

Payments Efficiency and Immediate Payments - Australia

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Overview

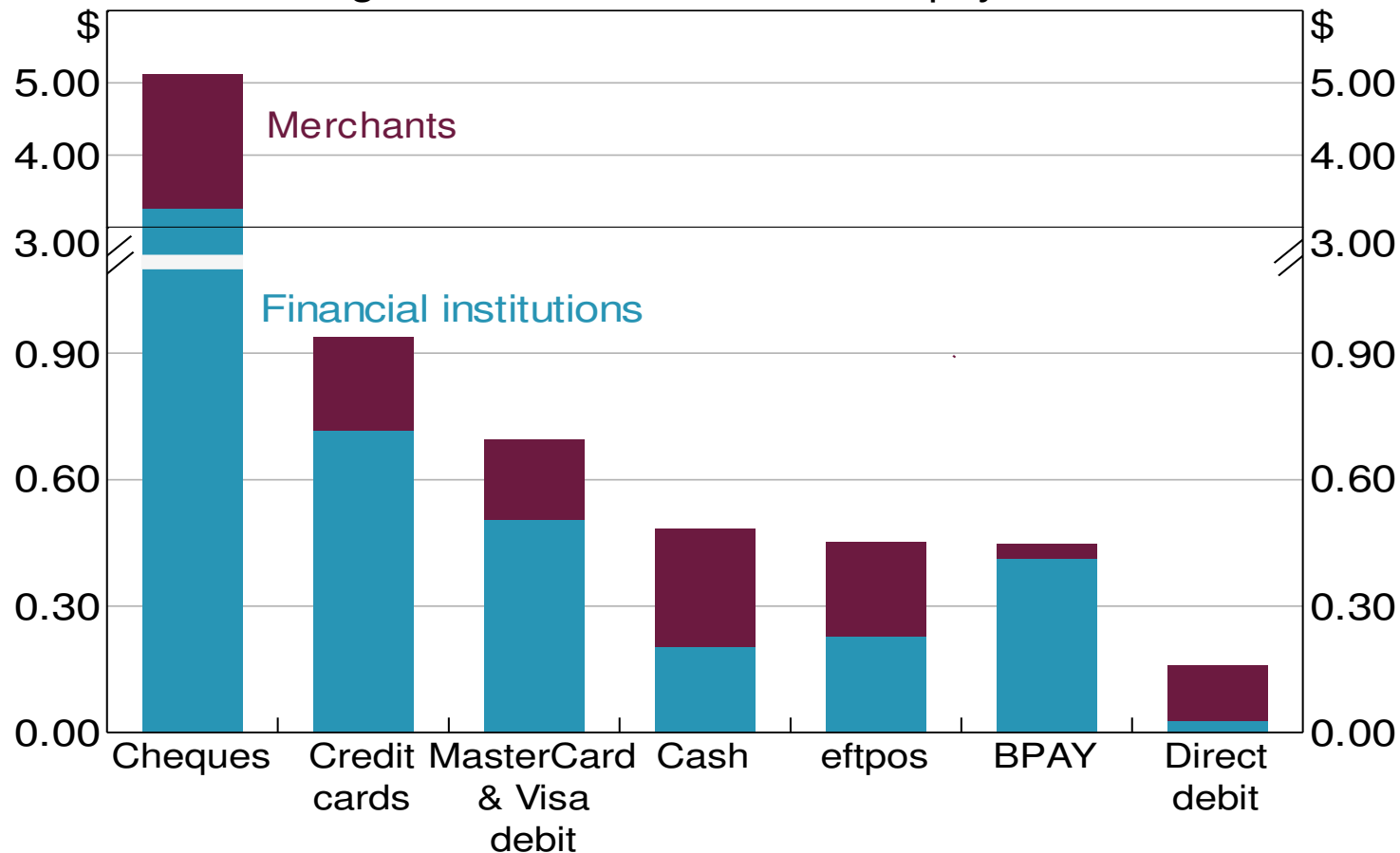
1. Payments Efficiency
2. The Path to Immediate Payments
3. The 'New Payments Platform'
4. Observations

What Do We Mean by Efficiency of Payment Systems?

