

## Reforming the Australian payments system

Graeme J. Thompson

### Policy objectives for the Australian payments system

The main interests of the Reserve Bank of Australia (RBA) in the payments system have traditionally been safety and stability. This has led us to concentrate on promoting the integrity of high-value payments and securities settlement systems. Our influence has derived from our role as a participant in those systems, our authority as bank supervisor and central bankers' suasion.

Following a recent Government inquiry, the RBA will be given specific statutory powers to regulate the payments system. As well as covering safety and stability questions, these powers will extend to promoting payments system efficiency and competitiveness, which have, to date, been secondary goals.

### Domestic reform – RTGS

Our major payments project in recent years has been the implementation of a domestic real-time gross settlement (RTGS) system. This is due to be fully operational in April 1998. We will then have an RTGS system of unusually wide scope – covering general-purpose high-value payments including the Australian dollar leg of foreign exchange transactions, and providing settlement of money and bond market transactions on a genuine Model I basis. We expect it to capture around 85% of interbank payments by value.

The scope and complexity of this project have presented many challenges:

- building consensus and commitment among the various stakeholders has required extensive explanation, persuasion and negotiation, and at times the RBA has had to rely on its central bank authority to impose

a solution. The major banks originally tended to see only costs and no commercial benefits in RTGS, owing in part to the concentrated nature of the banking system and the presumption that “too big to fail” would hold. The larger banks also saw their franchise as processors of smaller banks’ payments threatened. Different perceptions of the relative private and social benefits of RTGS have, in turn, led to disagreement over the sharing of costs;

- the banks, settlement system operators, owners of the existing high-value payments system and the RBA have had different views about RTGS design and areas of ownership. The banks were keen to control the delivery network and to keep customer details confidential from the central bank. The choice of S.W.I.F.T.’s Y-Copy for the industry’s delivery system was a compromise acceptable to all. Debate then moved to who would own the “gateway” between the various delivery systems and the settlement accounts at the RBA. We believed we should control this gateway to ensure that participants could access their settlement accounts directly and on equal terms. For these policy reasons and a number of operational reasons, we insisted on our model but, as a quid pro quo, agreed not to seek recovery of all of the associated costs;
- the RBA has often had to play a “broking” role between the credit, treasury, settlements, payments and IT people within the large commercial banks. These areas had little experience of working cooperatively together, had quite different cultures, and frequently understood little of each other’s business;
- marshalling the necessary personnel and budgetary resources has been a major task, both within the RBA and across the industry. RTGS has had to compete with other system developments, most of which were perceived to have a higher commercial priority. Fortunately, the project came sufficiently early not to have to compete with the banks’ main renovation work for the Year 2000 problem. But it was not so early that its builders were unable to take full account of Year 2000 compliance in its construction.

We draw some important lessons from our experience with the project, including that one should not underestimate the task of explaining and promoting the aims of payments reform to the banking industry. While doing this, the central bank must firmly establish an agenda and a timetable for reform, and make a public commitment to

that. It should then lead the pace on implementation, and set an example to the other stakeholders by delivering its particular parts of the project on time and in conformity with agreed quality standards. We outsourced many of these tasks and needed to monitor carefully the development of critical systems by contractors.

Clearly, too much democracy in a project with so many stakeholders can slow progress and complicate system design. Even so, consultation and occasional compromise are essential to maintaining goodwill and industry commitment. For instance, we agreed to absorb a sizable portion of our development costs and to recover the remainder over five years. We also abandoned our initial intention to charge ten basis points for intraday repos, and will levy only a flat rate transaction charge.

As to management, we found it useful to divide the project into a small number of sub-projects, each with its own publicly designated manager. During the busiest period, a high-level RBA committee met fortnightly to guide our internal work and review our dealings with the industry. Overall coordination has been achieved through a steering committee comprising the major stakeholders and chaired by the RBA. This committee has been advised by an independent project consultant who has also played a constructive liaison role among the main participants.

### **Tackling foreign exchange settlement risk**

The RBA now proposes to become more active in tackling international settlement risk.

