The Australian Payments System

Each day, the Australian community – consumers, businesses, financial institutions and governments – makes millions of payments to acquire goods and services, or to transact in financial and other assets. These payments can be made in cash or a variety of non-cash means, including cheques, credit and debit (EFTPOS) cards and a range of specialised high and low-value electronic payment systems. Non-cash payments total around $170 billion daily, the equivalent of Australia's Gross Domestic Product every four days. Together, the individual payment systems, the infrastructure that supports them and the organisations that operate them make up the Australian payments system.

The payments system covers two broad classes of payments: *retail* payments by consumers and businesses and *wholesale* payments to settle transactions in financial markets. Retail payments account for almost all payments by number but only a small part of the total value of payments; in contrast, wholesale payments are small in number but, being typically for very high values, account for most of the value of payments.

These arrangements, which can be quite complex, involve initiation of the payment – for example, by a customer writing a cheque or presenting a credit card – and some form of communications network that allows payment messages to be sent to all the relevant parties. When both the payer and the beneficiary have their account at the same financial institution, the payment can be completed on the books of that institution through a debit to the payer's account and a credit to the beneficiary's account. Where the payer and the beneficiary have their accounts at different financial institutions, the payment messages are exchanged or cleared between the institutions and funds are transferred in turn between the institutions. This last step is known as settlement between financial institutions (often called interbank settlement) and is usually done by debiting and crediting the accounts which the respective financial institutions hold at a settlement institution, usually the Reserve Bank.

The operations of some individual payment systems in Australia are co-ordinated by the Australian Payments Clearing Association (APCA); other systems are operated by domestic and international card schemes or independently by groups of financial institutions. Individual payment systems are governed by sets of rules normally determined by members. These rules deal with the requirements for participation in the system (e.g. which institutions can offer the particular payment service or what institutions need to do to offer the service), how

AUSTRALIA: PAYMENTS BETWEEN FINANCIAL INSTITUTIONS 2002

	RETAIL	**WHOLESALE**
Purpose	Retail and commercial payments	Foreign exchange, money market trades, corporate payments
Mechanism	Cash, cheques, direct credits and debits, cards	Real-time gross settlement
Daily turnover*	$20 billion	$120 billion
Average daily number*	9.5 million	20 000

*Excluding cash. Numbers and values of payments between financial institutions understate the total for the Australian community because they exclude payments between customers of the same financial institution.

While they vary considerably in detail, individual non-cash payment systems have a great deal in common. Each involves arrangements that allow the settlement or discharge of payment obligations through the transfer of funds from the accounts of payers to the accounts of beneficiaries.

the payment instructions are cleared between institutions, the procedures for determining each institution's settlement obligations and how settlement takes place.

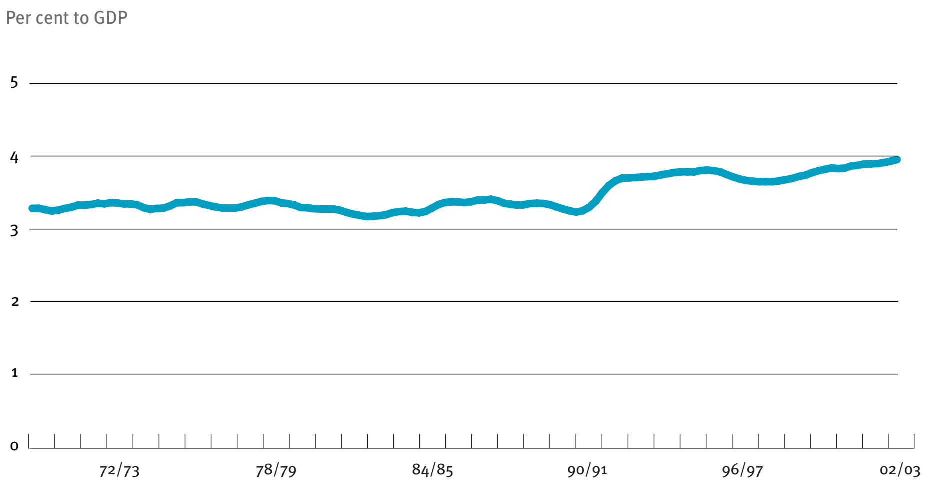
Retail payments

In its initial stocktake of the Australian payments system, published in its 1999 Report, the Payments System Board highlighted two particular characteristics of retail payments in Australia – the well-entrenched use of cash and the popularity of the cheque, for a long time the most frequently used non-cash means of payment. Australia was then one of a number of industrial countries, along with the United States, the United Kingdom, Canada and France, that used cheques extensively. Within a few short years, this characterisation has changed. Cash continues to be an important payment method in Australia but cheques have been clearly displaced by electronic means of payment.

