

BUSINESS SERVICES

The RBA provides banking, registry, settlement and note issue services to a range of customers. Banking and registry services are provided to the Commonwealth and South Australian Governments and some international institutions.¹ Settlement facilities are offered to banks and other financial institutions, while banks and armoured car companies form the customer base for the note issue function. With the exception of a very small amount of registry work, the RBA does not provide business services direct to the public.

In compliance with the Commonwealth Government's competition policy, separate financial data are recorded for the contestable transactional banking, RITS and registry businesses. These businesses fully meet all competitive neutrality and devolved banking requirements, including allowance for all relevant taxes. Pro forma sets of accounts for these contestable businesses, prepared in accordance with competitive neutrality guidelines, are set out elsewhere in this Report.

GOVERNMENT BANKING

The RBA provides both core banking and transactional banking facilities to the Commonwealth Government. The core banking facility, which is provided to the Department of Finance and Administration (DoFA), is non-contestable in terms of the Commonwealth Government's competition policy. As part of this facility, the RBA maintains six accounts for the Commonwealth Government, including the Official Public Account (OPA), and provides a

limited overdraft facility.² The release of funds from the OPA to agencies and the sweeping of the agencies' overnight balances from transactional bankers back to the OPA are also part of the core banking function. Overnight balances are returned to transactional bankers at the start of the next business day. Forecasting data from agencies and transactional bankers are collected electronically to assist the RBA to discharge its monetary policy and liquidity management responsibilities.

The devolution of responsibility for banking activities to agency heads was an integral part of a wider policy aimed at increasing the accountability and efficiency of budget-funded agencies. To encourage them to plan their cash management processes better, DoFA instituted a system of incentives to improve cash management performance. The RBA administers this on behalf of DoFA.

As part of the core banking facility, 5 800 deposits were made in 2000/01 totalling \$53 billion, well up on the 2 500 deposits totalling \$32 billion lodged in the previous year.

The other component of the RBA's government banking business, transactional banking, has undergone significant change over recent years. Under the Commonwealth Government's devolved banking arrangements implemented from 1 July 1999, agencies governed by the *Financial Management and Accountability Act 1997* (FMA Act) are required to market-test their transactional banking requirements. This process gathered pace over the past financial year with FMA Act agencies issuing nine tenders for their transactional banking requirements. The RBA was

¹ For many years, the RBA provided banking and registry services to a number of State and Territory governments. Over recent years, with the exception of South Australia, they have moved to other service providers.

² The conditions applying to the overdraft facility are set out in "The Separation of Debt Management and Monetary Policy", RBA Bulletin, November 1993.

unable to respond to a number of tenders because of special requirements stipulated by some agencies. Of those tenders decided during the year, the RBA retained the business of all agencies for which it bid.

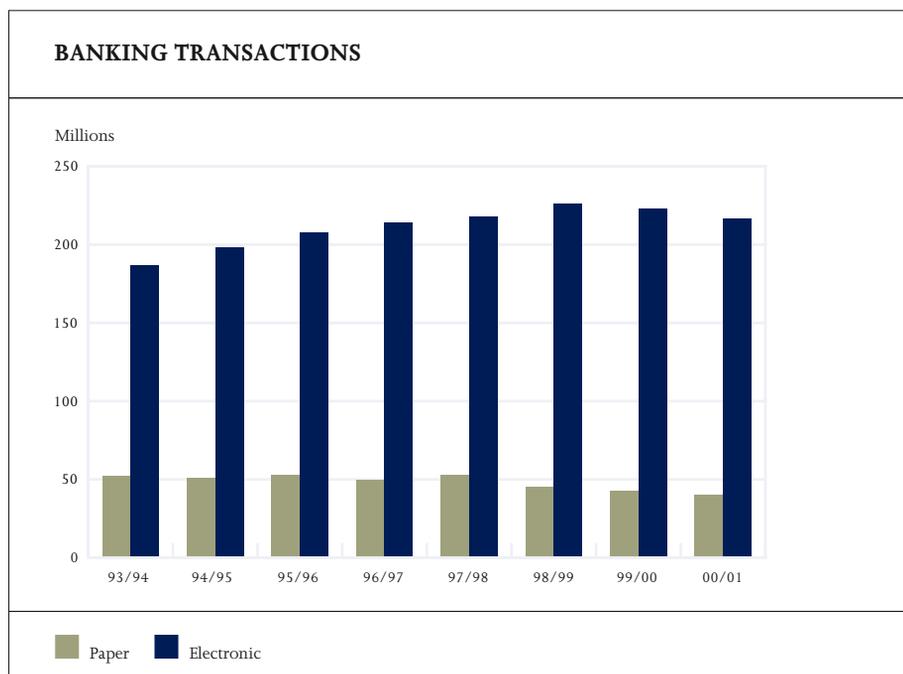
Against the background of a highly competitive transactional banking market, further restructuring of the functional areas within the RBA's Sydney and Canberra offices has been undertaken to enhance efficiency and strengthen the Canberra branch's capacity for the day-to-day contact with and support of customers.

