

# CommonwealthBank

Commonwealth Bank of Australia  
ABN 48 123 123 124

Level 6  
201 Sussex Street  
Sydney NSW 2000  
Australia

GPO Box 2719  
Sydney

Telephone (02) 9118 6545

Representation  
Business Products and Development

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Dr Chris Kent  
Head of Payments Policy Department  
Reserve Bank of Australia  
GPO Box 3947  
Sydney NSW 2001



By Email to: [pysubmissions@rba.gov.au](mailto:pysubmissions@rba.gov.au)

Dear Dr Kent,

## **Strategic Review of Innovation in the Payments System: Issues for Consultation - June 2011**

The Commonwealth Bank (the Bank) is pleased to lodge the attached Submission to the Reserve Bank of Australia (RBA) in response to the RBA's "*Strategic Review of Innovation in the Payments System: Issues for Consultation - June 2011*" Consultation Paper, released 30 June 2011.

Our Submission is comprised of three parts (attached), viz-

- Part A - General overview of key themes relevant to a discussion of innovation in payments
- Part B - Answers in response to the questions posed in the Consultation Paper
- Part C - Confidential Addendum

Please note that Part C attached is not for publication; Parts A and B will, we understand, be published on the RBA web site.

Thank you for the opportunity to contribute to this important debate. We look forward to meeting with you shortly to continue our dialogue around issues addressed herein.

Yours sincerely

[ Signed ]

Stuart Woodward  
General Manager  
Representation



# Response to Strategic Review of Innovation in the Payments System: Issues for Consultation - June 2011

## PART A

This Part A of the Bank's response to the "*Strategic Review of Innovation in the Payments System: Issues for Consultation - June 2011*" document provides a general overview of key themes relevant to a discussion on innovation in payments.

At the outset, we wish to acknowledge both the importance of innovation in payments, and the Commonwealth Bank's<sup>1</sup> (the Bank's) involvement therein. The Bank has often been at the forefront of proprietary level innovation, as well as being a keen proponent of broader, systemic, innovations and we approach this current consultation in the expectation that this will continue.

### 1. Payment Innovation

For most of our customers, payments are a part of everyday life that is taken for granted - necessary and generally ubiquitous. The ability to make trusted secure payments is one of the foundations on which the Bank functions. We understand that this affords us an opportunity to make an impact on our customers' lives by making payments faster, simpler and more efficient through innovation. This requires a mix of "systemic" and "proprietary" effort.

Innovation enriches our customers' lives and offers challenges and opportunities to those who participate in the payments industry. A few key themes are emerging that we believe will shape the future of payments in this market.

#### 1.1. Technology

Technology will continue to drive payment innovation at both a network and a proprietary level. This will result in faster, simpler payments for our customers, and provide efficiencies for payment providers. It will also contribute to the decline in less efficient payment forms such as cheques and cash.

#### 1.2. Security

Customers want trusted payment services. EMV (Europay, MasterCard and Visa "chip" based technology) has provided increased security of card payments, while online banking transactions are made more secure through two-factor authentications such as SMS. Additionally, customers want to know that their personal data is secure and protected. Intelligent monitoring of a customer's payment activity can help to alert customers to any security issues. The value of a secure payments system to a customer cannot be underestimated and payment providers will need to continue to invest in secure systems to support payments.

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<sup>1</sup> This submission is from the Commonwealth Bank only. Bankwest is making a separate submission.





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### 1.3. Customer Convenience

Customers want quicker, simpler and more efficient payments. Whether this is through quicker payments at point of sale (e.g. contactless and quick payment service), faster access to funds, or online payments made anywhere, anytime, customers are demanding more from payment providers.

### 1.4. Convergence of form factors

Customers are increasingly using non-traditional devices for payments. Online payments for example, once used to be made on a PC, largely during working hours. Increasingly, we are seeing payments on iPhones or iPads (or similar) out of regular working hours – 25% of the Bank's NetBank logins are now via mobile/tablet devices. Additionally, the Bank believes that, in the near future, mobile smartphones will start to replace card 'plastics' as a generally accepted form factor.

It is imperative that developments in the payment landscape, like those mentioned above, are customer led. Having said that we are often reminded of the famous Henry Ford quote (when he was asked about the first car he built):

*"If I'd asked my customers what they wanted, they'd have said a faster horse."*

Customers don't always know what is possible – they know what they want – they just don't know how to get there. So payment providers have the opportunity to show them what we can do and lead them on this journey - as we make payments quicker, easier, more convenient and simply more efficient.

Payments innovation does not happen overnight and is often faced with challenges such as:

- The scale of investment required for innovation;
- Complexities in trying to co-ordinate industry norms and standards;
- An increasingly interwoven and fast-moving world;
- The need for genuine network effects where both payers and receivers benefit; and
- Risks on both sides of the market that need to be managed.

Notwithstanding these challenges, customers will continue to want convenience, security and value for money in payments and it is important that we as an industry continue to drive innovation in payments.

It is important to call out that innovation is frequently risky. There is the old saying that only one idea out of 100 finally makes it to market - and that one idea has no guarantee of commercial success. As custodians of our shareholders' and customers' funds, we need to ensure we innovate for the right reasons such as customer value, rather than because a government or a regulator says we should. What we seek from a government or regulator is creation of, and support for, an environment under which innovation can flourish and under which viable and sustainable customer value propositions and business cases can drive competitive innovation.





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## 2. Innovation at The Commonwealth Bank

The Commonwealth Bank has a strong history of innovation in the Australian payments landscape, leading the market on a number of fronts in payment innovation, including -

### 2.1. Contactless

The Commonwealth's contactless journey began in 2006 with the progressive rollout of MasterCard Paypass cards. Today we have around 2.5 million contactless credit and 2.6 million contactless debit cards on issue. The Bank's recent focus has been on our merchant terminal fleet. Commencing with the small to medium enterprise market in late 2009, we now have nearly 25,000 contactless terminals conducting over 500 million transactions per month.

While we are pleased to be leading the way in Australia, the benefits of contactless payments can only be realised through ubiquity and we are looking forward to the time when the Bank's share of contactless cards and readers across the market is not quite so dominant. Payments are a network business and contactless payments are no different.

### 2.2. Online Banking – Australia's Number One Online Bank

The Commonwealth Bank has always led the market in online banking innovation.

**NetBank** is Australia's leading online banking site with over 5.5 million registered users. Recently, we launched our purpose built NetBank for tablet application and a refreshed CommBank app for iPhones and Android mobile phones. The Bank's latest digital offerings provide a new kind of service experience for this increasingly popular channel. Both apps are the next generation in mobile banking and cater to everyday banking needs while delivering new functionality.

**CommBiz** is the Commonwealth Bank's premium, multi-award-winning online banking platform for business. CommBiz handles massive numbers of complex transactions with ease, including payroll, third-party payments, international money transfers and foreign currency trades. Our online security leads the world - we are the first bank in Australia to provide world-best practice online banking security via NetLock, a USB device that creates a closed system to keep malicious code at bay.

**CommSec** is Australia's number one online broker, the first in Australia to launch an integrated cash management and online trading account as well as Australia's first iPhone trading platform.

### 2.3 Leading Payments Technology

#### Core Banking Platform

In 2010, the Bank successfully introduced its new core banking platform for retail deposit and transaction account customers. This year, we will move our business customers over to the new platform. The new platform enables our customers to experience a range of benefits including new product features, flexible pricing options and real time banking.

The background to this investment is that the Bank's legacy systems had become heavily siloed and inflexible. This led to the decision to update our infrastructure in order to meet future needs and remain competitive in a changing marketplace, resulting in a \$1.1billion Core Banking Modernisation program which began in 2007 and which is targeted to draw to a close in 2012.





