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Cuscal response to Treasury's Consultation Paper: Payments System Modernisation - Licensing - Defining Payment Functions

Cuscal Limited (Cuscal) welcomes the opportunity to provide feedback to the Treasury's Consultation on the foundations of a new tiered, risk-based licensing framework for PSPs, based on a defined list of payment functions.

Cuscal acknowledges that further consultation on the regulatory obligations under the new licensing framework and detailed elements of the payments licensing reforms will be held later in 2023 and 2024 and will provide more detailed feedback on these in due course, accordingly our comments focus on overall strategy, with an understanding that more detailed feedback will be provided in future consultations.

Our responses have been divided into sections in line with the structure and questions of the Consultation Paper.

Background to Cuscal

For over 45 years, Cuscal has leveraged its assets, licensing, and connectivity to provide intermediary and principal outsourcing activities on behalf of its clients. We are an end-to-end payments specialist that services more than 100 established ADI and challenger brand clients within Australia's financial system, including the majority of the mutual banking sector, and a growing number of corporate, FinTech and 'PayTech' enterprises. We enable their market connectivity so they may provide innovative products, business models, and drive improved customer outcomes.

We are an Authorised Deposit-taking Institution (ADI), the holder of an Australian Financial Services Licence, an Australian Credit Licence for Securitisation purposes and an Accredited Data recipient. Cuscal has Board representation with Australian Payments Plus (NPPA, BPAY, Eftpos), the Australian Payments Network and participates in numerous industry committees and forums

As a fully PCI-DSS accredited ADI, Cuscal is uniquely placed to provide secure and robust capabilities that facilitate access to markets that would otherwise be beyond the reach of some organisations. The services that we provide to our client institutions include card scheme sponsorship for issuing and acquiring, payment card issuing, card production services, digital banking applications, access to domestic payment services using direct entry, BPAY, the New Payments Platform (NPP) and Open Banking Data holder platform services. We also act as settlement agent for many of our clients through our Exchange Settlement Account with the Reserve Bank of Australia (RBA).





Introduction:

Cuscal is supportive of the proposed list of payment functions, provided there is sufficient flexibility to add new functions as required. Cuscal also supports the approach of 'same risk, same rules' for the proposed regulatory and licencing framework but would encourage Treasury to consider application of more detailed operational and capital risk management requirements for all PSPs. We recommend that all PSPs are licensed, regardless of whether there is a direct consumer relationship or whether they deal with the financial part of a transaction. While some excluded and exempted activities may be logical, if the legislation is appropriately flexible, there should be limited need for these in practice. Without consistent licencing, the enforcement of industry standards across all relevant PSPs is unlikely to be effective.

Principles underlying the list of payment functions:

- ❑ Cuscal is broadly supportive of the principles proposed by Treasury to drive the development of regulated payment functions, which include: Providing clarity and transparency; Targeting regulation to the risk posed; Ensuring the list can change and adapt; Consistency with other payment regulations.
- ❑ However, there is a clear tension between the principles of targeted regulation and tiered licencing, with the concepts of clarity and consistency. The balance would need ongoing oversight to deliver the desired level of sophistication of operating models, consistency of service and positive consumer outcomes.
- ❑ In addition to consistent application of payment regulations, Cuscal also encourages Treasury to consider a consistent approach to relevant industry standards. Equal application of security standards for all functions to enhance security and compliance along the end-to-end payment infrastructure is also vital to consumer confidence and protection, irrespective of whether a function is consumer-facing or not.

Defining payments functions:

