

Submission

to the

Reserve Bank

on the

Consultation Document: Strengthening Statutory Payment Oversight Powers

8 May 2013

Submission by the New Zealand Bankers' Association to the Reserve Bank on the Consultation Document: Strengthening Statutory Payment Oversight Powers

About NZBA

1. The New Zealand Bankers' Association ("**NZBA**") works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes that contribute to a safe and successful banking system that benefits New Zealanders and the New Zealand economy.
2. The following fourteen registered banks in New Zealand are members of NZBA:
 - ANZ Bank Limited;
 - ASB Bank Limited;
 - Bank of New Zealand;
 - Bank of Tokyo-Mitsubishi, UFJ;
 - Citibank, N.A.;
 - The Co-operative Bank Limited;
 - Heartland Bank Limited;
 - The Hongkong and Shanghai Banking Corporation Limited;
 - JPMorgan Chase Bank, N.A.;
 - Kiwibank Limited;
 - Rabobank New Zealand Limited;
 - SBS Bank;
 - TSB Bank Limited; and
 - Westpac New Zealand Limited.
3. If you have any questions about this submission, or would like to discuss any aspect of it further, please contact me:

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Executive Summary

4. The proposals set out in the Reserve Bank of New Zealand's ("Reserve Bank") Consultation Document *Strengthening Statutory Payment Oversight Powers* ("Consultation Document") will directly impact on NZBA's members. All fourteen of its member banks have some interaction with, and an interest in, the New Zealand payment and settlement system. That interaction may either be as direct settlement members or indirectly through agency arrangements with other banks. Banks also participate in securities settlement systems, which are jointly regulated with the Financial Markets Authority ("FMA"), and the "over the counter" ("OTC") derivatives market, which are touched on in the Consultation Document. Therefore, as NZBA acts as an industry voice, it is in NZBA's interests to submit on the Consultation Document. NZBA understands that a number of its members will also be making submissions.
5. NZBA understands the broad theme in the Reserve Bank's proposals in the Consultation Document of updating the Reserve Bank's approach to oversight of the New Zealand payment and settlement systems. However, NZBA members also believe the New Zealand payment system is working very well, with significant advancements having been made in the soundness and efficiency of the system over the last few years. Banks have collectively spent tens of millions of dollars upgrading payment systems in the last five years with the result that the decades-old infrastructure run by Interchange and Settlement Limited has been voluntarily replaced by the much more robust SWIFT infrastructure. This has enabled banks to move to much more regular settlement and interchange, with the consequential significant reduction in settlement risk, and enhanced efficiency in transferring money into customer accounts (hourly in the case of many banks).
6. All this has happened, and is continuing to happen, without the need for regulatory intervention. NZBA believes this demonstrates the banking industry's commitment to improving the safety and efficiency of payment systems. This is reinforced by the banks' support of Payments NZ Limited ("Payments NZ"), as shareholders and participants. The banks believe Payments NZ has shown the value of self governance (and thought leadership) by the industry, through its achievements over the last two and a half years and its ongoing work-plan.
7. Nevertheless, NZBA also acknowledges the attraction of aligning the Reserve Bank's oversight with the requirements of the CPSS/IOSCO *Principles for financial market infrastructures* ("PFMIs"). However, it is vital that those powers are a "well-designed set of graduated powers for the oversight of these systems, which will support the effectiveness of its oversight function and ensure the right incentives for industry and participants to act prudently, cooperate and progress in a timely manner"¹ and do not over reach what is actually needed and, in the process, create market friction and inefficiency through excessive, inconsistent or poorly constructed regulation or the application of powers.
8. Payment and settlement systems are highly specialised, technical and inter-dependent areas. Any assessment, or "redesign", of oversight powers must be built on a solid foundation, bearing this in mind. Simply applying powers similar to those

¹ Consultation Document at paragraph 24.

used for the prudential supervision of banks to payment systems would be wrong. It seems as though the intention is that the Reserve Bank would have two sets of powers to use in relation to banks, depending on whether the application relates to payments or the prudential supervision of banks. The NZBA has concerns about this, and particularly the potential for duplication and inconsistency. The NZBA would like to understand, in relation to its members (as opposed to payments systems generally), how the existing powers are inadequate to cover banks' participation in the payment system (where, for example, there are existing powers to give directions if banks are acting in a way prejudicial to the soundness of the financial system or not conducting business in a prudent manner). At this stage, NZBA feels that the current consultation falls short on this.

