3. Payments System Regulation and Policy Issues

This chapter summarises the main regulatory and policy work the Bank has undertaken over the past year on retail payment systems. A key area of focus was on implementing a number of policy actions aimed at enhancing competition and efficiency in the debit card market. The Bank also assisted the Treasury and other regulatory bodies on reforms to the regulatory framework for payments. With the ongoing transition away from cash towards electronic payments, the Bank has continued to examine issues on access to cash, and those related to the cost, reliability and security of electronic payment services. The Bank also continues to monitor the rapid pace of innovation in the payments system and changes in market structure. The Bank considered a number of policy and regulatory issues associated with innovations in the payments system throughout the year. Research on CBDC was also a key focus area and will remain so in the period ahead.

Promoting competitive, cost-effective and accessible electronic payments

Australia's payments system is evolving rapidly, with the use of electronic payments continuing to grow. This has been driven by advances in technology and changing expectations of end users for convenient and safe payments. The Bank has an important role to play in ensuring that payment services remain efficient and meet the needs of users of the payments system.

Encouraging competition and lower card payment costs for merchants

A key element of the Bank's work over the past year has been to continue to implement policy measures from the 2019–2021 Review of Retail Payments Regulation (the Review), and introduce new measures aimed at encouraging greater competition between card schemes and lowering card payment costs for merchants. During the year, the Bank:

- took steps to encourage greater availability of LCR functionality
- obtained undertakings from the international card schemes to reduce the risk that 'tying conduct' could limit competition in the debit card market
- collected and published new data on scheme fees, from schemes and issuers/acquirers, to provide greater transparency
- set expectations for the international card networks and acquirers that merchants should have a choice of whether to accept 'instalments' (BNPL) services, and be able to surcharge these transactions to recover the cost of these types of payment
- continued to monitor the adoption of mobile wallet payments and their associated costs.

Dual-network debit cards and least-cost routing

Around 85 per cent of debit cards issued in Australia are DNDCs, which allow domestic payments to be processed via either eftpos or one of the other debit networks (typically either

Debit Mastercard or Visa Debit). DNDCs facilitate competition between debit networks by allowing a choice of routing network to be made at the point of sale. LCR, or merchant-choice routing, is the ability for merchants to choose which debit network on a DNDC processes certain debit card transactions and helps merchants reduce their payments costs. A key focus for the Bank has continued to be encouraging widespread issuance of DNDCs and greater availability of LCR. Over the past year, the Bank:

- Monitored compliance with the expectation that large debit card issuers issue DNDCs and provision both networks on DNDCs in mobile wallets. Large issuers continue to make good progress in meeting the Bank's expectations in this regard.
- Encouraged acquirers, payment facilitators and gateway providers to make progress in meeting the Bank's expectation that they offer and promote LCR functionality to merchants in the device-present (in-person) and device-not-present (online) environments as applicable.
- Published six-monthly updates on LCR availability and take-up across the major acquirers for in-person transactions to provide greater transparency on the progress of individual institutions in meeting the Bank's expectations. Providers have generally made good progress in terms of availability, with LCR available to be turned on for 99 per cent of their merchants. However, the take-up of LCR by merchants remains much lower, with just over half of merchants on plans with LCR enabled. For online transactions, the Bank set an expectation that providers would offer LCR to merchants by the end of 2022; however, the industry did not meet this timeline. As of June 2023, the industry still needs to make significant progress on LCR availability and take-up for online transactions, though several LCR implementation programs across major acquirers are due to be rolled out in the second half of 2023.
- Announced a further expectation for the industry to deliver LCR functionality for mobile wallet transactions by the end of 2024. The Bank has been actively monitoring the industry's plans to meet this expectation.

Tying conduct

Mastercard and Visa have each given undertakings to the Bank that they will not engage in tying conduct involving their debit and credit card products. The undertakings address the Bank's concerns that the international schemes could engage in conduct that would limit competitive pressure in the debit card market, which has the potential to impose additional costs on the payments system. The schemes have committed not to engage in tying conduct, such as by making preferential 'strategic' interchange rates on credit card transactions conditional or 'tied' on the value or volume of a merchant's debit card transactions.

Transparency of scheme fees

During the year, the Bank implemented a new policy measure from the Review aimed at improving the transparency of scheme fees. These fees are charged by card networks to issuers and acquirers. They tend to be complex, opaque and are ultimately passed on to end users (consumers and merchants) in the form of higher costs.

The Bank published some aggregate data from its first collection of annual scheme fee data in a speech in early 2023.[1] The data showed that the fees make a significant contribution to payments costs, with net fees across the major card networks amounting to around $1.2 billion in

[1] See Connolly E (2023), 'The Shift to Electronic Payments – Some Policy Issues', Speech at the AFR Banking Summit, 28 March.

2021/22. On average, issuers paid higher fees to schemes on card transactions relative to acquirers, but also received significantly larger rebates. For domestic debit card transactions, the net scheme fee paid by issuers was 2 basis points of the transaction value, compared with 9 basis points for acquirers. Net scheme fees were a little higher for domestic credit cards, averaging 4 basis points for issuers and 11 basis points for acquirers. Scheme fees for international card transactions in Australia are particularly high at more than 150 basis points.

The data also showed that some types of transactions attract higher fees than others. For example, on average, domestic debit mobile and online transactions attract scheme fees that are more than twice the average fee incurred when a debit card is tapped. The Bank will continue to closely monitor trends in scheme fees over time and publish data annually with the aim of promoting transparency and competitive tension in the market.

