

BUSINESS SERVICES

The RBA provides a range of services including banking services to the Australian Government and other customers; a registry of Commonwealth Government securities and other securities; payments and settlement services; and currency distribution services. The commercial activities are run as individual businesses which seek to recover their full costs, and earn a return on notional capital, through fees and charges.

The RBA's principal focus in carrying out these activities as a central bank derives directly from the Reserve Bank Act which, among other things, says that:

- the RBA is empowered to carry on business as a central bank, and shall, in so far as the Commonwealth requires it to do so, act as banker and financial agent for the Commonwealth; and
- the RBA is empowered to print currency notes, and to issue, reissue and cancel currency notes.

Accordingly, the principal focus is:

- for banking and registry, to service the Commonwealth's requirements;
- for settlement services, to develop and operate sound, reliable payment and settlement systems that ensure that risks are well identified and controlled and that limit the spread of any problems that might arise; and
- for currency services, to meet the community's requirements for clean, counterfeit-free currency.

These activities are carried out by the Business Services Group which comprises the Banking, Payments Settlements and Note Issue Departments. Services are delivered through Head Office in Sydney, the branch in Canberra and via the National Note Processing Centre (NNPC) operated by the RBA's

subsidiary, Note Printing Australia Limited (NPA), at Craigieburn, Victoria.

During the year, the South Australian Government completed the evaluation of tenders for its transactional banking requirements and decided to move its banking from the RBA to another supplier. As a result, the RBA's Adelaide branch was closed on 14 March 2003.

Government Banking

Over recent years, the RBA's government banking activities have been repositioned to manage the effects of the Australian Government's competition policy on the market for transactional banking services. Since 1 July 1999, the banking business has been separated into two components – a core central banking facility is provided to the Department of Finance and Administration (Finance), which is non-contestable in terms of the Australian Government's competition policy, and transactional banking services are provided for government agencies in competition with private sector service providers.

In its core central banking role, the RBA maintains a group of bank accounts for the Australian Government, including the Official Public Account (OPA), whose aggregate balances represent the Government's daily cash balance and a term deposit facility for the investment of temporarily surplus Government funds. The Australian Government also has access to a strictly limited overdraft facility.

Under the core banking arrangements, payments are made from the OPA to agencies and end-of-day balances of agencies which come within the scope of the *Financial Management and Accountability Act 1997* (FMA Act) held with transactional bankers are swept

back to the OPA overnight. These balances are returned to transactional bankers at the start of the next business day. The service also includes electronic collection of forecasting data and reporting on high-value transactions from agencies and transactional bankers to assist the RBA in the discharge of its monetary policy and liquidity management responsibilities. Finance has indicated that these reporting arrangements will be extended to include agencies subject to the *Commonwealth Authorities and Companies Act 1997 (CAC Act)*.

Over recent years, the RBA has also administered a term deposit facility on behalf of Finance into which agencies deposit temporarily surplus departmental funds. During 2002/03, 5 042 deposits totalling \$49 billion were made using this facility, compared with \$62 billion (7 300 deposits) in the previous year. The much lower usage by agencies of the term deposit facility in the current year partly reflects changes following a Finance review of the operation of the facility which saw this arrangement discontinued from 1 July 2003.

The other component of the banking business is the provision of contestable transactional banking services to government customers. Under the Australian Government's devolved banking arrangements, agencies governed by the *FMA Act* are required to market-test their transactional banking requirements. Market-testing has been taking place over the past few years and the RBA has retained the business of 70 per cent of the agencies which have reviewed their transactional banking requirements and supplier arrangements. With all but a few agencies having now completed market-testing, emphasis has moved from consolidation of the banking business to continuing the development of transactional banking products and service delivery methods designed specifically for the unique needs of the Government. Monitoring and reporting of performance against the service level standards specified in contracts is ongoing. Feedback from customer service reviews confirms a very high level of customer satisfaction.

