FinTech Australia

SUBMISSION PAPER:

Payments System Review

January 2021

This Submission Paper was prepared by FinTech Australia working with and on behalf of its Members; over 300 FinTech Startups, VCs, Accelerators and Incubators across Australia.

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About this Submission

This document was created by FinTech Australia in consultation with its members, which consists of over 300 company representatives. In particular, the submission has been compiled with the support of our Co-leads:

- Rebecca Schot-Guppy, FinTech Australia
- Simone Joyce, FinTech Australia

This Submission has also been formally endorsed by the following FinTech Australia members:

- Truelayer
- TransferWise
- Paypa Plane
- Monoova
- Afterpay
- Bleu
- Square
- Payright

Submission Process

In developing this submission, our members held a series of member roundtables/teleconferences to discuss key issues as well as circulating working drafts of the submissions to each members to ensure everyone had the opportunity to provide input on the issues relating to the Payments System Review.

We also particularly acknowledge the support of The Fold Legal and contribution of our other policy partners to the topics explored in this submission.

Introduction

We would like to thank Treasury for allowing us the opportunity to respond to the Payment Systems Review issues paper. In drafting the below submission, we consulted extensively with our Payments Policy Working Group who provided feedback that we hope you find valuable. We look forward to the final report.

Executive Summary

This review presents a real opportunity to ensure Australia is well positioned to cement its position as a leader in the payments space. Key to achieving this outcome is ensuring that the payments regulatory landscape is flexible, fit for purpose and promotes innovation and competition.

We have provided 15 recommendations after extensive consultation with our members. We believe that these recommendations reflect the commercial realities of the payments landscape, will future proof the system and will strike an appropriate balance between regulation, innovation and competition.

Recommendations

No	Recommendation	Section
1.	***Recommendation: APRA and ASIC develop communication and triage protocols for payments that ensures a seamless approach to regulation***	***Q1***
2.	***Recommendation: APRA and ASIC's regulatory mandates specifically include a competition and innovation objective.***	***Q1***
3.	***Recommendation: A principles-based approach to regulation be adopted that takes into account:*** • ***The intended purpose of the facility – e.g. will it process instant payments, provide escrow services, process recurring payments or facilitate stored-value for later use;*** • ***The nature of the transaction – e.g. does the transaction involve the purchase of physical goods in-store or online, the purchase of digital products, or the purchase of regulated products or crypto assets etc.; and*** • ***The timeframe – e.g. is the service once-off, recurring or does it have an expiration date.***	***Q2***
4.	***Recommendation: A joint task force be established to design a principles-based approach to payments regulation.***	***Q2***
5.	***Recommendation: Regulators consider and design regulatory solutions to encourage innovation and competition.***	***Q3***
6.	***Recommendation: Government considers preparing a policy statement or road map for payments similar to what has recently been done for blockchain.***	***Q3***

7.	***Recommendation: The regulatory treatment of different payments should be revisited, particularly given the proliferation of payment technology solutions and the advancement in payment technology functionality.***	***Q4***
8.	***Recommendation: APRA take a fresh look at outsourcing and counterparty risk.***	***Q5***
9.	***Recommendation: A payments access model be developed that appropriates and builds on the successes of CDR.***	***Q5***
10.	***Recommendation: Implement a sandbox regime for payments.***	***Q7***
11.	***Recommendation: Implement a dispute resolution scheme for payments.***	***Q7***
12.	***Recommendation: ASIC's Moneysmart prepare educational content about the payments landscape and the various participants and solutions.***	***Q9***
13.	***Recommendation: Regulators adopt the position that they will only regulate where necessary and where the benefits of regulation outweigh any costs or unintended consequences.***	***Q10***
14.	***Recommendation: Regulators publish regular updates to guidance.***	***Q11***
15.	***Recommendation: Include a mechanism for regular review and easy amendments to the payments regulatory architecture.***	***Q11***

Introduction

The payments landscape has undergone rapid transformation and innovation in the past 5 years with the advent of digital wallets, real-time payments, buy now pay later services and cryptocurrencies, to name just a few.

We have also seen the roll out of new payments infrastructure, like the New Payment Platform (**NPP**), that provides more efficient and meaningful payment rails for processing payments, and the implementation of the Consumer Data Regime (**CDR**), which we hope in time will also provide opportunities to further innovate in the payments space.

Innovation in the payment space has certainly been a key focus area for fintechs locally and globally. The EY FinTech Australia Census 2020 (**FinTech Census**) notes that 30% of fintechs are involved in payments, wallets and supply chain. This is up 11% from 2019 and represents the largest category of fintechs in Australia. In addition to this, challenger / neobanks and digital / crypto currencies and exchanges account for a further 14% and 5% respectively of fintechs in Australia.

Global technology players (for example, Apple and Amazon) are also taking a keen interest in the payments space and are opening up their payment methods to others.

