

Banking and Payments

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

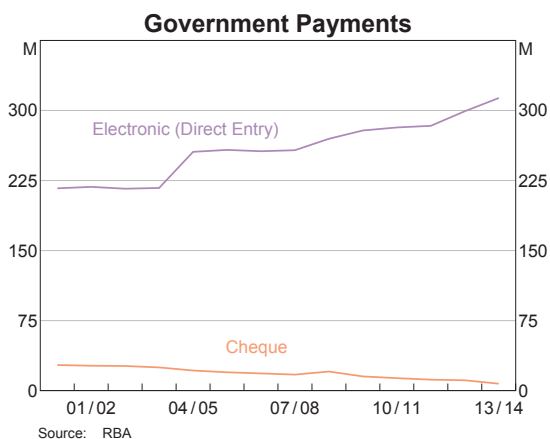
Banking

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

Core banking services are provided to the Department of Finance on behalf of the Australian Government and the Australian Office of Financial Management (AOFM). These services derive directly from the Reserve Bank's role as Australia's central bank and require the Bank to manage the consolidation of government agency account balances – irrespective of which financial institution each agency banks with – into the government's Official Public Accounts (OPA) at the Bank on a daily basis. This involves 'sweeping' balances from agency accounts at transactional banks to the OPA at the end of each business day and returning balances required to meet agencies' day-to-day payment obligations the following morning. The average daily sweep to and from the OPA was around \$3 billion in 2013/14. The Reserve Bank also provides the government with a term-deposit facility for investment of its excess cash reserves, as well as a short-term overdraft facility to cater for occasions when there is unexpected demand on Commonwealth cash balances. The overdraft facility was used on two occasions during the financial year.

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

The Reserve Bank's transactional banking services are associated with more traditional banking activities. Principal among these are services for making payments from government agencies to recipients' accounts. The Bank processed some 325 million payments, totalling \$490 billion, for government agencies in 2013/14. Most of these were made via



direct entry. The Australian Government also makes payments by eftpos, the RTGS system and cheque, though its use of cheques has fallen significantly in recent years relative to electronic payment methods. Cheques now make up less than 3 per cent of agency payments compared with around 10 per cent a decade ago. In addition to payments, the Bank provides its government agency customers with access to a number of services through which they can collect funds, including Electronic Funds Transfer, BPAY, eftpos, and card-based services via the phone and internet. The Bank processed 25 million collections-related transactions for the Australian Government in 2013/14, amounting to \$445 billion.

The provision of transactional banking services is consistent with the Reserve Bank's responsibilities under the *Reserve Bank Act 1959*. These services are offered in line with the Australian Government's competitive neutrality guidelines. To deliver the services, the Bank must compete with other commercial financial institutions, in many instances bidding for business at tenders conducted by the agencies themselves. It must also cost and price the services separately from the Bank's other activities, including its core banking services, and meet a prescribed minimum rate of return. Some 90 government agencies are transactional banking customers of the Bank. Pro forma business accounts for transactional banking are provided on page 81.

After-tax earnings from the Reserve Bank's transactional banking services were \$5.1 million in 2013/14. This is higher than in the previous year owing to increased transaction volumes through the Bank's online collection services.

The Reserve Bank works closely with its agency customers and with the Australian Government more generally to ensure that they have access to services that are consistent with their needs and those of the public. In 2013/14, the Bank added prepaid and corporate card products to the suite of services available to its agency customers. The prepaid card product is intended to assist agencies in managing their day-to-day running expenses, reducing their reliance on, and the cost of, using cash, while the corporate card product offers a level of convenience to agencies for managing larger expenditures. For some services, the Bank combines its specialist knowledge of the government sector with specific payment services and products from commercial providers to meet the government's banking needs. Many of the collection services mentioned above and the newly introduced card products are examples of this. The Bank will continue to make use of combined service arrangements as the government's banking needs evolve.

