

BUSINESS SERVICES

The services provided by the RBA encompass:

- banking and registry services for the Commonwealth and South Australian Governments and some international institutions;
- settlement facilities for banks and other financial institutions; and
- note issue services to banks via armoured car companies.

The RBA does not provide business services directly to the general public, with the exception of a very small amount of registry work.

The services provided by the RBA include two contestable businesses: transactional banking and registry. Separate financial data are recorded for these businesses which fully meet all competitive neutrality and devolved banking requirements, including allowance for all relevant taxes. Pro-forma sets of accounts for the contestable businesses, prepared in accordance with competitive neutrality guidelines, are set out elsewhere in this Report.

GOVERNMENT BANKING

The banking services provided to the Commonwealth Government by the RBA comprise two components. A core banking facility is provided to the Department of Finance and Administration (DoFA), which is non-contestable in terms of the Commonwealth Government's competition policy. This facility is made up of a group of bank accounts, including the Official Public Account (OPA), a term deposit facility for the investment of temporarily surplus Commonwealth funds and a strictly limited overdraft facility.

Under the core banking arrangements, payments are made from the OPA to agencies and end-of-day agency balances held with transactional bankers are

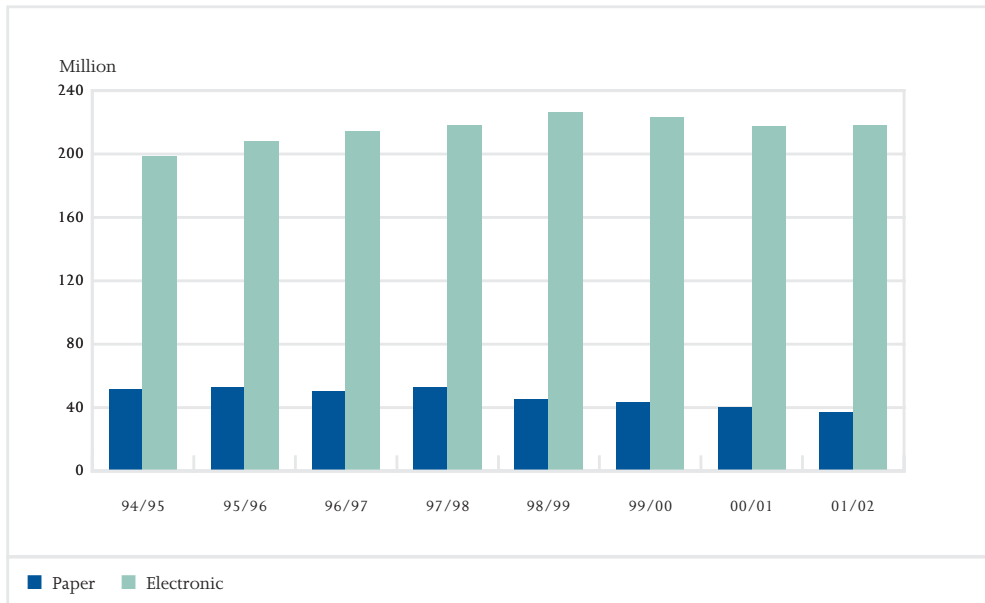
swept back to the OPA overnight. These balances are returned to transactional bankers at the start of the next business day. The services also embrace electronic collection of forecasting data and reporting on high value transactions from agencies and transactional bankers to assist the RBA in the discharge of its monetary policy and liquidity management responsibilities.

The RBA also administers a term deposit facility, on behalf of DoFA, through which agencies can deposit temporarily surplus departmental funds. During 2001/02, 7 300 deposits totalling \$62 billion were made using this facility compared with \$53 billion (5 800 deposits) in the previous year.

