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### **Review of Innovation in the Payments System**

Thank you for the opportunity to comment on the consultation paper, *Strategic Review of Innovation in the Payments System: Issues for Consultation*. Attached are the AFC's comments based on responses from some ADI members. Please contact me if you wish to discuss.

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## Strategic Review of Innovation in the Payments System: Issues for Consultation

Discussion questions	Response
<b>The Decline of Traditional Payment Methods</b>	
<b>The decline of cheques</b>	
<p><b>1. Are there aspects of cheque usage that are unlikely to be dealt with by industry initiatives currently underway or likely to be undertaken in the next five to ten years?</b></p>	<p>No</p>
<p><b>2. Could the decline in cheques be managed by pricing cheque use in a way that provides better signals to users?</b></p>	<p>Potentially, and that will likely happen, however in practice the costs are borne by the cheque processors and so essentially will be passed on. As that occurs Institutions will make decisions as to whether they in turn pass those increasing costs on to customers.</p> <p>The price of processing cheques will likely reduce in the short term with the withdrawal of UPSL from the market which means that the remaining two suppliers, Vipro and ANZ, will pick up UPSL's four customers volumes between themselves within their existing infrastructure. Clearly that is a short term one off which will offset the historical decline to those providers for approx. 2 years until the trend catches up and starts again. UPSL's decision however is illustrative of the cheque processing industry's challenges with declining volume based revenue against a fixed expense base under the current paper exchange methods.</p> <p>Addressing the items which impact the expense base for processing cheques via newer technologies is the best direction in managing the declining volumes.</p>
<p><b>3. Can a case be made for reforms to make cheque processing more efficient and therefore sustainable at lower cheque volumes?</b></p>	<p>Cheques could be better managed via introducing efficiencies such as image exchange and truncation to remove associated costs of processing paper such as: (a) removal of courier costs; (b) removal of the need for large real estate areas in all capital cities to process the paper; (c) efficiencies via higher levels of automation; and (d) reduced storage costs through paper elimination.</p>
<p><b>4. Could institutions unilaterally withdraw from the cheque system, leading to specialisation by a small number of institutions?</b></p>	<p>One of the largest issuers of cheques is Government at various levels. Not accepting cheques would potentially place a FI at odds with the needs of it's customers to access funds passed on to them. Whilst withdrawal of service may happen it would be some way down the track with a number of FI customer's needs to be addressed beforehand. Any FI which did make a move would potentially be in the sights of lobby groups and media + potentially alienate their customer base.</p>
<p><b>5. Is there a case for phasing out cheque clearing over time? How that could be managed while ensuring that satisfactory alternatives are developed?</b></p>	<p>That process is in place via the Future of Cheques work and the body of activities which is being undertaken. The UK experience would suggest that at some stage the phasing out could become political and so in the event that does happen careful management and certification of the methods in which decisions are reached will need to be applied.</p>

6. Should government agencies' policies on payments be used to influence cheque usage?	Yes
7. Should the approach to cheques be determined by individual institutions, determined collectively by the industry, or determined by the Payments System Board?	Via APCA through the Board and Management Committee One. If the Payments Board wishes to get more involved then they should do so via participation in this group.
<b>Cash Replacement</b>	
1. Are there any impediments to the development and adoption of products to replace cash?	There are no impediments, however as we move to products as outlined such as contactless there will be risks to be managed and investments to be made by the FI's and the card schemes. This change is already taking place. In terms of usage, there has been via the GFC an increase in demand for cash which seems to have been perceived as a safe haven by consumers. Assuming that is correct there will be ingrained values and perceptions as a nation which will take time to address. ie: the change is as much cultural as it is technical and there are many segments which prefer cash and will not use other means.
2. Is there any case for public intervention in cash replacement?	For FIs the cost of moving and holding cash is significant. Additionally, post ATM Direct Charging, most FI's have invested significantly in increasing their ATM footprint. There may be a decrease in costs for an FI with reduced cash in the system so that would be attractive. To answer this question would require greater transparency and consultation on the drivers for change and potentially an industry driven direction.
<b>The Environment for Innovation in the Australian Payments System</b>	
1. Do current governance arrangements adequately promote payments system innovation?	They could be better addressed via allowing greater participation through the APCA committees. The private deployers of ATM's noted are a good example. Additionally, the cheque processors not being represented in the Paper Clearing stream are another.  One item that is missing from the overall questions within this survey is the enormous sway which the Card Schemes have over the Payments industry. In many ways they determine innovation.
2. Are the needs of payments system users and non-ADI payment service providers adequately considered in decisions about the direction of the payments system?	By and large they are however there are examples of where they may not be.  It is the reality that under any proportional voting system the larger FIs will determine outcomes. That strong holding between a few players is true of most industries and is certainly not specific to the Payments Industry.  There is a case for some change however balancing dominance and equity with others will be difficult.
3. Are there ways of altering current governance structures to make innovation easier?	Difficult to identify. Also, with a proportional voting structure the larger FIs will dominate.