The Australian dollar and the Australian market both rank in the top ten in terms of global turnover, but Australia is not represented in many of the forums addressing this problem – the Committee on Payment and Settlement Systems, the G-20 banks, and so on. Also, the relative remoteness of the Australian time zone tends to make the problem both more acute and its solution more pressing. We will seek to ensure that the Australian dollar is included in international solutions to foreign exchange settlement risk.

Our first step has been to study FX settlement practices in the Australian market – attempting to replicate work in the G-10 and New York Foreign Exchange Committee. While this study is not complete, it is already apparent that the management of settlement risk by all banks,

both local and foreign, leaves a good deal to be desired. Many banks struggled to complete the survey and could not reconcile their responses with the turnover data they routinely provide to us. It is clear they are not managing their settlement risk in any sort of aggregated fashion. Furthermore, back office processes and arrangements with correspondents are often deficient.

We have spoken to all the survey respondents to discuss how each can best work towards achieving international best practice in managing settlement risk. And we will shortly be publishing the summary results of this study to create a broader awareness of the issues and the remedial steps which should be taken.

We will repeat our study next April to assess progress. This will coincide with the BIS triennial survey of foreign exchange turnover, and we will be asking banks to attempt to link and reconcile their turnover data with settlement positions.

Although the central banks in the East Asia and Pacific region (the EMEAP group) are working closely on payments system projects, including the publication of a Red Book on the Internet, they will probably have to look to broader international solutions to FX settlement risk. This is because, despite growing regional trade and investment flows, there are no markets quoting and trading, in any significant way, regional currency pairs. Most foreign exchange deals are against the US dollar. Consequently, bilateral links and even regional schemes seem unlikely to be the most promising way to reduce settlement exposures. Realistically, the practices associated with the trading of goods and services (i.e. priced in US dollars) and of the FX market are too ingrained for that situation to change quickly.

The BIS, the CPSS and the G-20 banks have made significant progress in reducing FX settlement risk over the past few years. Further advances are in prospect. The RBA looks forward to contributing to, and sharing in the fruits of, this work.

### **Financial system inquiry**

Australia's payments system has recently come under the microscope of a major financial system inquiry. This concluded that there was considerable room for improving competitiveness and efficiency in payments.

Subsequently, the Government has agreed that the RBA should not only be given specific statutory power to pursue the traditional objectives of stability and risk reduction, but should also have explicit responsibility for promoting payments system efficiency and competitiveness. This will include authority over the arrangements governing access – including pricing – to the various payments streams.

When the necessary legislation is in place, the RBA will have strong prescriptive powers to pursue these objectives. But our approach will be to establish a range of efficiency and access benchmarks and – where performance is deficient – to put the onus on the industry to reform its arrangements. Only where the industry is unresponsive will we be attracted to detailed regulation.

It is too early to judge how constructively the banks and other payments providers will respond to this new regime.

One of the key objectives of the reforms is to increase competitive pressure on established players by facilitating the participation of new entrants. Just how this will occur, and who the new players will be, is also not yet clear. There is, at present, no particular class of claimants for easier access – more a general view that entry should not be as restricted as in the past. (The possibility will exist for non-deposit-taking financial institutions, and even corporations engaged mainly in non-financial activities, to have settlement accounts with the central bank.) A particular challenge for the RBA will be to satisfy community aspirations for more competition without creating potential problems for settlement and confidence in settlement.

Some might argue whether it is a core role for the central bank to be responsible for efficiency and competitiveness in payments. This is not a role which we sought.

The Government has, however, decided that public policy needed to take a stronger hand in this area. And that the central bank was the most appropriate vehicle, because:

- it has a detailed understanding of how the payments system operates; and
- it is better placed than any other agency to strike a prudent balance between competition and safety. Perhaps to ensure that we do not lean too conservatively in the latter direction at the expense of the former, the Government has provided for a new second board of the RBA to sit alongside the main board. This Payments System Board,

which will be chaired by the Governor but have a majority of independent members, will oversee payments system policy and report regularly to the Parliament.

All of this will take the RBA into areas of responsibility which are somewhat unfamiliar to the central bankers. Striking the right balances between our various policy objectives, and between official regulation and industry self-regulation, promises to be an interesting task.