VocaLink response to APCA consultation on Low Value Payments

1 Introduction

VocaLink is pleased to provide this response to APCA's consultation on low value payments.

For reasons of convenience this document is limited to concise responses to the questions for payment service providers and questions for all as described in the paper. Where supporting material has already been submitted to APCA at an earlier stage in the process, we have referred to it rather than re-included it.

2 Overview

The sections below correspond to the sections in the consultation paper "Low Value Payments – Challenges for Evolution", with the same referencing.

3 Response

3.1 Reader commentary – usage and trends.

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?

Taking into account our experience in the UK, Euro2pe and Australia, whilst there are some differences we see many common themes in the take-up of cheques. First and foremost there is inertia. Whilst in the c2c and c2b it is a commonplace that this inertia is age related ("young people don't use cheques"), in (particularly small) businesses cheques are as embedded as the handshake on a deal.

This inertia relies on a variety of factors, most mentioned in the consultation document, but we would focus on the following:

- Tangibility – the cheque, handed over as a physical item confers a real (but misguided) sense of the immediate transfer of value.
- Simplicity of initiation - ubiquity, convenience and acceptability. The benefits of being able to direct a payment based on a common name (Mr Jones, Jones and Company etc) not their bank details, using a simple paper form has no real equal at this time for c2c.
- Discounted pricing – does the customer price always reflect the full price for a cheque transaction?
- Exploiting weaknesses in the process. We must not ignore the negatives in this process. Gaining extra credit from the clearing process, deferring payment by deliberately completing a cheque wrongly, claiming that it is "in the post" are all used to derive a "benefit" from this instrument.

These factors will change over time based on the availability of replacement instruments Just as retail cheque transactions at point of sale have been eliminated by the simplicity and ubiquity of card transactions (and the withdrawal by merchants of the facility to pay by cheque), the provision of simple to use alternatives for other situations will speed the reduction in cheques. Alternatives should possess the following characteristics:

- Simplicity of initiation. The use of unique proxies that are easy to remember such as mobile phone number, email address and company name to direct payments will simplify beneficiary identification. Mobile phone, on-line or ATM initiation will add significantly to convenience. Recent studies have pointed out that the majority of people are more likely to carry a mobile phone with them at all times than virtually any other object – including cash.
- Immediacy. The payment must be seen to be made immediately – by all parties. This will provide a sense of the transfer of value. This can be achieved by enabling notification of receipt or at least a promise to pay within seconds of payment initiation. Once again an individual or company should be able to view this over all electronic channels – in the case of a mobile phone via a "push" notification such as SMS.
- Irrevocability. The funds delivered should be cleared funds – and if possible able to be drawn upon immediately.
- Ubiquity. Ideally such transactions should be universally available to a common and transparent standard.

3-5 What additional factors would you wish to see considered in support of any case for change?

and

3-6 What additional commentary would you like to provide?

The following areas should be considered:

- B2B straight through processing and integration. Building on the ability to carry reference information, the ability of the low value payment system to integrate interactively with the services provided by other industries, (insurance, healthcare, manufacturing, retail etc) and government in order to offer a seamless transactional experience. In this we think it would be beneficial to develop end to end payment scenarios with representatives for these industries based on reduction of costs and improvement of efficiency. The majority of businesses are progressively moving to real time processes for logistics, stock control, manufacturing and internal accounting. It is therefore logical that payment processing if correspondingly real-time will enable integration with these processes, avoiding costly post event reconciliation and exception processing.
- The model established by BPAY, whilst relatively high cost and more attuned to regular consumer payments as opposed to B to B points to the potential efficiencies that can be achieved through process integration.
- Convergence. The ability of any infrastructure developed for LV payments to also support and integrate with other payment types such as high value, high care, cards and ATMs. Looking at the requirements of all such services and the growth in "spontaneous" (i.e. not regular) payments driven by changing lifestyles, it is clear that the best suited model to support all these payment types is a low-cost, real-time payment service.

  Of particular and immediate note is the potential synergy between Low Value payments and EFTPoS. Traditionally the domain of "cards", recent experience from in particular the Scandinavian countries indicates a high degree of substitutability between debit cards and low value payments. This is particularly noticeable as debit cards begin to share the market place with other initiation methods such as mobile phones and on-line payments. Accordingly it is our belief that initiatives for low value payments and EFTPoS should be considered within the same strategic context, with particular reference to use of the same underlying infrastructure.