Buy now, pay later services

In the Review, the Board concluded that it would be in the public interest for BNPL providers to remove their no-surcharge rules. The right of merchants to apply a payment surcharge can promote competition in the payments system and keep downward pressure on payments costs. By helping to keep merchants' costs down, the right to apply a surcharge means businesses can offer a lower price for goods and services to all of their customers and thereby reduce the extent to which users of lower cost payment methods subsidise users of more expensive payment methods.

However, the Bank's ability to impose standards to achieve this outcome is complicated by the current drafting of the relevant legislation, the *Payment Systems (Regulation) Act 1998* (PSRA). As discussed further below, during the year, the Bank assisted the Australian Government with its plan to reform the regulatory architecture for payments, including modernising the PSRA to enable the Bank to engage with a wider range of issues associated with new payments technologies and business models, such as BNPL and mobile wallets.

During the year, the Bank also continued to monitor developments in the BNPL sector, including the instalments services that the international card networks are planning to launch in Australia. The Board expects that from the launch of these services, merchants will be provided with:

- a choice of whether to accept instalments transactions
- clear information about the costs of accepting instalments transactions
- the ability to fully surcharge these transactions if a merchant wishes to recover the costs they incur.

If these expectations are not met, the Board would consider the merit of taking regulatory action, including on the issue of ensuring merchants have choice of which products to accept.

Card transactions using digital wallets

Another priority for the Bank has been to continue to monitor the adoption of digital wallets, which include mobile wallets (e.g. Apple Pay and Google Pay). As noted in the chapter on 'The Evolving Retail Payments Landscape', the data the Bank collects from issuers show that consumers are increasingly making a material share of their card payments through mobile wallets. The strong growth in their use indicates that consumers increasingly value the convenience and security of making payments from their mobile devices.

However, mobile wallet transactions on average attract materially higher interchange and scheme fees, costs which are passed on by acquirers to merchants in the form of higher merchant fees. In addition, mobile wallet services can also introduce new costs into the payments chain. The Bank would support greater transparency of the costs associated with mobile wallets. In particular, some mobile wallet providers have confidentiality restrictions that prevent issuers from disclosing the costs for this service. As a result, there is very little information in the public domain about how much issuers must pay mobile wallet providers. Greater transparency over these costs could help to boost efficiency and competition for payments using mobile wallets.

The future of the Bulk Electronic Clearing System

The Board has been monitoring the industry's plans to wind down and eventually retire the aging Bulk Electronic Clearing System (BECS). This system, also known as the Direct Entry system, is administered by AusPayNet and facilitates the clearing and settlement of bulk electronic transactions between financial institutions, including payroll, recurring payments to merchants and one-off account-to-account transfers. BECS processed around three-quarters of the value of non-cash payments in 2022/23 and is still heavily relied on by businesses and governments. However, use of the system has gradually been declining over recent years as more account-to-account credit transfers have migrated to Australia's fast payment system, the NPP.

While BECS remains a low-cost and reliable payment system, it has various technical limitations that reflect the time when it was created, including a delayed settlement model and a restricted messaging format that is incompatible with the modern ISO 20022 standard. The industry has since invested in newer payment systems, such as the NPP, that have more advanced capabilities, providing faster, more flexible, and data-rich payments. Given the costs of upgrading BECS, the industry has been discussing how the system could be wound down and eventually retired. There are some challenges that need to be addressed before BECS can be retired. These include ensuring that alternative payment systems are capable of reliably handling all of the transaction volume that would need to migrate from BECS, particularly bulk payments such as salaries and direct debits that are currently processed as batch files in BECS. There will also be a need to support the transition to alternative payment systems by the many businesses and government agencies that have BECS heavily embedded in their payment processing systems. AusPayNet is working with the industry to develop a plan for the retirement of BECS, which is expected to be published before the end of 2023.

Given the opportunities and challenges associated with the migration of BECS to more modern payment systems, the Board is closely monitoring the industry's plans in this area. The government has also indicated its support for an industry-led, phased transition away from BECS as part of its Strategic Plan for Australia's Payments System, published in June 2023. Further, the government has also announced that the Treasury will engage with relevant government agencies and other key users of BECS on their needs and readiness to transition away from BECS. Progress on the BECS transition will be monitored in future updates of the Strategic Plan.

New Payments Platform use and development

The NPP is a modern payments infrastructure that enables account-to-account payments to be processed in a data-rich format on a real-time, 24/7 basis. As noted in 'The Evolving Payments Landscape' chapter, NPP volumes have continued to grow strongly over the past year, with an increasing share of credit transfers previously processed by BECS now being processed via the NPP.

The Board is closely monitoring the industry's progress to develop the NPP into a viable alternative for the full range of payments processed by BECS. An essential aspect of this work is for financial institutions to connect all relevant accounts that can currently send and receive payments via BECS to the NPP. The Bank is requiring institutions to report their progress in making these accounts NPP reachable – based on the latest data, a little less than one-fifth of BECS-reachable accounts held at NPP participants are not connected to the NPP. These are mostly certain home loan, personal loan and superannuation accounts. The Bank will be engaging with NPP participants about their plans to make these accounts NPP reachable. The Bank is also engaging with a number of institutions that are not yet connected to the NPP to discuss their plans to make NPP services available to their customers.

