

Banking and Payments

The Reserve Bank provides a range of banking, registry and payment settlement services to participants in the Australian financial system, the Australian Government and other central banks and international bodies. These include services associated with the operation of the Australian Government's principal public accounts; transactional banking services to government agencies; custodial, registry and related services; and the operation of the real-time gross settlement (RTGS) system for high-value Australian dollar payments.

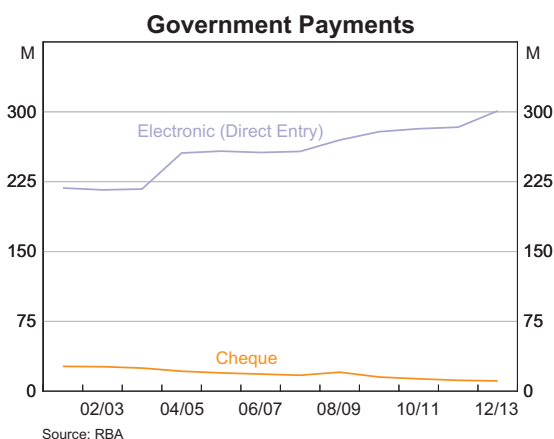
Banking

The Reserve Bank's banking services comprise two broad components: core and transactional banking services. Both are provided with the common objective of delivering secure and efficient arrangements to meet the banking and payments needs of the Australian Government and its agencies. In addition, the Bank provides banking and related services to a number of overseas central banks and official institutions.

Core banking services are provided to the Department of Finance and Deregulation (DoFD) on behalf of the Australian Government and the Australian Office of Financial Management (AOFM). These services derive directly from the Reserve Bank's role as Australia's central bank. They require the Bank to manage the consolidation of Australian Government agency account balances – irrespective of which financial institution each agency banks with – into the Government's Official Public Accounts (OPA) at the Bank on a daily basis. This involves 'sweeping' balances from agency accounts at transactional banks to the OPA at the end of each business day and transferring balances required to meet their day-to-day functions back the following morning. The average daily sweep to and from the OPA was \$4 billion and \$2 billion, respectively, in 2012/13. The Bank also provides the Government with a term deposit facility for investment of its excess cash reserves, as well as a short-term overdraft facility to cater for occasions when there is unexpected demand on Commonwealth cash balances. The overdraft facility is used infrequently and was not drawn upon in the reporting period.

While the Reserve Bank manages the consolidation of the Government's accounts, the AOFM has day-to-day responsibility for ensuring there are sufficient cash balances in the OPA and for investing excess funds in approved investments, including term deposits with the Bank.

The Reserve Bank's transactional banking services are associated with more traditional banking activities. Principal among these are services for making payments from government agencies to recipients' accounts. The Bank processed some 315 million payments, totalling \$455 billion, for government agencies in 2012/13. Most of these were made via



direct entry. The Australian Government also makes payments by eftpos, the RTGS system and cheque, though its use of cheques has fallen significantly in recent years relative to electronic payment methods. Cheques now make up less than 4 per cent of agency payments, compared with around 10 per cent a decade ago. In addition to payments, the Bank provides its government agency customers with access to a number of services through which they can collect funds, including Electronic Funds Transfer, BPAY, eftpos, and card-based services via phone and internet. The Bank processed 25 million collections-related transactions for the Australian Government in 2012/13, amounting to around \$430 billion.

The provision of transactional banking services is consistent with the Reserve Bank's responsibilities under the *Reserve Bank Act 1959*. The principal difference between core and transactional banking services is that the latter are offered on a commercial basis in line with the Australian Government's competitive neutrality guidelines. To deliver these services, the Bank must compete with other commercial financial institutions, in many instances bidding for business at tenders conducted by the agencies themselves. It must also cost and price the services separately from the Bank's other activities, including its core banking services, and meet a prescribed minimum rate of return. Some 90 government agencies are transactional banking customers of the Bank. Pro forma business accounts for transactional banking are provided with the Financial Statements in this Report (see page 125).

After-tax earnings from the Reserve Bank's transactional banking services were \$2.5 million in 2012/13. This is lower than in the previous year owing to higher costs in the provision of online transaction services and expenditure arising from improvements to banking systems.