In order to meet the government's changing service needs, the Reserve Bank must ensure that its underlying banking systems continue to provide the highest levels of reliability and efficiency. Consistent with this, the Bank is undertaking a program of work to upgrade its banking systems, moving them to a contemporary programming language and architecture, and re-engineering a number of business processes to ensure that they remain cost effective. The work is occurring in stages over several years. The first stage, involving the processing of RTGS payments for government agencies, was completed in mid 2014, and work on the second stage, which involves redevelopment of systems for processing payments to the government and its agencies, has commenced. Undertaking the work is a dedicated team of business analysts, application developers, testers and project managers, of which a number have been recruited externally to complement the Bank's existing resources. The work is overseen by a Steering Committee comprising senior Bank staff.

Registry

The Reserve Bank has for many years provided registry services for Commonwealth Government Securities (CGS) under agreement with the AOFM and for securities issued under Australian dollar debt programs by foreign official institutions. These services typically involve registration of new issues, ongoing maintenance of ownership records, distribution of interest payments and redemption of securities at maturity. In early 2014,

the AOFM transferred the registry services for CGS from the Bank to a commercial service provider. The transfer was consistent with announcements by the Australian Government in 2010 that it was looking to improve access to the bond market for retail investors, and by the AOFM in May 2013 that retail investors could thereafter buy and sell entitlements to CGS through an electronic platform provided by the Australian Securities Exchange (ASX).

The Reserve Bank had also for many years provided a facility that enabled retail investors to buy and sell CGS over the counter. The new arrangements announced by the AOFM for buying and selling entitlements to CGS on an electronic platform meant that the Bank's facility was no longer required. As noted in last year's Annual Report, the Bank closed its facility for selling CGS to retail investors in May 2013 as part of the initial stages of the changeover to the new platform. The Bank's facility to purchase CGS from retail investors was closed in early 2014 when the CGS registry moved to an external provider.

While the Reserve Bank no longer conducts the registry business for CGS, it continues to offer services to foreign official institutions with Australian dollar debt programs. Some 60 foreign institutions are customers of the Bank.

Earnings after tax for the registry business were \$0.1 million in 2013/14, a little lower than in the previous year reflecting the transfer of the CGS registry business.

Settlement Services

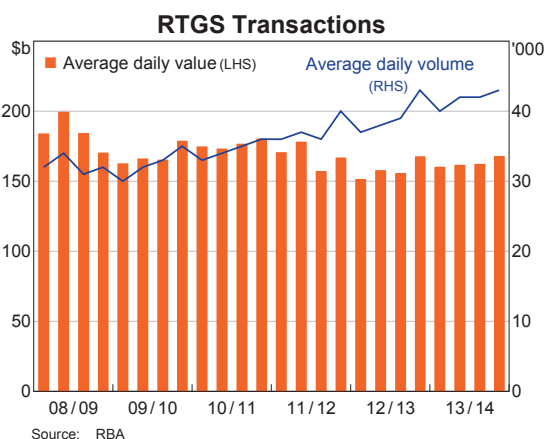
The Reserve Bank owns and operates the Reserve Bank Information and Transfer System (RITS), which effects settlement of payment obligations across Exchange Settlement (ES) accounts held with the Reserve Bank. Payments settled individually on an RTGS basis in RITS include time-critical customer and other bank payments, wholesale debt and money market transactions and the Australian dollar legs of foreign exchange transactions. The latter includes Australian dollar trades settled through CLS, a multi-currency settlement system designed to reduce foreign exchange settlement risk for which net amounts are paid to and received from CLS Bank International each day. Around 90 per cent of payments in Australia by value are settled in RITS on an RTGS basis.

At end June 2014, there were 60 institutions approved to operate an ES account. Another 27 institutions hold ES accounts but have appointed another ES account holder to settle RTGS transactions on their behalf in RITS. A further 65 institutions were Non-Transaction Members of RITS in order to participate in the Reserve Bank's domestic open market operations.

