



**RESERVE  
BANK  
*of*  
AUSTRALIA**

**PAYMENTS  
SYSTEM BOARD**

**ANNUAL REPORT 2009**

*Reserve Bank*

## Payments System Board

It is the duty of the Payments System Board to ensure, within the limits of its powers, that:

- the Bank's payments system policy is directed to the greatest advantage of the people of Australia;
- the powers of the Bank which deal with the payments system, set out in the *Payment Systems (Regulation) Act 1998* and the *Payment Systems and Netting Act 1998*, are exercised in a way that, in the Board's opinion, 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; and
- the powers of the Bank which deal with clearing and settlement facilities, 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.

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# PAYMENTS SYSTEM BOARD

## ANNUAL REPORT 2009

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*Reserve Bank*



# Functions and Objectives of the Payments System Board

The responsibilities of the Payments System Board are set out in the *Reserve Bank Act 1959*. In particular, the Act requires the Board to determine the Reserve Bank's payments system policy so as to 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.

In order to give effect to these responsibilities, the Bank has powers that are set out in two Acts: the *Payment Systems (Regulation) Act 1998* and the *Payment Systems and Netting Act 1998*.

Under the *Payment Systems (Regulation) Act* the Bank has the power to designate payment systems and to set standards and access regimes in designated systems. The Act also sets out the matters that the Bank must take into account when using these powers. The *Payment Systems and Netting Act* provides the Bank with the power to give legal certainty to certain settlement arrangements so as to ensure that risks of systemic disruptions from payment systems are minimised.

In addition, the *Reserve Bank Act* gives the Board responsibility for ensuring that clearing and settlement facilities contribute to the stability of the financial system. The relevant powers are set out in the *Corporations Act 2001*, which gives the Bank the power to determine financial stability standards for licensed securities clearing and settlement facilities.

This Report discusses the activities of the Board over 2008/09.

# Governance

## Composition of the Payments System Board

The Payments System Board comprises the Governor, who is Chairman, one representative of the Bank appointed by the Governor, one representative of the Australian Prudential Regulation Authority (APRA) appointed by APRA and up to five other members appointed by the Treasurer for terms up to five years. Details of the current members are set out on pages 4 and 5. Five members form a quorum at a meeting of the Board.

## Meetings of the Payments System Board

The *Reserve Bank Act* does not stipulate the frequency of Board meetings. Since its inception, the Board's practice has been to meet at least four times a year, and more often as needed; there were four meetings in 2008/09 (Table 1).

**Table 1: Number of Meetings Attended by Each Member in 2008/09<sup>(a)</sup>**

Glenn Stevens	4	(4)
Philip Lowe <sup>(b)</sup>	3	(3)
Malcolm Edey <sup>(c)</sup>	1	(1)
John Laker	4	(4)
Joe Gersh	4	(4)
Robert McLean	4	(4)
John Poynton	3	(4)
Catherine Walter	4	(4)

(a) Figures in brackets show the number of meetings each member was eligible to attend.

(b) Philip Lowe's term ended on 13 April 2009.

(c) Malcolm Edey was appointed to the Board on 14 April 2009.

## Conduct of Payments System Board Members

On appointment to the Board, each member is required under the *Reserve Bank Act* to sign a declaration to maintain confidentiality in relation to the affairs of the Board and the Bank. Further, members must by law meet the general obligations of directors of statutory authorities, as set out in the *Commonwealth Authorities and Companies Act 1997 (CAC Act)*. The *CAC Act* sets standards of conduct for directors

and officers of Commonwealth authorities, with many of these requirements being modelled on comparable areas of the Corporations law. As such, members of the Payments System Board must:

- discharge their duties with care and diligence;
- act in good faith, and in the best interests of the Bank;
- not use their position to benefit themselves or any other person, or to cause detriment to the Bank or any person;
- not use any information obtained by virtue of their position to benefit themselves or any other person, or to cause detriment to the Bank or any person; and
- declare any material personal interest where a conflict arises with the interests of the Bank.

## **Remuneration**

Fees of the non-executive members of the Payments System Board are determined by the Australian Government Remuneration Tribunal.

## **Indemnities**

Under the provisions of Section 27 of the *CAC Act* and pursuant to a resolution by the Reserve Bank Board on 3 November 1998, members of the Payments System Board have been indemnified against liabilities incurred arising out of the proper discharge of their responsibilities, provided that any such liability does not arise from conduct involving a lack of good faith. This indemnity does not extend to claims by the Bank itself or any subsidiary of the Bank.

# Payments System Board | August 2009



## **Glenn Stevens (Chairman)**

Chairman since 18 September 2006  
Present term ends 17 September 2013

Governor – Reserve Bank of Australia  
Chairman – Council of Financial Regulators



## **Malcolm Edey (Deputy Chairman)**

Deputy Chairman since 14 April 2009

Assistant Governor (Financial System) –  
Reserve Bank of Australia



## **John Laker AO**

Chairman – Australian Prudential Regulation Authority  
Member since 24 July 1998



## **Joe Gersh AM**

Member since 15 July 1998  
Present term ends 14 July 2013

Executive Chairman – Gersh Investment Partners Ltd  
Chairman – Australian Reinsurance Pool Corporation





**Robert McLean**

Member since 29 November 2006  
Present term ends 28 November 2011

Chairman – Imagination Entertainment Limited  
Senior Advisor – McKinsey & Company



**John Poynton AM**

Member since 26 May 2000  
Present term ends 24 May 2010

Executive Chairman – Azure Capital Pty Ltd  
Deputy Chairman – Austal Limited  
Director – Burswood Entertainment Complex  
Director – University of Western Australia Business School



**Catherine Walter AM**

Member since 3 September 2007  
Present term ends 2 September 2012

Chairman – Australian Synchrotron  
Chairman – Equisuper Pty Ltd  
Director – Australian Foundation Investment Company  
Company Director – James Hardie Industries NV  
Director – Melbourne Business School  
Director – Orica Limited  
Member – Financial Reporting Council

# Developments in the Retail Payments System

Use of non-cash payments in Australia continued to rise over 2008/09 at a rate similar to that of recent years. Trends in the composition likewise continued those of recent years – cheque use continued to decline and use of electronic methods of payment grew further. The recent trend in card payments – towards debit and away from credit – accelerated in 2008/09 and the use of BPAY also continued to grow strongly. Other developments during the year were an increase in credit card fraud and continued rapid adoption by merchants of surcharging of credit and charge cards.

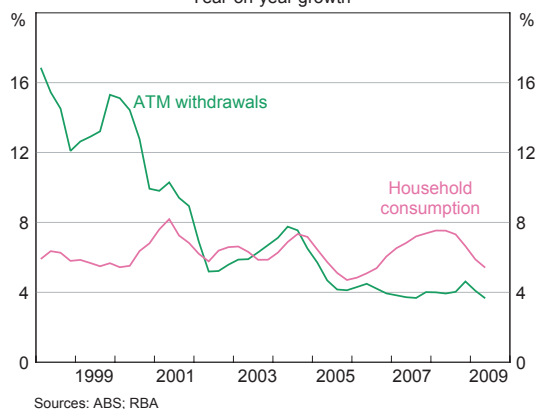
## Trends in Retail Payments Use

### Cash payments

Relatively little information is available on cash payments. A consumer survey undertaken by the Reserve Bank in 2007 indicated that, at that time, around 70 per cent of the number of consumer payments and 38 per cent of the value were undertaken using cash. There are no time-series data on cash payments. Some information can, however, be inferred from the value of cash withdrawals. These data suggest that cash payments continued to decline in importance relative to non-cash payments over the past year. The value of cash withdrawals increased by 1 per cent in 2008/09, around 4 percentage points slower than consumption growth over the same period.

The two primary means of accessing cash are through ATMs and over-the-counter at bank branches, although there is also a significant number of relatively small cash withdrawals using EFTPOS at merchants. The value of ATM withdrawals, which account for around 63 per cent

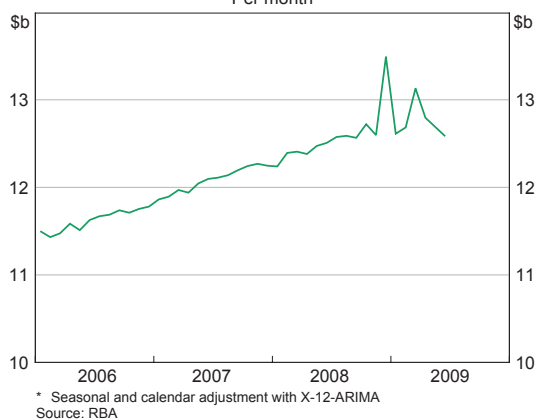
**Graph 1**  
**Value of ATM Withdrawals and Household Consumption**  
Year-on-year growth



of the value of cash withdrawals, rose by around 4 per cent over the year, around the same as in recent years but slower than consumption (Graph 1). The value of over-the-counter cash withdrawals, which account for around 26 per cent of cash withdrawals, fell by around 5 per cent. Within the year, however, there was substantial volatility in the month-to-month growth in cash withdrawals reflecting a number of special factors. First, there was a substantial rise in the value of cash withdrawals, both over-the-counter and at ATMs, in December 2008

and March 2009, coinciding with the Federal Government's stimulus payments (Graph 2). Second, there was a large rise in the number and value of EFTPOS cash outs in March 2009, possibly a reaction to the introduction of direct charging at ATMs. Cash advances on credit cards, a small and declining means of accessing cash, accounted for only 5 per cent of the total value of cash withdrawals in 2008/09, down around half a percentage point over the past two years.

**Graph 2**  
Value of ATM Withdrawals\*  
Per month



## Non-cash payments

The long-term trends in non-cash retail payments that have been observed in previous years continued in 2008/09. The number of non-cash payments grew by around 7 per cent over the year, although the value of those payments remained virtually unchanged. This growth was driven by electronic payment methods. In particular, use of debit cards continued to grow strongly during 2008/09, while growth in both credit card and direct entry payments was modest by recent standards (Table 2, Graph 3). In contrast, cheque use continued its long-term decline. Whereas a decade ago cheques accounted for around 30 per cent of the number of non-cash payments – the highest share of all non-cash payment instruments – they accounted for just 6 per cent in 2008/09.

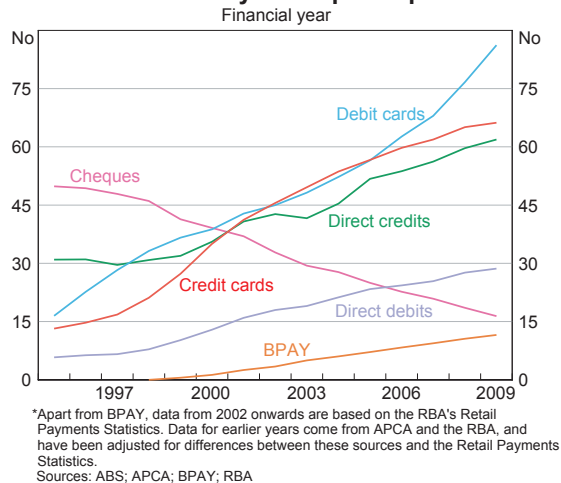
**Table 2: Australian Non-cash Retail Payments**

	2008/09			Growth, 2008/09	
	Per cent of total			Per cent	
	Number	Value	Average value (\$)	Number	Value
Cheques	6.0	10.8	4 225	-9.9	-15.2
Direct debits	10.6	35.9	8 000	5.9	1.4
Direct credits*	22.9	49.6	5 113	5.8	2.8
Debit cards	31.8	0.9	69	14.7	15.5
Credit cards	24.4	1.5	145	3.8	4.8
BPAY	4.3	1.3	714	11.6	12.5
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>2 358</b>	<b>7.1</b>	<b>0.2</b>

\*Excludes BPAY transactions  
Sources: BPAY; RBA

With growth in debit card transactions outpacing credit cards in recent years, debit cards were the most frequently used non-cash payment instrument in 2008/09, accounting for close to one-third of the number of non-cash payments. Credit card payments and direct credits each

**Graph 3**  
Non-cash Payments per Capita\*

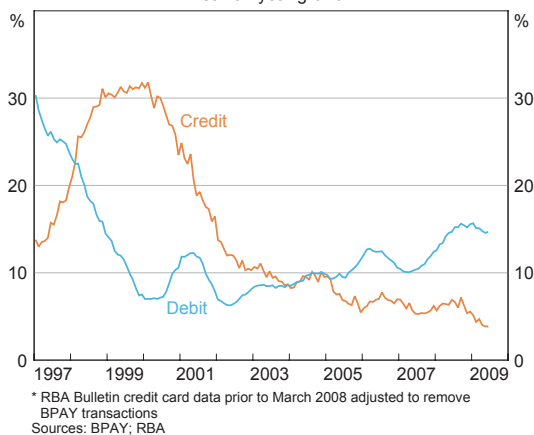


### Card-based payments

Growth in card-based payments remained strong in 2008/09. Total card payments increased by around 10 per cent by number and 9 per cent by value in the year to June 2009. These growth rates were slightly slower than in the previous year, consistent with weaker economic activity.

Within card payments, the trends in the growth of debit and credit card payments continued to diverge: debit card payments continued to grow strongly, while the use of credit cards moderated (Graph 4). Debit card payments grew by around 15 per cent by both number and value in the year to June 2009. In contrast, growth in credit and charge card payments slowed further to 4 per cent by number and 5 per cent by value over the same period. Consistent with these broad trends, over the past year the number of debit card accounts increased by nearly twice the rate of credit card accounts – 5 per cent, compared with 3 per cent, respectively. Nonetheless, while debit cards made up a higher share of card payments by number

**Graph 4**  
Number of Card Payments\*  
Year-on-year growth



accounted for roughly one-quarter of non-cash payments. In terms of value, however, direct debits and direct credits together made up 85 per cent of non-cash payments, reflecting the much larger average size of these payments. Cheques accounted for 11 per cent of value, while debit and credit cards together made up only around 2½ per cent.