Payments are a central part of everyday life for all Australians but the regulatory architecture that governs them is complex, fragmented, outdated and does not foster competition. Despite this, Australia is certainly viewed as a lead innovator in the payments space. If Australia is to continue to lead in this space, it is critical that we have a regulatory framework in place that is technology agnostic, is fair, and encourages and supports further innovation.

Other submissions

FinTech Australia has made a number of submissions relating to payments, including our submission to the Review of Retail Payments Regulation by the Reserve Bank of Australia dated February 2020 (**RBA Submission**) and our Senate Issues Paper Response date December 2019 (**Senate Submission**). This submission builds on these earlier submissions and refers to them throughout this document (where appropriate).

Questions

Q1: Does the regulatory architecture appropriately facilitate the development of an overall vision, strategy and principles for the Australian payments system?

Our members are of the view that the regulatory architecture for payments is fragmented, overly complicated and outdated. It can also stifle innovation and competition.

As the Issues Paper points out, there are five regulators that supervise discrete aspects of the payments ecosystem. Unfortunately, each regulator's mandate and the corresponding regulatory regimes currently do not neatly dovetail into each other. In some cases, there are overlaps and, in other cases, gaps. This fosters uncertainty for both regulators and participants.

Uncertainty is not the best breeding ground for innovation. It can make it difficult for new entrants (especially innovators) to understand how their business may be regulated and what regulatory approvals or compliance arrangements must be put in place. It also creates high regulatory barriers to entry, especially if the regulatory framework is overly complex to navigate.

On top of this, some regulators have failed to update outdated guidance that does not necessarily make sense in a digital world and does not specifically contemplate or cater for innovation in the payments space.

Our members certainly are of the view that the law and the regulators' approach needs to be updated to contemplate current innovation and new innovation that is yet to be designed or contemplated.

Further, the payments industry is heavily reliant on technology, which is scalable. Regulation should be fit for purpose and contemplate the nature of the regulated activity and its inherent risks, including scale. We consider this in further detail below.

Our members are encouraged by the Regulation of Stored-value Facilities in Australia: Consultation of a Review by the Council of Financial Regulators dated October 2019 (**CFR Report**) that seeks to simplify and harmonise one aspect of the payments space, the regulation of stored-valued facilities (currently, called purchased payment facilities). The CFR Report makes key strides in this respect by recommending that:

- A new class of regulated product called a stored-value facility be implemented to replace purchased payment facilities in line with global terminology;
- The Australian Prudential Regulation Authority (**APRA**) and Australian Securities Investments Commission (**ASIC**) be the only two regulators responsible for regulating stored-value facilities;
- A tiered approach to regulation of stored-value facilities be adopted to take into account the intended use, consumer risk and size;
- A review of the regulatory framework for purchased-payment facilities be undertaken by APRA; and
- APRA be given power to designate that certain facilities should be subject to prudential regulation.

While these are significant and important changes, our members are of the view that more needs to be done to make the regulatory architecture for payments technology agnostic as well as to promote competition and innovation. It is also important that the distinction of domestic and international gradually is softened in line with consumer trends at large. This could, for instance, involve investing in AUSTRAC APIs for IFTI reporting and similar measures. A system more readily open to the outside is likely to promote both competition and innovation.

The United Kingdom has sought to achieve this by introducing a single regulator (the Payments System Regulator) whose statutory objectives are to ensure:

- that payment systems are operated and developed in a way that considers and promotes the interests of all the businesses and consumers that use them;
- the promotion of effective competition in the markets for payment systems and services - between operators, payment system providers and infrastructure providers; and
- to promote the development of, and innovation in, payment systems, in particular the infrastructure used to operate those systems

Our members do not believe one regulator is necessarily the right approach for the Australian market, as some aspects of payments regulation should be prudentially regulated by APRA and others should be regulated by ASIC the conduct regulator.

However, our members would like to see regulators take a more collaborative and consultative approach. In instances where regulation may cut across multiple regulators, our members have experienced apathy to act in respect of permitting conduct (particularly, for novel innovations) but also in respect of sanctioning non-compliant conduct and, at times, inflexibility with a “patch protection” mindset.

As an alternative, our members would welcome dedicated channels or central contact points for payments in the regulators and for both APRA and ASIC to have a key understanding of each other's mandate. This would assist the regulators in meaningfully triaging participants when regulation is managed by the other regulator. In this regard, our members recommend that APRA and ASIC develop communication and triage protocols for payments that ensures a seamless approach to regulation.

In addition, our members think it is imperative that both APRA and ASIC have a regulatory objective to promote innovation and competition, similar to the United Kingdom. Otherwise, competition is very much left to market forces that heavily favour incumbents and those who have the capital and means to significantly invest in payments infrastructure, like the NPP. To this end, our members recommend that APRA and ASIC's mandates specifically include a competition and innovation objective.

> ***Recommendation: APRA and ASIC develop communication and triage protocols for payments that ensures a seamless approach to regulation.***
>
> ***Recommendation: APRA and ASIC's regulatory mandate specifically include a competition and innovation objective.***

Q2: How should our regulatory architecture be designed in order to balance the management of risk and efficiency in the payment system with the need for effectiveness for end-users?

