



31 March 2014

Mr David Murray

Financial System Enquiry

GPO Box 89

Sydney NSW 2001

Dear Mr Murray

Submission by Australian Settlements Limited to the Financial System Inquiry

Australian Settlements Limited (ASL) is pleased to have the opportunity to provide this submission to the Financial System Inquiry for consideration.

We believe that exploration of the areas detailed in this submission should occur to ensure the viability and stability of the Financial System along with the creation of a level-paying field for new and existing stakeholders in this environment.

We would welcome the opportunity to discuss these items with you further so as to clarify any areas.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'David Jay', with a small flourish underneath.

David Jay

Chief Executive Officer

Australian Settlements Limited

Executive Summary

Details of Australian Settlements Limited (ASL) as an entity can be found in Appendix A to this submission. Details of the ASL Membership are provided in Appendix B to this submission for your reference.

The issues specific to Mutual ADI's and, in particular ASL Members, are detailed below and encompass the following broad areas:

- Balanced and Consistent Regulation
- Payment Security
- Merchant Routing
- Payment Card Surcharging
- Payment Disruptors / New Market Entrants – level playing field
- Decline of Traditional Payment Methods

Summary of Recommendations

ASL believes that the Financial System will be better improved by exploring and including the following items within the scope of the Financial System Inquiry:

Section 1: Balanced and Consistent Regulation

- Lower regulatory burden for Mutual ADI's commensurate with the risk they pose to the Financial System;
- More regulation for new entrants to ensure they do not compromise the security and stability of the Financial System;
- A consistency amongst regulations and Codes of Conduct to ensure a level-playing field; and
- A single regulatory body to administer the relevant Acts and Codes applicable to the Financial System.

Section 2: Payment Security

- A liability shift of losses attributable to the party responsible for any data breaches;
- A framework to assist the Schemes in enforcing their security changes by implementation of a national framework around payment security;
- Education on the importance of personal security on electronic devices, PINs and passwords.

Section 3: Merchant Routing

- Allowing the cardholder the account selection choice in a contactless situation.

Section 4: Payment Card Surcharging

- A further review of the practice of payment card surcharging with either abolishment of the card surcharging rules or undertaking of a benchmarking process to ensure fairness in charging.

Section 5: Payment Disruptors / New Market Entrants

- Establishing a minimum standard and/or referral system to a relevant body, whether it be the Australian Payments Clearing Association, the Reserve Bank of Australia, Visa, Mastercard, eftpos, BPAY or the like, dependant on the type of transactions that will be processed;
- Ensuring that any new players 'register' their product and have it certified ;
- Early detection and remediation of any new entrants who enter the market without following proper protocols.

Section 6: Decline of Traditional Payment Methods

- Engagement of Consumer Groups to determine the most effective way of communicating the end of old payment methods (such as cheques);
- Consumer education on the security and practicality of electronic payments, and promoting the benefits of the same;
- More innovation in providing services consumers can embrace as 'preferred and secure' alternatives to paper cheques.

Section 1: Balanced and Consistent Regulation

Currently all ADI's are regulated by various bodies including the Australian Prudential Regulatory Authority (APRA), the Australian Securities and Investment Commission (ASIC), the Reserve Bank of Australia, the Australian Payments Clearing Association (APCA), and AUSTRAC, to name a few.

In absolute terms, the cost of regulation to Mutual ADI's is the same as that of the larger banks, however in terms relative to the low risk posed to the stability of the financial system by Mutual ADI's, there is a strong argument that the regulatory burden should be lower for Mutual ADI's than larger banks. ASL does acknowledge however that there is need for closer supervision and implementation of stringent controls on the ADI's that are underperforming at any given time.

There is a regulatory push for non-ADI institutions to be able to process transactions without the need to be regulated as heavily as an ADI. Whilst competition is warranted across the industry, this move would create an uneven playing field in that new entrants would not meet as high a regulatory burden as an ADI on an ongoing basis. This would create an unfair advantage across the industry and in many ways is anti-competitive.

Additionally, leaving public policy considerations to market forces may result in sub-optimal outcomes in the stability and security of the financial system.

In the above environment, Mutual ADI's face the challenge in terms of having a high regulatory cost in relative terms to larger banks, and having to compete with new entrants, who are not regulated in the same way but have the ability to innovate with the savings they make from regulatory exemption.

In relation to consistency of regulation, there are numerous voluntary Codes of Conduct across the industry. Wherever there is a code that is voluntary, or the ADI is deputised with running its own program, such as the Anti-Money Laundering / Counter Terrorism Financing laws, there will always be iterations of the interpretation of the meaning behind the legislation. The lack of clarity can put individual institutions at a disadvantage to others.

New entrants to the system appear to have little or no requirement to subscribe to any mandatory codes and as mentioned above, are not regulated under the same requirements as ADI's. Those ADI's who subscribe voluntarily to codes, generally do so to ensure the ethics of the financial system are observed however are often required to implement stringent internal compliance controls.