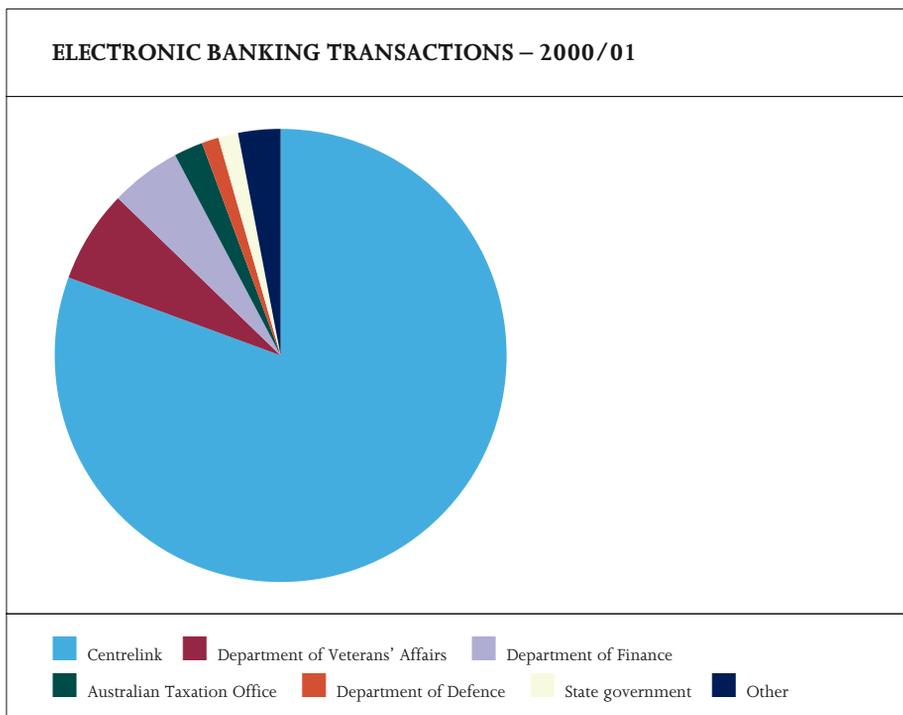
Electronic transactions through the Government Direct Entry System (GDES) fell to 217 million transactions from 223 million during the last year. The major reason for the fall was the streamlining of arrangements for the distribution of payments by Centrelink under its rent deduction scheme. The loss of some Commonwealth Government agency business and the full-year effect of the loss of the direct-entry business of the Western Australian and Australian Capital Territory

Governments also contributed to the reduction. These decreases were offset in part by increased volumes from the Australian Taxation Office and the Health Insurance Commission.

In its capacity as banker to the South Australian Government, the RBA operates as "prime contractor" for the provision of centralised banking services. Where the RBA is unable to provide any of these services in its own right, it contracts out the service and manages the relationship with sub-contractors. As well as continuing to move the mode of delivery of traditional transaction services to a more efficient electronic basis, the extensive use of merchant facilities and purchase-card programs has delivered significant efficiencies to the collection and payment processes of South Australian Government agencies.

Earnings after tax for the transactional banking business in 2000/01 were \$5.4 million compared with \$2.1 million in the previous year.





BUSINESS DEVELOPMENTS

Over the past year or so the Australian banking industry has experienced a significant increase in fraudulent alteration of cheques. The RBA has responded to this by developing a system specifically designed to protect its customers and itself against financial loss. The new system, known as the Cheque Verification System (CVS), uses cheque issue details provided by customers and image technology to confirm that the information on the cheque presented for collection is valid. Using high-speed image scanners, the captured cheque details are matched to the original cheque information supplied by the customer. Where these data do not match, the cheque is retrieved for visual inspection, and is then accepted or rejected. Rejected cheques are dishonoured through the banking system in the normal manner.

The CVS system has ensured that, where the

relevant cheque information has been provided to the RBA by customers, all fraudulently altered cheques have been identified and dishonoured to the presenting bank within the dishonour period. Neither the RBA nor these customers have suffered any losses through fraudulent alteration of cheques since the system was introduced. An additional benefit flowing from the CVS development has been an increased capability for the RBA to respond to customers' enquiries for information on presented cheques. With the stored images of cheques in the cheque database, an interface has been developed to allow online access to these data, which, in most cases, eliminates the need for the time-consuming retrieval of the physical cheque.