Per head of population, there were 86 debit card, 66 credit card and 62 direct credit transactions in 2008/09. This compares with only 16 cheque transactions.

(57 per cent), credit cards still comprised a higher share by value (62 per cent), reflecting the higher average size of a payment made on a credit card.

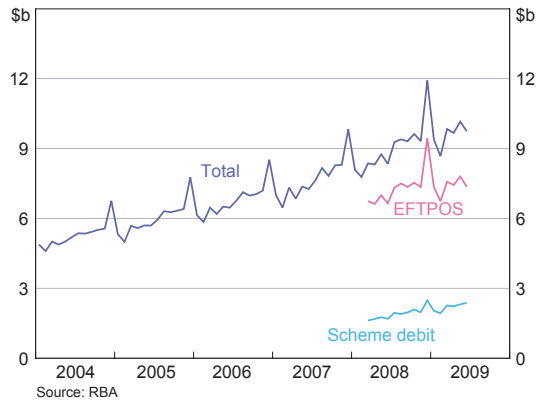
A number of factors may account for the divergence between growth in debit and credit card transactions in recent years. The first is that the Board's card payment reforms may have had an effect on the use of credit cards. Issuers responded to the reduction in interchange fees by increasing annual credit card fees and reducing the reward points offered (see 'Pricing to cardholders', below).

The increased use of surcharging by merchants may also have discouraged credit card use (see ‘Surcharging’, below). At the same time, the marginal cost of making EFTPOS transactions has been reduced for many customers as a result of the introduction of ‘all you can eat’ deposit account pricing, which, in part, reflects the Bank’s intervention on EFTPOS interchange fees.

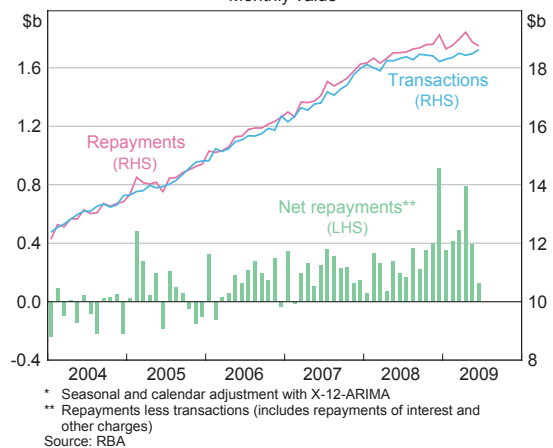
A second factor is that some of the strength in debit card growth has been driven by scheme debit products. These products draw funds from a deposit account held at a financial institution, but process transactions through the networks owned by the international card schemes, rather than the EFTPOS system. This means that, unlike EFTPOS, scheme debit cards can be used in card-not-present environments (such as the internet) and internationally. Scheme debit products have been actively promoted by the schemes and some issuers over recent years and have been growing strongly. The Bank recently started collecting data that allow EFTPOS and scheme debit transactions to be separately identified. These data indicate that over the year to the June 2009 quarter, the value of scheme debit purchases increased by 35 per cent, compared with a 12 per cent increase in the value of EFTPOS transactions. Scheme debit accounted for around one-quarter of the value of debit card payments in the June quarter of 2009, compared with a share of around one-fifth a year earlier (Graph 5).

A third factor that may have influenced credit and debit card spending has been the global financial crisis and the slowing in economic activity in Australia over the past year. There is some evidence that consumers have taken an increasingly cautious approach to debt and have therefore favoured the use of debit cards over credit cards. This has, for instance, been evident when the Government stimulus payments were made. These tended to boost debit card spending and cash withdrawals more than credit card spending. In addition, credit card repayments have typically exceeded credit card transactions since the end of last year, sometimes by large amounts (Graph 6). There were particularly large repayments relative to normal in December and April, suggesting that some consumers used the stimulus payments to reduce credit card debt.

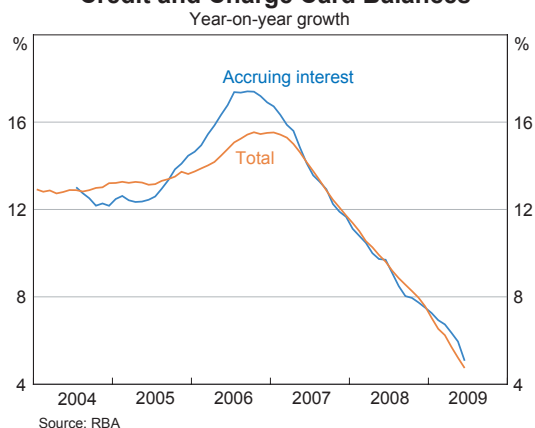
**Graph 5**  
Value of Debit Card Purchases  
Per month



**Graph 6**  
Credit and Charge Card Activity\*  
Monthly value



**Graph 7**  
**Credit and Charge Card Balances**



One result of this is that growth in balances outstanding on credit cards has slowed significantly over the past two years (Graph 7). The growth in balances accruing interest has also slowed, suggesting that there has been a greater tendency to pay balances off by the due date.

The relatively weak growth in credit card transactions over the past year appears to mainly reflect weak growth in card-present transactions, rather than card-not-present transactions. The number of card-present transactions, which

comprised 77 per cent of the share of total credit card transactions, was virtually unchanged over the year to the June quarter 2009, while card-not-present transactions grew by 7 per cent. Of card-not-present transactions, the strongest growth was in on-line transactions, which made up around 10 per cent of total credit card transactions, but mail-order and telephone-order transactions also grew strongly.

#### *Other electronic payments*

Growth in direct entry payments slowed slightly in 2008/09. The number of direct debit and direct credit transactions each grew by around 6 per cent, a little slower than the 9 per cent in 2007/08. Growth in values slowed more dramatically, from 14 per cent to 2 per cent, as the average size of direct entry payments declined. Nonetheless, average values remained quite high relative to most other retail payment instruments, at around \$8 000 for a direct debit and \$5 000 for a direct credit, reflecting the purposes for which direct entry transactions are used. Direct credits are typically used for payments such as salary, rent, social security and tax refunds, while direct debits are used for mortgage repayments and regular bill payments.

The use of BPAY also continued to grow strongly, although at a slower pace than in the previous year. In 2008/09, the number and value of BPAY payments grew by around 12 per cent, faster than all other non-cash payment methods except for debit cards. The average value of a BPAY transaction was fairly steady at around \$700, reflecting the concentration of payments in a small number of merchant categories where transactions are related to large household payments. These categories include, for example, housing and utilities, insurance payments and payment of taxes and fines.

#### *Cheques*

Cheque use continued to decline over 2008/09, accounting for around 6 per cent of the number and 11 per cent of the value of non-cash payments. Cheques nevertheless remained important for a variety of transactions, especially high-value payments such as property settlements and business transactions. The average value of a cheque in 2008/09 was \$4 225, a slight decline from \$4 492 for the previous year.

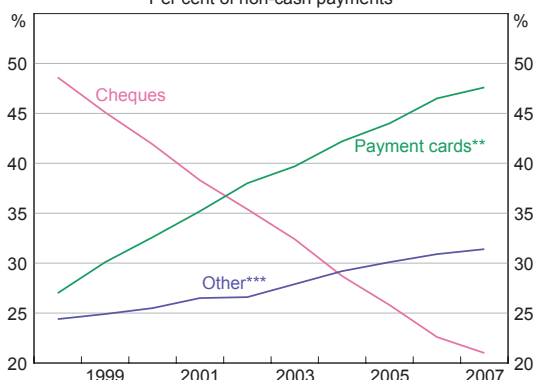
## International payment trends

International trends in payment instrument usage over the past few years have been similar to those in Australia. Electronic payment instruments, in particular payment cards, continued to increase in importance while cheque use declined (Graph 8). In 2007 (the latest period for which final data are available), payment cards were the most important retail payment instrument overseas, making up almost half of all non-cash payments compared with less than one-third at the end of the 1990s. Other electronic means

of payment, mainly payments through automated clearing houses, have not grown as quickly as payment cards but still accounted for around 30 per cent of non-cash payments in 2007. Use of cheques, while concentrated in a small group of countries, declined consistently over the past decade; cheques were used in only around 20 per cent of non-cash payments compared with almost 50 per cent in 1998.

While there has been a broad-based trend towards use of electronic payment instruments, there are some significant differences across countries in the types of payment instruments used (Table 3).

**Graph 8**  
**Non-cash Payments - International\***  
Per cent of non-cash payments



\* G10 countries plus Singapore  
 \*\* Japan payment cards data not available for 2007  
 \*\*\* Includes direct credit, direct debit and e-money transactions  
 Source: BIS

**Table 3: Non-cash Retail Payments in Selected Countries**

Number per capita, 2007

	Cheques	Direct debits	Direct credits	Debit cards *	Credit cards <sup>†</sup>	Total
Australia	20	27	68 **	72	66	253
Belgium	1	23	84	72	9	188
Canada	39	21	31	105	67	263
France	57	46	41	97 <sup>††</sup>	na	241
Germany	1	84	63	21	4	173
Italy	7	9	19	14	9	57
Japan	1	na	11	0	na	12
Netherlands	na	72	86	98	5	261
Singapore	19	12	6	37	na	73
Sweden	<1	23	71	126	21	240
Switzerland	<1	6	85	41	17	149
United Kingdom	26	49	51	83	33	242
United States	94	34	21	100	78	327

\* Includes scheme debit

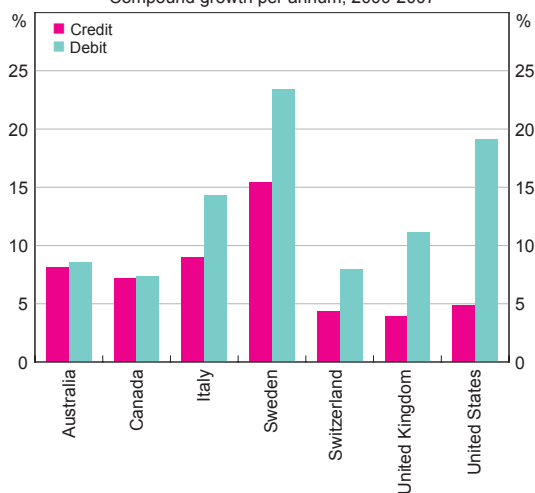
<sup>†</sup> Includes charge cards

\*\* Includes BPAY

<sup>††</sup> Split between debit and credit cards not available

Sources: ABS; BIS; RBA

**Graph 9**  
**Credit and Debit Card Payments per Capita**  
 Compound growth per annum, 2000-2007



Sources: ABS; BIS; RBA

In Germany and several other Western European countries, for example, electronic debits and credits have traditionally been the most used method of payment. In other countries, including Australia, Canada and the United States, payment cards have been the most heavily used payment instrument. Furthermore, while debit cards were used more frequently than credit cards in all the major countries in 2007, Australia, Canada and the United States remained relatively heavy users of credit cards. In all the major countries, however, debit card use has grown faster than credit card use over the past few years (Graph 9).

## Other Retail Payments Developments

### Interchange fees

Interchange fees in the MasterCard and Visa systems in Australia are regulated by the Reserve Bank. Under the regulations, the weighted average of these fees (which are paid by the transaction acquirer to the card issuer) must be at or below specified benchmarks on certain compliance dates. The benchmarks are currently 50 basis points for credit card transactions and 12 cents per transaction for Visa debit card transactions.<sup>1</sup> The benchmarks were unchanged in 2008/09.

This approach allows for significant variation of individual fees, provided that the weighted-average cap is met. Accordingly, MasterCard and Visa have set a variety of fees based on factors such as: the type of credit card account (consumer, commercial, premium); the type of merchant (government, charity, petroleum, high volume); the type of card (chip-enabled); and the type of transaction (card present/not present, micropayments) (Table 4). The regulatory arrangements required no change in interchange fees by the schemes during 2008/09 and none were made.

Interchange fees in the EFTPOS system are also regulated by the Reserve Bank. These fees (which are bilaterally negotiated and are paid by the card issuer to the transaction acquirer) are required to be between 4 and 5 cents per purchase transaction. This range remained unchanged during 2008/09.

<sup>1</sup> MasterCard has undertaken to voluntarily comply with the Visa Debit benchmark.



**Table 4: Interchange Fees**  
As at June 2009, excluding GST

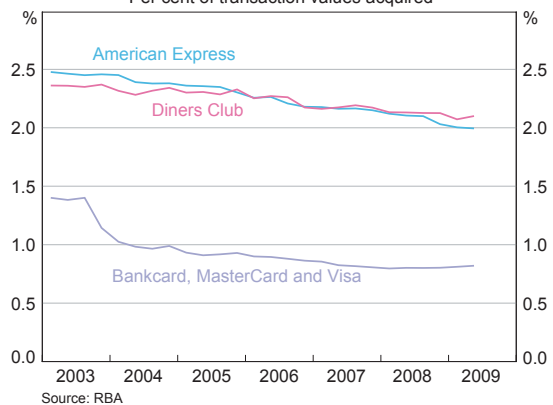
	Credit card		Debit card	
	MasterCard	Visa	MasterCard	Visa
Consumer standard	0.43%	0.55%	36.4¢	0.31%
Consumer electronic	0.43%	0.40%	9.1¢	8.0¢
Consumer chip	0.63%	0.50%	13.6¢	–
Commercial	1.15%	1.15%	36.4¢	–
Commercial chip	1.35%	–	40.9¢	–
Premium	0.95%	0.90%	–	–
Premium chip	1.15%	1.00%	–	–
VMAP*	–	0.30%	–	–
Tiered merchants	0.34%	–	3.6¢	–
Petroleum	0.34%	–	9.1¢	–
Government and utility				
– electronic	0.30%	30.0¢	29.1¢	8.0¢
– standard	0.30%	74.0¢	29.1¢	37.0¢
Micropayment	–	2.5¢	0.50%	2.5¢
Charity	0.00%	0.00%	0.00%	0.00%
Recurring payments	0.30%	0.40%	9.1¢	8.0¢
Quick/express payments	0.30%	0.40%	0.50%	8.0¢
Electronic incentive	–	–	–	4.0¢
<b>Benchmark</b>	<b>0.50%</b>	<b>0.50%</b>	<b>12.0¢</b>	<b>12.0¢</b>

\* Visa Merchant Alliance Program  
Sources: MasterCard website; RBA; Visa website

## Merchant service fees

On average, the fee paid by merchants when accepting payments on MasterCard and Visa credit cards was unchanged in 2008/09. The average merchant service fee for purchases on these cards was 0.81 per cent in 2008/09, the same as the previous year but 0.58 percentage points lower than prior to the Reserve Bank's reforms (Graph 10). Likewise, the margin between merchant service fees and interchange fees on MasterCard and Visa transactions – which had contracted over recent years – remained stable in 2008/09.

