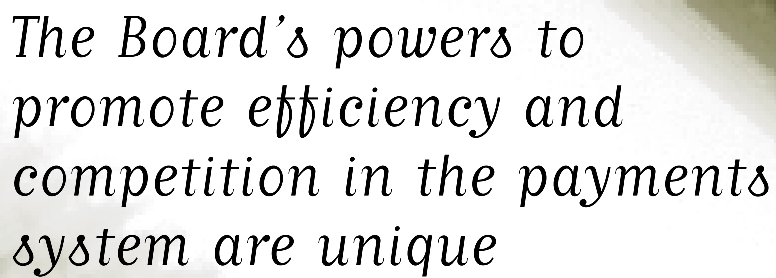

*The Board's powers to promote efficiency and competition in the payments system are unique*

# THE ROLE OF THE BOARD

## Origins of the Board

Until the establishment of the Payments System Board, the Reserve Bank exercised only informal oversight of the Australian payments system in the context of its broad mandate for financial system stability. The Australian Competition and Consumer Commission (ACCC) dealt with issues of access and competition in the payments system as part of its general responsibilities under the *Trade Practices Act 1974*.

Up to 1992, the Australian payments system had been controlled by the Australian Clearing House Association (ACHA), membership of which was made up of the banks, including the Reserve Bank, which then dominated cheque clearing. In 1992 the ACHA was replaced by the Australian Payments Clearing Association Ltd (APCA) which also included smaller banks, building societies and credit unions amongst its shareholders. Both the ACHA and APCA recognised the special role of the Reserve Bank but their rules gave it no more formal influence in decision making than other owners. The Bank also chaired the Australian Payments System Council (established in 1984), which advised the Treasurer on developments in the payments system but had no day-to-day role in operations or governance.

Like other central banks, the Reserve Bank's focus around that time was on improving the safety and stability of the payments system by reducing settlement, legal and operational risks, matters on which it was able to secure APCA's involvement and co-operation. The efficiency of the payments system was a secondary consideration. Even so, the governance of the payments system made it difficult to achieve efficiency gains that required industry co-operation; indeed, short-term concerns about competitiveness sometimes seemed to slow the pace of change.

In 1996, the Government established the Financial System Inquiry with a mandate to make recommendations "on the nature of the regulatory arrangements that will best ensure an efficient, responsive, competitive and flexible financial system... consistent with financial stability". The Inquiry devoted attention to the efficiency and governance of the Australian payments system, and concluded that there was considerable scope to increase efficiency without compromising safety. In reaching this conclusion, the Inquiry focused on Australia's heavy dependence on cheques, which resulted in relatively high payments system costs. Encouraging a change in the mixture of payment instruments, especially the substitution of electronic forms of payment for cheques, offered the potential for substantial gains in efficiency.

In summary, the Inquiry judged that Australia's payments system was not at international best practice. On the contrary, it was seen as being only in the middle of the field as far as efficiency was concerned.

The amounts at stake are substantial. The Inquiry itself lacked comprehensive data, but evidence from abroad suggests that the costs to financial institutions of providing payment services could be around half to one per cent of GDP. If the costs to consumers and firms are included, the same evidence suggests that as much as three per cent of GDP might be absorbed in making non-cash payments. If these figures applied to Australia as well, an "efficiency dividend" of only 10 per cent would generate savings in resources of over $1.5 billion a year.

Having identified the problem, the Inquiry also reviewed the self-regulatory arrangements which governed the Australian payments system. While they had their strengths in technical matters, the Inquiry was unconvinced that the existing co-operative arrangements, in which the Reserve Bank had only a limited role, could be sufficiently responsive to the goals of public policy - particularly the goal of improving overall efficiency.

The Inquiry recognised the Reserve Bank's experience and expertise in the payments system and recommended that a "separate and stronger structure" should be created within the Bank to give it greater authority to pursue improvements in efficiency and competition. This "structure" was the Payments System Board. The Government accepted the Inquiry's recommendations, formally establishing the Board on 1 July 1998 and giving the Bank extensive powers in the payments system. The Australian Payments System Council was disbanded.

