

# **Submission on Financial System Inquiry Final Report – Purchased Payment Facilities\***

## **Introduction**

Australia's purchased payment facility (PPF) market is relatively underdeveloped. Ironically the PPF regulatory regime was introduced following the previous financial system inquiry (the Wallis Inquiry) to encourage growth and innovation in new payment methods, yet today a major impediment to the growth of PPFs in Australia is the PPF regulatory regime.

PPFs are growing and innovating rapidly in other developed countries. In Hong Kong, the Octopus stored-value card was introduced in 1997 as a transport ticketing system and led to the implementation of the Oyster card in London some six years later. Octopus now has a penetration rate of 99% in Hong Kong, with over 6,000 service providers, and 15,000 retail outlets.<sup>1</sup> Octopus is one of the world's most universally accepted smart-card payment systems.<sup>2</sup> There is no reason Australia cannot replicate a success story like Hong Kong's Octopus system. This would benefit all Australians by making daily transacting quicker and easier, and should be of great interest to the Government as it moves the economy away from cash and the potential it offers to evade taxation. However, for such important policy goals to be achieved, the existing PPF regulatory regime needs extensive revision.

We support reform of the current PPF regime, however, would recommend a different path to that proposed in the FSI Recommendations.

This submission outlines our recommendations for the PPF regime and explains why we believe the FSI recommendations will not achieve their desired aim.

## **Complexities in Current Regulatory Regime**

The current regulatory regime established in 1998 has developed so that PPFs are subject to supervision by either the Reserve Bank of Australia (RBA), the Australian Prudential Regulation Authority (APRA), and/or the Australian Securities and Investments Commission (ASIC). PPF providers may need to hold an Australian Financial Services Licence (AFSL) and/or an Australian Credit Licence (ACL) under the supervision of ASIC, be authorised or exempted by the RBA, or be an authorised deposit-taking institution (ADI) authorised by APRA.

The Australian PPF landscape is currently principally regulated by exemptions. The only authorised PPF in Australia is PayPal. This approach is not ideal as a market characterised by regulatory exemptions is shaped by those exemptions. Our current system adversely influences market development, innovation and growth. With exemptions dominating this regulatory space, supervisors are also not well placed to monitor the PPF market and could be taken unawares by future developments.

Too often today when a foreign payments provider seeks legal advice on establishing a new type of PPF in Australia and is told it will need to apply for a AFSL or ACL straight away and that when its services grow to a significantly profitable scale it will need to be regulated as an ADI, the provider chooses not to enter our market. The payments providers who do

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<sup>1</sup> OCTOPUS, "Company Profile" (October 2014), at 9, available at [http://www.octopus.com.hk/web09\\_include/\\_document/en/company\\_profile.pdf](http://www.octopus.com.hk/web09_include/_document/en/company_profile.pdf)

<sup>2</sup> Michelle Li, "OCTOPUS: Making Everyday Life Easier" (October 2008), at 9, available at <http://michelleli.ca/wp-content/uploads/writings/octopus.pdf>; OCTOPUS, "Company Profile" (October 2014), at 9, available at [http://www.octopus.com.hk/web09\\_include/\\_document/en/company\\_profile.pdf](http://www.octopus.com.hk/web09_include/_document/en/company_profile.pdf)

enter our market typically have to craft their offering to qualify for an exemption often with the loss of much of the innovative functionality of their service.<sup>3</sup>

No record is available of the potential innovative services lost due to the potential regulatory burden deterring new market entrants or of the lost innovative approaches due to compliance with our exemptions regime but anecdotal evidence suggests both losses are considerable.<sup>4</sup>

For the PPF market to grow safely and freely, and for supervisors to be able to keep abreast of market developments and innovations, the widespread use of exemptions needs to be phased out; simple, expeditious authorisations should become the norm; and market data should be collected by the supervisor from all PPFs. The current authorisation and exemption regime under the *Payment Systems (Regulation) Act 1998* should be significantly amended or repealed. As it stands it does not balance innovation with regulation, market developments are being inhibited and we have no way of quantifying the extent of this inhibition because no data is collected on exempted entities or business ventures not proceeding due to regulatory burdens.

### **Financial System Inquiry (FSI) Report**

The Financial System Inquiry (FSI) Final Report has identified the complexity of the current PPF regulatory regime and recommendations 16 and 39 go some way towards removing the complexities.

Recommendation 16 (R16) of the FSI Final Report directly addresses PPF regulatory reform. R16 suggests that the thresholds for regulation by ASIC and APRA be clarified and enlarged, consumer protection be strengthened by mandating the application of the *ePayments Code*, and a separate prudential regime with two tiers of liquidity and other prudential requirements for PPFs be introduced.

Recommendation 39 (R39), which concerns technology neutrality, complements R16. R39 states that regulations should allow individuals to select alternative methods of financial service access to maintain fair treatment of all consumer segments. Technology neutrality is important because enabling any mode of technology whereby individuals can select alternative methods of financial service access promotes financial inclusion and competition among providers.

### **Our Recommendations**

#### ***1. The current licensing/authorisation regimes should be simplified from four to one.***<sup>5</sup>

Simplifying the current PPF regulatory regime will liberate the market. For example, Hong Kong's Octopus card stored value facility is regulated by one supervisor pursuant to one licensing regime. Octopus has become widely available and accessible, evolving into a multi-purpose stored-value facility that enables customers to pay for goods and services as well as transport. Indeed, over half of Octopus payments are now for non-transport related goods and

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<sup>3</sup> Interview by Ross Buckley of a partner in a major national law firm practising payments systems law, March 4, 2015.

