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Australian Competition & Consumer Commission

Determination

Applications for Authorisation

Australian Payments Clearing Association Limited

in relation to its proposed Regulations and Procedures for the High Value Clearing System

Date: 1 April 1998

Authorisation nos:
A90617
A90618
A90619

File nos:
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Summary

The Commission has considered applications for authorisation lodged by the Australian Payments Clearing Association Limited (APCA) in respect of its Regulations and Procedures for the High Value Clearing System (HVCS).

The HVCS arrangements form one component of the Real Time Gross Settlement (RTGS) system which is being established in Australia. The Reserve Bank of Australia (RBA) is enhancing the Reserve Bank Information & Transfer System (RITS) to produce the RTGS settlement platform.

The RTGS system consists of the RITS/RTGS central settlement platform, and a number of feeder systems (the HVCS, RITS and Austraclear's FINTRACS systems) which provide payments to be settled across that platform.

Australia currently has a 'deferred settlement' payment system, under which the settlement of clearing obligations between financial institutions occurs at 9.00am on the day after transfers of the payment messages underlying settlement have taken place. Under deferred settlement systems, should an institution be unable to meet its obligations, other institutions due to receive funds are exposed (settlement risk) and there is significant potential for other parties to fail (systemic risk).

Under the proposed RTGS system, settlement between institutions involved in a payment transaction occurs prior to transfer of the payment message between the institutions. APCA advises that introduction of the RTGS system will eliminate settlement and systemic risk for high value payments which are settled in real time. The key to RTGS is the irrevocable nature of payments settled in that system and the positioning of settlement as a pre-requisite to the completion of a payment transaction.

HVCS arrangements

Under the HVCS arrangements, members electronically exchange high value payments with each other through the SWIFT Payment Delivery System (SWIFT PDS). However, such payments will be exchanged only after settlement in respect of the payments has taken place between the members through the RITS/RTGS system (except during contingencies when RITS/RTGS is unavailable).

The HVCS arrangements do not prescribe any minimum dollar amount for payments exchanged between HVCS members. Rather such payments are described broadly as being 'usually characterised by their large size relative generally to payment instructions exchanged in other clearing systems, the need for robust security, and/or the time critical nature of the payments'.

However, it is expected that wholesale electronic payments currently exchanged between the four major banks (the ANZ, CBA, NBA, Westpac) and the Colonial State Bank through their Bank Interchange & Transfer System (BITS), and high

value paper warrants and cheques currently exchanged through APCA's paper clearing system (APCS), will migrate to the HVCS.

The Commission is satisfied that the HVCS arrangements will result in public benefit through increased cost efficiencies as high value warrants and cheques currently exchanged through APCA's paper clearing system migrate to the HVCS. It is also satisfied that the HVCS arrangements will result in public benefit through reduced settlement and systemic risk in the payments system as payments currently exchanged through BITS and through APCA's paper clearing system (which are settled on a net-deferred basis) migrate to the HVCS.

The HVCS, like APCA's other clearing systems, in essence provides a forum within which members consider, agree and promulgate relevant clearing standards and procedures. The advantage of membership of APCA's clearing systems is that members have the ability to contribute to the setting of such standards and procedures.

The Commission notes that organisations that need to clear and settle would not be excluded from membership of APCA's clearing systems (including HVCS) by the requirement that members be 'providers of payment services'. The Commission also considers that it is appropriate that membership of APCA's clearing systems, including HVCS, be limited to those organisations that participate in the process being regulated by APCA.

HVCS members must satisfy requirements as to prudential supervision; must be members of RITS and have their own exchange settlement account (ESA) with the RBA (in order to settle HVCS payment transactions through the RITS/RTGS system); and must be SWIFT members, sub-members or participants (in order to exchange payment instructions through the SWIFT PDS). The Commission is satisfied these requirements are likely to result in public benefit sufficient to outweigh any anti-competitive detriment likely to result from the requirements.

The Commission recognises that the setting of operational and technical requirements which apply to all participants in a payments clearing system would be likely to result in benefits in terms of the efficiency, security and integrity of the clearing system. At the same time it is important for competition in the provision of relevant payment services, that the operational and technical requirements are set at an appropriate level so as not to unnecessarily restrict participation in the clearing system. The Commission did not receive any submissions that the operational and technical requirements of the HVCS Procedures are set at an inappropriate level.