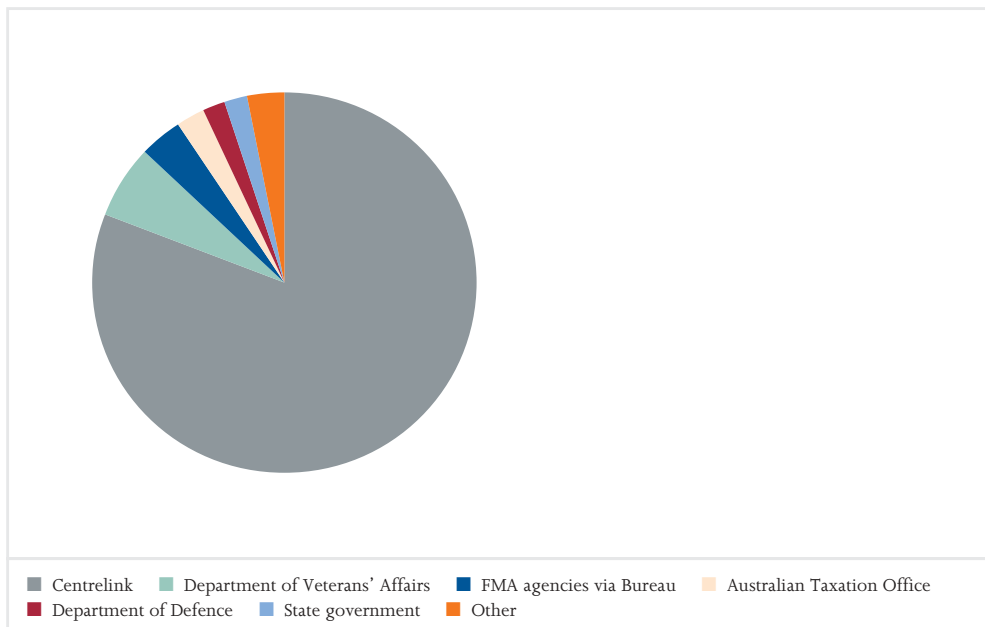
The other component of the RBA's banking business is the provision of contestable transactional banking services to government customers. The separation of the transactions business occurred when the Commonwealth Government implemented its devolved banking arrangements on 1 July 1999. Agencies governed by the *Financial Management and Accountability Act 1997 (FMA Act)* continued to review their transactional banking requirements and supplier arrangements during 2001/02. Of the reviews completed during the year, the RBA has retained the business of 75 per cent of the agencies involved. The market testing process is continuing, with further agencies expected to review their requirements in the coming year.

Since 1991, the RBA has distributed government payments direct to accounts at financial institutions through its Government Direct Entry System (GDES). This system, which uses an extensive communication network and warehousing capabilities, has incorporated same-day settlement since its inception.

GRAPH 17 / BANKING TRANSACTIONS



GRAPH 18 / ELECTRONIC BANKING TRANSACTIONS – 2001/02



The number of electronic transactions distributed through GDES showed a slight increase in 2001/02 to 218 million, from 217 million the previous year. The increase was due mainly to additional payments

being made by the Australian Taxation Office, Centrelink and the Health Insurance Commission, which were partly offset by a decrease in payments by some other customers. In contrast, volumes of

paper transactions have continued their steady decline.

The RBA has continued to provide transactional banking and contract management services to the Government of South Australia. This role embraces the provision of banking services across 20 major State Government agencies, covered by the *Public and Finance Audit Act 1987 (SA)*, and processes some seven million electronic and paper transactions through 300 bank accounts.

Earnings after tax for the contestable transactional banking business in 2001/02 were \$2.9 million compared with \$5.4 million in the previous year.

Business Developments

As mentioned in last year's Annual Report, the RBA has developed a cheque verification system in response to an increase in fraudulent alteration of customer cheques. The system combines cheque issue data provided by customers and image technology to confirm that the information on the cheques, as presented through the banking system, is valid. This system has proved to be most successful. The data-matching process of the system, together with daily reconciliation of presented cheques, has confirmed that, since its introduction, all attempts at fraudulent alteration of cheques have been detected in a timely manner. In addition, to protect further its customers against financial loss, the RBA has also developed a same-day cheque tracking and reconciliation system to complement the cheque verification system. The combined systems are known as the Cheque Reconciliation and Verification System (CRVS). The system has improved the competitiveness of the RBA in the transactional banking market and provides substantial benefits for customers.

During the year, the RBA worked with the Health Insurance Commission (HIC) to improve the efficiency of the arrangements for payment of

healthcare service providers. The review resulted in the introduction of a new facility which will streamline the payment process by automatically stopping cheques un-presented within 90 days, and replacing them with direct entry payment via GDES.

As foreshadowed last year, facilities to enable the direct crediting of Australian pension payments to overseas bank accounts in local currency have been developed for Centrelink. The facility has been progressively implemented from November 2001 and so far covers Australian pensioners residing in over 30 countries. Once fully implemented, some 80 per cent of monthly overseas pension payments will be made direct to bank accounts, ensuring more secure and timely delivery of entitlements.

