Strategic Priorities for the Reserve Bank's Payments Work

At its November 2018 meeting, the Payments System Board endorsed a set of strategic priorities to guide the Reserve Bank's payments policy work. These priorities reflected the Bank's assessment of the trends and developments in the retail payments and financial market infrastructure (FMI) areas that could have the most significant implications for competition, efficiency and risk over the next few years. The Bank's medium-term payments and FMI work agendas have been focused on these strategic priorities. The Board will periodically review the strategic priorities as the payments and FMI landscape evolves.

Understanding the Implications of Technology and Innovation in Payment Systems and FMIs

The payments, clearing and settlement industries have been going through a period of rapid technological change and innovation. New technologies are being applied, which is resulting in new products and services that better meet the needs of end users but which can also bring particular risks into sharper focus. Technology is also lowering barriers to entry, which is facilitating the entry of non-traditional players and changing market structures and competitive dynamics. There has been significant investment in fintech firms, many of which are using new technologies to address frictions and gaps in payments and settlement processes. This includes the emergence of digital banks, and potential new securities settlement facilities relying on digital technologies. Large global technology ('bigtech') companies like Apple and Google and online platforms like Facebook and Amazon are also looking to leverage their extensive user networks and technology capabilities to provide improved payment services. The introduction of open banking in Australia is also expected to facilitate increased competition from entities looking to leverage customer data held by banks to provide more convenient and personalised payment services. Finally, many FMIs are looking to improve and expand the scope of their services through new technology, such as in the case of ASX's current project to replace its cash equities clearing and settlement (CS) system, CHESS.

Technology-driven changes to the payments system and FMIs could have significant implications for the Bank's regulatory and oversight work, and also potentially for the way the Bank operates. The Bank needs to be in a position to understand how new technologies are being applied and what the implications are for competition, efficiency and the stability of payment systems and FMIs. This will require frequent liaison and possibly collaboration with innovators, technology providers and other industry stakeholders, as well as users affected by new technologies.

The Bank will also look to utilise its recently established in-house Innovation Lab as a way to help improve its understanding of new and emerging technologies that are relevant to its payments policy and FMI responsibilities.

The entry of technology-enabled players has the potential to significantly alter the structure of the payments industry and could raise access and competition issues that the Bank may need to address. For example, issues may arise in relation to how new entrants access existing payments infrastructures. There is also the potential for technology 'lock-out' issues to arise, whereby access to beneficial new technologies is restricted, or new technologies are applied, in ways that undermine competition and efficiency. The Bank will continue to work with other domestic regulators and the Treasury with a view to making the legal and regulatory framework accommodative of new technologies, and will look to ensure that the environment remains conducive to competition and that any new risks that technologies introduce are appropriately managed.

Overseeing the Evolution of the Payments Mix and Promoting Reliable, Secure and Low-cost Electronic Payment Services

As discussed in the chapter on 'Trends in Payments, Clearing and Settlement Systems', Australia's payments mix is continuing to evolve. The use of paper-based payment methods – cash and cheques – is continuing to decline, while the use of electronic payments, like cards and bank transfers, is growing. If anything, these trends have accelerated in recent years as innovations, such as contactless cards and digital wallets, have made electronic payment methods more convenient, accessible and secure. The availability of the New Payments Platform (NPP), and services that utilise its capabilities, should also provide additional impetus to the migration towards electronic payments. Consistent with its mandate, the Bank has a role to play in overseeing the transition towards an efficient and reliable payment system, while also making sure that the needs of the users of the payments system are adequately met. This raises a number of priorities for the Bank's payments policy work:

- The Bank will continue to monitor developments and contribute to debate through the provision of data and research on changes to the payments mix and the efficiency of Australia's payments system. In late 2019, for example, the Bank will undertake its fifth triennial survey of consumer payments, with the results to be published in the first half of 2020. The coverage of the survey will continue to evolve to take account of changing payment preferences and innovations.
- The shift to electronic payments, particularly cards, means merchants are becoming more reliant on acquirers and online payment providers for their payment needs. It is therefore important that the market for card acquiring services is competitive, efficient and responsive to the needs of merchants. The Bank has taken a number of regulatory actions aimed at improving competition and efficiency in the market for card payment services and recently has been pushing acquirers to provide least-cost routing functionality as a way to give merchants greater control over their payment costs. However, there continue to be concerns raised by some stakeholders about the degree of competition in the acquiring market. Given the importance of supporting the shift to electronic payments, the Bank will be closely monitoring the state of competition in the market for acquiring

services. Many of these issues will likely be addressed as part of the next comprehensive review of card payments regulation that the Bank will undertake in 2020.

