Commonwealth Bank

Submission to the Treasury Review of the Australian Payments System

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Public

1. INTRODUCTION

CBA welcomes Treasury's review of the regulatory architecture of the Australian payments system. The co-regulatory framework comprising of financial regulation and industry self-regulation has served Australia well in providing safe, reliable and efficient ways to pay. However extraordinary innovation in payments driven by new technologies and entrants is presenting new challenges and opportunities. This pace of change and diversification will only accelerate with the introduction of Open Banking and the Consumer Data Right in Australia. A future regulatory framework will need to incorporate new payment businesses and methods to ensure beneficial outcomes for end users. This review is a valuable first step to identify the limitations of the current framework and the desired features of future regulation. CBA's submission outlines the primary issues that will need to be addressed to optimise industry self-regulation and promote safe and sustainable innovation in payments. In doing so we hope to highlight the need for further consultation and comprehensive analysis to ensure the development of regulatory settings that will facilitate innovation and competition without compromising the integrity of Australia's financial system.

2. REGULATORY OBJECTIVES OF A FUTURE PAYMENTS SYSTEM

The overall objective of a future payments regulatory regime should be to enable the community to benefit from innovation and competition while still ensuring that the payments and financial system remains safe, resilient and stable.

A well designed payments regulatory architecture will be crucial to achievement of the Government's Job Maker Digital Business Plan and Australia's economic recovery and growth following the COVID-19 pandemic. As noted by the Bank of England, end-to-end operational and financial resilience across payment chains is critical for the smooth functioning of the economy.[1]

Technology has made payments cheaper, faster and more convenient. Banks have a long history of developing new ways to pay such as contactless payments and BeemIt. Newer entrants are now introducing additional services or functionality to existing payment systems or taking over some of the functions previously performed by banks.

The pace of technological change requires an agile regulatory regime that enables industry to adapt to new and emerging risks quickly through self-regulation. Formal regulation is needed to support co-ordinated and comprehensive participation in industry efforts to manage risk and protect end users. The high level of interdependence inherent in payments can expose the entire system to vulnerability when a single participant is compromised.

Payment system security and stability and innovation are not mutually exclusive. Consistent and uniform safeguards to engender trust and confidence in the payments system are essential for the ongoing widespread adoption of efficient digital payment methods.

[1] https://www.bankofengland.co.uk/-/media/boe/files/financial-policy-summary-and-record/2019/october-2019.pdf

3. LIMITATIONS OF THE CURRENT REGULATORY FRAMEWORK

The security, stability and resilience of the Australian payments infrastructure to date is largely due to the underlying financial regulation that governs traditional payment providers such as banks. This strong foundation has enabled innovative new services by fintechs and other new entrants to proliferate via systems and infrastructure developed and maintained by traditional payment providers.

Technological advances have transformed a linear payments value chain that historically involved predominantly financial institutions into a payments ecosystem of greater complexity and scale. New and diverse payment providers are not subject to stringent financial or banking regulations and many operate outside of industry self-regulation.

Additionally, there is a growing gap in consumer protections as digitisation of payments brings new and unforeseen threats. In line with the RBA's mandate, the current regulatory architecture is heavily weighted towards controlling the cost of payments, rather than consumer protection and customer experience considerations. ASIC's ePayments Code does not cover a range of payment options available to consumers, including digital wallets, contactless payments, tokenisation, biometrics, or the New Payments Platform.

Finally, there are clear opportunities to simplify, streamline and better co-ordinate regulation of payments. There is no avenue to create an integrated or coherent set of guiding principles for the Australian payments system. Instead, piecemeal objectives are generated through separate, numerous and at times overlapping industry, regulatory and government reviews. The detail of the government's payments policy objectives are not always clear or consistently communicated to industry. As a result participants face multiple and competing expectations and obligations, creating misalignment between government expectations and market outcomes. A lack of policy coherence also leads to contradictory objectives between different regulatory agencies, for example the tension between AUSTRAC financial crime regulation and ACCC expectations for lower pricing, innovation and competition in foreign exchange services.

4. A FUTURE REGULATORY ARCHITECTURE: OUR RECOMMENDATIONS

A future-fit regulatory framework will need to accommodate an evolving payments landscape and facilitate long term, forward looking solutions. Regulation should ensure that innovation and competition creates benefits for consumers and avoids causing harm. Failure of start-ups, security breaches, outages or financial losses will only impede growth and undermine confidence in the digital economy.

