Retail Payments Regulation and Policy Issues

The Reserve Bank determines policy for retail payments systems and undertakes research into retail payments issues under its remit to promote a safe, competitive and efficient payments system. Recent policy work has been focused on a comprehensive Review of Retail Payments Regulation that was commenced in late 2019. The review is looking at a range of topics, including competition and efficiency issues in the card payments market, the effectiveness of the Bank's existing card payments regulations, and some policy issues raised by innovation and the entry of new players into the payments market. With the transition away from cash and towards electronic payments, the Bank has also been examining whether there are any policy issues regarding access to cash services, as well as the cost, reliability and security of electronic payment services. The importance of this work has increased in light of the changes stemming from the COVID-19 pandemic. The Bank also continues to monitor the rapid pace of innovation in the payments system and changes in market structure.

Card Payment Costs and Compliance with the Bank's Card Regulations

As Australians have shifted away from cash and cheques, card payments have grown rapidly. When choosing to pay with a card, households are increasingly using debit cards, which have become the most frequently used payment method in Australia. Given the rapid growth in the use of cards, the Board has continued to focus on holding down the cost of card payments, including by encouraging the provision of least-cost routing (LCR) functionality and monitoring the effectiveness of and compliance with the Bank's card payments regulations. The Bank is also considering a number of issues relating to competition in the card payments market as part of its comprehensive Review of Retail Payments Regulation.

Least-cost routing

During the past year, the Bank has continued to encourage the provision of LCR functionality to merchants as a way to promote competition in the debit card market and help merchants reduce their card payment costs. LCR, also known as merchant choice routing, refers to terminal functionality provided by acquirers that enables merchants to route contactless dual-network debit card transactions to whichever network on the card costs them less to accept. From a merchant's perspective, the cost of accepting debit card payments can vary depending on which network the transaction is processed through, even though there is little or no difference from a customer perspective (see 'Box B: The Cost of Card Payments for Merchants'). With the majority of debit cards on issue in Australia being dual-network cards and there being a significant increase in the share of debit card transactions over the past decade, many merchants could benefit from cost savings by implementing LCR. Changing payment patterns in response to the COVID-19 pandemic, notably the shift from cash to contactless card payments, have also underscored the potential benefits of LCR.

Following pressure from the Reserve Bank over a number of years, most of the major acquirers had introduced some form of LCR functionality by the middle of 2019. The Bank has continued to monitor the rollout of LCR capabilities during the past year and the take-up among merchants. To date, take-up across most acquirers appears to have been fairly low and concentrated among larger merchants. To some extent, this may reflect a decline in potential cost savings to some merchants as the international card schemes have lowered some debit interchange fees in response to the competitive pressure flowing from LCR (see the section on 'Interchange Fees' below). However, the low take-up may also reflect a general lack of awareness among merchants of the potential benefits and implications of LCR, suggesting a role for more active promotion and education by acquirers. Moreover, some acquirers still only offer LCR on a limited range of the terminals they support and their LCR implementations vary in the degree of sophistication and potential cost savings they offer merchants. For example, only a few acquirers offer a version of LCR that maximises merchant savings by enabling 'dynamic' (or smart) routing based on transaction value and payment network; most require merchants to nominate one scheme for all debit transactions, although it is typically the case that one scheme is not the lowest cost for all transactions. Some smaller merchants may not have any incentives to implement LCR because they are on simple pricing plans that effectively charge the same rate for transactions on all schemes; the Bank is not aware of any acquirers taking advantage of the potential costs savings from LCR to improve the value offered by these types of plans.

Some merchants that have adopted LCR have identified various issues that limit its effectiveness. These include the existence of some cards with outdated chips that cannot be routed and issuer-imposed limits on the value of eftpos transactions preventing the routing of some transactions to eftpos. In addition, there have been a few reports of customers of some smaller financial institutions being charged fees for exceeding a fixed number of monthly eftpos transactions permitted under a legacy account product. Industry participants have indicated to the Bank that they are working to resolve these issues to support a more effective LCR experience.

The Bank has also been monitoring the response of card schemes and financial institutions to the rollout of LCR. While the competitive pressure associated with LCR appears have resulted in lower interchange rates for some merchants, particularly larger ones, there is some evidence that this has been accompanied by increases in rates on some other types of debit transactions, including where LCR is not an option. The Bank has also heard concerns from some merchants that they may be penalised by higher interchange rates on their credit transactions if they adopt

LCR for debit transactions. The Bank has been engaging with the Australian Competition and Consumer Commission (ACCC) on some of the competition issues associated with LCR.

Overall, while LCR has had the desired effect of improving competition in the debit card market and lowering payment costs to some merchants, there are still many merchants, particularly smaller ones, that may not be gaining the full benefits from this initiative. Consequently, as part of the Review of Retail Payments Regulation currently underway (see below), the Bank is considering whether any additional actions might be warranted in relation to LCR to enhance competition and efficiency in the debit card market. The importance of this work has increased in light of the shift from PIN to contactless transactions as a result of the pandemic.

Interchange fees

Wholesale interchange fees, which are paid by acquirers to issuers per transaction, are a significant component of the cost to merchants of accepting a card payment. The Bank's interchange standards cap the level of interchange fees that designated schemes can set for transactions on Australian-issued cards. Weighted-average interchange fees are required to be below a benchmark of 0.50 per cent for credit cards, and 8 cents for debit and prepaid cards. The weighted-average benchmarks provide flexibility to the schemes to set different rates for different card, transaction and merchant types. The benchmarks are supplemented by ceilings on individual interchange rates to limit the disparity between fees applicable to larger 'strategic' merchants and smaller businesses. These ceilings are: 0.80 per cent for credit cards; and 15 cents, or 0.20 per cent if the interchange fee is specified in percentage terms, for debit and prepaid cards.