- While the Bank's regulatory work to date has focused on improving competition and efficiency in the market for domestic retail payments, 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 online purchases from foreign retailers. However, cross-border retail payments are typically slower, costlier and more opaque than domestic payments. This may partly reflect the additional risks that must be managed and the larger number of intermediaries and other complexities involved, but there are concerns that inefficiencies and a lack of competition may be contributing to these outcomes. Recently, a number of new tech-driven providers have entered the market for cross-border retail payments and there have been a number of other innovations aimed at improving the functioning of the market. Given that safe and efficient cross-border retail payments are important for economic growth and financial inclusion, the Bank will be paying closer attention to developments in this market.
- The Bank will have a continuing role to play in identifying whether the payments system is meeting the needs of end-users and whether there are any barriers to cooperative innovation. The NPP was developed to address the gaps in the payments system identified by the Bank during the 2010–2012 Strategic Review of Innovation. More recently, the Bank made a number of recommendations aimed at promoting the timely roll-out of NPP services and the development of new functionality as part of the consultation on NPP access and functionality conducted jointly with the Australian Competition and Consumer Commission. The Bank will be monitoring the industry's progress in addressing these recommendations and supporting ongoing investment in the NPP as a platform for competition and innovation. The Bank will continue to engage with the Australian Payments Council to support it playing an effective role as the strategic coordination body for the development of the Australian payments system.
- Dealing with issues associated with the transition away from legacy payment systems, such as cheques, will also be a focus of the Bank's work. From an efficiency perspective, there will be benefits from proactively managing the decline of the cheque system, and possibly closing it at some point in the future. But this needs to be done in a way that enables the payment needs of remaining cheque users to be met via alternative options. The industry is pursuing a number of initiatives in this area in response to an action plan that was developed by the Australian Payments Council. Aside from cheques, a rapid migration of Direct Entry payments to the NPP could also raise questions about the future of the Direct Entry system at some point.
- Ensuring adequate access to cash during the transition to a 'less-cash' society will be a priority for the Bank. The transactional use of cash has been declining for some time, but cash is still used for a significant share of consumer purchases and some groups of the population remain particularly reliant on it. As cash use falls, financial institutions may reduce their provision of cash services. There

are already some signs of this in the ATM market, where some ATM deployers have begun rationalising their fleets in the context of a sustained decline in ATM use. While some rationalisation of these services may be warranted from an efficiency perspective, policy concerns could arise if it became difficult for people who still rely on cash to access it. The Bank will continue to monitor developments in this area and, at some point, may need to consider additional policy measures to safeguard access to cash.

- The resilience of retail payment systems is becoming increasingly important with the shift towards electronic payments. As people are carrying less cash, an outage of a retail payment system may mean that customers cannot undertake transactions, which disrupts commerce and can erode trust of consumers in electronic payments. Following a sharp jump in outages recently, the Bank will be looking to take additional steps to encourage improved operational resilience. To strengthen transparency and market discipline, the Bank will be working with Australian Prudential Regulatory Authority (APRA) and the industry to develop a standardised set of statistics on operational outages in retail payments to be publicly disclosed by individual institutions. The Bank will also be engaging more closely with retail payments providers on operational risks in retail payments and how these issues are being managed. If operational incidents continue to rise, the Bank could also consider imposing operational resilience standards on operators and participants in retail payment systems, as some other jurisdictions have done.
- Overseeing industry efforts to enhance the security of retail payments and minimise payment fraud will remain a priority for the Bank. As more transactions have moved online in recent years, card-not-present (CNP) payment fraud has grown significantly. Fraud imposes significant costs on merchants and other participants in the payments system, and can undermine confidence in the security of electronic payments. The Bank has therefore been encouraging the industry to take action to mitigate the upward trend in CNP fraud. A new industry framework aimed at strengthening the authentication of online CNP transactions has recently been introduced and the Bank will be monitoring its impact on CNP fraud and determining whether any other actions are required. In particular, the Bank will remain alert to the possible migration of fraud to less protected payment channels. Data security will also become a more pressing issue as the digitalisation of payments and other financial services results in more customer data being stored and shared. There are a range of technology-driven innovations that could help in mitigating fraud, such as tokenisation, biometrics, digital identity and other authentication systems. The Bank will continue to encourage the payments industry to work collaboratively to implement these solutions.