To facilitate the migration of payments from BECS, NPP participants will be required to uplift their NPP processing capacity to ensure they are able to accommodate additional payment volumes on the NPP. Participants will also need to develop and implement new capabilities to process bulk payments (e.g. payroll) on the NPP, without the need for their corporate customers to change their back-end processes.

Another part of the industry's work to develop the NPP is the introduction of new functionality under the industry agreed NPP Roadmap.[2] A major focus over the past year has been the delivery of the PayTo service, which provides households and businesses with the ability to authorise third parties to initiate NPP payments from their bank accounts. This service is designed to be a modern alternative to the direct debit system, giving payers greater control and transparency over their recurring payments, and payee businesses increased data capabilities and speed of settlement. PayTo could also be used in a range of other payment scenarios, including e-commerce transactions, billing and paying e-invoices.

A number of NPP participants, including three of the major banks, were not ready to offer the PayTo service by the June 2022 go-live date, limiting the adoption of the service and the realisation of benefits to end users. In response, the Bank obtained assurances from the relevant banks that they would meet their commitments by April 2023 and required regular progress reports. Most participants, including all of the major banks, are now offering the PayTo service to their retail customers (or payers). Some other aspects of PayTo, such as capabilities for payee businesses, are yet to be broadly rolled out.

One part of the NPP's capability where the Bank would like to see more widespread adoption is the PayID service. The PayID service provides a safer and more convenient way to address payments. PayIDs can be registered using information that is easy to remember such as phone numbers or email addresses. When sending a payment to a payee's PayID, the payer can also check the name of the account holder before confirming the payment. This can reduce the risk of mistaken payments and some types of scams. Although customer adoption of PayIDs has been rising, with around one-fifth of NPP payments now being initiated using a PayID, the Bank would like to see financial institutions do more to promote use of PayID among their customers, including for NPP payments to businesses.

Following the ongoing volume growth of the NPP and the addition of new services such as PayTo, AP+ has recently proposed significant changes to the NPP's wholesale pricing arrangements. The new pricing model involves switching from fixed pricing, where financial institutions were charged a fixed fee aimed at recovering NPP's operating costs, to per-transaction pricing. The model includes an interchange-like fee for PayTo transactions,

[2] NPP Australia (2022), 'NPP Roadmap October 2022', November.

which would be paid by the institution initiating the payment (on behalf of the merchant) to the institution making the payment (on behalf of the customer). The Board recently considered the new pricing arrangements in light of its mandate to promote competition and efficiency in the payments system. The Board indicated that it would apply the same principles to the wholesale pricing of NPP transactions as it has applied to competing payment systems. In particular, interchange fees should not be set at a level that inhibits the competitiveness and efficiency of the payments system, and they should be published to provide transparency.

The future of the cheques system

Managing the wind-down of the cheques system is another important element of modernising payments infrastructure in Australia. Cheque use has declined substantially in Australia over the past few decades as users have shifted to electronic payment methods. In 2022/23, cheque payments accounted for 0.1 per cent of the number of all non-cash retail payments, representing an average of less than one cheque transaction per person. As cheque use has declined, the per-transaction cost of supporting the cheque system, which is already high relative to other payment methods, has continued to rise. Financial institutions have been taking some steps to transition away from providing cheque services, such as ceasing to issue cheque books to new customers and promoting the use of alternative payment methods to their remaining cheque users. At the same time, many merchants are ceasing to accept cheques as a means of payment.

As part of the Strategic Plan, the Australian Government announced its intention to phase out government use of cheques by 2028, and the eventual wind-down of the cheques system by no later than 2030. While these initiatives will result in significant efficiency gains, there are a number of issues that will need to be addressed to allow them to be reached. These include amendments to legislation that requires or promotes the use of cheques and ensuring that alternative payment methods can address all payment scenarios that cheques are currently used for. Financial institutions also have an important role to play in assisting the few remaining customers currently using cheques to switch to alternative payment methods and ensuring customers are provided reasonable notice of any plans to withdraw cheque services. The government plans to initiate a public consultation before the end of 2023 on the support and changes required to retire the cheques system by 2030. The Bank will continue to monitor the wind-down of the cheques system and will engage with industry and the Treasury on the upcoming consultation process.

Access to cash and the Review of Banknote Distribution Arrangements

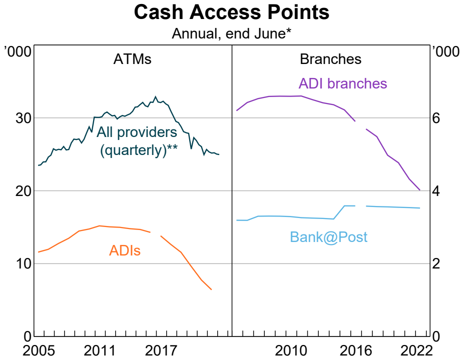
As discussed in the chapter on 'The Evolving Retail Payments Landscape', there has been a long-term structural decline in the use of cash for transactions in Australia, a trend that has accelerated since the COVID-19 pandemic as people have made more electronic and online payments. Nevertheless, cash remains an important payment method for certain groups in the community and it continues to provide an alternative means of payment during periods when electronic payments cannot be used. The Board has been monitoring trends in cash use closely and seeks to ensure that any associated changes in the availability or acceptance of cash do not cause undue hardship for people who still want to use cash.