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

Beyond such obvious technical considerations as bandwidth scalability, availability and resilience, which we take as absolutely mandatory we would identify the following:

- Choice. Ideally FIs should be offered some choice of network, to enable rationalised connectivity within their organisation. In our opinion this would be rationalised to an Australian community IP network and SWIFT. This would enable more internationally or focussed banks or those with significant market interests to leverage existing and mandated investment in SWIFT, whilst more domestic players would be able to connect without incurring the high entry costs fro SWIFT which for them may be problematic. In order to enable the two networks to co-exist and members of each to inter-operate, a gateway utility would have to be provided between the two networks.
- Access. The community of interest network must support all levels of ADI as well as others involved in the payment process, including industry utilities and, where sponsored by an ADI, other large payment generating organisations in both the public (government) and commercial space.
- Breadth. The network must be able to support all types of payment traffic, including LV, high value, cards, ATMs etc. It must also be capable of operating to recognised service levels (which may be expected to improve over time) for both

4-A2 What additional high level requirements would be important to assess between alternatives?

- Recognised security standards are essential within the network, (for example use of IdenTrust could be mandated fro authentication).
- The network must use standardised technology to enable it to be enhanced in line with technological advance over time. Proprietary technology and over-tight standards (for example X25) should be avoided.
- Uniform requirements for network architecture at the point of connection, (e.g. the arrangement of firewalls and setting of inbound and outbound policies must be adopted by all connected parties. Ideally there should be an independent third party to verify conformance.

4-A3 apart from transition, what other implications would there be if a change was made from bilateral network arrangements to COIN or VPN?

Provided the COIN enables any to any communication with strong authentication, the introduction of such a model can not be anything but beneficial. The improvements to access should reduce costs, potentially to all, but certainly to smaller and new entrants' participants.

4-A4 What do you consider the merits of a hub based service (the ACH model) vs. a VPN type model.

The two are complementary. An "ACH" is a form of industry utility which may be mandated. The use of a COIN or VPN model can enable access to an industry utility performing a "central infrastructure" function for some services, whilst other traffic may be routed bilaterally. For example in Europe, the SWIFT network (arguably the world's largest COIN) is increasingly being used to carry domestic traffic to and from industry utility providers. Traffic to and from VocaLink for processing represents the largest transactional volume across the SWIFT network, whilst the parties connecting to VocaLink for various processing services also route other traffic to each other bilaterally or via other industry utilities. Thus whilst not diminishing the role of a central/industry utility or "ACH" in any way, we would not argue that it requires a dedicated "hub and spoke" network.

4-A5 What further suggestions or variations would you add for this component?
Covered in previous answers to this section.

4-B2 Do you believe intra-day settlement would reduce concerns over settlement risk satisfactorily?

Intra-day settlement if performed on a multilateral basis will have some potential benefits in containing settlement risk. It also creates the potential to make greater calls on liquidity than a single consolidated daily settlement. For most countries the “sweet spot” for such settlement appears to be two or three settlements per day.

Alternative processes, such as continuous monitoring and the use of net credit caps for participants may be better mechanisms for managing risk in the example as described within this paper.

Intra day settlement appears to be most effective in controlling risk when combined with control of the distribution of the underlying payments – i.e. the payments are collated up to a set time, and a multilateral settlement requested. On successful completion of that settlement payment distribution is triggered to all parties and on posting to accounts are cleared to be drawn upon. This model is common in a number of European countries where the process is co-ordinated by a central ACH.

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

Where file by file settlement is bilateral it introduces demands for close monitoring of Exchange Settlement Accounts by the paying bank to ensure liquidity is available (there may be particular issues here concerned with the collection of direct debits). In addition the efficiency of the solution is dependent on the number, size and value of files requiring settlement through RTGS. It is conceivable that if these files are made too small they will impact performance of the RTGS processor, and if over sized will have be less advantageous than a multilateral net intraday settlement in terms of efficient use of liquidity.

4-B4 What further suggestions or variations would you add for this component?

We believe a system of continuous multilateral settlement within a central infrastructure is ideal to meet the needs of low value payments. Such a model makes the maximum use of the reciprocity within the system on a real-time basis, requiring the minimum allocation of capital to ensure the system runs effectively and in a completely risk-free manner. VocaLink has designed such a process as an enhancement to its Real-time payment proposition, and is currently in discussion with a number of parties within Australia and elsewhere to assess the practicality of introducing such a model. We would be happy to discuss this in detail with any readers of this document on a one to one basis.