Whether proxied by the ratio of currency (notes and coins in the hands of the non-bank public) to GDP, or by withdrawals from ATMs, cash remains a significant means of payment, especially for small-value payments. Despite earlier expectations, smart cards and "electronic money" have made no inroads on cash payments in Australia (or in most other countries). At the same time, the number of non-cash payments per capita has been rising strongly. Some substitution away from cash has undoubtedly taken place but other factors are also relevant. Many local authorities, utilities and insurance companies, for example, now offer quarterly or monthly payments in lieu of less frequent payment schedules. And payments are now being made (usually monthly) for services not previously available, such as cable television, Internet and mobile phones.

A number of considerations shape the choice of payment method for consumers and businesses. One

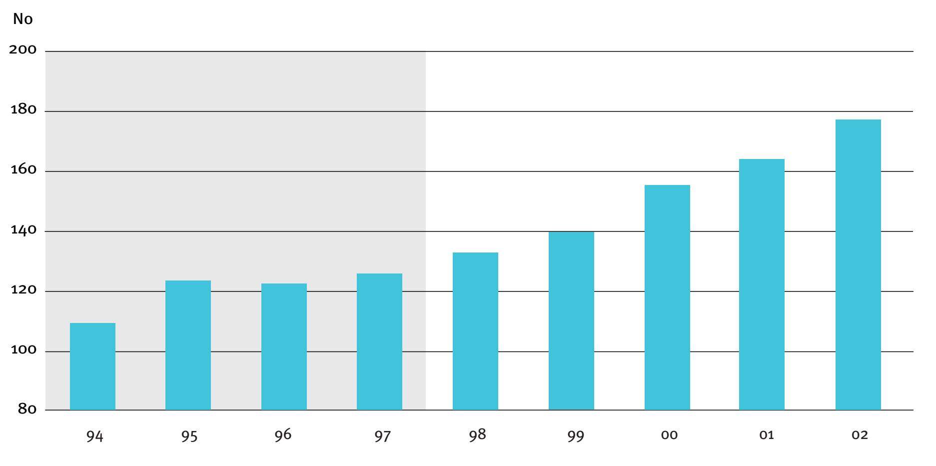
CURRENCY



is the quality of service, covering such features as the speed with which payments are processed, the convenience offered and the reliability and security of the payment method. Another is the structure and level of fees charged by financial institutions providing the payment services. Tastes and demographics also play a part. Technological advances which have improved the speed, convenience and flexibility of different payment methods have been a significant influence on the changing payments landscape in Australia over recent years. So, too, have been the price signals facing the user. This is most apparent in the growth of card-based payments. Credit card transactions have been rising sharply for some time – the number of credit card payments per head has quadrupled over the past decade – and the credit card has now become the most frequently used means of payment in Australia. Debit card (EFTPOS) usage has also been growing but at rates that have been outstripped by credit cards over recent years. As the Board has noted in earlier Reports, these divergent trends are not surprising in view of the structure of fees charged by financial institutions for providing card payment services. Consumers using a debit card generally pay a transaction fee to their financial institution (beyond a fee-free threshold) for accessing their own funds; credit cardholders who pay off their outstanding balances each month pay no transaction fees, and may be paid in the form of loyalty points, for using the funds of their financial institution.