**Graph 10**  
**Merchant Service Fees**  
Per cent of transaction values acquired



The combined average merchant service fee for the American Express/Diners Club schemes continued to decline in 2008/09, falling by 0.1 percentage points to 2.04 per cent. These fees have fallen steadily since the implementation of the reforms and in June 2009 were around 0.43 percentage points lower than they were prior to the reforms.

The aggregate net savings to merchants over 2008/09 from declines in merchant fees across all four schemes since the reforms were introduced is estimated at \$1.2 billion or around 74 cents for every credit or charge card purchase over the year.

Average merchant fees for EFTPOS transactions fell slightly over 2008/09 to 7.5 cents. Nevertheless, average EFTPOS merchant fees were 9 cents per transaction higher in June 2009 than they were prior to the reduction in interchange fees in 2006. As for credit cards, competition in acquiring has resulted in a reduction in the margin of EFTPOS merchant fees over interchange fees. Prior to the debit card reforms, the average merchant fee was around 18 cents higher than the interchange fee but this had declined to around 11 cents per transaction by the June quarter 2009. Over 2008/09 the margin fell by 1.1 cents.

### Pricing to cardholders

The average annual fee for standard rewards and gold rewards credit cards issued by major banks remained unchanged in 2008/09 at \$85 and \$140 respectively. Annual fees have been steady for around three years.

In 2008/09, credit card rewards programs attached to MasterCard/Visa cards issued by the major banks required spending of around \$17 000, on average, in order to obtain a \$100 shopping voucher. This was a slight decline in the value of rewards points, from 0.60 per cent of spending in June 2008 to 0.59 per cent of spending in June 2009 (Table 5).

**Table 5: Credit Card Rewards Programs**

Four largest banks, June 2009

	Average spending required for \$100 voucher	Benefit to cardholder as a proportion of spending (%)
2003	\$12 400	0.81
2004	\$14 400	0.69
2005	\$15 100	0.66
2006	\$16 000	0.63
2007	\$16 300	0.61
2008	\$16 700	0.60
2009	\$17 000	0.59

Sources: Banks' websites; Canstar Cannex

The benefit to the card holder as a proportion of spending does, however, vary somewhat across reward cards. For example, some issuers provide complementary three-party scheme cards to premium MasterCard/Visa credit card holders whereby cardholders can accrue rewards points more quickly if they use the three-party scheme card rather than a MasterCard/Visa card.

In addition, some large merchants have entered into co-branding arrangements with credit card issuers

whereby cardholders earn more points per dollar spent for purchases made at the merchant partner. In contrast, in some rewards programs, cardholders accrue points more slowly, or not at all, for spending above a certain amount.

Credit card interest rates fell during 2008/09, by an average of 1.6 percentage points for standard credit cards and 0.7 percentage points for low-rate cards, to stand at 17.9 per cent and

11.95 per cent respectively at the end of June 2009. These reductions, however, did not match the decrease in banks' funding costs over this period.

The pricing of EFTPOS transactions to customers is typically built into deposit account pricing and has not changed significantly over the past year. Debit card holders are usually charged a flat account-keeping fee of around \$4 per month, for which they are entitled to an unlimited number of free electronic transactions, including EFTPOS, scheme debit, own ATM, BPAY and direct entry transactions.

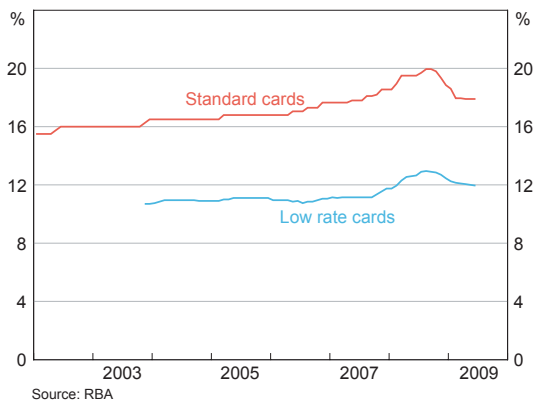
One major pricing development during 2008/09 was the introduction of direct charging by ATM owners for ATM services and the accompanying abolition of 'foreign fees' which had traditionally been charged by financial institutions when customers used an ATM belonging to another network. This is discussed in more detail in the chapter, 'Regulation of the Payments System'.

## Surcharging

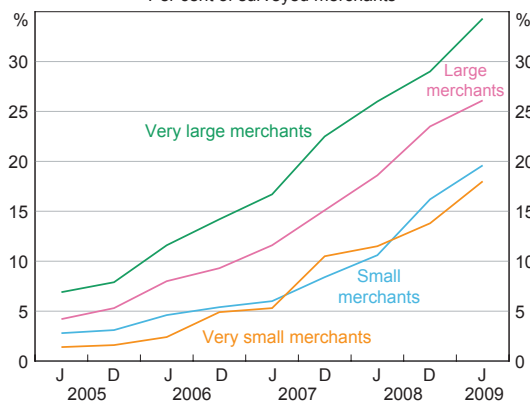
An important element of the Bank's reforms to card payment systems was the removal of the 'no surcharge' rules that had previously been imposed on merchants by the international card schemes. Under these rules, merchants were unable to pass on the costs of accepting these cards to cardholders. Following the removal of these rules on 1 January 2003, merchants could choose to surcharge for transactions, allowing them to better signal the relative costs of different payment methods, while also providing them with more ability to exert competitive pressure on interchange fees.

Data from East & Partners' half-yearly survey of the merchant acquiring business show that there has been strong growth in surcharging by merchants over recent years, although the majority of merchants still do not surcharge. In June 2009, just over one-third of very large merchants (those merchants with annual turnover exceeding \$340 million) imposed a surcharge on at least one of the credit cards they accepted (Graph 12). The rate of surcharging among smaller merchants has also risen noticeably

**Graph 11**  
**Credit Card Interest Rates**

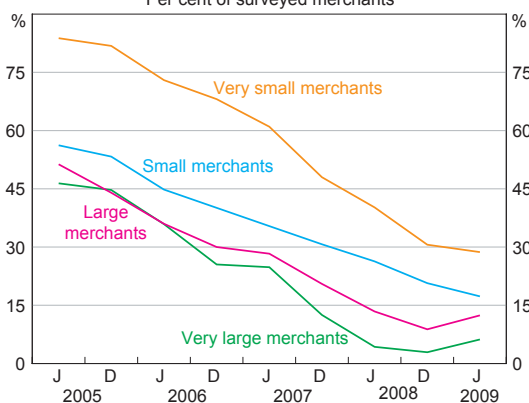


**Graph 12**  
**Merchants Surcharging Credit Cards\***  
Per cent of surveyed merchants



\* Very large merchants are those with annual turnover greater than \$340 million, large merchants \$20 million to \$340 million, small merchants \$5 million to \$20 million and very small merchants \$1 million to \$5 million.  
Source: East & Partners Pty Ltd

**Graph 13**  
**Merchants with No Surcharging Plans\***  
 Per cent of surveyed merchants



\* Very large merchants are those with annual turnover greater than \$340 million, large merchants \$20 million to \$340 million, small merchants \$5 million to \$20 million and very small merchants \$1 million to \$5 million.  
 Source: East & Partners Pty Ltd

over the past several years, although it is still around half the rate of larger merchants.

Data on merchants' plans to surcharge suggest that strong growth in surcharging will continue. As at June 2009, only 6 per cent of very large merchants surveyed had no plans to surcharge in the near future, down from 46 per cent four years ago (Graph 13). Even among very small merchants, less than 30 per cent have no plans to surcharge – down from over 83 per cent in June 2005.

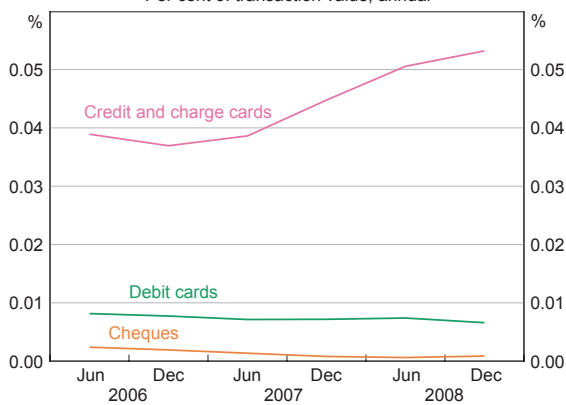
While there are no restrictions on the level of surcharges that can be applied, on average they have

broadly reflected the relative merchant service fees of the schemes. According to the East & Partners' survey, surcharges on MasterCard and Visa cards have been around 1 per cent on average, and those on American Express and Diners Club cards have been around 2 per cent on average over the past few years.

## Fraud

While fraud rates in Australia have remained relatively low by international standards, they have risen in recent years. The most recent data show that payments fraud rose to 8.2 cents for every \$1 000 of payments in the year to December 2008, from 6.3 cents in the preceding year.

**Graph 14**  
**Fraud Rates on Australian Payments**  
 Per cent of transaction value, annual



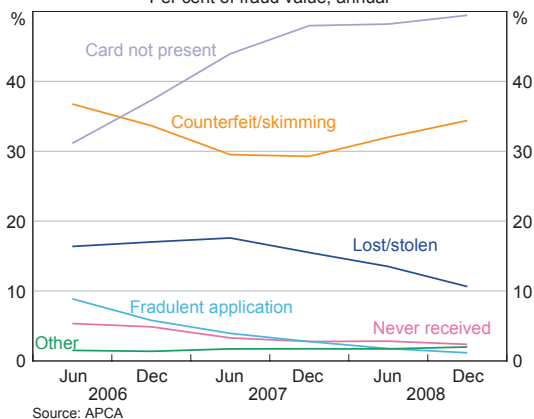
Source: APCA

Credit and charge card fraud continued to be the most significant and fastest growing component of payments fraud in Australia (Graph 14). In the year to December 2008, the rate of fraud on credit and charge cards increased by 19 per cent, from 45 cents to 53 cents in every \$1 000 of credit and charge card payments. The fraud rate on debit cards fell from 7.2 cents to 6.6 cents, while for cheques, fraud rates remained at less than 1 cent per \$1 000. The weighted-average fraud rate for debit and credit cards together was 32 cents in every \$1 000 transacted during 2008, up from 28 cents in 2007.

The two largest components of credit and charge card fraud are card-not-present (CNP) fraud and counterfeit or skimming fraud. CNP fraud typically involves the theft of genuine card details which are then used to make a purchase over the internet, by phone, or by mail order. This type of fraud increased by 33 per cent in 2008, and accounted for nearly half of the total value of credit and charge card fraud (Graph 15).

Counterfeit/skimming fraud typically involves the creation of a fake card using compromised details from the magnetic stripe of a genuine card. This was the second most common type of card fraud in 2008, accounting for one-third of the value of all credit and charge card fraud. As the industry moves to chip technology for credit and charge cards, this particular type of fraud is expected to abate somewhat, particularly if combined with compulsory use of Personal Identification Numbers (PINs).

**Graph 15**  
**Credit and Charge Card Fraud on Australian-issued Cards**  
 Per cent of fraud value, annual



# Performance of Australia's Payments Infrastructure during the Market Turbulence

An important issue for the Board in 2008/09 was the performance of Australia's payments infrastructure during the period of market turbulence in late 2008. Market volatility had increased significantly over 2007/08 as financial market strains first emerged, but rose further in late 2008 following the collapse of Lehman Brothers in September. During this period, the payments infrastructure (including central counterparties, securities settlement systems and high-value payment systems) continued to function well. Australia's central counterparties implemented a number of additional risk-management measures and settlement performance, both in the securities settlement facilities and the high-value payments system, remained sound.

## **Clearing and Settlement Facilities**

The clearing and settlement facilities performed well during the period of market turbulence. The two central counterparties took a number of steps to manage increased risk, including more intensive participant monitoring, increased margins and revisions to stress-test parameters.

## **Central counterparty risk management**

A central counterparty interposes itself as the legal counterparty to sales and purchases of financial instruments via a process known as novation. This simplifies market participants' counterparty risk management – as they are exposed only to the central counterparty – but concentrates risk in the central counterparty. With large price movements and concerns over the financial standing of some clearing participants, the risks faced by Australia's licensed central counterparties – Australian Clearing House (ACH) and SFE Clearing Corporation (SFECC) – increased in late 2008. Accordingly, the central counterparties intensified their risk management activities in a number of ways.

### *Participant monitoring*

The central counterparties assign internal credit ratings as part of their participant monitoring procedures. These ratings are based on the external credit rating or net tangible assets of the participant or its parent and are used to better understand the distribution of the central counterparties' risk exposures and assist in the interpretation of stress-test results (discussed below). During the heightened market uncertainty in late 2008, a number of participants were downgraded within this framework: ACH downgraded eight participants and SFECC downgraded two participants. As conditions stabilised during the first half of 2009, six ACH participants' ratings were upgraded.

