BUDDLE FINDLAY

The potential for payments innovation in New Zealand

Simon Jensen, Renee Stiles

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Once a frontrunner in the efficiency of its payment systems, New Zealand ('NZ') could be seen to have fallen behind other jurisdictions when it comes to innovation in the sector. However as Simon Jensen and Renee Stiles of Buddle Findlay discuss, there are a number of interesting developments in NZ that could see New Zealand's payments sector transformed, provided stakeholders work together. In this article, Simon and Renee discuss the specific projects taking place and their potential.

In the 1980s and 90s NZ was a world leader in terms of efficiency in payment systems, in particular with the recognised success of the now demised Databank, its replacement Interchange and Settlement Limited and the establishment of Paymark to run NZ's EFTPOS system. It is fair to say that NZ is probably no longer world leading, despite New Zealanders being recognised as technology savvy and early adopters, which makes the country a good test market. This is largely due to the advances seen in regulation and innovation in some parts of the world particularly in consumer to business payments, where innovation led by the nonbanking sector has been prolific, but the payment applications produced have yet to hit NZ. The following are some of the developments in the NZ payments industry that we believe have the potential to drive innovation in payments solutions if the industry is able to work together collaboratively and proactively.

Mobile payments

Mobile payments ('m-payments') and wallets are hardly unique, with the card schemes and multiple technology and entrepreneurial companies having products in the market. Further, rather than providing a new or innovative payment solution, most mobile offerings are in fact merely a new mechanism for the presentation of existing credit and debit products. However, this is not to say that they haven't captured the consumer's attention. NZ's contributions to mpayments come on two fronts:

Semble

The Semble mobile wallet is unique in that it is being brought to market by the collaboration of all of NZ's mobile network providers (2degrees, Spark and Vodafone) and NZ's largest electronic payments switch, Paymark, which is owned in turn by NZ's four largest banks (ANZ, ASB, BNZ and Westpac). Although it should be noted that as at the date of this article only ASB and BNZ are offering products through the Semble mobile wallet to their customers, with the others choosing to explore other options, or waiting to commit. Intended to go live early in 2015, the Semble mobile wallet is currently undertaking a pilot stage involving the use of bank cards, loyalty cards and transport cards using NFC technology-enabled Android smartphones and storing card data on a secure element in the SIM.

HCE

A number of large NZ banks are undertaking trials of m-payments using host card emulation ('HCE'), which transmits card data through NFC technology by emulating the card; these banks are planning launch dates in early 2015. Where NZ has led the way is in the development of Mobile Device Rules and Standards by Payments New Zealand (NZ's independent organisation with a mandate to preserve the integrity of NZ's systems by imposing standards and rules on participants who wish to access those systems) that govern m-payment systems to ensure the efficiency, integrity and security of m-payments and NZ's domestic payments systems.

Cryptocurrencies

As a geographically isolated country, cryptocurrencies with their ability to provide low cost and timely international transactions have obvious appeal to certain segments of the NZ population. However, the legal and regulatory landscape that applies to cryptocurrencies in NZ could be described as unclear. This is caused by the difficulty in succinctly categorising cryptocurrencies in a legal sense. The options are many: a currency, like cash; a commodity, like gold or diamonds; a security, like a bank account; or a payment system, like SWIFT. NZ regulators are divided, with the Inland Revenue Department treating cryptocurrencies as a foreign currency in some instances and as a commodity in others, the Reserve Bank stating that Bitcoin is not a currency, the Department of Internal Affairs and the Reserve Bank indicating that anti-money laundering legislation will apply to cryptocurrencies, and finally the Financial Markets Authority remaining silent to date.

In our view cryptocurrencies and their underlying technologies (eg. the blockchain) have characteristics of all of the above options.

However, the issue remains that current legislation was specifically drafted to deal with then current forms of funds, payment instruments and payment constructs and will require adaption in order to regulate cryptocurrencies. Further, it is unlikely that traditional ways of regulating will achieve the desired outcomes where there is no issuer of a cryptocurrency and no central authority governing authenticity and therefore no one to regulate. Ultimately regulators may have to just trust in the protocol.

