



NATIONAL AUSTRALIA BANK SUBMISSION

Payments System Modernisation
(Licensing: Defining Payment Functions)

July 2023

Introduction

National Australia Bank (**NAB**) welcomes the opportunity to respond to the Department of Treasury (**Treasury**) consultation on Payments System Modernisation (Licensing: Defining Payment Functions) (**Consultation Paper**).

NAB's response and focus is guided by the 25 questions in the Consultation Paper and responds thematically to these questions. As a member of both the Australian Banking Association (ABA) and the Australian Payments Network (AusPayNet), NAB has contributed to and supports their respective submissions to the Consultation.

NAB considers that a safe, secure, efficient and sustainable payments ecosystem underpins Australia's ongoing successful economic development. The licensing approach within that ecosystem is an important enabler and must be designed to accommodate the evolving nature of payments participants in Australia and globally and the highly interconnected nature of the payments ecosystem between participants. This means a broad principle-based perspective should be taken in designing the fundamental elements of a modernised, fit for purpose licensing approach. NAB's response is therefore informed by three principles:

1. A level regulatory playing field for industry participants involved in similar activities in the payment ecosystem (particularly where entities' activities pose similar levels of risk there must be similar rules and obligations applied).
2. Payment Service Providers (**PSP**) should hold a license regardless of whether the function they perform is customer facing or non-customer facing.
3. The payments licensing regime should avoid regulatory duplication, material gaps or unnecessary complexity.

Section 1: List of payment functions

1. Are there any other principles that should be considered in developing the list of payment functions?

NAB supports the proposed principles to drive development of the payment functions to be defined for licensing purposes. NAB believes that the second principle, '*Targeting regulation to the risk posed*' should address the differing levels of risk that are presented by the function a PSP is performing, in addition to the risks presented by the payment service itself.

2. Is the list of payment functions comprehensive, or should other functions be included?

3. Should all payment functions be treated as financial products under the corporations legislation or should some be treated as a financial service?

The list of payment functions outlined in Table 1 of the Consultation Paper is comprehensive. NAB notes that the current Financial Services Reform (**FSR**) regime recognises the distinct roles of issuer and distributor or arranger. The same hierarchy currently exists in payments and would benefit from being licensed and regulated:

- i. Introducers (may be on commission)

- ii. Payment facilitators who make their merchant facility available to sub-merchants and on-settle out of the settlement account held with a member of a scheme
- iii. Merchant market – places
- iv. Bill payment services in Direct Entry (e.g. aggregator providers) and potentially in PayTo, and Accredited Action Initiators who are able to send action initiation requests to Action Service Providers under the Consumer Data Right.

In principle, NAB agrees with the proposal to treat a Stored Value Facility (**SVF**) as a financial product. However, NAB suggests that more consideration be given to whether each Payment Facilitation service function should be treated as a financial product or financial service. The Reserve Bank of Australia (**RBA**) should be consulted on the treatment of clearing and settlement functions.

Consideration should also be given to the extent to which the financial advice regime would apply to the sale of merchant and other payment receivables products if all payment functions are to be treated as financial products or financial services. This could have unintended consequences for small businesses who benefit from competition in the issuance of payment instruments and payment initiation services. It may also not be appropriate to apply the financial advice regime to payments clearing and settlement services. For example, applying the disclosure and advice regimes to all payment functions may be unnecessarily burdensome for certain payment functions and have unintended consequences that limit innovation or access.

Section 2: Description of each payment function

4. Does the term ‘payment stablecoins’ accurately describe the types of stablecoins this paper seeks to capture for regulation or are there other terms that may be more appropriate?

5. Does the proposed definition of ‘payment stablecoins’ adequately distinguish itself from other stablecoin arrangements?

6. Is regulation as an SVF an appropriate framework for the regulation of payment stablecoin issuers? If not, why? What would be an appropriate alternative?

The list of proposed payment functions generally captures the range of payment services offered in Australia currently, noting payments is often an early adopter of emerging technology.

NAB agrees that the definition of ‘payment stablecoins’ is sufficiently broad. However, it does not fully capture the different types of activities able to be undertaken by market participants. For example, an eCommerce platform could issue a stablecoin that would be significantly different from a stablecoin issued by an authorised deposit-taking institution (**ADI**). Similarly, an ADI issued stablecoin differs from existing stablecoins issued by non-regulated entities.

