

Response to Questions raised in APCA's paper: Low Value Payments: Challenges of Evolution.

Question 3-4: What is your view as to why cheques are used in preference to electronic alternatives? Do you anticipate these factors changing over time?

Response: There are many reasons why cheques are used over electronic means. Many businesses have difficulty reconciling electronic payments to invoices due to lack of detail accompanying the payment. Small businesses may not be able to justify the expense required to put in place electronic alternatives for their customers. Lack of understanding of electronic alternatives, security concerns and the cost reductions that can be achieved by using electronic payments may also hinder a move to electronic payments.

This project and others currently underway will assist in overcoming some of these issues. Ultimately we believe it will only be by forced regulation that cheques will cease to be used.

Question 3-5: What additional aspects of the current situation would you wish to see considered in support of any case for changes?

Response: APCA's paper covers the aspects that we consider are appropriate. In particular we see the following as most important:

1. moving to near real time settlement being important to remove settlement exposure that exists between settling members;
2. removing the bi-lateral network configuration that is a barrier to entry and replacing it with a centralised hub or network 'cloud' that allows new entrants to connect once and be able to exchange items with all participants;
3. any new central hub to be scalable, not reliant on any one provider (telecommunications or technology) and as future proof as possible with respect to technology;
4. acknowledging a central hub style system may bring into place a single point of failure that can bring down the payment stream and protecting against this risk;
5. giving consumers certainty of payment via near real time electronic receipt;
6. an acknowledgement by all stakeholders that a balance needs to be obtained between giving consumers near real time payment and the ability to "protect" consumers from their own errors. A payment system that delivers near real time payment and receipt functionality can not have "refund/chargeback" rights for consumer initiated errors. They payments must be treated "like cash".
7. providing sufficient information in the electronic message to enable merchants to reconcile payments with invoices; and
8. allowing for electronic distribution of invoices.

Question 3-6: What additional commentary would you like to add?

Response: It is important that any new changes are brought in as quickly as is reasonable. Innovation in the Australian payments landscape in recent years has been driven by new entrants such as BPAY and PayPal. If APCA fail to implement these reforms then an opportunity exists for a new entrant to provide a viable solution outside of the current payments systems. In addition, APCA's members may be forced to respond to a demand by the Government as it has been in Great Britain.

APCA is an organisation run by its members being primarily the banks. In taking on this reform process it must consider the needs of all stakeholders, not just its members' needs. Often the arguments of expense/legacy systems/technology change windows are raised by some members as reasons not to change. These are reasons why that institution should not change, they are not reasons why the payment system should not change. In embarking on these changes, APCA must do so in a way that those who will raise these reasons are able to "opt out" or "join later". This will mean that those that can will, and will receive a competitive advantage for doing so.

A centralised system has the potential to allow for a centralised fraud detection and Anti-money laundering service to be built. Alternatively it can create a very large database that can be exploited.

Question 4A1: What factors do you consider most important to the selection of a network architecture for inter-FI payments traffic.

Response: We consider:

1. security;
2. reliability and redundancy;
3. flexibility;
4. scalability; and
5. simplicity,

as desirable features of any network architecture.

Question 4A2: What additional high level requirements would be important to assess between alternatives.

Response: Without providing a detailed technical response, we believe that the work undertaken by CECS members in the CECS Interchange Communications Facility Working Group could be used as a basis for any further technical analysis of alternatives. The network models assessed by the working group can be leveraged for other clearing streams and therefore it makes sense to look at cross-clearing stream network models.

Question 4A3: Apart from transition, what other implications would there be if a change was made from bilateral network arrangements to COIN or VPN.

Response: If participants are allowed to migrate at different times, then the old bilateral networks will need to be maintained for a period of time. It may therefore be necessary to mandate compliance to avoid the need to maintain these residual networks beyond an unreasonable timeframe.

Question 4A5: What further suggestions or variations would you add for this component.

Response: If a central hub/cloud is built then the current account switching project could become centralised with the hub/cloud being able to provide the necessary information to consumers. This requirement should be considered in the technical solution.

Question 4B1: What portion of your inwards payments would benefit from faster access to the funds received? Similarly, what proportions of your outwards payments would benefit from being recognised faster by the payee? Why? What specific timing issues or problems affect you?

Response: From a cash flow perspective all businesses would benefit from faster payment processing where payments are not currently receipted same day (e.g. chequing). Consumers wishing to use electronic payments for immediate purchases (in the same way that cards are currently used) would benefit. Solicitors settling transactions for clients could do away with bank cheques and any other similar "settlement" arrangement could use this system if funds are "guaranteed" once receipt is acknowledged.

Question 4B2: Do you believe intra day settlement would reduce your concerns over settlement risk satisfactorily?

Response: No. They will go a long way to reducing the overnight exposure, but will not eliminate settlement risk which should be a long term goal of this project. This is because our understanding is that files will still be processed beyond the last intraday settlement taking place leading to the overnight exposure. If participants process large files later to avoid the intra day payment then the exposure may only be reduced marginally. It will depend on all participants acting responsibly to clear as many files as possible during the day.

To remove settlement exposure will require 24/7 processing of files and payments where each file has a matching payment.

Question 4B3: What respective merits do you see in being able to support real time file by file settlement versus the adoption of (less frequent) intra day settlement windows? What other dependencies do these alternatives introduce?

Response: Refer above answer to 4B2.

Question 4B4: What further suggestions or variations would you add to this component?

Response: Refer to the answer to 4B2.

Question 4C4: Do you perceive any benefit in introducing as interim capability on existing BECS messages before adoption of ISO20022? Is this realistic for you?

