



Commonwealth Bank
of Australia

Payment System Modernisation (Licensing: Defining Payment Functions)

Response to Consultation Paper

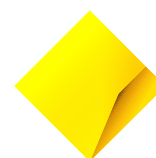
19 July 2023

Public

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1. Executive Summary

The Commonwealth Bank of Australia (CBA) welcomes the opportunity to contribute to the Government's consultation on Licensing: Defining Payment Functions. In the time since Australia's payments regulation was introduced, electronic payments have grown by over 3.6x and new technology has radically transformed how Australians make payments, with 85% of Australian retail payments made electronically in 2022 compared to 29% in 2007.¹ Today, 47% of all in-store card payments by CBA customers are made using mobile wallets² and one-third of Australians used a BNPL service in 2022³. Uptake is greater than in other countries, and 'big tech' has a significant presence in Australian payments, yet these services operate outside of payments regulation.

CBA's contribution to this transition – introducing NetBank online banking in 1996, tap-and-pay CBA cards in 2006, the Kaching banking app in 2011, and more recently Commbank Smart Health and Name Check are prime examples of safe and secure innovation within the regulatory framework, while subject to ongoing regulatory oversight. We believe that safe innovation contributes positively to Australia's economy and that such innovation will flourish under a comprehensive, well defined licensing regime that protects end users, the payments ecosystem at large, and our national sovereignty.

Well-designed regulation is pro innovation for all parties, as it sets clear expectations that users can rely on, companies can design to, and capital providers can leverage for greater certainty. Start-ups, big tech, and traditional ADIs will all be able to deliver safe innovations in an inclusive payments licensing regime. This is especially important for payments, where propositions are inherently network economies – and common standards are foundational for open networks to grow. For example, PSD2 is credited with opening up Europe's payments ecosystem, increasing competition, innovation and collaboration.⁴

The introduction of a comprehensive payments licensing regime will provide the guardrails for safe innovation and an accessible, efficient and trustworthy payments system. CBA considers the following factors are essential to achieving this outcome.

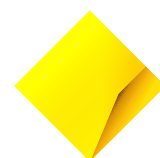
1. **It is critical to maintain pace in implementing licensing.** A modernised *Payment Systems (Regulation) Act 1998* (PSRA) is necessary but not sufficient to protect users and Australia's interests. Relying on designation powers alone will not guide safe innovation – licensing is urgently needed, particularly before the ecosystem opens up further as PayTo scales and CDR is introduced.
2. **Licensing should be comprehensive.** Any function involved in the flow of a payment should be included to reduce the need for intervention by the RBA or Treasury under the PSRA. Any service promoted as a payment service, such as by using 'Pay' in their name, should be in scope e.g. Ali Pay, WeChat Pay, Meta Pay, Google Pay, Apple Pay, Zip Pay, CBA Tap & Pay.
3. **Obligations should promote innovation without sacrificing safety.** Obligations must encourage responsible practices by all parties, large and small, that will build trust in Australia's payment system. Consistent with the EU, UK and Singapore, customer funds should be protected through safeguarding and capital requirements. Additional risk-based conditions can be tailored to minimise barriers to entry and ensure innovation is not stifled.

¹ <https://www.rba.gov.au/publications/bulletin/2023/jun/consumer-payment-behaviour-in-australia.html>

² <https://www.rba.gov.au/speeches/2023/sp-so-2023-03-28.html>; CBA's own data shows increased volumes by 24% and spend by 36% in the period April 2022 to April 2023.

³ <https://www.rba.gov.au/publications/bulletin/2023/jun/consumer-payment-behaviour-in-australia.html>

⁴ Data from the EBA's central register under PSD2 reveals that more than 2700 PIs and EMIs, including 400 non-bank TPPs, have been authorised or registered in the EU; <https://www.eba.europa.eu/eba-replies-european-commission%E2%80%99s-call-advice-%C2%A0-review-payment-services-directive>



4. **Complexity that may undermine confidence should be limited.** Licence exclusions and exceptions should be minimised to reduce regulatory arbitrage and complexity so consumers can be assured of their rights and providers can easily understand their obligations.
5. **Needs of all parties should be balanced.** As noted by the UK payments regulator, *'All parties involved in the transaction act together to minimise payment risks, and put in place the right processes to ensure that people feel safe.....because they know what will happen if things go wrong'*.⁵

The rapid growth of big technology companies in Australia's payments system lends further support for these reforms. Overseas, Big Tech's data advantages and network effects have allowed them to scale very quickly to gain systemic importance. CBA's own data shows increased volumes by 24% and spend by 36% in the period April 2022 to April 2023 for in-store payments with mobile wallets. Continued unchecked, ongoing growth in adoption at this pace could lead to outsized influence on the Australian payments system that will be difficult to reverse.