A major feature of transactional banking activity performed for government agencies is the processing and distribution of electronic direct entry transactions through the RBA's Government Direct Entry Service system. The number of electronic transactions processed during 2002/03 showed a slight decrease to 215 million, from 218 million the previous year. The fall in transactions, caused by the loss of the South Australian State Government business during the year, was partly offset by a general increase in electronic transactions by government agencies serviced by the RBA.

Earnings after tax for the contestable transactional banking business in 2002/03 were \$3.2 million, compared with \$2.9 million in the previous year.

Business Developments

The facility developed in conjunction with Centrelink to enable the direct crediting of Australian pension payments to overseas bank accounts in local currency has now been fully implemented. The facility enables Centrelink to make Australian pension payments directly into overseas bank accounts using recipient countries' automated clearing houses. Approximately 75 per cent of Centrelink's overseas pensioners now use this secure and timely delivery method. The new service has provided Centrelink with a number of service improvements including reduced transaction costs and back office savings, but just as importantly has delivered significant benefits to pensioners living overseas, including improved timing, lower cost and greater convenience over traditional paper-based payments. In the past these payments, made by cheque, took between two and four weeks to be delivered due to printing and local mail service delays and were often subject to expensive and lengthy clearance processes. In light of this very favourable feedback, Centrelink proposes to mandate direct crediting of overseas payments in those countries where the automated clearing house facilities are available.

The RBA's Cheque Reconciliation and Verification System (CRVS), which was developed in response to an increase in the incidence and sophistication of

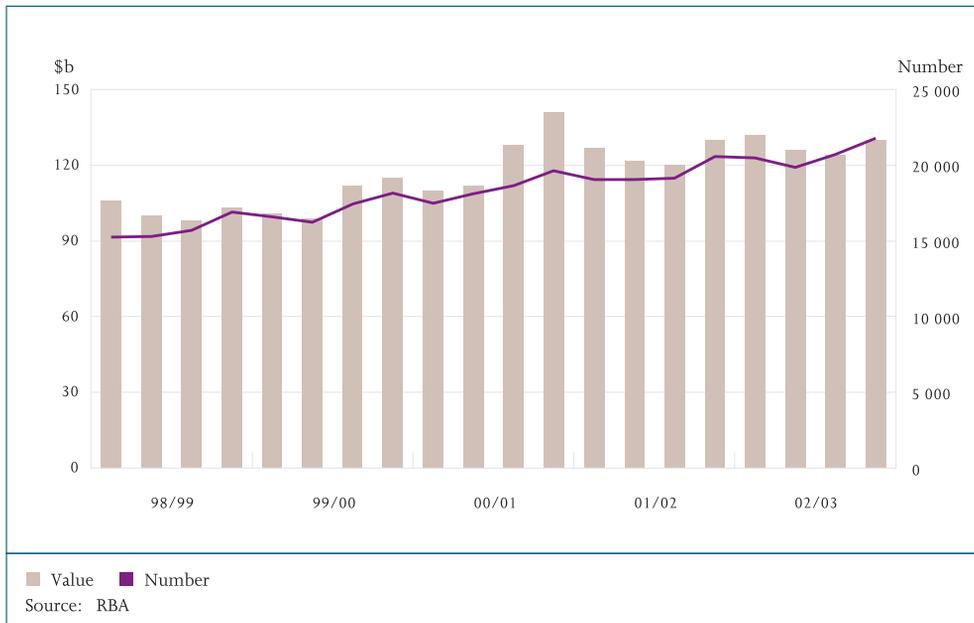
cheque fraud, has continued to be highly successful in detecting fraudulently altered cheques. The system combines cheque issue data provided by customers and image technology to verify that the information on the cheques when presented through the banking system is the same as that printed on the cheque when issued. CRVS enables the RBA to detect quickly changes to cheque information, thereby protecting itself and its customers from losses due to fraudulent cheque alteration. In the twelve-month period to end June, CRVS detected 178 fraudulent cheque alterations with a total value of approximately \$2.2 million. CRVS also provides a same-day cheque tracking and reconciliation system to complement the cheque verification component of the system. It is intended that those features of the cheque reconciliation system which assist enquiry and reconciliation processes will be made available to customers during 2003/04. A number of additional back-office processes, such as dishonouring cheques, have also been integrated into CRVS, reducing reliance on physical access to cheques and vouchers to perform the tasks involved. In addition to saving staff time, this has reduced the volume of cheques

transported between processing centres.