<p><b>4. Are there ways of altering current governance structures to take more account of the views of end-users?</b></p>	<p>We are not aware of any groups of end users seeking payment system reform. Those seeking reform will tend to be vendors of alternate systems or lobby groups on behalf of a particular industry seeking to overcome what they see as barriers of entry or usage for what they're trying to sell or introduce.</p>
<p><b>5. Could a new decision-making body with broad representation of payments system participants, service providers and end-users provide a better strategic focus for the payments system, taking adequate account of costs and the public interest?</b></p>	<p>That would simply be APCA under a different name with some additional participants; any additional members would, in our view, be welcome however subject to there being a consideration of their scale and or representation base insofar as considering their inclusion and voting rights.</p>
<p><b>6. How could such a body have the capacity to reach decisions across a diverse group of members?</b></p>	<p>The first consideration in any decision should be some straightforward decisions</p> <ul style="list-style-type: none"> <li>• Does this add value?</li> <li>• Is it addressing a real need?</li> <li>• What is the estimated take up or user base?</li> <li>• What is the cost of implementation?</li> <li>• Does the cost of implementation equal the need?</li> </ul> <p>Once those items are addressed then items can be prioritised for decision with perhaps the RBA as chair. Good ideas are plentiful however there needs to be a reality check and business case overlay.</p>
<p><b>7. Could such a group make binding decisions and how could they be enforced?</b></p>	<p>The example of the breakdown of MAMBO is a good example. We are unable to make any practical suggestions about enforcement although there has been much debate. We would not agree with forcing change however.</p>
<p><b>8. Could formalisation of a broader mandate for APCA, coupled with broader representation, provide better industry-wide outcomes?</b></p>	<p>Yes</p>
<p><b>9. What role should the Reserve Bank and the Payments System Board play in setting the reform agenda for the industry?</b></p>	<p>The most recent fundamental end user reform we have seen from the RBA was ATM Direct Charging. The RBA's website says the reform design was for 'transparency' and 'competitive pressure'. The end reality is that the competitive pressure has been upward rather than downward with ATM site rental costs having been subject to increases disproportionate to the rest of the R/E market which will at some point need to be passed on. In the private ATM deployer space we are advised that their target landlords are continually seeking higher levels of rebates on the fee charged, hence them passing on increases to the end user with fees now having increased 25% to \$2.50 in those sites; these deployers now own over half of all ATM's.</p> <p>The RBA and the Payments Board need to consult with the industry and work with it acknowledging that the FI's are the recipients of their customer's feedback and needs. As competitive organisations FIs are all looking for competitive advantage. There is a high burden on the FI's finite resources in the Payments Industry that arise through enabling these types of items</p>

	<p>coupled with the requirements of the schemes and other compliance activities. Most FIs also answer to shareholders so investment needs to be justified.</p> <p>Taking a leadership role in the existing APCA structures in moving debate to where they're seeking would be the logical method such as has happened with COIN and LVSS which will both drive efficiency. Potentially the RBA could make suggestions at a high level based on research. It would then be over to industry to assess the business case. Government intervention should only be considered where there is a clear case of market failure and a favourable cost-benefit.</p>
<p><b>10. Have concerns about breaches of the Competition and Consumer Act (formerly the Trade Practices Act) prevented the industry from achieving greater co-operative innovation? What approaches are suggested to deal with this in a way that does not undermine the intent of the Competition and Consumer Act? What are the advantages and disadvantages of each?</b></p>	<p>This was the case with the Account Switching reforms however they have been overcome. Where there is a will and an appetite from all parties these problems which are often held up as road blocks seem to be overcome. We do not have any specific suggestions.</p>
<p><b>Structure of clearing and settlement rules</b></p>	
<p><b>1. Does the current structure of clearing and settlement adequately allow for the introduction of new payment products? How could this be improved?</b></p>	<p>This may be of more interest to vendors of alternate payment products. We're not aware of their issues or needs at this stage but would be willing to consider these questions when we know specific examples and have an understanding of the demand for the product that they are promoting.</p>
<p><b>2. Is the current structure of rules applied to payment systems, including the five APCA clearing streams, the most appropriate?</b></p>	<p>Under the current structure and clearing streams, yes it is.</p>
<p><b>3. How should clearing and settlement rules change to take best advantage of upcoming functionality in RITS for same-day settlement of bilateral bulk payment files (and existing functionality for same-day batch settlement). Could rules be established for individual 'settlement streams', including for instance on the timing of availability of funds and the individual transaction values eligible for that stream?</b></p>	<p>The current rules associated with the deferred 9.00am settlement mandate that customer transactions are to be complete by no later than 9.00am of a business day. With the introduction of same day settlement but no change to the existing exchange requirements of Tier 1 members it is difficult to see any significant change to posting times. When it is mandated that all Tier 1 members must participate in all daily exchanges then a significant shift can be expected from members to "near real time" posting.</p> <p>There is a by product of multiple settlements which is the need to have a Treasury function managing the underlying position. Increasing exchanges increases Treasury requirements through the day so that burden and capacity also needs to be considered.</p>