Direct credits to customers' accounts at financial institutions have continued to grow steadily. The Commonwealth Government has provided an important lead in this area in paying social security benefits and other government disbursements by direct credit rather than by cheque, at a considerable saving in costs. Businesses are also making growing use of direct credits

NON-CASH RETAIL PAYMENTS PER CAPITA



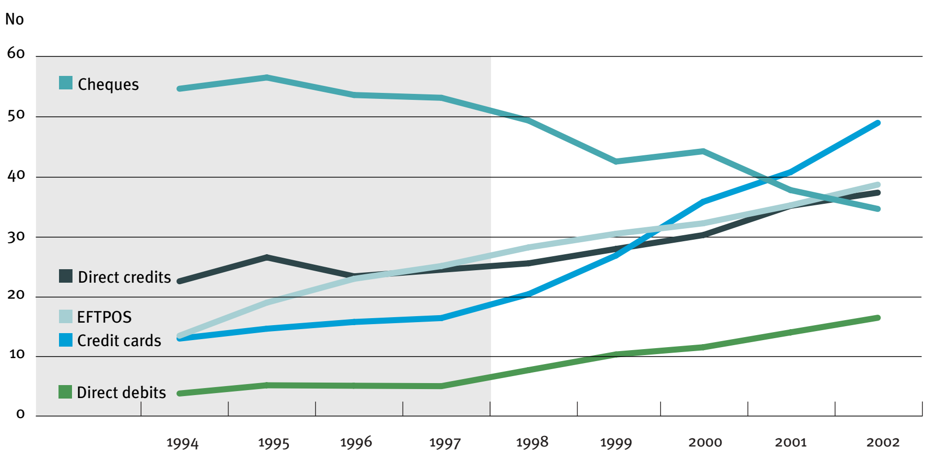
for recurring bulk payments of salaries, pensions, interest and dividends, where the beneficiary needs no special explanation of the payment credited to their account.

Australians are also showing greater willingness to use direct debits as a means of paying regular bills or recurring obligations. Over the past five years the number of direct debit transactions per capita has trebled, albeit from a low base. One reason behind this greater take-up has been the introduction of some basic consumer safeguards by billers. Another is the growing recognition by billers that direct debits are a very efficient and low cost means of payment. The number of billers offering a direct debit payment facility has also trebled over the past five years; the system has been better publicised; and many billers now offer discounts to customers who sign up to pay by direct debit rather than by more costly means.

The growth of electronic payment mechanisms has been at the expense of cheques. Although cheques remain a convenient and flexible means of payment for many Australians, consumers appear to be keen to embrace the newer payment technologies and may also be responding to increased fees for writing cheques, as financial institutions seek to recover the relatively high costs of providing this payment service. Businesses are the main users of cheques and their usage also appears to be trending down. However, the value of cheques written by business remains substantial – many businesses have yet to find an electronic replacement for cheques that allows the flexible reconciliation of payments with invoice data.

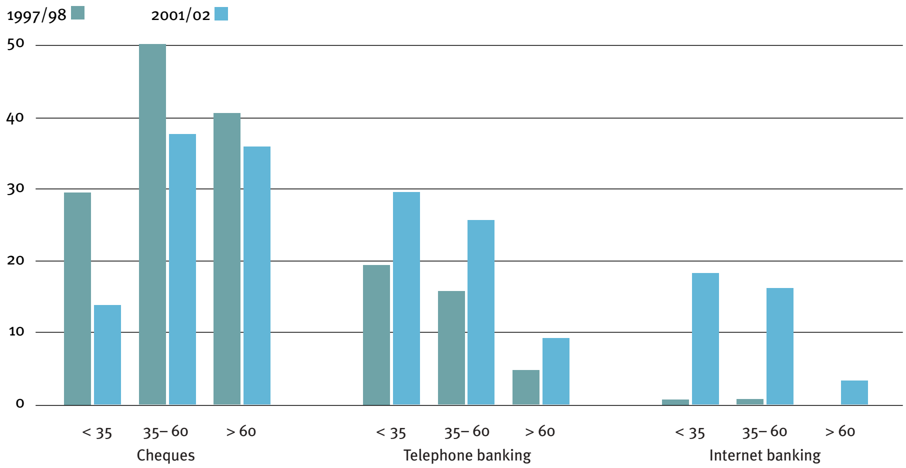
NON-CASH PAYMENTS PER CAPITA

Per year



USE OF PAYMENT CHANNELS

Per cent of age group



Source: Roy Morgan Research

Survey data provide some further insights into the changing pattern of retail payments for consumers. Over the past four years, a smaller proportion of survey respondents have written cheques, and a higher proportion have made electronic payments. In 2001/02, around 22 per cent of survey respondents had used telephone banking, and 13 per cent had used Internet banking, in the month prior to the survey. Younger consumers, generally with greater access to technology and perhaps a greater willingness to apply it, make much less use of cheques.