While the majority of government agencies use *ReserveLink*, an electronic banking package, to transfer and receive data files with the RBA, work continued during the year on establishing the infrastructure for secure banking services via the Internet. The new facility will provide customers with an account enquiry function and access to the output of back-office cheque processing functions to provide on-line reports on the status of cheque presentations as well as high-resolution images of presented cheques. A successful pilot of the system has been conducted and discussions are under way with interested customers on implementing the service over coming months. There are no plans to allow value payments to be effected via the Internet. These payments will continue to be made via *ReserveLink* or direct data link. However, the RBA is monitoring developments in Internet security technologies which might provide the required level of security and meet all relevant Australian Government guidelines to enable value payments to be made over the Internet.

In response to the specific needs of a number of Australian Government agencies, the RBA broadened

GRAPH 19 | RTGS TRANSACTIONS Average daily value and number



its range of payment collection services to include a phonepay collection service known as *Government EasyPay*.

Settlement and Registry Services

The Reserve Bank Information and Transfer System (RITS) is used by banks and other approved institutions to settle interbank payments across their Exchange Settlement (ES) accounts conducted with the RBA. By value, the bulk of these transactions is settled on a real-time gross settlement (RTGS) basis.

While no longer providing an electronic depository and settlement service for Commonwealth Government securities (CGS), RITS still provides a facility for members to participate in electronic tenders for CGS. Settlement of successful bids occurs in the Austraclear System, which has provided depository and settlement services for CGS since February 2002.

RTGS and Other Settlement Services

About 90 per cent of the value of interbank payments is settled on an RTGS basis; this includes all wholesale debt and money market settlements, a range of time

critical customer payments and Australian dollar foreign exchange settlements (including those settled by CLS Bank for which a net settlement is made across RITS).

The average daily number of payments settled in RITS in 2002/03 of 20 700 was 6.4 per cent higher than the previous financial year. Growth in the value of payments settled was more moderate, at 2.4 per cent. Since inception on 22 June 1998, there has been a significant increase in both the number and value of RTGS transactions. The end of financial year peak on 30 June 2003 of 31 000 transactions totalling \$201 billion compares with 21 000 and \$158 billion, respectively, on 30 June 1998.

Two developments of particular significance to the operation of RITS took place during 2002/03. First, as foreshadowed in last year's Annual Report, the RBA assumed responsibility for the computer operations, software development and support functions for RITS that were previously performed under contract by Austraclear Limited. The RBA worked in close co-operation with the SFE Corporation (the owner of Austraclear Limited) during this project to ensure the



HAVING BEEN OUTSOURCED FOR SOME YEARS, THE COMPUTER FUNCTIONS OF RITS WERE LAUNCHED 'IN-HOUSE' ON 21 OCTOBER 2002 BY GEOFF BOARD, ASSISTANT GOVERNOR (BUSINESS SERVICES). THE OPENING OF THE SYSTEM FOR SETTLEMENT PROCESSING WAS WITNESSED BY DAVID BROWN, MICHAEL HOGAN AND MANY STAFF MEMBERS INVOLVED IN THE PROJECT.

continuance of high service standards to RITS members. Following internal and industry testing, RITS successfully cut over to in-house operations on 21 October 2002.

Secondly, as discussed in the chapter on Operations in Financial Markets, the continuous linked settlement (CLS) initiative to reduce foreign exchange settlement risk commenced operations in September 2002. Foreign exchange settlements in CLS occur across the books of CLS Bank, with net obligations in CLS being funded by payments to CLS Bank across participating RTGS systems, including RITS. CLS Bank has been granted an ES account with the RBA for this purpose. Currently nine banks in Australia make payments to CLS Bank on their own account or that of other CLS settlement members.

To the extent that Australian dollar foreign exchange settlements take place across CLS Bank rather than direct gross payments across RITS, it is expected that, over time, this will cause the number and value of transactions settled by RITS to decline. To date, however, it is too early to discern any clear trends.

