it has often proven difficult to assess or prioritise the relative merits of competing schemes' innovations – picking clear or likely winners can be problematic. The reform agenda around industry innovation must be driven by both customer needs and commercial imperatives, informed by a broad public policy framework.

ANZ advocates for a more senior-level-representation 'Council' that will act as the custodian of an innovation roadmap and provide strategic direction. This body should involve a broad range of stakeholders, but with decision-making weighted to participants who bear the financial consequences of innovation. ANZ regards the RBA to be a key stakeholder to assist the industry in developing and implementing this roadmap.

Significant payments system participants and service providers could be represented, together with a small number of independent members. The inclusion of independent members could provide a number of benefits, including providing thought-leadership and perspectives from outside traditional stakeholder groups, as well as meeting corporate governance best-practice.

End-users may be best engaged via stakeholder forums, which would allow for engagement across a wide range of interested parties.

2.2 The Role of APCA

APCA has a proven track record in setting industry rules and standards, co-coordinating change across the payments system where appropriate, providing a 'voice' for the industry in various contexts, and being a centre of excellence for payments knowledge, statistics and analysis.

Its gradual shift in focus to identifying and promoting market-based and self-regulatory policy and strategic outcomes has had its challenges, particularly in assessing and prioritising initiatives across the various schemes operating in Australia.

Payment schemes have discrete governance arrangements and have an obligation to their shareholders to pursue commercial objectives. As a consequence, important industry benefits such as interoperability are not always achieved.

APCA should maintain its role in setting industry standards while broadening its mandate to encompass 'common operating standards' across all payment schemes. In addition, APCA can provide valuable support to the new governance forum proposed in **2.1**.

2.3 Competition Issues

ANZ recognises that competition law prevents the industry from being able to discuss pricing, even where that may result in advancing innovation and optimising investment outcomes.

More broadly, it is difficult to discuss pricing regimes that facilitate innovation and competition when the benefits largely accrue in one direction. This can particularly be the case when a participant operates a mono-line business.

A key challenge with pricing negotiations is that, because of entrenched anomalies in the existing industry pricing structure (end-user and/or interchange fees) which undervalue the product price relative to the economic benefit derived by the end-user, business cases for further innovation to improve the proposition may be economically unviable.

2.4 Structure of Clearing and Settlement Rules

The current structure of the Australian clearing and settlement environment supports a number of legacy clearing and settlement systems that are in decline (e.g. cash, APCS). While consumer demand and volumes are increasing for BECS, CECS and HVCS, ANZ recognises that the current environment does not support evolving consumer requirements for:

- Certainty of funds availability
- Enhanced transmission of data with payments
- Payment clearing cycles that address the gap between BECS and RTGS cycles.

Additionally, with the growing value of BECS transactions there is an opportunity to more effectively manage settlement risk and bank liquidity.

ANZ would support the development of a 'sixth' clearing and settlement system to address the gaps identified above. An Australian clearing and settlement 'roadmap' would enable participants to identify and schedule divestment and investment strategies to align with industry direction and timelines.

ANZ's experience has been that 'scale', not accessibility, is the key driver for industry clearing and settlement participation. Industry clearing and settlement participants need to meet stringent regulatory and industry compliance obligations that require significant capital investment. Without scale, there typically is no commercial incentive to directly participate in clearing and settlement.

ANZ would support rules that define timelines for certainty of funds availability (accounting entry posting) for each clearing system and see this development as an opportunity for payment product owners to confidently market products to meet differing consumer requirements for payment timeliness.

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All AUD-denominated payment clearing activities performed within Australia should apply common rules and standards, to ensure an appropriate level of prudential control is consistently applied by all organisations that undertake clearing activities, and to maintain public transparency and confidence.

2.5 System Architecture

Globally, the use of a common hub with segregated transmission mechanisms (for files and messages) for 'country-level' clearing and settlement connectivity is becoming more prevalent.

ANZ's global experience would suggest that hubs are a more efficient mechanism for managing clearing and settlement infrastructures and supporting ease of access. However, innovation is more likely to be influenced by the quality of the governance, constitution and membership profile, rather than the nature of the operating model.

ANZ supports new payments and clearing systems to be established utilising a hub model. ANZ believes that there are effective mechanisms that could be put in place to allow participants to opt in to a hub service, while providing a full service to new entrants.