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### Payments Hub

Many banks are examining internal payment hubs as a solution for modernising payments infrastructure to remain competitive and mitigate regulatory concerns over resiliency and compliance. The Bank has implemented such a hub.

The Bank's move to a payments hub-based strategy was an adjunct to the larger core banking system infrastructure modernisation program.

The Bank's payments hub strategy evolved from a realisation that the interaction between the Bank's payments systems and the core infrastructure, required a similar modernisation effort given that the payment infrastructure had grown to more than 70 payments related systems, including assembler mainframe applications written in COBOL, and numerous applications rapidly approaching end-of-life, dating back as many as 40 years. Multiple point to point integrations had scattered payments logic across channels, integration layers and product systems, and changes necessitated significant regression testing - frequently costing more than the development effort itself. Our investment in the payments hub will address these issues.

### eVolve

eVolve is the Bank's market leading on-line card payment solution for Australian businesses. eVolve provides easy to use technology to enable our merchant customers to offer more ways to pay by card; including online, by phone, in-person, via post, email, fax, or enrolling in a subscription or pay by instalment plan. Additionally, merchant customers are provided with an instant online store and the ability to take payments online - the first such offering in Australia.

### Mobile Payments

Recently, PT Commonwealth Bank Indonesia launched the country's first mobile banking application. The application represents breakthrough technological, investment and security features, which make it simple and easy for the bank to interact and engage with its customers. The innovative application is the first of its kind to include investment features, which will enable customers to purchase mutual funds and open time deposits (term deposits) anytime, anywhere, safeguarded by a priority security system.

## **3. Early Priorities**

The Bank notes the Payments System Board's view, as per Chapter 7 of the Consultation Document, of some immediate priorities in the payments system.

### 3.1. Governance Structure

The Bank supports both the need for change in payments industry governance and the work underway within APCA to explore enhancements to existing governance structures.

The Bank has been closely involved in the APCA Governance Review and the recent governance developments such as the ongoing work of the Australian Payments Forum (APF) and the establishment of a new stakeholder forum.

### 3.2. Payments Infrastructure

Several comments provided in Part B in response to specific questions raised in the Consultation Document relate to matters of payments infrastructure. In summary, while we understand the role of, and need for, collaborative effort, we believe that such effort needs to be directed to support competitive initiatives by payment system participants. Collaboration and co-ordination of standards is needed at a systemic level, however,





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each payment provider should be able to take those standards and develop their own competitive products and services.

### 3.3. Intra- Day Settlement

The Bank is supportive of the evolution of settlement arrangements for low value payments. We see this as a significant systemic innovation in the Australian payments landscape. Real time banking is a key feature of the Bank's newly implemented Core Banking system and we see improved access to payments over weekends and public holidays as a natural flow on.

The Bank remains committed to the development of an intra-day settlement model for low value payments. The Bank is an active member of the APCA working group looking at Settlement Evolution across low value payments. While we have some reservations about moving to a 7 day Bulk Electronic Clearing Stream exchange cycle at this point in time (because doing so would result in large unfunded and outstanding settlement positions whilst the money markets are closed and would require significant operational and system changes for all participants), we remain willing to explore alternatives.

In an increasingly 24/7 world, we completely understand that a 7 day direct entry exchange cycle would have much consequential customer appeal and accordingly we support the APCA settlement working group considering this.

### 3.4. Funds Availability to Customers

The Commonwealth Bank posts funds shortly after direct entry file exchanges. That is, once another financial institution sends us inward payment instructions, we credit our customer's account with the funds.

Additionally, for payments through the real time gross settlement system, payments to customers' accounts are processed within minutes, subject to straight through processing and Anti Money Laundering approvals.

### 3.5. Additional Data with Payments

The Bank supports efforts to promote transmission of richer, remittance information with payments. We see this as a necessity to drive down cheque usage by business and governments and to provide enhanced customer functionality.

### 3.6. Message Standards

The Bank is supportive of the development and use of more consistent message standards and supports the adoption of the ISO 20022 message standard. This will enable the carriage of data with payments through the payments system. The Bank agrees with the Board's view that the development of this Standard should be accelerated. We are a member of the APCA Standards Working Group, and at the same time, we are reviewing our own direct entry systems to cater for ISO 20022.

### 3.7. MAMBO

We note that the development of MAMBO is no longer progressing.

MAMBO had a powerful vision for making payments easier for consumers, business and government. It would have delivered faster and more secure payments.

As an industry vision, MAMBO required the participation of all the major banks. Unfortunately, over the recent past, despite initial commitments, some banks have decided that this customer vision is not important, in some cases citing competing technology priorities within their banks.





Customer satisfaction is extremely important to Commonwealth Bank. Therefore, the Bank remained willing to continue to commit the necessary resource to MAMBO, even while in the midst of a major, and globally leading, overhaul of its core banking platform.

The Bank is naturally very disappointed that other participants in MAMBO no longer supported this vision for making payments easier for all customers, making the project untenable.

However, the Bank is committed to continuing with its own investments to improve the ways that our customers can manage their finances.

#### **4. Regulatory Certainty**

For a payments system to function efficiently and effectively, regulatory certainty is needed. With new payment innovations, payment providers need certainty to ensure investment costs can be recouped. When there is uncertainty of regulation in the payments marketplace, risks increase and this can create an environment where innovation is discouraged.

Throughout the Reserve Bank's recent process of regulating the Australian payments system, the Bank has adhered to a list of principles in forming its position<sup>2</sup>. One of these principles is directly related to regulatory certainty; it states:

*Regulator Intervention - Regulator intervention should only occur when there has been demonstrated market failure. Where there is evidence of market failure, any regulation should be transparent and provide certainty given the impact on innovation, ongoing maintenance investment and the cost of implementing regulated change.*

This principle remains valid and is particularly relevant to instances of regulated innovation. Regulation can result in market uncertainty. Where that regulation relates to innovation, the resulting uncertainty can destroy the competitive market process of organic customer-focused innovation. This can be extremely damaging to the prospects of a functional industry, and undermine the potential gains to society from a competitive market for payments. For this reason, regulation of innovation should be exceptional.

#### **5. Reward for Innovation**

Rather than regulate or penalise payment providers for perceived failure to innovate, the Reserve Bank should look to reward or incentivise payment providers for innovation. Margins in payments are very thin and so regulating or forcing systemic upgrades can increase the cost to payment providers, and risks redirecting funds from true innovation.

Equally, we do not believe that regulating the level of interchange fees is an effective way to drive innovation in payments.

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<sup>2</sup> Refer <http://www.rba.gov.au/payments-system/reforms/review-card-reforms/pdf/cba-31082007.pdf> for the initial discussion of these principles.







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# Response to Strategic Review of Innovation in the Payments System: Issues for Consultation - June 2011

## PART B

### Introduction

The “*Strategic Review of Innovation in the Payments System: Issues for Consultation – June 2011*” document poses a number of “issues for discussion” in Chapters Four to Six. These are discussed, seriatim, below.

## Chapter 4: The Decline of Traditional Payment Methods

### 4.1 The Decline of Cheques

*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?*

- We fully support APCA’s review of the future of cheques. We strongly believe that the decline in cheque usage must be managed by the industry in a co-ordinated and consultative fashion. APCA’s consultation process (underway) will identify user groups who continue to pay by cheque, and the reasons behind their behaviour.
- We expect competitive market pressure; both at the systemic and proprietary level will continue to drive the industry to develop alternative payment methods suitable for cheque users.
- Regulatory assistance may be needed to endorse and co-ordinate any substantial changes made by the industry, thereby minimising any disruption to end users. In addition, the regulator could play a vital role in encouraging the Government, in its role as both an end user and legislator, to lead the transition from payment by cheque to other substitutable instruments.
- The decision by the UK Payments Council to reverse its decision to phase out cheque usage is surprising and disappointing. However, the UK public backlash against the initial decision may have been a response to the consultation process and unfounded fears about a lack of substitute payment methods, rather than any insurmountable impediments to phasing out the use of cheques. We expect the Payments Council will continue to pursue enhancements to the efficiency of the UK payments system, including cheques.