Compliance with the interchange benchmarks is observed quarterly, based on transactions in the preceding four quarters. In the event a scheme has exceeded the benchmark, it must reset its interchange fee schedule, such that had those fees applied over the preceding four quarters, the benchmark would not have been exceeded.

The international schemes have typically set their credit interchange fees such that the weighted-average rate is very close to the benchmark in most quarters, which has resulted in the need to reset their schedules frequently. In 2019/20, Visa was required to reset its credit interchange fee schedule twice, while Mastercard was required to reset in every quarter. Some submissions to the Bank's Review of Retail Payments Regulation noted that the frequency of resets created significant costs for participants in the payments system (see below). Schemes could reduce the frequency of required interchange fee resets by setting their rates more conservatively relative to the benchmark.

By contrast, there were no resets required for debit and prepaid cards in 2019/20, as weighted-average interchange fees remained below the benchmark for all designated schemes. In fact, weighted-average interchange fees generally trended down over the year, as schemes continued to respond to competitive pressures created by LCR. These responses included reductions by all the schemes in interchange fees for card-present transactions on standard consumer cards at non-strategic merchants, while Visa also reduced its fees for some strategic merchants. From July 2020, eftpos introduced new 'package rate' interchange categories for transactions on dual-network debit cards (DNDCs), which offer lower fees to merchants that route transactions to eftpos. By contrast, interchange fees for online debit transactions, for which LCR is not currently available, have remained relatively high. For example, the international schemes' fees for online transactions with standard consumer cards are both at the debit ceiling.

Over 2019/20, the schemes made a number of other voluntary changes to their interchange fee schedules. These included changes designed to encourage the adoption of tokenisation technologies to reduce fraud (see the section 'Payment Security Initiatives' below for further details).

Net compensation

To prevent circumvention of the interchange fee benchmarks and ceilings, the Bank's interchange standards contain a requirement that issuers may not receive 'net compensation' from a scheme in relation to card transactions. This requirement is intended to limit the possibility that schemes may use payments and other incentives to issuers (funded by higher scheme fees on acquirers) to effectively replicate interchange fee payments. This requirement was first introduced in July 2017. Following consultation with the industry, the Bank varied the standards effective July 2019 to:

- require the use of accrual accounting in determining net compensation
- clarify the definitions of various elements of net compensation, and
- make clear that only sponsoring issuers in multiple-issuer aggregator arrangements are required to comply.

These variations were intended to improve clarity and minimise compliance burden, but did not change the purpose or substantive effect of the standards. Following a review of 2018/19 compliance certifications, the Bank issued further guidance on the definitions of certain aspects of the net compensation provisions in May 2020, which was designed to support a consistent interpretation of the requirements across the industry. The certification process for 2019/20 indicated that the 'net compensation' provision was working as intended.

Surcharging

The Bank's surcharging standard protects the right of merchants to impose a surcharge on payments made using cards from designated schemes.[14] But it also ensures that consumers are not excessively surcharged, by limiting surcharges to the merchant's average cost of accepting a card payment for the relevant scheme. To support surcharging decisions, statements from acquirers and payment facilitators are required to include easy-to-understand information on the average cost of acceptance for each designated scheme. These requirements are complemented by powers given to the ACCC to monitor and enforce the ban on excessive surcharging. In addition, a number of card schemes that are not designated, and therefore not subject to the surcharging standard, have formally undertaken to keep their surcharging rules consistent with the standard.

The Bank's monitoring indicates that there has been a high level of compliance with the surcharging framework by schemes and acquirers. The ACCC has also indicated that there was a reduction in the number of surcharging complaints it received during 2019/20 and it did not commence any new formal enforcement proceedings relating to excessive surcharging during the year after dealing with a handful of cases in the prior few years.

Data from the Bank's 2019 Consumer Payments Survey (CPS) suggest that surcharges on card purchases remain relatively uncommon.

14 Under Australian consumer law, merchants are permitted to surcharge all payment methods (including cash). However, if a merchant's customers cannot avoid paying a surcharge through all accepted payment methods, the merchant must incorporate that surcharge amount into its advertised or displayed prices, rather than adding it on as a surcharge during the payment process.

Nonetheless, surcharging is more frequent in some merchant categories (for example, travel) and credit cards are more likely to incur a surcharge than debit cards.

Review of Retail Payments Regulation

In November 2019, the Bank commenced a holistic Review of Retail Payments Regulation with the publication of an Issues Paper and the start of a stakeholder consultation.[15] The Bank has conducted comprehensive reviews of its regulatory framework every five years or so, with the last one taking place in 2015/16. This timing recognises the trade-off between providing stability to the regulatory framework and responding to policy issues that emerge as the market evolves. Several developments suggested that it was particularly timely for the Board to review the regulatory framework. Two recent inquiries – one by the Productivity Commission (PC), another by the Black Economy Taskforce (BETF) – made some recommendations relevant to the Bank's payments regulations. The retail payments landscape has also changed appreciably in recent years, reflecting technological change, payments innovation, the entry of new providers and changing payment preferences of end users. The Review was originally intended to be completed during 2020 but was temporarily put on hold in March in order to reduce the demands on industry stakeholders during the COVID-19 pandemic. The Bank now expects to complete the Review in 2021.

