



Payment Systems Review Conference

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Lunchtime Address

*By Chris Hamilton, CEO,
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Governor Stephens, Professor Harper, Ladies and Gentlemen,

I am grateful for the opportunity to address such a distinguished audience of payment system luminaries. As an industry policy “lifer”, I view a senior industry audience the way an actor views a stage: one never passes up the opportunity to deliver a soliloquy.

My natural inclination is to expound at length on payment system policy: but after nearly 4 hours of it, with more to come, I recognise some obligation to give you a break over lunch!

I therefore propose to look past today’s immediate debates, and talk more generally about the overall process we are engaged in. I want to promote a conversation about solving tomorrow’s problems, rather than just trying to solve today’s - or even worse, yesterday’s. Ladies and Gentlemen, I want to make some observations about improving Australian payments industry governance. In doing so, let me make absolutely clear that I speak only for myself: my views have not been endorsed by any of APCA’s members.

We tend to think of the current debate as an exercise in regulatory reform: what kind of competition policy framework do we need in order to deliver a sound, efficient and competitive payment system? I want to suggest that the proper area for debate is “industry governance”, which covers rather more than regulation. It amounts to how a given industry is organised for long-term health and growth while continuously satisfying government and community expectations. The point is, regulation cannot be reformed independently of industry governance.

The word “governance” has acquired a lamentable taint, courtesy of the global debate on “corporate” governance. As any stock market investor knows, the “corporate governance” page in a company’s annual report can be reliably dismissed as the most boring page in the book; and yet, when companies collapse amid allegations of unethical conduct, commentators and regulators are quick to diagnose a failure of corporate governance. It’s curious really: there are not many activities that appear simultaneously boring AND suspicious.

Industry governance is very different, or at least I hope it is. Regulation is only one important manifestation of governance. There is also the formulation and articulation of underlying industry objectives (both public policy goals of government, and industry policy goals of participants), processes for industry planning and development and a wide range of implementation actions: network administration, technical standards, operational procedures, industry communications, public education, network operation, compliance, and so on.

As we engage in today's debates, we take for granted a large and complex separate body of industry governance, through APCA, the card schemes and others. We more or less assume static existence of these industry structures as a backdrop. Yet this body is constantly evolving: as merely one example, chip card implementation has made, and will continue to make, significant changes to industry governance structures in almost every area, including today's subjects of interchange fees, merchant restrictions and access criteria.

I want to question the wisdom of a segregated approach. To state the obvious, our industry is a continuously evolving network, with complex interconnections. We simply cannot assume a static environment and industry structure into which to insert targeted competition policy reforms. A much more holistic, evolutionary approach is needed.

To explore this, I am afraid I am going to need a sporting analogy, much as I generally dislike them. So bear with me while I talk about...netball. I assume you have all seen it played: like basketball, but with more players and a lot of extra rules to promote team cooperation. This provides a context to talk about the interplay of industry rules and competition, but there are some other good reasons to mention netball. For one thing, Australia has just become world champion, again, with New Zealand the runner up – again. For another, netball is the highest participation sport in Australia, with more than a million players. Netball is our sport.

I am not particularly a netball fan, although anything that keeps my daughter happy and running around outdoors is fine with me. But it is hard not to be impressed by those massive fields of netball courts in full swing on a Saturday, sometimes 20 or 30 games going on at once, game after game, a profusion of colour and movement punctuated by periodic blasts of the quarter-time siren. Well over a thousand young ladies and increasingly, young gentlemen, might take their exercise each Saturday at any one location. And this is happening across the country.

All those players and teams are focused on competing. They don't spend a lot of time thinking about who sets the rulebook, who administers the disciplinary system, how the divisions are organized, who runs the programme and supplies the referees, who promotes and develops the sport; The teams just want to play.