*2. Could the decline in cheques be managed by pricing cheque use in a way that provides better signals to users?*

- Given the cost to an FI of each cheque written is \$4.30<sup>3</sup>, passing on the full cost of cheques to end users is not feasible, and media commentary would be problematic for any FI attempting to do so. However, greater alignment of costs with price signals is an essential consideration when assessing the future of cheques.

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<sup>3</sup> Table 7, *Payment Costs in Australia: A Study of the Costs of Payment Methods*, Reserve Bank of Australia, 2007. This cost does not include user costs estimated at \$3 per unit by the RBA Payments Costs in Australia 2007.







- Pricing of cheques to end users would, however, become more feasible to FIs if considerable cost savings could be achieved to make cost-based pricing a possibility. This would, however, require investment in a payment method that is in decline. In addition, the industry's ability to collectively address cheque usage via price signals remains somewhat constrained by competition law.
- FI's need to be sensitive to the considerations of cheque users when setting usage prices. Cheque usage is high amongst elderly pensioners and rural customers, who could be financially disadvantaged if pricing was used as the exclusive means of discouraging payment by cheque.
- If cheque usage in Australia is to be actively discouraged, price signals will be a necessary component of a broader programme. Any such programme will need to be coordinated by the industry to deliver the best possible experience for cheque users.
- A mandate on the future of cheques handed down by the regulator is undesirable on its own. However, as noted in Question 1 above, the regulator may need to play a key supporting role as part of an industry programme.
- At some point, when cheque volumes decline far enough, the cheque payment system will become uneconomic for all users. The future of cheques needs to be well managed to address this.

### *3. Can a case be made for reforms to make cheque processing more efficient and therefore sustainable at lower cheque volumes?*

- Cheque usage is undergoing an irreversible long term decline in usage. Each FI has an incentive to make its own processes as efficient as possible, in order to cope with declining cheque volumes.
- Cheque processing costs for individual FIs could be reduced if the industry agreed to certain changes. In particular, we endorse the practice of cheque truncation whereby captured cheques are imaged and this image is exchanged, and the original paper cheque is destroyed. Cheque truncation saves FI's the expense of transporting paper cheques and keeping them in storage. We propose that cheque truncation is endorsed as an industry standard as soon as feasible. Any assistance from the Reserve Bank to encourage the industry to move quickly to adopt this technology would be valuable.
- Any regulation impacting cheques must ensure cheque usage is not encouraged; otherwise, the regulation will not be improving the efficiency of the overall payments system. Cheques are a high cost payment instrument, and increased levels of usage would undermine the overall efficiency of the payments system.
- Investment in improvements to cheque processing will require a viable business case and it will be challenging to justify investment in a declining payment instrument.

### *4. Could institutions unilaterally withdraw from the cheque system, leading to specialisation by a small number of institutions?*

- FI's universally withdrawing from the cheque system is not a possibility, as customers who receive a cheque will still wish to bank it. Furthermore, the Commonwealth Bank, and other large Australian banks, endeavour to provide their customers a full service offering.
- Niche financial service providers frequently struggle to be economic, especially if they are based on a single product offering. Such institutions are likely to struggle to establish a sustainable business model for cheque processing.

### *5. Is there a case for phasing out cheque clearing over time? How could that be managed while ensuring that satisfactory alternatives are developed?*

- Subject to the availability of sustainable alternatives, ending cheque use would greatly improve the efficiency of the Australian payments system. This is a desirable





outcome from the perspective of the overall efficiency of the payments system, FI's and most end users.

- Phasing out of cheque payment services in Australia would require industry-wide collaboration and meticulous co-ordination. We support such initiatives. Beyond this, the collective decision of the industry will require endorsement by the Reserve Bank, and possibly regulation to achieve this outcome.
- To successfully manage such a change, an education campaign would need to be created for cheque users, suitable substitute payment methods would need to be established, and FIs would need to effectively incentivise the change in customer behaviour.

#### *6. Should government agencies' policies on payments be used to influence cheque usage?*

- A change in the payment practices of Government agencies would send a very clear message to the public that payment trends are changing. Accordingly, we strongly encourage Government agencies to transition from payment by cheque to other substitute payment methods. This should be supported by Government policy.
- Government agencies are large users of cheques and suitable alternatives are currently available to them. This is an opportunity to Australia's State and Federal Governments to coordinate their payment behaviours and lead by example.

#### *7. Should the approach to cheques be determined by individual institutions, determined collectively by the industry, or determined by the Payments System Board?*

- There is limited impact that an individual FI can make upon industry-wide cheque usage. A co-ordinated approach at an industry level is the best approach to managing the decline in cheque usage. Collective action by the industry requires careful consideration of competition law. Assistance from the regulator in this co-ordinated industry effort will be beneficial. Regulation to bring into effect the decisions of the industry may be necessary.
- The primary means for dealing with the decline of cheques should be determined by the industry. A regulated determination preceding an industry decision is not desirable.

## **4.2 Cash Replacement**

#### *8. Are there any impediments to the development and adoption of products to replace cash?*

- Consumers are likely to carry cash until such time as card payments, or other cash substitutes, are universally accepted by merchants. This is not yet the case. However, just as important as merchant card acceptance is merchant restrictions on card payments. Impositions by merchants of minimum spend requirements for card payments, card type accepted and to a lesser extent surcharges, is a deterrent to greater replacement of cash by cards.
- Cash replacement in Australia requires the provision of suitable alternate means of payment. This requires investment by banks, and in some instances end users, as well as collaboration amongst industry participants. The Bank has invested heavily to both issue PayPass cards and deploy PayPass readers. Usage of both these cards and readers is growing rapidly on a monthly basis, but is as yet far from replacing cash as a means of everyday payment for low value transactions. Beyond this, the Bank is investigating the possibilities created by new technology to replace cash payments.
- Large numbers of the population have a strong attachment to cash. For some, cash is viewed as secure because its redemption is guaranteed by the federal government, and it can be held outside of a deposit account. Many seek the anonymity of cash payments, especially amongst the "underground" economy. For others, the lack of technology involved in paying by cash appeals.





- Cash has always been central to Australia's economy, and it will require much effort and time to overcome customer inertia to transition from cash to non-cash payment methods.

#### *9. Is there any case for public intervention in cash replacement?*

- The regulator has a role to play in encouraging the banking industry to transition to more efficient payment methods. However, FIs and their customers are best placed to determine what instruments will best replace cash. This will happen as part of the organic product development cycle. The Government has an important role to play in encouraging the public to use efficient payment methods. The Government, via the Reserve Bank and the Mint, issues Australian notes and coins. This provides an opportunity to educate and incentivise cash users towards more efficient payment methods.
- The regulator can encourage cash replacement by making known the full cost of cash to users.