Therefore all participants - whether they are customer facing or not - should hold a licence and fulfil their responsibilities to maintain the reliability and safety of the system. Australia's licensing regime and payments regulation should ensure that it does not encourage free riders and loopholes that could be disproportionately exploited by overseas technology companies, for example by developing closed loop payment propositions that sit on novel technology outside of regulation.

2. Objectives of the licensing framework

CBA supports the proposed objectives outlined in the Consultation Paper. However, to be consistent with Recommendation 1 of the Review of the Australian Payments System Final Report (the Farrell Review), that 'consumers and businesses should be at the centre of policy design and implementation',⁶ the primary objective of licensing should be to strengthen user protection and confidence in payments.

3. Payment functions

3.1 Stored value facilities (SVF)

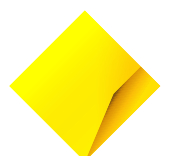
3.1.1 Traditional SVF

CBA supports the proposed regulatory framework for SVFs based on the recommendations of the Council of Financial Regulators. As set out in the Farrell Report, the regulatory oversight of SVFs should be proportionate to the risk they are introducing to the financial system. Irrespective of the size of a payment, consumers should expect the same minimum standards and rights. It may be appropriate to have exemptions for loyalty schemes or gift cards used for specific purposes that do not introduce risks into the payment system such as disaster relief or corporate prepaid cards for NDIS. However, as we have seen, gift cards can still be misused to perpetrate scams.⁷

⁵ <https://www.psr.org.uk/news-and-updates/thought-pieces/thought-pieces/unlocking-account-to-account-retail-payments-access-and-reliability/>

⁶ Farrell Review p17.

⁷ <https://www.scamwatch.gov.au/news-alerts/payment-demanded-by-gift-card-its-a-scam>



3.1.2 Payment Stablecoin SVF

CBA agrees that regulation as a SVF is an appropriate framework for the regulation of payment stablecoin issuers. However, there should be some flexibility in requirements that a stablecoin issuer is required to comply with under their licence given that there may be circumstances where the risk profile to consumers is higher than a SVF and therefore requires further conditions.

We believe that limiting the regulation to stablecoins that are collateralised by just fiat currency could be easily circumvented. For example, there could be derivative products that are created that could avoid this narrow definition but still ultimately result in the stablecoin being pegged to a fiat currency.

This issue could be resolved by adopting a broader definition which is complemented with an activity based test to avoid regulatory arbitrage. That is, if the stablecoin does not meet the broad definition but is still being used by consumers primarily as a means of payment, then it should be captured by the payments licensing regime.

3.2 Payment facilitation services (PFS)

Overall, the payment functions described in the Consultation Paper covers activities across the entire payment chain – from initiating to settling transactions – fairly comprehensively and will capture widely used payment services. The licensing regime should cover all functions that can cause, initiate, modify or influence the flow of a payment including any intermediaries that provide services to assist with making and receiving payments (e.g. mobile wallets, BNPL, third party payment initiators). Entities that are undertaking these activities are introducing risk into the system and it is therefore necessary and appropriate for policy makers to mitigate this risk through regulation.

CBA considers that the characterisation of digital wallets that do not store value as a ‘pass-through wallet’ is inaccurate. These digital wallets interact with the payment in a number of ways including storing payment credentials (as payment tokens), transmitting the payment token to merchants and their acquirers, and in some cases charging a fee for a transaction or monetising and altering the payments data. A true ‘pass through’ service would be more akin to a telecommunications provider that indirectly enables the transaction but does not in any other way engage with the payment.