The Issues Paper sought stakeholder feedback on a wide range of topics that could be covered by the Review. While some of the issues are directly relevant to the Bank's existing card payments regulation, the Review is intended to be broader ranging and will also consider whether there are any gaps in the retail payments system that should be addressed and whether there are any regulatory issues outside the narrower scope of card payments. Some of the specific topics raised in the Issues Paper included:

- the possibility of lowering the interchange fee benchmarks, particularly in light of recommendations in the recent PC and BETF inquiries[16,17]
- the costs to industry of frequent resets of interchange fee schedules by schemes to comply with the benchmarks, and whether alternative approaches to compliance may be less disruptive while still achieving the same policy objectives
- whether regulation should be extended to inter-regional interchange fees and whether, from a level-playing-field perspective, there is also a case to apply regulation to three-party schemes (which are not covered by interchange regulation)
- the functioning to date of LCR of contactless payments using DNDCs and whether further steps should be taken in relation to LCR to enhance competition and efficiency in the debit card market
- broader issues related to DNDCs, including whether changes in technology (such as the shift towards digital payments) have changed the case for promoting the continued issuance of DNDCs and what policy actions might be required to

15 For more information, see 'Review of Retail Payments Regulation'. Available at <https://www.rba.gov.au/payments-and-infrastructure/review-of-retail-payments-regulation/pdf/review-of-retail-payments-regulation-issues-paper-nov-2019.pdf>.

16 See Recommendation 17.1 of the PC's final inquiry report on Competition in the Australian Financial System. Available at <https://www.pc.gov.au/inquiries/completed/financial-system/report/financial-system.pdf>.

17 See Recommendation 3.3 of the BETF's Final Report. Available at <https://treasury.gov.au/sites/default/files/2019-03/Black-Economy-Taskforce_Final-Report.pdf>.

promote competition and efficiency in an environment where single-network cards became more prominent

- the implications of the growing importance of mobile devices and digital platforms for competition, efficiency and risk in the Australian retail payments system, including issues around the provisioning and tokenisation of DNDCs
- whether further policy action is warranted to enhance competition in the provision of acquiring services to merchants, including through greater price transparency
- whether 'buy now, pay later' providers should be required to remove any no-surcharge rules, consistent with earlier actions relating to card systems that applied such rules
- a range of broader strategic issues, including the future role of cash, the potential future role for a retail central bank digital currency, the implications of the prospective issuance of 'global stablecoins', the future of the cheque system, and the case for coordination or consolidation of the domestic payment schemes.

The Bank received over 50 written submissions in response to the Issues Paper and consulted with a wide range of interested parties before the Review was formally put on hold in March. It is expected that industry consultation could recommence in coming months, once the demands on stakeholders associated with the COVID-19 pandemic have eased. The Bank is planning to publish a conclusions paper during 2021 and will separately consult on any significant policy proposals coming out the Review.

Regulatory and legal developments in relation to interchange fees in some other jurisdictions may be relevant to aspects of the Bank's ongoing Review. In Europe, the European Commission recently assessed the effectiveness of its interchange fee regulations, which were implemented in 2015/16 and include caps on interchange fees. It concluded that the regulations had successfully reduced merchant payment costs, resulting in either improved services for consumers or lower consumer prices. It also found no evidence that lower interchange fees had led to higher cardholder fees or less innovation in card payments. In the United Kingdom, the Supreme Court in June found that interchange fees set by Visa and Mastercard breached European Union competition laws, by restricting competition in the acquiring market. The court concluded that these fees amounted to a collective agreement to fix a minimum price floor for merchant service fees, resulting in a large share of merchant service fees being immunised from competitive bargaining.

Declining Cash Use and the Supply of Cash Services

As discussed in the 'Trends in Payments, Clearing and Settlements' chapter, a structural decline in the use of cash for payment transactions has been underway in Australia for at least a decade. This trend can be largely explained by Australians opting for newer and more convenient electronic payment methods over cash. There are no indications to date that the shift away from cash has been the result of end users finding it difficult to access cash withdrawal or deposit services. Indeed, the amount of cash in circulation has continued to grow, reflecting the demand to hold cash for precautionary purposes and as a store of value. Moreover, the vast majority of merchants have continued to accept cash as a means of payment.

Recently, the outbreak of the COVID-19 pandemic appears to have accelerated the decline in the use of cash, with many consumers increasing their use of contactless payment methods or choosing to shop online. Many businesses have also been keen to encourage the use of contactless payments over cash; a few have gone as far as to stop accepting cash or imposing surcharges on the use of cash. While it is difficult to predict how enduring these recent changes in payment behaviour will be, it seems likely that some people will maintain their increased use of electronic payments going forward, implying a permanent step-down in cash use.

The ongoing decline in cash use could change the economics of providing cash distribution services with potentially adverse implications for the supply for cash services by banks and other participants. Given that many businesses and households still rely heavily on being able to access and use cash, the Board believes it is important to maintain adequate access to cash deposit and withdrawal services across the country, particularly in regional and remote areas where the reliance on cash is often higher. Accordingly, the Bank has been engaging with banks and cash-in-transit operators on the challenges of supplying cash distribution services as cash use declines. These discussions have highlighted a range of actions that have been taken, or are being considered, to improve efficiency and reduce the costs of providing cash services. Rationalisation of some ATMs (see below) and branch services has been part of the response.

Despite a reduction in the number of cash access points over recent years, analysis by Bank staff indicates that the vast majority of Australians continue to have good access to cash withdrawal and deposit services through bank branches, ATMs and Australia Post 'Bank@Post' outlets. The Board will continue to monitor access to cash services and trends in the use and acceptance of cash, and will consider whether any policy actions may be required to support the continued provision of cash services during the transition away from cash.

Developments in the ATM Industry

One area where the declining transactional use of cash has been having an impact is the ATM industry. As discussed in the 'Trends in Payments, Clearing and Settlement' chapter, the number and value of ATM cash withdrawals has been declining for more than a decade. This has prompted banks and other ATM deployers to begin to rationalise their ATM fleets over recent years, with the total number of active ATMs in Australia declining by about 15 per cent to March 2020 since the peak in 2016. For banks, the focus initially was on rationalising their off-branch fleets, and some banks have recently begun to sell their remaining off-branch fleets to third-party operators, supported by commercial arrangements that enable the banks' customers to continue using the machines fee-free. By contrast, banks have generally sought to maintain their branch ATM fleets, and they are also continuing to invest in upgrading the capabilities of these machines to handle a wider range of services, including cash deposits, as part of broader branch modernisation strategies.

