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## Electronic Funds Transfer Systems Practice and the Law

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I believe the most useful part I can play in presenting this paper on EFTS to this inaugural seminar of The Banking Law Association is to concentrate on what it is and why it is.

- What is Electronic Funds Transfer?
- Why is it now a major topic?

I will try and thread these two thoughts through my paper.

At the outset, let me say that EFT is evolutionary — not revolutionary.

Transfer of money value is very old. We have been paying each other for goods and services for quite a long time. History has many interesting — or seemingly interesting to us now, though no doubt quite mundane at the time — anecdotes on methods of payments of goods and services. One of the ones I like best in our short history concerns the payment for the construction of the Sydney Hospital; it included the loan of working bullocks and convicts, the provision of cattle for slaughter, and a monopoly of the import of spirits for three years. Macquarie used cattle and rum extensively as means of exchange. In 1813 the construction of the road from Sydney to Liverpool cost 400 gallons of rum.

The issue of what the payments system is all about is no less important, in Australia at least, in 1813 as it is 171 years later in 1984.

To use, again, the example of our own country, transfer of value — the payments system became quite a normal thing — except for gold discovery highlights — after banks became established and the early problems of finding a suitable medium were overcome. Bills of exchange, in their various forms, orders for payment, and cash filled the need. Any legislation which was necessary was no doubt borrowed from earlier established English law and tested from time to time in our courts.

I will not waste your time dwelling on any more history. My purpose in referring to it at all is to put the proposition that until some time recently, the payments system was nothing more than an exchange of value medium. Business, people, organisations, Government, exchanged value. The method of exchange was not seen as a service or facility in its own right, with its own special benefits — it was purely incidental to the transaction.

I used the words "until some time recently". One cannot put a precise time on when the change started; however, I think — certainly — that the time when private banks were granted Savings Bank licences in the mid-1950s was the turning point.

Banks, as the main players in the payments system, became serious about selling their products, and it was then, I believe, that the payments system started to evolve, not just as an exchange of value vehicle, but also as a vehicle for delivering enhanced financial service products. I don't suggest for one moment, that too many bankers in the 1950s realised that the game was changing. I think that realisation came much later.

You will notice that already I am talking more about payments systems than EFT. I believe one of the most important aspects of EFT is to place it in correct perspective with the payments system as a whole. EFT is one component of the Australian and world-wide payments system; of course an increasingly important component. But we must remember that it is only a component of an exchange of value system.

So, I would like to pause here with two propositions because they are fundamental to my whole theme.

1. Payments systems are no longer merely vehicles for exchange of value; they are a distribution network for the competitive delivery of financial service products.
2. EFT is a component of a payments system, but its evolution and growth is being determined by competition to sell financial products rather than exchange of value.

The reason I am dwelling on this aspect so much is because if we lose sight of the payments systems issues as we sell products based on electronic delivery, and the product becomes the only consideration, we might kill the goose that laid the golden egg. We might reconstruct the payments system to a point where it is not effective as a guarantee of exchange of value. Then businesses and people can have marvellous terminals promising all sorts of financial goodies from investments to travel instruments, but the problem of who plays who and when might not be solved. At the end of the day, the money has to be in the right place. There has to be a guaranteed final settlement from the stock of money.

EFT is the use of telecommunications to transmit financial data in computer readable form from point to point, from payer to receiver, without the need for supplementary paper documents to support the transaction. Inherent in any EFT transaction is the ability to guarantee to the receiving party, that that party has the money. So one of the most important features of any EFT system is the settlement process.

Another point to make about EFT is that it is no more than the latest in an evolving series of mechanisms for delivery instructions to bankers and others to effect changes to accounts; accordingly, it has no direct affect on the evolved arrangements between banker and customer for the conduct of the account. It thus leaves intact traditional formal arrangements concerning liability, confidentiality, privacy and banker/customer relationship. In particular, it implies no change to the quantity, type or availability of information kept on customers.

I think at this point I should briefly describe some EFT systems in Australia.

### **CEMTEX or direct entry**

This is the exchange of customer initiated data in computer readable form between banks (as cheques are exchanged), but it does not quite fit the electronic communications criteria in my definition.

### **Automatic teller machines**

Through these machines the customer of a financial institution accesses funds using a magnetically striped plastic card as an identifier/activator. The transaction is electronically processed to the customer's account. The machines have functions for dispensing cash or making transfers between accounts.

### **Westpac's Handyway point of sale system**

Terminals have been installed in Woolworths, BP and Food Plus outlets. They are connected by Telecom's Auspac network to Westpac's computer system. The connection is through a "front end" or "gateway" controller which has the capability of extending the facility so that instead of the transaction going into Westpac's computer system, it could be channelled to another financial institution's computer. This means that subject to satisfactory agreements, customers of other financial institutions could use the terminals at Woolworths, BP and Food Plus.

There are no technical or compatibility impediments to such arrangements. These transactions are also activated by magnetic stripe encoded plastic cards.