- ❑ Cuscal is supportive of the proposed list of payment functions, provided there is sufficient flexibility to add new functions as required.
- ❑ Cuscal understands that the clearing and settlement function is the only B2B function on the proposed list, with the rest covering B2C, however, clarification from Treasury would be helpful for the industry. This would further aid Treasury in their consideration of what requirements of the corporations legislation could be 'switched off' for particular functions or activities.
- ❑ The next consultation on the licensing framework would also benefit from separating clearing and settlement functions, due to the (logical) minimum account and operational requirements for settlement accounts and the role of the Reserve Bank of Australia in overseeing ESA accounts.
- ❑ Cuscal recommends that Treasury further considers how some of the delineations of the proposed functions might be 'arbitraged' and whether mitigating measures can be applied. For example, the \$50m limit for Standard SVFs, may lead to some controlling entities establishing different brands (all under the limit) to minimise their obligations. Accordingly, some of the licence restrictions and obligations may need to apply at a controlling entity level, akin to certain existing APRA standards. Similarly, Cuscal suggests that the two-day principle in relation to SVFs may be introducing unnecessary complexity and opportunity to circumvent licencing obligations.
- ❑ Cuscal recommends that any function that involves the holding of funds should be treated as a service, with clear triggers for when a PSP is deemed to be providing a financial service. For example, PFSs that provide payments for an SVF but do not hold funds should be treated as providing financial services, but the SVF provider should be treated as providing a financial product, no matter the size of the facility.
- ❑ Given the proposed tiered nature of the framework, public education may be required to ensure customers understand the different types of protections available to them as well as any differences in security standards which may impact their personal information.





Exclusions and exemptions:

- ❑ It is proposed that existing exclusions and exemptions in the Corporations Act or Corporations Regulations be retained, except for the following exclusions and exemptions: Exchange and settlement between non-cash payment providers; Certain electronic funds transfers; Payments debited to a credit facility; Unlicensed product issuers that use licensed intermediaries; Relief given to specified entities and non-cash payment facilities. In addition, it is proposed that the existing relief for low-value and limited-purpose facilities be maintained. Payments executed wholly in cash, as well as the physical transport of cash and coins will also be excluded from the list of payment functions for payments made in cash, given they do not present the same risks for customers.
- ❑ Cuscal notes, that while some excluded and exempted activities may be logical, if the legislation is flexible enough, there should be limited need for these in practice. We note in particular:
 - ❑ To ensure consistency and customer certainty, low-value payment facilities (based on a cap or threshold) should be required to hold a base license.
 - ❑ While it may be appropriate to retain conditional relief for incidental closed-loop non-cash payment facilities, issuers of facilities such as open-loop gift cards and loyalty schemes should not fall under this exemption and the delineation will need to be clearly defined.
 - ❑ Treasury should closely consider whether some form of structured exemption may be reasonable where an ADI supports certain functions “as a Service” on behalf of other businesses, such as fintechs, as it takes on the relevant risks and has, in practice, the highest regulatory oversight.
- ❑ Cuscal notes that the storage of payment and transaction data and the provision of security services do not appear to be captured within the list of payment functions. Given the importance of ensuring the integrity and security of payments data, we encourage Treasury to consider including these functions and entities that provide these services under the licensing framework.
- ❑ We also note that PFSs for payment stablecoins are not proposed to be captured under the PSP licensing framework. As payment stablecoins become more widely used as a means of payment and/or stored value, the regulatory framework should retain adequate flexibility to include payment stablecoin PFSs under the PSP licensing regime to ensure consistency in the payment ecosystem.
- ❑ Further clarity should be provided on whether the proposed licensing regime would cover offshore apps (such as WeChat), which also introduce risk to local consumers and business and carry reputational risks for the payment ecosystem.
- ❑ More broadly, as payment products continue to evolve, Treasury should consider how long it would take to bring a new product under the proposed new legislation. If the process is likely to be time consuming, a defined interim mobilisation approach for regulators could help protect consumers and the ecosystem and assist in bridging the gap.

Payment function risks:

- ❑ Cuscal supports the approach of ‘same risk, same rules’ for the proposed regulatory and licensing framework. The effective application of this principle requires a clear understanding of the types and levels of risks posed by the entities being regulated. PSPs present different risk to customers, other payment participants and the financial system. The risks posed by specific payment functions are grouped within the consultation into three broad categories (financial, operational and misconduct risks).
- ❑ Cuscal notes that as PSPs are already subject to various regulatory frameworks and accordingly not all risks will be addressed by the proposed payments licensing framework, especially where it would result in duplication or if it is more appropriately addressed elsewhere. However, this approach needs to be carefully considered to ensure no gaps are formed in the process. We encourage Treasury to consider other factors (such as scale, nature of business, customer base, transaction values and volumes, liquidity risk and enabling technology) that may affect a PSP’s risk profile.