## Chapter 5: The Environment for Innovation in the Australian Payments System

### 5.5 Models for Industry Governance

#### *10. Do current governance arrangements adequately promote payments system innovation?*

- The existing industry governance arrangements do promote, and have resulted in, payments system innovation. Recent examples include:
  - The formation of COIN, which has been managed by APCA.
  - APCA split EFTPOS governance out of Clearing Stream 3 and created eftpos Payments Australia Ltd (EPAL), as a commercial body to run eftpos, which has fostered innovation and competition.
- The Australian payments industry has been growing into its role as a self regulator, and is increasingly taking responsibility for industry outcomes.
- Collaborative industry innovation can be more difficult to achieve when the innovation needs to be underpinned by a commercial model. Only certain governance bodies are suited to delivering such innovations, including EPAL and BPAY.
- APCA makes frequent improvements to the operation of its five clearing streams and to the payments system more broadly. Many of these improvements are innovative in nature; however they will never receive the same notice as would a newly established payment method.
- Achieving agreement amongst a diverse group of competing industry participants with conflicting priorities about the need for a particular innovation, and how best to implement it, is inherently difficult. No matter which governance model is adopted, reaching a shared view typically requires at least some industry participants to prioritise the greater good over their own commercial interests. Compromises are difficult to reach when some competitors are perceived to fare better than others. Collaborative innovation will always be challenging to achieve in a highly competitive industry.

#### *11. Are the needs of payments system users and non-ADI payment service providers adequately considered in decisions about the direction of the payments system?*

- Non-ADI payment service providers' views are well considered by the payments industry when taking important decisions.
- APCA consults widely on major projects, for example the future of cheques investigation. APCA also runs a Stakeholder Forum, an Advisory Committee and the Australian Payments Forum.





- Non-ADI payment service providers also have a business relationship with a clearing bank. As part of this relationship, their bank consults with them on key industry decisions.

*12. Are there ways of altering current governance structures to make innovation easier?*

- The existing industry governing bodies are facilitating innovation although the Bank is open to considering ways in which this can be further improved. It is very difficult to reach an agreement as to how much innovation is enough, and how easy innovation needs to be.
- It is difficult to determine whether a change in governance structure will deliver an unambiguous benefit. Implementation of a new governance structure is a complex exercise, and it is difficult to adjudge what impact it will have on the levels of innovation.
- The Australian payments industry is conscious of the need to improve itself. APCA is currently reviewing its own governance structures. Achievable goals for our industry's governance bodies are greater levels of collaboration, and a stronger focus on achieving a shared vision.
- Collaboration could potentially be made easier if certain aspects of competition law were relaxed.

*13. Are there ways of altering current governance structures to take more account of the views of end-users?*

- APCA has recently introduced a Stakeholder Forum as part of an overhaul of its Advisory Council structure. This Forum will be improved over time, as experience is gained, to better solicit the views of a broad range of end users.
- The introduction of APCA's twice-yearly Australian Payments Forum has extended APCA's engagement to a broader cross-section of the industry, and accordingly captures the views of more end-users.

*14. 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?*

- We understand the benefits of broader industry representation and we consider this issue to be worthy of further debate.
- As a general rule, the more diverse a group of representatives is, the harder to reach an agreement. We are not certain that diversifying the representation on industry bodies will, by itself, improve the strategic focus on the payment system. What is more critical is that all representatives share a common commitment to making strategic decisions in the best interests of the overall payments system and thus providing the platform from which competition can flourish.
- The success of a broader industry body would depend very much upon the governance model employed. Unforeseen misgivings in the design of the governance model could render the body ineffective.
- The UK Payments Council's recent reversal in position over its plan to phase out cheques demonstrates that broad representation does not guarantee improved results when it comes to self regulation of the payments system. Such issues are fraught with complexities and will be difficult for anybody tasked with this matter.

*15. How could such a body have the capacity to reach decisions across a diverse group of members?*

- The ultimate success of a broad payments industry body will depend upon the model of governance adopted. Of crucial importance will be the body's charter, constitution, voting rights and its powers to enforce its decisions.





- If a formal company structure was adopted, the directors of the company would have a legal responsibility to act in the interests of the company itself.

*16. Could such a group make binding decisions and how could they be enforced?*

- Refer to Question 15.

*17. Could formalisation of a broader mandate for APCA, coupled with broader representation, provide better industry-wide outcomes?*

- APCA's Board is currently considering this as part of its governance review. We support this review and APCA's commitment to improving itself as an effective self regulator.
- APCA plays a vital role in Australia's payments industry. APCA is receptive to the challenge of becoming a more broadly represented body, and more active in initiating industry self-improvements. However, any changes to APCA must not compromise its existing functions.

*18. What role should the Reserve Bank and the Payments System Board play in setting the reform agenda for the industry?*

- The payments industry should be given every opportunity to innovate and self govern according to market need and competitive forces prior to any regulatory intervention. Otherwise, sub-optimal regulated outcomes may be imposed upon a functioning market.
- Regulation can discourage a responsible and competent industry from self-governance because regulatory intervention may then be seen as inevitable.
- The Reserve Bank is rightfully taking a close interest in the level of systemic innovation. The Reserve Bank should continue to monitor this and encourage the industry to set its own agenda for innovation and address any gaps in the market.
- The powers provided by the Payment Systems (Regulation) Act 1998 should be used sparingly, in accordance with the Reserve Bank's refrain that it is a "reluctant regulator".
- Ultimately, the regulatory focus should be to create an environment that supports and promotes innovation.

*19. 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?*

- APCA has for some time advocated a review of the Payment Systems (Regulation) Act 1998.
- It is necessary to resolve the uncertainty created by the overlap, and potential conflict, between competition law and payments regulations. For instance, the industry asked the Reserve Bank to designate the ATM network to avoid the risk of contravening the (then) Trade Practices Act.
- The Competition and Consumer Act 2010 limits interaction amongst industry participants over matters of collaboration, even on non-competitive matters. Often, if unsure about the legality of collaborating on a particular matter, FI's will shy away from discussions in order to keep well clear of competition law breaches and sanctions. Our experience is that industry participants are acutely aware of this legislation and very nervous about breaching it, or even being accused of doing so.







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## 5.6 Structure of Clearing and Settlement Rules

*20. Does the current structure of clearing and settlement adequately allow for the introduction of new payment products? How could this be improved?*

- Most new payment products integrate with an existing payment instrument or clearing stream. For example, BPAY transactions are cleared via the existing Bulk Electronic Clearing Stream and PayPal obtains funds from a customer via a direct entry or card payment in order to make a payment to the beneficiary. However, nothing prevents a newly developed payment instrument from establishing its own clearing stream.
- To date, most payments innovation has occurred at the point of interaction with end users. For retail payments, clearing and settlement happens later. The existing clearing and settlement procedures have been sufficient to support payments innovation, although we acknowledge the general desirability of more frequent exchange and settlement.
- Developments such as the RBA's Low Value Settlement System will lead to the clearing and settlement process becoming quicker and more efficient. This will make clearing and settlement even more conducive to innovation within retail payments.
- The Commonwealth Bank is currently making large investments in its core banking platform that will accelerate the finality of payments for our customers. All funds transfers between Commonwealth Bank retail customers now occur in real time with Business customers to follow later this year. Card payments and ATM transactions made by our customers are posted to their account in real time. Beyond this, the Bank memo posts direct entry payments. This means our customers will receive value from a direct credit payment made to them shortly after it is received in a BECS exchange, without having to wait for settlement the next day in the 9am batch.

*21. Is the current structure of rules applied to payment systems, including the five APCA clearing streams, the most appropriate?*

- APCA's clearing stream rules are necessary to ensure the security and integrity of our payment streams, and to set standards to achieve consistency amongst participants. Rules governing clearing and settlement streams, need to be maintained, regardless of who performs this role.
- It is appropriate that the industry's participants collectively determine the standards to which they will adhere, and the security measures to be applied to mitigate fraud. APCA represents the payments industry effectively and is a suitable body to carry out the role of setting clearing stream rules. At present, there is no body better suited to this role.