In relation to ADIs as issuers of stablecoins, NAB believes that the current prudential regulatory framework already sufficiently safeguards against financial markets instability. For example, banks are already regulated from a fractional reserve perspective to manage market and liquidity risk against the liabilities on their balance sheet.

7. Does the list of proposed payment functions adequately capture the range of payment services offered in Australia currently and into the future that should be regulated under a payments licensing regime?

8. Does the list need to be broken down in more detail, for example, should facilitation, authentication, authorisation and processing be separate functions?

9. Should any other payment functions be included?

NAB notes the FSR regime recognises the distinct roles of issuer and distributor or arranger. The same hierarchy currently exists in payments and should be considered.

NAB supports a risk-based approach to applying regulatory obligations. NAB notes the breadth of the function ‘payment facilitation, authentication, authorisation and processing services’, and encourages consideration of obligations applying to entities who may only offer part of that service. To provide clarity and transparency it may be necessary to apply a specific obligation to a component of this broader function, for example to authentication. There may also be occasions where specificity will best be achieved at the level of standards or framework rules, rather than at a license level.

Consideration should be given to the extent to which merchant terminal manufacturers and providers ought to be regulated beyond their registration with a card scheme. Payment capture devices can significantly influence the ways in which regulated aspects of payment acquiring are presented to and implemented by merchants.

Licensing associated with payments clearing and settlement services should be further explored in consultation with the RBA. NAB is unclear from the description whether the intent is to capture existing entities performing these functions or provide access to additional entities to perform clearing and or settlement to PSPs who are not ADIs and the way this could be done without introducing further counterparty risk before triggering additional licensing requirements. The RBA batch administration model and clearing and settlement functions within each payment scheme should also be considered.

Section 3: Excluded and exempted activity

10. Would the removal of the identified exclusions create unintended consequences?

11. Which existing exclusions and exemptions applicable to non-cash payment facilities should be amended or removed to support regulation of the proposed payment functions? Do any existing exclusions or exemptions require updating, such as the relief for low-value facilities?

12. Should the incidental product exclusion apply to the proposed list of payment functions?

13. Should any exclusions or exemptions be revised to be more consistent with comparable jurisdictions? For example, should the ‘single payee’ exclusions and relief for loyalty schemes, electronic road toll devices, prepaid mobile phone account and gift cards be replaced by a general exclusion for payment instruments that can be used only in a limited way?

14. Should the exclusion for low value facilities apply to any PFS, such as money transfer services? If so, what thresholds should be considered a low value PFS?

15. Should any other exclusions or exemptions be provided?

NAB supports in principle the removal of the exclusions and exemptions as outlined in the Consultation Paper for:

- Certain electronic funds transfers
- Unlicensed product issuers that use licensed intermediaries

NAB suggests the incidental product exclusion should be retained but with more specific guidance as to what constitutes ‘incidental’. The exclusion for low-value facilities should not be extended to money transfer services.

Section 4: Characterising the risk of each payment function

16. Are there any other risk characteristics of a payment function that should be considered?

NAB agrees that the broad categories of risk identified in the consultation paper (financial, operational and misconduct), and the identified groups of impacted stakeholders (consumers and businesses as well as the financial system as a whole), cover the main risk characteristics of a payment function.

While other risks, such as data security are addressed elsewhere in legislation (e.g. in privacy law), existing AFSL licensing obligations can extend to having adequate cybersecurity systems, thereby providing separate obligations and protections. To ensure a level playing field, and to protect customer data and the effective operation of the system, NAB urges the ‘base licence’ for all PSPs should extend to these additional risks in the same way as the s912A general obligations will apply to PSPs who hold AFSLs. The required standard and threshold for these general licence obligations should be proportionate to the risks arising from that PSP’s activities.

17. What are the types of payment risks posed by the performance of each of the proposed payment functions?

18. While having regard to the obligations proposed to be imposed on the payment functions (outlined in Section 7), are the risks posed by the performance of each payment function appropriately mitigated by the payments licensing regime? Or are they more appropriately addressed by a framework outside of the payments licensing regime such as the *PSRA* or *AML/CTF Act*?