The decline in the transactional use of cash has been affecting the economics of providing cash services. This has been evident by the reduced number of cash access points over recent years, including a 24 per cent decline in the number of ATMs since 2016 (Graph 3.1). Despite this decline, analysis by Bank staff indicates that the average distance people have to travel to access cash services has changed little in recent years, partly reflecting the continued strong geographic coverage of Bank@Post outlets.[3] That said, there are vulnerabilities to cash access in some communities, particularly in non-metropolitan areas, where there are fewer alternative cash access options. Challenges could also emerge in relation to cash acceptance; while the rate of cash acceptance among merchants remains high, surveys indicate that a substantial share of merchants are planning to discourage or stop cash payments at some point in the future.

The trend decline in cash use is also having adverse implications for the economics of the wholesale banknote distribution system, which is the process by which banknotes are obtained from the Reserve Bank by financial institutions and moved around the country via cash-in-transit (CIT) companies. This system is critical to facilitating the flow of cash in the Australian economy. One manifestation of these challenges is the merger of the two largest CIT providers, Armaguard and Prosegur, which the ACCC authorised in June. In approving the merger, the ACCC noted that structural decline and overcapacity in the CIT industry raised the risk of one or both of the CIT companies exiting the industry suddenly, which could cause significant disruption to the availability of cash in the economy. The Bank made public submissions to the ACCC's merger authorisation process. These submissions highlighted the challenges facing the banknote distribution industry and the importance of placing the industry on a sustainable footing to avoid any significant disruption to cash availability.

Graph 3.1

Cash Access Points



* Series break in annual data in June 2017 due to APRA data collection change.

** The decrease in the number of active ATMs in June 2020 was largely due to temporary COVID-19-related venue closures.

Sources: APRA; AusPayNet; RBA.

Following its Review of Banknote Distribution Arrangements, which concluded in August 2022, the Bank has taken steps to remove impediments to improving efficiency in the cash distribution system.[4] This includes moving to a transparent and standardised contractual arrangement for the distribution of banknotes as well as establishing an industry forum to facilitate more timely changes to make the distribution of cash more effective, efficient, resilient and sustainable.

The government has also highlighted the importance of maintaining adequate access to cash in Australia as a key priority in its Strategic Plan for the Payments System. As part of this, the Bank is engaging with the Treasury on developing options for maintaining adequate access to cash, including potential responses to any sudden disruptions in cash access. The Board will continue to monitor access to cash services and trends in the use and acceptance of cash, and will consider whether any additional actions by the Bank might be required to support the continued provision of cash services.

Data and research on payment trends

The Bank collects a wide range of payments-related data and conducts research on the

[3] Guttmann R, T Livermore and Z Zhang (2023), 'The Cash-use Cycle in Australia', RBA *Bulletin*, March.

[4] RBA (2022), 'Review of Banknote Distribution Arrangements: Conclusions Paper', August.

implications for the efficiency and competitiveness of Australia's payments system. During the year, the Bank launched a review of its Retail Payments Statistics collection aimed at ensuring that it remains a valuable source of information for the Bank, the industry and the wider community as payments trends continue to evolve. The Bank publishes data from this collection, including on the use of debit and credit cards, ATMs, bulk electronic transfers, the NPP, cheques and merchant fees. In recent years, the Bank has also started separately collecting data on BNPL and mobile wallet transactions, the availability and adoption of LCR, and scheme fees charged by card networks to issuers and acquirers. The Bank highlighted these new data during the year through various publications and speeches.

As discussed in the chapter on 'The Evolving Retail Payments Landscape', the Bank completed its sixth triennial CPS during the year, with the results published in two *Bulletin* articles in June. The CPS collects comprehensive data on consumers' use of, and attitudes towards, different payment methods, and is an important source for understanding trends in consumers' use of cash for payments.

Payments regulatory reforms

The structure of the payments system is evolving rapidly, with new entities becoming involved in the payments value chain and new technologies being used to facilitate payments. This is providing benefits to end users of the payments system. However, it can also raise concerns about access, competition and efficiency. Questions can also arise about how new players and technologies fit within existing regulatory structures and whether any changes to regulation are required to accommodate them. The Bank has been assisting the Treasury and other regulatory bodies on reforms to the regulatory framework for payments.

Reform of the payments regulatory architecture

In December 2021, the government announced its response to several government reviews and inquiries into the regulatory framework for payments in Australia, including the Treasury Payments System Review that concluded in mid-2021.[5] In its response, the government committed to a comprehensive set of reforms to the regulatory architecture for payments. Key initiatives include:

- releasing a government strategic plan for the payments system, to provide greater certainty for industry, better inform participants' investment decisions, and ensure the system and regulators can respond to future developments and innovations
- modernising the PSRA, to ensure that regulators and the government can address new risks related to payments as the payments system evolves and increases in complexity
- introducing a new tiered licensing framework for PSPs, to improve regulatory certainty and ensure appropriate regulatory oversight for these entities.

The Bank has been supporting Treasury with advancing its payments reforms, some of which have implications for the Bank's regulatory powers and responsibilities in the retail payments system.

Modernising the Payment Systems (Regulation) Act

In June 2023, the Treasury released a consultation paper[6] on proposed changes to the PSRA, with the main changes strongly supported by the Bank. These changes include:

[5] See Treasury (2021), 'Transforming Australia's Payments System', Government Response, 8 December.

[6] See Treasury (2023), 'Reforms to the Payment Systems (Regulation) Act 1998', Consultation Paper, 7 June.