## The Board's responsibilities and powers

The Board's responsibilities and powers are set out in four separate Acts:

- *Reserve Bank Act 1959*
- *Payment Systems (Regulation) Act 1998*
- *Payment Systems and Netting Act 1998*
- *Cheques Act 1986*

The *Reserve Bank Act 1959*, as amended, gives the Payments System Board responsibility for determining the Reserve Bank's payments system policy. It must exercise this responsibility in a way that will best contribute to:

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

Increasingly, central banks are being given explicit authority for payments system safety and stability, but the Board's legislative responsibility and powers to promote efficiency and competition in the payments system are unique. Inevitably, this responsibility must broaden the Bank's traditional focus on the high-value wholesale payment systems which underpin stability, to encompass the retail and commercial systems where large numbers of transactions provide scope for efficiency gains.

The Bank's wide-ranging powers in the payments system are set out in the *Payment Systems (Regulation) Act 1998*.

It may:

- "designate" a particular payment system as being subject to its regulation. Designation has no other effect; it is simply the first of a number of steps the Bank must take to exercise its powers;
- determine rules for participation in that system, including rules on access for new participants. The Reserve Bank now has the ultimate say on questions of access to the payments system, since access is inextricably linked to efficiency. In dealing with access matters, the Bank will work closely with the ACCC (see below);
- set standards for safety and efficiency for that system. These may deal with issues such as technical requirements, procedures, performance benchmarks and pricing; and
- arbitrate on disputes in that system over matters relating to access, financial safety, competitiveness and systemic risk, if the parties concerned wish.

The *Payment Systems (Regulation) Act 1998* also gives the Reserve Bank extensive powers to gather information from a payment system or from individual participants.

When it introduced this legislation, the Government said that it saw advantages in a co-regulatory approach and it built considerable flexibility into the new regulatory regime. In the first instance, the private sector will continue to operate its payment systems and may enter into co-operative arrangements, which need to be authorised by the ACCC. However, if the Bank is not satisfied with the performance of a payment system in improving access, efficiency and safety, it may invoke its powers. It may then decide, in the public interest, to set access conditions or impose standards for that system. In doing so, however, it is required to take into account the interests of all those potentially affected, including existing operators and participants. Full public consultation is required and the Bank's decisions can be subject to judicial review.

The *Payment Systems and Netting Act 1998* gives the Board a role in removing two important legal uncertainties in the Australian payments system:

- under the so-called "zero hour" rule, a court may date the bankruptcy of an institution from the midnight before the bankruptcy order is made. Such a rule would threaten the irrevocable nature of payments in the RTGS system; the strength of this system is that payments cannot be unwound if a participant were to fail after having made payments earlier in the day. Similar concerns arise in the case of "delivery-versus-payment" arrangements in securities settlement systems, which provide liquidity to financial markets; and
- some payment systems in Australia settle on a multilateral net basis. Rather than routinely paying and receiving gross obligations, members of the system pay and receive the relatively small net amounts owed "to the system". This is convenient and efficient, but carries the risk that in the event of the bankruptcy of one of the parties, its administrator might "cherry pick" and insist that solvent institutions meet their gross obligations to pay it while refusing to honour its obligation to do likewise. Solvent parties would then receive little in return for their

payments to the failed institution, putting them under liquidity pressures and threatening their own solvency.

The *Payment Systems and Netting Act 1998* provides the basis for removing these uncertainties. The Act exempts transactions in approved RTGS systems from a possible "zero hour" ruling and ensures that approved multilateral netting arrangements cannot be set aside. The Act does not specify which particular systems are exempt; instead, as a means of providing flexibility, the Reserve Bank has been given the power to approve RTGS systems and multilateral netting arrangements which apply for such approval.