Response: It would largely depend on the timing such a measure. It will take a significant amount of work to ensure any modification to our and our clients' software does not have any unintended consequences. To obtain any benefit, payees' would need to modify their systems to be able to reconcile the payment data with the payment. If this is a short term measure then it would seem to require a large amount of effort for little value. If implementation of a more modern system is however years away then such a measure may have merit.

Question 4C5: What are your views regarding the adoption of international standards vs development of local standards for payments integration?

Response: Unless it is impractical due to cost or other reason, then the international standard should be the default standard. It is to everyone's advantage that where possible only one standard is required. There is a precedent in CECS where the ISO8583 was used as a basis for the AS2805 EFT Standard. It would not be unreasonable to expect that for new payment systems that an existing standard could be used thus removing the need to develop an Australian standard.

Question 4C6: What other commentary would you provide on this component?

Response: ISO20022 is merely a framework in which local protocols can be accommodated. It seems sensible to adopt this framework going forward if BECS is to undergo major changes.

Question 4D2: Are there other clearing related requirements you would suggest?

Response: The proposal allows for "instant" purchase of goods. This would be an attractive feature for fraudsters. The expected cost of fraud and how it is dealt with needs to be considered.

Payers would benefit if they could see the end destination is the intended destination prior to sending the payment as it would allow them to correct errors before payments were sent. Privacy laws prevent this but any future proposal could seek to exempt those laws based on consumer benefit.

Question 4D3: What additional impacts would these concepts present?

Response: We have not considered the system requirements of such a proposal other than at a high level.

Sending multiple batch files throughout the day would not pose a problem for Indue and its clients as they do this now.

Real time notification without real time settlement means the Payee Institution is still subject to the overnight settlement exposure created by a failure of the Payer Institution.

Question 4D4: What further suggestions or variations would you add?

Response: These concepts need to be dealt with together and not in isolation. Settlement risk and faster payments are intertwined. Similarly security vs convenience and privacy vs certainty are also issues affecting all aspects of these various components. At the end of the day we need a clear destination and a clear route that encompasses all these ideas, rather than looking at each component in isolation.

Question 4E3: How familiar are you with the Finvoice model or equivalents elsewhere? What additional lessons do you believe we could derive from these?

Response: We are aware of this industry development but do not have a full appreciation of this payment method.

Question 4E5: What is your view of wider services such as these being provided to customers through payment service providers?

Response: As per our response to Question 4D4, looking at this concept in isolation sounds reasonable but would come at significant cost. The real question is can this type of service be accommodated in any planned overall system changes? With many multinational companies do we want to adopt an international standard? To build this capability on its own would appear to be cost prohibitive.

Question 4E6: What other comments would you like to make regarding this proposition or variations?

Response: Refer to response to Question 4D4.

Question 4F3: What other commentary would you provide regarding this component?

Response: We do not consider the customer interface to have any significant issues as each institution can develop its own solution. The only restrictions are on the information that can be included in the BECS file. If this changes, institutions should be left to develop the way in which they communicate with their customers. The ability for a customer to change a payment service provider should not hinge on the customer interface as this will restrict development and innovation if it is standardised.

Question 5-1: What is your view of the respective priority of initiatives?

Response: From an industry perspective we see the removal of settlement risk and removal of the costly bi-lateral arrangements as the main priorities.

Currently both of these aspects act as barriers to entrants and innovation.

From a customer perspective the current inability to reconcile electronic payments to the message data appears to be a major hurdle in business moving away from cheques.

However we believe that as an industry we need to look beyond the short term issues of the current systems and focus on delivering tomorrow's payment solutions. Initially we should be identifying our end goal before looking to see what parts of the current system can be leveraged to deliver this goal. Whilst we believe this is APCA's intent, the way it has been presented in compartmentalised modules, it appears that we are looking to address the issues in a patchwork fashion.

Question 5-2: What is your view of the "case for action" Where would you look for benefits?

Response: History shows that payment systems evolve over time. BECS only commenced in 1994, BPAY in 1997. Both of these payment systems have done much to erode the use of cheques to such an extent we all ask when will the use of cheques end, not if they will disappear. If a payment system does not innovate and take advantage of the developments in technologies and customer demands, then it, like cheques, will lose relevancy over time.

Accordingly we believe there is a strong case for action if the current payment systems, which have been identified as not meeting the needs and expectations of its customers, and those that provide them, wish to continue in these roles in the future. Failure to do so will simply result in others, using more modern technology, developing the solutions that our customers are indicating to us that they require. For BECS, Paypal and BPAY are clear examples of this type of evolution. The demise of Bankcard to the scheme cards is another.

Question 5-3: What is your view on the "emergence of convergence"?

Response: The convergence of all electronic payment types into a common framework is logical and practicable. Streamlining will enable much greater efficiencies and remove some of the issue of "legacy systems" that currently constrain future development.

Question 5-4: What is your view on the future of the cheque as a payment type.

Response: When a more convenient and cheaper payment system becomes available the use of cheques will decline rapidly until a point is reached that the cost of maintaining the system outweighs the benefits and therefore the higher unit costs are either passed to the consumers or the payment system will be retired.

Question 5-5: What final comments would you like to make on the future of Low Value Payments in Australia?

Response: The concept of convergence means that any consideration of Low Value payments should also include a consideration of Micro Payments. Not only are cheques a costly payment method, so too is cash. Various state government initiatives in this area have all met with varying degrees of limited success. If a Micro Payment delivery method can be leveraged of the Low Value payment system then enormous benefits to the economy as a whole could be achieved.