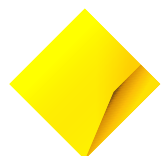
With their digital wallet offerings and other activities, ‘big tech’ have made payments an integral part of their strategy. In Australia big tech platforms offer the ability to make and accept payments, effectively creating a ‘closed loop’ that should be subject to licensing. As noted by the Treasurer, ‘our policies and regulations predate the development of mobile payments’.⁸

It is important that all licensed PFS functions are also clearly captured under the PSRA. CBA’s understanding from the Consultation Paper is that there will be no formal relationship between the changes proposed to the PSRA and the introduction of the licensing regime. As markets, consumer demands and technology continue to evolve, gaps between the scope of the PSRA and licensing may arise which could potentially compromise the RBA’s ability to deliver on its mandate. Therefore we believe this gap should be closed.

Consistent with the proposed changes to the definition of ‘payment system’ in the PSRA that recognises that a ‘payment’ is essentially a ‘transfer of value’,⁹ the list of payments functions should also adopt a

⁸ Treasurer’s Address to the Australian Banking Association, 7 June 2023, Sydney, <https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/speeches/address-australian-banking-association-sydney>

⁹ Reforms to the Payment System (Regulation) Act 1998 p 6-7



neutral approach to remain relevant as technology evolves, and limit regulatory arbitrage. Payments using cryptocurrency continue to gain momentum with a number of apps allowing Australians to transfer value through cryptocurrency. PayTo on the NPP is used to transfer funds to crypto wallets to purchase cryptocurrencies. Some apps allow payment in fiat currency to another party using blockchain rails, while others enable payment in cryptocurrency itself. From a customer perspective, end users should be able to expect the same minimum rights regardless of the way they choose to pay.

Payments reforms should align with other parts of the government's digital economy agenda. As expressed by the Treasurer, the new licensing framework should ensure that 'payments providers are treated consistently, no matter the technology they're using.'¹⁰ Therefore the 'payment initiation' function should include payment initiation under the CDR and a licence should be required for CDR payment initiation.

4. Incorporating functions into law

4.1 General Australian Financial Services Licence (AFSL) and Corporations Act obligations

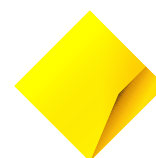
CBA considers that the general AFSL and Corporations Act obligations will encourage better risk management practices by all participants, whether or not they are customer facing, which will build trust and confidence in the safety of the payments system. Obligations on all parties to have appropriate processes in place are increasingly important in the context of 'nested' or layered business practices that limits visibility over the end to end transaction.

For example, PayTo on NPP allows 'nested' payment requests where a payment provider can on-board other payment providers. As a result, four or five payment providers may be involved in processing a payment from the customer's bank to the merchant, introducing a number of stages during which the payment may be intercepted by scammers or cyberattacks, or errors could arise.

Under such arrangements, each party has a role to play to ensure the safe and successful processing of a payment. Hence, CBA considers that all payment service providers (PSPs), inclusive of both providers of SVFs and PFSs, should hold an AFSL without exception. To promote competition from a level playing field and set a clear baseline for consumer protection it is appropriate that all PSPs meet the general obligations that apply to AFSL holders to:

- take all steps necessary to provide the services efficiently, honestly and fairly;
- have adequate resources (including adequate capital and liquidity);
- adequately manage conflicts of interest;
- comply with licence conditions (including by having adequate compliance arrangements to ensure that they comply with all financial services laws);
- comply with all financial services laws (including the consumer protection provisions in the ASIC Act);
- ensure that staff who provide PFSs are adequately trained;
- have internal dispute resolution processes that comply with RG271 and membership of the Australian Financial Complaints Authority (at least where payment facilitation services are provided to retail clients);

¹⁰ Treasurer's Address to the Australian Banking Association, 7 June 2023, Sydney, <https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/speeches/address-australian-banking-association-sydney>



- where payment facilitation services are provided to consumers or small businesses (or to retail clients), have arrangements for compensating those persons for loss or damage suffered because of breaches of Chapter 7 obligations (including adequate insurance); and
- report significant breaches of financial services laws to ASIC.