Investment in a 'sixth' clearing system would enable the industry to transition to a 'hub' environment unfettered by legacy infrastructure constraints, which would avoid forcing participants to transition within industry deadlines, and can establish an infrastructure platform to support subsequent clearing system rationalisation and convergence.

3. INNOVATION GAPS IN THE AUSTRALIAN PAYMENTS SYSTEM

3.1 The Transmission of Data with Payments

ANZ supports developing the ability to transmit data with payments, and supports adoption of ISO 20022 as the payment messaging standard. Adoption of ISO 20022 or similar internationally-recognised standards would enhance the Australian payments industry's ability to implement transmission of additional data by standardising payment flows across proprietary platforms.

Demand for the ability to transmit data with payments has been identified across a broad range of needs:

- For consumers this capability benefits customers' overall management of finances by providing more information and context for their payment transactions
- For businesses, customers with complex receipts and high volumes of receipts are consistently challenged with recognising and reconciling payments. Data-enriched payments enable a greater degree of automation and straight-through-processing of transactions. This would benefit industries such as the superannuation industry.

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3.2 Timeliness of Payments

ANZ supports improvements in timeliness of payments that enable faster access to funds and real-time payment confirmation.

Demand for improved timeliness of payments is most common in two areas:

- **Faster access to funds:** consumers and businesses value the option of electronic payments being available shortly after initiation by the payer. ANZ sees multiple clearing cycles as the key enabler to faster availability of funds
- **Real-time payment confirmation:** particularly important for merchants processing card, direct entry and BPAY payments.

The key industry dependency for timely payments is the timing of clearing cycles. The key industry dependency for real-time payment confirmation is the set of clearing system rules that establish benchmarks for certainty of funds availability by other clearing participants.

Payments system changes will be required if the industry agrees to set a minimum standard for firstly posting, and secondly making funds available to customers. ANZ's preference is for minimum posting standards to be achieved collectively through APCA's *Settlement Evolution* project.

Careful consideration and consultation is required to ensure that any incremental risks associated with changes to timeliness are well understood and accepted by industry participants. ANZ has concerns about mandating a 24-hours-a-day, 7-days-a-week funds availability proposition due to operational implications and the impact on security and fraud management. In addition, it would impact institutions' system change windows, and could result in potential settlement and liquidity issues.

3.3 Ease of Addressing Payments

Innovation has already occurred in increasing ease of addressing payments using existing infrastructure (e.g. ANZ goMoney and PayPal). As such, ANZ does not consider that public intervention is required to stimulate further innovation.

3.4 Person-to-person Payments

ANZ considers that innovation with respect to person-to-person payments has occurred, and can be further enhanced by leveraging existing payments infrastructure and enhancements (e.g. ANZ goMoney).

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3.5 Mobile Payments

ANZ considers that mobile payments can be delivered by leveraging existing payment infrastructure and enhancements.

The ability for consumers and businesses to make and receive mobile payments has created new demand and increased payment frequency in both local and international markets.

Simplicity and stability of mobile platforms will be critical to building confidence and broader adoption. The industry will need to determine a framework for managing payments that ties into core banking infrastructure as well as managing partnerships which often span outside the banking market.

Security is paramount to mobile payments, with fraudulent applications and mobile operating system viruses being key threats. Institutions must have robust technical and operational controls implemented to mitigate exposure to these threats. Public intervention could be considered in the area of minimum security protocols for mobile payments. This could be achieved through a set of certifiable standards.

3.6 Electronic Purse Systems

A nationally-based electronic purse system, if it is implemented as a closed-loop payment scheme or application, would need to be worked through and supported by all relevant stakeholders and participants. The 'network effect' is critical for success, and overseas experience suggests that it will require key services such as transit to be included, together with general payments, to ensure commercial viability and consumer adoption. Government support to achieve interoperability across State-based transit payment applications is therefore critical to drive success.

ANZ would be cautious about supporting the establishment of a new payment scheme – ideally any ubiquitous electronic purse system would leverage an existing payment scheme and payment system.

3.7 Standards

ANZ advocates the adoption of international standards that align the transmission of payments message flows and provide participants a choice of which scheme to use without the loss of data in transmissions.

The inter-linking of the Australian payments system with international systems is more likely to occur using an extensible international standard such as ISO 20022 – e.g. the domestic clearing and settling of transactions initiated internationally. Also, this would support the consistent validation of payments irrespective of the transmission and settlement service used.