Wholesale payments

Wholesale ("high-value") payments account for most of the value of payments settled between Australian financial institutions, although the number of such payments – around 20 000 each day – is relatively small. These payments are to settle transactions in wholesale markets in government and other fixed-interest securities, the Australian dollar leg of foreign exchange transactions and a range of time-critical corporate transactions. Around 90 per cent of the value of interbank payments is settled through Australia's real-time gross settlement (RTGS) system, introduced in June 1998 and operated by the Reserve Bank. Under this system, all high-value payments are settled individually, as they are made, using funds in institutions' Exchange Settlement Accounts at the Reserve Bank.

There are two high-value payment streams which settle on an RTGS basis. Austraclear is an electronic depository and settlement system for Commonwealth Government Securities (CGS) – a role it assumed from the Reserve Bank in February 2002 – and for other debt securities. The SWIFT Payment Delivery System (PDS) is the main vehicle for making payments which do not have an associated securities transaction. (The RTGS system also settles directly a range of other interbank transfers.)

RTGS TRANSACTIONS 2002

Daily average, March-December

	SYSTEM	VALUE ($ billion)	NUMBER (Thousands)
CGS, other fixed-interest and money market transactions	Austraclear	30.3	2.6
Foreign exchange, corporate transactions, etc	SWIFT PDS	88.5	17.1
Other interbank transfers	RTGS	6.4	0.2

Overall, RTGS payments average around $120 billion each day.

The role of the Board

The Payments System Board of the Reserve Bank was established on 1 July 1998 with a mandate to promote safety, efficiency and competition in the Australian payments system. In September 2001, the Board was also given responsibility for the safety of systems that clear and settle securities transactions in Australia.

The Reserve Bank's formal involvement in the payments system was a response to the recommendations of the Financial System Inquiry (the Wallis Committee), which had concluded that Australia's payments system was not at international best practice, particularly as far as the efficiency of retail payments was concerned. The additional responsibility for securities clearing and settlement facilities is a recognition of the importance of safe and well-functioning facilities of this type for overall financial system stability, an enduring central bank concern.

The Board's mandate in the payments system is set out in the amended *Reserve Bank Act 1959*. The Board is responsible for determining the Reserve Bank's payments system policy and it must exercise this responsibility in a way that will best contribute to:

- controlling risk in the financial system;
- promoting the efficiency of the payments system; and
- promoting competition in the market for payment services, consistent with the overall stability of the financial system.

The regulatory powers which support this mandate are vested in the Reserve Bank and are set out, in the main, in the *Payment Systems (Regulation) Act 1998*. Under this Act, the Reserve Bank may:

- "designate" a particular payment system as being subject to its regulation. Designation is the first of a number of steps the Bank must take to exercise its powers;
- determine rules for participation in that system, including rules on access for new participants;
- set standards for safety and efficiency for that system. The Act does not define or limit the matters on which the Reserve Bank may determine standards; and
- arbitrate on disputes in that system over matters relating to access, financial safety, competitiveness and systemic risk, if the parties concerned wish.

These powers are intended to be exercised if the Bank is not satisfied with the performance of a payment system in improving access, efficiency and safety, and other means of achieving these objectives have proved ineffective.

As with the payments system, the Board has been given responsibility to determine policies with respect to the safety of clearing and settlement facilities while the powers to carry out those policies are vested in the Reserve Bank. Under recent amendments to the *Reserve Bank Act 1959,* the Board's mandate in this area is to ensure, within the limits of its powers, that the powers and functions of the Reserve Bank, which are set out in Part 7.3 of the *Corporations Act 2001,* are exercised in a way that, in the Board's opinion, will best contribute to the overall stability of the financial system. The Reserve Bank itself has formal responsibility for ensuring that clearing and settlement facilities conduct their affairs in a way that is consistent with financial system stability. As part of this role, it has the power to set and monitor compliance with financial stability standards for clearing and settlement systems.

The new regulatory regime for securities clearing and settlement systems came into force in March 2002, with a two-year transition period for systems that were not explicitly regulated under the previous regime.

The Board's approach to its mandate has been outlined in previous Reports. The balance of this Report provides details of the Board's activities in carrying out its responsibilities over the past year.