We support the proposal that PSPs performing several functions would only need one AFSL, which would specify the payment functions they are authorised to perform. Payments is a rapidly evolving environment with complex business and technological arrangements. Players enter and exit, often changing or evolving their offerings and therefore the function they play in the ecosystem. An inclusive licence with common base obligations is better suited for this and enables regulators to add and subtract licence obligations based on the functions that the PSP is actually providing at a particular time. A static approach to licensing and regulation which sees entities as distinct units operating in isolation alongside each other does not reflect a payments ecosystem that is complex, interconnected and always changing.

4.2 Should payment functions be treated as financial products or as a financial service?

4.2.1 Stored value facilities

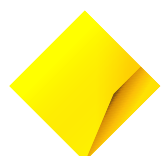
SVFs should be defined as financial products (most likely as new items added to section 764A of the Corporations Act) as SVFs are capable of being issued, applied for, acquired, varied, sold or disposed of. Characterising SVFs as financial products would mean that in addition to the issuance of SVFs, advice, custody and other dealing conduct in relation to SVFs would also be a financial service for which AFSL coverage is required, and product specific obligations like design and distribution, hawking and specific disclosure obligations would prima facie apply.

CBA supports the regulatory obligations proposed for major and standard SVFs. Additional obligations may be required to avoid confusion with a deposit product issued by an Authorised Deposit Institution. These may include requirements for disclosure at the time of account opening that the SVF is not covered by the Australian Government guarantee, and rules to prevent paying interest or something that is 'interest-like' (such as balances driven by time and value).

4.2.2 Payment facilitation services

Payment facilitation services should be defined as financial services (most likely as a new item in section 766A of the Corporations Act), without any elements needing them to relate to a financial product. This would avoid conceptual difficulties regarding dealing in, market making and custody in relation to payment services, avoid the need to prepare a PDS for such services (although some form of disclosure may be required for higher risk services provided to consumers and small businesses, and possibly also design and distribution and hawking obligations where the risk of a particular kind of PFS not being fit for purpose, or being the subject of pressure selling conduct, may cause heightened harm to a retail client), and to ensure that each provision of a service is a regulated activity. It would also preclude payment facilitators from using the incidental product exemption as a loophole to avoid regulation.

CBA agrees that the payment functions list should be added as a non-exhaustive list of inclusions to a new definition of 'payment services', replacing the non-cash payments concept. A non-exhaustive list in the definitions will provide greater certainty to participants about whether or not they are providing a



regulated service. The proposed definitions are sufficiently broad to accommodate new payments solutions that may emerge in the future.

4.3 Excluded and exempted activities

Exclusions and exceptions should be minimised to reduce complexity so payments providers can easily understand their rights and obligations. CBA agrees that the existing exclusions and exemptions for low value and limited purpose non-cash payment facilities in the Consultation Paper should be removed to ensure consistent regulation of payment services. We consider that the exemption under s 765A(1)(j) 'A facility that is a designated payment system' should also be removed as:

- payment systems, whether designated or not, facilitate and process payments and so their operators engage in activities that are specifically identified in the Consultation Paper as being within the proposed regulatory perimeter; and
- designation under the PSRA serves a different purpose to the AFSL regime – the AFSL regime concerns consumer protection and minimum standards for financial products and services, whereas the PSRA regime concerns broader public interest matters such as standards and access.

CBA agrees with the proposal that the identified licensing exemptions in the Consultation Paper could be retained, with modifications to apply to the newly defined payment functions. However exemptions should relate to genuinely low value, low risk, limited use products, for example, things like library photocopier cards. Loyalty points programs that have broad acceptance/transferability, the ability to convert to fiat currency, or can store material amounts of value have a greater capacity to introduce risk into the payment ecosystem and would be considered to be a stored value facility and/or a PFS. Care should be taken to ensure exemptions cannot be used as a loophole for new entrants to avoid regulation.

5. Risks of each payment function

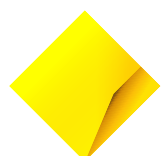
5.1 General risks

5.1.1 Financial risks

The Consultation Paper suggests that financial risks are confined to SVFs. In CBA's experience, PFSs that facilitate money in transit are equally exposed to financial risk. The nominal values of payment flows may be many times the working capital levels of some payment facilitators, meaning an operational failure could result in material losses for customers e.g. a single PayTo request may range from \$20 to \$50,000. Payment licensing frameworks in other jurisdictions have recognised that financial risks are associated with PFSs.