*22. 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?*

- APCA is currently working on changes to its clearing stream rules to recognise the replacement of exchange summaries with the LVSS.
- The LVSS makes an ideal platform to offer same day settlement; APCA has formed an expert group to investigate the introduction of same day settlement. The industry is endeavouring to design its preferred model of same day settlement.
- Any changes to the existing rules of a clearing stream concerning the timing of funds availability and permissible transaction values would require thorough deliberation amongst clearing stream members. Care needs to be taken to ensure no new risks are introduced.
- Without an industry rule regarding the timing of funds availability after settlement, there is no guarantee intraday settlement will result in same-day posting of funds by all FIs.





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*23. 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?*

- A 'skeleton' of common rules could be applied across all clearing and settlement structures, upon which specific variations could be built. However, an unambiguous improvement from this approach would be needed to move away from the existing clearing system rules, which support a reliable and functional payments system. The current sets of rules have been customised for each payment stream and are effective in facilitating clearing of payments.
- There is no need to mandate a common set of clearing and settlement rules across all streams; the payments industry could implement such a change if it perceived this to be beneficial.

*24. 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?*

- We do not consider clearing and settlement to be a barrier to entry for potential providers of payments products. The emergence of PayPal, electronic tolling, BPAY, closed loop gift cards, etc. demonstrates this. While encouraging new payments providers, we need to maintain the integrity of clearing and settlement systems by setting appropriate technical and security standards, and imposing suitable risk mitigants.
- Adoption of consistent industry standards is beneficial. However, it may not be necessary for every clearing stream to adopt the same detailed standards. Individual clearing streams already adhere to appropriate standards.

## **5.7 System Architecture**

*25. Do existing clearing arrangements allow sufficiently easy access for new participants? If not, what could be done to improve this?*

- A stable and reliable payments system requires minimum standards of security and compliance. Prudential requirements are also essential. Relaxation of these standards could jeopardise the stability and reliability of the payments system. Beyond these standards, we are open to improvements in access to the payments system, although we do not perceive any pressing need for improvement.
- PayPal, Tyro and Woolworths are all examples of recent entrants to Australia's payments system who have all found suitable access to payments clearing streams.

*26. Could greater use of hubs improve efficiency, access and innovation in the Australian payments system?*

- Hubs are an important aspect of payments system design that have implications for system access and development. New payment systems that adopt a hub-based model will likely be more efficient than those that adopt bilateral direct connections. It is unlikely that any newly created payment system would adopt a bilateral direct connection model.
- The definition of a hub is not, however, clear. We do not restrict our view of a hub to a piece of central hardware. What is important is that the arrangements permit easy access for new participants and are conducive to system development.
- A network such as Community of Interest Network (COIN) could be considered a virtual hub. COIN is a common communication network with a single connection for each participant. The network is governed by common rules set by a management







committee. COIN offers many of the same benefits as a traditional hub and spoke model. It is not clear that there are compelling reasons to favour traditional hubs over virtual hubs.

- Modern technology could make virtual hubs based upon IP networks more cost effective than a conventional hardware based hub.
- We consider the adoption of appropriate and flexible global standards to be vital in payment system design. This is more important than the adoption of a conventional hub. So long as the behaviour and operations of all system participants are uniform and mandated to comply with agreed standards, system access and development is simplified.
- The case for moving from an existing bilateral model to a hub may be difficult to justify commercially. Forced migration is not appropriate. Rather, existing participants should be given a long time frame to migrate to the hub at their convenience, for instance as part of a systems upgrade and subject to business case justification. This approach is more cost effective than mandating a forced migration within a short time frame, in which each participant will most likely implement the change as a standalone project. EPAL is taking a suitable approach; it is seeking to build the long term capability to move to a hub model, and then members will be able to migrate over time as circumstances permit.

*27. 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?*

- Subject to the comments above in response to Question 26, hubs are suitable for many payment, clearing and settlement systems. There is no reason why multiple systems cannot run on a single hub.
- The downside of hubs is that they concentrate the risk of system downtime. This can result in a single point of failure if adequate replication of each system component is not built in. System participants and designers need to be satisfied that sufficient redundancy measures have been built in to each aspect of a payment system to minimise the amount of disruption caused by the failure of any single system component.
- Maintaining a single link to a single hub running multiple payment systems is desirable from an efficiency perspective, as opposed to maintaining separate connections to separate hubs for each payment system. However, the downtime risk of operating all payments systems on a single hub is enormous. Also, specific technical detail would need to be assessed.
- The cost of developing and maintaining a hub needs to be supported by a sustainable economic model.

*28. Should hubs be considered best practice for new payment systems? Should existing systems 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?*

- Refer to Question 26.

*29. What type of ownership, governance and management arrangements would be desirable for a hub?*

- There is potential for any number of arrangements to successfully operate a hub.
- A model of private ownership will provide a commercial focus. This will allow the hub to become economically viable and address its development needs. However, it comes at the risk of monopolistic pricing, especially so because the greatest cost efficiencies can be achieved when a single hub operates all payment systems.





- A publicly-owned hub may overcome the risk of monopolistic pricing, but the lack of a commercial focus could make the payments systems using the hub less efficient and potentially unable to respond to changes in technology in a timely manner. A public institution may not have the capabilities to successfully operate a commercially viable payments hub.
- A shared public-private ownership model could be created to take the best characteristics of these two models and overcome their flaws. Given how closely the Reserve Bank and the industry works together on many initiatives, including RITS and the LVSS, this approach could have merit. However, there is no guarantee this approach will be more successful than a private or public ownership model.

## Chapter 6: Innovation Gaps in the Australian Payments System

### 6.1 The Transmission of Data with Payments

*30. How widespread is the demand for the innovation in question and how significant would the impacts be?*

- Large efficiencies could be gained by users of direct entry payments, especially for B2B purposes, if the payment message contained fields to enable the transmission of meaningful remittance data. Accordingly, we expect the demand for such an innovation, were it to be introduced, will be strong.
- The degree of uptake for any such innovation will correspond to how effectively the innovation addresses the unmet need. A system based around the ISO 20022 standard that offers payment messages incorporating numerous fields suited to B2B transactions, and sufficient data capacity, would be better placed to tap into this demand than an innovation that were to tie a separate data message to the payment message.

*31. Are there any specific impediments to that innovation occurring, e.g. barriers to entry, co-ordination problems, technological constraints?*

- There are numerous challenges to developing innovative industry-wide payment methods that permit the carriage of remittance data. Such an innovation will require considerable investment from each industry participant. Sourcing funds for an investment with an uncertain payoff is always difficult. However, requiring multiple industry members to raise funding at the same time is even more difficult.
- In the case of the Commonwealth Bank, we are currently investing large amounts of funds in, amongst other things, a core banking renewal program and associated developments. The Bank has assigned large numbers of highly skilled employees to these projects.
- Before funds can be assigned to any project, a business case must be established to justify the use of funds. Demonstrating that an innovation will be successful and recoup the opportunity cost of these funds is not easy. This process prevents funds being wasted on speculative investments with little prospect of success. The same process can also make it difficult to obtain funding for innovative purposes.
- Co-ordinated industry-wide innovation is more difficult to initiate than proprietary investment. Not only is it difficult to reach an alignment of views to pursue the innovation, it can reduce the incentive to innovate if your competitors will have access to the same innovation.

*32. Is there a case for public intervention?*

- FIs are best placed to manage the innovation process within the payments industry. FIs interact frequently with their customers and understand their needs. Regulated innovation will never be as effective as organic innovation. A regulator's role does





not extend to, nor is it best suited to, choosing which innovations should become mainstream.