Close to 42 000 RTGS transactions worth \$163 billion were settled in RITS, on average, each day during 2013/14. While RTGS volumes have continued to grow steadily, values have remained broadly unchanged over recent years.

RITS also settles some payments on a net basis. One such arrangement – the daily CHES batch – is for settlement of payments arising from stock market transactions, and is managed by the ASX as Batch Administrator. CHES batch settlement averaged around \$930 million each day in 2013/14.

Obligations arising from cheques, debit and credit cards and direct entry transactions are exchanged



through clearing systems administered by the Australian Payments Clearing Association (APCA). These are largely low value and settle on a multilaterally netted basis in RITS. Prior to 25 November 2013, all of these obligations were settled at 9.00 am the next business day. Since 25 November 2013, direct entry obligations are able to be settled on a same-day basis.¹ This occurs shortly after the official industry clearing exchange times, in five multilaterally netted batches at 10.45 am, 1.45 pm, 4.45 pm, 7.15 pm and 9.15 pm. Around \$17 billion per day in total is cleared through the direct entry system, with around 60 per cent of that in the final two exchanges of the day.

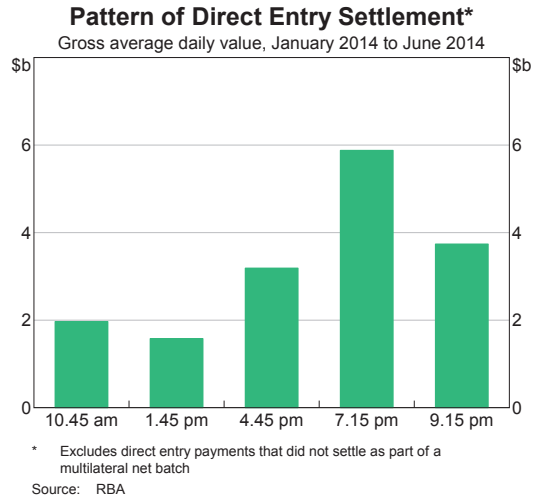
The more timely settlement of direct entry obligations has reduced the credit risk that can arise when financial institutions post payments to customer accounts ahead of interbank settlement. This outcome built on prior work by the Reserve Bank, industry bodies and financial institutions to establish the RITS Low Value Settlement Service, and met one of the objectives set by the Payments System Board as outlined in the *Strategic Review of Innovation in the Payments System: Conclusions*, released in June 2012.²

Significant changes to operational and liquidity arrangements, including extending the RITS Evening Settlement Session, were required to facilitate settlement of obligations arising from the final two clearing exchanges. The Reserve Bank also introduced a new liquidity instrument – an open RBA repo – to assist direct entry participants to obtain sufficient ES funds to meet their evening direct entry obligations.³

The transition to the new arrangements has progressed smoothly although, as expected, there has been some decline in netting efficiency in moving from settling direct entry obligations in one batch with cheques and credit and debit card obligations, to five separate batches. The daily average of net retail obligations settled in RITS (the five new multilateral settlements and the remaining 9.00 am settlement) has grown from around \$4 billion per day in 2012/13 to \$7 billion in the first half of 2014. These settlements covered about 14 million underlying transactions worth around \$22 billion on average each day.

The changes to liquidity arrangements for same-day settlement have resulted in a substantial increase in system liquidity in RITS. Open RBA repos are mostly used by ES account holders that participate in evening direct entry settlement, and have largely replaced their use of intraday repos. Participants now have around \$21 billion outstanding in open RBA repos, while the use of intraday repos has declined by \$9 billion since 2012/13. The changes have resulted in system liquidity increasing to a new high of around \$24 billion, or 15 per cent of RTGS payments.