1. expanding the regulatory perimeter of the PSRA, by updating existing definitions of a 'payment system' and 'participant', to ensure that all entities that play a role in facilitating or enabling payments, including new entrants, can be appropriately regulated
2. introducing reforms to ensure the government can intervene to address emerging payment issues of national significance that lie beyond the remit of independent regulators
3. making other changes to the PSRA to ensure the regulatory architecture is appropriate and effective, such as enabling the Bank to issue directions to, and accept court-enforceable undertakings from, payment system participants.

New payment service providers licensing framework

The introduction of a new tiered licensing regime for PSPs is an important initiative. By addressing some of the regulatory uncertainties and barriers that many PSPs currently face when entering the Australian payments market, it should help promote competition and innovation in the supply of payment services. At the same time, PSP licensees will be required to appropriately manage risks to payments users.

As a first step in this process, in June 2023 the Treasury released a consultation paper[7] on proposed definitions for payment functions for which a PSP licence would be required. These functions include providing stored-value facilities, issuing payment stablecoins, providing services that involve initiating or facilitating payments, and providing services that involve the clearing and settlement of payments. Treasury plans to consult later in 2023 on proposed obligations for PSP licensees. The Bank is supporting Treasury in this work, particularly in relation to access to payments system and industry standard setting – these are the areas where the Bank would have a role under the revised payments regulatory architecture.

Access to payment systems

The Bank supports PSPs having competitive access to payment systems when providing services to their customers, while managing the associated risks. Many PSPs connect to payment systems indirectly through a sponsoring institution. While indirect access suits many providers, some may prefer to participate directly in clearing and settling payments on behalf of their customers without relying on another financial institution. There has been increasing interest from non-bank PSPs in becoming direct participants in payment systems over recent years. Yet some payment systems currently have access criteria that make it difficult, if not impossible, for non-bank PSPs to gain direct access. Payment system operators often rely on the risk management requirements imposed on banks and their supervision by APRA to mitigate risks to the payment system and its participants.

The Payments System Review recommended that the Bank develop a set of 'common access requirements' to help facilitate direct access to Australian payment systems for non-bank PSPs. The intention is that these requirements would be incorporated into the new tiered PSP licensing framework that the government plans to introduce. Accordingly, the Bank has been consulting with payment system operators, PSPs and other financial regulators about a possible set of requirements for PSPs seeking to clear or settle payments in Australia. The CFR has also been considering the role of Council agencies in setting regulatory standards for and supervising PSPs that seek direct access to payment systems.[8]

The aim of this reform initiative is to create a more level playing field for non-bank PSPs, while

[7] See Treasury (2023), 'Payments System Modernisation (Licensing: Defining Payment Functions)', Consultation Paper, 7 June.

managing the risks that they may pose as direct participants to the relevant payment systems and the economy. Lowering the barriers to entry faced by PSPs seeking to directly participate in Australian payment systems by introducing appropriate risk-based regulation will support a more diverse, competitive and innovative payments ecosystem in Australia.

Industry standard setting

The Payments System Review considered that industry bodies are best placed to set technical standards for participants in the payments ecosystem, given the pace of change in payments technology, market structures and business models. It recommended that all relevant participants across the payments system should be required to adhere to a 'core' set of industry technical standards. This broad adherence is aimed at maximising the system-wide benefits of the standards and ensuring a level playing field across participants. Given the mandatory nature of core technical standards, it was proposed that the Bank would be provided with the power to authorise and oversee the effectiveness of industry bodies setting mandatory standards for payments. In fulfilling this new responsibility, the Bank would have regard to a standard-setting body's governance, independence and capabilities, and that the body performs its functions in a way that is consistent with broader payments policy objectives.

The Bank has been working with the Treasury on the design of the proposed new regulatory regime for industry standard setting. The general aspects of this proposed new regime will be consulted on as part of Treasury's broader consultation on the new PSP licensing framework.

[8] See CFR, 'Quarterly Statement by the Council of Financial Regulators – June 2023', Media Release No 2023-02, 14 June.

Promoting the resilience and safety of payment systems

Payment systems need to be operationally resilient, safe and secure. Reliability and security problems can impose significant costs on end users, cause economic disruption and damage public confidence in the financial system. At a minimum, payment systems need effective risk management frameworks, particularly for managing operational risk. The Board considers it vital that participants in the payments industry invest in resilient and secure infrastructure, systems and customer services, and that strong efforts are made to minimise fraud and scams.

Supervision of high-value payment systems

The Bank supervises or oversees the safety and stability of payment systems that are systemically important, since they handle high-value payments for key financial market infrastructures. In February the Board reviewed developments in the payments landscape and affirmed that RITS and CLS Bank International (CLS) are the systemically important payment systems operating in Australia.

Oversight of RITS

RITS is Australia's high-value settlement system, which is owned and operated by the Bank and used by banks and other approved institutions to settle their payment obligations on an RTGS basis. As critical national infrastructure for the Australian payments system, RITS needs to function as a highly available and resilient system. The operation of RITS is overseen by the Board. To support the Board's oversight, the Bank's Payments Policy Department conducts assessments of RITS against the PFMI, which are international standards set by the CPMI and the Technical Committee of IOSCO.