9. While NZBA accepts that an assessment of the Reserve Bank's oversight of the payments industry is a valid aim, NZBA does not believe that the Consultation Document successfully addresses the Reserve Bank's aspirations and minimum standard for effective regulation. This is especially so if the Consultation Document is the sole document and is not followed by further rounds of public consultation with affected parties. The Organisation for Economic Co-operation and Development ("OECD") is also clear on the fact that public consultation and transparency are integral parts of effective regulation.
10. The proposals ultimately lack detail and clarity, especially, for example, regarding:
 - how existing powers in relation to banks are inadequate;
 - the scope of the proposed powers, including:
 - how powers would apply, if at all, to agency banks;
 - the rationale behind those powers, especially bearing in mind the nature of the New Zealand payment and settlement systems; and
 - against whom, ultimately, the powers will be exercised.
11. NZBA has concerns with the proposed definitions of "system" or "systemically important system". The proposals in the Consultation Document attempt to delineate where the Reserve Bank will be taking action and focussing its approach, and where it will not, but why some entities have been included for discussion in the Consultation Document, and others not, is unclear. The current uncertainty of the definitions may be affecting this. Such uncertainty may affect NZBA's members in a number of ways.
12. NZBA also believes that the suitability of the proposals to the New Zealand payment and settlement systems has not been adequately addressed. The nature of the New Zealand payments market is fundamentally suited to, and has succeeded because of, a highly self-governed approach. Too much intervention may be counterproductive to maintaining and further developing efficient payment and settlement systems in the future.
13. The Consultation Document, along with the consultation process itself, needs to be sharper. Broadly:
 - NZBA understands the need for the Reserve Bank to ensure that it has the necessary payment system oversight powers and that alignment with international principles is important;

- however, NZBA is unsure if all of the proposed powers in the Consultation Document are appropriate for a New Zealand payment and settlement system or market and there is not currently enough information or time to adequately address this;
 - if there are no further rounds of consultation, there is a concerning lack of detail and clarity in the Consultation Document, especially, for example, regarding:
 - the scope, rationale, and focus of the proposed powers;
 - definitions, such as "systems" and "systemically important system";
 - who is and who is not going to be affected by the proposals;
 - why some parties like Paymark and EFTPOS NZ are critical infrastructure providers and others like Visa and Mastercard are not (and why telecommunications companies are not); and
 - the role that Payments NZ and its members can play in ensuring a set of "graduated powers";
 - the current emphasis on self-governance is working and an overly interventionist approach may be counterproductive and undermine the industry's current stability and development;
 - payment and settlement systems are highly specialised, inter-dependent, and require technical expertise. To this end, NZBA strongly believes that further public consultation with affected parties is appropriate, and necessary, to take advantage of the level of expertise available in the market; and
 - regulating a network, such as a payment system, is very different from regulating a financial institution and requires much more specialist expertise and raises important issues about even handed application of powers where multiple parties are affected (which is typically the case in payment systems).
14. The extent to which the proposals in the Consultation Document will ultimately change the status quo is unclear, but NZBA does think that it is clear that there are no current issues with New Zealand payment and settlement systems that urgently require addressing. NZBA **strongly** recommends that the consultation process be sharpened, lengthened, and that the Reserve Bank take this opportunity to consult further with the industry specialists and make use of the expertise that is entrenched throughout the New Zealand payment and settlement system.