To overcome the anomalies that exist because of the existing structure, it would serve the industry better to have one regulatory body to administer the various codes that exist.

This body would need to oversee the new market entrants to ensure that, at a minimum, they are subject to testing that ensured ongoing security and stability of the financial system.

Recommendation

ASL believes the following regulatory amendments should be considered:

- Lower regulatory burden for Mutual ADI's commensurate with the risk they pose to the Financial System;
- More regulation for new entrants to ensure they do not compromise the security and stability of the Financial System;
- A consistency amongst regulations and Codes of Conduct to ensure a level-playing field; an
- A single regulatory body to administer the relevant Acts and Codes applicable to the Financial System.

Section 2: Payment Security

Fraud is a prevalent issue in the payments industry. Whilst card skimming and card number compromise activities form a large part of the fraud picture, the historically lax approach by consumers in the personal protection of passwords, PINs and User ID's contributes to the fraud losses suffered each year by financial institutions.

Card Schemes are undertaking very important work in reducing the risk of loss. The PIN@POS project is a clear example of their commitment to reducing fraud. However they cannot do it alone and require support from all areas of the value chain in card payments.

Government and consumer groups need to implement ways to educate consumers on the importance of virus protection on personal computers and security of PINs and passwords. We acknowledge that the Financial Institutions promote this behaviour within their websites and terms and conditions collateral, etc, however there is no real gauge on how well that message is received by the public. If the government and/or consumer groups promote the importance of these preventative measures, there may be a better effect on the outcome.

Similarly more work needs to be carried out in ensuring merchants / gateway providers are held accountable for any data breaches. A national framework to ensure compliance would help reduce the risk to consumers on card details being compromised. Currently most losses are borne by the Financial Institution, even though they have little control over this type of breach occurring. If a shift of liability to any proven breach by a merchant / gateway provider was implemented, we would see urgency from merchants / gateway providers to comply with security requirements more pro-actively.

As payment methods are emerging, there is a new trend in the removal of card details, passwords and PINs being a part of the transaction. While Schemes work very hard to ensure the necessary security requirements are employed into any payment, they have no real backing to ensure compliance other than their own rules. To enhance their efforts, we see that a framework around payment security which details requirements for all stakeholders of the payment chain will go a long way to achieving a more robust payment security regime in the Australian region.

Recommendation

ASL believes that the security of payments in Australia will be fortified further if:

- Consumers are educated in the importance of personal security on electronic devices;
- Consumer are armed with relevant information on how to maintain their passwords and PINs securely;
- A liability shift occurs to the party responsible for any data breaches; and
- A framework to assist the Schemes in enforcing their security changes by implementation of a national framework around payment security.

Section 3: Merchant Routing

In recent times there has been discussion surrounding Merchant Routing. The Reserve Bank of Australia sponsored arrangements with respect to contactless Multi-Network Debit cards which included the ability for merchants to choose the application on the card that they wished to route transactions.

In the contactless environment, the holder of the card needs to be certain as to what type of transaction they are performing and which account will be debited when they use their card. In many institutions, cardholders are able to have multiple accounts linked to one card and they can, in a contact transaction, choose which account they want debited to suit their circumstance. The issue they face if they are not able to select their own account in the contactless environment is that they:

- May not have sufficient funds available in one of their accounts and if the transaction is routed down a network where that account is linked, then they may incur overdrawn fees, overdraft interest, or endure the embarrassment of having a transaction declined;
- May bank with an institution that has a fee structure that charges for one type of transaction and not another. By removing their choice of account, they may be charged a fee through no choice of their own; and
- Will become confused as to handling their financial affairs which could lead to hardship in some cases. For example the cardholder may have a particular account linked to a card that has travel insurance activated as part of performing the transaction. If the merchant routes the transaction to an account other than the one that has the insurance, and the cardholder is unaware of this and then attempts to claim on said insurance, they will likely suffer a financial loss due to a circumstance outside of their control.

Recommendation

ASL believes that the cardholder, as the everyday user of the card, and therefore the one entity who understands how they want their card to work, should be given the choice in a contactless situation and merchants should not be afforded the opportunity to route a transaction a certain way so that they can achieve a financial benefit to the detriment of the cardholder.

Section 4: Payment Card Surcharging

Payment card surcharging in Australia has become more prevalent following an announcement by the Reserve Bank of Australia to allow recovery of reasonable costs in performing a card transaction.

The major issue with this resolution is that there is no clear indication of what constitutes the cost to perform a transaction, in that some merchants charge the cardholder 5% of the transaction and others charge 3%, while most charge nothing extra. Even though arrangements between Acquirers and Merchants are commercial and proprietary, there appears to be a discord between some large companies (with market dominance) who are likely to incur lower merchant service and transaction fees, who are surcharging, and SME's that do not surcharge and are likely to incur higher merchant and transaction fees.

Recommendation

ASL believes that this practice of payment card surcharging should be reviewed further, with the following two options to be considered.

