1 September 2011

Mr Christopher Kent
Head of Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
SYDNEY NSW 2001

Dear Mr Kent

FSC SUBMISSION – RBA REVIEW OF INNOVATION IN THE PAYMENTS SYSTEM

Thank you for the opportunity to provide this submission to the Reserve Bank of Australia's strategic review of innovation in the payments system.

The Financial Services Council (*FSC*) represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks. The FSC has over 130 members who are responsible for investing $1.8 trillion on behalf of more than 11 million Australians.

The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Stock Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Please find our submission enclosed. We look forward to discussing our submission with you. I can be contacted on 02 9299 3022.

Yours sincerely

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FINANCIAL SERVICES COUNCIL

SUBMISSION TO THE RESERVE BANK OF AUSTRALIA

STRATEGIC REVIEW OF INNOVATION IN THE PAYMENTS SYSTEM

INDEX

1. Introduction

The Financial Services Council (*FSC*) appreciates the opportunity to furnish the Reserve Bank of Australia (*RBA*) with this paper. In particular, we welcome the RBA's focus on payments system innovation.

Although Australia benefits from sound financial regulation and sensible payments oversight, there are numerous instances of where innovation and alignment in the system has not occurred.

As a long term advocate of payments innovation, we welcomed the June 2010 announcement of the strategic review into innovation in the payments system. We believe that the June 2011 issues paper's identification of two key issues in its introductory remarks provides an appropriate focus of the Review.

The paper notes its aim as being upon: "any areas where the Australian payments system may not currently be meeting the needs of end-users or may be at risk of lagging behind other countries in the next five to ten years" and on locating "current or emerging gaps in the payments system".[1]

The paper further notes that "ease of integration with other processes", "interoperability" and "open access" are important payments system attributes. The FSC views this as an excellent summary of where attention is required.

The financial services industry is a major business user of the payments infrastructure. The industry contains a number of subsectors which utilise payments in drastically varying manners. There are telling examples where alignment of payment practices within the financial services sector has not been achieved. As one of the largest users of the payments infrastructure, lack of convergence of payment process is difficult to justify.

Retail banking operations have traditionally developed and used different payment systems than those used throughout the wealth management sector. The retail banking groups have maintained a heavy involvement in the development of non-cash payments systems. In association with the retail banking groups, the RBA established the Australian Payments Clearing Association in the early 1990s as a payments standard organisation primarily for their own usage.

On behalf of a wider range of stakeholders than retail banking groups, APCA today manages payment rules for cheques, ATM / EFTPOS, high value, wholesale cash and direct entry.

While retail banking groups are heavy users of the electronic payment systems, the wealth management sector remains a major user of cheques for non-cash payments. This disconnection is costly and inefficient for both the financial services industry and heavy users of the payments system, such as employers.

Therefore, the lack of standardisation within the wealth management subsector and capacity constraints within the payments system has combined to deliver inefficient and costly payment usage for many users.

The Commonwealth Government is presently addressing the lack of standardisation in the wealth management (superannuation) subsector through the introduction of mandatory data standards. The capacity of the direct entry system to be flexible and scalable will be critical to the long-term success of this project.

This RBA review represents a critical element in achieving an efficient wealth management payments system. The long-term success of the superannuation efficiency reforms will be heavily influenced by the capacity of the payments system.

[1] Reserve Bank of Australia: *Strategic Review of Innovation in the Payments System: Issues for Consultation* – June 2011 p1

This submission will outline barriers to innovation faced by the wealth management subsector. Further, the superannuation efficiency reforms and their relevance to the RBA review will be canvassed. Recommendations to address the prevailing costly and inefficient practices will be provided at the conclusion.

In addressing the issues at hand, positions in this paper are outlined under the headings contained on page one. The substantive content can be found under each heading. These matters are dealt with in detail while the specific questions posed in the issues paper are answered in a concise manner in each relevant section.

2. Barriers to innovation / capacity constraints

The lack of standardisation in the wealth management subsector of the financial services industry is addressed in section 4.

Context

This section canvasses the barriers which wealth management providers encounter when endeavouring to use efficient payment processes.