The Bank has indicated that it has an open mind to the consolidation of ATMs under one or more ATM utilities, whether jointly owned by participants or outsourced. In an environment of declining ATM use and rising costs of ATM deployment, such arrangements may be a more efficient way to sustain a broad coverage of ATMs, which is particularly important for regional and remote areas that often have fewer options for accessing cash services.

The Bank has been keen to ensure that its ATM Access Regime does not pose any unnecessary impediments to consolidation in the industry. The Board reviewed the ATM Access Regime last year and decided to retain it in its current form, with another review to take place within the next couple of years. Even though the policy case for retaining the Access Regime may not have been as strong as when it was introduced over a decade ago, the Board concluded that it could still serve a useful purpose of promoting fair access to the ATM industry. This was consistent with the views of a number of stakeholders who wanted the Access Regime to be retained, at least until changes associated with the ongoing consolidation of the industry had played out. Notwithstanding this, the Board recently indicated that it would be open to considering specific exemptions to the interchange restrictions in the Access Regime, so that sensible consolidation initiatives that can help sustain a broad coverage of ATMs are not inhibited. The Bank will continue to engage with industry participants to understand developments in the ATM industry, and is happy to respond to any stakeholders who have concerns about the impact of the Access Regime.

The Future of the Cheques System

As discussed in the chapter 'Trends in Payments, Clearing and Settlement Systems', the use of cheques in Australia has continued to decline at a rapid rate in recent years, and the changes associated with COVID-19 are likely to further accelerate the transition away from cheques as more people adopt digital alternatives. Given the largely fixed costs of maintaining the cheques system, the average cost of processing cheque transactions will continue to rise as cheque use falls further. Therefore, from an efficiency perspective, the Board believes there would be benefits in proactively managing the decline in the cheques system, with a view to closing it at some point in the future.

While any decision to withdraw from providing cheque services will ultimately be a matter for financial institutions based on their customers' needs, the Bank has been engaging with the industry on the steps that would be required to wind down the cheques system. Key among these will be sustained efforts by financial institutions to raise awareness of viable alternatives to cheques for customers that still use them and to support those customers in transitioning to alternative payment methods. There are also a number of legislative barriers that will need to be addressed. For example, there is some state and federal legislation that still mandates the use of cheques as a means of payment in certain circumstances or that otherwise would prevent financial institutions from stopping accepting cheques. The Bank will continue to work with the industry to support an orderly wind-down of the cheques system in a way that enables the payment needs of remaining cheque users to be adequately met.

Regulatory Framework for Stored-value Facilities

During 2019/20 the Board continued to be briefed on the Bank's work with the Council of Financial Regulators (CFR) to review the regulatory framework for stored-value facilities (SVFs) in Australia. These products encompass a wide range of facilities that enable customers to store funds electronically for the purpose of making payments. The CFR's review was initiated in mid 2018 and was carried out by a working group chaired by the Bank that included representatives from the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC) and Treasury.

Broadly speaking, the objectives of the review were to consider whether aspects of the regulation of SVFs could be simplified and made more transparent, and to ensure that the regulatory arrangements do not pose undue obstacles to innovation and competition, while maintaining appropriate levels of consumer protection. The review addressed recommendations from the PC's 2018 Inquiry into Competition in the Australian Financial System and the earlier 2014 Financial System Inquiry.

The outcome of the review was a set of recommendations for a revised regulatory framework for SVFs that was provided to the Government for consideration in October 2019. The recommendations were aimed at modernising the regulatory arrangements for SVFs, recognising the potential for such facilities to play a more prominent role in the payments system in the future (as has occurred in some other jurisdictions). The CFR's recommendations sought to simplify the regulatory framework in a way that would be conducive to innovation, while providing appropriate consumer protections. While the Government has yet to formally respond to the recommendations, the Bank, APRA and ASIC have continued to administer their respective regulatory requirements in relation to SVFs and been actively engaging with a number of current and prospective providers of SVFs about the Australian regulatory requirements.

Review of Regulation of E-conveyancing Platforms

E-conveyancing refers to the digitisation of property conveyancing transactions, including for the lodgment of property dealings with land registries, financial settlement, and payment of associated duties and taxes. Australia's first e-conveyancing platform, Property Exchange Australia Limited (PEXA), was formed out of a joint initiative by state governments and began operating in 2014. A second platform, Sympli, began offering services in late 2019. E-conveyancing is available in most states and territories, and use of e-conveyancing platforms has been made mandatory for almost all types of real property transactions in New South Wales, Victoria, Western Australia and South Australia, with other states and territories likely to follow suit.

The regulatory framework for e-conveyancing is currently administered by the Australian Registrars' National Electronic Conveyancing Council (ARNECC), which comprises the state and territory Registrars General. While the Bank does not have a formal supervisory mandate in relation to e-conveyancing, the Council of Financial Regulators recently agreed to form a working group with the ACCC and ARNECC to review elements of the regulatory framework for e-conveyancing systems, with the aim of identifying enhancements that would promote consumer protection, resilience and competition in the e-conveyancing market. The Board will monitor this work and consider whether it has any implications for the Bank's role in the regulation and oversight of payments systems and financial market infrastructures (FMIs). The Bank has also been participating as an observer in state-led work on the interoperability of e-conveyancing systems.