Financial risks include solvency risk that an institution cannot fully meet its debts as they come due, resulting in loss of customer funds.¹¹ CBA considers that the risk of insolvency applies to all PSPs, irrespective of whether they store value or not. While value held on behalf of an end user is at risk if not properly safeguarded, insolvency of a non-stored value payment facilitation service can also result in loss of either value or data by an end user. This may be as a result of that entity's position within the chain of

¹¹ Consultation paper p 22.



entities handling value or data and could even lead to a severe disruption to the wider payments ecosystem. This view is consistent with the approach taken in Canada, UK and EU.

The UK Government noted that providers of digital payment services ‘...have diverse business models that range from small money remittance firms to non-bank current account providers targeting SMEs, the underbanked, and the digital generation. Consumers and businesses are increasingly using Payment Institutions and Electronic Money Institutions as their transactional banking provider to, among other things, access their salaries and savings as well as make payments.’¹² Following a number of insolvencies in the UK where customers were left without access to their money for prolonged periods, the Government introduced a bespoke Special Administration Regime for Payment Institutions and Electronic Money Institutions.¹³

5.1.2 Operational risks

A failure in controls can lead to a range of errors such as duplicate payments, payments sent to the incorrect recipient or in the incorrect amounts. The recent order issued by the United States Consumer Financial Protection Bureau (CFPB) against ACI Worldwide and one of its subsidiaries, ACI Payments, for improperly initiating approximately \$2.3 billion USD in unlawful mortgage payment transactions demonstrates the extent of financial loss that can arise from operational errors by PFSs.¹⁴

The automated nature of newer payment solutions that allow high volumes of payments to be distributed simultaneously to numerous recipients in real time can multiply the effects of such errors e.g. a merchant receivables product that collects consumer payments and distributes to respective merchant accounts using PayTo. We understand that some participants may collect up to \$50M/day for distribution under such a model, without insurance or capital to cover any potential loss.

The Consultation Paper indicates that the impact of an operational risk event may relate to the size or centrality of the entity’s role within the broader payment ecosystem.¹⁵ Any potential impact of an operational risk event to the wider payments ecosystem may not just relate to the size or centrality of the entity but also to the specific role or roles that they play within the ecosystem as well as the nature of that event and whether it can be contained.

The payments ecosystem is complex and interconnected. A failure may have upstream or downstream impacts on other entities that may have no commercial or technical relationship with the entity suffering the failure. Careful consideration is required of not only the impact to end users of their data and value being mishandled but also the impact that a failure or outage might have throughout the wider ecosystem. As recently noted by US academic Hillary Allen:

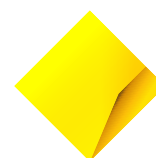
The functioning of the retail payments ecosystem could be (similarly) compromised by disruptions to the availability and integrity of its data and systems. Such disruptions could be the result of a cyber attack, but they also could arise from other operational problems. For example... a payments provider might succumb to a software bug that prevents it from transmitting payment instructions from payer to payee. That provider might try to route their customers’ payment orders to a second payments provider while the bug is being fixed, but the second provider may be suffering the same problem simultaneously (financial services providers

¹²https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/940738/201202_Lapwing_consultation_document_with_annexes.pdf

¹³ https://www.legislation.gov.uk/ukxi/2021/716/pdfs/ukxiem_20210716_en.pdf

¹⁴ <https://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-action-aci-worldwide-illegally-processing-2-3-billion-mortgage-payments-homeowners-did-not-authorize/>

¹⁵ Consultation Paper p 22.



are increasingly sourcing their technology from the same third-party vendors, so such an outcome is becoming increasingly likely). Or the second provider might have been functioning well initially, but its systems could buckle under the increased load of payment instructions it receives as a result of the first provider's technological problem'.¹⁶

5.1.3 Misconduct risks

Misconduct in the provision of the financial products and services can undermine confidence in the financial system. Misconduct by non-customer facing entities can still have a detrimental impact on consumers and businesses as well as the overall financial system.