To meet the needs of end-users in relation to emerging innovations in the payments system CBA considers a future regulatory architecture requires the following features:

i. **Robust security and stability standards:** Existing minimum standards should be maintained and consistently applied. The payments system has been recognised as a potential transmission mechanism through which 'unsound' organisations can jeopardise the stability of the whole financial system. The collapse of German fintech Wirecard demonstrated how risks that are not readily apparent can have wide reaching impacts due to market interconnectedness.[2] Any party that relies on the payment rails directly or indirectly and introduces risk to the security or stability of the payments system should bear the same responsibility and liability.

ii. **Self-regulation:** The pace of change in, and the exceedingly specialised and networked nature of the payments industry, requires an ongoing central role for industry self-regulation. Industry

[2] https://www.ft.com/content/0e84428b-bee6-45e6-bef1-b03f6f9be335

responses need to be guided by clear and coherent government policy. Formal regulation needs to play a role in supervision and supporting comprehensive participation and alignment across sectors. Inconsistent commitment to self-regulation creates inequality within the fintech industry (when only some fintechs are members of AusPayNet), as well as with incumbents and could compromise safety and stability. For example, devices can be used to process payments that connect to the underlying payment rails, yet do not comply with AusPayNet security requirements.

iii. **Joint policy forum:** The new framework should include a formal forum to facilitate the communication of government policy objectives to industry participants and improve co-ordination between regulators, and with industry. Joint efforts between the private sector and regulators (such as pilots to trial central bank digital currencies) will be essential for technologies that are 'over the horizon'. The response to the COVID-19 crisis demonstrated the positive outcomes that can be achieved from increased collaboration between government, regulators and the private sector.

iv. **Competitive neutrality:** To stimulate innovation, new entrants and traditional providers should receive the same regulatory relief or 'safe harbour' provisions when launching similar products and services. The European Union's Expert Group on Regulatory Obstacles to Financial Innovation (ROFIEG) has recommended that regulation of the financial sector should follow the principle of 'same activity creating the same risks should be regulated by the same rules'.[3]

Large non-financial entities (for example global technology companies) with significant market share or importance to the payments landscape must adhere to rules and standards, and a level of transparency similar to traditional payment providers, to ensure innovation does not create long term detriment. For example, pricing practices should face the same scrutiny that is applied to incumbents to assess the impact on the overall cost of transactions. The UK's Competition and Markets Authority has attempted to identify large digital platforms that require closer supervision as those that have 'strategic market status'.[4]

To remain flexible to changes in the market it would be preferable to base regulation on the nature of the risk rather than the type of institution. As stated by Sir Jon Cunliffe, Deputy Governor Financial Stability of the Bank of England, 'the same risks have to be subject to the same regulation'.[5]

v. **Equal minimum consumer protections across equivalent services:** Minimum security and consumer protection requirements should not be compromised and should apply to all entities regardless of size. Poor consumer outcomes can erode confidence and deter the uptake of new and innovative payment methods. Accordingly, good consumer outcomes and streamlined customer experiences are integral to achieving policy, regulatory and commercial objectives. Consumers and businesses have the right to expect similar protections for similar services. Consistent protections and avenues for recourse when things go wrong will create certainty for customers, simplify obligations for fintechs and improve the long term prospects of new payments businesses.

vi. **Shared responsibility for investment and innovation:** Payments infrastructure will be increasingly burdened as a growing number of new entrants utilise the same payment rails. Most new innovations, including Buy Now Pay Later, digital wallets and point of sale devices are dependent on the pre-existing underlying payments infrastructure. To remain viable, the maintenance and

[3] https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/191113-report-expert-group-regulatory-obstacles-financial-innovation_en.pdf
[4] https://assets.publishing.service.gov.uk/media/5fce7567e90e07562f98286c/Digital_Taskforce_-_Advice.pdf
[5] https://www.bankofengland.co.uk/-/media/boe/files/speech/2020/its-time-to-talk-about-money-speech-by-jon-cunliffe.pdf?la=en&hash=A39E014DBBA2C5E88D1B8339E61598CBD62BCA3E

ongoing modernisation of critical payments infrastructure will need to become a shared responsibility by all parties that benefit financially, directly or indirectly, from its use. Regulation should encourage proportionate contribution and fair value arrangements, and allow for sufficient returns to ensure sustainable and ongoing investment in the payments system. Commercial incentives created by Government will also need to play a role to encourage ongoing private sector investment and innovation.

vii. **Co-ordinated regulatory intervention:** In a digital environment, any regulatory change in payments will involve some impact on 'in house' technology infrastructure. The payments industry is facing a number of large scale initiatives such as the ISO20022 SWIFT migration and upscaling the New Payments Platform. The implementation of policy and regulatory objectives can be assisted greatly by co-ordination amongst regulators and consultation with the industry. Such an approach will allow participants to better manage the change burden, and ensure better outcomes by avoiding change congestion and duplication.