1. Technical efficiency
 - units of input for a unit of output
2. Allocative efficiency
 - are resources directed (or is the payments system being used) in a way that best contributes to welfare?
3. Dynamic efficiency
 - is the payments system able to evolve as the needs of users evolve?

Direct Resource Costs

Per average-sized transaction for each payment method



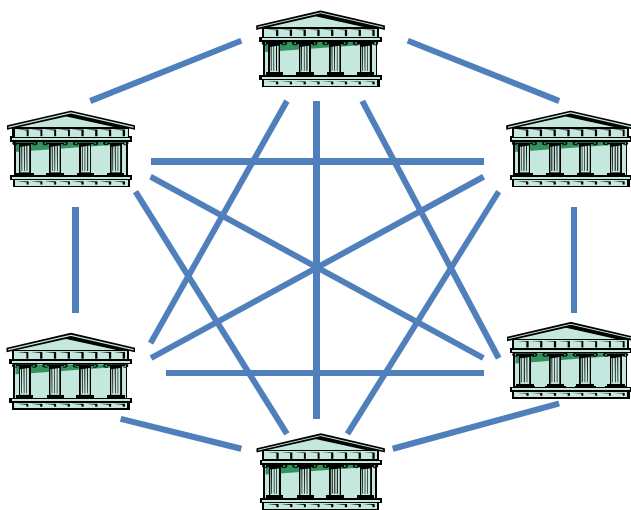
* Payment function only

Source: RBA

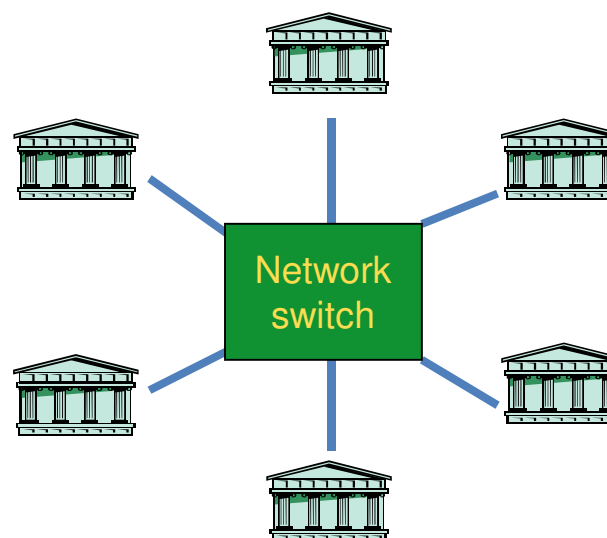
Dynamic Efficiency Considerations

- Consideration has tended to focus on the **structure** and **governance** of our payment systems
- A number of key Australian payment systems developed as bilateral systems
 - each participant making separate physical connections and negotiating business arrangements with each other
 - e.g. applied to, bulk files, domestic debit (eftpos), ATMs
- Cooperatively set rule book through Australian Payments Clearing Association, but bilateral contracts

Dynamic Efficiency Considerations



a. bilateral



b. centralised

Dynamic Efficiency Considerations

- Bilateral systems do not support competition
 - new entrants must establish a connection with all other participants, leading to considerable expense
 - incumbents have a lot of power in negotiations with new players
- Ability to innovate is also constrained (see below)

Dynamic Efficiency Considerations

Some improvements have been made

- Access regimes/codes have been introduced to give the right to connect and to ensure a level playing field
- Physical bilateral connections have been replaced by IP-based Community of Interest Network (COIN)
- RBA encouraged set-up of a separate scheme for domestic debit to provide more effective governance
 - scheme has independently moved system to hub architecture

The Path to Immediate Payments

Strategic Review of Innovation in the Payments System

- Concluded in mid 2012
- Responded to industry's apparent difficulty in innovating
 - in contrast to earlier decades
- Identified a distinction between:
 - **Proprietary innovation:** controlled largely by one party, which has both the ability and incentive to innovate
 - **Cooperative innovation:** where networks are run collectively by financial institutions and no-one has control

Example: Vigorous competition on mobile banking apps, but ageing cooperative systems made payments between different banks' apps very slow.