For many years, the majority of government agencies have effected the transfer and receipt of data files with the RBA through ReserveLink, the Bank's electronic banking package. ReserveLink offers a secure closed network environment for both data and value payment files. Since 2000, agencies have also been able to pass electronic remittance advices and related electronic payments via ReserveLink to their e-commerce trading partners. The use of this service has significantly increased to over 300 000 transactions annually. In response to customer demand and in line with government policy, extensive work has been undertaken during the year to establish the infrastructure to allow the RBA to provide, in a secure environment, some banking services via the Internet. Initially, this facility will provide bank account enquiry functions, but it is intended that, subsequently, access to cheque processing output, including image data, will be made available. Customers will be able to receive on-line reports on the status of cheque presentations. The new processes will complement existing initiatives implemented to combat cheque fraud and streamline cheque clearance procedures. Given the

often sensitive nature and high value of government payments, the RBA has no plans, at this stage, to provide for value payments to be effected via the Internet. These payments will continue to be made via ReserveLink or direct data link.

SETTLEMENT AND REGISTRY SERVICES

The Reserve Bank Information and Transfer System (RITS) is used by banks and other approved institutions to settle interbank payments, mostly on a real-time gross settlement (RTGS) basis. RITS also provides a facility for electronic tendering for Commonwealth Government securities (CGS). From July 1991 until February 2002, the system also provided an electronic depository and settlement service for CGS. In February 2002, in the interests of clearing system efficiency, members transferred all CGS to the Austraclear system operated by SFE Corporation Limited (see below).

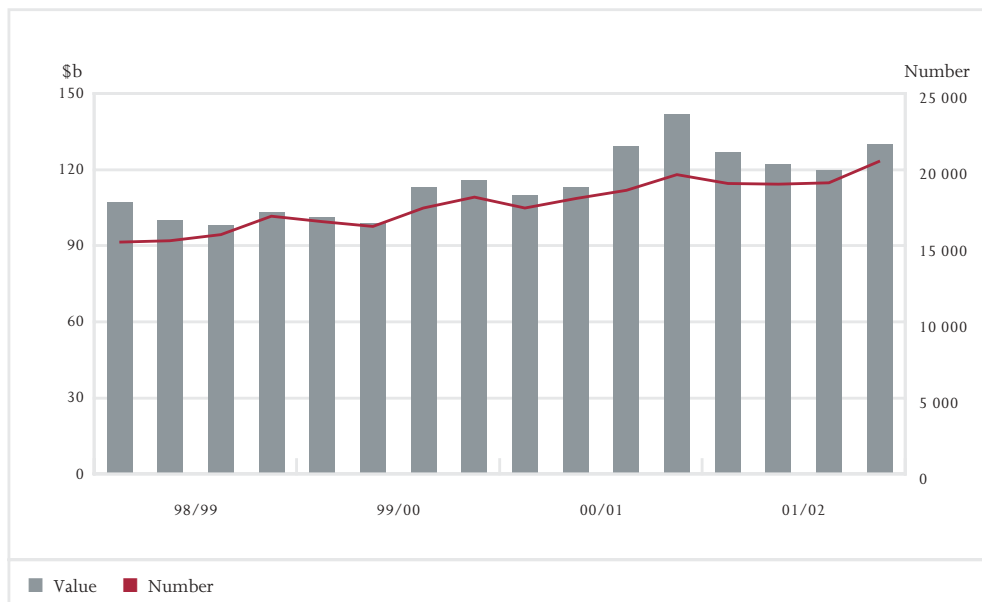
RTGS and Other Settlement Services

About 90 per cent of the value of interbank payments is settled on an RTGS basis; this includes all wholesale debt and money market settlements, Australian dollar foreign exchange settlements and a range of time-critical customer payments.

During 2001/02, the daily number and value of payments settled in RITS was relatively steady, following strong growth in the first half of 2001. Nevertheless, the end of financial year peak on 28 June 2002 of 33 000 transactions totalling over \$220 billion was significantly higher than for the final day of the previous financial year.

As noted in earlier chapters, the “continuous linked settlement” (CLS) initiative is expected to commence later in this year. Under CLS, foreign exchange settlement risk in the participating currencies will be reduced due to the simultaneous settlement of both legs of eligible foreign exchange transactions across the books of CLS Bank. The introduction of

GRAPH 19 / RTGS TRANSACTIONS Average daily value and number



CLS will mean extended operating hours for RITS to synchronise with CLS settlement hours during the European morning.

In preparation for CLS, co-ordinated testing involving CLS Bank, participating RTGS systems and a small group of member banks has been under way since March 2002. Testing entered a new phase in May, including extended hours for RITS, to enable low-value trial transactions to be processed across the production RTGS systems.