Mostly, the debate about EFT now taking place centres around the last example which is Electronic Funds Transfer at Point of Sale (EFTPOS). Again, this debate seems to me to be revolving around two major issues:

1. The method of construction of an EFTPOS facility for the Australian consumer.
2. The viability of EFTPOS when cost/benefit, issues, consumer issues, legal issues, political issues and others are taken into account.

Let me talk about each of the two major subjects of debate.

### **Method of construction of an EFTPOS facility**

There are probably two broad options:

1. A system with a central organisation in machinery management and control, that is, it is centrally owned and operated.
2. A system with distributed machinery management and control. That is, ownership and operation is in the hands of different players, or groups of players, who co-operate for exchange of value.

I accept there are variations on those two themes, but would like to stay with the two concepts for the purpose of this discussion paper.

I also believe there are four groups of players with the main interests in the construction of a facility:

#### *Consumers:*

The facility must provide an acceptable service, useful in today's environment, satisfactory as to price and performance, and a contribution to an enhanced standard of living.

#### *Retailers and service providers*

Will require an operationally efficient system with benefits outweighing costs, which will enable them to enhance their business of retailing and selling, and keep and grow their customer base.

#### *Financial institutions*

Seek to provide financial and financially related products and services using the money payments system as a vehicle or distribution network.

#### *Government*

Through the Reserve Bank, the Treasury will wish to ensure that prudential requirements are met and the integrity of the money payments system in Australia remains secure.

Back to the construction of the facility.

So there are four groups of players looking at two major options in the construction of the facility. Let me now take a little licence and postulate some position taking within this matrix:

**Consumers** will wish to retain the right of choice of financial institution and retailer. If this is retained, and if a system is operationally acceptable and price competitive, consumers would probably prefer to see a facility with distributed ownership, where competition in the future will determine the level of service and price rather than a centrally owned and managed facility.

**Retailers and service providers** will have three major objectives. They will not be able to have a multiplicity of terminals on their counters, yet they want access to every piece of plastic which has been issued. Their third objective is to be sure they have their money at the end of the day. If these objectives are met, they will opt for the facility which would be the least cost to them. If they had to contribute to the cost of building, operating and managing a central facility, they may prefer to see a distributed system, retaining their right to negotiate competitive prices.

**Financial institutions** differ in their positions according to their own business objectives. However, at the core of the debate between financial institutions is the operation, management and cost of the payments system. *The major large financial institutions* would probably prefer to see a distributed facility with competing institutions co-operating for exchange of value. They would agree that Australia's payment system, which is one of the few, if not the only one which gives national same day value for all on demand transactions, is highly geared in favour of the user and is one of the most efficient in the world. Also, at the core of this issue is cost and product delivery. The banks pay for the cost of the payment system. My estimate is about \$2bn per year. Banks believe that if the system is to be used for product delivery those delivering the product should share the cost. At the same time, efficiency and integrity must be maintained.

Financial institutions suggesting a central facility believe that one facility would be more cost effective than distributed switching. This leaves open for debate whether a single monopoly operation is eventually more costly to the consumer than competing distributed operations.

**The Government**, through the Treasury and Reserve Bank, will have as their main concern, in my opinion, the effectiveness of the exchange of value system, the authority and integrity of the system and their ability to retain effective control of monetary policy. If one of two options appeared to them to jeopardise those concerns, I am sure they would need to take a position.

At the risk of too much repetition, I will stress again the changing nature of the payments system, because it is important that this audience, at least, understands that evolving EFT is not a computer room issue, but a structural issue concerning the operations of Australia's payments mechanism, both internally and externally, and this operation cannot be put at risk. EFT is not just consumer banking, it has the capability for millions, or billions of dollars, to be switched instantly from point to point. The point I am making, while it strays a little from the debate on centralised or distributed EFTPOS facilities, is that I do not believe there is very much scope to change the structure of the Australian Payments System without putting it at risk.

I should mention security; in the debate on whether a major national EFTPOS facility should be centrally owned and managed, or owned separately by the operators and operated as a distributed network, the question of security should not influence the debate. Security is a function of cost, and levels of security, through encryption and programmable features, can be built in to any system to any level agreed by the contributing parties.

The second major subject of debate is:

**Viability of EFTPOS taking account of issues such as cost benefit, consumer protection, legal, political etc**

The debate in this area, I believe, can be broadly categorised as follows:

1. Protecting the rights of the consumer in a system where there is no paper record authenticating the transaction.
2. Building a legal agreement between the major parties (consumer, retailer, financial institution) which on the one hand adequately protects their position, yet on the other, does not so inhibit the process as to make it unworkable.
3. Agreeing who pays for what costs.

Inherent in all three elements is the problem of communicating the correct messages for understanding by all parties.