Why is Cooperative Innovation Difficult?

- If the benefits of innovation fall evenly among banks, there is no competitive advantage from proceeding
 - If the benefits fall unevenly due to different business mixes, those that are relative losers will oppose
 - Banks have different investment cycles – it's always the wrong time for some
 - Payments are seen as a technical area; those involved in industry bodies may not have the authority (or incentive) to commit their organisation to the expense
 - Decision-making by committee is inherently slow
 - Improving one payment system might attract business away from another profitable system
- => The desires of payments system users might receive little weight

Innovation Review: Factors Valued by Users

- **Timeliness** – both authorisation and funds availability
- **Accessibility** – available when and where required
- **Ease of use** – number of steps, information required, potential for errors
- **Ease of integration with other processes** – remittance information available, message formats
- **Safety and reliability** – available when expected and does not expose user to losses

Innovation Review: Gaps in the Payments System

The ability to:

- make retail payments with near-real-time funds availability
- make and *receive* payments outside normal banking hours
 - currently funds sent Friday night received Monday or Tuesday
- send additional remittance information with payments
 - main business and internet transfer system allows only 18 characters
- easily ‘address’ payments
 - currently 6 digit branch number and 9 digit account number

Innovation Review: Conclusions

- Given the fundamental coordination problem for the industry, the Reserve Bank and its Payments System Board would play a catalyst role by identifying 'Strategic Objectives' that it would like the industry to meet
- The industry would determine the best way to achieve them
 - a beacon on a hill, not a road map
- The first set of Strategic Objectives would be meeting the gaps identified by the Innovation Review
 - immediate payments
 - availability out of normal banking hours
 - improved remittance information
 - easier 'addressing'
- Target date 2016 for most

Innovation Review: Conclusions

- Industry challenged for a single industry response within 3 months
- Industry agreed to meet strategic objectives with a single system – the New Payments Platform (NPP)
 - delivery date is 2017
- NPP is an industry-run initiative
 - RBA played a catalyst role, but had indicated that it might consider other ways to meet the public interest if required

Introducing the New Payments Platform (NPP)

NPP Project

- Has been running in different forms since 2nd half 2012
- 12 current members, including major and mid-tier banks, the Reserve Bank and organisations representing credit unions and building societies
 - RBA is represented in capacity of provider of banking services, infrastructure provider and regulator
- Others welcome to join at any time
- Expected that all deposit-taking institutions will connect directly or indirectly

Features of the NPP: Real-Time Settlement

- The system will settle transactions line-by-line in real time, rather than batch settlement
- Settlement provided by an extension on the RBA's RTGS system (RITS) – the 'Fast Settlement Service' (FSS)
- Participants hold part of their RITS balances separately for NPP settlement
- Automated triggers can move funds between FSS and RITS as required