The central counterparties also maintain a 'watch list' of participants deemed to warrant more intensive monitoring. Inclusion on the watch list might, for instance, reflect issues arising

from routine review of financial returns by ASX Markets Supervision, or concerns emerging from a specific event or media report. In the first stage of intensive monitoring, there is greater scrutiny of the exposures participants bring to the central counterparty. Should a participant's perceived financial standing deteriorate further, restrictions may be placed on its trading, clearing and settlement activities. At its peak, 15 ACH participants and six SFECC participants were on the watch list (some of which were related group entities). By mid-2009, the number of participants on the watch list had dropped back, to eight at ACH, and three at SFECC.

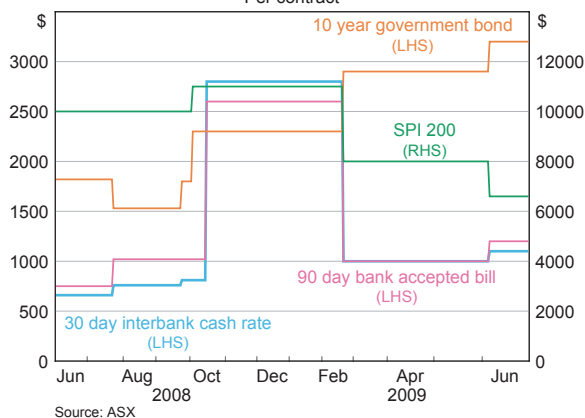
### Margining

Initial margins are collected by the central counterparties to cover any losses arising in the close out of derivatives positions should a default occur. Both ACH and SFECC set initial margin intervals on the basis of a three standard deviation confidence interval for price movements over an assumed close-out period of either one or two days.

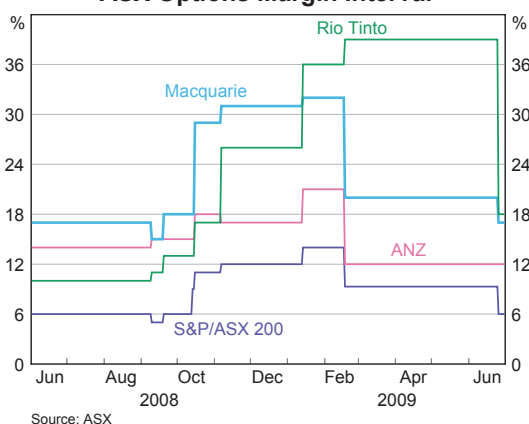
During the period of heightened market volatility in late 2008, the central counterparties took steps to increase the degree of margin coverage. In the December quarter, ACH carried out eight *ad hoc* reviews of exchange-traded option margin intervals, and SFECC carried out two reviews of margin rates for its main futures contracts. Some large adjustments were implemented, including sharp increases in margin rates for the major interest rate contracts traded on the Sydney Futures Exchange (SFE). These rate increases led to large calls on participants – the two SFECC reviews led to calls amounting to a total of \$900 million in October 2008. The large increase in margin rates in late 2008 has since been largely unwound for many – though not all – contracts as market conditions have stabilised and volatility has receded (Graphs 16 and 17).

The central counterparties also typically call for intraday margin

**Graph 16**  
**SFE Futures Initial Margin**  
Per contract



**Graph 17**  
**ASX Options Margin Interval**



in the event that initial margin coverage is eroded by 50 per cent. During the turbulent period, intraday margin was called at a lower erosion threshold of 40 per cent (or 30 per cent for participants on the watch list), leading to a substantial increase in the frequency of such calls. These calls were often sizeable. At SFECC, for instance, almost 100 intraday calls took place in the final quarter of 2008, mostly in October, for a total of more than \$6 billion. Again, as market conditions stabilised, the frequency of intraday calls declined. Just 19 calls were made in the first half of 2009, totalling less than \$200 million.

### *Stress testing*

Both central counterparties use stress testing to assess the adequacy of their risk resources and call additional collateral to cover large and concentrated exposures identified via the stress-testing process. At SFECC, collateral called in this way is termed Additional Initial Margin; at ACH, such calls are known as Contributions and Additional Cover. Calls for additional collateral were made by both central counterparties during late 2008. At ACH these were concentrated around the time of the December index futures expiry, which traditionally leads to large cash market exposures associated with the unwinding of index arbitrage positions. At SFECC, there were also some high stress-test exposures through October and November 2008, which led to a peak in Additional Initial Margin held of more than \$300 million.

The extreme market conditions in late 2008 resulted in some price movements that were close to, and in one case exceeded, the scenarios used by the central counterparties in stress testing. At ACH, the magnitude of some stress tests was adjusted in conjunction with an expansion of the range of stress-test scenarios in December 2008. These changes had been planned prior to the market turbulence and the revised price-move scenarios are all more extreme than those experienced during that period. SFECC also revised upwards some of its stress-test parameters in its annual review of these scenarios in late 2008.

### **Equity settlement performance during the market turbulence**

Despite an increase in equity settlement fails during the turbulence, due in part to complications arising from Lehman's failure, fail rates remained low by international standards.

As Lehman Brothers participated only indirectly in the Australian central counterparties and equity settlement facility, the bankruptcy of its US parent did not result in any direct exposures for the facilities and Lehman's pre-existing cash equity trades and open derivatives positions were either settled or closed out relatively smoothly by its clearers. Some increase in equity settlement fails was, however, observed as delays occurred in obtaining approval from the European administrator for the release of Lehman's securities. Settlement fails subsequently increased further following the imposition of the ban on short selling by the Australian Securities and Investments Commission (ASIC), as some securities lenders were reluctant to lend securities due to initial uncertainties as to the scope of the ban.<sup>2</sup>

Nevertheless, the fail rate remained low by international standards and the increase was temporary. The downward trend in the fail rate – which had commenced in mid-2008 – resumed, with the rate settling at around 0.1 per cent during the first half of 2009 (Graph 18). This would seem to reflect

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<sup>2</sup> ASIC subsequently published a 'no-action' letter, stating that sales of securities that were on loan within securities lending programmes would not be deemed short selling as long as the securities were recalled within a reasonable time frame after executing the sale.



enhancements to the settlement fails regime implemented during 2008/09, including an increase in penalty fees applied in the event of a failed settlement delivery, and a requirement to close out positions remaining unsettled on the fifth day after trade date. These developments are discussed further in ‘Oversight of Clearing and Settlement Facilities’ below.

### CLS Bank

CLS Bank provides a settlement facility used by global financial market participants, including those in Australia, to effect payment-versus-payment (PvP) settlement in the foreign exchange market. CLS was specifically designed to manage the risk that one party might pay away the currency it is selling and, due to the failure of its counterparty, not receive in return the currency it is purchasing.

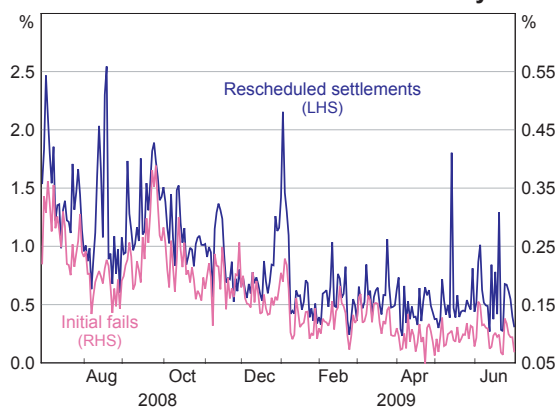
CLS performed as designed in the face of the failure of Lehman Brothers and no participants were exposed to principal risk as a result of this event. While Lehman used CLS to settle its foreign exchange transactions, it did so by engaging another bank to settle on its behalf. Between 15 September (when Lehman Brothers filed for bankruptcy) and 17 September, Lehman’s settlement bank continued to settle CLS instructions on Lehman’s behalf. Over this period, however, some of Lehman Brothers’ counterparties chose to withdraw trades from CLS so as to minimise their overall exposure to Lehman Brothers by netting these positions against other exposures outside CLS. The CLS system required this to be done on a trade-by-trade basis, which proved inefficient and slow; CLS has been developing ‘bulk-rescind’ functionality to address this issue.

CLS also provides one-sided settlement services in respect of non-deliverable forwards and credit default swaps (CDS). The average value of one-sided settlements has typically been very low but can be much higher when there is a credit event and CLS is called upon to settle close-out obligations arising under CDS agreements. Several such events occurred over the past year, including in late 2008 following the failures of Lehman Brothers and three Icelandic banks, and the conservatorship of Fannie Mae and Freddie Mac. In each case, settlement proceeded smoothly.

### High-value Payments

The high-value payments system experienced no difficulties during the period of turbulence in late 2008, although there appeared to be some changes in payment behaviour. In particular,

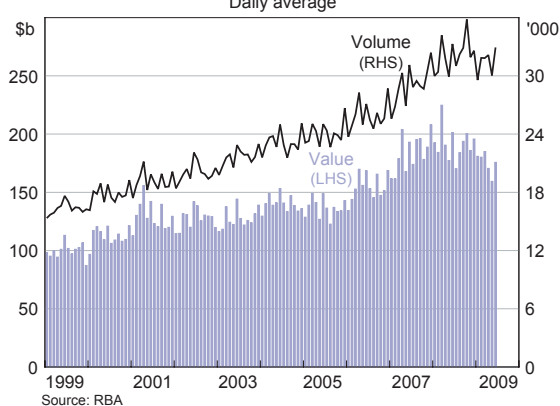
**Graph 18**  
**Rate of Initial Fails and Settlements Rescheduled to Next Settlement Day\***



\* A trade is recorded as an initial fail if the trade cannot settle due to insufficient stock on the original scheduled settlement date, which is three business days after the trade date (ie, t+3). A trade is recorded as a rescheduled settlement if, having failed to settle on the scheduled settlement date, it is rescheduled for settlement on the next business date (ie, t+4). If that trade fails to settle on the rescheduled date, it will again be rescheduled for settlement on the next business date (ie, t+5) and will be recorded as another rescheduled settlement.

Source: ASX

**Graph 19**  
**RTGS Transactions**  
Daily average



the timeliness of settlement in the Reserve Bank Information and Transfer System (RITS) improved somewhat while, at the same time, there were more frequent RITS extensions.

The most noticeable change over the past year was a decline in the value of transactions settled across RITS. While the number of transactions settled per day rose by 5 per cent over 2008/09, the value of transactions settled fell by 5 per cent over the year (Graph 19). The decline in value is consistent with a decline in wholesale market activity since the market turbulence.

### Timing of settlement in RITS

Over 2008/09, there was an improvement in the rate at which payments were settled through RITS. This was most evident from September 2008, when financial instability was at its highest. In 2006/07, around half of each day's payments by value were usually completed by 2.45pm. By contrast, from August 2007 to mid September 2008, half of the day's payments were completed by 2.30pm on average, with a further improvement to 2.00pm during the period of extreme uncertainty from mid September to end October 2008. This rate of throughput continued through to the end of June 2009 (Table 6).

**Table 6: RITS Throughput**

	Time by which each percentage of total is settled*		
	25 per cent	50 per cent	75 per cent
Jul 06 to Jul 07	12:00	14:45	16:15
Aug 07 to 12 Sep 08	11:45	14:30	16:00
15 Sep 08 to Oct 08	11:30	14:00	16:00
Nov 08 to Jun 09	11:30	14:00	15:45

\*Excluding payments to and from the RBA.  
Source: RBA

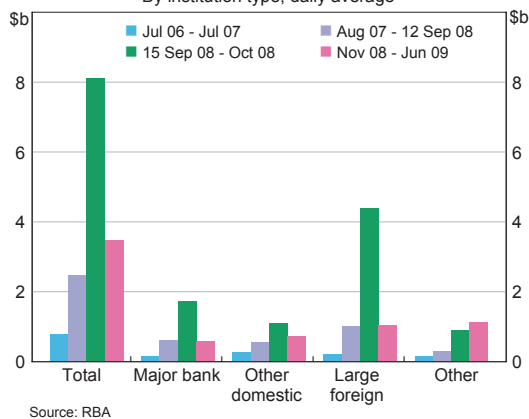
The improvement in 'throughput' times was, on the surface, somewhat surprising. In an environment of financial instability and concerns about the credit worthiness of counterparties, participants might be expected to be reluctant to 'pay away' first. Rather, they might be expected to conserve liquidity and minimise their underlying net-creditor positions *vis-à-vis* some counterparties. Instead, however, there is some evidence that the higher level of Exchange

Settlement (ES) balances with the Reserve Bank in response to strained conditions in the interbank markets led to earlier payments. Some of the large subsidiaries and branches of foreign banks, in particular, appeared to have access to higher ES balances held overnight and were therefore able to make more payments earlier in the day (Graph 20). In 2009, average ES balances declined again, but a slight deterioration in the throughput of the foreign banks was outweighed by an improvement in the throughput of the larger domestic banks.

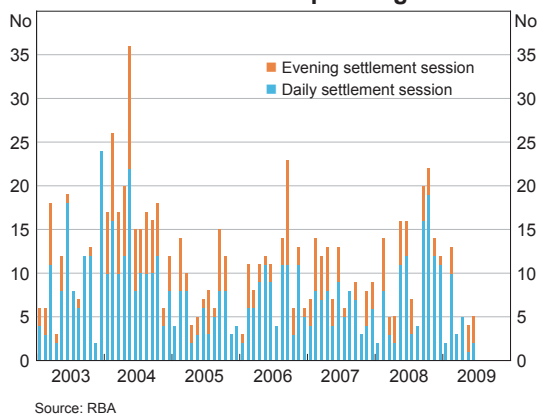
### Settlement extensions

Despite the increased timeliness of settlement in RITS during late 2008, there was also an increase in end-of-day RITS extensions. The uncertainty in late 2008 appeared to result in some banks tightening internal credit monitoring processes and strengthening collateral requirements. With some banks finding it difficult to locate a willing lender, the end-of-day reallocation of liquidity in the overnight market for interbank funds was disrupted. Consequently, in September and October 2008, the frequency of RITS extensions increased to levels not seen since 2006 (Graph 21). Since then, however, the frequency of RITS extensions has declined.