The introduction of CLS has also meant extended operating hours for RITS in order to synchronise with CLS settlement hours during the European morning. Settlement in RITS closes at 7.00 pm in Australian eastern standard time and 9.00 pm in Australian eastern daylight saving time, compared with its previous closing time of 5.15 pm.

In addition to RTGS payments, RITS settles two batches of netted interbank payments each day. The 9.00 am batch consists of positions collated by the RBA on behalf of the Australian Payments Clearing Association arising from the previous day's "low value" clearings (paper, and bulk and retail electronic). The second batch settles net positions for equity transactions in CHESS, the electronic settlement system operated by the Australian Stock Exchange.

Work is under way to update RITS, as follows:

- The user interface for on-line access to RITS by members is being redeveloped to provide a windows-based facility. A firm implementation date has not yet been set; however, current planning is for members to be able to use the new interface by the end of 2004.
- A major means of sending payments to RITS is via the SWIFT FIN service. SWIFT has commenced a global project to migrate the transmission of SWIFT FIN messages to a new, more modern network which uses Internet-protocol technology. This will entail a compulsory, phased migration for all members of SWIFT. In Australia, the RBA is working in collaboration with the Australian Payments Clearing Association to ensure an efficient migration of SWIFT payments to the new network. As part of this, the RBA is planning to cut over the RITS SWIFT connections to the new "SWIFTNET" service by the end of November 2003.
- A range of enhancements to RITS functionality is also under development, including improved batch settlement facilities. The first package of changes, comprising a number of smaller enhancements, such as additional search criteria for banks to use in viewing settled payments, is expected to be implemented by the end of 2003.

Settlement services are also provided for financial market transactions undertaken by the RBA in the domestic securities and foreign exchange markets, and other RBA transactions such as those relating to banks' currency note lodgements and withdrawals. The Australian Government also uses the service for its high value transactions including, for example, the settlement of tenders in CGS, as do around 22 overseas central banks and official institutions for settlement of their Australian dollar investment transactions.

Registry Services

The RBA maintains the CGS register on behalf of the Australian Office of Financial Management (AOFM) and other smaller registries for a number of official foreign institutions who have Australian dollar debt programs. Services were also provided to the South Australian Government Financing Authority until November 2002, when their business was transferred to another service provider.

Core services provided by the registry include the issue, transfer and registration of securities, the maintenance of ownership records, the distribution of interest payments and the redemption of securities at maturity. In addition to these core functions, a number of services specific to CGS are provided, including:

- management and encashment of physical securities in circulation (some of which date back to, or beyond, the Second World War);
- maintenance of records and management of unclaimed monies relating specifically to CGS holdings;
- performance of historical searches, as a result of the large stockholder base associated with previous issues of Australian Savings Bonds and the Australian Government's long history as an issuer of debt securities; and
- operation of a small investor facility, enabling retail investors to access CGS by purchasing securities from the RBA's own portfolio at market-related prices. The RBA also repurchases CGS through the same facility.

Registry activity in 2002/03 remained low by historical standards, but was in line with recent years. The registry operations continue to be actively managed to ensure that services are delivered in as cost-effective a manner as possible, given the small size of the operation, while retaining a focus on quality of service.

Earnings after tax for the contestable registry business in 2002/03 were \$0.1 million, compared with \$0.2 million in the previous year.

Note Issue

The RBA's note issue functions include the issue of new and reissuable quality notes; 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 new note designs and security features.

During 2002/03, the RBA continued to work with the commercial banks to fine tune the new cash distribution arrangements introduced in November 2001. Under these arrangements, the commercial banks own the working stocks of notes and coin required to operate the cash distribution system and are encouraged to deal, wherever possible, directly with each other in managing short-term surpluses and shortfalls in their holdings of currency. Under previous arrangements, the RBA owned the working stocks and individual commercial banks dealt directly with the RBA for their note and coin requirements. The RBA continues to make payments to the commercial banks for interest forgone on the working stocks, up to a specified maximum, provided the stocks are held in approved cash centres and the commercial banks sort notes for quality according to a specified standard.