As mentioned in our response to Q1 above, the regulatory architecture is fragmented, overly complicated and does not neatly fit together. It is also outdated and is not sufficiently flexible to contemplate current as well as any future innovation or changes in the payments landscape. Further, the regulatory landscape currently lacks the ability to scale to the payment technology use and risk profile.

Accordingly, our members are of the view that detailed and prescriptive legislation is not conducive to innovation in the payments space. Rather, a principles-based approach should be favoured that appropriately balances market risk, operator risk and customer protection. This could build on the recommendations made in the CFR Report, which promotes a tiered approach to regulation.

However, the proposed tiered approach focuses on the monetary value of transactions and the total amount processed by an operator. This is not preferable as it precipitates regulatory arbitrage purely based on a chosen number and accordingly, does not necessarily reflect the

inherent risks associated with a specific payment facility or service. It may also cause providers to limit functionality or access to fall below numerical thresholds. This may stifle competition and inhibit solutions that are end-user driven / centric.

Instead, our members recommend a principles-based approach that takes into account:

- The intended purpose of the facility – e.g., will it process instant payments, provide escrow services, process recurring payments or facilitate stored-value for later use;
- The nature of the transaction – e.g., does the transaction involve the purchase of physical goods in-store or online, the purchase of digital products, or the purchase of regulated products or crypto assets etc.; and
- The timeframe – e.g., is the service once-off, recurring or does it have an expiration date.

This view is adopted by our members because these are the key drivers of actual risk in the payments space. That is to say, while a tiered approach with thresholds is an easy system to administer, it does not well align with actual risk, as risk is driven by additional factors in addition to how widespread usage of a given system is.

We acknowledge that implementing an approach like this is not a small task, but it would better future proof the payments regulatory architecture and apportion the regulatory burden appropriately across participants in the payment industry according to the risks attaching to specific businesses. It would require alignment and harmonisation between the different legislative regimes and regulators. To ensure proper scoping and implementation, our members recommend that, in addition to the recommendations in the CFR Report, a joint task force be established to design a principles based approach to payments regulation. This joint task force should consult and collaborate with industry and overseas counterparts to ensure that it has access to the best practical expertise and can build on the experiences of, and learnings from, other jurisdictions.

Recommendation: A principles-based approach to regulation be adopted that takes into account:

- ***The intended purpose of the facility – e.g., will it process instant payments, provide escrow services, process recurring payments or facilitate stored-value for later use;***
- ***The nature of the transaction – e.g., does the transaction involve the purchase of physical goods in-store or online, the purchase of digital products, or the purchase of regulated products or crypto assets etc.; and***
- ***The timeframe – e.g., is the service once-off, recurring or does it have an expiration date.***

Recommendation: A joint task force be established to design a principles based approach to payments regulation.

Q3: What is the appropriate balance between self-regulation, formal regulation and government policy to ensure the payment system continues to work in the best interests of end-users?

In addition to regulation, it is imperative that there is efficient, accessible and innovative payments infrastructure. To date, much of the payments infrastructure has been funded, developed and operated by industry, particularly incumbents like the banks.

An example is the NPP, which was launched in 2018 and provides open infrastructure for fast payments in Australia. While open access to all payment rails is challenging, industry funded infrastructure can present additional access and competition issues. This is because infrastructure owners can set or apply access parameters in a manner that make it unnecessarily challenging for fintechs. While our members appreciate that infrastructure owners should be able to recoup their investment, it is critical that market power is not unduly concentrated amongst those that have the resources and capital to invest in key infrastructure.

To the extent that it is so concentrated, self-regulation presents challenges. At times, our members have been frustrated with requirements imposed by bank and scheme operators to access infrastructure. These requirements are often driven by bank risk positions and do present a real barrier to competition. It has happened that a bank's internal position on permissible use cases is adjusted in light of pressure media and political climate rather than regulatory changes. Whilst it is important to allow banks to make risk-based decisions in compliance with their regulatory obligations and strategy, it is also important to recognise that little incentive or motivation currently exists for incumbents to work with payment technology companies. This places potentially innovative companies in a difficult position where they cannot test and iterate their innovations. This was touched upon in our RBA Submission.

Presently, a fintech can only access the payment rails via a bank. This presents competition and access issues that the regulatory landscape has not been designed to address. This is perpetuated by the fact that most payment infrastructure is industry designed and funded. There is also the potential for conflicts as operators of payments rails determine access rules while also accessing the payment rails for their own products and services.

If we truly want open and accessible payments infrastructure, consideration needs to be had as to what role regulators and Government should play in the design and operation of infrastructure as opposed to leaving industry to design, operate and self-regulate in this respect. In particular,

what levers can be deployed or used by regulators and / or Government to ensure access and, in turn competition, is appropriate.