The *Cheques Act 1986* was amended in 1998 to provide that cheques that are settled in a recognised settlement system will be deemed dishonoured if the financial institution on which they are drawn is unable to provide the funds. This gives an important protection to institutions at which such cheques are deposited, because it allows them to reverse any provisional credits made on the basis of these cheques. The Reserve Bank has been given responsibility under the *Cheques Act 1986* to determine that a system for settlement of cheques is a recognised settlement system.

The Payments System Board is likely to acquire additional responsibilities as part of the Government's ongoing Corporate Law Economic Reform Program (CLERP). In March 1999, the Government released a consultation paper, *Financial Products, Service Providers and Markets - An Integrated Framework*, which proposes a role for the Board in the regulation of securities clearing and settlement systems. Under the proposals, the regulation of clearing and settlement facilities would be the responsibility of the Australian Securities and Investments Commission (ASIC), with a significant role for self-regulation. However, the Treasurer may declare that a particular clearing and settlement facility is of such significance to the stability and integrity of the payments system that it should be regulated by the Board. Such a declaration would remove that facility from the coverage of the Corporations Law and place it under a comparable regulatory regime in the *Payment Systems (Regulation) Act 1998*. This Act would need to be amended to give effect to these proposals.

## Relationship with the Reserve Bank Board and the Government

The Reserve Bank now has two Boards. The *Reserve Bank Act 1959* provides a clear delineation between the Payments System Board, which has responsibility for the Bank's payments system policy, and the Reserve Bank Board, which has responsibility for the Bank's monetary and banking policies and all other policies except for payments system policy. Instances of conflict over policies should therefore be rare. However, if a conflict were to arise, the view of the Reserve Bank Board would prevail to the extent that there was any inconsistency in policy. If there are disagreements between the Boards on questions of jurisdiction or inconsistency of policy, they are to be resolved by the Governor, who chairs both Boards.

Members of the Payments System Board are not directors of the Reserve Bank in terms of the *Commonwealth Authorities and Companies Act*

*1997*. However, they are subject to those sections of that Act which deal with the conduct of officers and directors, including disclosure requirements, use of inside information and disqualification.

The Payments System Board is required to inform the Government of its policies. In the event of a difference of opinion between the Government and the Board, the provisions of the *Reserve Bank Act 1959* provide a mechanism for dispute resolution.

## Relationship with the ACCC

The ACCC has a longstanding role in the Australian payments system. Payment systems often rely on co-operative arrangements between participants which are otherwise competitors; such arrangements therefore have the potential to contravene the provisions of the *Trade Practices Act 1974*. However, if the ACCC judges the arrangements as being, on balance, in the public interest, it may authorise them. Over recent years the ACCC has authorised a number of such arrangements, particularly those operated by APCA for cheque clearing, direct entry and high-value transactions. With the enactment of the *Payment Systems (Regulation) Act 1998*, there is an onus on the Reserve Bank and the ACCC to take a consistent approach to policies on access and competition in the payments system. This has been facilitated through a Memorandum of Understanding (MOU) between the two parties signed in September 1998. The MOU makes it clear that:

- the ACCC is responsible for ensuring that payments system arrangements comply with the competition and access provisions of the *Trade Practices Act 1974*, in the absence of any specific Reserve Bank initiatives. Under its adjudication role, the ACCC may grant immunity from court action for certain anti-competitive practices, if it is satisfied that such practices are in the public interest. It may also accept undertakings in respect of third-party access to essential facilities; and
- if the Reserve Bank, after public consultation, uses its powers to impose an access regime and/or set standards for a particular payment system, participants in that system will not be at risk under the *Trade Practices Act 1974* by complying with the Bank's requirements.

The effect is that the ACCC retains responsibility for competition and access in a payment system, unless the Bank designates that system and follows up by imposing an access regime and/or setting standards for it. If the Bank does so, its requirements are paramount. Designation does not, by itself, remove a system from the ACCC's coverage.

In terms of the MOU, Reserve Bank and ACCC staff are in close contact on relevant matters. The Governor and the Chairman of the ACCC also meet at least once a year to discuss issues of mutual interest in the payments system.