Australian Banking Association

22 January 2021

Secretariat
Payments System Review
The Treasury
Langton Crescent
Parkes ACT 2600
via email: PaymentsReview@treasury.gov.au

Dear Mr Farrell

Payments System Review: Issues paper

The Australian Banking Association (ABA) welcomes the opportunity to make a submission to the Payments System Review. The payments industry is undergoing significant change globally and the pace of change is expected to continue in coming years. This is a time to take stock and ensure the Australian payments system and its regulation will be future-fit.

Australia's payments system has served its participants and users well and the ABA strongly supports continuing the self-regulatory arrangements within our regulatory architecture. The payments regulatory architecture should support innovation, as well as ensure the stability, and security of an expanded payments ecosystem.

The payments system is closely interconnected to our economy, and monetary and financial systems. Ensuring ongoing stability, security and reliability is therefore critical. Australian consumers and businesses have embraced payments innovation because they trust that their payments will be made in a timely, safe and secure way. Our regulatory settings on payments innovation must support continued investment in secure and reliable infrastructure for the benefit of all.

As part of the payments system, banks actively develop and support innovation so that customers can access new, secure, and competitive banking and payments solutions. Banks continue to invest in payments infrastructure that underpins new services.

The ABA's detailed submission is attached. If you have any questions, please contact me at rhonda.luo@ausbanking.org.au or 0430 724 852.

Yours sincerely

Rhonda Luo
Policy Director

Australian Banking Association

ABA response to the Treasury payments review

Introduction: payments and innovation

Australia's payments system has served its participants and users well. The co-regulation architecture established by the *Payment System (Regulation) Act 1998* (**PSA**) has enabled competition from domestic and foreign participants, development of significant payments infrastructure, and has allowed industry to deliver flexible and rapid responses to market developments.

However, the payments industry has evolved significantly in recent years and a review is warranted.

The Australian payments system is deeply interconnected to the economy, and monetary and financial system, which makes its safety paramount. This importance has increased due to the growth of digital payment methods.

As the discussion paper points out, innovation in payments should be considered through the lens of consumer and business end-users. These users rightly expect that when they make a payment, whether this is done through traditional channels or via a new app, their payments will be made in a timely, safe and secure way and their data will be secure. Users have embraced innovation because of trust in the system. As such, retaining user trust in both emerging products and services, and in the system more broadly, is a pre-requisite to payments innovation now and into the future.

Australian banks continue to build and invest in payments infrastructure, and provide associated support and customer service. Banks actively develop and support technology solutions so that customers can access new, secure, and competitive payments solutions and products, such as apps, digital wallets, and contactless payment. Innovations like PayID are possible because the banks worked with regulators to build innovative payment infrastructure such as the New Payments Platform (**NPP**). Many significant innovations in the Australian payment system have required coordination between, and investment by, entities that are competitors.

Expansion of payments ecosystem

In December 2020, the Reserve Bank of Australia (**RBA**) Governor described the changes we have seen in the payments system in this way: *In some cases it is now better to think of a payments ecosystem, rather than a payments system. In this ecosystem, the payment chains can be longer and there are more entities involved and new technologies used*.

The payments industry was traditionally made up of banks, with a small, homogenous group of participants. Now, it has expanded to include a diverse group of entities including fintechs and companies known as 'big tech'. Competition between existing participants and new providers has had positive outcomes by way of innovative products and services, enhanced user experience and ease of making payments for businesses and consumers. However, business models not predicated on the existing regulatory premise of prudential stability of the payments system are putting pressure on the effectiveness of co-regulation and incentives to invest in payments infrastructure.

These new entities offer services or products that have 'relied on existing payment rails for clearing and settlement of transactions – i.e. supplementing existing card payment methods with new features, channels or business models'.[1] Under the current regulatory architecture, these entities are not subject to RBA regulation nor required to be subject to industry self-regulation.

The entry of big tech adds to the pressure. The ACCC's digital platform inquiry recognised the dominance of big tech, the imbalance in market power between these companies and the news media business, and the gaps in consumer protection.[2] An analogy can be drawn with big tech's role in the payments system as digital payment methods become more important. In immediate terms, the entry of big tech has added costs to payment infrastructure and payment processing, which are currently having

[1] Reserve Bank of Australia, Review of Retail Payments Regulation – Issues Paper (November 2019)
[2] Australian Competition and Consumer Commission, Digital Platform Inquiry – Final Report (July 2019)

to be absorbed by business end-users and banks. Other questions worth considering relate to these entities' access to and use of consumer data including payments data.

Trust, reliability & stability

Traditionally, the safety and stability of the payments system, and outcomes for individual consumer and business end-users, was sufficiently ensured by banking and other financial services regulation. For example, banks are subject to prudential regulation, consumer protection regulation, and financial crime and anti-money laundering regulation. Many of these obligations do not apply to new entrants in the payments system. As new entrants including big tech and alternative players outside the current regulatory framework gain market share, any regulatory gaps or uneven application of regulatory obligations can create problems for both the payments system and end-users.

