

Governor's Foreword

The Payments System Board has a mandate for promoting efficiency and competition and controlling risk in the Australian payments system. While the issues that the Board addresses are frequently complex, they have important implications for the functioning of the economy and the broader wellbeing of the population. This annual report serves both to meet the Board's accountability requirements under the *Reserve Bank Act 1959* and also to promote a greater understanding of the Reserve Bank's policies with respect to the payments system and its oversight of financial market infrastructures.

The Bank's work in the retail payments area is occurring in an environment that is continuing to change rapidly. The decline in the use of cheques is accelerating, posing questions for the industry about the future of the cheque system. The use of cash is also falling, though the number and value of banknotes on issue continues to rise, highlighting their continued importance as a payment mechanism and a store of value. Accordingly, the Bank is implementing the Next Generation Banknote program, starting with the issuance of the new \$5 banknote in September. The use of electronic payments continues to grow strongly, both in the debit and credit card systems and in other systems, such as the Direct Entry system and BPAY. There is also a shift under way from traditional payment cards to other devices or 'form factors', most notably mobile phones.

End users of the payments system have increasing expectations concerning the speed and availability of payments and the capacity to combine information with payments. The Bank has encouraged a major upgrade of Australia's retail payments infrastructure through its *Strategic Review of Innovation in the Payments System*. The Board welcomes the industry's continued good progress on the New Payments Platform (NPP) project, which will enable payments by households, businesses and government agencies that are real-time, available on a 24/7 basis, data-rich and easily addressed. The NPP is scheduled to go live in late 2017 and will bring Australia's retail payments functionality to the global frontier. The Bank is contributing to the process of innovation by participating in the NPP, including by developing the Fast Settlement Service (FSS), which will serve as the settlements hub for the new industry platform. Development of the FSS is well advanced, with test NPP payments already having been settled and the FSS test environment expected to be used for industry testing from October this year.

The Bank's regulatory responsibilities in the retail payments area include promoting competition and efficiency. Consistent with this, the Bank recently completed a wide-ranging review of card payments regulation, which addressed some issues raised in the recommendations of the Financial System Inquiry. The review process included publication of an Issues Paper in March 2015, a Consultation Paper with draft standards in December 2015 and a Conclusions Paper

in May 2016. The Bank consulted widely with stakeholders throughout the review process. At the conclusion of the review, the Payments System Board determined three new standards, two dealing with interchange payments in debit and credit card systems and one relating to merchant surcharging. The Bank worked closely with the Treasury and the Australian Competition and Consumer Commission to ensure that the new surcharging regime will be as clear as possible for the industry, merchants, consumers and regulators. The Bank will now begin to monitor the impact of the new standards, which will be implemented in a staged manner, starting with a new framework for surcharging by large merchants that took effect on 1 September. End users of the payments system, including leading consumer and merchant organisations, have expressed significant support for the reforms contained in the new standards.

In the area of financial market infrastructures (FMIs), the Bank has responsibilities as supervisor of Australian-licensed clearing and settlement (CS) facilities and as overseer of high-value payment systems. The staff devote significant effort to the ongoing supervision of CS facilities and to the annual assessments against the domestic regulatory standards that are prepared for the Board. The Bank published its assessments of the four ASX CS facilities in September 2015, of LCH.Clearnet Limited's SwapClear Service in December 2015 and of Chicago Mercantile Exchange Inc. in March 2016. The Board is encouraged by the strong risk management practices of these entities, which has been validated in various episodes of market turmoil in recent years, including the sharp price changes seen following the recent UK referendum on membership of the European Union. The Board also noted the smooth shift from three- to two-day settlement of domestic equity transactions in March this year.

The Bank continues to work with other domestic and foreign regulators on issues relevant to FMI regulation. An important domestic policy focus in recent years has been the development of a special resolution regime for FMIs. The government consulted on the design of such a regime in 2015, including the proposal that the Bank will be the resolution authority for central counterparties (CCPs) and securities settlement facilities. The conclusions from this consultation were published in November 2015 and indicated that stakeholders were generally supportive of the proposed regime. The Bank will continue to work with the government and other domestic financial regulators to develop legislation to underpin the proposed regime as well as operational plans to execute powers granted under the regime. Internationally, the resilience of CCPs remains a strong focus in the global standard-setting bodies given the implementation of mandatory central clearing for over-the-counter derivatives. These bodies have established a joint CCP Workplan to examine potential risks to financial stability arising from the increasingly prominent role of CCPs, and to consider the need for additional policy guidance. Bank staff have been closely engaged in this international work, given its relevance to Australia's domestic regulatory standards.

The Bank's payments policy area also acts as overseer of Australia's high-value payment system, the Reserve Bank Information and Transfer System (RITS), which is a key part of Australia's financial infrastructure. The 2015 assessment of RITS against the Principles for Financial Market Infrastructures was published in December 2015 and concluded that RITS observed all of the relevant principles. Reflecting the critical importance of RITS to the Australian financial system, the Bank invests significantly in its technical and business infrastructure and in operational resourcing to ensure that RITS

continues to operate to appropriately high standards of availability and resilience, and that it meets the changing needs of the Australian payments system. The Bank is committed to ensuring RITS is well protected from cyber attack and work is ongoing to ensure RITS's cyber resilience continues to be at a very high standard. More broadly, there has been an increasing focus on cyber security in the international regulatory and oversight groups in which the Bank participates.

Finally, the Board and Bank staff also pay close attention to new technologies, including distributed ledger technologies and other forms of 'fintech', which have the potential to significantly change the payments landscape and the operation of FMIs. The initial applications of blockchain and distributed ledgers related to private digital currencies. However, there is now increasing focus on their potential use for clearing and settlement of securities transactions, with the ASX Group giving serious consideration to replacing its CHESSE cash equities clearing and settlement system with

a permissioned distributed ledger solution. Bank staff liaise actively with the private sector to better understand trends in these areas and have participated in a range of domestic and international working groups with other regulators.

Once again the Board joins me in thanking the staff and management of the Bank for their work in helping the Board meet its mandate for efficiency, competition and controlling risk in the Australian payments system.

As my term as Governor ends shortly, I express my personal thanks to the staff and the members of the Payments System Board for their support and their outstanding contribution to the goals of payments system competition, safety and efficiency.



Glenn Stevens AC
Chair, Payments System Board
15 September 2016