- ❑ There may also be benefit in splitting out the 'facilitation, authentication, authorisation and processing' category to ensure that the licensing obligations applicable to each of these types of PSPs remains appropriate. In particular, 'facilitation' as a concept may be too broad and could create confusion. For example, POS and payment terminal providers and telecommunications companies could both be captured by this concept so the breadth of coverage by this term may need refinement.
- ❑ Operational risk has been identified as a common key risk across all payment functions, with mitigating controls focused on mandatory technical industry standards. While technology risks are a key risk, operational risk also covers processes, controls, people, infrastructure and external events. Technical standards addressing interoperability and security will not be sufficient to address all operational risks. Accordingly, we encourage Treasury to consider whether more detailed operational risk management requirements should apply to all PFSs, in line with requirements in Canada, Singapore, and the UK. This would also encourage all participants to deter 'bad actors' from entering the ecosystem and improve due diligence and oversight controls.
- ❑ Additional thought should also be given by Treasury on how the new framework will: address risks associated with adequate capital and the cost of liquidity; aid in preventing scams; and improve the overall payment system's resilience to cyber risks. For example, Cuscal recommends that stress testing should apply to all PSPs that touch customer funds - in the event of a cyber-attack or other external event, PSPs need to have adequate capital (not just liquidity) to protect customer funds.
- ❑ Cuscal also urges Treasury to consider reputational risk in more detail. While some PSPs might not have a direct customer relationship, the interconnected nature of the payments industry means that most functions could ultimately have an impact on customer outcomes and impact consumer confidence and trust in the payment ecosystem.

Licensing requirements and regulatory obligations:

- ❑ A number of jurisdictions including the EU, UK, Singapore and Canada have implemented functional definitions of payment services as part of their payments system regulatory frameworks. The proposed list of payment functions in this consultation paper draws closely on the EU/UK list of payment services and their e-money institution authorisation framework. It is proposed that the payments licence be implemented through the AFSL regime to minimise the number of licences a PSP may need to hold and ensure payment services are regulated in a manner consistent with other financial services. PSPs would only be authorised to provide the specified payment functions under their licence and new functions would require licence variations.
- ❑ Cuscal is supportive of the proposed approach and our view is that all PSPs should be licensed, regardless of whether there is a direct consumer relationship or whether they deal with the financial part of a transaction. Broad licensing is critical to ensuring industry-wide participation in, and compliance with, industry standards. For example, while a PFS may not handle the financial part of a transaction, they are still in control of who the parties to the transaction are, often minimising visibility or application of risk management tools for the bank, and accordingly introducing a level of risk that needs to be adequately managed. Without consistent licensing, the enforcement of industry standards across all relevant PSPs is unlikely to be effective.
- ❑ Cuscal also encourages Treasury to further consider how other supporting industry standards, such as the AusPayNet and NPPA rules, will link into the new regime.
- ❑ Risk is introduced through the chain of services as a PSP's ability to adequately control distribution is diluted, with visibility of the end customer/consumer complicated by B2B or B2B2C layers of payment products and services. To mitigate this risk, the licensing framework should consider not only the function a PSP provides but also the customers the licence allows them to deal with, like the existing delineation of wholesale and retail clients.





- Under the proposed approach, each regulator would remain responsible for ensuring compliance with and enforcing requirements within their remit. Given the complexities and unique risks in the payments ecosystem, Cuscal believe there may be benefit in setting up a dedicated payments system regulator (as had been done in the UK), noting especially the existing difficulties faced by regulators in understanding the breadth of challenges and intricacies of the payments ecosystem. In the alternative, as per our previous submissions, we encourage Treasury to consider the appointment of a payments industry convenor to guide and encourage collaboration between regulators and industry on the continued development of payments-related matters.

In closing, we trust that our above responses will assist the Treasury in formulating its approach to the new licensing framework for payment service providers, and we look forward to further discussing our submission and future consultations with you.

If we can be of any further assistance in the interim, please feel free to contact me at kmckenna@cuscal.com.au.

Yours sincerely,

Kieran McKenna
Chief Risk Officer