Justification for change

Alignment with international norms

15. NZBA accepts that the Reserve Bank's current payment oversight powers may be considered "light-handed" when compared to other international approaches² and that it is often important to consider alignment with international principles (although noting the Reserve Bank often (and rightly) does not align with international principles, where it thinks that it is not necessary for the New Zealand market).
16. However, the fact that other jurisdictions hold a tighter grip over their payment and settlement systems does not in itself justify New Zealand adopting the same heavy-

² As addressed in paragraph 22 of the Consultation Document.

handed approach. There are several approaches internationally that governments have taken to the regulation of payment systems, and these approaches often support rather than detract from self-regulation and self-governance. Approaches in similar jurisdictions, such as Canada, also include entirely separate legislation that covers payment systems.

17. The international principles and standards referred to in the Consultation Document, such as the PFMLs and the Financial Stability Board's ("FSB's") *Key Attributes of Effective Resolution Regimes for Financial Institutions* ("Key Attributes"), are also relatively new and have yet to be fully adopted by many international jurisdictions. In fact, NZBA notes that, at footnote 15 of the Consultation Document, the Reserve Bank states that it is still currently developing its proposals to adopt the PFMLs, to be released for public consultation later this year. It does not seem logical to base the overhaul of the payment system oversight powers on international principles that have yet to be adopted by the Reserve Bank itself. This process should, at the earliest, occur simultaneously.
18. At this stage, the level of consultation has simply not been broad enough to be able to consider the best approach for New Zealand in light of the international experiences available.

Alignment with other supervisory functions and oversight powers

19. Similarly, the fact that the Reserve Bank's statutory payment oversight powers are limited in comparison to its powers in respect of banks, non-bank deposit takers ("NBDTs") and insurance companies does not, in itself, justify an overhaul. A bald statement (for example in paragraph 23 of the Consultation Document) that proposed powers are justified because they will align the Reserve Bank's multiple supervisory functions with each other ignores the fact that payment systems and payment system participants are very different creatures to a bank, an NBDT or an insurance company.
20. Banks', NBDTs', and insurance companies' biggest stakeholders are generally customers/depositors/insured parties. Payment systems are very different, with a range of very diverse entities involved, including customers, merchants, banks, switches, payment aggregators, card schemes, telcos and standards bodies. A homogenous, or "one size fits all" approach is unlikely to work.
21. In this case, an increase in the Reserve Bank's direct statutory oversight powers, to require systems to comply with the Reserve Bank's oversight mandates, does not find an equivalent justification in the protection of the public. Imposing conditions relating to issues such as standards compliance, disclosure, and governance structures (as well as the ability to appoint or remove directors) is not necessarily appropriate in, and should not automatically transfer to, the payments sphere, and the Consultation Document does not express a clear rationale for proposals as they relate to the unique nature of the payment system.
22. In fact, NZBA feels that several of the proposed powers may have a negative impact on efficiency of the payment system if they interfere too far with the current situation. Further consultation on the appropriateness of the proposals will be able to clearly highlight what the justifications are for change, and an ideal outcome for New Zealand.

23. Furthermore, while paragraph 52 of the Consultation Document states that the Reserve Bank has had regard to alignment of powers "where appropriate", the lack of detail in the Consultation Document around the proposed powers tends to suggest that there has not been extensive consideration. The NZBA do not think that all of the proposed powers are appropriate for the New Zealand payment system, or payment system participants, and believes that further public consultation with affected parties will help to flesh out the nature of the proposed powers, with the unique nature of the New Zealand payment system in mind.
24. NZBA recognises that the proposals aim to align payment oversight powers with the Reserve Bank's current prudential supervision regime for banks. However, the Reserve Bank already has powers that it can exercise against banks and these should be largely sufficient. It appears that the Reserve Bank's intention is to have two sets of overlapping powers in relation to banks, to use depending on whether the application relates to the bank's interaction with the payment system or relates to the prudential supervision of banks. The NZBA has concerns about this and the potential for duplication and inconsistency. If the proposals essentially bring in another set of powers to exercise against NZBA's member banks, the NZBA would like to understand why the existing powers are inadequate to cover banks as participants in the payment system. Existing powers already give the Reserve Bank the ability to give directions if a bank's actions are prejudicial to the soundness of the financial system. This, presumably, applies to whether those actions are prejudicial to the payment system. Non banks need rules and powers appropriate to them. Simply applying powers similar to those used for the prudential supervision of banks and applying them to payment systems would be ill-considered.
25. NZBA's concern also lies with the fact that if the proposed powers are not developed in a way that is appropriate for the payment system overall (and its range of bank and non-bank participants and operators), then the ability of NZBA's members to access and engage with an efficient New Zealand payment system that is responsive to the banks' changing needs in a rapidly evolving industry may diminish. NZBA stresses the importance of a "well-designed set of graduated powers for the oversight of these systems, which will support the effectiveness of its oversight function and ensure the right incentives for industry and participants to act prudently, cooperate and progress in a timely manner"³ and further stresses this can only happen with high levels of collaboration with payment industry specialists.