On the first point, protecting the rights of the consumer, the debate is probably about whether we should legislate before a facility gets into full swing and if so, what should we legislate to achieve. I have a strong belief that the major issue in point is that the consumer should not be placed in a position of having to prove the other party wrong if a transaction is in dispute. I also believe that if we cannot get this right, we will not have EFTPOS on a large scale. However, surely we can get it right, and surely we can do it against a background that banks and most financial institutions are only in existence because their business is to protect their customers' money, not place it in jeopardy. By this I mean that when we come to work out how to solve this issue, banks certainly will be talking about their record, their propensity to spend adequately on protection when building new systems, and their desire to accommodate the most stringent measures of protection that can be sustained. I believe banks would say that legislation would be best left until a good live working model was available and they would build their case on past performance, particularly the more recent performance of plastic credit cards, and more recently again, debit cards. In my bank, we have had probably nearly 200m Bankcard transactions since Bankcard started and from my enquiries, I cannot find one single instance where we have invoked the \$50 liability enunciated in the terms and conditions of agreement between the cardholder and the bank.

Also, it is my understanding that in so far as Bankcard is concerned, and remember there are 3 or 4 million cardholders making huge numbers of transactions, there is no major consumer issue outstanding at this time.

On the subject of building a legal agreement between the major parties, I probably suffer more from pessimism rather than optimism. The reason is simple, and it goes back to my earlier statements about payments systems, and delivery of products through the payments system, and co-operation versus competition. In my opinion, one of the reasons there are no national full scale EFTPOS systems operating in the world is because all the parties concerned have not been able to iron out all the operating contractual aspects to a point where they can be written into acceptable legal agreements. Why have they not been able to do so? Here are some of the issues which need to be covered in agreements:

- *Payments systems aspects*, such as end of day settlement and discovery and rectification of errors within timeframes. I am not referring here to privacy or consumer legislation, merely operating rules within the payments system.
- *Security and the level of standards*

There is a range from more expensive through to less expensive. This is one area where the lowest common denominator — often a yardstick in consortium or shared ventures — simply cannot apply.

- *Management role of a facility*

In a volume transaction business with high volume members and low volume members, parties usually find the management role difficult to come to terms with.

- *Ownership and voting*

Low volume members usually want equal ownership and voting, high volume members usually prefer a formula based on volume.

- *Special conditions to suit parties with special objectives* — and there are many.

- *Marks and logos*

- *Other applications* — within a POS system such as Other Products.

- *Marketing issues*

I could go on but to sum up, there are:

- technology/operations agreements;
- ownership and management agreements;
- system operation agreements;
- marketing agreements

and I can assure you they are not easily achieved.

Finally, who pays for what?

I have left this issue until last, but not because of its relative importance. What are the costs? What are the various components of the costs?

First, I would stress again the point that the payments system is the core of the matter, and the payments system in Australia is really 6,000 or so branches of banks. At the end of the day, almost every financial transaction in Australia gets settled through one of those branches.

The elements of cost can be described in the following categories:

- computers, switching systems and telecommunications
- terminals
- one time Research & Development
- implementation
- legal
- stationery
- marketing
- settlement through the payments system

I shall comment very briefly on a few of these components.

The final cost of computers, switching systems and telecommunications to the operator would not necessarily vary greatly whether shared or individual facilities. However, larger financial institutions with computer switching systems and networks of their own would no doubt find it less costly to build on what they have, rather than subscribe to the building up of a totally new and separate venture.

Terminals are probably the highest cost component in any facility. These costs are coming down, but at present, terminals with sufficient facilities for a viable operation are around \$10,000. Fifty thousand terminals would therefore cost \$50m. Who pays?

Ideally, the cost is shared between the beneficiaries, including the consumer, but only if the service is more acceptable, both as to price and performance than existing money habits.

The implementation is an often underrated component of cost because people have to be trained to train people to operate the facility.

I need not enlarge on legal costs except to say that usually what happens is that legal work is carried out both individually and collectively.

The cost to the participants in actually moving transactions around from point to point and receiving value at the end point — in effect the cost of the payments system is much more difficult to assess. It is reasonably simple to calculate or estimate the operational cost of the transaction from the time it is keyed in until merchants and consumers receive statements from their financial institution. What is not so easy to estimate is the cost of providing settlement at the 6,000 or so branches of banks. Because, at the end of the day — one way or another — guaranteed settlement can only take place, in the final form at a bank. It is the sharing of this cost which must be resolved.

In this paper I have attempted to outline the essential characteristics of EFT and how I see the position of the various parties concerned. It is important that in discussion on the subject, we do not channel our thinking along lines of consumer credit. In everything I have said the debit card concept has been dominating my reasoning — not credit cards. Eventually, I am sure EFT will be 95% debit card and 5% credit cards, so I just want to emphasise that consumer credit is another subject.

In summary, today in this outline of EFT, I have tried to:

- emphasise the importance of the payments system in the subject;
- describe what I believe EFT is;
- comment on the main areas of debate;
- postulate the positions of the various participants or groups of participants;
- briefly discuss consumer and legal issues.