The RBA is also represented on the Fraud Committee of the Australian Payments Clearing Association. This Committee deals with fraud

activities related to the full range of payment methods (cheques, bills, cards, electronic banking, etc).

In October 2000, the RBA commenced processing overseas pension payments on behalf of Centrelink. Over 50 000 Australian pensioners reside overseas and receive a monthly pension cheque from Centrelink.

A new project is under way to enable direct crediting of overseas bank accounts (in those countries which have an automated clearing house system), as is done with domestic payments. This will enable a more timely and safer delivery at significantly reduced cost to recipients.

One of the Government's primary goals from its Electronic Procurement Implementation Strategy, released in April 2000, was for agencies to issue remittance advices electronically by the end of 2000. To assist agencies meet this goal, the RBA developed an electronic remittance advice service as an extension to its existing RBA Document Printing Service. Other electronic advices/forms were also identified and subsequently introduced. This extended service now provides for delivery of remittance information via email, facsimile or post, the warehousing of remittance information for release on a nominated date and the provision for redirection of returned electronic documents. The South Australian Government has developed an interface to its general ledger system, which will provide its agencies with the capacity to introduce this facility as part of their electronic business solutions.

SETTLEMENT AND REGISTRY SERVICES

The Reserve Bank Information and Transfer System (RITS) provides facilities for the electronic settlement of transactions in Commonwealth Government securities (CGS), electronic tendering

for CGS, automatic interest and maturity payments for securities lodged in the system and for settling the interbank payments associated with equity transactions on the Australian Stock Exchange's electronic settlement system, CHESS.

Over 99 per cent of CGS turnover in the market is handled by RITS and securities with a face value of \$64 billion are lodged in the system. There are 136 members of the system representing 248 organisations.

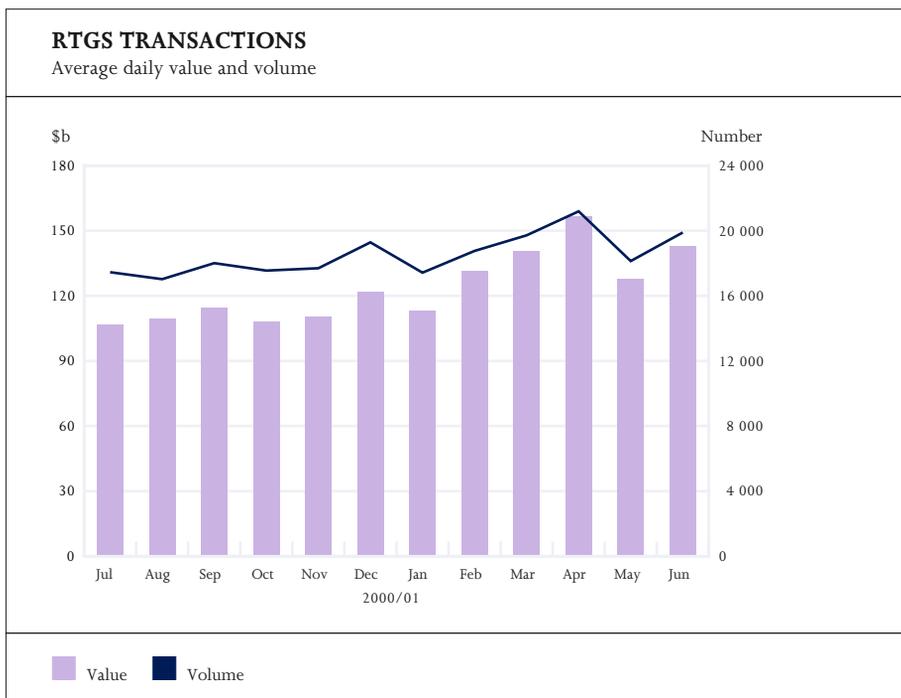
RITS also provides facilities through which banks and other approved institutions access their Exchange Settlement accounts with the RBA on a real-time gross settlement (RTGS) basis.

RTGS System

About 90 per cent of total values exchanged between banks are settled across RITS on an RTGS basis and hence are not subject to interbank settlement risk. RTGS payments include securities markets settlements, the Australian dollar leg of foreign exchange transactions and important or time-critical customer payments.

The RTGS system has now been in operation for three years. The daily number and value of transactions settled by RITS increased during 2000/01, with most of the growth occurring between February and April 2001. New peaks for value at \$215 billion and volume at 27 400 transactions occurred on 29 June 2001.