The superannuation industry is the largest element of the wealth management subsector. Of the $1.8 trillion funds under management in Australia, superannuation accounts for over $1.3 trillion.[2] Due to the compulsory nine per cent contribution rate applied to most working Australians, there are significant flows and transactional volumes in this industry.

In 2010, $144 billion flowed into superannuation funds.[3] Of this, around 75 per cent of the contributions were employer contributions (compulsory) and 25 per cent from the member (non compulsory).

The users of the system are therefore predominantly employers but also members of superannuation funds and superannuation providers.

Super System Review

The Commonwealth Government's Super System Review (*Cooper Review*) of 2009-10 investigated the inefficiency of the superannuation industry's "back office". It named a set of recommendations "SuperStream" to address cost and inefficiency including specific recommendations to introduce mandatory data standards across the superannuation industry.

The linkage between the Cooper Review and the RBA's strategic review was noted in the final report:

> The Panel has considered the Payments System Board (*PSB*) as one possibility. The Panel notes that the PSB has commenced a strategic review of innovations in the Australian payments system. Given its focus on structural innovation where competing industry providers need to engage on developments that improve the overall system, the Panel sees this as a useful vehicle to give consideration to issues surrounding the implementation of SuperStream.[4]

Subsequently there have been considerable advances on the recommendations made under "SuperStream". The level of progress achieved by the Treasury (in consultation with the superannuation industry) in developing these critical standards has been impressive considering the starting point. Accordingly, this strategic review provides the opportunity to ensure that the benefit of this work is realised and that inefficient processes canvassed below are sustainably addressed.

The capacity of the payments system was clearly out of the terms of reference for the Cooper Review but represents a linchpin in achieving an efficient superannuation and broader wealth management payments system.

Scale of the inefficiency

The Cooper Review found that 60 per cent of employers use cheques for providing superannuation contributions.[5]

That is, off the $108 billion worth of employer contributions paid in 2010, over $64 billion would have been paid via cheque.

[2] ABS 5655.0 Managed Funds, March 2011
[3] APRA Quarterly Statistics, December 2010
[4] Super System Review Part Two p299
[5] Based on Colmar Brunton Social Research, *Attitudinal Survey for the Australian Taxation Office* cited in the Cooper Review

The Review determined that while some users had the capacity to use Electronic Funds Transfer (*EFT*) in making superannuation payments, this had both limited usage and a constrained ability to carry necessary data with the payment.

Straight through Processing (*STP*), a payment process with greater efficiency than EFT was less widely used according to the Review. STP offers the following benefits in superannuation:

- Bulk employer contributions can be processed together, resulting in a direct lowering of costs;
- A low-cost alternative for employers;
- Elimination of reconciliation problems between payments and instructions;
- The ability to automate payment allocations from bank statements or payment advice;
- The ability to return payments where required; and
- The ability to be responsive as timeliness is improved.

Although the Cooper Review identified that the lack of standardisation and high level of variation in the superannuation industry was a significant driver of inefficient practice, it did not note the considerable barriers to innovation / capacity constraints.

In recommending that the superannuation industry have standards imposed upon it in statute, the Review did not consider the limitations of the underlying payments infrastructure in delivering the efficiency benefits.

Bulk Electronic Clearing System (*BECS*) / Direct Entry System

Given the heavy involvement of employers in the processing of superannuation payments, the payments system utilised by employers is critical. Employers of all sizes widely use accounting and payroll software which leverages the Bulk Electronic Clearing System (*BECS*) – but better known as the Direct Entry (*DE*) payments system. Employers will typically use the DE system for paying salaries and bills.

According to APCA: “businesses and consumers make about 20 million non-cash payments in Australia each business day; a third of these are made by Direct Entry.”[6]

The superannuation efficiency reforms will make it mandatory for superannuation funds to use data standards when engaging with users such as employers. This standardisation has obvious efficiency benefits. However the capacity of the underlying payments system will be a key determinant in the success of this project.

The DE lacks the necessary capacity to carry sufficient data which is required to support the new standards.