The Reserve Bank typically works closely with its agency customers and with the Government more generally to ensure that they have access to services that are consistent with their needs and those of the public. In 2012/13 the Bank assisted the Department of Health and Ageing and the Australian Treasury in establishing a system of accounts for the National Health Funding Pool, under which hospital funding is coordinated between the Federal, state and territory governments, and worked with the Australian Prudential Regulation Authority to establish arrangements for paying depositors in the event of a failed authorised deposit-taking institution under the Government's Financial Claims Scheme. For some services, the Bank combines its specialist knowledge of the government sector with specific payment services and products from commercial providers to meet the Government's banking needs. Many of the collection services mentioned above – including eftpos and card-based phone and internet services – are examples of this. The Bank expects to make greater use of combined service arrangements as the Government's banking needs continue to evolve.

In common with other financial institutions, the Reserve Bank relies heavily on information technology and systems to deliver banking services to its customers. These systems require changes and improvements over time to ensure that they provide the highest levels of service, reliability and efficiency. Following a 15-month assessment of requirements, the Bank began a major program of work in July 2012 to upgrade its banking systems, a number of which have been in place for around 20 years and are, consequently, becoming costly to maintain. The program of work – which is occurring in stages over several years – will see the migration of existing systems to a contemporary programming language and architecture and result in more cost-effective banking processes. The first stage, involving the processing of RTGS payments for government agencies, is scheduled for completion in mid 2014. A dedicated team of business analysts, application developers and project managers is undertaking this work. A number of staff have been recruited externally to complement the Bank's existing resources. Further recruiting will take place over the next few years as the project progresses. Oversight is being provided by a steering committee comprising senior Bank staff.

Registry

The 2012 Annual Report noted that the Australian Government had decided to transfer the provision of registry services for Commonwealth Government Securities (CGS) from the Reserve Bank to a commercial service provider from the end of 2012. The decision followed an announcement by the Government in 2010 that it was looking to improve access to the bond market for retail investors. These services have been provided by the Bank under agreement with the AOFM, and typically include registration of new issues, ongoing maintenance of ownership records, distribution of interest payments and redemption of securities at maturity. Reflecting the complexities involved in resourcing these services, the AOFM now expects the transfer to occur at the end of 2013.

The Reserve Bank has also for many years provided a facility that enables retail investors to buy and sell CGS over the counter. In May, the AOFM announced that, as part of arrangements to improve access to bond markets, retail investors can now buy and sell entitlements to CGS through an electronic platform provided by the Australian Securities Exchange (ASX). The new arrangements mean that a separate, over-the-counter service provided by the Bank is no longer required. As a result, the Bank closed its facility for selling CGS to retail investors in May at the time of the AOFM's announcement. Arrangements by which the Bank will purchase CGS from investors through the facility will cease around the end of the year when the CGS registry is expected to move to an external provider.

Registry services are provided by the Reserve Bank to a number of foreign official institutions that have Australian dollar debt programs. These are not affected by the move in the CGS registry.

Earnings after tax for the registry business were \$0.2 million in 2012/13, similar to earnings in the previous year.

Settlement Services

The Reserve Bank owns and operates the Reserve Bank Information and Transfer System (RITS), which provides for the settlement of payment obligations across Exchange Settlement Accounts (ESAs) held with the Bank. Payments settled individually on an RTGS basis include time-critical customer payments, all wholesale debt and money market transactions and the Australian dollar legs of foreign exchange transactions. The latter includes Australian dollar trades involved in continuous linked settlement (CLS), for which net amounts are paid to and received from CLS Bank International each day. Around 90 per cent of electronic payments in Australia by value are settled in RITS on an RTGS basis.

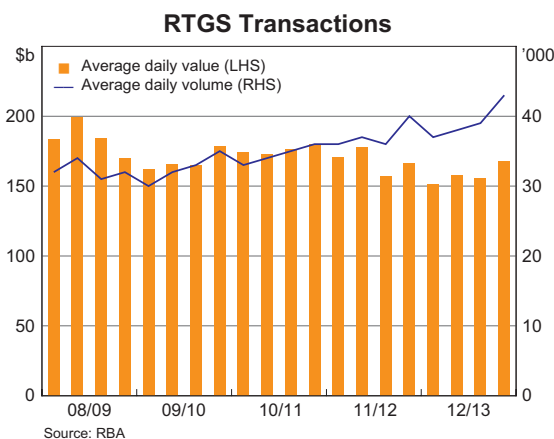
RITS also settles some payments on a net basis. One such arrangement – the daily CHES batch – is for settlement of payments arising from stock market transactions and is managed by the ASX as Batch Administrator. Another batch arrangement is for settlement of obligations arising from cheque, direct entry and retail card transactions that are cleared through low-value systems prior to settlement across RITS. Settlement of these obligations currently occurs at 9.00 am on the next business morning. The Reserve Bank has been working with the payments industry over recent years to allow these transactions to settle on a more timely basis.