Promoting the Reliability of Electronic Retail Payments

Reliability is a key feature of an effective electronic payments system. Outages to retail payment services that impede the sending and receipt of payments can cause significant inconvenience, and in some cases harm, to households and businesses and can be disruptive to other payments providers. With the increasing use of electronic payment services and the reduction in people carrying cash, the reliability of electronic payment services has become more critical to the smooth functioning of the economy.

Data collected by the Bank indicate a significant increase in the frequency and duration of retail payments outages in recent years (see 'Trends in Payments, Clearing and Settlement Systems'). To promote improved reliability in retail payments services, the Bank began working with the industry in late 2019 to enhance its quarterly data collection for retail payments incidents, and develop a standard set of statistics on operational outages to be publicly disclosed by individual institutions. The initiative has been supported by APRA, which is contributing to the process. Better and more transparent information about the reliability of retail payment services is intended to raise the profile of this issue among financial institutions and their customers, and enable improved measurement and benchmarking of operational performance. These benefits should support public confidence in the electronic retail payments system over the longer term.

Recognising the considerable operational impact of the COVID-19 pandemic on retail payments providers, in March 2020 the Bank postponed its engagement with the industry on the reporting and disclosure frameworks for retail payments incidents. It expects to recommence industry discussions in the latter part of 2020, with the aim of introducing the new requirements from around mid 2021.

Operational reliability in retail payments depends not only on end user services provided by individual institutions, but also on the underlying infrastructure that supports payments. This includes shared payments infrastructure for processing card and electronic bank transfers, as well as services provided by the telecommunications and energy sectors. While outages to these infrastructures have been more isolated than those at individual institutions over the past few years, they can have a major impact if they occur – in many cases infrastructure outages represent a 'single point of failure' that would disrupt the services of all payment providers at the same time. As part of its focus on the systemic resilience of retail payments, the Australian Payments Council is developing a strategy to address system-wide operational risks in a more coordinated way. The Board is continuing to monitor the efforts by the retail payments industry to ensure their systems and services are resilient and reliable.

Payment Security Initiatives

Security is another key feature of an effective electronic payments system. Retail payment fraud imposes significant costs on consumers, businesses and financial institutions, and can potentially undermine confidence in the use and acceptance of electronic payments. Overseeing industry efforts to enhance the security of retail payments is therefore a priority for the Board. Bank staff regularly brief the Board on developments in payment fraud as well as technology-led innovations that may enhance payment security.

A major focus for the industry in recent years has been addressing rising fraud on card-not-present (CNP) transactions (see 'Trends in Payments, Clearing and Settlement Systems' for data on card payment fraud). The industry has pursued various initiatives to combat CNP fraud, including upgrading security where merchants hold card data, tokenising card details and improving fraud detection tools. In addition, the industry, led by AusPayNet, has recently implemented a coordinated framework that aims to reduce CNP fraud through stronger authentication of online transactions. A core aspect of the framework is a requirement for Strong Customer Authentication (SCA) at Australian issuers and merchants who consistently exceed specified fraud thresholds.[18] Acquirers are responsible for monitoring and reporting on merchant fraud rates and ensuring merchant compliance with the framework. Breaches of the requirements by merchant acquirers or issuers can result in mandatory SCA requirements for all CNP transactions and possible fines.

While the various card-related security initiatives appear to be having some success in reducing card fraud, losses associated with customer data theft and scams are becoming more significant. Data from the ACCC indicate that financial losses from scams have been growing rapidly in recent years (despite the fact that many scams go unreported by victims); there has also been an increase in scam activity and losses recently associated with the COVID-19 pandemic. One type of scam that has gained prominence is 'authorised push payment' (APP) fraud, which involves fraudsters deceiving people into making payments to them – for example, by posing as a legitimate business seeking payment. APP fraud poses particular challenges because by authorising the payment to a fraudster (albeit unwittingly), the victim may not be able to easily recover their funds via their bank, and these types of payments are not covered by the consumer redress requirements of the ePayments Code.

In response to the growth of new types of fraud and scams, payments providers have been increasing their efforts to educate customers of the risks and the precautions that can be taken. In addition, AusPayNet's recent fraud report highlighted the issue of scams and provided some data on scam reports and losses.[19] And to help prevent and investigate fraud, several organisations, including the major banks and the Australian Government, have been sharing intelligence and data on financial and cyber crime via the Australian Financial Crimes Exchange. Other countries have also taken steps to reduce the risk of losses from payment fraud and scams. For example, the United Kingdom has launched a voluntary industry code designed to improve processes for preventing, detecting and compensating victims of APP fraud. It also recently implemented a Confirmation of Payee service, which enables a payer to check that the intended payee is the true owner of the account before authorising a payment. This is similar to the PayID service for the New Payments Platform (NPP) in Australia, where the payer can check the account name of the PayID before confirming a payment.

The payments industry has a good track record of collaboration to address payment security issues and the Board has been encouraging the industry to continue to work together to address any emerging problems in relation to fraud and scams. Further industry efforts to raise awareness of scam risks and to strengthen fraud detection and prevention will be especially important as more transactions take place online and use of real-time payment methods like the NPP grows.

One development that could help in reducing fraud in Australia is the introduction of digital identity services. The Bank strongly supported the work of the payments industry over the past few years to develop the TrustID digital identity

18 SCA involves verifying that the person making the transaction is the actual cardholder using two or more independent authentification factors drawn from: something that only the customer should possess (e.g. a card or mobile device); something that only they should know (e.g. a PIN or password); and something the customer is (e.g. a biometric feature such as a fingerprint or facial profile).