Transmitting the data with payments, with the reconciliation and validation opportunities that it provides, has been elusive in the wealth management industry – which has led users (especially employers) to resort to cheque usage. This is succinctly explained in the issues paper as: “businesses, in particular, find that the absence of an electronic means to carry additional data with payments results in them either having to resort to cheques or to separate data and payment information and reconcile them at a later stage.”[7]

The primary restriction in the DE system is that superannuation, as a payment type, requires a large amount of data or characters in the data fields which accompany a payment in a transaction reference. The DE system presently has the capacity to carry 18 characters in a transaction reference with a payment.

Bulk clearing systems in comparable nations have the capacity to carry significantly more data with a payment, such as the United States Fedwire system which carries up to 9,000 characters.

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[6] Australian Payment Clearing Association – Direct Entry Fact Sheet
[7] RBA Issues paper p22

The superannuation example, captured in the issues paper, correctly identifies the evident limitations of the DE system for superannuation contributions. The additional data which can not be carried through the system includes:

- Australian Business Number (*ABN*);
- Contact details for the employer;
- Contact details for the employee;
- Tax File Number (*TFN*);
- Contribution reference; and
- Type of contribution.

The new superannuation data standards presently being developed as part of the superannuation efficiency reforms and SBR program, canvassed in section 4, may require additional characters to support the long term efficiency of the standards.

Additional data capacity included as part of an ISO 20022 post-DE system will increase the likelihood that alignment of processes for stakeholders such as employers will be achieved as payments and data can be linked.

The issues paper canvasses potentially three solutions to address the DE system's limitations:

- Re-engineering the system to allow a richer messaging standard to accompany payments;
- A proprietary approach which could direct the payment recipient to additional data which was unable to be transmitted with the payment; and
- A new ISO 20022-compliant system.

We believe the answer is likely to be the creation of a new ISO 20022-compliant system. For the cost and practicality reasons identified in the Issues Paper, it would be difficult and costly to re-engineer the DE system.

Accordingly a new system should transition DE system users to the new ISO 20022 system over a set period. This system will ultimately replace the DE system.

The FSC has worked with APCA on its Low Value Payments Roadmap since 2009. The process has contained significant discussion and consultation on the capacity constraints evident in the DE system.

The FSC has been encouraged by APCA's determination to address the capacity constraints identified in the DE system by collaborating with users and considering options for implementing an ISO 20022 solution; which is APCA's position.

We have been further encouraged by APCA's involvement in the superannuation efficiency reforms as an active participant on the Treasury "SuperStream" working party.

However we remain hopeful that APCA will be able to execute and deliver the ISO 20022 solution to replace and operate alongside the DE system with an appropriate transitional timeframe.

The superannuation efficiency reforms will deliver a suite of standards which provide APCA with certainty that the wealth management industry would become a major user of a new ISO 20022-compliant system to replace the DE system.

In our view, proprietary solutions do not represent a long-term, globally consistent solution which is likely to entrench an intermediary and additional cost in the system. MAMBO accounts remain in development and several key participants have recently withdrawn from the joint project. The FSC does not support proprietary solutions when open architecture outcomes can be achieved.

The major provider of superannuation payments, employers, presently uses the DE system for a range of other payments such as salaries and supplier payments. This is often because their payroll software leverages the DE system. In a transition from DE to an ISO 20022 system, payroll software will move to leverage a new system.

The underlying payment infrastructure used by employers is therefore a critical consideration.

In seeking integration of payment processes for this important group of payment system users, we strongly believe that the solution lies in aligning the payment activities through the payments system.

As noted, our preferred pathway is not to upgrade the DE system but to transition from DE to an ISO 20022 system. Provided this new system can support any conceivable payment type an employer may make in a seamless manner, this will deliver the most efficient, sustainable and integrated solution for addressing payments inefficiency in the wealth management industry.

Further comments on the superannuation reforms are provided under section 4. Comments on the regulatory framework and APCA can be found in section 5.

QUESTIONS – THE DE SYSTEM

6.33 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?

As stated with reasons given above, in considering the three options canvassed in the issues paper, we believe that transitioning from the DE system to an ISO 20022-compliant system will be the best approach.

