



NPP Australia Limited's
Supplementary Response to the Reserve Bank of Australia's
NPP Functionality and Access Consultation: Conclusions Paper

30 October 2019

Introduction

The RBA's [NPP Functionality and Access Consultation: Conclusions Paper](#) issued on 13 June 2019 outlined 13 recommendations in relation to NPP Functionality and Access. NPP Australia (NPPA) provided an initial response to these 13 recommendations on 30 July 2019 which can be downloaded [here](#).

This Supplementary Response outlines measures that address the recommendations in the Conclusions Paper regarding NPP participation eligibility, NPPA shareholding and governance (recommendation items #5 through to #8 and #10). It builds on, and should be read in conjunction with, NPPA's initial response.

The RBA's Conclusions Paper observed that NPPA was required by its Shareholders' Agreement to review access and subscription requirements for new joiners by November 2019. This review commenced as planned in May 2019. As part of that broader review, and in the context of our initial response to the Conclusions Paper, NPPA appraised the eligibility criteria for directly-connected NPP Participants, identifying opportunities to further liberalise access safely, and for improving the governance model.

NPPA has now finalised the review for all categories of direct participation and has approved a comprehensive suite of measures to liberalise NPP eligibility, subscription and access arrangements to meaningfully address the recommendations made in the Conclusions Paper. The particular measures are detailed further in this Supplementary Response, however in summary, they will result in:

- (a) permitting the admission of non-ADIs as **Settlement Participants** and *halving* the overall subscription requirement for Settlement Participants relative to Full Participants¹ or Clearing Participants (effective 1 November 2019);
- (b) a 75% reduction in the upfront subscription costs payable by new joiners, by end 2027; and
- (c) providing new joiners the option of subscribing for partly paid shares, thereby enabling payment for shares by instalments.

These measures, together with NPPA's *Mandatory Compliance Framework* described in detail in our initial response, supports our continued commitment to delivering fair, equitable and open NPP access and best practice governance outcomes in line with regulatory policy objectives.

If further regulatory developments occur (for example, the creation of a supervised regulatory framework for non-ADI specialist Payment System Providers similar to that in the UK), then NPPA would consider additional amendments to its access framework (similar to when Restricted ADIs were incorporated into the NPP Access framework in March 2018).

¹ Defined as an NPP Participant which connects directly to the NPP platform for the purposes of sending and receiving NPP payments and Non-Value Messages and is authorised by the RBA to use the FSS for settlement of NPP payments.

Access to the NPP ADI Requirement

5. Direct access to the NPP should be open to a range of payments service providers. NPPA should assess and report on options for amending the NPP Regulations, and other arrangements, to allow for an entity that is not an ADI to potentially become an NPP Participant. The participation of non-ADIs would be subject to requirements appropriately tailored and calibrated to the key risk and operational considerations essential for participation in the NPP.

NPPA should:

- by end October 2019, submit to the Bank and the ACCC an assessment of options for revised participation requirements for non-ADI participants
- by end March 2020, implement any revised participation requirements for non-ADI participants.

As noted in our initial response, the access and governance arrangements for the NPP are deliberately and carefully structured to be as open and inclusive as possible. NPPA has established graduated, risk-based, eligibility criteria for directly connected Full Participants, Clearing Participants, Settlement Participants and Connected Institutions and minimal requirements for indirectly connected (sponsored) institutions, to cater to the needs of different organisations while ensuring the safety and security of the real-time payments system, payments data and customer accounts.

The admission of non-ADIs as Full Participants or Clearing Participants would constitute a fundamental change to the operating model for NPP established during the NPP program. The NPP rule framework has been developed on the basis that all directly connected Full and Clearing Participants are prudentially supervised. Any variation to this model would require wholesale revision of the NPP operating rules, participation requirements and risk-management controls and would also require substantial uplift in NPPA's administrative capabilities and compliance obligations, including significant regulatory obligations as a Reporting Entity for the purposes of the *AML/CTF Act*.

The RBA's Conclusions Paper challenged NPPA to consider whether the ADI eligibility requirement unnecessarily limits access, and if non-ADIs should be eligible to connect directly to the NPP under an appropriately tailored certification regime. Having carefully considered the relevant factors (set out below) our view remains that the ADI eligibility requirement for Full and Clearing Participants is prudent and appropriate given the pronounced operational and security risks associated with clearing activities. However, non-ADIs *could* safely participate as Settlement Participants and as a result of this conclusion, we have implemented substantive changes to the eligibility criteria for NPPA to enable this.

Rationale for the ADI Eligibility Requirement

The NPP facilitates near real-time credit transfers between deposit accounts held at different institutions. Institutions that offer deposit-taking and stored value facilities (other than low value facilities) require a banking licence, hence the threshold requirement to be an ADI to connect *directly* to the NPP.