<sup>4</sup> *Ibid.*

<sup>5</sup> The four regimes being the Credit Licence and Financial Services Licence regimes administered by ASIC, and the regimes of the RBA and APRA.

services.<sup>6</sup> Octopus is also demonstrating its ability to adapt to financial innovation by progressively transitioning its services from smart-cards to smart-phones.<sup>7</sup>

A single licensing/authorisation regime should be light touch to foster financial inclusion and to promote technological innovations, and because PPFs are not extensive today in Australia the regulatory department initially doesn't need to be large. A single regime also offers greater flexibility and lower compliance costs.

## ***2. The number of PPF supervisors should be reduced from three to one.***

The current regulatory regime is fragmented, complex, and lacks clarity because the three current supervisors' PPF regulatory roles are not functionally aligned with their regulatory design. The RBA is aware of this problem as illustrated in its Supplementary Submission to the Financial System Inquiry (August 2014), which stated that the RBA was not well placed to authorise and supervise individual PPFs as the regulatory functions are markedly different to those in relation to retail payments, which focus more on high-level policy and less on regulatory oversight. Furthermore, the RBA has stated that PPFs require less supervision and regulation than ADIs.

Under the current regime, none of the supervisors are ideally placed to supervise all PPFs. Furthermore, judging by the predisposition for granting exemptions rather than applying the PPF regulatory regime, it is arguable that none of the supervisors are seeking an expanded supervisory role.

We recommend Australia establish a single new regulator, a "one-stop shop" to regulate PPFs. In our view, this new regulator should be within ASIC as its principal roles are consumer protection. New funding needs to be provided to ASIC to enable it to undertake this task properly. Payments system staff from the RBA will probably need to be seconded to ASIC, at least in the early phase.

## ***3. The ePayments Code's current prescriptive list of transactions should be replaced with a broad provision.***

The FSI recommends service providers subscribe to the *ePayments Code* in its current form as a means, inter alia, of extending consumer protection regulation to PPFs. We argue that mandating subscription to the current *ePayments Code* will not capture all innovations in the PPF sphere. The current *ePayments Code* provides a prescriptive list of transactions to which it applies and gives ASIC power to extend the list. It also falls somewhat short in terms of technology neutrality. A better approach would be regulation that is principles-based and functional in design, focusing on outcomes rather than prescribing the method by which these will be achieved. One way to remedy this regulatory design flaw is to amend the Code so it applies to digital financial services generally (involving payments, transfers, withdrawals, and any other transaction). This is simpler and cleaner than having ASIC discretionarily determine which transactions are captured by the Code beyond the prescriptive list.

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<sup>6</sup> Ben Fung, Miguel Molico and Gerald Stuber, "Electronic Money and Payments: Recent Developments and Issues", Bank of Canada Discussion Paper 2014/2 (2014), at 27.

<sup>7</sup> Kanis Li, "Octopus takes mobile step to winning more customers", South China Morning Post (9 September 2013), available at <http://www.scmp.com/business/companies/article/1306562/octopus-takes-mobile-step-winning-more-customers>; See also, OCTOPUS, "Company Profile" (October 2014), at 9, available at [http://www.octopus.com.hk/web09\\_include/\\_document/en/company\\_profile.pdf](http://www.octopus.com.hk/web09_include/_document/en/company_profile.pdf)

#### **4. *The Data-Mining legislative provisions need to be consolidated and streamlined***

Data-mining is a key commercial driver of innovative financial products and services. Data-mining enables companies to profile consumers through their PPF spending patterns and target individualised marketing to them. Collecting and mining data from consumers in the PPF sphere gives rise to market conduct and consumer protection concerns. Currently, there are several key statutes that PPF providers have to consider when mining data: *Spam Act 2003* (Cth); *Privacy Act 1988* (Cth); and the anti-hawking provisions in the *Corporations Act 2001* (Cth). Compliance with these data-mining related legislative provisions places a disproportionate regulatory burden on small PPF providers that may stifle innovation, competition, and market growth.

A proportional regulatory approach should be adopted that streamlines the current PPF data-mining regulatory regime. These data-mining consumer protections and market conduct provisions should all be simplified and consolidated in an *ePayments Code*. Simplifying these provisions is important to allow for innovation, competition, and market growth to flourish.

#### **5. *Market information needs to be collected for all PPFs***

Market information concerning the turnover, structure and innovations in the Australian PPF market needs to be regularly collected. This information enables market reviews to identify risks, and will underpin future regulatory guidance and policy development.

The PPF regulator should substantially improve the information available on this market sector, both in terms of value and volumes of transactions and methods of access used when paying with stored value.

### **Conclusion**

By international standards Australia's current retail payments system is reliable but expensive. PPFs provide the vehicle through which innovative payments providers are likely to disrupt the current system to the distinct benefit of consumers across the nation yet our current regulatory regime stifles much of this innovation. The five recommendations we have made, particularly the establishment of a consolidated regulatory regime administered by a single regulator within ASIC, will lay the groundwork for innovative disruption to support Australia's prosperity while protecting the interests of consumers.

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