<p><b>4. Are there alternative models for clearing rules? For instance, could a set of generic (but narrowly focused) clearing standards cover multiple payment systems, with more detailed system rules applied at the individual system level? Should such clearing arrangements be mandatory for all payment systems, including those not currently party to APCA arrangements?</b></p>	<p>This may be possible via SWIFT as the clearing message delivery channel. Mandatory for all clearing arrangements would be the preferred model.</p>
<p><b>5. What other ways are there of allowing providers of new payment products or systems easy access to clearing and settlement arrangements. Is there a case for establishing a standard minimum payment message type that participants are obliged to accept from agreed counterparties?</b></p>	<p>There is support for having a standard minimum payment message type that participants accept.</p> <p>There needs to be a method to address the suitability for: (a) payment types; (b) the vendor; and (c) the technology to be accepted into the payments system.</p>
<p><b>6. Do existing clearing arrangements allow sufficiently easy access for new participants? If not, what could be done to improve this?</b></p>	<p>If the question is posed from the perspective of new entrants or FI's accessing arrangements our understanding is that it is not difficult and is mainly achieved through sub contracting to existing participants / specialists; given the large investment required this is the most effective way.</p> <p>We are not in a position to answer from the perspective of new payment type vendors.</p>
<p><b>System Architecture</b></p>	
<p><b>1. Could greater use of hubs improve efficiency, access and innovation in the Australian payments system?</b></p>	<p>In theory yes, depending on the views of the large FIs which dominate the initial design and the development prioritisation. Also the introduction of a hub could potentially result in an additional level of cost which may not be commensurate with the innovation delivered.</p>
<p><b>2. In what areas would a hub or hubs be useful – for instance, for transmission of clearing files, or for real-time individual transactions? For what type of payments would a hub be useful? What functions could a hub or hubs provide? Could a hub be available for use by multiple payment systems?</b></p>	<p>MAMBO is the most recent and so most useful example of a hub which was going to be designed for real time transactions.</p> <p>This seemed to provide an opportunity to introduce an industry wide solution that enabled individuals and businesses flexibility in the method of payment available. This would have been especially helpful to micro businesses where the cost of other payment mechanisms can be cost prohibitive.</p> <p>Unfortunately MAMBO is not continuing. For similar reasons, the development of a multi stream hub seems unlikely to eventuate unless there is sufficient incentive/impetus for FIs to collaborate.</p>
<p><b>3. Should hubs be considered best practice for new payment systems? Should existing systems</b></p>	<p>The concept of a hub has merit. However, practice v theory can differ. Joining a network is one thing – however, there have been occasions where the amount of traffic generate by some players has not warranted others to allocate resources to</p>