Option 1 – Reverse the initial decision to allow card surcharging by reinstating the right of payment systems to enforce “no-surcharge” rules.

Option 2 – Undertake a benchmarking process to determine an arbitrary average cost of transaction processing for merchants, and then apply a cap on the amount of surcharging so that there is better understanding from consumers on how much it will cost them across the board.

Section 5: Payment Disruptors / New Market Entrants

Over the past couple of years there have been many emerging stories of payment providers and instruments clogging news feeds from innovation subscriptions.

Emerging technologies need to be embraced across the industry as a means of enhancing innovation and removing old methods. However some of these technologies cause confusion for stakeholders in the transaction chain.

A prominent example occurred where a mag stripe card reading device on a smart phone was deployed in Australia without the proper Card Scheme processing protocols being followed to comply with the security features employed in using chip technology. Whilst the Schemes managed to remove the devices in a timely fashion, there is a notion that any new technology to be brought into the Australian market should be subject to an industry 'test' and not one driven by the provider of the service.

The practice of new entrants bringing their product to the market and then dealing with consequences poses a high risk to the stability of the financial system in that the potential fallout from a security breach may not be realised until a major breach of industry operating standards applies.

Recommendation

ASL believes that a balance of embracing new players with minimal access barriers and retaining stability in the financial system can be achieved by:

- Establishing a minimum standard and/or referral system to a relevant body, whether it be the Australian Payments Clearing Association, the Reserve Bank of Australia, Visa, Mastercard, eftpos, BPAY or the like, dependant on the type of transactions that will be processed;
- Ensuring that any new players 'register' the product and have it certified (not unlike the current requirements for physical payment mechanisms such as ATM and eftpos terminals); and
- Early detection and remediation of any new entrants who enter the market without following appropriate protocols.

Section 6: Decline of Traditional Payment Methods

With the decline of cheques, there has been a substantial focus on the need for innovative means of payments, such as the New Payments Platform, and PEXA. Whilst Australia has taken on board the negative public response experienced in the United Kingdom, from the announcement of a 'drop dead' date for cheques, Australia needs to remove the cheque payment option by encouraging the public to embrace the new technologies available and commence a gradual phase out of the paper instrument, in a way that keeps the Australian public in favour of such a move.

In an environment of negative claims surrounding fraud activity on new payment methods, many of which are unsubstantiated, the Government and the Payments Industry stakeholders, along with the support of consumer groups, need to develop a plan to phase out the paper cheque regime.

The New Payments Platform and the unknown Overlay Services that ensue, will go a long way to providing these means of payments, however a holistic view to the phased approach of cheque removal is required for its success.

Recommendation

ASL believes this will be achieved by:

- Engagement of Consumer Groups to determine the most effective way of communicating such a change;
- Consumer education on the security and practicality of electronic payments;
- Providing consumers with a comparison of similarities of a paper cheque exchange and an electronic transaction exchange;
- More innovation in providing a like-for-like service that consumers can embrace as a 'preferred and secure' alternative to paper cheques;
- Promoting the benefits and safety of electronic payments to help modify consumer attitudes toward the electronic payment methods; and
- Making the process easier to make payments for social clubs, children's social and sporting group committees to assist in filtering that process of payment into personal finance management.

Appendix A – About Australian Settlements Limited

ASL is a strong and independent company committed to continuing its long history of providing our Mutual ADI Members the benefits of acting together to obtain scale and market presence and hence to achieve better outcomes than would be available to any one client acting alone.

ASL has operated for over 20 years supporting Australian Mutual organisations, was the first non-bank to hold an Exchange Settlement Account, and has an enviable performance record. ASL is an approved deposit taking institution and is supervised by the Australian Prudential Regulation Authority.

ASL specialises in providing a range of wholesale payments services to financial institutions. ASL provides high quality, value for money and efficient service to its Members. ASL has partnerships with best of breed service suppliers to ensure that it can bring to its member clients the best solutions possible to their financial payments needs.

ASL acts as:

- A leading provider of payment services;
- A strong voice in the payments arena;
- An innovative and growing organisation; and
- A provider of attractive products, superior service and exceptional value.

ASL has a strong business model focused on working collaboratively with our Members to provide scale advantages in their business operations. The strength of the relationship between the Member base and ASL's management team is an ongoing strength and key strategic advantage of the business. Collaboration remains a hallmark of ASL

Appendix B – ASL Members

ASL Members are comprised of:

Arab Bank Australia Limited

B&E Limited

Community Mutual Limited incorporating:

- Community Mutual Group
- New England Mutual
- Orana Mutual
- Hunter Mutual

Financial Transaction Services (First Data Corporation)

Gateway Credit Union

Greater Building Society Limited

Heritage Bank Limited

Hume Building Society Limited

IMB Limited

Lifepan Australia Limited / Big Sky Building Society

Newcastle Permanent Building Society

Pioneer Building Society

SGE Credit Union Limited

Summerland Credit Union Limited

The Rock Building Society Limited

Wide Bay Australia Limited