A lack of detail and clarity

26. In any event, at this stage the definitions of "systems" and "systemically important systems" need further thought. Who is, or is not, included as a system (and in what ways) is unclear despite the proposal in paragraph 29 of the Consultation Document that "system" be "defined clearly in legislation".
27. NZBA presumes that powers will apply to its member banks as under the Consultation Document's definition of "system" they would be seen as "participants" in the payment system. However, the position of banks in an agency relationship is less certain. These banks are not direct "participants" in a payment system and rely

³ Consultation Document at paragraph 24.

- on their agent bank to execute settlement on their behalf. NZBA presumes that an agency bank will be a "system" or a relevant entity within a "system" for the purposes of the proposed oversight powers, but clarification on that point is necessary.
28. A more robust framework regarding who is, and who is not, included within the regime (and to what extent they will be affected) can be developed through further public consultation. A more detailed approach will allow for the proposals and the consultation to be more transparent as it will permit identification of whether or not a party will be affected, and allow for all affected to give feedback.
29. The OECD in its 2005 *Guiding Principles for Regulatory Quality and Performance* ("OECD Guiding Principles"), at principle 3, states that during regulatory reform, governments should:

Consult with all significantly affected and potentially interested parties, whether domestic or foreign, where appropriate at the earliest possible stage while developing or reviewing regulations, ensuring that the consultation itself is timely and transparent, and that its scope is clearly understood.

30. Further on this point, the Consultation Document proposes that the new powers be extended to central counterparties ("CCPs") in the OTC derivatives market. As the Consultation Document acknowledges, there are currently no OTC derivatives CCPs operating in New Zealand.⁴ Therefore, NZBA believes that it could be seen as premature to identify CCPs specifically, and seek powers in relation to them, without the opportunity to consult with them. Although only collaboration with overseas regulators is proposed, presumably this will involve no new powers and simply depend on the Reserve Bank's relationship with other regulators. If this is the case, the Consultation Document should say this.
31. NZBA's member banks also participate in securities settlement systems, particularly NZClear and the NZCDC Settlement System. These two systems are both specified in the Consultation Document as designated systems but it is unclear what changes are proposed for them. Those systems are already designated – and it is not clear whether recognition will significantly change anything for them. However, on the wide definition of systems, banks as "participants" may be caught by powers relating to those systems – where they are currently not. Presumably this is not intended.

Further consultation a necessity

32. Ultimately, NZBA believes that a more detailed second level of consultation is necessary. The New Zealand payments market is currently operating in a very well-governed manner and NZBA is concerned that if the proposed powers are not applied in a proportionate and proper manner, that this may have a negative impact on the efficiency of the payment system.
33. The nature of the payments market is such that it is suited to a high level of self-governance. The participants in the payment system operate in a very specialised network. As noted above, NZBA believes that the success or otherwise of this network is greatly dependent on the current level of co-operation and collaboration between the parties within the payment system (and their continued ability to co-

⁴ See paragraph 22 of the Consultation Document.