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

ISO20022 standards represent an important element in striving for globally-recognised, compatible data standards. Other jurisdictions utilising ISO 20022 standards have been in a position to transmit large amounts of data with payments.

APCA's commitment to ISO 20022 is a welcome step but we believe there must be a transition clearly outlined from DE to a new ISO 20022 system.

6.35 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?

The superannuation industry has completed a large amount of work in developing standards during 2011, despite achieving little over the previous decade. This continuing body of work, which is a Treasury project with industry input will deliver agreed standards and will provide the opportunity to link payments with data. The standards will be ISO 20022 and SBR compliant to ensure they can be aligned with other processes and standards.

However the long term success of project will depend upon the capacity of the payments system. The objective of linking payments with a richer data set will only be achieved if capacity is increased.

3. Impact of cheque usage and inefficient behaviour

As a result of the lack of standardisation in the superannuation industry and capacity constraints in the payment system, usage of electronic payment instruments remains low in the wealth management subsector. High cheque usage remains at a time when according to APCA, the number of cheques in Australia has fallen “from 437 million in 2006 to 276 million in 2010, a drop of nearly 37 per cent in four years”.[8]

Despite being in overall decline, cheque usage remains rampant – with at least $64 billion worth of superannuation contributions in 2010 being provided via cheque.

The issues paper notes that superannuation payments account as one of the heaviest users of cheques. This is a particularly expensive scenario for wealth management providers and it is worth considering the cost impact.

From a broader perspective, the RBA has estimated the economic cost of a cheque to be $7.69 compared to $0.67 for EFTPOS.[9] The bulk of this cost is borne by the issuing financial institution which has been forced to subsume higher fixed costs as cheque usage has steadily declined.

In responding to this issues paper, the FSC has undertaken cost research to assess the specific transaction cost differential of the three most common superannuation processing types. The following is a comparison of processing costs:

- Cheque - $5.49
- EFTPOS - $1.84
- Straight Through Processing (STP) - $0.31[10]

As can be seen, the cost of processing these transactions varies widely. Processing costs are typically included in the unit cost of the financial product; therefore a high processing cost will typically be borne by the consumer.

The major sources of transactions in the superannuation industry are employer contributions for which no data exists. There is however transaction data on rollovers which are balance transfers between superannuation entities.

During the 2009-10 financial year, over 1.9 million rollovers were undertaken.[11] Comparing the cost of processing contributions above for the 1.9 rollovers in 2009-10, the following is the cost differential based on the above figures:

- Cheque - $10,431,000
- STP - $589,000

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<u>QUESTIONS - CHEQUE USAGE</u>

4.1 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?

No – the superannuation efficiency reforms canvassed in section 4 of this paper provide a comprehensive solution which will drive behavioural change away from cheques. This will be driven by the creation of standards in the wealth management industry. For this project’s success, it is critical that the payment system’s capacity evolves. This is considered in sections 3 and 5.

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

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[8] APCA – The Role of Cheques in An Evolving Payments System
[9] RBA Payments Costs in Australia p117
[10] This survey of FSC members took place in July 2011 and asked major superannuation providers to determine the cost of processing superannuation contributions by different methods. The data has been averaged across the three processes.
[11] APRA – Annual Superannuation Bulletin June 2010 (Issued January 2011) page 27

It would be unreasonable to include a levy on cheque usage until the wealth management industry has bedded down standards and the payments system has increased its capacity. It is only when common users such as employers are afforded the opportunity for efficient processes that sanctions could be considered.

4.6 Should government agencies' policies on payments be used to influence cheque usage?

Given the significant cost of cheques which is ultimately payable by a member of a superannuation fund, the government should endeavour to remove unnecessary cost from a system of compulsory savings.

However, any coordinated effort to remove cheques from the payments system in the longer term should only occur when users are armed with an efficient and simple alternative.

4.7 Should the approach to cheques be determined by individual institutions, determined collectively by the industry or determined by the Payments System Board?

The wealth management industry spent over a decade debating amongst itself how best to develop data standards without resolution until the government intervened and drove a swift outcome. Ultimately it was a government / industry partnership which was successful in agreeing on an approach.