4-C3 What is your view of the potential offered by ISO20022 as a payments framework for both inter-FI and FI-customer services? What alternatives should be considered?
4C-4 Do you perceive benefit in introducing an interim capability on existing BECS messages before adoption of ISO 20022? Is this realistic for you?
4-C5 What are your views regarding the adoption of international standards vs. the development of local standards fro payments and payments integration?
4-C6 Other commentary?

ISO 20022 is fast becoming the de-facto standard for new payments development globally, with significant investment by ISO/SWIFT in its development. Whilst consideration of its application to Australian Low Value payments must be carefully and individually considered it is likely that many of the considerations have already been addressed in the standards design process which can potentially speed up implementation. Given the global impetus, it would seem sensible for Australia to move in that direction. The question of an interim step is key. It is strongly arguable that an interim step (i.e. enhance existing message types) will create as much disruption as moving to a new standard, (given the need to conduct industry testing and manage migration), and we see no evidence of this process being advocated elsewhere. It would therefore not seem appropriate. If ISO 20022 is ruled out, then it may make sense to update the existing format, although perhaps message standards such as ISO8583, more commonly used in the cards world, but eminently capable of modification to suit LV payments, and with rich data content, should perhaps be considered as (non-XML) alternatives.

Regarding international standards, we should anecdotally look to the cards world, where pretty much world-wide interoperability has been achieved through the use of variations on a common standards set. Similarly SWIFT's previous generation of FIN messages have been similarly successful, although on a much smaller transaction base. Also one must consider the high cost of standards development and maintenance on a national scale, although some would argue the effort of maintaining local use rules for international standards is itself a not insignificant effort. A further aspect of the benefit of using international standards is in the range of potential innovative products, developed elsewhere that may be easily adapted to the market, and the potential for Australian-made solutions to be deployed elsewhere.

4-D1 Are there other clearing-related requirements you would suggest?
4-D2 What additional impacts would these concepts present?
4-D4 What further suggestions or variations would you suggest?

VocaLink firmly advocates the adoption of real-time transaction by transaction clearing as the future for all payment types. The presentation to APCA made on 4 June 2004 illustrated some of the benefits which are summarised below:

- Near instantaneous transfer of value, (irrevocably)
- Ability to seamlessly integrate with exogenous systems, for example taxation, bill payment, invoice settlement. This includes complex dependencies, with the ability for a third party agency to approve or reject a transaction in process.
- A platform that is extensible to accommodate future payment needs, across a variety of existing and emerging payment types, including on-line, mobile, contactless. Thus achieving convergence to a single rationalised payments platform.

Integration with bank processing is less significant on the sender side (where existing pay anyone facilities, ATM and Debit card interfaces or mobile payments platforms could be readily modified to achieve real-time payments initiation) than the recipient where the ability to post in real-time is the key component. However the trend towards real-time accounting is strong in Australia, with significant core banking system updates planned by most major banks – so this is a diminishing issue. The ability to migrate from current asynchronous processes requires the ability to:

- Interoperate between both systems through a central utility for a period of time
- Provide transparency of fate to payment initiators, (i.e. identifying whether a payment has been delivered real-time or conventionally.

- Ensure consistency in settlement processes.

Such facilities can most easily be provided by a single payments utility, in order to avoid duplication of effort within banks.

4-E3 to 4-E6. Invoicing and wider payments applications.

A real-time system, through its ability to integrate with external systems and single message basis is fundamentally better orientated towards application extensions within the payments value chain, whilst retaining the core integrity of a general purpose payment instrument. It is important to maintain this separation rather than develop new application-specific payment vehicles in order to maintain flexibility and low costs.

Please also see our response to earlier sections of this document.

4-F3 Customer Interface

VocaLink is broadly in agreement with the statements made within this section.

The development of competitive customer propositions which enable payments either directly or as part of a wider proposition is essential to innovation within the payments domain. The provision of a robust and flexible payments backbone is, we believe, essential to achieving this objective. The underlying inter-bank payments instrument should, whilst delivering reliable service levels, support multiple schemes and customer propositions rather than mandating a single unchangeable standard. However it essential that “vanilla” payment services are made available with a high minimum standards of service.

ENDS