We consider that the ADI eligibility criterion is necessary and appropriate for direct clearing/settling participants for the following key reasons:

- (a) ADIs are subject to ongoing oversight and are required to comply with prudential standards relating to organisational governance, capital adequacy, liquidity management, risk management, BCP and information security, that serve to support the existing NPP technical, operational and security framework. Failure to comply with prudential requirements risks regulatory intervention and potentially licence revocation. This externalised discipline relieves NPPA of the responsibility to oversee Participants in relation to those aspects of their business operations and reduces the counterparty risks to other participants.

- (b) ADIs are bound also by industry codes of practice and obligations to consumers, such as ePayments Code, Banking Code of Practice, Department of Human Services Code of Operation, that do not apply to non-ADIs. The NPP rules framework aligns to those standards and requirements.
- (c) Alternative regulatory or supervisory frameworks, including AFS licensing and ESA holding, are not proxies for prudential or payment service provider regulation, as the RBA itself notes in its Conclusions Paper. The RBA also notes that developing a new regulatory regime for non-ADI specialist payment providers – such as the stringent regulatory framework administered by the FCA and which applies to non-ADI payment service providers in the UK - would be logistically challenging in the short-to-medium term. For NPPA, retrofitting the NPP rules framework for non-ADI clearing/settlement Participants, introduces risks and administrative burdens that are avoidable, given the other options for non-ADI participation.
- (d) If a new supervised regulatory framework for non-ADI specialist Payment Service Providers emerges in the future, the NPP participation framework is flexible enough, or is able to be modified, to accommodate them (as it was for the newly created class of Restricted ADIs in March 2018).
- (e) In the absence of an effective regulatory framework for non-ADI payment service providers that could support direct participation, we consider that indirect participation in the NPP via one of the several NPP Participants who offers agency services is appropriate. The NPP is unique in terms of its participation base, with three NPP Participants whose business model is predicated entirely on offering wholesale indirect access, and at least two others currently offering agency services on a highly contestable, commercial basis, with this number expected to increase over time. More than 75 ADIs and non-ADI payment service providers connect indirectly to the NPP today via these Participants.

Alternatives to ADI-licensing – such as third-party certification – are suboptimal for several reasons:

- (a) There is no existing system in place to ensure consistency, quality and independence of third-party certification;
- (b) There is no system in place to monitor the effectiveness and accuracy of third-party certification;
- (c) Certification is retrospective and given at a point in time, and does not provide assurance of future capacity and compliance; and
- (d) NPPA would be required to undertake a more involved monitoring and enforcement role, which it is currently not resourced to do, or necessarily empowered to do.

On balance, we contend that the risks of admitting non-ADIs as Full Participants or Clearing Participants, and the limitations of any third-party certification regime, outweigh any benefits that might flow from substantially altering the access model.

We do, however, generally agree that an entity that proposes to join the NPP as a Settlement Participant does not present the same operational or legal risk profile as a Full or Clearing Participant and does not need to be an ADI. Settlement Participants do not connect to the infrastructure or the Addressing Service and are not principally liable for the settlement of transactions (the Full or Clearing Participant as the sponsoring Participant is actually responsible as principal for the settlement of all transactions signed by it, with the settlement arrangement reflected in the Business Reference Data Table for routing and RITS purposes).

NPPA has approved Constitutional amendments to vary the eligibility criteria for NPP participation as it relates to Settlement Participants so that from 1 November 2019, a new joiner seeking to join as a Settlement Participant will not need to be an ADI (requiring an Exchange Settlement Account with the RBA) and will be required to subscribe for only *half* the number of shares that it would otherwise be required to subscribe for as a Full Participant or Clearing Participant (reflecting the lesser infrastructure requirements and NPPA related management overhead).

Effect of the ADI Eligibility Requirement

Every ADI in Australia is eligible to connect directly to the NPP as a Full Participant or Clearing Participant, or to participate as a Settlement Participant. However, ADIs and non-ADI payment service providers are not *required* to connect to the NPP directly in order to use the NPP’s capabilities.

Many ADIs and non-ADI payment service providers have chosen to connect indirectly to the NPP as Identified Institutions via a directly connected NPP Participant that provides agency services. Identified Institutions are not bound by the NPP rules, are not required to contribute any capital to NPPA and are not required to be ADIs. As previously mentioned, these Identified Institutions currently connect via one of the several NPP Participants who provide agency services (three of which solely provide technical access to the NPP for more than 70 ADIs and non-ADI specialist payment service providers).

To the extent that an entity is – as the RBA Conclusions Paper notes - *ineligible to be an ADI because it does not hold deposits*, we suggest that its business objectives are likely to be met by participating indirectly in the NPP as either an Identified Institution sponsored into the NPP or as a Connected Institution, having the ability to send Non-Value Messages, such as payment initiation messages². In this regard, we note the [NPP Roadmap](#) and the important native technical capability and payment initiation messaging functionality that is scheduled for delivery in late 2021.

