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EXECUTIVE SUMMARY

The Commonwealth Bank welcomes the opportunity to provide a submission to the Council of Financial Regulators (CFR) Review of Retail Payments Regulation.

The Commonwealth Bank believes a highly competitive banking system that is stable, fair, efficient and safe through the economic cycle is good for customers, shareholders and the Australian economy. It is working hard to create a better, stronger bank that focuses on customers' wellbeing, leads on operational standards and compliance, drives industry innovation, and contributes to communities and the economy in ways that reflect its size and heritage.

The predominant reasons for regulation of stored value facilities (SVFs) should be to protect consumers' stored value and data, and to safeguard the stability, efficiency and integrity of the broader payments system. Regulatory controls that ensure security, efficiency and confidence will promote competition, innovation and uptake of new services. Therefore, the Commonwealth Bank supports a proportionate approach to regulation based on the maturity of the organisation, as well as the nature of risk that a new payment service may introduce into the payments system.

The Commonwealth Bank has had the opportunity to consider the submission produced by Australian Payments Network (AusPayNet), and is supportive of AusPayNet's positions.

1. What is the outlook for stored-value facilities in Australia?

The payments system has changed significantly in recent years and the pace of change is accelerating. Australians are embracing the convenience of contactless cards, online shopping continues to grow and mobile payments are gaining traction. Australia's payments mix is becoming increasingly digital, with the decline of consumer use of cheques and cash as payment methods. There has been stronger growth in debit versus credit over the last decade that favours SVFs. Hence it is anticipated that Australian consumers will rapidly adopt new payment methods such as SVFs.

A number of new payments services have been enabled by technological advances such as third party wallets and 'buy now, pay later' applications that have the potential to store value. It is expected an increasing number of non-traditional providers will continue to enter the market. Internationally, a number of non-financial institutions such as ride hailing services and retailers have merged e-wallet capabilities into their core offering. These new payments providers may fall outside of existing regulatory frameworks, presenting risks to the system as a whole.

Commonwealth Bank provides customers with the choice of their preferred digital payment method and currently supports Google Pay, Samsung Pay, Fitbit Pay and Garmin Pay in addition to our own solution. These payment options will only increase in the future as more solutions come to market. We have observed a corresponding increase in the level of fraud targeted at these new applications.

2. How do you view the environment in relation to innovation and competition?

New market entrants and emerging business models have contributed to today's highly competitive financial services sector with numerous, diverse providers ranging from traditional financial institutions, fintech start- ups and a growing range of global technology businesses.

New entrants to the market continue to find creative ways to offer consumers alternative value propositions to traditional financial services providers. Some new competitors take advantage of business models that are not subject to the same level of regulatory oversight as traditional business models. Based on the international experience it is likely that many of these may consider expanding and differentiating the services they offer in the future.

New technologies are expected to continue to stimulate innovation and competition in payments. Smartphones alone have significantly increased the frequency of payments related innovations. Strong controls and standards are essential to encourage the uptake and success of new technologies and payment solutions. In our experience, if customers find a new application unreliable or undergoes a negative digital experience (such as fraud), they will quickly revert back to traditional payment methods.

3. How can regulation appropriately balance consumer protection aims while supporting an innovative and competitive industry?

The Commonwealth Bank considers there should be uniform best practice standards relating to fraud management and security for consumers to maintain trust in the payments system and promote uptake of SVFs. Adequate consumer protections will improve the likelihood of success of new entrants by building confidence in new products and services. The ePayments Code - if updated to reflect technological advances – could be an appropriate means to outline the expected standards.

The Commonwealth Bank, as a long term subscriber to the ePayments Code, supports making the ePayments code mandatory for all participants in the payments ecosystem, including SVFs.
The Commonwealth Bank supports recommendation 17.3 in the Final Report of the Productivity Commission Inquiry into Competition in the Australian Financial System that in addition to updating and mandating the Code, ASIC should more clearly define the liability provisions for unauthorised

transactions when third parties are involved, including participation in financial dispute resolution schemes.

New participants in the payments system should also be subject to consumer data privacy and security obligations to ensure consumer information is handled appropriately. To the extent possible, this should align with safeguards arising out of the Consumer Data Right and Open Banking, to reduce complexity for both consumers and participants.

4. Is there potential to clarify the definition of stored-value facilities and the intended coverage of stored-value regulation?

A simpler, technologically neutral definition of SVFs would be of benefit to capture the wide range of payments service providers involved in different stages of the payments process. The definition would need to be sufficiently broad so that regulations would be applicable to both existing as well as potential SVFs. It may be helpful to harmonise terminology with international jurisdictions. In Singapore the operation of stored value facilities will soon be regulated as e-money issuance with an expanded definition.[1] The UK[2] and EU[3] also use the term 'e-money' to describe electronically stored monetary value.

5. What regulatory boundaries or thresholds for stored-value facilities are appropriate?

SVFs should comply with AML/CTF obligations as a baseline requirement to protect and maintain the stability and integrity of the payment system. The Hong Kong Monetary Authority and more recently the Financial Conduct Authority has recognised that SVFs are vulnerable to similar AML/CTF risks as other retail payment products and services.[4]

Purely numerical or volume based thresholds may not be sufficient to ensure appropriate regulatory oversight.