But even the most one-eyed fan would have to concede the necessity of a substantial support hierarchy beyond their beloved team. Clubs, leagues, state associations and national associations all play a role. This, ladies and gentlemen, is netball governance: the total framework within which the game is played, with some of the most important work taking place off the court. A good framework will see entertaining games featuring skilled and innovative teams, a happy and growing band of players and spectators and hopefully over the long term, a prosperous and growing sport. A bad framework could

see a sport in decline – and no more world titles. Clearly, Netball Australia is doing something right!

If I can stretch my analogy a little further, the complex and serious business of netball governance is achieved collectively by players, or ex-players and their families: those that know and often quite literally have skin in the game work together to help it prosper. And so it is with payment systems: historically, the great majority of system governance has been and still is done by the players, through associations like APCA and, historically, the card schemes.

Payment systems, however, are in no sense a game. They are vital to a well-functioning economy. That is all the more reason to think about the design of industry governance. Our industry features millions of games played amongst dozens of clubs, some fielding just one team, some fielding thousands, every single day. There are multiple divisions, a complex rule book and teams constantly looking to innovate and find a competitive edge – and we wouldn't have it any other way.

For a host of reasons that are still, as we have seen, hotly debated, the central bank has intervened in specific, but important, aspects of the governance framework in order to achieve particular public policy goals. My immediate concern is not whether the reforms were necessary. Nor is it how that intervention came about: rather my concern is the implications of recent history for the long-term evolution of the industry.

To illustrate, I am afraid I am going to tell you a very little about the rules of netball. Netball has a “one step” rule: in simple terms, when you catch the ball you have to stop and pass before you can take another step. Quaintly, I believe this derives from Victorian ladies wishing to play basketball in long skirts, bustles and button-up shoes. This is hard to imagine, with the speed and athleticism of the best players today. In the modern game, the step rule has been criticized as leading to player injury: the sudden stopping turns ankles, twists knees and causes other joint damage. I have heard it argued that netball, not rugby, is responsible for Australia's global leadership in knee reconstruction techniques.

Now imagine, if you will, a netball governance crisis. Please note I am making this part up: I am sure nothing like this would ever happen to the real Netball Australia, by all accounts a highly professional organisation. The sport's imaginary administrators are under pressure to fix the step rule and reduce the injury rate. Their inclination is to resist, regarding the rule as integral to the grand traditions of “their” sport. They argue amongst themselves, but cannot distil a consensus to act.

An imaginary Minister for Sport, perhaps faced with electoral defeat and casting around for vote-winning issues, fixes on a plan to win the support of all netball players: eliminate

injury from the sport. He (note the gender) tries consulting with the netball administrators, but gets nowhere – they resent the interference. With the election bearing down on him, The Minister enacts legislation requiring that the umpires must allow two extra steps after catching the ball. Very noble, you might say: a targeted intervention based in sound public policy. The press is very positive.

The clubs are not so sure. Initially, there is confusion and dispute: what does the legislation mean? Who interprets it and explains it to thousands of referees, given the netball administrators dislike the whole idea? The other rules, built on an assumption that there is a step rule, now don't make sense, and have to be overhauled by these same disgruntled administrators. They reluctantly comply, but seek to minimize impact on the way the game is played by requiring senior players to take 2 tiny little steps after catching the ball, with a complex table of increasing step-lengths for different divisions. Teams react by changing tactics to focus on speed, and the faster game leads to more player contact and, ironically, new injuries. The injury rate does not perceptibly decline. Finally, other countries don't have this rule: the Australians have to play differently away from home. At the next world championship, the New Zealanders take the Australians to the cleaners. Back home, the netball administrators take the Minister to court.

A silly example, perhaps, and I am sure there will be a range of views about the validity of the analogy with payment systems regulation. I certainly mean no specific criticism of anyone involved in payment systems – or netball for that matter! But regardless of whose side you are on in my imaginary netball crisis, some very unfortunate results arose from a lot of people acting with the best of intentions.