- operate and collaborate). The payment system is rapidly evolving and there is concern that the proposals as they currently stand will not clearly ensure that the industry will be able to continue to act pro-actively.
34. Although noting the Reserve Bank has said the powers should be "graduated" and "well-designed", NZBA would be concerned if the outcome of the Reserve Bank's Consultation Document was a more interventionist approach to the payments industry that impacts on the industry's ability to evolve rapidly. The industry has demonstrated its ability to do this to the point where on a number of metrics (e.g. cash in circulation, use of electronic payments) New Zealand has the most efficient payment system in the world. This has occurred because of the collaborative approach between the Reserve Bank and payment system participants as well as the willingness of the Reserve Bank to listen to the industry and work with it to achieve successful outcomes.
 35. It would be disappointing if the proposed changes signalled a more interventionist approach without very sound justification – we believe that would be counterproductive to soundness and efficiency.
 36. This underpins the point that further and clearer guidance is needed and should be achieved through further rounds of public consultation with affected parties. It is unclear how the proposals will affect the efficiency of the payment system and therefore NZBA believes it is important for a regulatory impact statement to be released.
 37. The cost of the proposals must also be fully addressed and understood. Without further opportunities to consult, there is a risk of poorly targeted regulation – the payment and settlement area requires a high level of expertise and there is opportunity for the Reserve Bank to make use of the resources available to it through further public consultation and possibly industry workshops. Effective consultation will allow for stakeholders' views to be heard and adequately.
 38. Further, on the OECD Guiding Principles, at principle 1, the OECD recommends adopting and establishing principles of "good regulation". These include:
 - clearly identified policy goals;
 - sound legal and empirical basis for policy goals;
 - producing benefits that justify the costs;
 - minimising costs and market distortions;
 - promotion of innovation through market incentives and goal-based approaches;
 - clear, simple, practical regulation for those affected parties;
 - consistency with other regulations and policies; and
 - compatibility, as far as possible, with competition, trade and investment-facilitating principles at domestic and international levels.
 39. Principle 1 of the OECD Guiding Principles goes on to discuss strengthening quality regulation by "making effective use of consultation, including advisory bodies of stakeholders". Ultimately, NZBA recommends further consultation to address the OECD Guiding Principles, and that the benefits of doing so would be felt across the industry.

Consultation Document Questions

1. Do you agree with the gaps and issues identified in the conclusion reached? Are there any other factors that the Reserve Bank should be taking into account – if yes, please provide more details.

NZBA does not agree that there is any issue that urgently needs addressing and questions any approach that does not involve further public consultation with the industry.

One of the gaps identified was a lack of alignment of payment supervisory powers with those available to the Reserve Bank for supervision of banks, NBDTs, and insurance companies. However, the different nature of these entities means that a broad brush assessment supporting alignment of powers is inappropriate. Further thought is necessary to enable the Reserve Bank to consider whether a proposed power is particularly appropriate for payment systems and their participants.

NZBA also feels that, while alignment with international principles and "moving towards the international norm" is generally a valid aim, it needs careful consideration (as it is not always the right move for New Zealand, as the Reserve Bank itself has acknowledged in the past). The fact that New Zealand currently has a "light-handed" approach, and other governments have adopted more direct and heavy-handed powers, is not a justification in itself to move full steam towards regulatory interventionism. New Zealand has developed one of the worlds sounded and most efficient payment systems, with one of the lightest regulatory regimes, so international approaches may not necessarily mean it is the best approach for New Zealand. Once again, further consultation is necessary to assess the positive and negative aspects of international regimes and how they might apply to a New Zealand market. Many other jurisdictions are currently in the process of updating and consulting about payment system oversight powers and there is no need to act with haste in this situation. Further consideration should be given to the valuable role that Payments NZ plays in the payment system, and can play in the future.

2. Do you agree with the proposed definition of "systems"? If not, please provide more details. Alternatively, do you think the term "FMI" would be adopted? If so, why?

NZBA does not agree with the proposed definition of "systems". The definition is too broad and the lack of certainty regarding who, or who is not, affected highlights that more work is required to address the lack of specificity. Affected parties should also be clearly identified and consulted.