The FSC views the PSB and APCA as well-positioned to engage with major cheque users to determine a view for the future of cheques in Australia.

4. Superannuation efficiency reforms

Context

The Commonwealth Government's Cooper Review provided a number of recommendations on limiting cost and inefficiency in the superannuation industry. (See section 2 for additional context). These reforms are known as "SuperStream".

In February 2011, the Treasury began consulting with the superannuation, payments, employer and union industry representatives to implement these recommendations. The endorsement was provided by the Government in a December 2010 policy announcement "Stronger Super".

A Treasury-chaired working group, known as the SuperStream Working Group, began regular meetings in February 2011 – which are due to conclude in December 2011. The FSC has three representatives on this group. Working with the Treasury, ATO and APRA, the group has a wide mandate to make recommendations to the Minister for Financial Services and Superannuation on how to deliver the reform package.

As part of a suite of efficiency measures which will affect consumers, employers and superannuation funds, the SuperStream reforms contain a government commitment to mandatory, legislated data standards.

Standards – a recent history

For over a decade, the wealth management industry (including regulated superannuation entities and providers of managed investments) endeavoured to agree on a set of data standards for managing transactions between entities.

This endeavour was known as Superannuation Wealth and Investment Management Electronic Commerce (Swim EC). Although Swim EC had reasonably broad support through the representative bodies of the wealth management industry, including the FSC, it ultimately failed.

Neither common data fields for employers (contribution standard) nor common data fields for providers (rollover standard) have been widely applied. The major factor which consigned Swim EC to failure was the lack of compulsion.

For instance, despite the launch of a revised Swim EC contribution standard in 2005 by the then Assistant Treasurer designed to remove variation for employers in dealing with superannuation funds, the standard was not widely applied. Critically, the government did not consider making the standard compulsory.

It was not until 2010, prior to the Cooper Review being finalised, that the government provided a measure of impetus into the industry to agree upon some standardisation.

The consultation leading up to the creation of the government's Medicare Small Business Clearing House in 2010 required that the superannuation industry agree to the contents of a contribution standard.

Standards – SuperStream

In developing a set of mandatory data standards for the superannuation industry, this process will produce a contribution and rollover standard for employers and superannuation providers. A standard for reporting to government will also be developed.

From the outset, all participants to the consultation agreed it was of the utmost importance that these standards were aligned with other comparable standards, that they would leverage existing processes and be as universal as possible. In a practical sense this means that the standards will be aligned to the global ISO 20022 standard and the government's broader initiative known as Standard Business Reporting (SBR).

According to the SuperStream consultation papers:

> There was agreement that the introduction of data standards should provide opportunities to revise the current reporting arrangements to government. The reuse of data standards should provide an opportunity to streamline reports through consolidating requirements, improving the stability of information reported and regularity of reporting. ISO20022 and APCA reforms are to be considered during the design process to ensure future alignment.[12]

By the beginning of the 2012-13 financial year, the FSC expects there will be legislated standards across the superannuation industry.

These standards will be integrated into accounting and payroll software through the ATO's standing working party for software developers. Superannuation standards, like all relevant SBR standards, will become a basic embedded element of accounting and payroll software.

This marks a significant historical change for the superannuation industry. It is a coming of age in that the industry, with the strong guidance and direction from government, has agreed to a set of standards which will deliver alignment in payment processes.

Alignment of superannuation payments with other common non-cash payments has not been achieved and has led to the duplication of processes, inefficiency and unnecessary cost. Employer superannuation contributions which account for the bulk of superannuation payments have relied on a different, often manual process for providing contributions to a superannuation provider.

The embedding of superannuation data standards in mainstream payment software and processes delivers the alignment. However the value of alignment will inevitably be reliant on the capacity to deliver which is determined by the underlying payments system infrastructure.

For the reasons given above, if the capacity constraints in the DE system are not addressed, the success of the superannuation efficiency reforms could be limited. The greatest risk is that employers, as the largest users, continue to rely on cheques.

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[12] The Treasury - Stronger Super Consultation Paper (not yet released)

5. Payments system regulation in Australia

Context

Australia's financial regulatory framework has been heavily tested during the past three years in a period of global financial uncertainty. National financial stability has been maintained which is an endorsement of the both the regulatory structure and the collaboration between the Council of Financial Regulators.