The AUSTRAC risk assessment of stored value cards (SVCs) found that the risk level of individual SVCs varied significantly depending on the features of the specific product, regardless of the applicable thresholds.[5]

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[1] http://www.mas.gov.sg/~/media/resource/publications/consult_papers/2017/Consultation%20on%20Proposed%20Payment%20Services%20Bill%20MAS%20P0212017.pdf

[2] https://www.fca.org.uk/firms/payment-services-regulations-e-money-regulations

[3] https://ec.europa.eu/info/business-economy-euro/banking-and-finance/consumer-finance-and-payments/payment-services/e-money_en

[4] http://www.mas.gov.sg/~/media/resource/legislation_guidelines/aml/PSOAN02%20Revised%20Notice%20to%20Holders%20of%20SVF%20Final.pdf

(HK) https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/aml-cft/Guideline-on-AMLCFT-(for-SVF)_English.pdf

[5] http://www.austrac.gov.au/stored-value-cards

The regulatory framework should reflect the level of risk that the new service introduces into the payments system. Given the networked design of the payments system, participant failure could raise liquidity, credit and reputation risks for other participants. New payment services that require access to core payments infrastructure or intersect with traditional payments products should be subject to a higher standard of regulation due to the potential for flow on effects. For example, a domestically based 'closed loop' system or a 'single purpose' SVF (used for payment only of goods or services provided by the holder of that stored value facility) is less likely to pose a risk to the broader financial system. The Proposed Payment Services Bill in Singapore seeks to calibrate regulation according to the activities undertaken by the payments provider and the related risks.[6]

6. Are there other criteria that could be used to define regulatory boundaries for stored-value facilities?

The Commonwealth Bank sees a need to differentiate new entrants that are 'start ups'- who may benefit from additional support to create a level playing field - from established organisations that are simply entering a new market. Such a criteria should align with and compliment ASIC and APRA's eligibility requirements for the sandbox and Restricted ADI (RADI) respectively. For example, APRA envisaged that the RADI licence would apply to start-ups with limited financial resources that that require the time to build resources and capabilities in order to meet the prudential framework.[7]

Interoperability measures may need to be considered as payment providers reach scale to prevent fragmentation of payment services that could reduce the efficiency and user experience of the payment system in the long term.

7. What are your views on a 'tiered' approach to prudential supervision for stored-value facilities?

A graduated approach to regulation is preferable to a 'tiered' regime. A two-tier regime risks creating an uneven regulatory environment that introduces risk to the payment system and lowered levels of consumer protection on a permanent basis.

The Commonwealth Bank is supportive of a graduated regulatory framework for purchased payment facilities (PPFs) and SVFs that allows for prudential regulation proportionate to the maturity of the organisation and the relative risk to the broader payments system that can be progressively upgraded to ensure a level playing field.

A graduated framework should provide an interim step to facilitate entry into the payments system by supporting new and innovative businesses to navigate the regulatory environment. A graduated framework is consistent with other measures to foster competition and innovation such as APRA's phased licensing framework for new ADIs and ASIC's regulatory sandbox for fintech start-ups.

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[6] http://www.mas.gov.sg/News-and-Publications/Consultation-Paper/2017/Consultation-Paper-on-Proposed-Payment-Services-Bill.aspx

[7] https://www.apra.gov.au/sites/default/files/phased-licence-response-paper-20180504.pdf

8. What is the appropriate regulatory approach to emerging products and services?

Any new risk and associated cost imposed upon the payments system is borne by its existing users and participants. Regulators must be vigilant in managing the risks introduced to the payments system by new and innovative payment offerings. Emerging products and services also need to be supported by appropriate consumer protection measures to prevent poor customer outcomes deterring widespread adoption of new and innovative solutions.

The framework may need the flexibility to adapt to growing and evolving payment services. For example, the Octopus Card in Hong Kong expanded from a transport payment card into small-value payments in the retail sector, government road tolls, parking, access control for residential and commercial building, support for various facilities in schools and self-service kiosks. [8]

Regulatory design needs to be forward looking to accommodate future innovation. Just as smart phones have created opportunities for rapid innovation in payments, advances in automation, the internet of things and AI may create new opportunities that are not yet on the horizon.

A register of emerging payment products and services that sit outside of regulatory boundaries and thresholds (similar to the Financial Conduct Authority's register for 'small electronic money institutions' in the UK[9]) may be useful to allow regulators to monitor and prepare for emerging risks.

9. How could the transparency and communication of regulation be improved?

A single regulator model would minimise confusion by reducing regulatory overlap and streamline the regulatory process. Consistency and co-ordination with other payments regulation is also desirable.

Where possible, alignment of definitions and approaches between domestic financial regulators such as eligibility requirements would also help to reduce complexity. Harmonisation with international terminology may also simplify the process for foreign entrants.

AusPayNet, in their capacity as a self-regulatory body for the payment system has observed significant payment knowledge gaps in new and potential entrants into the payments industry that may provide insights on how to enhance communication for new participants.

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[8] https://www.octopus.com.hk/en/consumer/octopus-cards/about/index.html

[9] https://www.fca.org.uk/firms/authorisation-registration-emoney-payment-institutions

The Commonwealth Bank would welcome the opportunity to discuss this submission with you.

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