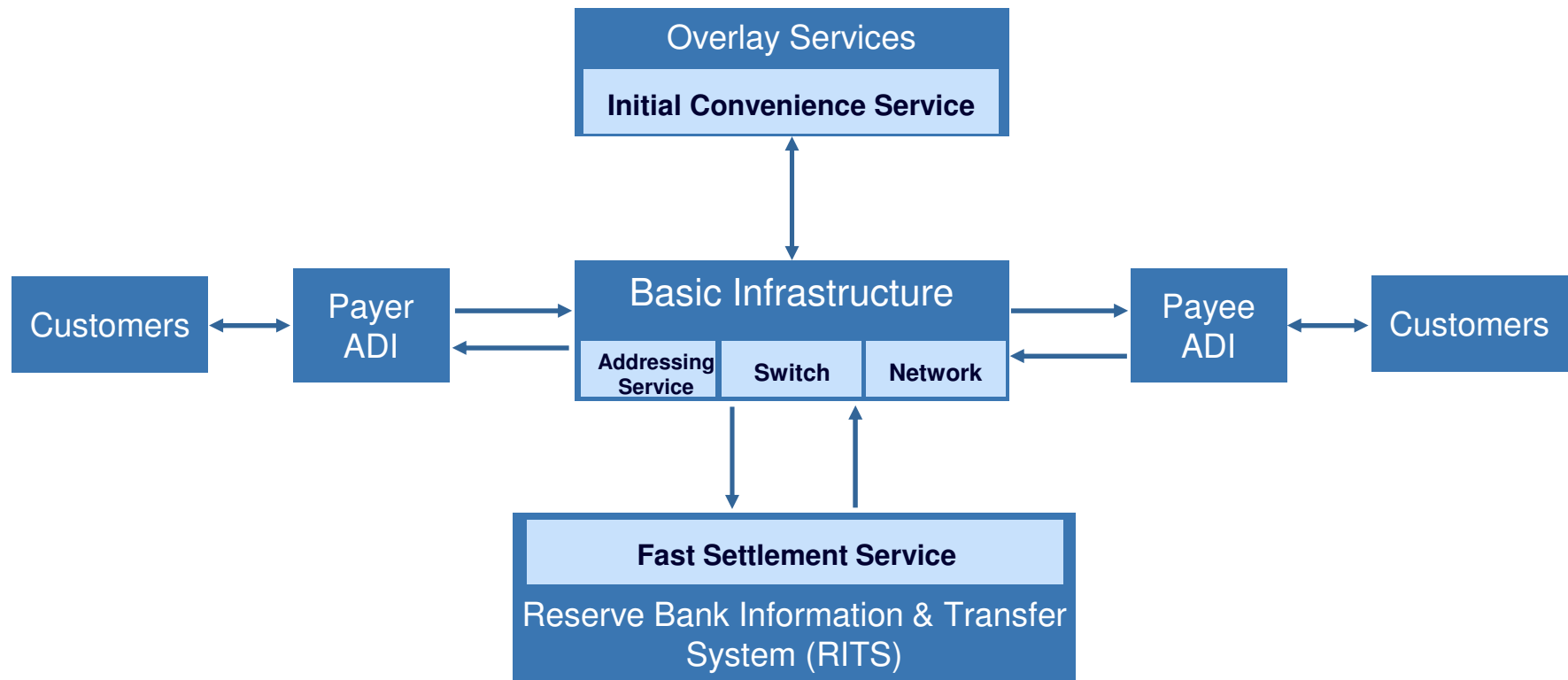
Rationale

- Removes necessity of risk management for deferred settlement, e.g. counterparty limits
- Batching no longer required by technology constraints