- Regulated innovation can lead to an inefficient payments system if FIs are forced to develop unprofitable payments methods.
- Regulatory intervention runs the risk of the industry refraining from innovation in anticipation of a regulated outcome being forced upon it.
- The regulator can assist the industry in its efforts to collaboratively innovate. This may require the regulator to play a co-ordination role. In addition, the regulator can amend regulation or legislation that undermines the innovation process.

*33. 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?*

- Direct entry payments have existed in various forms in Australia for many years. Over this time, many bank systems, and user systems, have integrated with the direct entry system. Making wholesale changes to the direct entry system would be more difficult than initiating a new purpose built combined payment and remittance data system because of the number of systems that would be affected.
- The important consideration here is that payments systems are often very complex and linked to customer data information systems. Systemic changes to the current DE system will be very costly and possibly destabilising. The current system is not broken, – it just needs improvement.
- The Bank is open to considering new infrastructure to support as many types of payments as possible.

*34. What role should messaging standards, such as ISO 20022, play in any solution for transmission of additional data?*

- Adoption of well-designed global standards is beneficial to the industry. However, any benefit must be weighed against the extent of systems development to accommodate the change. Hence standards are easier to implement as part of a new initiative, rather than applied as a change to an existing system.
- We support the work undertaken by APCA to investigate the ISO 20022 standard.

*35. 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?*

- We understand the need for the transmission of superannuation account information. The superannuation industry is a key stakeholder in APCA's development process and will also be actively consulted as part of APCA's investigation of ISO 20022.
- Wealth Management is a major business within the CBA Group; as such we have a keen interest in addressing this issue.





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## 6.2 The Timeliness of Payments

*30. How widespread is the demand for the innovation in question and how significant would the impacts be?*

- There are two aspects to the timing of payments; the timing of authorisation and the timing of posting. There has been much innovation recently to improve the timing of both.
- Card payments have long offered real time authorisation, and the growth in scheme debit cards has enabled online merchants to receive real time authorisation of debit payments.
- The Bank has done much to accelerate the posting of payments to its customers' accounts. The Bank's core banking renewal means that funds transfers between Commonwealth Bank retail customers now happen in real time. Furthermore, payments made by our cardholders are now posted to their account in real time.
- The Commonwealth Bank also memo posts direct credit payments to our customers' accounts. This means that a customer will have the funds from a direct credit payment posted to their account within a short period of time, following the BECS exchange in which we received the transaction.
- Customers now expect faster and simpler payments. This will increase the pressure on the industry to further improve the timing of payments. The rapid advancement in everyday technology available to Australians is adding to the pressure on banks to invest in technology to allow real time retail payments. This pressure is stimulating competition in the banking industry.
- However, for a large number of payments, speed is not the most important attribute. For instance, the existing DE system is well suited to the needs of payroll batch payments. These users are unlikely to move to a more rapid payments system if it means incurring a higher price.

*31. Are there any specific impediments to that innovation occurring, e.g. barriers to entry, co-ordination problems, technological constraints?*

- Intraday settlement would offer the potential for industry-wide improvements in the timeliness of funds availability to customers. However, an industry-wide improvement in the time taken to post funds from a direct entry transaction would require an industry posting standard. Reaching agreement on this will not be easy because the existing BECS system is comprehensively integrated into the many banking systems of each FI and also users. As such, some BECS participants may be reluctant to agree to a posting standard because of the difficulties in implementing such a change.
- Before intraday settlement can be introduced, an agreement needs to be reached as to whether participation in intraday settlement sessions is mandatory for all direct settlers. Furthermore, the large values of BECS files that get exchanged in the two final exchanges of the day, which include the BPAY batch, needs to be addressed.
- The level of investment required for many innovations in payments can be sizeable. Margins on payments are very small and so large investments in innovations need to have a viable business case.
- Refer to 6.1 Question 31.

*32. Is there a case for public intervention?*

- There are numerous initiatives underway in the industry, as previously discussed, which are addressing the need for timely payments.
- Refer to 6.1 Question 32.





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*36. To what extent will systems already under development or discussion address issues related to the timeliness of payments? What gaps will remain?*

- More and more FIs are accelerating their posting of payment funds. Beyond this, APCA is working to introduce an industry agreed model of intraday settlement.
- For many users of the Australian payments system, the speed at which payments are authorised and funds are made available is sufficient for their needs.

*37. What new systems or enhancements to existing systems would be required to achieve more timely payments? How could these innovations be achieved?*

- Intraday settlement combined with a posting standard will improve the speed of funds availability from direct entry transactions for accounts held at FIs that do not currently memo post. Fundamental systems changes are required of many banking systems in order to implement intraday settlement. Some FIs may have difficulty in meeting a minimum posting standard for those account lines running on outdated systems. In particular, banks operating aging core banking systems that are due for substantial investment to upgrade them to meet modern banking requirements may have difficulty implementing a minimum posting standard.
- The Bank is well placed to offer immediate value on transactions as a consequence of its core banking overhaul enabling real time payments for low value retail transactions.

*38. Would multiple same-day interbank settlements be sufficient to facilitate faster availability of funds?*

- Many banks have already decided to accelerate posting of funds to customers without intraday settlement. Intraday settlement would be effective in providing a guaranteed industry-wide reduction in the time taken to post funds if a rule is enacted to compel banks to post within a given timeframe following settlement. If no such rule is introduced, there is no guarantee intraday settlement will result in accelerated posting practices across every account at every FI.
- Intraday settlement could introduce considerable risk to the payment system unless various concerns are addressed. Optional participation in intraday settlement would result in reduced liquidity for those remaining participants. Furthermore, some FIs could incur an increase in overnight exposure to counterparties if large values of payments were exchanged by selected participants outside of the intraday settlement window.
- Refer to Question 37.

*39. Is there a case for a real-time settlement system for low-value payments and how should it be provided?*

- Clearing and settling exchanged batch retail payment files at the same time would be much more feasible than authorising, clearing and settling each individual retail payment in real time.
- This concept should be considered by the APCA intraday settlement working group.

*40. 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?*

- Many banks do provide customers with an expectation as to when funds from a payment will be made available, particularly for pay-anyone internet banking







transfers. This is a matter of customer service, and can be expected to be addressed by competitive forces.

- Refer to Question 37.

*41. 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?*

- Weekend exchanges would require numerous significant organisational changes. FI's treasury departments do not currently operate on weekends; this would be necessary to facilitate 7-day settlement. Furthermore, significant systems development would be necessary.
- The treasury department of each bank requires access to money markets to enable settlement and at present money markets close for the weekend.
- Since most businesses, or at least their finance departments, do not work on weekends, we do not believe 7 day posting of funds from payments would make a difference to many business users of the payments system. It may have more appeal to individuals.
- Refer to Question 30.

### 6.3 Ease of Addressing Payments

*30. How widespread is the demand for the innovation in question and how significant would the impacts be?*

- We believe improved addressing of payments would appeal strongly to users of P2P payments, but may have limited appeal beyond this.
- Simplification of addressing of P2P payments will be extremely appealing to existing users of pay anyone internet banking transfers.
- The Bank supports EPAL's plans to market credit EFTPOS transactions. Card payments remove the need for manually addressing payments, and credit EFTPOS will extend the capability of automated payment addressing to B2C card payments.

*31. Are there any specific impediments to that innovation occurring, e.g. barriers to entry, co-ordination problems, technological constraints?*

- The means of addressing an existing payment instrument is ingrained in the payment message file and banking systems. In some instances hardware and customer systems are designed around the means by which a payment instrument is addressed. The downstream consequences of changing the means of addressing a payment instrument are likely prohibitive. It may be more practical and economical to design a new payment instrument with a new means of addressing payments.
- Refer to 6.1 Question 31.