<p><b>be migrated to a hub? Could hub services be offered in a way that allows participants to opt in, while providing full services to new entrants?</b></p>	<p>enable the connection. Any hub arrangement would need to overcome this issue.</p>
<p><b>4. What type of ownership, governance and management arrangements would be desirable for a hub?</b></p>	<p>The same model as for COIN with voting aligned to number of connections opposed to amount of traffic.</p>
<p><b>Innovation Gaps in the Australian Payments System</b></p>	
<p><b>1. How widespread is the demand for the innovation in question and how significant would the impacts be?</b></p>	<p>The demand for innovation is not something our member FIs receive a great deal of. The main item that would be well received is same day settlement.</p>
<p><b>2. Are there any specific impediments to that innovation occurring, e.g. barriers to entry, co-ordination problems, technological constraints?</b></p>	<p>Scheme innovation is apparent and demonstrative. There may be a tendency for co-ordination bodies to hold on to some existing methods. It is suggested that the RBA may consult with innovation areas within the FIs in consultation with the specialists to gain a balanced view.</p>
<p><b>3. Is there a case for public intervention?</b></p>	<p>There is no obvious case. However, as always, public intervention is warranted to the extent that: (a) following a government/industry investigation there is an identifiable market failure; (b) possible solutions are recommended; and (c) there is a positive cost benefit for the particular solutions.</p>
<p><b>The transmission of data with payments</b></p>	
<p><b>1. Possible solutions to the transmission of additional data with payments include: the use of existing free data fields in the DE system for a referencing system; the reconfiguration of the DE system to accept much larger quantities of free-form information; or the use of another system for payments requiring the carriage of additional data. Are there other alternatives? What are the advantages and disadvantages of each? Which option is preferred? How should that option be implemented?</b></p>	<p>The issue may be overstated and may represent the view of some lobby groups who represent a small portion of the population. Their 'important theme' would require a high level of investment to enable the functionality for a small user group. It is not simply just the payment system but also those systems which takes, feeds or display data such as Internet Banking, statements and other core systems. The impediments are that there are a lot of systems which have been built to the existing standards and so to do undo these will require a great deal of work, investment and potentially new systems.</p> <p>Before getting to solution, a proper determination would need to be undertaken to determine what is the actual demand for this feature? What use will be made of the data supplied that is in excess of the current BECS field of 18 and by how many?</p>
<p><b>2. What role should messaging standards, such as ISO 20022, play in any solution for transmission of additional data?</b></p>	<p>It makes sense to have a common messaging system</p>

<p><b>3. The superannuation industry is working to address issues associated with transmission of data related to superannuation accounts and payments. Is there a contribution that can be made by the payments industry beyond the proposals discussed above?</b></p>	<p>Yes, however the need and by how many should to be considered.</p>
<p><b>The timeliness of payments</b></p>	
<p><b>1. To what extent will systems already under development or discussion address issues related to the timeliness of payments? What gaps will remain?</b></p>	<p>As the RBA enables LVSS and then moves to intra day settlement in phase 2, those FIs that are capable of intra day processing will enable it. Those who aren't will be at a competitive disadvantage forcing them into making the enabling investment, so as to maintain competitive parity.</p>
<p><b>2. What new systems or enhancements to existing systems would be required to achieve more timely payments? How could these innovations be achieved?</b></p>	<p>Each bank will need their own determination of hardware / software or development on existing; all of this is readily available but will be subject to a substantial investment of time and potentially expenditure. It should be noted that these are payments engines which are complex systems with national repercussions if they fail including much media attention.</p>
<p><b>3. Would multiple same-day interbank settlements be sufficient to facilitate faster availability of funds?</b></p>	<p>Yes – it would require intra-day settlement. Same day settlement could take place after close of business.</p>
<p><b>4. Is there a case for a real-time settlement system for low-value payments and how should it be provided?</b></p>	<p>This is very rarely requested so, if that is the situation, a large investment is not warranted.  From what feedback we do get we believe that customers are, in the main, seeking “same day” settlement rather than “real time” settlement.</p>
<p><b>5. To what extent would financial institutions' own systems need to change to allow faster access to incoming payments to customers' accounts? What would this involve and how could it best be achieved? Could the desired improvements be achieved by competitive pressures if financial institutions were forced to publicly disclose information on the timing actually achieved on payments? Would some form of mandated time limit for availability of funds be appropriate?</b></p>	<p>In the first instance we would look to competitive pressures and public disclosure prior to consideration of any mandates. FIs which apply payments to accounts in both real time and batch modes may support the concept of multiple exchanges for the benefit of our customers. If this is introduced FIs would look to facilitate processing of inward credits upon receipt. Systems support mechanisms across the industry would need to change to resolve technical problems as they occur.</p>



