

16 September 2011

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

## Strategic review of innovation in the Payments System

Dear Chris

We refer to your media release dated 30 June 2011 concerning the Bank's review of innovation and the request made in the release for written submissions from interested parties. Our responses to specific areas in your consultation document are below.

### 4 The Decline of Traditional Payment methods

#### 4.1 The Decline of Cheques

It is generally acknowledged that the current decline of cheques is irreversible and therefore it is important for the industry to contemplate the impacts of the ongoing decline of cheques. We support the consultation process APCA has initiated and believe that this is an industry issue and as such, requires broad industry consultation and collaboration in developing effective strategies to meet the product's decline without placing undue difficulty on any one group of consumers.

We see the government as a key stakeholder from both a user perspective and public policy perspective and therefore a coordinated approach needs the support of government if it is to succeed.

Government agencies policy direction on the distribution of payments will be an important influence on cheque usage and the future direction of this product. As part of the government's reform agenda, alternatives to cheques are being investigated and in some cases have been implemented. An example of one such alternative is the BasicsCard product used by government in the delivery of its income management legislation.

We consider any move by government agencies to persist with the large scale use of cheques as a means of delivering government payments such as welfare, is not in the long term interest of the payment system. We believe that to pursue such a policy would frustrate innovation in how welfare payments are delivered and deny the recipients the ability to benefit from this innovation in terms of how they access their payment. Equally, given some government agencies are large scale users of cheques, we would expect that other alternatives will present government with the opportunity

to reduce the cost of delivering welfare which supports the more effective use of taxpayers' money.

We would support any move to make the costs of the cheque product as a payment product more transparent to consumers and in so doing, provide better price signals. This said we must understand this cost while taking into account the demographics of regular cheque users who may find it difficult to use alternatives. These include customers that live in rural and remote areas as well as the elderly.

While the credit unions that Indue sponsors into the cheque system have already taken a variety of steps to reduce the use of cheques and offer substitutes to their members, to date there has been no move to completely remove cheques as a payment option for their members.

Notwithstanding the decline in chequing volumes, and that it would seem unlikely that the product will be completely retired in the short to medium term, we believe that there is merit in investigating what system-wide efficiencies could be implemented that would benefit all financial institutions. Although we expect volumes will continue to decline, there will be a period of time when financial institutions must continue to provide cheque facilities to both consumers and businesses irrespective of the volumes.

On this basis it would be beneficial for the industry to investigate ways to contain the cost of cheques. One example of how we may be able to achieve this is through cheque truncation. In this case we see merit in being able to change the physical cheques into an electronic instrument by creating an image of the paper instrument and undertaking all processing (as much as possible) using the image rather than the physical paper instrument.

#### **4.2 Cash Replacement**

There have been a number of recent developments that are providing alternative to cash payments. The first is contactless payments and the second, ePAL's work in changing the acceptance practices of merchants for small transaction values. In the case of contactless payments both Visa and MasterCard have positioned contactless payments as an easy alternative payment method to cash and financial institutions in Australia have embraced this technology from both an issuing and acquiring perspective.

In the case of ePAL, there is work underway to educate merchants to lower the minimum spend limit on eftpos cards to provide a cost effective alternative to cash payments.

Both these initiatives are evidence that impediments to the development and adoption of products to replace cash do not exist and we expect that over time competitive pressures from schemes will drive further innovation in this area without the need for public policy intervention.

## **5 The Environment for Innovation in the Australian Payments System**

### **5.5 Models for Industry Governance**

In recent years APCA has emerged as the payments industries self-regulatory body. In playing this role, APCA has been instrumental in promoting an environment for co-operation amongst industry participants.

One notable example of APCA's success in this area has been the establishment of the Australian Payments Forum, whose aim is to provide an environment for the industry to promote innovation and the evolution of the payment systems in a collaborative manner whilst ensuring there remains competition amongst participants.

One area however, where we believe change can create improvement is in the governance structure of APCA. More specifically, in the level of independence at the Board level. If APCA seeks to continue to play a significant role in industry self-regulation, it is important to consider whether the current governance arrangements and the ability of the existing structure to promote change, will be for the benefit of the broader industry and the payments system, rather than its majority members.

At present the APCA board is wholly comprised – with the exception of the Chairman – of appointed directors from APCA members that meet specific criteria which in the main are based on transaction value and volume. At a practical level this results in members that have a larger market share nominating directors and by default forming part of the governance structure.

We believe the composition of the APCA board needs to include more than one independent director to ensure the interests of all members and other stakeholders (e.g. consumers, government, and regulators), and the system at large are taken into consideration. A more independent board will give APCA greater credibility in its role as the industries self-regulatory body.

### **5.6 Structure of Clearing and Settlement Rules**

While the current clearing and settlement arrangements can be used for new payment products - demonstrated by the use of BECS for the clearing of BPAY transactions – we believe that the development of any new payment system should not rely on any of the existing arrangements.

With the expectation by consumers that funds will be available real-time, any new system should look to address the gap between the immediacy of funds expected by consumers and current deferred net settlement between institutions. As the payment of transactions in real-time grows so does the risk to institutions of the once a day 9am exchange.

With the development of a new payment system based on a new network architecture addressing some of the current inefficiencies of bilateral networks, there is also that ability to redefine settlement processes without the need to re-engineer existing systems.