*32. Is there a case for public intervention?*

- Refer to 6.1 Question 32.

### 6.4 Person-to-person Payments

*30. How widespread is the demand for the innovation in question and how significant would the impacts be?*

- It is hard to measure the demand for P2P payments innovation. P2P payments have numerous existing alternatives. If a suitable innovation emerges to simplify P2P payment, we would expect to see significant substitution away from these existing and more traditional means of P2P payment.
- Cash is one such means of making P2P payments. However, as the prevalence of cash in our economy reduces, demand for a simple and convenient means of electronic P2P payment will increase. Without the development of new P2P payment methods, we expect growth of pay anyone transfers will increase.





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*31. Are there any specific impediments to that innovation occurring, e.g. barriers to entry, co-ordination problems, technological constraints?*

- The low price associated with existing P2P payment options makes it difficult to launch a commercially viable system of electronic P2P payment. Cash, direct credits and cheques all have a low or negligible price associated with use and customers may be reluctant to move to a new P2P system with a commercially appropriate price.
- While difficult to measure, the number of P2P payments is unlikely to compromise a major proportion of total retail payments. Payments at shopfront and online retailers, B2B payments, B2C payments including payroll, and bill payments are each likely to be more numerous than P2P payments. A low volume of payments makes it difficult to recover the investment required to innovate.
- Refer to 6.1 Question 31.

*32. Is there a case for public intervention?*

- Refer to 6.1 Question 32.

## **6.5 Mobile Payments**

*30. How widespread is the demand for the innovation in question and how significant would the impacts be?*

- Of all potential areas of innovation in payments, consumers are probably most eager for innovation in mobile payments. Much of this interest stems from the rapid advances in mobile phone and tablet computer hardware. On any given day, 20-30% of NetBank logons are performed using a mobile device.
- Much effort is being expended within the banking industry to develop mobile payment offerings for customers. The potential gain in customers to be obtained by the FI that becomes the leader in pioneering mobile payments makes this a highly competitive space.
- The Commonwealth Bank currently offers a service called eVolve Mobile to merchants that allows them to accept card payments using a mobile internet device. The Bank is looking closely at the potential for low value payments offered by mobile smartphone devices.

*31. Are there any specific impediments to that innovation occurring, e.g. barriers to entry, co-ordination problems, technological constraints?*

- Rapid changes in smartphone technology makes investing in mobile payments a risky proposition. Early investment comes with a risk that the mobile technology involved will be superseded.
- If investment in mobile payments technology requires collaboration with hardware manufacturers and/or telcos, the investment decision and innovation process becomes much more complicated.
- Stable globally-recognised standards for mobile payments may be necessary to encourage investment by FIs.
- Refer to 6.1 Question 31.

*32. Is there a case for public intervention?*

- The regulator of payment systems should not regulate the technology employed in an emerging market such as mobile payments, which is reliant upon rapid advances in technology. The eventual mobile payments product offerings are best developed by industry participants in a competitive and innovative market unencumbered by regulation.
- Refer to 6.1 Question 32.







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*42. 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?*

- It is difficult to predict what form mobile payments will take in ten years time. It is quite likely that various iterations of mobile payments will have captured mainstream usage within this time.
- Current developments suggest applications for smartphones to facilitate mobile payments will become increasingly prevalent over the next few years. These applications will permit person to person payment and contactless card-based payment. These applications will be designed to be 'native' to the operating system of the device. SMS-based payment appears to be out of favour.

*43. Are there impediments to the development of mobile payments in Australia? If so, what type of payments are being impeded and how?*

- Soon enough, NFC contactless payment applications will be available to Australian consumers. However, at present the number of NFC-equipped smartphones in use by Australians is negligible. Recently, a major manufacturer of smart phones released a flagship model Smartphone with an NFC chip incorporated. In some markets, including Australia, this phone is sold without an NFC chip. Some anecdotal reports have emerged stating the decision not to sell NFC models of this phone in Australia was encouraged by telcos.
- Mobile P2P payments could be in wide use by now if there was a suitable means of addressing a payment without the need to include a bank account number and BSB. Innovative mobile P2P payment offerings will stimulate much growth in the use of mobile payments, and further innovation in this space.
- Emergence of numerous smart phone operating systems requires additional work to create multiple applications for multiple smartphone platforms.

*44. 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?*

- Smartphones offer some potential improvements in payments security. Smartphones are password protected and are sooner noticed should they go missing than a payment card. Applications on a smartphone can have multiple security settings, and allow for user customisation of these settings, which is not possible with a payment card. For instance, mobile payment applications can be pass code protected.
- Designing applications for multiple mobile platforms is a complication. Security features and vulnerability to malware varies across platforms.

*45. 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?*

- Existing payment standards allow for development of new mobile payment functionality. Innovation would allow a payments provider to adapt the existing card or direct entry payments infrastructure to offer mobile payments. The international card schemes have standards that are suitable for NFC mobile payments.
- Mobile smartphone devices are advancing at a rapid rate. It is only recently that mobile phones have developed the features and functionality to make them an ideal platform for payment. Payment offerings that take advantage of this new technology are likely to emerge quickly.
- There are no obvious regulatory or structural impediments preventing payments providers from collaborating with technology, or other, providers to develop mobile payment solutions. Any impediments to this innovation would most likely be commercial in nature.





- The introduction of mandated standards would likely inhibit rather than encourage mobile payments developments. Mandated domestic standards for mobile payments risk putting Australia out of step with the rest of the world, and consequently becoming an impediment to innovation.

## 6.6 Electronic Purse Systems

*30. How widespread is the demand for the innovation in question and how significant would the impacts be?*

### Contactless Electronic Ticketing

- The Bank is involved in the provision of transit ticketing solutions using contactless electronic purses in Brisbane (Go Card), Perth (Smartrider) and Canberra (MyWay). While these solutions provide commuters and transport operators with more efficient electronic ticketing (as opposed to paper tickets), electronic purses still require commuters to 'top-up' funds and operators to issue cards. Additionally, the Bank is part of the consortium to deliver the Sydney Transit Ticketing solution.
- The Bank has long been a supporter of contactless electronic ticketing using open-loop networks.
- The benefits to transit operators of open loop payments are obvious, as they do not need to issue cards or provide top-up capabilities. Account top-ups typically require a retail distribution network where commission is paid to the retailer on each sale and top up. Additionally, the Issuer of the open-loop card would do most of the customer servicing.
- For commuters, using their own debit or credit card in the transit system means they only need to carry one card for all transactions, and they do not need to arrange top-ups to the card. If we had a ubiquitous transit solution across Australia, one card could be used across all transit systems.

### Prepaid Cards

- There is growing demand for pre-paid solutions that use open-loop technology.
- Increasingly our customers are seeking solutions for single-load and re-loadable pre-paid cards. These can be for compensation, reimbursements, emergency access to cash or per-diems.
- Prepaid cards need to provide access to the POS and ATM network and as such, the scheme based pre-paid cards currently provide the best solution.
- Additionally, we are seeing convergence of technologies where a pre-paid card is used for many purposes. For example, our University of Canberra card is a reloadable contactless EMV pre-paid card; students can load money onto the card to make purchases on and off campus. Stored on the EMV chip is a mi-fare application that provides access to printing, photocopying, building access and library borrowing so that students have an all-in-one card. This has been very successful and other universities are following.