19 See Australian Payments Network (2020), 'Australian Payment Fraud 2020', Final Report, August. <https://www.auspaynet.com.au/resources/fraud-statistics/2019-Calendar-year>.

framework, which was designed to facilitate the emergence of a network of competing but interoperable digital identity services. These are services that would allow users to establish their identity online with a preferred service provider and then to use this digital identity to prove who they are when interacting online with businesses or government. With the growing digitalisation of the Australian economy, the availability of digital identity services has become increasingly important to improve the security and convenience of online transactions, including payments, and could also significantly reduce the costs to businesses of identifying customers. Following the release of the first version of the TrustID framework in mid 2019, an industry working group led by AusPayNet has been working to develop the framework's governance and accreditation arrangements. The Board has continued to monitor developments in digital identity during the past year and is hoping to see some digital identity services launch in the near future.

Over the past few years, the Australian Government's Digital Transformation Agency has developed a Trusted Digital Identity Framework (TDIF) that provides a set of rules and standards to support the creation and use of digital identity services to conveniently and securely access government services online. Recent updates to the framework have helped to align aspects of the TDIF and TrustID framework; eventually, a digital identity established by a private sector provider (say a bank) may be able to be used to securely access government online services. Two digital identity providers have already been accredited under the TDIF and over the past year and the number of government services where a digital identity can be used has increased rapidly, with more state and federal government services in the pipeline.

Innovation in Payments and the Digital Economy

The Bank has continued to engage with a range of stakeholders on issues related to innovation in the payments system and the digital economy, including by holding discussions with representatives from the financial technology (fintech) and regulatory technology (regtech) sectors, providing submissions to relevant public consultations and through staff attendance at industry events.

In 2019/20, the Bank made two public submissions to inquiries dealing with issues related to innovation in the payments system. In late 2019, the Bank made a submission to the Senate Select Committee on Financial Technology and Regulatory Technology. This submission outlined recent trends and innovations in the Australian payments system and provided an overview of the Bank's recent policy work relating to the fintech and regtech sectors, including in relation to payments system access issues.

In early 2020, the Bank made a submission to the Treasury's Inquiry into Future Directions for the Consumer Data Right (CDR). The Inquiry had called for views on how the CDR could be expanded to enhance competition and innovation in the digital economy. The Bank's submission highlighted its strong support for the CDR in the financial sector, and noted some areas where expansion of the CDR could facilitate innovation and promote competition in a range of financial services, including payments. In particular, the Bank lent support to the expansion of the CDR in the banking sector to include 'write access', provided any security concerns could be appropriately addressed, and for the Inquiry to also consider linkages with digital identity services. Expanding the CDR to encompass 'write access' could facilitate the development of services that make it easier for consumers to switch to financial products that better suit their needs or enable them to securely authorise third parties to initiate payments on their behalf. The link to digital identity services could facilitate consumers receiving the full benefit of services delivered under the CDR, including reducing frictions associated with switching accounts and authorising access to their data under the CDR. The Bank also noted that the CDR could reduce the reliance of the financial sector on 'screen scraping', which has raised security concerns in the past because it typically requires consumers to disclose their internet banking credentials to third parties.

NPP Access and Functionality

The Board continues to have a strong interest in the development and use of the NPP. In mid 2019 the Bank published the conclusions from a public consultation undertaken jointly with the ACCC on functionality and access arrangements for the NPP. The report contained a number of recommendations directed at NPP Australia Limited (NPPA) and NPP participants. Some of the recommendations aimed to encourage the timely rollout of NPP services and the development of new functionality, while others were focused on access arrangements for new participants. NPPA supported all of the recommendations and published a report on how it planned to address them in October 2019.

In response to the recommendations on access, NPPA agreed to modify its participation requirements so that non-authorised deposit-taking institutions (non-ADIs) could join as settlement participants. However, it retained the ADI requirement for full and clearing participants reflecting the importance it placed on prudential supervision in helping to manage the risks associated with direct connection to the infrastructure. NPPA also took steps to lower the initial cost of joining the NPP by halving the shareholder subscription requirement for settlement participants, introducing the option of partly paid shares, and removing the obligation for new joiners to pay pre-program design costs. Starting from 2023, NPPA will also reduce the issue price for new shares by 75 per cent, over a five-year period. In terms of assessing applications for participation, NPPA has extended the mandate of its board-level Governance Committee (comprising the CEO and independent directors) to evaluate new applications to join and has agreed to increase transparency around the outcomes of applications. In line with another Bank and ACCC recommendation, a third independent director was appointed in February, bringing the total number of directors to 13.

NPPA also addressed recommendations aimed at the timely rollout of new capabilities by introducing a 'mandatory compliance framework', under which NPPA can designate core capabilities that NPP participants must support within a specified period of time, with penalties for non-compliance. NPPA also published its first roadmap of future NPP functionality in October 2019. One important element of the roadmap, which is mandatory for all participants, is the development of a 'Mandated Payments Service'. This service will allow end users to establish and manage standing authorisations for NPP payments to be initiated from their accounts by third parties. This will provide a transparent, convenient and secure way for consumers and businesses to make and receive recurring and 'debit-like' payments through the NPP.

Another roadmap initiative that has the potential to generate efficiencies for NPP users is the development of customised message standards that will support automation and straight-through processing for payroll, tax, superannuation and e-invoicing payments sent through the NPP. While it will be optional for participants to send these payment types, the Bank anticipates that financial institutions will compete to provide their customers with the ability to make and receive these data-rich payments. NPPA has also enhanced and extended its Application Programming Interface (API) framework during the past year, providing tools that will assist financial institutions to develop APIs that will enable third parties to utilise the functionality of the NPP.

NPPA published an update in April, which indicated that there had been progress towards delivery of the capabilities in the roadmap during the first six months, despite the impact that the COVID-19 pandemic was having on the financial sector. The prolonged impact of the pandemic will, however, likely delay the implementation of some of the capabilities in the roadmap.