Competition and innovation will certainly be top of mind for regulators if it is included in their mandate per our recommendation in Q1 above. However, more can be done. Some options include:

- Putting in place a dispute resolution scheme that participants can access for certain disputes or issues in relation to the access or operation of key payments infrastructure; and
- Developing a sandbox for innovators to test and iterate their payment innovations in a live environment.

Please refer to Q6 below for more detail on these options as well as other ones. Our members recommend that the regulators consider and design regulatory solutions to encourage innovation and competition.

Regard should also be had as to whether payment infrastructure should be developed in collaboration with fintechs. The rollout of CDR (which has not been without its challenges) provides a good example of cross industry collaboration and early adoption by fintechs. The payments space could adopt many of the mechanisms used in CDR and build on the lessons learnt. It is also worthwhile considering whether industry bodies should have a seat at the table and represent their membership base in the design and roll out of key infrastructure.

Industry is becoming more sophisticated and measured with the development of industry codes. One example is the ePayments Code, which is a voluntary code of practice administered by ASIC that regulates electronic payments. Our members acknowledge the recommendation that compliance with the ePayments Code should be mandatory for stored-value facilities. However, it is critical that industry codes are not viewed as an opportunity to regulate by stealth and impose obligations that are inconsistent with Government policy and in turn current regulation.

To this end, our members are of the view that the industry would benefit from an overarching policy statement from Government on its commitment to competition and innovation in the payments space. The Government's response to the Select Committee's Report on the Second Issues Paper for the Financial Technology and Regulatory Technology Inquiry may provide fertile opportunity to do so. Our members recommend that Government consider preparing a policy statement or road map for payments similar to what has recently been done for blockchain users.

> ***Recommendation: Regulators consider and design regulatory solutions to encourage innovation and competition.***

Recommendation: Government considers preparing a policy statement or road map for payments similar to what has recently been done for blockchain.

Q4: Are there gaps (or duplication) in the current architecture that need addressing to ensure the system continues to work in the best interests of end-users?

Our members note that some of the recommendations in the CFR Report address some existing gaps and overlaps in the current payments regulatory architecture, namely:

- Clarifying the application of the client money requirements to purchased-payment facilities;
- The introduction of stored-value facilities as a new class of regulated product, which will remove any current overlap with non-cash payment facilities;
- Making APRA and ASIC the only regulators responsible for regulating and licensing stored-value facilities; and
- Introducing a power for APRA to designate certain facilities to be subject to APRA supervision in the public interest.

These are great initiatives to address gaps and overlaps. However, our members are of the view that there are other instances that require attention and appropriate solutions.

The Corporations Act treats non-cash payment facilities as a financial product, not a financial service. This creates complexity as the regulation of non-cash payment facilities as a financial product does not readily align with, or reflect, the operation of payment systems, for example, it is the "issue of" the facility itself (which is the financial product) that is principally regulated and not each payment (because each payment is not regulated as a financial service). One practical result of this issue is the application of the client money requirements to purchased payment facilities. While the CFR Report has recommended this be changed to ensure that these requirements do apply to stored-value cards (where appropriate), this issue extends beyond the client money requirements.

Regulatory guidance can go some way to redressing this. However, to date regulator guidance has unfortunately not plugged this gap and in some instances has perpetuated confusion. This is not helped by the fact that much of the guidance relating to payments is heavily out of date. While the first port of call may be to update regulatory guidance to clarify this, the broader question is whether the treatment of non-cash payment facilities needs to be reimagined. One possibility is to apply a similar regime to payments as is applied to custody and depository services.

Currently, there are a number of exemptions for non-cash payment facilities, including the operator exemption.[1] The operator exemption exempts certain operators from the need to hold an Australian financial services licence (**AFSL**) if they meet a number of conditions, which include providing one-off payments only (i.e. they do not process payments under a standing instruction). Though there are some distinctions between one-off and recurring payments, advancements in technology make these distinctions less important than in the past. While recurring payments should be established with more rigorous consent-to-pay processes and provide the payer with information about their rights in relation to such payments, our members recommend that the regulatory treatment of the different payments should be revisited particularly given the proliferation of payment technology solutions and the advancement in payment technology functionality. This will become even more important as the Mandated Payment Service (MPS) is likely to erode the distinction between one-off and recurring payments further.

Payment initiation services are becoming more common in the payments space. A payment initiator is a third party who facilitates the payment via direct bank transfer for a customer's bank account. The service removes the need to use online payment gateways. The launch of the MPS is likely to lead to a rapid growth in payments initiators. It is unclear whether payment initiators provide their own non-cash payment facility that is regulated and requires an AFSL or whether they are just accessing another provider's non-cash payment facility. To date, ASIC has been unable to form a firm view on this and this uncertainty has made it difficult to innovate and expand in this space. This is another example of how the current regulation of payment systems as a financial product instead of a financial service creates uncertainty, as it becomes difficult to apply existing ill-fitting principles to new scenarios.