NAB notes the proposal to characterise payment system functions as financial products or services within chapter 7 of the *Corporations Act* where appropriate. While this would avoid creating a new regime for payments, consideration should be given to a number of unique characteristics of the payments industry. These include:

- i. Whether as a payer or a receiver the participant has an active relationship with the provider engaging in multiple interactions daily. This is true whether the participant is an individual or a major business conducting thousands of transactions daily.
- ii. Payment systems involve extensive rules both as to the participants' membership and participation, and governance of the conduct of the payment system and the processes.

Regulation needs to reflect these characteristics to be effective and workable. This may not work optimally by placing all products, services and processes into the current regime.

Liquidity and financial risks need special consideration, such as the ability of a PSP to fund not only their position, but also to have sufficient capital reserves to address mistakes if compensation is required for consumers or businesses.

Each Payment System may have different liability models depending on risk mitigation at either a system and or product level. NAB encourages this to be considered, particularly for risks associated with issuance of payment instruments and payment initiation services.

Section 5: Overview of possible regulatory obligations

19. Is the proposed risk-based approach to applying regulatory obligations appropriate?

20. Should payment functions that are not customer facing be required to hold a payments licence? Should providers of these non-customer facing payment functions have different regulatory obligations, such as only having to comply with relevant industry standards?

21. Should the common access requirements and industry standards be linked to the payments licence? For example, would it be appropriate for some entities to only be required to comply with mandatory industry standards but not be required to hold an AFSL or comply with the ePayments code?

22. What types of businesses should be subject to the common access requirements? There is limited information available on the number and size of non-bank PSPs interested in directly participating in Australian payment systems to clear and settle payments. If this is something that your business is interested in, please provide further information (including via a confidential submission).

23. Further information is sought to help identify the number and profile of participants that perform each payment function and therefore may potentially be affected by the new licensing framework.

24. How can the payments licensing processes across regulators be further streamlined?

25. Is the proposal to provide central guidance and a website portal for PSP licensing processes a good alternative to the single point of contact proposal recommended by the Payments System Review?

NAB supports a risk-based approach to applying regulatory obligations. Obligations should acknowledge the highly automated nature of the processes necessary for the efficient operation of payment systems, and the role of the payment network operators and their regimes.

NAB believes that PSPs should hold a license regardless of whether the function they perform is customer facing or non-customer facing. Whilst a function may not be customer facing (such as the provision of payment switching services) the entity can still have the potential to disrupt payments for both businesses and consumers resulting in the potential loss of revenue and the inability to acquire goods and services.

The application for and maintenance of an AFSL may not be needed to address the risk presented by some functions and may be more logically addressed through other mechanisms such as standards. To that end, licensing should be scalable and proportionate to the size of entities and the risk they present.

The ability for Regulators and Authorised Standards Setting Bodies to set and enforce common access requirements and industry standards should be recognised in the Payments Licensing framework. Common access requirements and compliance with payments industry standards should be linked to, and indeed be, an obligation of the payments licence.

NAB notes the Government's Strategic Payments Plan proposes further consultation on introducing common access requirements and mandating the ePayments Code in 2025-26. NAB

encourages consideration of these items as a matter of priority following the planned introduction of legislation for the new licensing framework in 2024 to ensure clarity for participants and new entrants to the payments ecosystem.

If a licensing regime is established within the Corporations Act, legislation should clarify that payments receivables are no longer regulated under the Australian Consumer Law to avoid layering and repetition of regulation. NAB encourages consideration of reducing duplicate, conflicting or ineffective regulation that adds significant cost and administrative burden to regulated entities.

NAB supports the proposal to provide central guidance and a website portal for PSP licensing processes, and the streamlining of processes across regulators. As outlined in NAB's February 2023 response to the Government's draft Strategic Plan for the Payments System, collaboration between payment system regulators is increasingly important. While NAB has noted the intent to improve the coordination of the various regulators who oversee the payments system, further cooperation is required to give greater certainty and clarity to industry participants.

Conclusion

Thank you for the opportunity to provide comments on the Consultation Paper. NAB looks forward to participating in further consultation on this topic in the future. NAB is more than happy to discuss any aspect of this submission with Treasury.