The gaps have the potential to introduce new risk into the payments system or undermine the effectiveness of existing regulation, including consumer protection, and the detection and prevention of money laundering and financial crime. For example, the detection and prevention of financial crime can become more difficult to achieve where a single entity does not have visibility of the entire transaction path. Some risks and harm may not become visible for some time, liability may not be clear or may fall disproportionately on traditional participants.

Incentive to invest and build

Increasing numbers of new products and services will rely on the same underlying infrastructure so it is important that ongoing investment, maintenance and development is sustainable.

Because some new offerings place themselves outside the purview of regulatory protections to end users, but use the underlying payment rails which do have protections, the cost of supporting customers when things go wrong often falls to the banks even though the bank may have limited visibility or involvement in the transaction. This can also apply to processing of more complex payments, including additional transaction fees to switch providers, and technology and operational support. These additional costs can work against steps to reduce overall transaction costs for customers.

Consideration may need to be given to how fair and proportionate contribution to the costs of building or operating payments infrastructure and supporting end users consistently can be sustained across the value chain.

As with any asset, a country's payments system requires ongoing maintenance and investment, otherwise it will degrade. If existing payment system participants continue to cross-subsidise the costs incurred by new service providers, it will reduce the commercial incentive to maintain existing infrastructure and critically weaken the business case for building new infrastructure. These costs could also reduce their capacity to invest in new technologies and services that can help to achieve the government's digital economy agenda.

Regulatory architecture for today and the future

The payments industry is undergoing significant change globally, and the recent pace of change is expected to continue.

The entry of 'big tech' and fintech, and rapid growth of new business models (i.e., 'buy now, pay later' where merchants pay for consumers to access credit), have highlighted the limits of entity-based regulation and the RBA's regulatory remit. The payments system and the Australian economy are facing new horizons of open data, emerging technology and non-bank payment providers, as well as the challenge of heightened cyber security risk that were not contemplated when the PSA was adopted. The next few years may see new types of opportunities and risks introduced into the payments system. This is a time to take stock and ensure payments regulation will be fit for purpose in the future.

Within a co-regulatory architecture, regulation needs to be limited, function- or risk-based and be capable of responding to changing market structure and business models. Regulators need to understand how payments are changing and be able to adapt. Retaining and strengthening self-regulation allows industry to be responsive given the speed of change.

A future-fit co-regulatory architecture would best equip the industry, regulators and government to address future opportunities and challenges like:

- How crypto-currency and digital currencies can change how payments are made, and challenge the role of money (as a unit of account, medium of exchange, store of value). What is the impact on the broader economy, in terms of how money moves around the economy, the central bank's control of the money supply and the monetary system?
- How will AI and other technology further change how payments are made, how to align payment industry developments with whole-of-government policy such as digital ID and AI. How can the payments industry support Australia's digital economy?
- How does the presence of strong domestic payment infrastructure relate to other government economic policies, for example, the link between payment system resilience and national security, domestic infrastructure investment's flow on impact for Australia's skill base, employment and tax base?

Recommendations

The ABA's recommendations are set out below. The ABA strongly encourages the government to undertake further industry consultation on the key issues identified by the industry, in order to inform conclusions and potential changes arising from this review.

1. Build on the strengths of our existing regulatory architecture. The ABA strongly supports retaining a role for industry self-regulation.
2. Rather than regulation based on entity type, regulation could identify the various functions and services in the payment system.
    a. Doing so can allocate regulatory obligations and liability appropriately across parties in the value chain and help to ensure consistent protection for consumer and business end-users.
    b. Comprehensive application of regulatory obligations, including reciprocity is also important to achieve policy objectives in related areas such as anti-money laundering and financial crime.
3. Improve co-ordination between regulators and government for a whole of government and whole of economy approach (ie, via statements of expectations for regulators). This can help to implement the government's digital economy agenda.
    a. Where there are multiple regulators of payment functions/products, enhance coordination to minimise regulatory gaps that allow arbitrage. Regulatory coordination can also help to streamline and rationalise regulatory obligations such as reporting obligations.
    b. Policy and regulatory decisions about innovation and competition should be made by a regulator or department with payments expertise.
    c. As a range of industries are thinking differently about payments as a transfer of value, regulatory coordination may also be needed with other sectoral regulators or self-regulatory bodies.
    d. Require a single and 'future-fit' privacy regime and a more nimble financial crime and anti-money laundering regime – both critical for a digital economy.
4. Identify and clarify when regulators and/or government can and should intervene to support industry responses to achieve strategic outcomes.
    a. This may include communication of policy objectives, encouraging or mandating comprehensive coverage of self-regulatory measures, and specific issues like working with industry to plan for the retirement of cheques.