> ***Recommendation: The regulatory treatment of different payments should be revisited, particularly given the proliferation of payment technology solutions and the advancement in payment technology functionality.***

Q5: How should the regulatory architecture be designed to best facilitate the coordination of participants and regulators to meet the requirements of end-users?

The regulatory architecture should be designed to promote competition, innovation and end user functionality.

Key to this is ensuring fair access to payment rails for fintechs. This is because payment functionality is critical to, or a core business activity of, many fintechs. Fintechs need access to

[1] Regulation 7.1.07G *Corporations Regulations* 2001 (Cth).

payment rails for many reasons including providing payment services and processing payments essential to or that underpin their service offerings for end-users.

As it currently stands, fintechs must receive sponsorship and permission from a bank to access and use the payment rails. This is true for the vast majority of payment rails including debit / credit schemes (i.e. Eftpos, Visa and MasterCard), BECs, BPAY and NPP. Effectively, banks act as gatekeepers, controlling who, and how, participants can access the payment 'streams'. It is entirely up to the bank to decide who they allow access to the payment rails, including any conditions or limitations imposed. This means banks effectively limit what participants and functionality end-users have access to. In fact, some rails, e.g., BPAY, has a singly-sponsor rule which means that a fintech only can be sponsored by one ADI at a time, thereby exposing fintechs to changes in commercial and risk terms without an ability easily to move across to a competing ADI.

Feedback from our members is that banks often raise risk appetite and information security issues as a bar to entry. While banks should be able to determine their own risk appetite, the presumption that a fintech or new innovation is inherently riskier needs to be challenged and displaced. In many cases, the fintech or innovation is actually more stable, secure and agile. In any event, the bank does not assume the risk of any fintech, the fintech ultimately bears all responsibility for those risks and any liabilities. In our members' view, regulators could do more to challenge this status quo and recalibrate this view on risk, particularly APRA in the context of outsourcing. Our members recommend that APRA take a fresh look at outsourcing and counterparty risk given the successes of payment innovators to date and the rollout of CDR.

As outlined in our response to Q3 above, more can be done to ensure incumbents that own and operate payment rails are encouraged to provide fair access to fintechs. This is particularly in light of the fact that banks generate revenue for each transaction that flows via their channels into the various payment streams. It is not a free service. In most cases, transactional activity for commercial entities is revenue-generating for the bank and seen as necessary to recoup infrastructure spend.

There is potential for a symbiotic relationship – the bank can grow their channel and transaction volume by giving fintechs access to critical payment functionality to operate and grow their business. However, to date, fintechs have struggled to obtain such access and the process for obtaining access is timely, costly and opaque. This does raise competition issues and if banks are the entry points into payment rails for fintechs, thought needs to be had as to what controls and measures can be implemented to encourage fair access. We have suggested some in our response to Q3 above but there are others (which we address below).

There are some valid and obvious concerns that banks cite for not providing payment rails access to fintechs. Predominantly, these relate to anti-money laundering and counter-terrorism financing (**AML / CTF**) processes and the concern that giving access to process payments within the banking environment may lead to breaches of the bank's protocols. There is also the question of risk appetite. Banks are often concerned about credit risk and whether the fintech will be able to fulfil chargeback or disputed payment obligations should there be a need to return a large volume of payments. We are also aware that data security is raised as a potential barrier. However, with the rollout of CDR our members are of the view that this will prove to be less of an issue over time.

These considerations are important and our members do not advocate for controls in these areas to be relaxed. However, many of these concerns (and other similar concerns such as information security) could be easily addressed with appropriate controls including requiring fintechs to implement certain compliance procedures and processes and providing the bank with sufficient oversight and the ability to audit. There is also opportunity to develop robust industry practices that fintechs can adopt and which can standardise the approach reducing risk and encouraging portability amongst bank providers. This would provide fintechs with a clear pathway to access that would eliminate much of the cost and time and promote fairer access to improve competition, which ultimately improves end-user outcomes.

There is the perception that banks are reluctant to provide payment service access to fintechs as there is no easy pathway to 'yes'. The current approval procedures within the banks do not seem to easily align with the business models and processes of fintechs. Considering the caution with which banks need to proceed, the lack of a set of precedents, rules and expectations relating to third party access to payment rails makes 'no' the easier and safest option.

This caution and lack of risk appetite was evidenced by the 'unbanking' of multiple fintechs at the end of 2019/beginning of 2020, particularly in the payment and cryptocurrency space. During this time, many fintechs had their access previously granted by banks withdrawn, creating enormous pressure to find new sponsorships, change their business model or end their service.

Introducing a framework that essentially opens access to payment rails by setting parameters under which the bank can say 'yes' will have significant positive effects on the competitive landscape, the adoption of new payment rails (i.e. the NPP), the economic outlook for fintechs and the possibilities for innovative collaboration between banks and fintechs.

If regulators wish to encourage competition in this sector, then a significant step forward would be to create a framework that supports and positions (perhaps even compels) banks to allow

fintechs access to payment rails. This would create more certain pathways to access the 'raw materials' that many fintechs require in order to operate.