**Graph 20**  
**ES Account Opening Balances**  
 By institution type, daily average



**Graph 21**  
**Extensions to RITS Operating Hours**



# Regulation of the Payments System

## Review of the Payments System Reforms

In September 2008, the Board published the conclusions to its review of the payments system reforms. The review set out to examine: the effects of the reforms to date; the case for ongoing regulation; and, if the existing regulatory approach was to be retained, what changes if any should be made. Two consultation documents were issued during the review process – *Reform of Australia's Payments System: Issues for the 2007/08 Review* and *Reform of Australia's Payments System: Preliminary Conclusions of the 2007/08 Review* (Preliminary Conclusions) – and extensive industry consultations were held, including an industry conference in late 2007, hosted jointly with the Centre for Business and Public Policy at the Melbourne Business School.

## Final conclusions of the review

In *Reform of Australia's Payments System: Conclusions of the 2007/08 Review* (Final Conclusions), the Board reaffirmed its view, expressed in the Preliminary Conclusions, that the reforms had met their key objectives of: increasing transparency; improving competition by removing restrictions on merchants and liberalising access; and promoting more appropriate price signals to consumers. Nevertheless, the Board concluded that the competitive forces acting on interchange fees remained relatively weak and, as a result, aspects of the payments system would continue to require close oversight.

The Board also confirmed its preliminary view that there was an opportunity for it to step back from the direct regulation of interchange fees, provided that industry participants took steps to reduce the risk that interchange fees would rise from their current levels in the absence of regulation. The Board identified two developments that could provide it with such comfort.

First, industry participants could take steps to further strengthen the competitive environment, such as:

- changes to the EFTPOS system, including the introduction of a central scheme and arrangements to effectively manage the system's development, reform of access arrangements, and the development of an alternative online payment instrument (either by the EFTPOS scheme or some other channel);
- further modification of honour-all-cards rules to ensure merchants would be able to separately decline or accept cards that attract different interchange fees; and
- increased transparency of scheme fees.

Second, the Board's concerns regarding upward pressure on interchange fees in the absence of regulation could be addressed through voluntary commitments from the schemes not to raise credit card interchange fees from current levels. This alternative was suggested in the course of consultation on the Preliminary Conclusions. The Board concluded that, if commitments were provided by the schemes, the further modification to honour-all-cards rules suggested in the first approach would not be necessary. The Board did not see the need to obtain similar

commitments in respect of scheme debit or EFTPOS interchange fees, instead relying on the ability of merchants to steer transactions through the cheaper debit system to constrain the level of debit card interchange fees.

In the event that the industry failed to make sufficient progress in improving the competitive environment and the schemes did not provide voluntary commitments to cap interchange fees by August 2009, the Board concluded that a continuation of interchange regulation would be necessary. The Board maintained its view, expressed in the Preliminary Conclusions, that the credit card interchange fee benchmark should be further reduced to 0.30 per cent in this case. In response to consultation, however, the Board decided to adopt a more flexible common debit card interchange benchmark, requiring that the weighted average of interchange fees in each of the EFTPOS and scheme debit systems fall within a range between 5 cents paid to the issuer and 5 cents paid to the acquirer. Merchants had argued that the original proposal for a common benchmark of 5 cents paid to the issuer would remove any incentive for merchants to promote the use of the EFTPOS system.

The Final Conclusions also made clear that, irrespective of whether interchange fee regulation is removed, the Board required that the schemes continue to allow merchants to surcharge and make separate acceptance decisions for scheme debit and credit cards. The Board also sought greater transparency of scheme fees.

## **Industry progress**

Following the release of the Final Conclusions, the Board closely monitored industry progress towards enhancing competition, and discussed the possibility of voluntary commitments to cap credit card interchange fees with the schemes. While progress was made in both these areas, the Board concluded in August 2009 that it was not sufficient to allow the removal of regulation.

In terms of enhancing competition, the Board recognised that the industry had taken a number of steps to address the Board's concerns. A new company to manage the EFTPOS system, EFTPOS Payments Australia Limited, was established in April 2009 with 14 initial members. The scheme board has eight initial industry-appointed directors, including representatives of both large and small financial institutions and large merchants. In addition, three independent directors have been appointed, one of which is Chairman of the company. The Board also noted the commitment of the industry to enhance the BPAY system to allow, among other things, online payments (known as Project MAMBO).

While these were important developments, and would potentially exert competitive pressure on interchange fees in the future, the Board was not convinced that the initiatives had yet reached that point. The Board therefore concluded that these developments were, by themselves, insufficient for it to be comfortable stepping back from regulation of interchange fees. Furthermore, despite the willingness of both MasterCard and Visa to work with the Bank to implement voluntary undertakings, the set of undertakings developed did not meet the Board's requirements. In these circumstances, the Board took the view that it would not be in the public interest to remove interchange regulation. However, given the progress that had been made, the Board decided to defer consideration of any further reduction in interchange fees. It indicated that it would keep matters under review, and would be prepared to re-open consideration of the regulations in light of industry developments.

In the meantime, the Board considered that the difference in regulatory treatment of the scheme debit and EFTPOS systems might be detrimental to competition. It therefore indicated its intention to consult on the possibility of changing the interchange regulation on the EFTPOS system to be consistent with that applying with respect to scheme debit. This consultation process has now commenced.

## **Reform of the ATM System**

On 3 March 2009, a package of reforms designed to improve competition in the Australian ATM system came into effect. As discussed in last year's Annual Report, the reforms were agreed by the industry in mid-2007 and were the outcome of many years of work by the industry, supported by the Reserve Bank. The main elements of the reforms included:

- an objective and transparent industry-developed access code, implemented through the Australian Payments Clearing Association (APCA);
- ATM owners having the freedom to charge cardholders directly for the use of an ATM, with any charge being disclosed to the cardholder prior to the transaction being finalised; and
- the abolition of bilateral interchange fees paid by banks and other financial institutions to ATM owners for the provision of ATM services.

These reforms addressed concerns the Board had held for a number of years and were expected to have three main effects:

- the new industry Access Code, combined with the removal of bilaterally negotiated interchange fees and a cap on connection costs would make access to the ATM system as a direct participant easier;
- greater transparency of ATM fees through disclosure at the ATM would directly benefit consumers and would promote greater competition on fees between ATM owners; and
- the greater flexibility in pricing allowed to ATM owners would enable deployment of ATMs in locations where they might not otherwise have been viable and provide a more sustainable business model for independent deployers.

## **Implementation of the reforms**

Given that the broad details of the reform package were developed by industry, in consultation with the Reserve Bank, it had been anticipated that the reforms could be entirely implemented by the industry. However, while the industry was able to implement an Access Code, participants came to the view that additional legal certainty was required for two elements of the reforms – arrangements for setting interchange fees to zero and establishment of a cap on the cost of connection to the ATM system. In September 2008 the industry asked the Bank to use its regulatory powers to provide the required certainty.

In December 2008, the Bank designated the ATM system and released a draft Access Regime for consultation. The draft Regime addressed the two areas where intervention was requested by the industry, and also set out limited circumstances under which interchange fees could continue to be paid.

After a period of consultation, involving both written submissions and meetings with interested parties, the ATM Access Regime was finalised and came into effect on 3 March 2009 – coinciding with the implementation of the Access Code and the start of direct charging at ATMs.

The Access Regime imposed a cap on the fee that each existing direct participant in the system could charge a new entrant for establishing a bilateral connection. The cap was set at \$76 700, the lowest cost of providing a connection reported to APCA in a survey of participants in mid-2008. The Board was of the view, however, that direct clearing and settling arrangements are fundamental aspects of banking business and the Access Regime prohibited charging of fees for establishing such arrangements.

The Access Regime eliminated interchange fees in the ATM system in most circumstances. The Board recognised, however, that interchange-like fees could be pro-competitive in some circumstances. In particular, fees that allow small institutions access to a larger network of ATMs than they would be able to provide themselves, free of direct charges, could help those institutions to compete on a more equal footing with the larger players in the industry. To that end, the Access Regime allowed interchange fees to be paid between members of an ATM sub-network – in line with the original industry proposal. The Regime also allowed institutions to establish one-way arrangements in which they pay fees to an ATM owner so that their customers can access those ATMs without a direct charge being levied. Institutions were only permitted to access one additional network of ATMs in this way.

In addition, during the consultation process it was suggested that some flexibility be incorporated into the Access Regime through an exemption power. The Board saw merit in this suggestion, particularly given the wide variety of business and technical arrangements in place across the ATM system and the likelihood that in some circumstances payment of an interchange-like fee may be in the public interest. A clause was therefore incorporated into the Access Regime, allowing the Bank to grant an exemption to the interchange fee provisions and setting out the matters that the Bank would take into account in doing so. Notice of any exemptions granted would be published on the Bank's website.

## Early effects of the reforms

Early evidence suggests that the reforms are having the anticipated effect. Customers appear to be responding to more transparent pricing of foreign ATM transactions, deployment of ATMs appears to be expanding and there has been some early evidence of direct price competition.

The overall cost of a post-reform foreign ATM transaction in many cases is similar to that prior to the reforms. For instance, a major bank customer making a foreign ATM withdrawal prior to 3 March would have paid a \$2.00 foreign fee to their own bank, but no fee directly to the ATM owner. Within a short period of the implementation of the reforms, most institutions had ceased levying foreign fees. Customers making a foreign transaction are therefore now paying only the direct charge levied by the ATM owner. Most owners charge \$2.00 across their networks for a withdrawal, but some charge a lower fee, meaning that customers can pay less than \$2.00 by shopping around. One major bank, for instance, charges \$1.50 for a withdrawal and some owners are charging as little as \$1.00. On the other hand, there are some reported

instances of direct charges being higher than \$2.00. Direct charges on balance enquiries vary: in some cases there is no charge but in other cases, the charge is the same as for a cash withdrawal (Table 7).

**Table 7: Direct Charges – Major Networks<sup>(a)</sup>**  
Per cent

	Cash withdrawal	Balance enquiry
ANZ	\$2.00	\$2.00
Bank of Queensland	\$2.00	\$2.00
BankWest	\$2.00	\$1.00
Cashcard	\$2.00	\$0.75
Cashconnect <sup>(b)</sup>	\$2.00	\$1.00
Commonwealth Bank	\$2.00	\$2.00
Customers	\$1.00 to \$2.00 <sup>(c)</sup>	\$1.50 to \$2.00 <sup>(c)</sup>
iCash	\$1.00 to \$2.00 <sup>(c)</sup>	\$1.00 to \$2.00 <sup>(c)</sup>
NAB <sup>(d)</sup>	\$1.50	\$0.50
RediATM <sup>(e)</sup>	\$1.50 to \$2.00	\$0 to \$1.00
St. George	\$2.00	\$2.00
Westpac	\$2.00	\$2.00

(a) Data current as at 30 September.

(b) Also deploys 'branded' ATMs for other institutions which may apply different charges.

(c) Predominantly \$2.00.

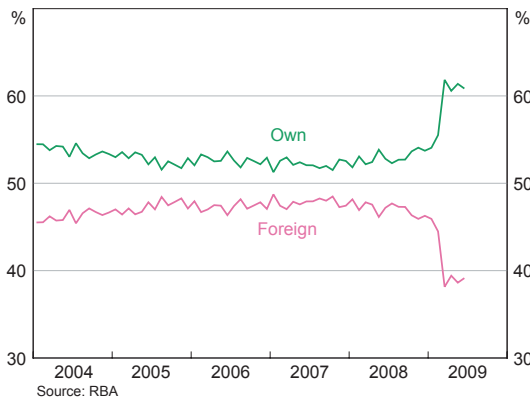
(d) Now part of the RediATM Network.

(e) At the discretion of sub-network members, but withdrawals capped at \$2.00 and balance enquiries capped at \$1.00.

Source: RBA

For the most part, there has been little change in the level of direct charges since their introduction in March, although there is anecdotal evidence that some owners have lowered fees on individual machines.

**Graph 22**  
**Composition of ATM Withdrawals**  
Per cent of domestic withdrawals



Source: RBA

The greater transparency of fees following the reforms appears to have made cardholders more sensitive to the cost of foreign ATM transactions. There was a marked shift away from foreign ATMs, towards use of cardholders' own institutions' ATMs, in March 2009 and this has largely been maintained (Graph 22). As a share of total ATM transactions, foreign transactions fell from an average of around 47 per cent in the year prior to the reforms, to 38 per cent in March 2009. Average withdrawal amounts have also increased, particularly at foreign ATMs.



There is also evidence that the reforms have altered the competitive dynamics in the ATM system. Financial institutions view the capacity to offer customers a sizeable network of fee-free ATMs as critical to their ability to compete. This has seen many institutions take up the flexibility provided by the ATM Access Regime to gain access to a wider network of ATMs by joining a sub-network or entering a one-way agreement with another network. In mid June, for example, the National Australia Bank (NAB) entered into an agreement to join Cuscal's RediATM sub-network. Cuscal sought guidance from the Reserve Bank as to whether this agreement would be consistent with the spirit of the Access Regime. The Board was of the view that the agreement would be pro-competitive and within the spirit of the reforms. It was also satisfied that the payment of an interchange fee by a major bank within a sub-network arrangement does not give rise to access concerns, provided that those fees are common to all members and the criteria for membership of the sub-network are fair, objective and transparent. In addition, the Board was of the view that the expansion of the RediATM network would increase the capacity of many small financial institutions to compete with banks offering the largest networks, promoting competition between card issuers and providing benefits to customers of NAB and RediATM members through an improvement in the availability of fee-free ATMs.