## **5.7 Systems Architecture**

It is generally acknowledged by industry participants that the bilateral network architecture of Australia's payments systems has limited our ability to innovate, increased the costs of upgrading infrastructure and proven to be a barrier to new entrants that wish to participate in the payments system.

However, to move a payment system based on bilateral links to a hub will be very costly, time consuming and complex. Financial institutions have invested significant resources in building systems that are based on a bilateral network and while moving to a hub will give significant benefit, in many cases these will not outweigh the costs in migrating. On this basis we do not support regulation that will force participants to develop new network models for existing payment systems without some consideration for the financial implications created by the required investments.

As an alternative to retro-fitting a new network model to existing payment systems to overcome the current limitations of our bilateral networks, we believe that the development of any new payment system, both batch and real-time, should be based on a hub. Using a global standard such as ISO 20022, both batch and real-time payments could potentially use the same hub infrastructure. We would expect this to reduce the cost of innovating and reduce the costs for new entrants which would have the effect of improving competition.

One benefit a hub could provide is a simplified settlement process. For example, in the case of eftpos, settlement could be changed to a process similar to the international card schemes where members have a single daily settlement position rather than the current situation where settlement is conducted individually with each counterparty. A hub could also provide data validation and value added services such as risk services (fraud monitoring), stand-in, reporting and dispute processing.

## **6 Innovation Gaps in the Australian Payments System**

### **6.1 Transmission of Data with Payments**

Indue supports adoption of the ISO 20022 financial message standard to support the transmission of data with payments.

ISO 20022 which is based on XML format, does not have the restriction of fixed length data fields which for example exist in the Direct Entry file format. When a direct credit transaction is initiated and additional data to the financial data is required to be sent, this can only be achieved by sending a letter, email or fax separate to the payment. In the case of ISO 20022, the non-financial data can be included in the financial message, thus removing the need to match two separate sources of data at the point of receipt.

A payment system based on ISO 20022 will provide an electronic alternative payment method for say cheques. It will also deliver business efficiencies through straight through processing of non-financial data relating to a payment direct into businesses software systems.

Refer to section 6.7 for additional comments.

## **6.2 The Timeliness of Payments**

The settlement processes that currently support our payment system (CS1, CS2 and CS3 for consumer payments) are built on deferred net settlement. Typically settlement occurs daily while file clearing occurs at multiple times during the normal course of a business day. While batch processing has served us well, it is not as efficient at exchanging value as a real time settlement system is and as such, some delays can be experienced between when a payment is made and when the recipient of the payment actually receives the value in their account.

We believe that the delay in settlement typically associated with a batch processing system can be a key impediment to innovation in the payment system. Over the last 20 years consumer patterns with regards to how and when payments are made have changed. Most noticeably is the growing weekend trade for consumer purchases.

While the extended trading hours have given consumers more convenience and changed their expectation, the payment infrastructure that supports this trade has essentially not changed. As volumes continue to grow, so does the settlement exposure for financial institutions. We would expect that this problem will only get worse as online channels for retail trade increase in popularity and more products are purchased on line outside of traditional business hours.

## **6.5 Mobile Payments**

It is our view that mobile payments will take the form of contactless payments at point of sale, mobile internet (eCommerce) and person to person real-time payments.

We have already seen a number of pilots in Australia for contactless mobile payments using microSD technology and Indue itself is underway with a pilot program of this type. The contactless infrastructure that has to date been deployed for contactless cards is being leveraged for mobile payments. This has been achieved without the need to make changes to contactless point of sale terminals to support mobile devices and as such it has made the business case easier for issuers to offer a mobile solution to their customers.

As newer technology such as NFC capable devices start to become more widespread, the complexity for facilitating mobile payments will increase and there will be a requirement for financial institutions to collaborate with telecommunication network providers, handset manufacturers and software application developers.

As solutions get more complex, it will be important to ensure that innovation does not get obstructed through a lack of ability for each party to agree on what part of the solution they will be responsible for and for solutions to become obsolete through rapid advances in technology.

The key to success of mobile payments will be to ensure the technology is stable, the transaction secure and the user interface simple.

## 6.7 Standards

We support the adoption of international message standards to ensure there is a high degree of interoperability to other markets. However, the challenge we face as an industry is that to retrospectively implement a new standard into legacy payment systems will be very costly, time consuming and complex. Financial institutions have invested significant resources in building systems that use existing standards and while moving to a global standard will give significant benefit, in many cases these will not outweigh the costs in migrating.

We believe a more realistic solution is to base a new payment system on the ISO 20022 standard rather than redevelop the systems already in place. This will give Australia a high degree of compatibility to global markets and the benefit of being able to transmit both financial and non-financial data.

Adoption of ISO 20022 will also be an incentive for international vendors to invest and provide innovative payment solutions for the Australian market without the requirement to tailor these to the proprietary standards used today.

### Conclusion

We thank you for the opportunity to contribute to the current debate on innovation in the Australian payments system and the invitation to respond to your consultation paper. We look forward to discussing our views with you and participating in the forums you plan to hold in the coming months.

Should you have any questions about our submission, please feel free to contact me on (07) 3258 4248.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Michael Swannell', with a stylized, cursive flourish at the end.

Michael Swannell  
Executive Manager - Payments