An observation in respect to misconduct risk is that many contemporary payment activities are subject to a significant degree of automation. Once the processes are established, there may be little if any human intervention. The advent of increasingly complex algorithms and Artificial Intelligence means that policymakers and regulators need to be prepared for challenges with attributing the actions of licensed entities back to a decision made by an identifiable human or group of humans. Indeed, some versions of decentralized finance and distributed ledger technology are premised on the basis that there is “no one in charge”. These emerging issues reinforce the need for compliance by licensed participants with standards set by an Authorised Standard Setting Body to minimise risks to the overall system. It may also be important that economy-wide concepts around the regulation of responsible AI inform payments licensing as it evolves.¹⁷

5.1.4 Systemic risks

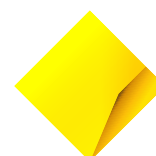
The systemic risk described in the Consultation Paper, arising from entities so deeply ingrained in the payment system that their failure has broader financial stability implications is particularly relevant to the role of global technology companies in payments. The popularity of contactless payments in Australia has seen the emergence of new infrastructure critically needed for payment system operations. Control over access to essential payment infrastructure could be used to create additional cost or influence over the operation of Australia's payment system. While the PSRA will enable intervention by the RBA or the Treasurer when risks present a threat to the public interest or national interest, licence obligations such as compliance with industry standards to promote interoperability and access can prevent concentration of risk as technology and consumer preferences continue to evolve, and new business models develop.

CBA agrees that some risks may also be addressed through other regulatory frameworks. The payments licensing regime however is a priority and should set the benchmark for related reforms such as the AML/CTF regime and CDR action initiation. We are at the cusp of opening the payments system to third party payments initiation via PayTo, with a number of participants connected directly or indirectly to the NPP without payments specific licensing.¹⁸ The introduction of CDR payment initiation will compound these risks, making payments licensing a critical precursor to successful third party payment initiation.

¹⁶ Hilary J Allen (2021) Payments Failure, American University Washington College of Law Research Paper No. 2021- 11, pp.471-2

¹⁷ <https://www.industry.gov.au/news/responsible-ai-australia-have-your-say>

¹⁸ There are approximately 27 non-ADI participants connected to the NPP.



The Government Roadmap and Strategic Plan for Australia's Payment System can provide a useful mechanism to aid alignment of frameworks relevant to payments and meet the Government's expectations for more collaboration amongst regulators.

6. Regulatory obligations

6.1 AFSL

In considering the proposed regulatory obligations for each payment function based on the risks they create, it appears as though the three risk categories identified in the Consultation Paper – financial, operational and misconduct risk – apply in some respect to all SVFs and PFSs. It is on this basis that we recommend general AFSL and Corporations Act obligations are imposed on all licensees, whether they are customer facing or not. As noted, this will encourage better risk management practices by all participants, which will build trust and confidence in the safety of the payments system.

Over 6000 AFSLs in Australia are held by various sized businesses. The requirement to hold an AFSL will bring PSPs in line with the minimum standards required by these other providers of financial products and services. Chapter 7 of the Corporations Act sets out the basic foundations for providing financial products and services in Australia to maintain consumers' confidence in the financial system. The obligation to provide services 'efficiently, honestly and fairly' will help mitigate the misconduct risks identified above by enabling ASIC to take action for breach of the AFSL. Similarly the requirement for dispute processes would benefit all users of payment services.¹⁹

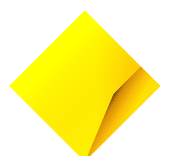
The application of base obligations on all licensees also reduces opportunities for regulatory arbitrage. It would be on top of these base obligations for all licensees that further obligations can be tailored based on risk profile and maturity so that start-ups can operate with fewer regulatory requirements.