As an alternative to sub-network arrangements and one-way agreements, other larger issuer-owned networks appear to have been expanding their ATM fleets. At the same time independent ATM deployers have been exploring strategies to take advantage of the new pricing arrangements and the changed focus of issuers. Among other things, there is evidence that greater pricing flexibility is attracting new deployers into the market.

The reforms have yet to be tested in terms of access, with no new direct connections or direct clearing/settlement arrangements having been established. While the Board is satisfied that the reforms have improved access, it nevertheless sees a need for more fundamental reform of the architecture of both the ATM system and the EFTPOS system. The Board noted in its December 2008 consultation document on the ATM Access Regime that the current technology underpinning the ATM and EFTPOS systems will need to be updated over the next year or so and that this provides an opportunity for the industry to improve the architecture of these systems in a way that promotes efficiency and supports more open access. The Board is aware that the industry is working on this issue and it will be taking an active interest in progress over the coming year.

## Overseas Developments

Overseas, there has been continued regulatory interest in the operations of card schemes, particularly interchange fees.

In Europe, the European Commission (EC) reached an agreement with MasterCard on cross-border interchange fees.<sup>3</sup> In December 2007, the EC ruled that MasterCard's cross-border interchange fees were illegal under European Union competition law. As a result, MasterCard was required to remove its interchange fees on cross-border card transactions using MasterCard and Maestro-branded debit and consumer credit cards by June 2008. Since then, MasterCard has been in discussions with the EC on an appropriate methodology to determine its cross-border multilateral interchange fees (MIFs).

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<sup>3</sup> See <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/515&format=HTML&aged=0&language=EN&guiLanguage=en>

As a result of these discussions, MasterCard provided three undertakings to the EC. In return, the EC agreed not to pursue MasterCard further on its MIFs. The undertakings were that from July 2009:

- the cross-border MIF would be calculated based on the savings to merchants obtained from transactions being made using cards rather than cash. The resulting maximum weighted average MIF was determined to be 0.3 per cent per transaction for consumer credit cards (down from a range of 0.8 to 1.9 per cent in 2007) and 0.2 per cent per transaction for consumer debit cards (down from a range of 0.4 to 0.75 per cent in 2007);
- scheme fee increases announced in October 2008 would be repealed;<sup>4</sup> and
- there would be improvements to transparency, including merchants being offered and charged different rates for different cards (unblended rates).

The EC is continuing its antitrust investigations into Visa which commenced in March 2008 when a 2002 exemption expired. The EC sent Visa a ‘Statement of Objections’ on 3 April 2009 outlining its preliminary view that MIFs set directly by Visa infringe European Union competition law.<sup>5</sup> The Statement of Objections also suggested that other system rules and practices restrict merchants’ ability to manage their payments costs. The EC specifically mentioned the honour-all-cards rule, the no-surcharge rule and the blending of merchants’ fees.

In New Zealand, the Commerce Commission reached agreements with MasterCard and Visa to alter a number of their practices.<sup>6</sup> MasterCard and Visa have each agreed to make changes to the way their rules apply in New Zealand. In particular:

- credit card issuers in each of the schemes will be able to individually set their interchange fees, subject to maximum rates determined by the schemes;
- merchants will not be prevented from applying surcharges and will be able to encourage customers to pay by means other than a credit card; and
- non-bank organisations that wish to provide acquiring services will be permitted to join the schemes provided they meet relevant financial and prudential criteria.

On the basis of these agreements, the Commerce Commission discontinued its proceedings against the schemes.

In other countries, there have been enquiries into scheme practices. The US government initiated a study into credit card interchange fees, examining a range of issues including the ability of merchants to negotiate pricing with network operators and card issuers. The study is required to recommend appropriate legislative and administrative actions.

In Canada a Senate Standing Committee conducted an inquiry into the operation of credit and debit card systems in Canada. While only an advisory body, the Committee made a number

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4 In September 2008, MasterCard Europe notified significant increases in its ‘card scheme fees’ from 1 October 2008. This drew complaints from merchants and the EC was considering whether the action represented an attempt to circumvent the ban on cross-border MIFs.

5 See <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/151&format=HTML&aged=0&language=EN&guiLanguage=en>

6 See ‘Commerce Commission and MasterCard agree to settle credit card interchange fee proceedings’ at <http://www.comcom.govt.nz/MediaCentre/MediaReleases/200910/commercecommissionandmastercardagr.aspx> and ‘Commerce Commission and Visa reach agreement to settle credit card interchange fee proceedings’ at <http://www.comcom.govt.nz/MediaCentre/MediaReleases/200910/commercecommissionandvisareachagre.aspx>

of recommendations including: permitting merchants to bargain collectively with scheme operators and card issuers; allowing merchant surcharges; prohibiting 'honour all cards' rules (including those requiring merchants to accept a scheme operator's higher-cost premium cards); and setting all debit card interchange fees to zero for three years.

# Oversight of Clearing and Settlement Facilities

The *Reserve Bank Act* assigns responsibility to the Payments System Board for ensuring that the powers and functions of the Reserve Bank relating to the oversight of clearing and settlement (CS) facilities under the *Corporations Act* are exercised in a way that ‘will best contribute to the overall stability of the financial system’.

Under the *Corporations Act*, CS facilities licensed to operate in Australia are required to comply with financial stability standards set by the Reserve Bank.<sup>7</sup> Four licensed CS facilities, all owned by the Australian Securities Exchange (ASX), are currently required to meet the Financial Stability Standards:<sup>8</sup>

- Australian Clearing House (ACH) – the central counterparty for cash equities and equity-related derivatives traded on the ASX market;
- SFE Clearing Corporation (SFECC) – the central counterparty for derivatives traded on the Sydney Futures Exchange (SFE);
- ASX Settlement and Transfer Corporation (ASTC) – the settlement facility for cash equities and warrants traded on the ASX market; and
- Austraclear – the settlement facility for fixed-income securities traded in over-the-counter markets.

While assessment is ongoing throughout the year, the Board conducts a formal assessment of each facility’s compliance with the standards once a year. The assessments covering the 2007/08 financial year were published in October 2008.

Other work of the Board in relation to its oversight of CS facilities during 2008/09 included: variation to the *Financial Stability Standard for Central Counterparties*, to give effect to a regime for oversight of overseas facilities; and variation to the *Financial Stability Standard for Securities Settlement Facilities*, to require the collection and publication of data on equities securities lending.

In addition, the Board had oversight of two pieces of work undertaken by the Reserve Bank: the review of participation requirements in central counterparties, carried out jointly with ASIC in early 2009; and a survey of the over-the-counter (OTC) derivatives market in Australia carried out by the Reserve Bank jointly with ASIC and APRA.

The Board’s work in these areas is summarised below.

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<sup>7</sup> These standards, along with minimum measures relevant to meeting the standards and guidance on their interpretation, are available at <http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/standards.html>

<sup>8</sup> An additional licensed facility, IMB Limited, falls outside the scope of the *Financial Stability Standard for Securities Settlement Facilities* due to its small size and the limited nature of its operations.

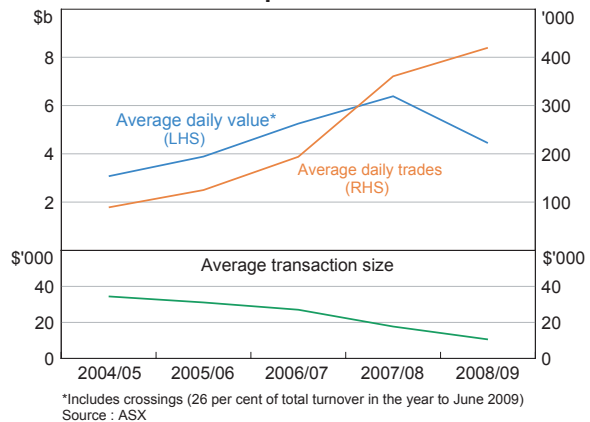
## Developments in Clearing and Settlement over 2008/09

Volatility in financial markets rose to extremely high levels over 2008/09, reflecting strains throughout the global financial system. In response, traded volumes and values in a number of the markets served by Australia's CS facilities declined, in some cases substantially. The turbulence in financial markets and associated concerns with some firms' financial positions also resulted in an increase in the risks faced by the central counterparties. While Lehman Brothers was not a direct participant in either central counterparty or ASTC, the investment bank's failure did pose some challenges. Nevertheless, as discussed above in 'Performance of Australia's Payments Infrastructure during the Market Turbulence', all four licensed CS facilities were resilient to the turbulent conditions during this period.

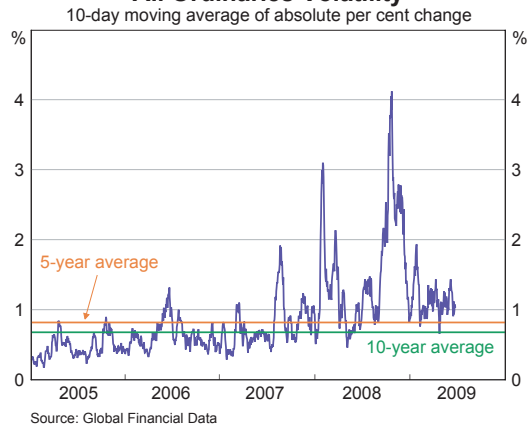
The value of equities and derivatives transactions processed by the licensed CS facilities declined in 2008/09. While average daily trading volumes increased by around 16 per cent in the cash equities market, the average daily value fell by 30 per cent, reflecting the substantial decline in share prices during the year (Graph 23). Combined with the longer term trend towards breaking up large orders for gradual release into the market, this resulted in a continuing fall in the average transaction size. The fall in average settlement value on each side of the daily net Clearing House Electronic Sub-register System (CHES) settlement batch was more moderate than the fall in the value of cash equities trades, as a result of the netting of obligations in the batch. The average settlement value on each side of the daily net CHES settlement batch fell by 2 per cent to about \$620 million in 2008/09.

The slower growth in trading activity in 2008/09 reflected an increase in risk aversion among market participants in the face of the financial market turbulence. Market volatility had been elevated since September 2007 when financial market strains first emerged, but was particularly high in late 2008 following the bankruptcy of Lehman Brothers (Graph 24). The ban on

**Graph 23**  
**Cash Equities Trades**



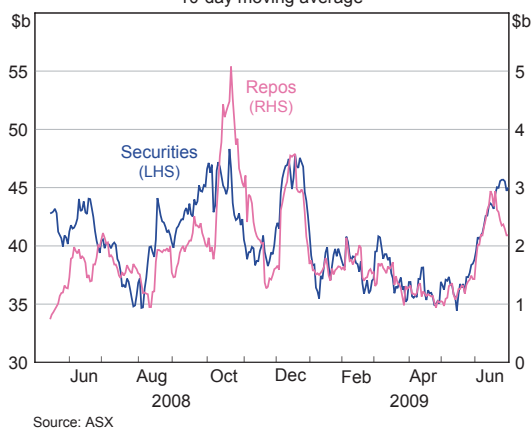
**Graph 24**  
**All Ordinaries Volatility**



covered short selling imposed by ASIC in September 2008 – due to concerns about its potential to contribute to unwarranted price fluctuations in an already volatile market – may also have limited trading activity to some extent. The ban was subsequently removed in November 2008 for non-financial stocks and in May 2009 for financial stocks.

Activity in the ASX and SFE derivatives markets declined substantially during the year in response to the turbulent market conditions, with only a modest recovery late in 2008/09, at least for the major interest rate contracts. Volumes traded on the SFE market fell by 28 per cent in 2008/09, with average open interest in the government bond contracts declining by around a third, and open interest in the 90-day bank accepted bill futures contract declining by 5 per cent. Volumes traded on the smaller ASX derivatives market fell by 18 per cent in 2008/09.

**Graph 25**  
DVP Transactions in Austraclear  
10-day moving average



Trading in debt securities was also relatively subdued, after strong growth in recent years. The value of debt securities settled through Austraclear (comprising outright purchases and sales, as well as repos of debt securities) averaged around \$42 billion in 2008/09, broadly flat, compared with growth of around 30 per cent in each of the previous two financial years. There was, however, some variability within the year, including a sharp increase in repo activity in September and October 2008 as market participants' demand for liquidity rose during the financial market turbulence (Graph 25).

Notwithstanding the decline in trading activity, the risks faced by the central counterparties – as measured by the value of margin collected from participants – increased during 2008/09 as market volatility rose. The central counterparties' participant monitoring also intensified as strains in the financial system threatened the financial standing of some clearing participants. More details on the central counterparties' risk-management activities, including additional steps taken in response to the market turbulence, are discussed above in 'Performance of Australia's Payments Infrastructure during the Market Turbulence'.

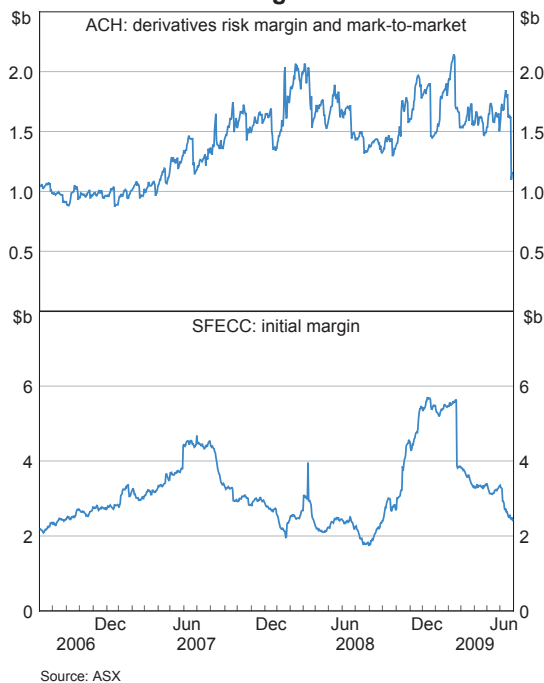
In the case of ACH, average daily exposure to participants' settlement obligations arising from cash equities trades on the ASX market (almost three-quarters of which are novated to ACH) was \$993 million in 2008/09.<sup>9</sup> This was a 23 per cent fall from the exposure faced in 2007/08 due to the decline in traded values. However, taking into account the increased market volatility, the risks faced by ACH in relation to these exposures increased. ACH does not routinely collect margins in respect of participants' cash equity positions, but does calculate

<sup>9</sup> The daily exposure faced by ACH arises from unsettled trades through the three-day settlement cycle. ACH's average total settlement exposure from a single day's trades was \$466 million in 2008/09, down by 24 per cent from the previous year.

a notional margin amount for ASX 200 stocks. Average daily notional initial margin rose by 10 per cent to \$175 million, with average mark-to-market margin little changed at \$41 million.