On 4 March 1998 the Commission issued a draft determination proposing, subject to any pre-decision conference requested pursuant to section 90A of the Act, to grant authorisation in respect of the HVCS arrangements for a period of 10 years. No pre-decision conference was requested. The Commission therefore grants authorisation to APCA in respect of the HVCS arrangements until 23 April 2008.

List of abbreviations

AAPBS	Australian Association of Permanent Building Societies Incorporated
AFIC	Australian Financial Institutions Commission
Amex	American Express
ANZ	Australia and New Zealand Banking Group Limited
APCA	Australian Payments Clearing Association
APCA PDS	APCA Payment Delivery System
APCS	Australian Paper Clearing System
APSC	Australian Payments System Council
ASL	AAPBS Settlements Limited
ASX	Australian Stock Exchange Settlement and Transfer Corporation
ATM	Automatic teller machine
BECS	Bulk Electronic Clearing System
BITS	Bank Interchange Transfer System
CBA	Commonwealth Bank of Australia
CBT	Computer Based Terminal
CECS	Consumer Electronic Clearing System
CHESS	Clearing House Electronic Sub-register System
CHESS CBUG	CHESS Client Bank User Group
CUFSAL	Credit Union Financial Services (Australia) Limited
CUSCAL	Credit Union Services Corporation (Australia) Limited
EDI	Electronic data interchange
EFTPOS	Electronic funds transfer at point of sale

ESA	Exchange Settlement Account
HVCS	High Value Clearing System
NAB	National Australia Bank
NBFI	Non-Banking Financial Institution
NTV	National transaction volume
POS	Point of sale
RBA	Reserve Bank of Australia
RITS	Reserve Bank Information and Transfer System
RTGS	Real Time Gross Settlement
SSP	Special Services Provider
SWIFT	Society for Worldwide Interbank Financial Transactions
SWIFT PDS	SWIFT Payment Delivery System
SWIFT PDS CUG	SWIFT PDS Closed User Group
TPC	Trade Practices Commission

Contents

1. Introduction

1.1 On 29 April 1997 the Australian Payments Clearing Association Limited (APCA)[1] lodged three applications for authorisation in respect of its proposed Regulations and Procedures for the High Value Clearing System.

1.2 Application A90617 was made under sub-section 88(1) of the *Trade Practices Act* (the Act) for an authorisation to make a contract or arrangement, or arrive at an understanding, where a provision of the proposed contract, arrangement or understanding would be, or might be, an exclusionary provision within the meaning of section 45 of the Act.

1.3 Application A90618 was made under sub-section 88(1) of the Act for an authorisation to give effect to a provision of a contract, arrangement or understanding, which provision has the purpose, or has or may have the effect, of substantially lessening competition within the meaning of section 45 of the Act.

1.4 Application A90619 was made under sub-section 88(8) of the Act for an authorisation to engage in conduct that constitutes, or may constitute, the practice of exclusive dealing within the meaning of section 47 of the Act.

1.5 APCA described the contract, arrangement or understanding, referred to in paragraphs 1.2 and 1.3 above, as the Regulations and Procedures for the High Value Clearing System (HVCS) to be established by it. The provisions that would or might be exclusionary provisions were identified as including, without limitation, Regulation 5 (HVCS membership) and Regulation 6.1 (entrance fees).

1.6 APCA described the conduct that would or may constitute exclusive dealing as including, without limitation, conduct pursuant to Regulation 5 (HVCS membership requirements).

1.7 On 18 June 1997 the Commission granted APCA interim authorisation in respect of the HVCS Regulations and Procedures until 31 October 1997. This interim authorisation was later extended until the Commission's final determination in respect of these applications. Interim authorisation was granted to enable APCA to commence the phased introduction of the HVCS as of 1 July 1997.

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[1] APCA was formed in February 1992 to oversee and manage the development and operation of the Australian payments clearing system. It has a wide ranging charter which includes maintaining secure and efficient operational policies and procedures in the payments system, and ensuring competitive and equitable participation in payments clearing.

2. Background

Payments system

2.1 A 'payment' is the transfer of a financial asset, of the kind generally used as a medium of exchange, from one person to another. Such assets are generally cash or obligations drawn on organisations which, in the normal course of their business, provide the means for their customers to transfer value to third parties. Cash payments are still important in volume terms, but non-cash means of making payments predominate in value terms and are increasingly replacing cash.