Given that the CDR has and will continue to create a framework for access that encompasses operational, technical and security constructs, it would be reasonable to apply this approach for the payments landscape in terms of access (not data). Our members recommend that an access model be developed that appropriates and builds on the successes of CDR.

The restricted ADI licence has enabled several challenger banks to obtain direct access to payment rails. However, new or early-stage fintech companies rarely have the resources and time to apply and qualify for this licence. In many cases, the only reason for applying for such a licence would be access to payment rails (not for their product or service value proposition). This is not a logical, practical or efficient industry outcome. Competition and the efficient allocation of capital could be achieved if there was fair access to payment rails. While an ADI licence may be a future milestone for some payments businesses, lack of access should not be the key driver to an earlier decision to apply for one. Without a regulatory framework that supports access, innovation in early stages simply cannot happen. This in turn effects that long-term outlook for competition and innovation in payments and adjacent fintech product and services in Australia.

> ***Recommendation: APRA take a fresh look at outsourcing and counterparty risk.***
>
> ***Recommendation: A payment's access model be developed that appropriates and builds on the successes of CDR.***

Q6: What are the required features of a future regulatory architecture to ensure it is well-placed to meet the needs of end-users in relation to emerging innovations in the payments system such as those discussed above? Are changes needed to existing structures, roles and mandates involved in the governance of the system?

A customer-centric approach that supports payment innovation is required to ensure that the regulatory architecture is best placed to meet the needs of end-users. This requires fintechs to have access to payment rails to design and deliver payments innovation that incumbents are not necessarily motivated to do.

As outlined in our response to Q6 above, there are access issues. However, there are a number of measures that can be implemented to help change this. It may also require a change to industry's view of who the "customer" is – indeed, there is opportunity for there to be a number of customers in the value chain.

Further, payment providers need to champion user experience and functionality. Often this requires testing and innovating. As outlined in our response to Q3 above and Q7 below a sandbox may be beneficial in this regard.

As one of our members has put it, “if we start asking what would make users’ lives easier, safer and cheaper, we will start to develop cool new payment technology that consumers will embrace.".

Q7: What regulatory architecture is needed to provide support and clarity for businesses – particularly new entrants – to invest and innovate in our payments system?

As outlined in our response to Q3 above, a dispute resolution scheme and sandbox would provide appropriate levers to facilitate access and competition.

The dispute resolution scheme could operate in a manner similar to the Australian Financial Complaints (**AFCA**) Scheme but be streamlined to include a narrow range of matters and a process to accommodate the types of disputes and complainants. Representatives from all industry bodies could form a committee of decision makers for this scheme, which would provide technical industry knowledge and expertise as well as a range of stakeholder views. Alternatively, a specialist payments division could be created within AFCA, in the same way that, historically, the Financial Ombudsman Service allocated payment disputes involving the EFT Code to case managers who had the industry knowledge and expertise to handle EFT Code disputes.

The sandbox could operate in a similar fashion to ASIC’s regulatory sandbox. It could provide a live environment to test and innovate payment solutions. It would require the participation of banks (similar to CDR) and could function as a collaborative testing ground where new entrants would be able to access payment rails in low volumes and value to test their product and technology. Banks would be able to use the data generated in the sandbox to satisfy any technology requirements before granting full sponsorship outside of the sandbox. It would also provide fintechs with secure and meaningful data to refine their offering. The sandbox process could also form part of the access to payments framework as described above i.e. be a condition before full access is granted.

Consideration should also be given to what role banks play in encouraging and fostering innovation in the payments place. Some banks have set up their own venture capital funds to invest in early stage start-ups. However, fairer and broader access to payment rails may encourage investment from other local and global players in the payments space.

Recommendation: Implement a sandbox regime for payments.

Recommendation: Implement a dispute resolution scheme for payments.

Q8: How can the regulatory architecture enable participants in the payments system to make better use of data to improve cross-border payments and other payments that benefit end-users?

Cross border payments is a complex issue. However, our members are of the view that developing and adopting standard messaging protocols globally and the use of digital currencies will improve this segment.

One of the challenges is the lack of interconnectivity between the different payment infrastructures across borders, which are often designed and owned by incumbents. Incumbents generally lack support for new technology due to the long lead times for development and heavy resource allocation. Like with other major industry developments, it is likely that third party payment fintechs (like Transferwise or Airwallex) will drive the agenda for better cross-border payments similar to what we have seen in the foreign currency space.

Overall, it is important that the practical differences between domestic and cross-border processes are minimised. Owing to her geography, Australia has often maintained a degree of separation between 'at home' and 'abroad' that does not exist in, e.g., Europe. While global commerce and international travel has started to erode this distinction, payment systems have yet to follow suit. Certain differences in reporting regimes between domestic and cross-border transactions are of course justified but the technological and regulatory architecture have to be improved to ensure that the customer experience of the two transaction types approaches parity.