Business services and overlay services based on payment initiation messaging, and admission of non-ADI Connected Institutions will largely address the objectives of this recommendation, while preserving the important ecosystem protections intended by the ADI eligibility criterion for directly connected Full Participants or Clearing Participants.

Shareholding Requirement for Participants

6. By end December 2019, NPPA should introduce more gradation into the shareholding requirement by creating at least one additional lower band, so that subscription requirements can be more closely tied to an entity’s size or expected contribution to NPP transaction volumes

NPPA operates as a mutually owned industry utility. Shareholding grants the right to directly connect to the NPP infrastructure and included in the shareholding cost is the hardware and software componentry required to connect via an NPP payment gateway. Preserving the mutual structure of NPPA ensures ongoing investment in the platform is funded and aligned to the needs and interests of a broad range of end users.

NPPA has set subscription requirements for prospective NPP Participants on the basis of their relative size and significance to the Australian payments systems. Requirements are defined by reference to the three governance bands that use the same classification used by APRA (total resident assets):

High Band Shareholders	assets more than \$100 billion
Medium Band Shareholders	assets between \$10 billion and \$100 billion
Low Band Shareholders	assets below \$10 billion.

Preserving parity between shareholders within bands is an important principle in terms of allocating future capital funding commitments and operating costs, and calculating impact of non-compliance under the Mandatory Compliance Framework.

NPPA has approved Constitutional amendments to provide for an annual reduction in the Issue Price of new shares in the company from 1 January 2023, such that by end 2027, upfront costs payable by prospective

² See www.nppa.com.au/the-platform/accessing-the-platform/ for more information on the different ways to access the platform

Participants will be 75% lower than the costs currently payable, while maintaining parity between them and founder shareholders in the same governance band.

NPPA considers that the creation of an additional lower band would be inequitable, particularly having regard to the investment made by existing Low Band Shareholders, and is, in our view unnecessary, on the basis of the commitment to reduce costs of subscription over time, and also taking into account the additional 50% reduction in shares that would be required to be subscribed to by Settlement Participants.

7. By end December 2019, NPPA should establish an access route for direct participation that is based either on acquiring shares in instalments or on periodic subscription or membership fees, rather than the upfront purchase of shares.

NPPA has approved Constitutional amendments to enable the issuance of partly paid shares and to enable payment for shares to be made in four equal instalments over two years. New joiners that elect to subscribe for partly paid shares are entitled to exercise all the voting and governance rights attaching to them.

8. By end December 2019, NPPA should consider allowing NPP participant applicants that did not exist when the NPPA was being developed to subscribe to a lower amount of shares than usual.

Parity between shareholders within the same governance band is a core principle of the NPP governance model, as described in relation to recommendation 6) above. Hence the importance of each shareholder within a band holding the same number of shares.

The substantial reduction in the issue price of shares will reduce the costs payable by new joiners by 75%, by end 2027. As mentioned previously, Settlement Participants will also only be required to subscribe for half the number of shares required for Full Participants or Clearing Participants, effective 1 November 2019.

Further, NPPA has approved Constitutional amendments to relieve new joiners, who were not part of the original NPP participation group, of any obligation to pay pre-programme design costs.

10. By end December 2019, NPPA should review its arrangements for applications for access as a participant, connected institution or overlay service provider. Where an application has been rejected by the NPPA Board, or by NPPA management during its initial assessment, the applicant should be able to ask for a review of the decision by an Evaluation Panel. The Evaluation Panel should be comprised of three independent directors and two independent external experts appointed by the three independent directors. The Panel should have the binding power to overturn the earlier denial of an application if it decides that the applicant has met all of the eligibility requirements and also the power to ask NPPA to review the access criteria if it believes the criteria impose unreasonable conditions.

It is NPPA's view that there are fair and transparent processes in place to support new applications for access as a Participant, Connected Institution or Overlay Service Provider. Access decisions for new Participant, Connected Institution and Overlay Service Provider applications, are in most instances determined by NPPA's management under a delegated authority to the CEO. In practice, it is NPPA's view that there are unlikely to be any circumstances in which a potential application would be rejected without material flaws that would be objectively clear to an applicant.

As noted in our Initial Response, the NPPA Board approved the formation of the NPP Governance Committee,

as a sub-committee of the Board, comprising the independent directors and CEO, to specifically consider and determine matters that might otherwise raise perceptions of conflict, such as, for example determinations of non-compliance with mandatory compliance requirements.

NPPA will extend the Terms of Reference for the NPP Governance Committee to enable it to function as an independent evaluation committee for the purposes of making first instance determinations of new joiner applications. The mechanical provisions of the NPP Regulations relating to the determination of new joiner applications will be amended to reflect this approach.

The Terms of Reference for the NPP Governance Committee already enable it to appoint an independent advisor to assist with matters before it.

If required, decisions made by the NPP Governance Committee may be appealed by applicants to the full NPPA Board.