This issue, it is worth noting, is not limited to NZ as regulators internationally also seem to be struggling with how to regulate cryptocurrencies.

Payment system regulation

While up to NZD $35 billion per day passes through NZ's payment systems, to date regulatory intervention has had a very light touch. A payment system is defined in the Reserve Bank of New Zealand Act 1989 as 'a system or arrangement for clearing and settling payment obligations or processing payment instructions.' However, the Reserve Bank's powers in relation to payment systems are limited. It can currently only request information or data relating to a payment system.

Following various rounds of consultation it is likely that the Reserve Bank will be seeking expanded powers in relation to payment systems in the near future; however, this will likely be limited to those that are systemically important or of system-wide importance. This regulatory reform will be a material change for the Reserve Bank's role across the domestic payment system as it shifts from an interested observer to a stakeholder with prescriptive requirements. While this may be seen as a dramatic shift, it will simply bring the overall NZ payments egulation and governance model n line with the rest of the world. No longer will the Reserve Bank need to rely on moral suasion to drive its payment reform agenda; instead it will have the ability to instruct on matters such as the design and operation of systems, interconnectivity with other payment systems, the ability to approve new or instruct existing operators and enact policy and regulation.

However, even the proposed amendments to payments oversight are at a high level. Based on international precedent, NZ may need to look to a more prescriptive approach, particularly targeted at non-bank payment service providers.

Payment system replacement

In 2014 the Reserve Bank undertook a strategic review of the payment and settlement systems it operates. As a result of this review the Reserve Bank has indicated its intention to replace its current gross settlement system (Exchange Settlement Account System or 'ESAS') and its security settlement system and central securities depository ('NZClear') in order to ensure that these payment and settlement systems are modern, modular, standardised and meet the current and future needs of both the Reserve Bank and the NZ economy.

The project is still in its infancy, however, and the payments industry is watching closely to see if the Reserve Bank is merely undertaking a technology refit project in order to replace aging infrastructure or if a more innovative approach will be taken. If an innovative approach is taken, of interest will be the degree to which the Reserve Bank seeks to align NZ's domestic payment systems with Australia's New Payments Platform (which will provide data-rich real time interchange). Such alignment could eventually diminish the reliance on international value transfer systems such as PayPal and card schemes to move money back and forth across the Tasman.

The Pacific Islands

Many Pacific Islands currently lack modern, inclusive and digital payment systems, a constraint that hampers and will continue to hamper their ability to achieve economic and social aspirations. Electronic settlements, internet banking and mobile technology, which have revolutionised the way mobile banking is undertaken both by business and consumers, are exacerbating the gap between customer expectations and the reality of banking in many parts of the Pacific.

The Pacific Islands have strong ties with NZ, including strong tourism and trade ties, shared cultural history, diaspora in NZ and in some cases use of the NZ dollar, NZ citizenship and governance in free association with NZ. Further, many of the banks that operate in the Pacific have related entities in NZ. We believe the quickest and most efficient way for Pacific Islands, particularly those who use the NZ dollar, to modernise their payment systems is likely to be to leverage the NZ payment system. The integration process would require amendment or alignment of various payment rules, operational standards and legislative frameworks, in addition to the implementation of modern technology. In fact, NZ payment system technology has already been integral in modernising the payment system in one of the Pacific Islands, Niue, where a NZ bank has established offshore branch operations and a NZ electronic point of sale system has been used to implement EFTPOS with consequential reductions in cost on the island and an improved tourist experience.

This article was written by Simon Jensen and Renee Stiles the January 2015 edition of E-Finance & Payments Law & Policy, an international law journal providing analysis and guidance on rules and regulations in the payments sector.

Auckland

188 Quay Street
Auckland 1010

PO Box 1433
Auckland 1140
New Zealand

P: +64 9 358 2555
F: +64 9 358 2055

Wellington

Aon Centre
1 Willis Street
Wellington 6011

PO Box 2694
Wellington 6140
New Zealand

P: +64 4 499 4242
F: +64 4 499 4141

Christchurch

83 Victoria Street
Christchurch 8013

PO Box 322
Christchurch 8140
New Zealand

P: +64 3 379 1747
F: +64 3 379 5659