

## Evolution of payments systems

This is one of those “futurist” articles – the kind that predicts the end of payment services/banking/life as we know it within 10 years. The problem with most such articles is they assume that because something becomes technologically possible, it will probably happen. You might say it is a very human trait to be distracted from what is important by what is novel. Instead of exploring the “wow” factor of new technology, this article attempts to preview the (somewhat less glamorous) business drivers of future payment services.

Technology is an enabler, but not a driver.

Over 10 years ago, I secured a “hardship posting” to Paris for 6 months. I applied for a French bank account, and was given a chip card for use in the ATMs on every street corner. I could also use it, with PIN, in any restaurant (when in Paris,...). At the end of the meal, Monsieur would arrive at the table with a cordless chip terminal. The card never left my sight, and I could enter the PIN without getting up. “What clever people!” I remember thinking.

The above describes a level of payment technology not yet generally available in Australia or, for that matter, in the home of payment cards, the United States. Clearly, technological capability is not a particularly good predictor of future evolution.

In the Parisian example, the French payments system had three distinctive features that led to its adoption of chip technology significantly earlier than many others: relatively high fraud losses, relatively high telecommunications costs (leading to electronic card payment solutions that did not rely on online verification) and a relatively centralised, growth-oriented, national card infrastructure. None of this had much to do with technological capability. Necessity is the mother of invention, not the other way around.

So, having leapt 10 years back in time, let us now leap 10 years forward. What will the Australian payments landscape look like? Chip cards are a safe bet, even though we still enjoy an enviably low level of fraud losses. But what other industry changes might we see?

Competition,  
globalisation,  
convergence... what  
will the Australian  
payments landscape  
look like in 10 years?

One thing to watch is global competition amongst commercialised payment schemes. There is a tendency to think of Visa and MasterCard as big, comfortable, bank-controlled utilities, because of their mutual history. But the schemes are increasingly aggressive commercial entities in a rapidly changing global market; the “bank utility” view is already outdated.

Over the coming decade, the schemes will face new competition from a number of directions. For example, China UnionPay is already the world’s second-largest issuer of branded cards. Granted, it is an intensely domestic brand today, but already showing signs of expansion and centered in the world economy’s growth engine for the next decade. There are others with the potential to develop as global competitors: American Express is changing its business model to broaden its appeal, and the European national debit card schemes may yet produce a transnational alternative to Visa and MasterCard.

Let us assume, then, a more intense, complex and commercial global market for payment scheme services. Australian financial institutions will want to keep their scheme options open, even as commercialised card schemes try to build customer loyalty ahead of emerging competition.

This competition will only intensify with payment type convergence. Today, we treat cards as a separate market from other electronic payments – although there are already areas of direct competition between card payments and other electronic payment methods, such as retail bill payment. A card is just an identifying/authenticating device: in the future the form factor could be your PDA or phone, even parts of your anatomy. What keeps card business conceptually separate from other electronic payments is not technology, but real-time payment assurance: card schemes are built around providing a merchant with a high degree of certainty that payment will be received from a consumer he has no knowledge of. Giving merchants such assurance provides the basis for ubiquity and convenience and the card schemes have done a fine job of delivering both global ubiquity and great convenience in the last 10 years or so.

At one time, no other retail payment methodology (apart from cash) could match the real-time payment assurance of card payments. But that time is, of course, already past. Internet-based account and stored-value systems – PayPal and its competitors – are already as familiar to Generation Y as bank accounts and a great deal more familiar than cheques. Equally importantly, these new payment providers are as brand-savvy as the card schemes.

To cater to this young demographic, the next generation of electronic low value payment mechanisms will all feature near real-time payment assurance. An industry-wide example is the Faster payments system being developed in the UK, but there are other context-specific offerings.

So the implication is: watch out for convergence of card business with electronic payments business. As markets converge, so will products, networks and back office systems.

There are some very interesting implications of this converging, global competition in the areas of operating standards and regulation.

Historically, card schemes and national payment systems have tended to set their own standards. But in a globally competitive market, something has to give: competition on price and service is one thing, but competing operating standards impose large costs on industry participants; and as the number of competitors increases, the costs become prohibitive. So, there will be a strong push towards integrated, global standards as the basis for payment system competition. We are already seeing this in the UNIFI standards<sup>1</sup> and in the card scheme efforts to develop cross-scheme standards (PCI). The implication for a mature domestic system like Australia is that we need to stay in touch with global standards development: it could have major business implications. Participants need to be able not only to anticipate global standards and their impact on back office systems, but also to contribute to standards evolution.

In the same vein, card schemes and national payment systems have historically acted as self-regulatory bodies – setting policy, making rules, enforcing compliance. If there is direct, intense competition amongst commercial payment service providers, can

they continue to do this? Regulators have in recent years recognised the economic importance of payment systems of all kinds, and taken a correspondingly greater interest in their regulatory frameworks. As schemes commercialise and compete, regulators will scrutinise their behaviour for adherence to good industry policy. When something similar happened to the world's stock exchanges, the general trend was to reduce the self-regulatory powers of commercialised exchanges. The obvious risk is an accumulation of new, intrusive public regulation.

The implication seems to be that industry self-regulatory structures need attention. Australian payments organisations need to devote some attention to self-regulation if they want to continue to enjoy the commercial freedom they have enjoyed in the past, while at the same time ensuring regulatory certainty and system stability to the satisfaction of the public regulators.

The rest of this “Views” section explores these ideas, and some others, in a little more detail.

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The ideas and opinions expressed in this article are those of the author and not necessarily those of APCA or any APCA member. This article has been included in APCA's 2007 Annual Review for the purpose of promoting industry discussion on topical issues.

1. For a discussion of standards, see article “The international standards revolution”.