In October 2022, the Bank experienced a major technical outage that impacted two RITS services (the FSS and the Low Value Clearing and Settlement Services (LVCS and LVSS).[9]

Following the incident, the Board asked the Bank to commission an external review of the outage. The 2023 RITS Assessment was a targeted assessment on Governance (Principle 2), Framework for the Comprehensive Management of Risks (Principle 3) and Operational Risk (Principle 17), drawing on the findings of the external review. The assessment was endorsed by the Board and published in June 2023.[10] The assessment highlights a number of improvement opportunities, including the need to consistently and effectively embed accountabilities, processes, systems and controls, and better identify, monitor and manage risk.

Oversight of CLS Bank International

CLS operates a payment-versus-payment settlement system (CLS Settlement) for foreign exchange transactions in 18 currencies, including the Australian dollar. CLS is chartered in the United States and is regulated and supervised by the Federal Reserve. The Bank participates in a cooperative oversight arrangement for CLS, facilitated by the Federal Reserve.

Oversight of Prominent Payment Systems

In February the Board agreed to extend its payments system oversight to include prominent payment systems (PPS) where an outage could cause significant economic disruption and damage confidence in the financial system. The prominence of a payment system will be considered by the Bank on a case-by-case basis, taking into account a range of criteria including size, criticality, interconnectedness, and the potential financial and economic impact of an outage in that system. The payment systems currently considered to meet the criteria of prominence include the NPP, eftpos, Mastercard and Visa. These systems have also been specified as critical to the security and reliability of the financial services and markets sector by the government. The Bank has been consulting with PPS and interested parties on the development and implementation of a graduated, risk-based PPS oversight framework. The Bank will also continue to periodically assess the importance of all payment systems to the Australian economy and financial system.

Oversight of compliance by payment system operators

The Bank is the relevant Commonwealth regulator to oversee the compliance of specified payment system operators with the requirements of the *Security of Critical Infrastructure Act 2018* (SoCI). The payment systems that have been specified as critical to the security and reliability of the financial services and markets sector under the SoCI Act are the Mastercard debit and credit card systems, the Visa debit and credit card systems, the eftpos card system and the NPP. Operators of these systems must maintain a risk management program for the purpose of mitigating significant threats to the reliability and security of their critical infrastructure assets and attest their compliance to the Bank annually.

Oversight of SWIFT

SWIFT provides critical messaging and connectivity services to both RITS and CLS, as well as other financial market infrastructures and market participants in Australia and overseas. The G10 central banks oversee SWIFT through the SWIFT Cooperative Oversight Group (OG). The Bank is a member of the SWIFT Oversight Forum (SOF), which affords a broader set of central banks the opportunity to discuss oversight matters and provide input into the OG's priorities and policies. Oversight of SWIFT is

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[9] See RBA, 'Final Incident Report – RBA Technology Outage on 12 October', Media Release No 2022-40, 28 November.

[10] RBA (2022), 'Targeted assessment of the Reserve Bank Information and Transfer System', May.

supported by a set of standards which align with standards for critical services providers in the PFMI.

Reliability statistics for retail payment services

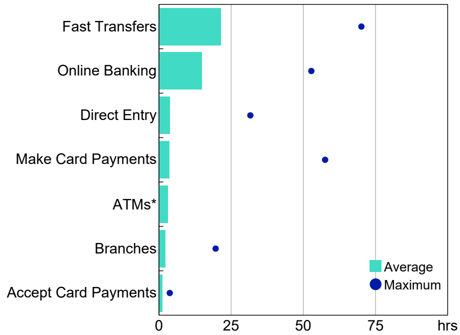
As the reliance on electronic payments increases and use of cash declines, the reliability of retail payment services becomes more important. The Bank collects data quarterly to improve the quality and transparency of information about retail payment service reliability, enabling improved benchmarking of operational performance. Overall, data collected from banks and other financial institutions show a substantial rise in the number and total duration of operational outages in recent years.

Excluding one lengthy ATM outage reported at one institution in December 2022, online banking and fast payments (i.e. NPP) continue to be the least reliable retail payment services provided to households and businesses over the year to June 2023. The average cumulative downtime per provider during the year was around 22 hours for fast payments and 15 hours for online banking (Graph 3.2). The Board will continue to monitor information on retail payment services and will consider whether any policy actions are needed to enhance the reliability of retail payment services provided to end users.

Graph 3.2

Downtime per Service Provider

Year to June 2023



* ATM downtime maximum of 244 hours has been truncated

Source: RBA.

Payment scams

Payment scams occur when people are deceived or manipulated into sending funds or personal information to criminals – for example, when scammers offer an attractive investment scheme that is fake or send a fake bill from a legitimate business seeking payment. According to data published by the ACCC, financial losses from scams rose by 63 per cent to $2.9 billion in 2022, with losses from investment scams growing by 113 per cent (Graph 3.3).[11]

Government efforts to combat scams and online fraud were announced in the 2023/24 Budget. Significant funding was allocated to the ACCC to set up the National Anti-Scams Centre, which launched on 1 July 2023. The Centre's activities will include coordinating efforts across government and industry to facilitate the sharing of intelligence, raising consumer awareness, and leveraging expertise to disrupt scams. At the industry level, the Australian Banking Association has announced a new Fraud Reporting Exchange platform to facilitate the quick reporting of fraudulent payments and provide banks with the ability to halt multiple fraudulent transactions, share intelligence, and assist with loss-prevention efforts.