Q9: Given rapid changes to the system, what need is there for education for end-users (including consumers and businesses) about payments and who should provide that education?

Our members are of the view that end-users (especially the younger generations) will actively seek out alternate payment solutions and are very adept in self-education. We have seen this with the growth in the Buy Now Pay Later Sector.

Comparison and aggregator sites also provide useful content that may assist end-users to make an informed decision when it comes to payment solutions.

That being said, our members are of the view that many Australians have a rudimentary knowledge of the different payment solutions and providers out there. The starting position is to go to a bank as it is familiar and perceived to be the easiest and safest option. However, this is often not the case. Many fintechs out there provide simple and secure payment solutions competitive with bank offerings.

To help balance this misperception, our members recommend that educational content about the payments landscape and the various participants and solutions be prepared. It is quite a complicated landscape, and business and consumers alike would benefit from a simple explanation of the different players, their roles and offerings. Graphics could certainly help with this. ASIC's Moneysmart could drive this as well as consumer led bodies. This would certainly align with a competition mandate for ASIC.

> ***Recommendation: ASIC's Moneysmart prepare educational content about the payments landscape and the various participants and solutions.***

Q10: How does Australia's regulatory architecture compare with that of other jurisdictions, particularly as it relates to the encouragement of innovation and competition?

As the issues paper notes, Singapore, the United Kingdom and New Zealand all have pathways for fintech companies to access payment rails. These take different forms but all achieve the same goal of working to foster innovation in the payments space. It is interesting that the NPP has been designed (unlike some fast payment schemes) as 'open architecture' in an effort to democratise access but this vision is let down by no clear regulatory framework to drive banks to sponsor companies onto the NPP (see our response to Q5 above).

In Singapore there is a strong focus on fintechs, which includes high level of government support in the form of grants and programs to pair businesses and foster innovation.

Fintechs in Australia do not receive the same level of support, which leads to adverse competition outcomes given the high barriers to entry that exist in the payments space.

Further, a common experience of our members is that Australian regulators are not willing to provide any advice (unlike their overseas counterparts) and that it can be frustrating and expensive for start-ups to obtain their own advice as to whether and how their payments

business will be regulated. Much of this is driven by our overly complex and fragmented payments regulatory landscape.

Singapore has an international reputation for supporting innovation, which is attributed to their digital-friendly environment, their high-quality infrastructure, and their government's commitment to promoting innovation.

In order to promote innovation, Australia would need to invest in its payments infrastructure and provide incentives for research and collaboration between incoming fintechs and industry incumbents. The NPP is an example of improved infrastructure, but as mentioned elsewhere in this submission, access to it is a real issue for fintechs due to lack of collaboration by incumbents with fintechs.

Research and development grants are one of the topics that are being considered further in the Select Committee's Second Issues Paper for the Financial Technology and Regulatory Technology Inquiry. Our members are hopeful that the Report will make a number of recommendations to improve Australia's grant program and that the Government acts on those recommendations. Especially, our members see value in grants that encourage new entrants to invest in building and designing payments infrastructure.

While there are some bank-led venture capital and incubation programs, there are not any structured Government policies or initiatives that encourage collaboration between fintechs and incumbents. Our members recommend that the Government develop a platform to pair fintechs with incumbents, especially in the payments space.

New Zealand also has a highly innovative and competitive regulatory environment. Payments NZ has previously identified collaboration as key to the success of the payments industry.[2] A core objective of the 'Payments Direction' (the cornerstone strategic initiative that allows Payments NZ to work collaboratively with the industry in relation to payments systems) is to collaborate with the industry, and identify opportunities that allow collaborative industry activity.

New Zealand also has an extremely high level of ongoing oversight and review of its regulatory architecture, both as part of the Payments Direction and separately. It conducts bi-annual 'environmental scans' and 'environmental refreshes'. This high level of ongoing oversight allows New Zealand to respond to market and industry changes quickly and efficiently.

A competition mandate for Australia's regulators would encourage similar competitive market scans in the payments space. Currently, this is a real gap in Australia's regulatory architecture

[2] https://www.paymentsnz.co.nz/our-work/payments-direction/

as competition is not front of mind for the payments regulators. This gap does not arm the regulators with sufficient knowledge or power to respond to the competitive forces in the payments landscape.

The United Kingdom has made 'competitive markets' and 'innovation' a stated key characteristic of their regulation. These goals are stated in the Financial Services (Banking Reform) Act 2013 which is the legislation that governs their payment systems. The Payments System Regulator (PSR) monitors and tracks innovation developments in the sector to identify barriers to existing or potential innovation. The PSR also promotes effective competition in the payments systems industry by taking positive action such as:

- issuing directions (contained in the PSR Policy Statement);
- requiring sponsor banks to publish terms and conditions, to make it easier for payment service providers to assess their indirect access options, strengthen bargaining power and compete more effectively; and
- launching detailed market reviews that examine key aspects of payment systems markets.