2.2 Where both parties to a payment transaction maintain accounts with the same organisation, payment arrangements are relatively simple. The organisation debits the paying customer and credits the receiving customer. Where the parties to a payment transaction are customers of different organisations, a process is needed for both organisations to reflect the change in their customers' accounts and for value to pass between those organisations. The process is called clearing and settlement.

2.3 A 'payments system' is the institutional infrastructure which carries payment messages and transfers funds from one party's account to another's. It underpins commerce and is at the core of the financial system. A payments system comprises:

- payment instrument(s) - the form which a payment message takes (eg cheque, credit card) and is the means by which one party transfers value to a third party;
- delivery mechanism(s) - the means by which payment messages are carried from one point within the payments system to another;
- clearing - the cross institutional exchange of individual payment messages for the purpose of obtaining settlement. It entails sorting, routing and exchanging payment instructions; verifying sums and correcting errors; and determining net amounts owing in settlement of debts between the financial institutions involved (clearing in Australia is primarily regulated under the rules of APCA); and
- settlement - the exchange of value between organisations for the purpose of providing finality of payment for the obligations arising out of payments clearing.

Australia's payments systems

2.4 The systems used for making payments in Australia are as follows:

- *paper* - mainly cheques and payment orders;

- *direct entry* - which allows organisations to make arrangements with their financial institution to debit (eg, for payment of insurance premiums, utility bills) and/or credit (eg, with employees' salaries) large numbers of customers' accounts on a regular basis;

- *financial EDI* - Electronic Data Interchange (EDI) is the electronic transfer of business information between trading partners. Financial EDI is an EDI message using established standards which contains both the remittance advice relating to a purchase of goods or services and the corresponding payments message. (APCA is currently working to develop industry procedures and standards for exchanging financial EDI messages between financial institutions.);

- *consumer electronic* - electronic funds transfer at point of sale (EFTPOS), debit and credit cards, stored value cards;

- *high value* - the Bank Interchange Transfer System (BITS), which is a large-value payments system built around bilateral links between its members (the four major banks and the Colonial State Bank); Reserve Bank Information and Transfer System (RITS), which provides registry, depository and trading facilities for Commonwealth Government Securities; and Austraclear's 'Fintracs' system, which provides registry, depository and trading facilities for money market securities (private sector and semi-government securities).

2.5 APCA estimates that 8 million transactions are processed through Australia's payments system each working day with an estimated value of over $90 billion.

2.6 In 1996, based on the gross value of payments exchanged between the settlement members of APCA - cheque payments accounted for 26 per cent of the value of non-cash payments; RITS, BITS and Austraclear payments accounted for 67 per cent; and the remaining 7 per cent was accounted for by direct entry and consumer electronic payments.

2.7 Volume figures give a different perspective. The large-value electronic systems (BITS, Fintracs and RITS) handle relatively few payments compared with the other systems. Around 4 million cheques are used for payments transactions each day. Direct entry, credit card and EFTPOS payments also collectively number around 4 million per day.

2.8 The following tables, extracted from the 1996/97 annual report of the Australian Payments System Council (APSC)[2] provides further data on the size and growth of these payments systems. APSC advises that non-cash payments may usefully be classified as wholesale (high-value) and retail (low-value).

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[2] APSC is a non-statutory body, chaired by the RBA, whose functions include monitoring developments in Australia's payments system and fostering improvements in the payments system.

Table 1: Value of gross payments exchanged between direct clearers (per day)

	($ billions) 1991	1997
Cheques and other paper debits	30	31
Retail electronic:		
- direct entry	1	2
- plastic cards (ATM, EFTPOS, credit cards)	*	*
Wholesale electronic:		
- BITS	12	26
- Austraclear	7	18
- RITS	1	14
Total	**51**	**91**

NOTE: Figures based on monthly surveys conducted during the year, and do not include data on transactions between a bank and its customers, or between two customers of the same bank ('own items').
* Figures for plastic card payments total less than half of $1 billion per day.

Table 2: Volume of non-cash payments (per cent of total)

	1991	1996
Cheques	60	43
Direct entry:		
- credits	20	20
- debits	5	5
Credit cards	10	13
Debit cards (EFTPOS)	5	18

NOTE: Data in Table 2 are drawn from a series of surveys undertaken at different times by APCA and include "own items". (As noted, the value figures in Table 1 above do not include "own items", so that data in Tables 1 and 2 are not strictly comparable.)