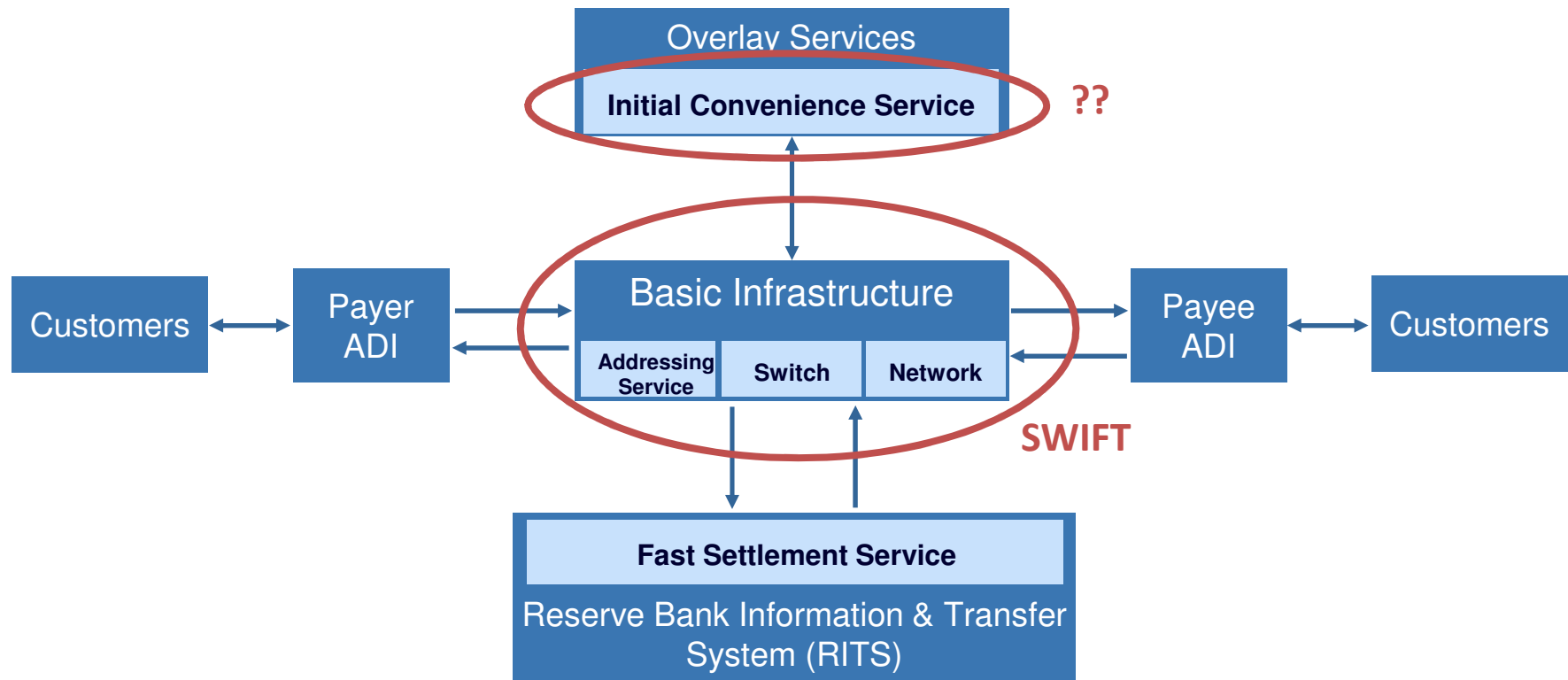
Features of the NPP: Two-Tier Structure

- Structure attempts to be as open as possible to competition and new uses of the NPP
- ‘Basic Infrastructure’ will be operated as an industry utility
- Multiple commercial services can be offered as ‘overlay services’ accessing the Basic Infrastructure

Features of the NPP: Two-Tier Structure



Features of the NPP: Two-Tier Structure



Observations on Australia's Experience: 1

- The Reserve Bank's role of setting the challenge for the industry, then staying engaged throughout the process, has been important
 - both for the overall project and keeping the public interest in sight
- But has been helped by
 - the constructive approach taken by financial institutions and the Australian Payments Clearing Association
 - a fairly concentrated banking sector
 - 'scars' from past failed cooperative projects

Observations on Australia's Experience: 2

- The immediacy, improved data and simpler addressing provided by NPP will all be valuable
- But NPP is not designed to replace any system, so it is not yet clear how it will change the shape of our payments system
 - some of the remaining reasons for cheque use will disappear
 - our bulk file system is the closest equivalent but is inexpensive and fit for purpose for many payments
 - unclear how it will interact with card systems

Observations on Australia's Experience: 3

- Performing a clear and comprehensive cost-benefit analysis from a national perspective is difficult because the uncertainties about the ways in which the system will be used are too great
- But there is little doubt that
 - the benefits of the project should be long-lived
 - the cost of moving away from 1980s payments technology will need to be incurred at some point, regardless
 - a 24x7 world will increasingly demand simple, data-rich, 24x7 payments
 - banks can be confident that if they don't provide what customers demand, new players will

Questions?