

Overview

The mandate of the Payments System Board of the Reserve Bank is to promote safety, efficiency and competition in the payments system in Australia and, in a recent extension of its responsibilities, to promote the safety of systems that clear and settle securities transactions in Australia's wholesale financial markets. This broad and evolving mandate is a recognition of the importance of robust payments and settlement systems for the overall stability of the Australian financial system, a longstanding central bank concern. It is an acknowledgment, as well, that the market and governance arrangements prevailing in Australia over a long period have not been conducive to efficient resource allocation and vigorous competition in the payments system.

For some time, the Board has focused its efforts on the retail payments system, through which consumers and businesses make their payments. The Board's own work has confirmed that there is scope for significant improvement in this area. Retail payments patterns in Australia are now changing at what seems a relatively quick pace. Technological advances are enhancing the features and the range of choice of payment methods. For many consumers, electronic means of payment are supplanting the traditional cheque, although the "smart card" revolution remains elusive and e-commerce has yet to develop an effective replacement for the cheque for business use.

As in other markets for goods and services, price incentives facing users of the various means of payment are also shaping payments patterns.

The Board's concern has been that, in the rapidly growing area of card networks (credit cards, debit cards and ATM networks), price incentives are not the outcome of normal competitive processes. They are the outcome, instead, of arrangements for wholesale ("interchange") fees – fees paid between financial institutions – that have proven rigid over time and immune to competitive pressures, and of restrictions on entry to the card networks, both explicit and informal. In Australia's highly concentrated banking system, the fee structures for the main competing payment methods are set by the same group of banks and other deposit-taking institutions. This is not an environment, in the Board's judgment, in which current price signals can be relied upon to ensure that consumers confront the cost of their payment choices and that resources are allocated to their most efficient use.

Against this background, the Board has embarked on a major reform of card networks that is intended to allow normal market mechanisms to operate more effectively in the Australian payments system, in the community's interest. A key part of this agenda was completed in August 2002 when the Bank, after extensive consultations, announced its reforms to credit card schemes in Australia. These reforms are described in the body of this Report. In this case, the Bank used its formal powers in the payments system not to regulate the credit card market, but to end scheme restrictions already in place that do not allow competitive forces to work.

Reform of interchange fee arrangements in debit card and ATM networks has followed a different path and timetable. Industry participants were initially reluctant to embrace the Board's broad agenda but the finalisation of credit card reforms has added impetus to industry reviews of existing arrangements. To this point, the Board has been content to limit the Bank's role to that of facilitator, bringing industry participants together and helping to develop options for reform in both debit card and ATM networks, but stepping back more recently to see whether an industry-led consensus could be developed and implemented in a timely fashion. Considerable progress on reform to debit card interchange fees has been made over the past year and a proposal to reduce these fees to zero is currently before the Australian Competition and Consumer Commission. Industry commitment to reform of ATM arrangements has been much slower to develop but proposals for a "direct charging" regime that would replace ATM interchange fees have recently been put out for public consultation.

The Board strongly supports proposed reforms to debit card and ATM networks that would bring to an end the ossified structure of bilateral interchange fees. Such reforms, accompanied by the removal of current (informal) barriers to entry to these networks, will deliver more efficient and transparent pricing of debit card and ATM services and a significant reduction in transaction fees for users. In the Board's view, the sensible timetable for debit card reform is one that coincides with

credit card reform, with ATM reforms following as soon as is practicable.

The safety of payments and settlement systems has become a matter of increasing international attention, particularly in the wake of the severe shocks to the global financial system over the recent period. Compliance with accepted payments and settlement standards now forms part of assessments by international financial institutions of a country's vulnerability to financial disturbances. Australia continues to be well served by its domestic high-value payments system and the Board is closely monitoring the evolution of international standards. In the safety and stability area, an important milestone in 2002 was the commencement of operations by CLS Bank, a special-purpose bank that settles foreign exchange transactions in major currencies, including the Australian dollar. The Board has been a strong supporter of this global initiative, which significantly reduces foreign exchange settlement risks for member banks. Over the past year, a particular priority for the Board has been the development of financial stability standards for securities clearing and settlement systems, to give effect to its new responsibilities in this area. These standards are designed to ensure that Australia's crucial "back office" systems are able to withstand shocks, whether from the inability of a participant to meet its obligations or an operational failure. The standards have already been the subject of a public consultation process and are expected to be released in final form shortly.