Reflecting the critical importance of RITS to the Australian financial system, the Reserve Bank invests significantly in its technical and business infrastructure and in operational resourcing. This ensures that RITS operates to appropriately high standards of availability and resilience and that its settlement services evolve to meet the



1 For more detailed information, see Fraser S and A Gatty (2014), 'The Introduction of Same-day Settlement of Direct Entry Obligations in Australia', *RBA Bulletin*, June, pp 55–64.

2 See RBA (2012), *Strategic Review of Innovation in the Payments System: Conclusions*, June.

3 More detail on the changes to liquidity arrangements is provided in the chapter on 'Operations in Financial Markets'.

changing needs of the payments system. In addition to the introduction of same-day settlement of direct entry obligations, major project work undertaken in 2013/14 included the completion of an upgrade to the RITS core infrastructure in June 2014. This project upgraded RITS servers, operating system and databases, and enhanced network and system infrastructure monitoring capabilities.

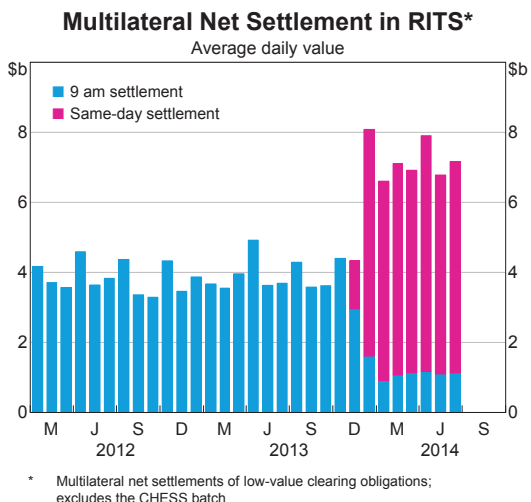
The Reserve Bank also carried out development work on two significant new infrastructure projects in 2013/14. The first of these is the development of functionality in RITS to settle the interbank cash settlement leg of property transactions. This forms part of a single national e-conveyancing solution for the Australian property industry being delivered by Property Exchange Australia Limited (PEXA).⁴ The initiative is intended to remove the existing manual processes and paperwork associated with property transactions by moving to an electronic platform, and is expected to deliver significant benefits to consumers and property industry participants through efficiency gains and cost savings. The new functionality in RITS is expected to be implemented in late 2014.

The second important initiative, which is likely to facilitate future payments innovation and efficiency improvements for Australian consumers and businesses, is the New Payments Platform (NPP). The program to develop the NPP by 2016 is an industry collaboration in response to the objectives outlined in the *Strategic Review of Innovation in the Payments System: Conclusions*, released in June 2012. The NPP is expected to operate on a 24/7 basis and provide real-time bank account transfers with immediate funds availability, facilities for the remittance of information with payments, and more user-friendly ways to address payments, for example, through the use of mobile phone numbers and email addresses.

The Reserve Bank is supporting the industry program by developing the RITS Fast Settlement Service (FSS). The FSS will settle individual NPP payments immediately across ES accounts, removing the need for financial institutions to manage credit risk, and enabling clearing and settlement of customer payments in a matter of seconds.

The Reserve Bank recovers its operating costs from RITS members through a combination of annual and transaction-based fees. There was a major restructure of RITS fees in July 2012, which sought to provide a more representative distribution of costs among members. A further small adjustment to the structure of RITS fees took effect from July 2014, but this does not materially affect the total of fees collected.

Around 60 overseas central banks and official institutions hold accounts at the Reserve Bank for settlement of their Australian dollar transactions and safe custody services. Overseas demand for Australian dollar investments remains strong, with the amount held in custody by the Bank for these institutions increasing by \$2.9 billion to \$71.6 billion by 30 June 2014.



⁴ PEXA (formerly National E-Conveyancing Development Limited) was created by the Council of Australian Governments (COAG) in 2010 to deliver a national e-conveyancing solution in line with COAG's *National Partnership Agreement to Deliver a Seamless National Economy*.

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