Major changes to the settlement of foreign exchange transactions are planned over the coming year with the establishment of the "continuous linked settlement" (CLS) Bank. This is a global initiative which will reduce foreign exchange risk by ensuring that participants settling in one currency do so if, and only if, receipt in the other currency is assured. CLS Bank is being developed by over 60 shareholder banks



active in foreign exchange markets, including the four major Australian banks. For Australia, participation in CLS will require alterations to the operating hours of payment and settlement systems so that they overlap with the core hours of the CLS Bank, which are from 3.00pm to 8.00pm in winter and from 5.00pm to 10.00pm in summer. Accordingly, modifications were made to RITS in November 2000 to facilitate this.

Other changes to RITS implemented in November included the introduction of facilities to permit optional real-time gross settlement of high-value equity transactions from CHES.

Settlement services are also provided for the RBA's own transactions in the domestic securities and foreign exchange markets, as well as for those arising from business conducted by official customers domestically and abroad. The RBA also acts as collateral of banks' obligations arising from the low-value clearing streams (paper, and bulk

and retail electronic) managed by the Australian Payments Clearing Association.

Registry Services

The RBA provides registry services to the Commonwealth Government, the South Australian Government Financing Authority and a number of other domestic and foreign institutions. These services encompass the issue, transfer and registration of securities, the maintenance of ownership records, the distribution of periodical interest payments and the redemption of securities at maturity.

In line with previous years, the RBA has continued to actively manage this declining area of business, ensuring that the provision of services remains cost-effective for issuers, while maintaining its focus on quality of service.



THE NEW NATIONAL NOTE PROCESSING CENTRE, LOCATED AT NOTE PRINTING AUSTRALIA AT CRAIGIEBURN, VICTORIA.

Forthcoming changes to the *Commonwealth Inscribed Stock Act* will allow for the electronic transfer of ownership. While the impact that this change might have on the RBA's traditional registry operations is not yet clear, the RBA has indicated that it will continue to provide registry services for as long as the Commonwealth requires it to do so.

NOTE ISSUE

The note issue functions of the RBA comprise the issue of notes (new and reissuable); the processing of notes returned from circulation for authentication and quality-control purposes; general oversight of cash distribution arrangements; and research into and development of note designs and security features.

Over recent years, significant changes have occurred to the RBA's note issue activities. The volume of notes processed has declined

sharply in large part because of changes to note distribution arrangements introduced to eliminate the excessive churn and cross-shipping of notes that was occurring. These changes were facilitated by the move to polymer-based currency notes which, because of their greater security and durability, do not need to be checked for fitness and authenticity as frequently as in the past to keep the circulation clean and free of counterfeits. With the scaling-back of note-processing activities, the decision was taken in late 1999 to close the remaining branch-based cash services operations and to centralise the note-processing function at a new National Note Processing Centre (NNPC) at Note Printing Australia Limited at Craigieburn, outside Melbourne. This facility commenced operation in June 2001 and the Sydney cash services operation was closed.

The reduced note-processing task has, in turn, enabled further changes to be made to note distribution arrangements which will provide a sound framework for the major participants in the cash industry to seek additional efficiencies in cash distribution and inventory management. From August 2001, commercial banks will progressively assume ownership of the working stocks of currency notes and coin currently owned by the RBA, but held externally in Note and Coin Pools. Prior to that, the RBA had provided depository facilities to the main participants in currency distribution arrangements through its ownership of external working stocks of currency. These stocks could be accessed daily. However, arrangements are now being introduced under which those who need the stocks for their ongoing business also own them. Some banks are net receivers of cash and others are net payers. Previously, no direct links had arisen between these parties, as the RBA was interposed between them. Under the new arrangements, participants deal directly with each other to satisfy their

demands for currency and reduce their surpluses.

These latest changes will provide further opportunities for the more efficient recirculation of currency between the various participants. Additional features of the new arrangements are that banks will receive payment from the RBA for additional holding costs in the form of interest forgone that will flow from taking ownership of the working stocks, and they will be obliged to ensure that notes are appropriately sorted for fitness for reissue, according to standards set by the RBA.

Notes on Issue

Demand for currency over 2000/01 continued to increase broadly in line with economic activity. The value of notes on issue rose by almost seven per cent to \$27.2 billion. Again the increase was driven by strong growth in the \$50 and \$100 denominations, although their share of total circulation remained steady. There was also unusually strong demand for \$5 notes, reflecting the issue of the new Federation \$5 note from January 2001.