The RITS Low Value Settlement Service (LVSS), described in previous Annual Reports, enables RITS Members to provide settlement instructions to RITS at around the same time as file-based clearing activity takes place between the institutions. During 2012, the LVSS replaced legacy arrangements whereby only aggregated settlement instructions were sent to the Reserve Bank during overnight processing, prior to settlement across RITS at 9.00 am on the next business day. Settlement instructions relating to low-value clearing obligations are

now sent directly to RITS multiple times during the day and are able to be settled on the same day as clearing files are exchanged. Accordingly, the Bank is working closely with APCA and RITS Members to introduce same-day settlement for the direct entry system. The implementation of this industry project is scheduled for November 2013. This outcome is in line with the conclusions of the Payments System Board's *Strategic Review of Innovation in the Payments System* published in June 2012.

At the end of June 2013, there were 62 institutions approved to operate an ESA. A further 23 institutions hold ESAs but have appointed another ESA holder to settle their RTGS transactions on their behalf in RITS. Another 45 institutions were Non-Transaction Members of RITS in order to participate in the Reserve Bank's domestic open market operations.

Close to 39 000 RTGS transactions worth \$157 billion were settled in RITS, on average, each day during 2012/13. While RTGS volumes have grown steadily since the global financial crisis in 2008, values are yet to return to the levels that prevailed before the crisis.



In addition to RTGS payments, the daily value of obligations settled on a net deferred basis at 9.00 am each day using the LVSS averaged \$3.8 billion in 2012/13. These settlements covered 12 million underlying transactions worth around \$20 billion on average each day. CHES batch settlements averaged around \$767 million each day in 2012/13.

The liquidity used to settle transactions in RITS during the day comes from overnight balances held in ESAs and intraday repurchase transactions undertaken with the Reserve Bank (see the chapter on 'Operations in Financial Markets'). Intraday liquidity in RITS was close to all-time peak levels in 2012/13; combined with subdued payment values, this contributed to faster throughput of transactions in RITS.

Reflecting the critical importance of RITS to the Australian financial system, the Reserve Bank invests significantly in its technical and business infrastructure and in operational resourcing. This ensures that RITS operates to appropriately high standards of availability and resilience and that its settlement services evolve to meet the changing needs of the payments system. In addition to the work involved in migrating to LVSS, major infrastructure work undertaken in 2012/13 included:

- upgrading the RITS certificate authority, which provides security credentials for accessing and operating the RITS user interface
- undertaking proof of concept testing ahead of a required replacement of RITS servers, operating systems and databases scheduled for completion in 2014
- providing additional functionality in RITS for new liquidity arrangements that will support extended settlement hours for direct entry payments
- introducing enhanced transaction management functionality in RITS to assist Members with management of small-value payments.

Over the coming year, the Reserve Bank will be considering further enhancements to RITS and related payment services. One important development will be the RITS Fast Settlement Service, which will provide high-speed settlement services to support the New Payments Platform being developed by the payments industry. This is an initiative proposed in response to the objectives outlined in the Payments System Board's *Strategic Review of Innovation in the Payments System*. The New Payments Platform is expected to provide real-time bank account to bank account transfers on a 24/7 basis, immediate funds availability to recipients, richer remittance information, ease of addressing payments, and settlement of each payment in ES funds via a new RITS Fast Settlement Service. This new infrastructure is expected to be the basis for future payments innovation.

In managing RITS, the Reserve Bank aims to recover its operating costs from RITS Members. Capital and development costs of major upgrades and functional enhancements are absorbed by the Bank as a policy-related expense. In July 2012, the Bank revised the RITS fee structure to provide a more representative distribution of costs among Members. Key changes to the fee structure were a reduced RTGS settlement fee, abolition of separate fees for cash transfers, the introduction of a fee based on values settled and the introduction of annual fees for membership and for the use of the Automated Information Facility.

More than 50 overseas central banks hold accounts at the Reserve Bank for settlement of their Australian dollar transactions and safe custody services. Reflecting increased overseas demand for Australian dollar investments, the amount held in custody by the Bank for these institutions increased by \$6.5 billion to \$68.7 billion over the reporting period.

The Reserve Bank also provides settlement services for banknote lodgements and withdrawals by commercial banks and for RTGS settlement of (mainly high-value) transactions undertaken by the Bank and its customers, including the Australian Government, and overseas central banks and official institutions.