Similarly, while derivatives traded volumes and open interest declined, the risk associated with the remaining positions rose as market volatility increased. Both ACH and SFECC raised initial margin levels sharply in late 2008. For ASX-traded derivatives, the daily average of initial (risk) and mark-to-market margins required by ACH was broadly constant at around \$1.6 billion in 2008/09, despite the decline in positions (Graph 26). Initial margins collected in respect of trades on the SFE market increased by 26 per cent to a daily average of \$3.6 billion in 2008/09.

**Graph 26  
Margins**



Source: ASX

Consistent with international developments, the Australian cash equities market faces the prospect of competition in trading. Three applications for market licences to provide trading platforms for ASX-listed equities to compete with the ASX market are currently awaiting a decision by the Minister for Financial Services, Superannuation and Corporate Law.<sup>10</sup> If these licences are granted, arrangements would need to be made to enable the new trading platforms to clear and settle trades. ASX has consulted with industry and market licence applicants on how these platforms might connect to ACH and ASTC and in December 2008 published draft high-level business requirements for the provision of these services to non-ASX trading platforms. The Reserve Bank has been in regular dialogue with ASX and ASIC on this matter.

## 2007/08 Assessment

In October 2008, the Reserve Bank published its Assessment of the four licensed CS facilities against the relevant Financial Stability Standards, covering the year to end-June 2008. The Reserve Bank concluded that all four facilities met the relevant standard over this period.

The period covered by the Assessment was a challenging one in many respects. Volatility, particularly in the equities market, increased significantly, as did traded volumes and values in a range of markets. There were also some highly publicised financial difficulties at a number of

<sup>10</sup> The Minister has indicated that the applications will be dealt with in conjunction with the implementation of new arrangements for market supervision. This is scheduled for the third-quarter of 2010. Under the new arrangements, supervision of market participants will transfer from ASX Markets Supervision to ASIC. Should competition be permitted, these arrangements will facilitate the monitoring of participants' activities across market venues.

brokers. Given these developments, the Assessment paid particular attention to the adequacy of the facilities' risk controls, both in terms of ongoing monitoring of participants and management of financial risks.

The Assessment drew out a number of important developments during the period under review, particularly in respect of risk-management practices at ACH and SFECC. These included:

- *Enhancements to stress-testing capabilities:* Both ACH and SFECC continued to enhance their stress-testing arrangements, with SFECC implementing a new stress-testing framework during the assessment period. The Assessment concluded that the introduction of these arrangements provided a useful way to gauge the adequacy of the central counterparties' risk resources, particularly as the value of novated trades increases over time.
- *The mapping of stress-test outcomes to risk resources:* ACH completed the phased implementation of a regime whereby additional collateral is called from participants when large exposures are identified by daily stress tests. This was seen as particularly important in respect of the cash equities market, where the absence of routine margining left ACH reliant entirely on pooled risk resources to cover exposures. A similar arrangement had been in place at SFECC for some time.
- *The introduction of greater flexibility to treasury investments and the management of risk resources:* During the 2007/08 assessment period, ASX created a new corporate entity, ASX Clearing Corporation (ASXCC), to manage the investment of all assets held by ACH and SFECC as well as raise market-based funding for these entities. The Assessment concluded that this new structure would add flexibility to the treasury function and the management of the central counterparties' resources.<sup>11</sup>

The Assessment also highlighted a number of areas in respect of which further consideration by ASX was encouraged.<sup>12</sup> These included:

(i) *The need for enhancements to existing arrangements for the settlement of cash equities*

In the *Review of Settlement Practices for Australian Equities* (the Review), published in May 2008, the Board recommended changes to existing settlement processes to address the risks revealed by a disruption to equity settlement in late January. The Assessment of ASTC encouraged ASX to give further consideration to the recommendations in the Review, and in particular modifying the batch-settlement process by introducing a firm deadline for the back out of the settlement obligations of a participant that is unable to meet its payment obligations. In response, ASX released a consultation document in December 2008, seeking views on a range of possible amendments to existing processes. These included: establishing a firm deadline for the back out of settlement obligations; requiring that participants connect to CHES RTGS, an existing, but currently unused, mechanism for delivery-versus-payment (DVP) settlement outside of the single daily net batch process; and removing ACH derivatives margins from the daily equity settlement

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11 ASX had planned to raise funds for the central counterparties' pooled risk resources by issuing principal-reducing notes via ASXCC. Given turbulent conditions in financial markets, plans to issue these notes were placed on hold until late in the 2008/09 assessment period and have since been postponed indefinitely.

12 Dialogue continued with ASX through 2008/09 on several of the matters raised in the 2007/08 Assessment, with further developments summarised and discussed in the 2008/09 Assessment of the four licensed facilities, published in September 2009: <http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/Pdf/2008-09-report-clrg-settlement-facilities.pdf>



batch (so as to ensure that timely settlement of payments integral to central counterparty risk management were not dependent on completion of the equity settlement process).<sup>13</sup>

At the time of publication of the Assessment, ASX had already made progress in respect of the Board's recommendation that arrangements for dealing with settlement fails be enhanced. These included the announcement of:

- an increase in the minimum and maximum penalty fees applied in respect of failed trades – an increase in the minimum from \$50 to \$100, and an increase in the maximum from \$2 000 to \$5 000; and
- a regime whereby if a trade remained unsettled on the fifth day after trade date (ie, two days after the intended settlement date), the party failing to deliver would be required to close out the position in the market.

Both changes were ultimately implemented after the assessment period – on 1 September 2008 and 30 March 2009, respectively.

In addition, as suggested in the Review, the Reserve Bank opened a dialogue with ASX, other regulators, and market participants around a framework for disclosure of equities securities lending activity. This was progressed after the assessment period and is discussed further in 'Disclosure of Equities Securities Lending', below.

*(ii) The arrangements for monitoring participants*

In light of the financial difficulties experienced by several brokers in early 2008, considerable attention was paid in the 2007/08 Assessment to the facilities' monitoring of their participants. These problems highlighted that risks to clearing and settlement processes arising from participants' off-market activities were not adequately captured by existing monitoring arrangements. The Assessment noted the Reserve Bank's interest in the outcome of further review of these arrangements by ASX Markets Supervision. There was also seen to be a case for continuing dialogue on these matters during the 2008/09 assessment period.

In a related development, ACH and SFECC both announced their intention to raise minimum capital requirements for participants. This triggered an adverse reaction, particularly among smaller ACH clearing participants. The Reserve Bank indicated its broad support for efforts to raise the average financial standing of clearing participants, but noted the importance of a risk-based approach to setting participation requirements. In the event, the Minister for Superannuation and Corporate Law asked the Reserve Bank and ASIC to conduct a review of the central counterparties' participation requirements, with particular reference to the prospective increase in minimum capital requirements at ACH. This review was carried out in early 2009, with a joint report published in April 2009.<sup>14</sup> This is discussed further in 'Review of Participation Requirements in Central Counterparties', below.

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<sup>13</sup> ASX has since announced its conclusions and will proceed with a number of enhancements during 2009/10. These include a firm deadline for the back out of settlement obligations and removal of ACH derivatives margins from the daily settlement batch (requiring instead that these be settled via Austraclear).

<sup>14</sup> The joint ASIC/RBA Review of Participation Requirements in Central Counterparties is available at: [http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/RevParReqCenCou/rprcc\\_032009.pdf](http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/RevParReqCenCou/rprcc_032009.pdf)

(iii) *Treasury investment policy*

A new harmonised treasury investment policy was established during the 2007/08 assessment period. The new policy restricted investment to high-quality liquid assets and applied new ratings-dependent limits for unsecured issuer exposures. One issue identified, however, was that the policy still left open the potential for large concentrated exposures to the four largest domestic banks. While recognising difficulties in achieving adequate diversification in suitably high quality and liquid Australian dollar assets, the Assessment noted that the Reserve Bank would be continuing a dialogue with ASX on this matter, in the context of establishment of the new treasury arrangements in ASXCC.

## Oversight of Overseas Central Counterparties

In 2008/09, the Board finalised its policy on the application of the *Financial Stability Standard for Central Counterparties* to overseas central counterparties licensed to operate in Australia.

To date, all licensed central counterparties have been required to comply in full with the *Financial Stability Standard for Central Counterparties*, irrespective of any other regulatory obligations they are required to meet. With a trend emerging internationally towards cross-border provision of clearing services, the Board endorsed the publication of a consultation paper in October 2008 which set out a proposed regime for the oversight of overseas central counterparties.<sup>15</sup> Following a review of submissions, the regime was finalised by the Board and the *Financial Stability Standard for Central Counterparties* was varied in February 2009 to give effect to the new arrangements.<sup>16</sup> Under the regime, any overseas central counterparty licensed under Section 824B(2) of the *Corporations Act* would be exempt from full assessment against the Standard as long as it was able to provide documentary evidence from the overseas regulator that it met all relevant requirements.

A licence may be granted under Section 824B(2) at the Minister's discretion, and only where the applicant is deemed to operate under a 'sufficiently equivalent' regulatory regime in its home jurisdiction.<sup>17</sup> While the concept of sufficient equivalence is explicitly recognised in the *Corporations Act*, the Act provides no detail on how it is to be assessed. Therefore, guidance was also developed on how the Reserve Bank would approach the assessment of sufficient equivalence in relation to the degree of protection from systemic risk. Following a further round of consultation, the Board finalised a three-step approach to this assessment in July 2009, considering: the clarity and coverage of the overseas regime; the oversight process of the overseas regulator; and observed outcomes.<sup>18</sup>

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15 *The document* Consultation on Variation of the Financial Stability Standard for Central Counterparties: Oversight of Overseas Facilities is available at: [http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/Pdf/coof\\_102008.pdf](http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/Pdf/coof_102008.pdf)

16 *The Notice of Variation* is available at: [http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/notice\\_of\\_variation\\_fsscc\\_0209.pdf](http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/notice_of_variation_fsscc_0209.pdf)

17 *The guidance associated with the varied Standard stresses that an overseas central counterparty subject to this regime will retain direct obligations to the Reserve Bank. These obligations might be more onerous where the central counterparty provides services for a particularly large or systemically important market. Indeed, in some circumstances, the Reserve Bank could advise the Minister that licensing under the alternate regime for overseas facilities was not appropriate and that the applicant should operate under a full domestic licence (and hence be subject to full assessment against the Financial Stability Standard for Central Counterparties).*

18 *The consultation document* Consultation on Assessing Sufficient Equivalence is available at: [http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/ConAssessSuffEqu/ase\\_052009.pdf](http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/ConAssessSuffEqu/ase_052009.pdf) and the final guidance is available at: <http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/assessing.html>

## Disclosure of Equities Securities Lending

An important conclusion from the *Review of Settlement Practices for Australian Equities* was that improved disclosure of securities lending activity in the Australian equities market could help to enhance the robustness of the settlement process and the functioning of the market. During 2008/09, the Reserve Bank worked closely with ASX and others on developing new disclosure arrangements.

In October 2008, the Board endorsed the release of a consultation document setting out a proposed variation to one of the measures underpinning the *Financial Stability Standard for Securities Settlement Facilities* that would have the effect of requiring ASX to collect and publish relevant information on securities lending activity.<sup>19</sup> Following consultation, a number of practical issues related to how the new arrangements might be implemented were discussed with industry participants, and the regime was finalised in February 2009.<sup>20</sup> Under the regime, settlement participants in ASTC will be required to provide data to ASX on both securities lending transactions and outstanding positions. The key features are:

- Real-time tagging of all securities loan-related settlement instructions submitted to CHESSE. These data will be particularly useful for ASTC as operator of the securities settlement facility, to give visibility of loan-related transactions submitted for settlement and allow settlement performance of such trades to be monitored effectively.
- Daily reporting to ASX by settlement participants of their outstanding on-loan and borrowed positions, by security. These data will provide a gauge of outstanding loans which might be subject to recall, and allow for separate identification of chains of loans. The Reserve Bank will also work with ASX and others to encourage non-settlement participants to provide similar data on a voluntary basis.
- Quarterly reporting of the aggregate number of shares committed to lending programs by settlement participants. The Reserve Bank will also work with ASX and the industry to obtain these data from non-settlement participants on a voluntary basis.
- Daily publication by ASX of the number and value of tagged transactions and the aggregate on-loan position for settlement participants in each security. These will be published alongside relevant comparative statistics and explanatory notes.

ASX is working towards full implementation of the regime by end-December 2009. In the meantime, a pilot phase for the direct positional reporting began in late May 2009, during which the Reserve Bank has been working with ASX and reporting parties to refine the requirements, test systems and processes, and ensure data quality.