During the period November 2002 to June 2003, average daily commercial bank holdings of working stocks were some \$915 million lower than for the corresponding period in 2001/02. The reduced holdings reflect a higher level of comfort by the commercial banks with the new arrangements. As commercial banks gain further experience with the new system and develop new, more efficient arrangements for the exchange of cash between them, working stock levels should continue to decline.

The RBA is in the process of upgrading its high-speed note processing equipment to improve its ability to check notes for authenticity and the quality-of-fitness-sorting being done by the commercial banks, and to monitor the general

quality of notes in circulation. The new equipment will be progressively installed during 2003/04 at the National Note Processing Centre (NNPC).

Notes on Issue

The value of Australian notes on issue rose by \$243 million, or 0.8 per cent, over 2002/03 to \$32.2 billion. The increase is significantly lower than the 2001/02 increase of \$4.8 billion, or 17.5 per cent which, in large part, reflected the changed ownership arrangements for the cash distribution working stocks. Under the new cash distribution arrangements, the working stocks are recorded as “on issue” whereas previously they were not. Excluding the effect of the new arrangements, notes on issue still grew more slowly over 2002/03 (3.6 per cent) than during 2001/02 (6.2 per cent), the first time for a number of years that growth in the value of notes on issue has not matched growth in the economy. The increase occurred in the value of \$100 (2.8 per cent) and \$50 (1.4 per cent) notes on issue, with the value of other denominations decreasing, continuing the underlying trend towards a greater proportion of notes on issue being accounted for by the higher denominations.

Note Processing and Distribution

Note processing and distribution activities are centralised at the NNPC. Armoured car companies transport notes to and from the NNPC on behalf of the commercial banks. Under arrangements between the RBA and the commercial banks, unfit notes, surplus fit notes following seasonal peaks in demand, and notes sought by the RBA for authenticity and quality sampling purposes are returned to the NNPC. The commercial banks also draw notes from the NNPC to meet demand when notes cannot be obtained from other commercial banks.

During 2002/03 192 million notes (\$6.4 billion) were despatched from the NNPC and 205 million (\$6.2 billion) were returned. This level of activity is similar to the previous year. Of the 205 million notes returned 199 million notes were processed through high-speed note processing equipment for verification, authentication and quality control compared to 125 million notes processed during 2001/02. Notes deemed fit for reissue represented 41 per cent of notes processed compared with 47 per cent last year. The increase in processing volume and the levelling-out of the proportion of notes classified

Value of Notes on Issue (\$ million)

At end June	\$1(a)	\$2(b)	\$5	\$10	\$20	\$50	\$100	Total	Increase (per cent)
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
2002	0 (c)	45	530	791	2 789	14 718	13 057	31 930	17.5
2003	0 (c)	45	515	759	2 510	14 918	13 426	32 173	0.8

(a) Last issued May 1984

(b) Last issued June 1988

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

as fit for reissue over recent years reflects familiarisation with the changes made to processing and distribution arrangements.

The NNPC also receives and assesses for value notes that have been mutilated and are difficult for the general public and commercial banks to assess accurately. During the year the NNPC assessed 10 865 mutilated note claims with a total value of \$2.6 million. This was around twice the number assessed last year. The increase in mutilated note claims in large part reflects instances of incorrect classification of unfit notes into the mutilated category on the part of banks and armoured car companies. Over the period ahead, the RBA will work with participants to increase the level and quality of fitness sorting.

Counterfeiting Activity

Counterfeiting of Australian currency notes decreased in 2002/03, with around 9 counterfeits passed per million notes in circulation, compared to around 14 counterfeits per million in 2001/02. The rate of counterfeiting remains very low compared with the experience of other countries.

Around 90 per cent of counterfeits passed in 2002/03 were paper reproductions of polymer notes – typically \$50 notes. The vast majority of counterfeits are of poor quality and are generally easily detected by inspection and feel.

To maintain the standing of polymer notes at the forefront of anti-counterfeiting technology, the RBA continues to maintain active research and development programs into new security features.