The Board has welcomed the constructive response by NPPA to the recommendations in the joint Bank/ACCC consultation. Over the past year there has been an increase in the number of entities connected to the NPP, including a number of non-ADI entities that have been indirectly connected and are providing innovative payment solutions to their customers. The roadmap includes important new capabilities that have the potential to deliver significant value to consumers and businesses and support further innovation. The Board has also been actively monitoring the rollout of core NPP services by the major banks; despite initial delays, all of these banks are now providing the ability to send and receive NPP payments to the bulk of their retail and business customer accounts. The Bank will continue to monitor and respond to any policy issues that arise in relation to NPP access and functionality. As indicated in the 2019 consultation report with the ACCC, the Bank and the ACCC will undertake a second public consultation on NPP access and functionality starting in 2021.

Migration to ISO 20022 Messaging Standard

Migrating the message formats used for domestic and cross-border payments to a new format based on the ISO 20022 standard is a key strategic issue for the Australian payments industry.[20] Currently, payments over the Society for Worldwide Interbank Financial Telecommunication (SWIFT) network use a proprietary format. SWIFT has planned migration of cross-border payments using its network to ISO 20022 by November 2025, after which it will cease support for the currently used message formats for these payments. A number of jurisdictions have made plans to adopt ISO 20022 in their domestic payments systems ahead of that date. SWIFT has stated that its goal is to eventually migrate all messages sent across its network (including those used in domestic systems) to the new format.

Accordingly, in 2019 the Bank and the Australian Payments Council (APC) undertook an industry consultation to develop a plan for migration of Australian payment systems to ISO 20022. The Bank and APC received submissions from a wide range of industry stakeholders and published the conclusions to the consultation in February 2020.

20 ISO 20022 is an internationally recognised messaging format developed and maintained by the International Organization for Standardization (ISO). It is an open standard that is increasingly being used for messaging in various parts of the financial industry, including for payments initiation, clearing and settlement. Some of the beneficial features of ISO 20022 are that it is flexible, data-rich and network independent. Its growing international adoption is expected to promote interoperability, innovation, efficiency, risk control and resilience in payment, clearing and settlement processes.

The Conclusions Paper confirmed that the scope of the domestic migration would be the High Value Clearing System (HVCS), which is used by financial institutions to clear high-value customer payments, correspondent banking flows and the Australian dollar leg of foreign exchange transactions (with settlement occurring in the Reserve Bank Information and Transfer System (RITS)). The NPP already uses ISO 20022 messaging, and the industry did not consider the conversion of other domestic payment systems (such as the direct entry and the cheque clearing systems) to be worthwhile given the prospective or actual decline in their use. Migration of the HVCS will be a major undertaking for the industry, and rather than migrating all messages in a 'big bang' approach, the project will include a coexistence phase where both ISO 20022 and the existing message formats will be supported for certain payment types. During this phase, ISO 20022 messages with enhanced data content must be used for domestic payments relating to correspondent banking and cross-border flows where the original payment instruction is in ISO 20022 format, but other HVCS transactions can continue to use the existing message formats.

Since the release of the Conclusions Paper, SWIFT has announced a one-year delay to the start of its cross-border payments migration. In line with this change the domestic coexistence phase will begin in November 2022 and is expected to conclude by November 2024, one year ahead of the cross-border deadline. These timeframes are broadly in line with international targets for the migration of domestic payments systems.

In Australia, the industry-led migration project has now commenced. The project is being managed by AusPayNet and overseen by a steering committee comprising an independent chair, the CEO of AusPayNet and senior executives from the four major banks, four other financial institutions, and the Reserve Bank. The Board will receive regular updates from the steering committee, enabling it to monitor progress with the migration and respond if necessary.

Enhancing Cross-border Retail Payment Services

Having efficient and competitive cross-border retail payment services in Australia is important for economic activity and financial inclusion. Retail payments are increasingly crossing borders, whether that be businesses servicing foreign clients or buying supplies from abroad, or individuals sending money overseas or making purchases from foreign retailers. Yet traditional services for cross-border retail payments are far more expensive than those for domestic payments, even considering the additional risks and complexities involved for providers. High prices partly reflect a lack of competition among traditional providers, as well as poor price transparency; there can be additional fees incurred after the transaction, and customers may not be aware of how the 'retail' exchange rate they are being quoted compares with the wholesale exchange rate.[21] In addition, longstanding frictions in the correspondent banking arrangements raise input costs and slow down processing times for bank-intermediated international money transfers.

In this context, the Board has supported a focus on the efficiency of cross-border retail payments as a strategic priority for the Bank's payments policy work. One aspect of this work has been the Bank's engagement with digital

21 A recent ACCC inquiry made several recommendations to enhance competitive dynamics and pricing practices in cross-border retail payment services. See ACCC (2019), 'Foreign currency conversion services in Australia', Final Report, July. Available at <https://www.accc.gov.au/system/files/Foreign currency conversion services inquiry - final report_0.PDF>.

non-bank providers of cross-border payments that have entered the Australian market in recent years seeking to provide services at lower cost than the incumbents. Another area of focus for the Bank has been the very high cost of money transfers to the South Pacific region. For example, the mark-ups over the wholesale exchange rate for transferring funds to South Pacific countries tend to be noticeably higher than for remittances outside the region. The high cost of sending money to the South Pacific is a particular problem as many people there rely on remittances from family and friends in Australia and New Zealand. The Bank is working closely with the Reserve Bank of New Zealand, other South Pacific central banks and multilateral organisations to develop a regional Know-Your-Customer (KYC) framework, which will cover the governance, technical and legal requirements in each jurisdiction. In the longer term, service providers may be sought to operate within the framework. The objective of this work is to help to improve the efficiency and effectiveness of the KYC arrangements for entities servicing the South Pacific. This should support the flow of remittances from Australia and New Zealand to the South Pacific, and also help reduce the cost of these flows.