Additionally, each subsector of the financial services industry has been subject to substantive review by the Commonwealth Government. The FSC believes that despite some non-structural reforms proposed in the wealth management and retail banking subsectors, both the industry and regulatory framework is robust. In our view, this includes the underlying payments regulation and practices.

Legal framework

Payments regulation is vested in the RBA's Payment Systems Board (*PSB*) under the *Reserve Bank Act 1959*, the *Payment Systems (Regulation) Act 1998*, the *Payment Systems and Netting Act 1998* and the *Corporations Act 2001*.

The PSB is required to exercise its power in a manner which (amongst other duties) contributes to "promoting the efficiency of the payments system and promoting competition in the market for payment services, consistent with the overall stability of the payment system."[13]

Further, the PSB has extensive powers which allow it to regulate payment systems directly.[14] The PSB is empowered to designate a payment system where it has the "intention to apply regulation consistent with the goals of promoting efficiency…"[15]

The powers derived from the RBA Act provide broad regulatory capacity whilst the PSB is also the recipient of "day-to-day" regulatory authority.

The PSB has rarely used its legislative capacity to designate a payment system as it has largely promoted industry self regulation, which has mostly been successful in promoting stability in the national payments system.

It is therefore evident that the PSB has, over the past two decades, fostered the development of the stand-alone self regulating messaging standard owner APCA, whilst maintaining its regulatory powers; with rare intervention.

APCA

As the regulator of the payments system, the RBA has provided a significant level of autonomy to APCA as a messaging standard self-regulatory authority.

As a self regulator, APCA has been closer to the end users of the payments system – and many users of the payments system have benefited.

However as identified by the RBA in the issues paper:

> Innovation in (APCA's systems) these arrangements requires agreement of the participating members. APCA's structures have been designed to facilitate this, but the very nature of the agreement required can make change difficult. Fundamental change in these areas has at times been hard to come by.[16]

This statement refers to the situation which has been observed globally and domestically where payment systems have stifled innovation. In the case of the wealth management industry, the lack of innovation has been evident due to the lack of sophistication in the DE system.

[13] *Reserve Bank Act 1959 (Commonwealth)* s10B(3)
[14] *Payment Systems (Regulation) Act 1998 (Cth)* Part 3
[15] *Op Cit*
[16] RBA Issues Paper p11

The wealth management industry is an example identified in the issues paper “where the needs of the business community and government agencies are not being fully met…”[17] The rapid development of the wealth management sector following the introduction of compulsory superannuation in 1992 has neither assisted itself nor been assisted by payments innovation.

As noted on section two, the FSC has worked with APCA since 2009 on its Low Value Payments Roadmap. In our opinion, this APCA initiative has been chiefly focused on addressing innovation gaps in the payments system. Our focus in this consultation with APCA has been on the inability of DE system to bear additional data – a gaping innovation gap.

The wealth management payments landscape has changed dramatically since the inception of the roadmap process. The concept of legislated, mandatory data standards in the superannuation industry was not a likely scenario at that time. Accordingly the lack of certainty about standardisation in the wealth management industry did not assist APCA in considering changes which would be necessary to accommodate additional data.

As stated, the FSC expects there will be legislated standards by 1 July 2012, which provides the certainty that APCA may need in order to justify transitioning from the DE to a new ISO 20022 system.

Nonetheless, we have been encouraged by APCA’s determination during the interceding period of 2009-11 to address the capacity constraints identified in the DE system. APCA has been committed to cross-industry engagement and has provided dedicated resources to assess the size of the problem; through the roadmap process.

The FSC believes that APCA has undertaken the necessary work to understand the capacity constraints which have undermined the wealth management’s industries desire to replace the DE system.

APCA can now make decisions on the DE system with the knowledge that legislated, mandatory superannuation data standards are forthcoming, imminent and require augmentation of the payments system for successful application. It assures another significant user group in making the case for reform.

As financial institutions control APCA’s board, many of which are the same entities which advocated for superannuation efficiency reform, the FSC believes that on public policy grounds, the case has been made for the DE system to be replaced.