Ensuring the Bank Has the Appropriate Supervision Powers and Oversight Framework for Clearing and Settlement Facilities

Not having the powers to respond appropriately and quickly to a policy problem or crisis at CS facilities is a key policy risk. In 2012, the Council of Financial Regulators (CFR) outlined a set of proposed enhancements to the regulatory regime for FMIs, which included enhanced supervisory powers for the Australian Securities and Investments Commission (ASIC) and the Bank. The envisaged changes include giving the Bank its own enforcement powers to underpin its supervision of CS facilities, rather than the Bank having to request that ASIC issue a direction relevant to the Bank's responsibility for systemic risk. More recently, the International Monetary Fund (IMF) has made related recommendations in its Financial Sector Assessment Program review, including that the legal basis for enforcing corrective actions at FMIs should be strengthened. The IMF recommended that the Bank and ASIC's powers be independent from the Minister.

The Bank and ASIC will be continuing to work on proposals that would address the recommendations of the CFR and IMF. This is likely to involve the development of some legislative amendments, to provide for a set of enhanced powers that would ensure that supervisors of CS facilities have appropriate supervisory and enforcement powers. Stakeholders will be given the opportunity to provide feedback on any significant new proposals, potentially as part of the consultation on FMI resolution powers.

In addition, the potential for the increased cross-border provision of post-trade services, as well as the prospective entry of CS facility start-ups to contest existing markets, has suggested a broad-based review of the Bank's policy approach to ensure that staff resources are suitably directed towards the right risks and issues. CS facility licensees operating in Australia have historically tended to be well established in their operations and either systemically important to Australia or with ambitions to be so. Consequently, while the Bank's approach to supervising and assessing CS facilities was intended to be graduated and proportional to the degree of systemic risk posed to the Australian financial system, in practice, there was little differentiation in the approach taken to different facilities, owing to the similarities in importance of these facilities. An important consideration in the review is to ensure the framework encourages the provision of CS facility services to Australian participants and markets in line with Australian financial stability interests, while also taking advantage of oversight by home regulators with supervisory approaches that are sufficiently equivalent to our own. The results of this review are underpinning some changes to the Bank's policies for supervising and assessing CS facilities that were announced in June. Looking ahead, the staff will be modifying the Bank's supervisory approach to better ensure that the frequency, scope and detail of assessments is proportionate to the degree of systemic risk posed by the CS facility to the Australian financial system and the confidence that the Bank has in oversight of the facility in other jurisdictions, including in cooperative oversight arrangements that the Bank participates in.

Developing an FMI Resolution Regime and Crisis Management Arrangements

The Bank, in cooperation with other CFR agencies, is continuing to develop a resolution regime for FMIs. Importantly, this regime will provide legislative powers for a resolution authority to deal with the failure (or likely failure) of an FMI, consistent with objectives of ensuring continuity of services that are critical to the financial system and the maintenance of financial stability. It is expected that the Bank will be the designated resolution authority for CS facilities. This will be a very significant responsibility, and Payments Policy Department has had a small team working solely on resolution for around two years.

Work is currently focused on finalising the design of the regime, in terms of the powers a resolution authority should have and how it is able to deploy them. While a public consultation on the high-level design of the regime was carried out in 2015, further consultation is planned for late 2019. The focus will then turn to the preparation of draft legislation for subsequent introduction into parliament.

The proposed regime would give the Bank significant new statutory powers that would be utilised quite differently from supervisory powers. The Bank will need to ensure it has the appropriate experience and expertise to run such a regime. Other work would need to be done to develop and test formal crisis management arrangements in the event that resolution becomes necessary.