The Bank is also contributing to a number of global workstreams seeking to enhance the efficiency of cross-border retail payments, most notably the work of the Financial Stability Board (FSB) and Committee on Payments and Market Infrastructures (CPMI) for the G20. This work has identified several focus areas to help address the frictions in existing cross-border payment arrangements, such as coordinating regulatory and supervisory frameworks across jurisidictions (e.g. in relation to anti-money laundering/counter terrorism financing (AML/CTF) regulatory requirements) and improving existing payment infrastructures and arrangements (e.g. enhancing direct access to payment systems and extending operating hours). The final phase of this workstream, to be completed by October 2020, involves developing a 'roadmap' with coordinated actions and timelines for implementing the various proposed improvements.

Policy Issues Related to Stablecoins

The Bank is continuing to monitor developments related to so-called stablecoins, a number of which have been launched or proposed in recent years. Stablecoins are a type of cryptocurrency that are designed to avoid the price volatility experienced by many other cryptocurrencies, such as Bitcoin, typically by backing the stablecoins on issue with safe assets or using algorithmic techniques to try and match the supply of coins with demand. By seeking to reduce price volatility, the intention is to make the stablecoin more attractive to hold as a store of value and medium of exchange. Stablecoins that became widely used in multiple countries could make cross-border payments less expensive and overcome some of the challenges associated with financial exclusion. However, without appropriate oversight and regulation, stablecoins have the potential to be used for money laundering or illicit activities and could raise consumer protection and privacy concerns. A stablecoin that became widely used could also have adverse implications for monetary and financial stability, at least in smaller economies. Recognising the importance of these issues, Bank staff are participating in several global regulatory groups focused on stablecoins, including an FSB working group that is developing recommendations on the appropriate regulatory and oversight approach for global stablecoin arrangements.

At present, there are few Australian dollar-denominated stablecoins and use of stablecoins as a payment method has been very limited in Australia. The Libra project is one of the most high-profile stablecoin initiatives to have been emerged in recent years. The project was originally conceived by Facebook but is now overseen by the Libra Association, a consortium of 27 predominantly payments and technology companies (including Facebook) based in Switzerland. The stated goals of the Libra project are to create an efficient global payments system and improve financial inclusion. The plan is to issue Libra 'coins' on a blockchain-based network that users will access via third-party digital wallets and other services to make payments to other users. The intention is that all of the coins issued will be fully backed by assets held in cash or cash-equivalents and short-term government securities and managed by a Swiss-based entity. It was initially proposed that there would only be multi-currency Libra coins, but the project has since been updated to include the possibility of issuing single-currency coins (initially for the US dollar, pound sterling and euro), which may be more appealing to users who wish to hold a stablecoin denominated in their local currency.

In April the Libra Association applied for a payment system licence from the Swiss Financial Market Supervisory Authority (FINMA). FINMA is considering the application, but the outcome and duration of the process is currently unknown. Given the international scope of the project and the need for a coordinated approach, FINMA has established a regulatory college to incorporate feedback from other supervisory authorities and central banks from around the world. The Bank is participating in these discussions on behalf of other Australian financial regulators. Separately, the Bank and other Australian regulators have been engaging with Facebook on its plans to launch a digital wallet for the Libra payment system called Novi (recently rebranded from Calibra), through which Australians would be able to purchase and hold Libra. These discussions have focused on how Novi – and the Libra payment system more broadly – would be treated under Australian regulatory requirements.

Central Bank Digital Currency

Over the past year, central banks in a number of jurisdictions have continued to undertake research into central bank digital currencies (CBDC) and conduct experiments in this area. For example, Sweden's Riksbank has begun considering technical solutions for an 'ekrona' in response to a sharp decline in the use and holding of cash. And the Bank of Canada has begun contingency planning for the potential introduction of a general purpose, cash-like CBDC.

The Bank does not currently consider that there is a strong case to issue a CBDC for retail (or household) use. There is a range of safe and convenient electronic payment methods already available to households, with new ones being developed, and so it is not clear there would be strong demand for a CBDC as an alternative means of payment. Moreover, a government guarantee of deposits with banks and other authorised deposit-taking institutions up to $250,000 per account means most people already have access to a safe form of digital account-based money. The introduction of a CBDC that is widely available and with no balance limits could also have significant implications for the size and structure of the financial system, and for financial stability and the central bank's balance sheet. For example, in times of financial sector stress, the relative ease of switching from commercial bank deposits to a CBDC (compared with switching to physical banknotes) could heighten the risk of runs on the banking sector, which might have adverse implications for financial stability.

However, the Bank has been exploring some of the technological and policy implications of a form of wholesale CBDC, in particular a settlement token based on distributed ledger technology that could be used in transactions between financial institutions and other wholesale market participants. Some of this work has taken place in the Bank's in-house Innovation Lab and included the development in 2019 of a limited proof-of-concept (POC) for a wholesale settlement system running on a private, permissioned Ethereum network. The POC simulated the issuance of central bank-backed tokens to commercial banks in exchange for exchange settlement account balances, the exchange of these tokens among the commercial banks, and their eventual redemption with the central bank.

The Bank has also recently embarked on a collaborative project with a number of external parties to develop a POC that will build on the Bank's in-house project. This POC will explore the implications of 'atomic' delivery versus payment settlement of a tokenised asset within a single distributed ledger, other programmability features of CBDC and tokenised assets, and the use of CBDC tokens by non-bank wholesale market participants that would not ordinarily have access to exchange settlement accounts. The project will also explore the ability of a distributed ledger technology-based platform to address features like security, privacy and resilience, which would be important in any enterprise-grade application such as a CBDC system.