The PSR has also taken the position that they will only regulate where necessary, and where the benefits of regulation will outweigh any costs or unintended consequences. Our members recommend that Australia's regulator should adopt a similar approach. A common complaint amongst participants in the financial and payments industries is that regulatory and compliance obligations are onerous and expensive and engagement with regulators can be challenging.

> ***Recommendation: Regulators adopt the position that they will only regulate where necessary and where the benefits of regulation outweigh any costs or unintended consequences.***

Q11: Are there are lessons from international experiences that can improve Australia's regulatory architecture to ensure it responds effectively to new developments in the future for the benefit of end-users?

While there are a number of significant differences between Australia's regulatory architecture and comparable international regulatory frameworks (such as New Zealand, Singapore and the United Kingdom), there are also a number of lessons that Australia can learn from international examples. In looking to our overseas counterparts it is important to appropriately contextualise and apply any learnings to the Australian regulatory and commercial environment.

The key learning is to take appropriate action to address the issue of access to payments rails and to consolidate regulatory discussion to eliminate fragmentation and ensure all participants are moving in the same direction. There is also the issue of oversight and responsiveness.

As part of addressing access, the United Kingdom specifically designed the Financial Conduct Authority to be ready to give advice and have discussions with companies looking to navigate the regulatory environment of the payments landscape. 'Developing and protecting competitive markets' and 'contributing to the creation of innovative market conditions' are also key characteristics of the PSR's Policy Statement.

However, similar outcomes can only be effectively achieved in Australia if regulators are prepared to provide more meaningful guidance and responses to questions from new entrants. It also requires a holistic knowledge and broader market view of the payments landscape - not just the narrow view of a single regulator.

Another step that Australia could take to promote meaningful guidance would be to follow Payments NZ's example and publish regular updates to ensure that its activities are accessible and transparent for market participants. This would allow market participants to understand the regulator's areas of concern and focus and also identify any 'blind-spots' or gaps in the market that should be the subject of review. Our members recommend that Australia's regulators should adopt a similar approach.

The United Kingdom also carries on extensive consultation when contemplating changes to the regulatory architecture – for example, when conducting a review into the supply of card-acquiring services, the PSR consulted on its findings and proposed remedies with the industry. This is also a feature of New Zealand's regulatory architecture – New Zealand conducts regular, comprehensive 'environmental scans' and 'environmental refreshes' to identify key themes that capture the trends and influences relevant to the payments ecosystem.

Singapore's regulatory architecture should also be viewed as market leading given Singapore topped both the IMD's World Competitiveness 2020 ranking and the World Economic Forum's Global Competitiveness ranking in 2019. The key drivers of Singapore's success are the quality of its institutions and infrastructure.

While there are numerous acts and regulations that address payments and more than one regulator responsible for payments, the key principles – access, guidance, and ease of communication – can nonetheless be achieved. For example, as a starting point, regulators could collaborate to develop industry guidance and a website that included all relevant information for payments similar to what has been done with CDR (with links to other sources where required).

Holistic policy making can also be achieved by providing Treasury with a greater role in setting overall policy. In the UK, the Government is responsible for designating the payment systems that come within the remit of the PSR. In Australia, the RBA has authority to both designate and regulate. As a central policy agency, Treasury is better equipped to consider the areas that warrant potential further regulatory intervention.

As recommended above, each regulator's mandate should explicitly promote competition and innovation. This could be done by including these objectives in the governing legislation (similarly to the United Kingdom's approach). Competition would also help to support consumer protection outcomes.

Finally, our members recommend the payments regulatory architecture should include a mechanism that lends itself to regular reviews and easy amendments, similarly to the current 'environmental' reviews and scans that are undertaken in New Zealand. This would ensure that the regulatory architecture is treated like a living regime that mirrors the industries it serves, rather than a static and unchanging regime. This is best achieved with a principles based approach as recommended above.

Recommendation: Regulators publish regular updates to guidance.

Recommendation: Include a mechanism for regular review and easy amendments to the payments regulatory architecture.

Conclusion

Our members are of the view that payments is a critical industry for Australia and presents huge potential. While we are seen as market leaders in a number of segments, our regulatory framework needs to be updated to ensure that it is fit for purpose and can respond to changes in payments technology and use. The changes proposed by the CFR Report are a solid starting point but do not go far enough. Competition needs to be included in our regulators' mandates and a number of regulatory levers need to be included to ensure fair, efficient and innovative payments regulation. Further, regulation of payments should respond and scale to the use and risk inherent in payments technology. This requires a principles-based approach that considers payments technology holistically.

About FinTech Australia

FinTech Australia is the peak industry body for the Australian fintech Industry, representing over 300 fintech Startups, Hubs, Accelerators and Venture Capital Funds across the nation.

Our vision is to make Australia one of the world's leading markets for fintech innovation and investment. This submission has been compiled by FinTech Australia and its members in an effort to drive cultural, policy and regulatory change toward realising this vision.

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