## Review of Participation Requirements in Central Counterparties

In December 2008 the Reserve Bank and ASIC were asked by the Minister for Superannuation and Corporate Law to provide advice on what is an appropriate 'core liquid capital' requirement for participants in Australia's licensed clearing facilities. This followed the implementation of a

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<sup>19</sup> The document *Consultation on Disclosure of Equities Securities Lending* is available at: [http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/Pdf/cdesl\\_102008.pdf](http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/Pdf/cdesl_102008.pdf)

<sup>20</sup> The document *Disclosure of Equities Securities Lending* is available at: [http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/DisEquSecLen0209/desl\\_022009.pdf](http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/DisEquSecLen0209/desl_022009.pdf)

rule change at ACH whereby the minimum ‘core liquid capital’ requirement for participants was to be increased from \$100 000 to \$2 million with effect from 1 January 2009, and further to \$10 million with effect from 1 January 2010.

Following consultation with ACH participants, the Reserve Bank and ASIC produced a report, which was published in April 2009. The report concluded that there was a strong in-principle case for ACH to set a minimum level of capital for its clearing participants, and that an increase from the previous level of \$100 000 was appropriate. Given developments in financial markets over late 2008 and early 2009, however, and uncertainties in the market for third-party clearing, the report recommended a more gradual implementation of the increase in minimum capital requirements. This would allow additional time for the third-party clearing market to deepen and provide further scope for smaller brokers to examine various alternative business strategies.

The Minister accepted these recommendations. ACH also expressed broad agreement with the conclusions of the report and announced an extension to its timetable for increasing minimum capital requirements. The revised timetable is:

- an increase to \$5 million effective 1 July 2010 (and to \$10 million for third-party clearers); and
- a further increase to \$10 million, effective 1 January 2012 (with a further increase for third-party clearers to be confirmed).

ASX also announced its intention to consult on possible additional enhancements to its risk framework, with routine margining of cash equities explicitly mentioned.

## **Survey of the OTC Derivatives Market in Australia**

In April 2008, the Financial Stability Forum (FSF) released a report analysing the sources of the emerging turbulence in financial markets and making recommendations to increase the resilience of the financial system.<sup>21</sup> One of the recommendations was to ensure a robust legal and operational infrastructure for the OTC derivatives market.

Following the publication of the FSF report, APRA, ASIC and the Reserve Bank formed a working group to monitor international developments in the OTC derivatives market and assess the conduct of business in the Australian market in the context of the FSF recommendations. The first step was to carry out a survey of OTC derivative market participants in Australia, with an important focus being on risk-management and post-trade processing practices.

The survey was circulated in two phases, in December 2008 and March 2009, with a number of face-to-face meetings also held with respondents. A report detailing the key findings was issued in May 2009. Survey responses confirmed that the scale of activity in the Australian OTC derivatives market is relatively low by international standards and, with the possible exception of the interest rate and foreign exchange segments of the market, also low in absolute terms. Furthermore, Australian market practices have accommodated increasing volumes in recent years, and have also proved resilient to shocks, such as the bankruptcy of Lehman Brothers

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<sup>21</sup> *The Financial Stability Forum was re-established in April 2009 as the Financial Stability Board (FSB). The FSB has an expanded membership and a strengthened mandate.*

in September 2008. Perhaps reflecting these factors, improvements to risk-management and operational practices in Australia appear to have been pursued with less urgency than has been the case internationally.

Nevertheless, the survey revealed a number of important developments and enhancements in these areas over time, reflecting general industry-wide improvements in risk management, in part driven by international regulatory initiatives. For instance, there was evidence of increasing acceptance of the importance of timely execution of industry-standard documentation, a continuing trend towards collateralisation of exposures, and a gradual shift towards increased automation and use of third-party platforms for key post-trade processing functions.

While acknowledging these developments, the working group reached the conclusion that there remained room for further enhancement to operational and risk-management practices in the Australian OTC derivatives market. The report on the survey listed a number of areas in which industry was encouraged to work with the authorities to strengthen market practices. In particular, the report encouraged industry to take steps to:

- promote market transparency;
- ensure continued progress in the timely negotiation of industry standard legal documentation;
- expand the use of collateral to manage counterparty credit risks;
- promote Australian access to central counterparties for OTC derivatives products;
- expand the use of automated facilities for confirmations processing;
- expand the use of multilateral ‘portfolio compression’ and reconciliation tools; and
- increase Australian influence in international industry fora.

Following publication of the report, an industry forum was held to present the findings and elicit feedback from industry participants. Through June 2009, a number of bilateral meetings were also held with relevant industry associations and other stakeholders. The three financial authorities will continue to work collaboratively with industry through 2009/10 to promote the enhancements set out in the report.

# Other Regulatory Responsibilities

## Exchange Settlement Accounts

The Payments System Board has ongoing responsibility for the Bank's policy on access to ES accounts. Under current policy, both Authorised Deposit-taking Institutions (ADIs) and third-party payment providers supervised by APRA are eligible to hold ES accounts, provided the Bank is satisfied that they have the liquidity to meet settlement obligations under routine conditions, during seasonal peaks and during periods of stress. Organisations not supervised by APRA that operate in the deferred net settlement systems would typically also be subject to ongoing collateral requirements. ADIs that account for at least 0.25 per cent of all RTGS payments are required to settle on their own behalf. Smaller institutions may elect to settle using another ES account holder as an agent.

In 2008/09, the Bank granted ES accounts to nine institutions, up from three the previous year. In part, this was in response to a decision by the Reserve Bank to expand the securities it is willing to accept in repurchase agreements to include debt issued by ADIs that hold an ES account. Five building societies applied for and were granted ES accounts in 2008/09. ES accounts were also granted to three foreign banks applying to become ADIs and one third-party payment provider – the Australian Clearing House – which intends to use its ES account for margin-related funds movements and treasury investment-related settlements. All but two of these institutions applied for and were granted permission to settle using another ES account holder as an agent. A full list of ES account holders is available on the Bank's website.

## Oversight of Continuous Linked Settlement (CLS) Bank

CLS Bank is chartered in the United States and regulated and supervised by the Federal Reserve System. Co-operative oversight by the central banks of the currencies that settle in CLS is, however, conducted through the CLS Oversight Committee, which is co-ordinated by the Federal Reserve. These oversight arrangements were finalised in late 2008, replacing the previous arrangements under the auspices of the Committee on Payment and Settlement Systems Subgroup on Foreign Exchange Settlement Risk. As CLS settles foreign exchange transactions involving the Australian dollar, the Reserve Bank is represented on the CLS Oversight Committee. The Oversight Protocol for CLS is published on the US Federal Reserve's website.<sup>22</sup>

In March 2009, CLS Bank began settling one-sided Australian dollar payments, including non-deliverable forwards and credit derivatives. CLS has also been authorised to settle foreign exchange option premiums but has not yet commenced operation of this facility.

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<sup>22</sup> The Oversight Protocol is available at: [http://www.federalreserve.gov/paymentsystems/cls\\_protocol.htm](http://www.federalreserve.gov/paymentsystems/cls_protocol.htm)

# Engagement with Industry

## Liaison with Industry

Over 2008/09, the Reserve Bank consulted with industry participants on a number of issues. It also continued to liaise closely with the Treasury, the Australian Competition and Consumer Commission (ACCC), APRA and ASIC on matters including the retail payments system, clearing and settlement facilities, and policy issues arising from the global financial crisis.

On the payments side, the Reserve Bank finalised its consultation on the review of the payments system reforms in July and August 2008. In addition, it consulted in early 2009 on an Access Regime for the ATM system to support industry efforts to reform the ATM arrangements.

On the clearing and settlement side, the Reserve Bank consulted on two variations to the Financial Stability Standards. The first was a variation to the *Financial Stability Standard for Central Counterparties* to establish a regime for oversight of overseas central counterparties licensed to operate in Australia. As the regime was designed to apply to overseas facilities that are regulated in a 'sufficiently equivalent' regime overseas, the Reserve Bank also undertook consultation on the process it would use to assess sufficient equivalence of an overseas regulatory regime. The second was a variation to the *Financial Stability Standard for Securities Settlement Facilities* to require disclosure of data on equities securities lending. This consultation involved both bilateral consultation and a number of 'round table' discussions with ASX and participants in the securities lending market.

In addition, the Reserve Bank undertook a number of projects in the clearing and settlement area that involved consultation. At the request of the Minister for Superannuation and Corporate Law, the Reserve Bank and ASIC conducted a review of participation requirements in central counterparties. This involved substantial consultation with brokers active in the equity market as well as ASX. The Reserve Bank also worked with APRA and ASIC to conduct a survey of OTC derivatives in Australia, the outcome of which was a report highlighting some areas in which market practices could be strengthened. The Reserve Bank, APRA and ASIC opened a dialogue with market participants, key infrastructure providers and relevant industry associations to promote the enhancements outlined in the report.

In line with its liaison agreement with APCA, the Reserve Bank met with the APCA management after each APCA Board meeting – a total of 7 times in 2008/09 – as well as with the Board on one occasion.

Reserve Bank staff have made a number of presentations on payments system issues over 2008/09. The Chairman of the Board spoke on 'Public Policy and the Payments System' at the Ian Little Memorial Lecture in March 2009. The Deputy Chairman addressed participants at Cards and Payments Australasia in March 2009 on 'Payments System Reforms: Innovation and Competition' and the Card Payments Forum organised by APCA also in March 2009. The Head of Payments Policy gave presentations to APCA, Australian Settlements Limited, the Prepaid

International Forum and the Cashcard Network Members Forum, as well as participating on a panel at Cards and Payments Australasia.

## **International Meetings**

The Reserve Bank was represented on two international groups in 2008/09: the CLS Oversight Committee and the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) Working Group on Payment and Settlement Systems. The CLS Oversight Committee held two meetings in 2008/09 as did the EMEAP working group.

In July 2009, the Reserve Bank was invited to join the Bank for International Settlements' Committee on Payment and Settlement Systems (CPSS). The CPSS, which is comprised of senior officials from 23 central banks, serves as a forum to monitor and analyse developments in domestic payment, settlement and clearing systems as well as in cross-border and multicurrency systems.

In addition, the Reserve Bank has provided technical assistance on payments issues to a number of other central banks.



# The Board's Decisions and Reserve Bank Reports

This section lists developments since mid 2008. The Payments System Board's 2006 Annual Report contained a list of the Board's decisions and related Bank reports up to that time. Subsequent Reports have contained an annual update.

## 2008

Media Release 2008-16, 'Reform of Australia's Payments System: Conclusions of the 2007/08 Review' (Announcing the release of the conclusions of the extensive review of the payments system reforms undertaken by the Board), 26 September 2008.

*Reform of Australia's Payments System: Conclusions of the 2007/08 Review*, Reserve Bank of Australia, Sydney, September 2008.

Media Release 2008-24, '2007/08 Assessment of Australia's Clearing and Settlement Facilities and Consultation on Variation of the Financial Stability Standards' (Announcing the results of the Bank's 2007/08 assessment of Australia's licensed clearing and settlement facilities against the Financial Stability Standards and the release of consultation documents regarding its proposals to modify the *Financial Stability Standard for Securities Settlement Facilities* to improve transparency in the equities securities lending market and the *Financial Stability Standard for Central Counterparties* to establish a framework for regulation of overseas central counterparties), 24 October 2008.

*2007/08 Assessment of Clearing and Settlement Facilities in Australia*, Reserve Bank of Australia, Sydney, October 2008.

*Consultation on Variation of the Financial Stability Standard for Securities Settlement Facilities: Disclosure of Equities Securities Lending*, Reserve Bank of Australia, Sydney, October 2008.

*Consultation on Variation of the Financial Stability Standard for Central Counterparties: Oversight of Overseas Facilities*, Reserve Bank of Australia, Sydney, October 2008.

Media Release 2008-28, 'Payments System Reform' (Announcing the designation by the Bank of the Australian ATM system and the release of a consultation document setting out a draft Access Regime; the Board's decision to vary the interchange fee Standards for the MasterCard and Visa credit card systems, the Visa Debit system and the EFTPOS system to allow the Bank to waive or suspend the requirement to recalculate the benchmarks for interchange fees (and its approval of a waiver for the 2009 recalculation); and the continuation of discussions between the Bank and PayPal regarding merchant restrictions), 10 December 2008.

*Access Regime for the ATM System: A Consultation Document*, Reserve Bank of Australia, Sydney, December 2008.

## 2009

Media Release 2009-03, 'Payments System Issues' (Announcing the release of an Access Regime for the ATM system; the introduction of variations to the *Financial Stability Standard for Securities Settlement Facilities* and the *Financial Stability Standard for Central Counterparties* along the lines proposed in October 2008; and the outcome of the Bank's discussions with PayPal on merchant restrictions), 24 February 2009.

*An Access Regime for the ATM System*, Reserve Bank of Australia, Sydney, February 2009.

*Disclosure of Equities Securities Lending*, Reserve Bank of Australia, Sydney, February 2009.

*Review of Participation Requirements in Central Counterparties*, Reserve Bank of Australia, Sydney, March 2009.

*The Introduction of Direct Charging for ATMs*, Reserve Bank of Australia, Sydney, April 2009.

Media Release 2009-10, 'Payments System Issues' (Announcing the release of a consultation document on assessing sufficient equivalence of regulation of clearing and settlement facilities; the imminent release of a survey of the OTC derivatives market in Australia; and the Board's view on industry progress in meeting the necessary conditions for the removal of interchange regulation), 20 May 2009.

*Consultation on Assessing Sufficient Equivalence*, Reserve Bank of Australia, Sydney, May 2009.

Joint Media Release, 'Report Released Today: Survey of the OTC Derivatives Market in Australia' (Announcing the release of a survey of the OTC derivatives market in Australia, undertaken by a group comprising APRA, ASIC and the Bank), 22 May 2009.

*Survey of the OTC Derivatives Market in Australia*, Reserve Bank of Australia, Sydney, May 2009.

Media Release 2009-18, 'Payments System Reform' (Announcing the Board's decision to continue interchange regulation as industry progress was insufficient to warrant its removal; and the Board's intention to consult on removing the difference in the regulatory treatment of the scheme debit and EFTPOS systems), 26 August 2009.