An example is the lack of certainty regarding the position of agency banks. While NZBA presumes that banks will generally be caught under the current definition of "system" as "participants" in the payment system, a bank in an agency relationship participates through their agent back and not directly. Thus, they are not technically "participants".

If this were to be the only round of consultation, the Reserve Bank has not achieved their stated aim, at paragraph 29 of the Consultation Document, for systems to be "defined clearly".

3. Do you agree with adopting the CPSS/IOSCO definition of "systemically important systems"? If not, please provide more details. Are there any additional factors that the Reserve Bank should take into account when making assessment of the systemic importance of a system? If so, what are those factors?

NZBA agrees that international principles, such as those of CPSS/IOSCO, have a valid place in the assessment of regulatory oversight. In principle, therefore, NZBA agrees with adopting the CPSS/IOSCO definition of "systemically important systems". Nonetheless, any international experience must be assessed in light of the realities of a New Zealand payment system market and its development. Application of the definitions needs to be clear and further development and consultation is required.

4. Do you agree with the proposed co-regulatory model? If not, how should oversight responsibility be shared between the Reserve Bank and FMA?

If a co-regulatory model were to be implemented, the same observations would apply as with other aspects of the Consultation Document. Further detail is needed on how this would actually operate in practice and consultation with affected parties would help to address this.

5. Are there any powers that are proposed in this paper not appropriate in your view? If yes, please explain which ones and why. Are there any powers the Reserve Bank should seek and why?

NZBA recognises that most of the powers have equivalent counterparts in the Reserve Bank's prudential supervision of banks, and would like clarity on why there is a need for another set for banks and whether the insinuation is that the current powers held by the Reserve Bank are inadequate.

NZBA does not agree that pure alignment is appropriate without further assessment of whether a power is suitable to the entity it purports to be applied to – i.e. non-bank payment system participants, payment systems, etc. NZBA is concerned about the effect that an interventionist approach will have on its members' ability to engage and collaborate with an efficient payment system network and that it, overall, may become less responsive to banks' changing needs in a rapidly evolving industry.

6. Do you agree that separating the two regimes would represent a better framework overall? Please provide more details to your answer. Do you have any comments about how these two regimes would work?

Separating the two regimes is appropriate and once properly developed would provide a better overall framework.

7. Do you agree with the efficiency considerations discussed in this paper? If not, please explain why. Are there any efficiency related areas that you consider the Reserve Bank should look into? If so, please provide details on those areas.

NZBA agrees that it is vital that the proposals implement a "well-designed set of graduated powers for the oversight of these systems, which will support the effectiveness of its oversight function and ensure the right incentives for industry and participants to act prudently, cooperate and progress in a timely manner"⁵. However, for efficiency's sake, NZBA believes this is best left to the market and that the proposals currently risk implementing powers that are too heavy. This could undermine the payment system's current efficiency or, in the pursuit of efficiency, result in participants incurring costs that exceed benefits.

NZBA is concerned that an increasingly interventionist approach may have a detrimental effect on the efficiency of the payment system. The nature of the New Zealand payment system is such that it is an exceptionally specialised network and it relies on the ability of those within it to cooperate and collaborate. The current emphasis on a high level of self-governance, with valuable co-ordination and leadership provided by Payments NZ, suits the network nature of the industry and NZBA would be concerned if the payment industry's ability to respond to NZBA's members' and their customers' needs was negatively impacted.

8. What are the pros and cons for the Reserve Bank to maintain a list of all payment and settlement systems in New Zealand? Are you supportive of the Reserve Bank having such a list? If not, please provide detailed comments.

Once the definitions of "systems", and criteria for inclusion on such a list, etc, are clarified, NZBA supports the proposal for the Reserve Bank to maintain a list of all payment system entities. A list should provide detail and clarity to those affected by the proposals and will ensure a level of transparency and a level playing field.

⁵ Consultation Document at paragraph 24.