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

Settlement services are also provided for the RBA's own transactions in the domestic securities and foreign exchange markets, as well as those arising from the Commonwealth Government and other official customers.

RITS computer operations, software development and support functions are currently performed for the RBA under contract by Austraclear Limited, part of the SFE Corporation group since its merger with the SFE in 2000. This was a logical arrangement given the close similarity between the securities settlement function in the RITS and Austraclear systems. However, the securities settlement function in RITS is now redundant following the move of CGS from RITS, and, since the Austraclear merger with the SFE, its business focus has necessarily shifted.

As the provision of the infrastructure for interbank settlement is a core central bank activity, the RBA has decided to assume responsibility for the RITS operations, development and support functions

currently undertaken by SFE Corporation. This will allow the RITS and Austraclear systems to be developed independently according to their respective business priorities and user requirements. There will be no impact on RITS functionality or services provided to banks and other RITS members.

The RBA is working closely with the SFE Corporation to ensure a smooth transition, which is currently expected to be complete by November 2002.

Transfer of CGS from RITS to the Austraclear System

In July 2001, the RBA wrote to RITS members asking whether they would favour movement of their CGS holdings in RITS to the Austraclear system. If a clear majority of CGS holders within RITS supported such a move, the RBA would cease providing an electronic CGS settlement service and transfer its CGS holdings to Austraclear in order to allow the market to benefit from one central settlement system for debt securities.

As members overwhelmingly supported this proposal, the RBA in October 2001 advised that it would cease providing an electronic settlement system for securities in RITS and that it would assist members to move their portfolios to Austraclear. The transfer of all securities occurred smoothly in the week of 18 to 22 February 2002.

Registry Services

During the year, the RBA provided registry services to the Commonwealth Government, the South Australian Government Financing Authority (SAFA) and a number of other official domestic and foreign institutions. The core functions of this service cover the issue, transfer and registration of securities, the maintenance of ownership records, the distribution of interest payments and the redemption of securities at maturity. After the close of the financial year, SAFA advised that, following a tender process, it had

decided to transfer its business to another registry services provider.

The RBA also executed agreements covering the provision of registry services to a number of official foreign entities which have established domestic Australian dollar debt programs.

Changes to the *Commonwealth Inscribed Stock Act*, which enable the electronic transfer of ownership of Commonwealth Government securities, came into effect in early 2002. As yet, these changes have not had any impact on the RBA's traditional registry operation.

In line with the aim of providing quality registry services in the most effective and cost-efficient manner, the registry uses the RBA's CRVS system to protect issuers and stock-holders against losses resulting from the fraudulent alteration of registry cheques. Stock-holders will also be provided with the option of receiving their statements via e-mail during the course of the next financial year. Such a facility would not only provide stock-holders with a more timely delivery of information, but also reduce the cost to issuers of providing information to their stock-holders.

Earnings after tax for the contestable registry business in 2001/02 were \$0.2 million compared with \$0.5 million in the previous year.

NOTE ISSUE

The RBA's note issue functions include the issue of new and reissuable quality notes; the processing of notes returned from circulation for authentication and quality-control purposes; general oversight of cash distribution arrangements; and research into, and development of new note designs and security features.

Significant changes in the RBA's note issue activities, which began several years ago, were largely

completed during 2001. First, in June 2001, the new centralised National Note Processing Centre (NNPC) – located at Note Printing Australia Limited's Craigieburn site – commenced operations. Prior to this, the RBA had run branch-based cash services operations in each capital city. These operations were progressively closed between 1997 and 2001.

Second, in November 2001, the RBA completed the introduction of new cash distribution arrangements. This involved the purchase by commercial banks of working stocks of notes and coin, which previously had been owned by the RBA, but held in note and coin pools operated by armoured car companies. Because commercial banks must purchase stocks of currency for full value, the result of this change in arrangements is that the RBA's balance sheet and profits are higher: when banks purchase currency, the RBA invests the resulting funds in interest-bearing assets. Conversely, the commercial banks have forgone interest, by holding additional currency. As part of the new arrangements, therefore, the RBA agreed to make payments to the commercial banks for interest forgone on currency stocks held in approved cash centres, up to a specified maximum. It is a condition of receiving these payments that banks sort notes for quality, to a standard set and monitored by the RBA.

The intention of these new arrangements is to encourage commercial banks, where possible, to deal directly with each other to manage short-term surpluses and shortfalls in holdings of currency, rather than having each individual bank deal directly with the RBA. The banks have taken some time to adapt to the new system, but as experience grows, improved practices should reduce the level of working stocks of currency held by banks.