For the purposes of this industry’s efficiency reforms, this must occur prior to the superannuation standards being bedded down and compulsory in July 2014.

As noted, APCA’s December 2010 decision to adopt ISO 20022 in the Australian payments industry as a non-binding schema is encouraging but will not be sufficient unless ISO 20022 is universally adopted. This global standard must become mandatory in Australia.

There will be a cost for meeting the cost of this innovation. The issues paper considers whether the APCA self regulatory model, controlled by financial institutions sometimes fails to meet user needs throughout the economy as innovation costs are met by APCA members.

The issues paper further considers whether there are instances where innovation could be funded or facilitated by the public sector such as through the Real Time Gross Settlement (RTGS) system.

Consistent with our view that the case has been made for replacing the DE system, we believe that these costs can be borne by APCA members given the transitional timeframe which we recommended.

[17] RBA Issues Paper p15

A further issue is the regulatory governance structure of the payments system. The FSC contends that despite APCA's commitment to wide and comprehensive user group / community consultation and commitment to innovation and adoption of ISO 20022, the execution has not been achieved.

It is therefore a critical matter to consider. In our view, representation on a board can be relevant but, in this instance, it is not as important as regulatory capacity and authority. The *Payment Systems Regulation Act 1998* and other Acts have created a regulatory framework where the government and the self regulator are concurrently responsible for innovation. This submission has highlighted areas where innovation has not been achieved under this regulatory structure.

Accordingly, the *Payment Systems Regulation Act 1998* should be examined with an explicit requirement to consider the regulatory balance and vest the innovation mandate in one party. This could be achieved in one of two ways.

Firstly, APCA could be armed with deeper powers to compel payments system participants to innovate, upgrade and adhere to its direction. Such delegated powers could be based on the financial market rules which are vested in licensees such as the Australian Securities Exchange.

Secondly, the PSB could assume a deeper day-to-day regulatory function which could involve similar powers.

QUESTIONS – REGULATORY AND GOVERNANCE

5.10 Do current governance arrangements adequately promote payments system innovation?
5.12 Are there ways of altering current governance structure to make innovation easier?
5.17 Could formalisation of a broader mandate for APCA, coupled with broader representation, provide better industry-wide outcomes?

Refer to the above comments.

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

The PSB should work closely with APCA and its members to ensure that Australia maintains its position as a world-leader in financial regulation and stability. In particular, the PSB should use its power to ensure that the payments infrastructure is serving the needs of major users.

QUESTIONS – STANDARDS / ISO 20022

6.46 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?
6.47 Should all new payment systems be required to adopt ISO 20022? Should existing systems be required to do so?

Universal adoption of ISO 20022 in the payments system represents a critical step in increasing the capacity of the payments system. The data which can be carried with a payment under ISO 20022 will address the misalignment of processes for payment users in the wealth management industry.

In particular, the combination of standardisation of superannuation contributions and the ability to use the post-DE system for remitting payments will remove cheque usage by employers to superannuation funds.

Given the wide usage of the DE system for payments by users such as employers, the FSC believes the DE system should be replaced by an ISO 20022 system. Although we welcome APCA's position that ISO 20022 should be adopted, this must be compulsorily applied.

In light of the cost of inefficient processes (cheque usage compared to electronic payment), the case has been made for upgrading the payments system capacity. ISO 20022 provides a global standard for building capacity to meet the needs of all users and to remove this unnecessary cost and inefficiency.

6. Recommendations

1. The Direct Entry system should ultimately be replaced by an ISO 20022 payments system;

2. A transition strategy from the Direct Entry system to the new ISO 20022 system should be clearly outlined;

3. The transition must begin from July 1 2014 to align with the superannuation efficiency reforms;

4. This payments system must support the proposed superannuation data standards;

5. The regulatory balance between the Reserve Bank of Australia and the Australian Payments Clearing Association (APCA) in the *Payment Systems Regulation Act 1998* should be considered to explicitly resolve which organisation has a mandate for innovation; and

6. Additional regulatory capacity to compel users to innovate should be delivered.