So, to recap the message so far: we need to focus on the industry governance process itself, and think beyond specific regulatory reforms to encompass the long-term health and evolution of the industry. We need to look beyond today's problems, and establish a framework to solve tomorrow's.

There is, in fact, a well-tried method for undertaking this holistic and evolutionary governance exercise. It is used in every market economy, and has provided the backdrop for breathtaking industry success stories, such as the growth of the world's financial markets in the last 20 years. It has also had some notable failures, which serve as cautionary tales for the future. I refer, of course, to industry self-governance.

It is my conviction that industry self-governance, that is, governance with the whole-hearted engagement of participants, is critical for the long-term success of the payments industry. Self-governance allocates governance responsibilities and costs to those with the resources, the expertise, and the incentives, to carry them out over the long term, and as the environment changes.

On the other hand, it has its particular challenges: of regulatory capture, credibility and promotion of healthy competition. The need to provide assurance and oversight that these risks are managed leads to a co-regulatory partnership: industry and government each have a role. The hard bit for government usually lies in accepting that in a partnership, one side does not get to call all the shots; the hard bit for industry usually lies in accepting the need to invest senior time and expertise in industry governance, when they could be maximising returns from competitive activity.

This line of thought lead APCA and its sister organisations in the United Kingdom, Europe, Canada, Ireland and South Africa to do some work together recently. The results are contained in “Principles of Payment Industry Self-Governance” published a few days ago. The Principles were developed by the “International Council of Payment Association Chief Executives” affectionately, if unfortunately, known as “ICPACE”. Copies of the Principles can be found on APCA’s website. It turns out that ICPACE is a pretty good group for this work: we are veterans of self-governance in a range of financial services disciplines, and our jobs necessarily involve working extensively *with* Government in its many forms, as we work *for* industries. We have learned a lot from each other.

I won’t take you through the detail of the Principles today, but let me cover the highlights. Effective payments industry self-governance will exhibit 5 key characteristics:

- **Certainty**, or if you like clarity and consistency, not just at the level of rules and processes, but at the level of underlying policies and objectives;
- **Legitimacy**, revolving around the engagement of all stakeholders, public and private, and the industry’s ability to make good governance “stick”;
- **Transparency**, summarising a broad commitment to due process and accountability;
- **Flexibility**, harnessing one of the great strengths of self-governance: regulation that is responsive to rapidly changing market conditions; and
- **Efficiency**, focusing on imposing the minimum restriction and cost on industry activity consistent with widely supported industry and public objectives.

The Principles contain a deal of underlying analysis, including some overseas comparisons. But they are not a recipe for success; more a set of analysis tools. There is

no one “right” way to do payment system self-governance, given the enormous variations in history, culture and market dynamics around the world.

Perhaps the most recent experiment derives from the United Kingdom, where a newly formed Payments Council, comprising both industry participants and independents, has in

the last few days published a consultative document for a proposed National Payments Plan to, and I quote, “work with all those involved in payments to drive payments forward”. You cannot get much more holistic and evolutionary than that.

A much longer-standing, and quite different, example of self-governance derives from the Canadian Payments Association, formed under legislation and with delegated legislative powers. The Association’s Board is chaired by the central bank, composed of industry participants, and assisted by a legislated Stakeholder Advisory Council comprising industry users and service providers.

I hope the Principles can be used to develop a broader debate about Australian payments industry governance. I do not mean to suggest that today’s conference is not valuable – unquestionably it is. But our current process raises a question in my mind, relating back to the certainty and legitimacy principles mentioned above. The question is this: who really owns the governance framework? RBA rightly asserts responsibility for public policy objectives in the payment system, together with an oversight and if necessary, enforcement responsibility. But is it, to borrow the British phrase, “driving payments forward”? The Wallis Committee in 1997 got rather close to suggesting this for the proposed Payment Systems Board. But the PSB itself has, if I may say with due respect, sensibly recognised the great difficulty in a government regulator taking up such a role. In a 2006 speech, Dr Lowe said:

We have a strong view that the issues of architecture and governance are best dealt with by industry, rather than through regulation. After all, it is industry that, at least in the first instance, must pay for any investment in the system, and it is industry that must operate the system.