Notes on Issue

The changed arrangements for ownership of the working stocks of currency have had a substantial impact on the value of currency recorded as “on issue” as, under the new system, working stocks held by the banks are recorded this way, whereas when they were held by the RBA they were not. Hence, the value of Australian notes on issue increased by \$4.8 billion, or 17.5 per cent, over 2001/02 to \$32 billion. These factors also had the effect of increasing the share of the value of notes in circulation accounted for by \$20 and \$50 denominations, and reducing the share attributed to the \$100 denomination. However, excluding the effects of the new distribution arrangements, it is estimated that notes on issue grew a little more slowly over 2001/02 (6.2 per cent) than in the previous year (6.8 per cent), while the underlying trend towards a greater proportion of notes on issue being accounted for by the higher denominations continued.

Note Processing and Distribution

Under the new cash distribution arrangements, commercial banks return to the NNPC only notes

that are unfit, surplus fit notes following seasonal peaks in demand, and notes requested by the RBA for return for quality sampling purposes.

Over 2001/02, 397 million notes (\$13.5 billion) were dispatched from and returned to the NNPC. Around 125 million were processed through high-speed note processing equipment for verification, authentication and quality control. Only 47 per cent of notes processed were deemed fit for reissue, down from 77 per cent last year. The increased proportion earmarked for destruction reflects both the impact of the new cash distribution arrangements which, in addition to improving the efficiency of circulation of currency within the community, also seek to reduce the number of fit notes unnecessarily returned for processing, and a deliberate focus by the RBA on improving the quality of notes in circulation following a temporary decline as the new processing and distribution arrangements were bedded down.

The NNPC also receives notes that have been damaged and cannot easily be assessed for value by the general public or banks. They include notes that have been disfigured, heat affected, defaced or otherwise mutilated. Mutilated notes are returned

Value of Notes on Issue (\$ million)

At end June	\$1(a)	\$2(b)	\$5	\$10	\$20	\$50	\$100	Total	Increase (per cent)
1996	19	48	337	583	1 868	7 928	8 399	19 182	3.5
1997	19	47	351	601	1 837	8 912	8 297	20 064	4.6
1998	19	47	361	617	1 804	9 523	9 280	21 651	7.9
1999	0 (c)	46	379	639	1 850	10 356	10 282	23 552	8.8
2000	0 (c)	46	397	646	1 917	11 188	11 240	25 434	8.0
2001	0 (c)	45	431	662	2 014	12 055	11 961	27 168	6.8
2002	0 (c)	45	530	791	2 789	14 718	13 057	31 930	17.5

(a) Last issued May 1984

(b) Last issued June 1988

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

to the NNPC for the most part via banks, for closer inspection and assessment. During the year the NNPC assessed 4 987 mutilated note claims with a total value of \$2.3 million.

Counterfeiting Activity

Counterfeiting of Australian currency notes increased in 2001/02, with around 14 counterfeits passed per million notes in circulation, compared to around five counterfeits per million in the previous year. This rate remains very low by international standards. Much of the increase was attributable to counterfeiting of the \$50 note. Around 92 per cent of counterfeits passed are paper reproductions of polymer notes, and are of poor quality; they are easily detected by simple visual inspection, as well as by feel.

Over recent years, there has been rapid growth in the availability and sophistication of low-cost desktop scanners, printers and image-editing software, and this has led to an increase in digital counterfeiting worldwide. However, for Australia and some other countries, the enhanced security provided by polymer notes remains an important deterrent to counterfeiting. By increasing the range of skills and number of steps required to produce a quality counterfeit note, the use of polymer substrate makes counterfeiting more difficult, time-consuming and costly.

Federation \$5 Note

A new \$5 note was issued during 2001 as the RBA's contribution to the Centenary of Federation celebrations. Around 70 million pieces were issued over the course of the year. From the beginning of 2002, the RBA began reissuing the standard \$5 note. Federation \$5 notes will continue to circulate until such time as they become unfit and are withdrawn from circulation.

Change to Note Design

In March 2002, the RBA began issuing a \$20 note that incorporated a minor design change: the inclusion of the printed names of Mary Reibey and John Flynn, which appear just beneath their portraits. This change followed numerous enquiries from the public about the people featured on Australia's banknotes. The Federation \$5 note, issued in 2001, was the first note to include printed portrait names. Printed names will be included in the design of the \$10, \$50 and \$100 notes when these are next printed.

Information about the portraits on currency notes is available on the Bank's website at www.rba.gov.au.