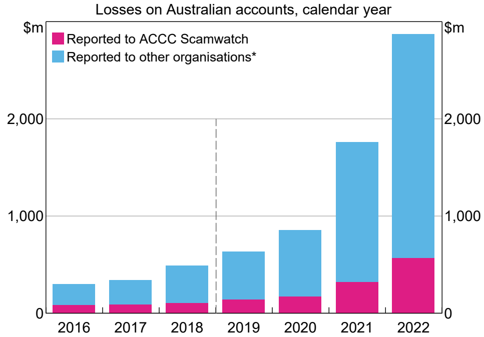
[11] See ACCC (2023), 'Targeting Scams: Report of the ACCC on Scams Activity 2022', April.

While these efforts are welcome, further measures by financial institutions are needed, including actions to increase the adoption and use of NPP PayIDs by business and personal customers and enhance the exchange of fraud and financial crimes information.

Graph 3.3

Total Scam Losses

Losses on Australian accounts, calendar year



* Includes ReportCyber, ASIC, ACMA, ATO and banks when available. Collection of individual bank data began in 2019 and expanded in 2020 and 2021; adjusted to take account of duplicate scam reports where possible.

Sources: ACCC; AusPayNet; RBA.

Enhancing cross-border payments

Payments are increasingly crossing borders as global commerce continues to grow. The need for efficient, competitive and safe cross-border payment services has therefore grown. However, the end-user experience for cross-border payment services often falls well short of that for domestic payments.

Recognising the challenges in cross-border payments and need for global collaboration, the G20 countries (including Australia) endorsed a roadmap to make cross-border payments cheaper, faster, more transparent and more accessible. The roadmap is a multi-year program of targets, milestones and responsibilities, aimed at addressing various frictions in wholesale and retail cross-border payment arrangements. A foundational aspect of the roadmap is a set of quantitative global targets for cost, speed, transparency and access to be met by 2027. In early 2023, the FSB released a revised plan of priority actions that shift the focus of the roadmap from analysis of the problems and possible responses to the implementation of specific initiatives that are expected to have a significant impact on the problems, including by individual countries.[12]

Contribution to implementing the G20 roadmap to enhance cross-border payments

The Bank has been contributing to the international effort to enhance cross-border payments through its participation in international working groups responsible for various aspects of the roadmap. The Bank is also undertaking several key actions to encourage the adoption of new functionality and messaging capabilities for cross-border payments over the coming years, in collaboration with Australian industry participants and other regulatory agencies. These actions should, over time, improve the international interoperability of payment systems and help deliver better outcomes for Australian customers.

A priority action under the roadmap over the next few years is transitioning to richer, internationally harmonised message formats for payments, based on the ISO 20022 messaging standard, which should help to lower costs and speed up payments over time. The Bank is chairing a CPMI working group that is developing a set of harmonised ISO 20022 requirements for end-to-end use in cross-border payment transactions. These requirements will help to align the implementation and use of ISO 20022 globally to deliver its full benefits. The Bank is also participating in an industry-led project to update Australia's High Value Clearing System (HVCS) – the system used to process

[12] Financial Stability Board (2023), 'G20 Roadmap for Enhancing Cross-border Payments: Priority Actions for Achieving the G20 Targets', February.

correspondent banking flows and the Australian dollar leg of foreign exchange transactions – to the ISO 20022 standard. The HVCS successfully adopted the ISO 20022 format in March 2023, with full migration expected by November 2024.

Another important initiative that will help Australia make progress in meeting its G20 commitments is the industry's adoption of fast payment capabilities for cross-border payments. The NPP's new international payments business service will allow the final Australian dollar leg of inbound cross-border payments to be processed through the NPP. This should significantly speed up processing times for payments coming into Australia – according to data from SWIFT, more than 80 per cent of the time taken for a cross-border payment to reach an Australian recipient is due to the final Australian dollar leg.[13] In addition to speeding up incoming transactions, extra data about the sender will be carried with these payments, making it easier for providers to meet their financial crime compliance obligations. The Board and the government have communicated their expectations that NPP participants meet their commitment to accept incoming payments under this service by December 2023.

Explore interlinking the NPP to fast payment systems in other jurisdictions

Fostering the interlinking of fast payment systems has been identified as another priority for the next phase of work under the G20 roadmap. Singapore and Thailand became the first countries to link up their fast payment systems in 2021, followed by Singapore and India earlier this year. Similar bilateral projects are being explored in other jurisdictions. At the same time, the BIS Innovation Hub and partner organisations are continuing to develop 'Nexus', a bridging platform that is designed to standardise the way that domestic fast payment systems can connect to each other on a multilateral basis.

Linking up national fast payment systems across borders has the potential to generate significant efficiency benefits and reduce the need for PSPs to maintain intermediary relationships or participate in multiple payment systems. Establishing a well-designed interlinking arrangement across multiple fast payment systems would be a major undertaking for industry and national authorities.

It is important that Australia keeps up to date with these developments in the global cross-border payments market and supports the international work to explore the interlinking of fast payment systems. Accordingly, the Bank has established with Australian industry participants a group to study the issues involved with potentially linking up the NPP with fast payment systems elsewhere in the world. The group's analysis will identify and consider the benefits and challenges associated with interlinking, as well as the arrangements required to achieve interoperability and help manage risk. This study is expected to be completed by around the end of this year.