Dr Lowe had made similar observations about technological evolution. I certainly acknowledge the wisdom of this, but perhaps differ on the extent to which the more controversial elements of competition policy are severable.

The ICPACE Principles provide the starting point for a different kind of co-regulatory partnership between payments industry, and payments regulator. The industry must assume responsibility for its own governance, and do so within a framework of long-term commitment to industry health and growth. This is the best way to provide certainty, flexibility and efficiency. However, it also needs to validate governance actions against public policy goals clearly enunciated by the regulator, thereby achieving transparency

and legitimacy. In simple terms, the regulator’s job is to ask the hard policy questions; but the industry must both provide, and own, the answers.

So, how could our imaginary netball governance crisis have been resolved? Well no doubt, great value could be had from a series of empirical studies of injury occurrence patterns and injury costs and some contributions from the sports medicine academic fraternity. But as well as high-quality inputs, they needed a quality process: a platform for engagement that commits stakeholders to the long-term solution. The answer must be built into the overall framework and culture of the industry; it must be forward-looking and flexible.

This requires our Minister for Sport to recognize that the intervention, however necessary from his perspective, creates a new challenge to long-term governance: it raises uncertainty about who really is responsible for minimising injury. Equally, the netball administrators need to invest in reaching a result that credibly takes account of the public concerns about player injury, and can also distil a clear way forward from the wide range of interests and views across the sport – and if you’ve ever been to a suburban netball game, you will know that passions run high. A payments conference is tame by comparison.

An industry committee within APCA has been exploring possible options for Australian Payments, but what we need now is the input of others. APCA’s submission to the RBA review proposed the involvement of all stakeholders in the joint design and implementation of a new self-governance process. If any group can make this happen, ladies and gentlemen, this audience can. I believe there are solid indicators that the time is right. Let me mention some governance developments outside the controversial area of today’s conference:

- Following some joint work by the 4 largest banks, and an ABA council decision, an APCA committee is developing a business development scheme proposal for the domestic EFTPOS system, responding to RBA commentary on EFTPOS governance. This has significant implications for proposals on card reform, because it provides an important step towards promoting competition in the card services market;
- The industry has also (eventually) responded constructively to RBA’s public policy concerns in the ATM network, with ABA sponsoring a reference to APCA to implement a governance solution hammered about between all the main players. APCA is on track to meet that challenge and provide a fully self-regulatory solution designed by and for industry participants in response to RBA policy concerns.
- The industry has been working cooperatively on ensuring the smooth and consumer-friendly implementation of chip cards, a topic that last year attracted Parliamentary Standing Committee attention. A steering group comprising financial institutions, merchants and card schemes is now developing industry-wide coordination plans for chip rollout.

- APCA has recently conducted a public consultation process to respond to Commonwealth Treasury concerns about barriers to account switching in Australia. I hope we will see results early next year;
- In low value payments, the industry is working towards a response to governance, access and innovation questions raised by RBA, again through an APCA committee. We hope to present a suggested roadmap for industry debate in the first half of 2008.

Ladies and gentlemen, this programme of work suggests a significant and growing level of commitment to industry self-governance, and the basis for a better way forward.

I have spent my working life in complex financial services network industries, as have my colleagues in ICPACE. We are acutely aware of the great strengths, and at the same time the frustrations, of industry self-governance. Sir Winston Churchill famously observed that

“No one pretends that democracy is perfect or all-wise. Indeed, it has been said that democracy is the worst form of government, except all those other forms that have been tried from time to time.”

And so it is with participative governance generally, be it payments industry self-governance, or even, dare I say it, netball administration.

Thankyou.