### E-Wallets

- The concept of e-wallets, as alternatives to physical cards, has gained traction with a number of variations of the e-wallet available.
- These concepts allow easy purchase of goods and payment of bills online.
- A range of e-wallet concepts exist ranging from regulated online payments providers such as PayPal to other variants of e-wallets.
- The e-wallet concept allows anyone with an email address to send and receive money to just about anybody, or to settle bills through money stored online in safe systems. Typically, all that is needed is registration on the e-purse provider's website by filling out a simple form. This creates an electronic account or e-purse to which a customer can transfer money from a bank account.





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*31. Are there any specific impediments to that innovation occurring, e.g. barriers to entry, co-ordination problems, technological constraints?*

Contactless Electronic Ticketing

- Contactless open-loop ticketing technology can be rolled out now. Advances in chip technology easily enable EMV debit and credit cards to be used in transit systems.
- Around the world, transit operators are moving towards acceptance of scheme payment cards in their systems - recognising the benefits of convenience, security and ubiquity in places such as Paris, New York, Utah and, later this year, London.
- The technology is now relatively simple to implement, with the commuter simply tapping their scheme debit or credit card against the reader when boarding and exiting the train, ferry or bus. The final charge is processed through the back office system that matches up individual card 'taps' within a specified duration to calculate the trip cost.
- For this technology to be widely accepted, co-ordination between state transit operators is required. Although each transit operator could move towards this platform on their own, a ubiquitous solution that enabled commuters to access transit of all forms, in each state using the one card would be beneficial to all commuters.
- Refer to 6.1 Question 31.

Prepaid Cards

- CBA has recently invested in a pre-paid platform that enables us to rollout tailored pre-paid programs for our customers.
- However, margins on pre-paid programs can be very tight and business case justification is sometimes difficult.
- Refer to 6.1 Question 31.

E-Wallets

- Refer to 6.1 Question 31

*32. Is there a case for public intervention?*

Contactless Electronic Ticketing

- While co-ordination of various state transit operators would be beneficial, we do not believe there is a need for any regulatory intervention.
- Refer to 6.1 Question 32.

Prepaid Cards

- Some retailers will not accept bank-issued pre-paid cards as a payment instrument. This makes for a confusing proposition to customers where banks have to explain to customers that, while a scheme debit or credit card is accepted in store, a pre-paid card may not be.
- Refer to 6.1 Question 32.

E-Wallets

- Refer to 6.1 Question 31





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## 6.7 Standards

*30. How widespread is the demand for the innovation in question and how significant would the impacts be?*

- Demand for deployment of standards is likely to be driven by FIs and not end-users. Adoption of well-designed global standards is beneficial to the industry. However, any benefit must be weighed against the extent of systems development needed to accommodate the change. Hence, standards are easier to implement as part of a new initiative, rather than applied as a change to an existing system.
- Non-competitive matters such as security are most likely to be conducive to industry agreement on new standards.
- We support the work undertaken by APCA to investigate the ISO 20022 standard.

*31. Are there any specific impediments to that innovation occurring, e.g. barriers to entry, co-ordination problems, technological constraints?*

- Retrofitting a new standard to an existing payment system is much more costly and difficult than adopting a global standard for use in a newly created payment system.
- Refer to 6.1 Question 31.

*32. Is there a case for public intervention?*

- Government co-ordination of the various state transit ticketing programs would be beneficial to all transit network users. A standard fare system with standard payment options across the country should be targeted, and possibly mandated.
- Refer to 6.1 Question 32.

*46. 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?*

- The main benefits of adopting ISO 20022, as identified in the Consultation Document, are compatibility with a greater number of systems, interoperability with other payments systems and enhanced message content.
- As the providers and operators of Australia's payments systems, it is best left to the payments industry participants to decide whether there is a case to implement this standard.

*47. Should all new payment systems be required to adopt ISO 20022? Should existing systems be required to do so?*

- ISO 20022 could be agreed to as the required standard for all new payments systems. This can be achieved because new payment systems do not have legacy systems that need to be upgraded.
- The aggregate cost to society of all existing Australian payments systems moving to the ISO 20022 standard would be enormous. Each FI, and many users, has a large web of integrated systems designed around existing AS2805 and other standards. The complexity of upgrading each system to handle ISO 20022 and in some instances having to replace a system, and redesigning the process to ensure the upgraded systems all work collectively to accurately and reliably perform their intended functions cannot be underestimated.

*48. To what extent are other standards, such as device standards, an impediment to competition and innovation? Is this justified?*

- We do not consider device standards to be an impediment to competition or innovation.
- Most standards relate to security or operational arrangements, and do not impede the core tenets of competition.





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*49. How should compliance with industry standards, both by new entrants and incumbents, be monitored?*

- The Australian payments industry has an enviable record for security and reliability. Much of this is attributable to the industry having set appropriate standards, and proper policing of these standards by the industry. The industry should be entrusted to continue this role.
- It is undesirable that compliance with standards becomes a burdensome workload. However, the industry needs to ensure that its monitoring and enforcement procedures are effective and appropriate.

*50. 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?*

- Deliberation over security standards needs to be undertaken by the industry and should be rigorous. Security standards are designed to uphold the integrity of payments systems and are not a competitive matter. There should be no compromises in the setting of security standards, and no leniency in policing them.

## **6.8 Future Trends**

*51. 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?*

A large number of trends are emerging in the payments landscape that provides both challenges as well as opportunities.

1. Customers are demanding greater choice and faster, more convenient payments
  - Customer value propositions for simpler and faster payments must be consumer led.
  - As technology advances, consumers' use of electronic payments will increase and further move away from cheques and cash.
  - Customers want control of payments. For example, the ability to set limits, block transaction types and monitor their spending.
  - The consumer shift from credit to debit in the current economic environment is driven by convenience and credit control.
  - The growth of peer to peer payments cannot be ignored.
2. Businesses demand more
  - Businesses are demanding more value-added services beyond basic payments.
  - Provision of services along the value chain from e-invoicing to auto-reconciliation all help to optimise a business' working capital.
  - Increased need for simple, cost effective cross-border transactions is expected.
3. Security
  - Consumers need complete trust in the payments system. Security of a payments system is of utmost importance.
4. Form and Speed in Payments
  - We are already seeing a shift in card payments from signature to PIN, and to contactless and quick payment service.





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- Form factors will change with a gradual move away from plastic cards to mobile smartphones.
5. Innovation is driving how banking is conducted and how payments are made
    - There is a huge shift towards anytime, anyplace banking and payments on any mobile device.
    - Approximately 25% of logons to CBA's NetBank are via a mobile device.
  6. Continued pressure on pricing
    - Innovation comes at a cost. While there is a need to continue to test and learn with new payment innovations, there is not an endless source of funding for innovation.
    - Payment margins are too thin to justify ongoing costly innovation.
  7. Ongoing technology developments
    - Technological developments will continue to drive the decline in cash and cheque payments, with an increase in online, cards and contactless payments.
    - Mobile payments in the near future will further shift how consumers move money around.
  8. Convergence of multiple card applications onto one card
    - Cards (or other form factors such as mobile smartphones) are becoming smarter. Issuers will leverage innovation to move towards multi-application cards that offer payment, access, identification, transit ticketing and more.
  9. Growth of Social Networks and Micropayments
    - Social Networking is a key piece of transformational process that we need to continue to explore, understand and try to work out the best way to use.
    - Already social networking sites enable transactions through currencies such as Facebook credits and Bitcoins.
    - Micropayment companies are increasingly enabling social network users to buy virtual goods for their online worlds.

As listed above, there is ample evidence of rapid changes in the payments landscape. Some of these trends will provide the opportunity for individual payment providers to develop competitive innovation for products and services, while other trends will require payment providers to collaborate for systemic innovation.