Researching central bank digital currencies and other innovations in digital money

There is significant innovation occurring in the payments system related to the emergence of new technologies and the broader digitalisation of the economy. The Bank has been seeking to understand these new technologies and innovations and any implications for the competition, efficiency and safety of the payments system. As the Bank considers how the payment system could evolve in the future, a particular area of focus has been on researching CBDCs and other innovations in digital money.

[13] Nilsson T, R Bouther, M Van Acoleyen and L Cohen (2022), 'SWIFT GPI Data Indicate Drivers of Fast Cross-border Transfers', BIS CPMI Paper, February.

Central bank digital currencies

Most central banks, including the Reserve Bank, are investigating the potential implications of issuing CBDC. A CBDC refers to a digital form of money that would be issued by a central bank and could be used by households and/or businesses as a medium of exchange. It would function as a complement to existing forms of money (such as deposits in commercial bank accounts). Consideration of CBDC has generally distinguished between two broad use cases: a CBDC for retail (or general purpose) use, which would be like a digital version of cash that is essentially universally accessible; or a CBDC for wholesale use, which would be accessible only to certain wholesale market participants (such as banks, institutional investors and large corporates) for use in wholesale payment and settlement systems.

Over the past year, the Bank collaborated with the Digital Finance Cooperative Research Centre on a research project that focused on exploring potential applications of a retail or wholesale CBDC. The project involved the development and issuance of a limited-scale pilot CBDC that selected industry participants could use to demonstrate how a CBDC could support innovative and value-adding payment and settlement services to households and businesses. The project also explored some of the legal, regulatory, operational and technical considerations associated with a CBDC.

The project generated a significant amount of interest and engagement from industry participants. A large number of use case proposals were submitted and 15 were selected for participation in the live pilot, which took place between March and July. The submissions covered a wide range of use cases that issuance of a CBDC could support, with three key themes emerging:

1. There was strong interest in the potential for a CBDC to be used as a low-risk settlement asset to support the development of various kinds of tokenised asset markets.
2. Another focus was on leveraging the potential programmability features of a CBDC to automate and speed up various kinds of complex payment processes.
3. A number of use cases highlighted the potential for a CBDC to increase the resilience of the payments system and support digital economy inclusion, including by being able to be used in an offline environment for 'cash-like' peer-to-peer payments.

In addition to the findings related to use cases, the project also highlighted a number of areas where further work on the legal and regulatory underpinnings for a CBDC would be required, including the legal framework under which a CBDC could be issued and the regulatory treatment of business models that use CBDC. A report on the findings of the project was published in August 2023.

The results of the pilot CBDC project will feed into further work the Bank is undertaking with the Treasury to explore the policy case for a CBDC. As noted in the government's Strategic Plan for the Payments System, the Bank and the Treasury are intending to publish a paper in mid-2024 that will take stock of the research work to date and outline a forward workplan on CBDC, including plans for further stakeholder engagement.

Other innovations in digital money

The Bank has been exploring CBDC within the broader context of research into the future of digital money in Australia. This has included exploring the potential for new forms of private digital money to emerge and the associated benefits, risks and other implications.

One area of focus has been on stablecoins, which are a type of crypto-asset that is designed to maintain a stable value relative to a specified unit of account or store of value, such as a national currency or commodity.[14] Stablecoins aim to overcome some of the shortcomings of unbacked crypto-assets (e.g. Bitcoin), particularly price volatility, potentially making them more attractive to be used as a means of payment or store of value. To date, most activity globally has been concentrated in a small number of US-dollar-denominated stablecoins, which are mostly being used as a 'bridge' to facilitate trading between national currencies and other crypto-assets. However, there has been growing interest in the potential for stablecoins to be used in a broader range of payments and financial services. In Australia, issuance of stablecoins has been relatively limited to date, though some financial institutions have been piloting Australian-dollar stablecoins and exploring their use in cross-border payments and the settlement of tokenised asset transactions.

Regulators and international bodies have been undertaking significant work in recent years to understand and address risks arising from stablecoin activity. A common theme across jurisdictions has been to focus regulatory attention on stablecoins that could become widely used for payments. In Australia, the Bank has been involved in work with the other CFR agencies to develop a regulatory framework for payment stablecoins. The Treasury's recent consultation on modernising the payments licensing framework proposed that issuers of payment stablecoins be regulated in a similar way to stored-value facilities, including that major issuers be supervised by APRA. The Board supports the development of a modern, risk-based regulatory framework for payment stablecoins. The Bank will continue to explore how appropriately regulated stablecoins could play a role in supporting innovation in the payments system.

Consistent with the G20 cross-border payments roadmap, another area of research focus for the Bank has been to explore the potential for innovations in digital money, such as CBDCs or stablecoins, to enhance cross-border payments. The BIS Innovation Hub has been facilitating research projects among central banks that have been exploring the use of CBDCs for cross-border payments. The Bank recently joined as a member observer of Project mBridge, a project facilitated by the BIS Innovation Hub in Hong Kong and involving a number of other central banks that is exploring how CBDCs could be used for cross-border payments using a common multi-CBDC platform. Bank staff were also involved in a project facilitated by SWIFT in early 2023 that demonstrated an interlinking solution capable of connecting CBDC networks and existing payment systems for cross-border transactions.[15]

[14] Dark C, E Rogerson, N Rowbotham and P Wallis (2022), 'Stablecoins: Market Developments, Risks and Regulation', RBA *Bulletin*, December.

[15] Swift (2023), 'Connecting Digital Islands – Swift CBDC Sandbox Project', Results Report, March.