viii. **Alignment with broader digital policy:** The overlapping nature of digital markets requires alignment between payments system regulation and cyber, privacy and data regulation across sectors. Harmonisation with existing digital reforms is necessary to form part of a nationally co-ordinated approach to building a safe, secure and thriving digital economy. For instance, the United Kingdom has established a Digital Regulation Cooperation Forum (DRCF) to enhance co-ordination and cooperation between regulators in digital markets.

ix. **Global focus:** A future fit regulatory framework will need to reflect the global nature of digital payments. Reforms should promote interoperability, alignment with international best practice standards and co-ordinated regulatory activity across jurisdictions. The regulatory regime should support Australia's international competitiveness, protect national sovereignty and prevent disproportionate reliance on international actors for basic internal market functions that underpin the economy. The European Union's 'Vision for European retail payments' includes the availability of competitive domestic payments solutions to support Europe's economic and financial sovereignty.[6]

5. CONCLUSION

CBA recommends that further consultation is necessary to consider how existing structures, roles and mandates involved in the governance of the system should be adapted, co-ordinated or consolidated to maximise the benefits of innovation and competition in payments. Whilst we have not at this stage made a specific recommendation in relation to which government agencies or industry self-regulatory bodies should assume accountabilities in any future model, we believe it is important that any future design should preserve the specialised payments expertise accumulated by the RBA's Payments Policy Department over the past twenty years. A robust assessment of the network and flow on implications of regulatory reform aimed at stimulating competition and innovation is required to avoid long-term outcomes that are counter to the Government's policy objectives and Australia's economic recovery from the COVID-19 pandemic. Payments is the 'gateway' to financial services and payment activities are currently the focus of innovation in financial services. In a digital environment, payments regulation must be designed within the context of interrelated digital activity and impacts on the broader economy.

[6] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020DC0592&from=EN

APPENDIX: THE EXISTING REGULATORY ARCHITECTURE OF THE AUSTRALIAN PAYMENTS SYSTEM

The Australian Payments System

The payments system in Australia consists of the infrastructure and institutions that together enable the exchange of value between participants in the economy. Retail payments involves the numerous ways consumers transfer money and the systems and service providers that facilitate these payment methods. In Australia a range of payment types can be used via a variety of channels (mobile, online, phone, in person or card). A number of domestic and international systems are available to clear and settle payments including BECS, BPAY, eftpos, international card schemes, NPP and SWIFT.

Multiple intermediaries co-operate to co-ordinate a range of activities to process a single payment. Each transaction is underpinned by operating procedures, a communications network to initiate and transmit payment information, and industry and regulatory and organisational frameworks that enable the transfer of funds from the payer to payee and to settle payments. Innovations in payments and value adding services provided by new entrants have largely been built upon these established systems and arrangements.

The stability and general smooth functioning of payments in Australia has meant that these processes underlying payment transactions are ubiquitous and intangible and not well understood by the broader community.

The specialised expertise, high level of interdependence, and requirement for network effects that characterises payments means more co-operation is needed between regulators and industry (as well as within industry) compared to other financial markets. As a consequence, self-regulation plays a central role in the payments regulatory architecture.

Self-regulation

A multitude of industry rules, guidelines and standards have developed and evolved over time in response to changing payments trends and technology. As a result, what are in effect ‘self-regulatory’ measures are interspersed through the policies and participation agreements of various members of the payments industry. AusPayNet manage regulations and standards for payments clearing and settlement yet also functions as an industry association. Each payment scheme (eg. international card schemes, eftpos, BPAY, NPPA) likewise has its own rules and obligations – some of which are commercial but many that relate to security and stability of the payment system or consumer protection (e.g. scheme chargeback rules and mistaken payment processes). Additionally, due to interdependencies in payments there are arrangements between banks such as fraud stop/indemnity agreements that developed in response to the emergence of payment scams.

Under these arrangements combined with the oversight of the RBA (described below) the payments industry has effectively responded to emerging risks including strategies to manage ‘Card Not Present’ fraud, the TrustID Framework and innovations such as PayID.

Formal regulation

Payments are primarily governed through banking and financial services regulation. As noted in the Issues Paper, the Reserve Bank of Australia (RBA) is the principal payments system regulator. Central banks in most developed countries play a leadership role in payments in line with their monetary and banking policy responsibilities. ASIC, ACCC, AUSTRAC and APRA also hold discrete responsibilities relating to payments.

However even independent regulation in payments is characterised by an intermingling with other roles. There are several distinct aspects to the RBA’s role in the payments system, comprising those of policymaker, overseer and supervisor, banker to the government and owner and operator of key national payments settlement infrastructure. This hybrid structure has allowed RBA’s Payments Policy Department to accumulate substantial specialised payments expertise over time. However, at times these multiple roles in payments can create confusion and uncertainty for regulated entities when they interact with the RBA.