<p><b>6. How strong is the demand for payment options that will provide availability of funds 24 hours a day, 7 days a week? What would need to occur to achieve this?</b></p>	<p>We would suggest that the demand is limited with few requests of this type.</p> <p>If there was a move to real time settlement for ourselves, it would be very difficult to determine what the liquidity impacts may be. Also, the costs of supporting these systems 24/7, both operationally and technically, would be a significant imposition at several levels.</p>
<p><b>Mobile payments</b></p>	
<p><b>1. What form are mobile payments likely to take in Australia over the next five to ten years – SMS-based, mobile internet, contactless or some other form?</b></p>	<p>SMS seems to be used as a supplementary tool for alerts and / or payment confirmation however not as a payment enabler. Contactless growth will be determined by uptake, the schemes and loss levels.</p> <p>One bank is seeing that 30% of Internet Banking customers log on via mobile apps, a significant uplift over the past 3 years, so as technology allows faster screen build times we would envisage mobile internet to be the growth area coupled with a managed escalation of contactless.</p>
<p><b>2. Are there impediments to the development of mobile payments in Australia? If so, what type of payments are being impeded and how?</b></p>	<p>There is a preference for a gradual development approach to mobile payments so that unforeseen events or impediments can be properly actioned. Domestic consumer appetite for the payment innovation needs to be evidenced.</p> <p>There are many examples of ATM Operators offering enhanced functionality failing to receive take up domestically. ATM's appear to be seen as cash dispensers only. However in other markets the consumer uses them for many purposes. It is far more complex than a case of build it and they will come.</p>
<p><b>3. Are there security issues particular to mobile phones that may impede adoption of some types of mobile payments in the future? Are there likely to be issues with interoperability of mobile payment systems?</b></p>	<p>Emerging payment systems such as NFC are dependant on the mobile device in regards to software and hardware integration. Likewise for mobile credit payments such as Square which are emerging in the US and being supported by banks and telcos. Creating specific applications (e.g. iPhone app) to utilise the chip inside upcoming NFC phones will assist in having tighter monitoring of security as they will be specific to devices. With the lack of NFC enabled phones, the security processes are difficult to identify.</p> <p>The last question is very general. It would be part of an acceptance criteria when considering alternate methods.</p>
<p><b>4. Are there adequate standards to support the development of mobile payments in Australia? If not, what standards are lacking, what types of mobile payments are affected, and who should be responsible for setting them?</b></p>	<p>We are aware of only one FI to implement a mobile payments solution that leverages existing SMS, OTP password and payment gateway technologies. NFC payments are yet to enter Australia so standards are yet to be established. Some banks have conducted internal trials with NFC with limited success but this is due, in light of feedback, to software/hardware integration rather than security.</p> <p>Ostensibly this needs standards and potentially APCA or a similar body to drive them.</p>
<p><b>Standards</b></p>	
<p><b>1. What is the case for moving to ISO 20022 compliant standards for Australia's retail payment systems? What is the preferred process for doing so?</b></p>	<p>The introduction of ISO 20022 would potentially provide a number of benefits including the ability to increase remittance details thereby reducing the need of some businesses to continue the use of cheques. Standardising to the ISO format would reduce the need to customise systems and software to cater for domestic standards.</p>

<p><b>2. Should all new payment systems be required to adopt ISO 20022? Should existing systems be required to do so?</b></p>	<p>A move to ISO 20022 would take some time to fully implement however it would seem to be sensible to ensure that from a given date all new systems were capable of supporting it and a sunset date whereby all existing systems were capable.</p>
<p><b>3. To what extent are other standards, such as device standards, an impediment to competition and innovation? Is this justified?</b></p>	<p>It is important that a robust structure is in place to manage the various payment channels and mechanisms and whilst it may at times impede innovation its purpose should be to protect the integrity of the payments system.</p>
<p><b>4. How should compliance with industry standards, both by new entrants and incumbents, be monitored?</b></p>	<p>APCA, or another such body, should be tasked with the management of all participants to ensure that a balance is struck which enables innovation and competition whilst maintaining confidence and integrity of the system and given the necessary powers to take action where participants put the system at risk.</p>
<p><b>5. Is there a case for greater industry co-operation on the setting of security standards for retail payments? If so, how should this be achieved?</b></p>	<p>From our perspective a great deal of cooperation currently occurs but this can always be improved, any interactions should be managed by an independent body such as APCA who are provided with sufficient powers to ensure that standards are adhered to.</p>
<p><b>Future trends</b></p>	
<p><b>1. Are there any significant changes in the payments landscape in prospect that have not been considered by this paper, for instance in terms of architecture or significantly different payment products? What will be the implications of these changes? Are there actions that should be taken now to take full advantage of these changes?</b></p>	<p>From our perspective the demise of MAMBO has left a significant gap in any payments road map as alternate payment mechanisms which could have driven competition were reliant on the ability to undertake low cost real time transactions in areas currently dominated by Visa and MasterCard.</p> <p>The need for a low cost option for micro businesses to receive and make payments would have been addressed to some extent by MAMBO so an alternate solution to that is something which appears to be lacking.</p> <p>A solution to this would provide an additional level of competition to Visa and MasterCard but would need to be driven in a manner which had a more holistic industry approach than was taken under MAMBO.</p>