6.2 Authorised standards setting body

All payments ecosystem participants benefit from a safe and resilient payment system. The majority of new payment innovations rely on the same existing underlying infrastructure: card schemes, direct entry or the NPP. CBA therefore considers that PFSs should become members of the Authorised Standard Setting Body and contribute to the cost of its operations. CBA agrees that mandating the standards for relevant participants is necessary to ensure consistency and a level playing field for PSPs. As noted in the Consultation Paper, core technical standards will promote interoperability, security and accessibility. Interoperability will be important to create an open, accessible ecosystem that enables competition and innovation. According to the World Bank, 'increased interoperability of payment systems has the potential to boost competition in payment services, resulting in more innovative products and services for end users.'²⁰ Enabling interoperability between payment systems can help ensure a minimum standard of service for end users and consistency in customer experiences.

¹⁹ <https://www.afr.com/companies/financial-services/caught-up-in-the-great-buy-now-pay-later-scam-20220131-p59sj7>;
<https://hermoney.com/save/budgeting/hidden-risks-of-buy-now-pay-later-services/>

²⁰ https://fastpayments.worldbank.org/sites/default/files/2021-10/Interoperability_in_FPS_Final.pdf



6.3 Capital requirements

It is important to ensure that all PSPs are able to meet their liabilities in relation to their activities. All participants should hold sufficient capital to rectify financial losses arising from settlement and operational risks as outlined above. Consistent with the EU's updated Payment Services Directive (PSD3), it would be appropriate to adjust the level of the initial capital attached to individual services to the nature and the risks attached to the services to take into account the wide range of functions covered by the licensing regime.²¹

As in the ACI example above, files can be incorrectly processed leading to unauthorised debit transactions from a customer bank account. A payment service provider may be a small fintech that may not have sufficient reserves to ensure customers are able to access their funds while the incorrect payments are retrieved and rectified. In a real time environment when scams are prevalent some of these payments may be irreversible, particularly when funds are transferred to an offshore account or to cryptocurrencies.

6.4 Safeguarding customer funds

To mitigate solvency and liquidity risks, licensing should impose safeguarding requirements to protect customer funds on any participant that receives funds for the execution of a payment transaction. Canada, UK, EU and Singapore all impose requirements to protect customer funds through a range of options such as ensuring that those funds are either placed in a separate account from the institution's working capital and other funds, or are covered by an appropriate insurance policy or comparable guarantee.²² Consideration will need to be given to whether the existing client money rules in the Corporations Act will sufficiently mitigate solvency risks associated with PFSs.

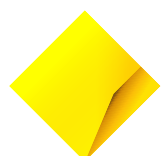
6.5 Updated ePayments Code

As recommended by the Farrell Review, the ePayments Code should be mandated for all holders of the payments licence. To reflect the scope of the licensing regime and PSRA, the ePayments Code should be updated to extend expectations and processes for mistaken and unauthorised payments to all payment methods, and mandated for all licence holders. Currently the ePayments Code prescribes the process and obligations of ADIs to co-operate to trace and recover funds from an unintended recipient's account.²³ As noted above, numerous non-bank intermediaries may now be involved in processing a single transaction. All participants (both sending and receiving institutions) should have obligations to participate in the process to retrieve misdirected funds and minimise financial loss by customers. It would be appropriate that some provisions of the ePayments Code would not apply to PSPs that do not directly interface with consumer or business customers e.g. disclosure and receipt requirements.

²¹ PSD3 p15

²² <https://www.fca.org.uk/publications/multi-firm-reviews/safeguarding-arrangements-non-bank-payment-service-providers>; <https://canadagazette.gc.ca/rp-pr/p1/2023/2023-02-11/html/reg3-eng.html>;

²³ S26-36 Mistaken internet payments, ASIC ePayments Code <https://download.asic.gov.au/media/lloeicwb/epayments-code-published-02-june-2022.pdf>



7. Conclusion

It is important to ensure that all entities providing payment services be brought within the scope of certain minimum regulatory requirements. Baseline AFSL and Corporations Act requirements together with tailored risk-based licence obligations will provide regulation for responsible innovation so that Australians can reliably transact in a safe and secure manner. The proposed licensing regime should complement and enhance the proposed reforms to the PSRA to foster competition between big tech, fintech and large ADI payments providers that can lead to further innovation and better service offerings. Licensing in combination with the proposed amendments to the PSRA is core to achieving the Government's vision of a "modern, world-class and efficient payments system that is safe, trusted and accessible".