Value of Notes on Issue

(\$ million)

At end June	\$1 ^(a)	\$2 ^(b)	\$5	\$10	\$20	\$50	\$100	Total	Increase (per cent)
1995	20	49	332	614	1 848	7 193	8 482	18 538	5.5
1996	19	48	337	583	1 868	7 928	8 399	19 182	3.5
1997	19	47	351	601	1 837	8 912	8 297	20 064	4.6
1998	19	47	361	617	1 804	9 523	9 280	21 651	7.9
1999	0 ^(c)	46	379	639	1 850	10 356	10 282	23 552	8.8
2000	0 ^(c)	46	397	646	1 917	11 188	11 240	25 434	8.0
2001	0 ^(c)	45	431	662	2 014	12 055	11 961	27 168	6.8

(a) Last issued May 1984

(b) Last issued June 1988

(c) See Notes To and Forming Part of the Financial Statements, Note 1(j)

Over the course of 2000/01, \$125 billion of currency notes were issued into circulation and \$123 billion returned. Turnover was up by about 18 per cent on 1999/2000, reflecting the changes made to cash distribution arrangements described in last year's *Annual Report* which have facilitated better access to RBA note stocks held externally in Note and Coin Pools.

Note Processing and Distribution

In the latest year, the number of notes processed through high-speed note counting and sorting machines at the RBA decreased from 450 million (\$18 billion) in 1999/2000 to around 153 million (\$4 billion). The greater reduction of processing in dollar terms when compared with the reduction in numbers of notes processed reflects higher \$5 note-processing levels resulting from the issue of the Federation \$5 note into circulation in January. From June 2001, note-processing has been conducted at the NNPC.

As well as improving the efficiency of circulation of currency within the community, the new cash

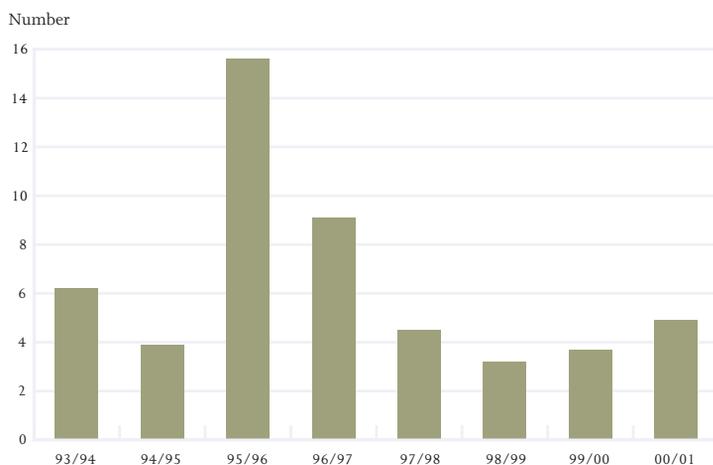
distribution arrangements also seek to reduce the number of "fit" notes unnecessarily returned for processing. The effects are already becoming evident and in 2000/01 only 77 per cent of notes processed by the RBA were deemed fit for reissue compared to 93 per cent for the previous year.

Counterfeiting Activity

Counterfeiting of Australian currency notes was again low, with only 3 003 counterfeits detected during 2000/01. Although this is an increase compared to the 2 100 counterfeits detected the previous year, the numbers remain modest compared with the experience of other countries and well down on levels seen in some previous years.

The counterfeits detected were for the most part low grade, on a paper substrate and could be easily identified by their different feel compared with a genuine note, as well as by visual inspection. A very small number of counterfeits printed on a plastic material were also detected during the year.

COUNTERFEITS PASSED PER MILLION NOTES IN CIRCULATION



Notwithstanding the low level of counterfeiting activity, the RBA has an active research and development program aimed at continually improving the security of polymer notes by putting obstacles in the way of would-be counterfeiters.

Federation \$5 Note

On 1 January 2001 the RBA issued a new \$5 note as its contribution to the Centenary of Federation celebrations.

The new note features two prominent Australians who made unique contributions towards the birth and development of our nation. On the front is Sir Henry Parkes and on the reverse is Catherine Helen Spence. The note was designed by Garry Emery, one of Australia's leading graphic designers, who also designed the current \$20 note.

It is important that notes are able to be easily authenticated not only by individuals, but also by machines that accept, dispense and count notes. Such machines are becoming much more common. Prior to the issue of a new note, the RBA provides machine manufacturers with sample notes to enable as many note validators as possible to be upgraded in advance of the issue date. The proliferation and sophistication of note-accepting machines has made speedy conversion a more complex and lengthy process leading to the likelihood that not all machines will be converted by issue date. Unfortunately, some conversion problems were encountered with the issue of the Federation \$5 note but, within several months, upgrading of equipment was largely complete.