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Innovation Review

Dear Chris

Thank you for the opportunity to comment on the RBA's Innovation Review. Overall our view on Innovation is set out below.

We view Innovation as any change to products or processes. Importantly, this includes making our systems more reliable, fraud-resistant, efficient and stable as well as ensuring that our products and services meet and exceed our customers' expectations in the face of increasing technological advance which enables (and is driven by) competitors such as PayPal, Google, Paymate and Poli.

Generally

The Westpac Group consistently makes significant investment in innovation projects; project investment is expected to be around \$1b for each of FY11, FY12 and FY13¹. Any additional directed capital investment (ie innovation without a business case) arising from this Innovation Review would crowd out revenue-generating innovations.

We also note that collaborative investment in interbank payments systems is complex and is necessarily something that should not be rushed. On this basis, we expect that any specific investments required under RBA's direction would be subject to a separate and specific public consultation.

To this end, we are encouraged by clarifications from you that the RBA is not in the business of picking winners, or regulating innovation into existence.

In your 7/7/11 speech, you also referred to issues such as:

- The existence of (positive) network externalities arising from cooperative investment. From our perspective these network externalities are difficult to capture due to

¹ The Westpac Group IT & Productivity Update, 8 October 2010

competitive firms (in the network) offering what quickly become commoditised new services (because of the nature of cooperative investment).

- Competition laws impacting on cooperatives. This is related to the above point.
- The impact of devaluing existing infrastructure. The likelihood of detrimental effects on existing revenue streams for existing players arising from cooperative innovations. We note that the same effect [akas cannibalisation], arises from proprietary innovations.

In our experience, these issues are the key factors when considering the business case for collaborative investments.

In line with the above issues you raised and noting the large amount of innovation already on foot, our view is that the most important changes to the environment for collaborative innovation is that the business models must make commercial sense and must be sustainable.

This may take the form of, for example, the Payments System Board (PSB) generally allowing commercial arrangements to be set (without restriction) for collaborative ventures provided that: (a) the commercial arrangements are transparent; (b) end-user pricing is unrestricted; and (c) access to the arrangements is transparent.

Our view is that industry players will be materially better placed to settle on collaborative investments once there is clarity around what commercial arrangements will be sustainable.

The Specifics

Our view is that the primary action that PSB can take to foster collaborative investment in the payments space is set out above. On this basis, we have kept our responses to the specific questions at the topic level.

Declining Cheque Usage

We agree that cheque usage is declining and that certain customer segments are unlikely to be happy that firms and consumers increasingly stop accepting them. This needs to be managed very carefully. We support APCA's open and inclusive process and welcome RBA's involvement in the process.

Industry Governance and its Impact on Collaborative Innovation

As noted above collaborative innovation/investment has hurdles that proprietary investments do not have. The relevant section of the Consultation Document (section 5.1 to 5.5) also appears to recognise this.

It is not clear that the different types of industry governance would make a material difference either way. In the end, commercial entities need to make the complex decisions trading off collaborative investments against all other potential investments and the industry governance model is generally a secondary concern.

We support the efforts that APCA is undertaking to re-configure the self-regulatory environment.

Structure of Clearing and Settlement Rules

Our view is that the existing clearing and settlement arrangements are not a material factor affecting collaborative investment decisions. If a commercial imperative is sufficiently strong, we have no evidence of clearing and settlement rules inhibiting innovation.

System Architecture

The issue of bilateral v central hub is becoming less of an issue with new technology (such as cloud) enabling virtual models. Physical infrastructure becomes less relevant with communications protocols taking the focus. Our view is that central hubs are likely to develop if and when demand for them grows. The hybrid model contemplated is already effectively available to those who need them. Indue, CUSCAL and agent/appointor arrangements are examples of this type of hybrid already in place.

Transmission of Data with Payments

There are many proprietary methods of addressing this business issue. Our view is that is being dealt with competitively today, however if commercial arrangements were able to be sustainable set, a collaborative model could also be considered without diluting value and discouraging competition.

Timeliness of Payments

Our view is that as demand grows for greater timeliness of access to funds and notification, investments will occur to solve this for our customers in a competitive fashion.

Many banks' (including Westpac) systems are configured to provide access to inward direct entry credits (for example) to deposit accounts prior to overnight update and all banks update prior to settlement. We regard this type of service as a competitive issue, where competition is working (see another major bank's recent update to match our services).

Based on existing practices, we do not see changes to the frequency of settlement as having a material impact of the timeliness of availability of funds.

Mobile Payments

We see mobile payments as an area where a lot of exploratory work is being done to work out how best to bring mobile payments to customers in a secure and reliable way. At this stage, we have not identified regulatory hurdles. On this basis, regulatory intervention is unlikely to be helpful in stimulating investment. The risk here is that an intervention will saddle Australia with sub-optimal technology.

Standards / ISO20022

We see global standards as being a valuable resource when considering innovation, but not something that should be mandated.

There is risk in enforcing compliance with global standards as broadly as is envisaged in the Consultation Document. It seems to us that knowledge of the standards should be sufficient and if the business issue being addressed requires variation from the standard or something very different, the innovation should be able to proceed without regulatory intervention.

Yours Sincerely

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