26 July 2023

Director
Payments Licensing Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via email: paymentslicensingconsultation@treasury.gov.au

Dear Director,

Consultation Paper – Payments System Modernisation (Licensing: Defining Payment Functions), June 2023

Coles Group Limited (**Coles**) welcomes the opportunity to respond to the *Payments System Modernisation (Licensing: Defining Payment Functions)* consultation paper dated June 2023 (the **Paper**).

Coles is a national food and drinks retailer which also provides financial services to our customers. We serve approximately 20 million customers each week through our store network and online platform. Relevantly, Coles operates as an acquirer with our own payments switch to process customer card transactions, including for a number of non-Coles retailers. We hold direct scheme memberships with eftpos, Mastercard and Visa, but rely on a third-party bank to access the Reserve Bank of Australia settlement accounts as part of our acquiring service. Coles also issues various gift facilities.

We have sought to provide our comments on the Paper given Coles' role as an acquirer and major retailer. In each of these roles we are a regular participant in industry groups and forums, such as the Australian Payments Network and the Australian Retailers Association, while also being a shareholder in Australian Payments Plus.

Coles believes that, as the Australian payments ecosystem continues to evolve, Treasury plays a critical role in ensuring a robust, efficient and competitively balanced payments industry. We believe this Paper and the intent within goes some way to achieving this. We do however have feedback in certain areas, which we outline below.

Introducing a tiered regulatory regime

Coles supports the proposal to introduce graduated regulatory obligations that reflect the fact that risks differ across types of payment functions and levels of engagement with consumers. It is our view that the factors which distinguish the risk levels across types of payment functions and products should inform the tiers of regulation that apply to 'stored value facilities' (**SVFs**) and 'payment facilitation services' (**PFSs**).

While Coles appreciates that the proposal in the Paper is still in its preliminary stages, we suggest the following principles to assist Treasury in reflecting these distinctions in any reforms:

- (**Number of tiers**) The Paper proposes two tiers of regulation relating to providers of SVFs ('major SVFs' and 'standard SVFs') and a single licensing tier for PPFs. More tiers should be introduced in both cases to avoid disproportionate compliance outcomes for certain participants. For example, 'payment authentication' and certain 'processing' PFSs do not present the same misconduct or financial risks as 'issuers of payment instruments' or providers of 'clearing or settlement services' on account of them not being consumer-

facing and not holding funds in designated consumer accounts; they should not be regulated in the same way.

- (**Criteria for tiers**) The licencing tiers for payment functions should reflect the changing financial, operational and misconduct risks that accompany the different types of payment function.

  It follows that the highest tiers of regulation should be reserved for systemically important SVF and PFS providers. Transaction volume and value will be relevant to this assessment but should not be the only factor, as it overlooks the fact that certain arrangements or user cohorts might present lower financial risks. For example, SVF and PFS providers that have a purely B2B offering or do not hold funds in designated financial accounts would warrant more moderate regulatory obligations and different threshold criteria given their lower risk profile. Similarly, PFS providers that only pose operational risks (eg, an outage that affects downstream users) should have the fewest regulatory obligations. These participants should not be caught by regimes that have a solvency or consumer protection focus. Instead, they should only be required to comply with technical standards and, to the extent applicable to non-consumer facing operations, the relevant aspects of the revised ePayments Code. However, Coles' view is that the standards should be maintained separately from the Code for ease of revision as technical innovations improve.

  Additional criteria to distinguish the various tiers of SVF providers should draw on functional features that contribute to the overall risk profile of the SVF, such as the ability to reload or cash-out stored value. However, the amount of time that an SVF stores value – such as the two business day period suggested in footnote 10 of the Paper – appears to be an arbitrary distinction that could result in a provider of a SVF incurring a disproportionate compliance burden because of how it chooses to manage its financial risk. For example, a merchant acquirer might choose to store money for a longer period due to its particular settlement arrangements, or because it has secured a bank guarantee, holds certain funds in trust or processes payments for a merchant that carries a high chargeback risk. Coles suggests that it would be relevant to consider the format in which the funds are stored, and associated risks such as user sophistication, in replacement of any timeline for holding value.

- (**Progressively 'switched off' obligations**) Coles agrees with the acknowledgment in the Paper that many of the existing requirements in the financial services legislation should not apply to providers of payment functions. In particular, we note that a number of the obligations with a consumer protection focus are inappropriate for SVF and PFS providers that contract with businesses rather than consumers. For example:
  - it is not necessary for these participants to have a dispute resolution system or compensation arrangements that comply with the requirements of ss 912(1)(g) and (2) of the Corporations Act;
  - there is limited utility in requiring these participants to meet all of the disclosure obligations in Parts 7.7 and 7.9 of the Corporations Act (eg, to provide a financial services guide and product disclosure statement); and
  - these participants should not be required to meet the design and distribution obligations (**DDO Regime**) in Part 7.8A of the Corporations Act. The DDO Regime addresses a particular set of misconduct risks, aiming to ensure that financial products are targeted and sold to the right customers. These misconduct risks do not apply to providers of PVFs (eg, providers of processing, facilitation, authorisation, clearing and settlement services), who are not typically consumer-facing, and instead would be better directed at providers of retail-facing SVF facilities and payment instruments (eg, issuers of cards, digital wallets that hold value and buy-now-pay-later products), including where such facilities are white labelled by another party.

We also add that it might be necessary to refine the concepts of 'dealing' and 'arranging' in relation to a financial product under the current regime to avoid inadvertently capturing inappropriate participants in the various types of payment transactions, such as merchants. Otherwise, these parties might need to hold their own licence or be an authorised representative, which would be a counterintuitive outcome.

Transitioning to a dedicated payments regulator and new licencing regime

The Paper proposes that, under the new licensing regime, major SVF providers would be jointly regulated by the Australian Securities and Investments Commission (**ASIC**) and the Australian Prudential Regulatory Authority (**APRA**).

Coles has a strong preference for consolidated guidance, points of contact and a streamlined application process. While these objectives could be achieved if ASIC and APRA have clearly defined, mutually exclusive mandates, introducing a dedicated payments regulator might be a simpler path to the same outcome (and we note this is the approach in both Singapore and Hong Kong). Equally, it may be simpler to introduce a separate licencing regime rather than retrofitting the payments tiers into the current AFSL regime. Coles would support both these changes.

Clarifying the distinction between open-loop and closed-loop in relation to gift facilities

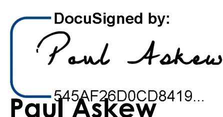
Finally, Coles agrees with the proposal in the Paper that the existing exclusions and exemptions in the Corporations Act and Corporations Regulations be retained and/or enshrined in statute. This would provide sought-after comfort and stability to industry participants that rely on the various exceptions, due to the comparative ease with which class orders can be repealed or remade. However, as the issuer of various gift facilities, including gift facilities that can be used at a number of different retailers, Coles wishes to clarify that:

- the distinction between open-loop and closed-loop arrangements does not operate in the manner suggested by footnote 32 of the Paper in practice, nor is it the language of the current regulations relating to such facilities; and
- Coles is strongly of the view that the current formulation of the conditional relief is a more appropriate approach than pursuing enshrined definitions of open and closed loop facilities.

Conclusion

Coles welcomes further engagement with Treasury as you continue industry consultation around future payment licencing requirements. Should you have any queries on our response, we would welcome a meeting to discuss.

Yours sincerely,



Paul Askew
General Manager, Financial Services