2.9 In terms of the value of payments, the growth in the 1991-1997 period was in the wholesale electronic systems (increased from just over a third to two-thirds of the total), which has clearly reduced the usage of cheques for wholesale payments. In volume terms, the main area of growth in the period 1991-1996 was in the retail electronic systems, particularly EFTPOS; with the relative importance of cheques declining.

APCA

2.10 APCA, which was incorporated in February 1992, is a public company limited by both shares and guarantee. Its Memorandum and Articles of Association were granted authorisation by the Commission's predecessor, the Trade Practices Commission (TPC) in September 1993. APCA's charter, as set out in its

Memorandum of Association, is to co-ordinate, manage and ensure the implementation and operation of effective payments clearing and settlement systems, policies and procedures.

2.11 APCA does not process payments. It co-ordinates and manages payments clearing arrangements for each of the clearing systems it establishes. Individual institutions are responsible for their own clearing operations, and must conduct their clearing according to APCA's rules as set out in the Regulations and Procedures for each system. APCA is currently responsible for establishing and managing four payments clearing systems:

- Australian Paper Clearing System (APCS) - operating under APCA's management, Regulations and Procedures authorised by the TPC in September 1993;

- Bulk Electronic Clearing System (BECS)- operating under APCA's management, Regulations and Procedures authorised by the TPC in October 1994;

- Consumer Electronic Clearing System (CECS) - being established, applications for authorisation of the Regulations and Procedures being considered by the Commission (draft determination issued on 20 August 1997);

- High Value Clearing System (HVCS) - being established, Regulations and Procedures are the subject of the current applications for authorisation.

APCA's charter does not restrict it to these four clearing systems. It may establish additional clearing systems if the need arises.

2.12 APCA has three broad categories of membership - share members, participating members and associate members. However, its Memorandum and Articles of Association provide for the creation of additional categories of membership if required.

2.13 APCA's shares are divided into five classes - ordinary shares, and 'A', 'B', 'C' and 'D' class voting redeemable preference shares.

- The RBA, Australia and New Zealand Banking Group Limited (ANZ), Commonwealth Bank of Australia (CBA), National Australia Bank Limited (NAB), and Westpac Banking Corporation (Westpac) may each hold one ordinary share.

- 'A' class voting redeemable preference shares may be held by state and regional banks. 'B' class voting redeemable preference shares may be held by other licensed banks. Each such bank is entitled to one share plus an additional share for each clearing system in which it participates.

- 'C' class voting redeemable preference shares may be held by the Australian Association of Permanent Building Societies Incorporated (AAPBS), and permanent building societies which are not members of AAPBS. 'D' class voting redeemable preference shares may be held by Credit Union Financial Services (Australia) Limited (CUFSAL), and credit unions which are not affiliated with the CUFSAL group. The allocation of these shares is determined on the basis of the percentage of the total assets of the building society industry (at 30 June each year) held by AAPBS members and non-members; and the percentage of total assets of the credit union industry (at 30 June each year) held by CUFSAL affiliated and non-affiliated credit unions; respectively.

2.14 The holders of each ordinary share have one vote at general meetings of the company and are entitled to appoint one director to the APCA Board. The holders of each class of voting redeemable preference shares collectively have one vote, and collectively are entitled to elect one director. (The questions of how the vote of share members with the same class of voting redeemable preference shares is to be cast at general meetings, and the appointment or removal of a director by such share members, are determined by a simple majority with members having one vote for each such share held.)

2.15 Participating members of APCA are institutions which participate on a day-to-day operational basis in one or more of APCA's clearing systems. There are four classes of participating membership, corresponding to the four clearing systems. Eligibility criteria for participating members is specified in the regulations of each clearing system. A participating member has no right to vote at general meetings of the company, but is entitled to attend and speak at such meetings. The APCA Board may terminate the membership of a participating member provided the pre-conditions specified in the relevant regulations have been fulfilled.

2.16 The APCA Board may admit any person, other than a share member or a participating member, as an associate member of the company. An associate member has no right to vote at general meetings of the company, but is entitled to attend and speak at such meetings. The APCA Board may terminate the membership of an associate member and is not obliged to give any reason for such decisions.

2.17 The business of the company is managed by the Board. However, the Board must establish a committee of management in respect of each clearing system to be responsible for the efficient operation and management of the relevant system. The Board must adopt and prescribe the regulations for each clearing system. The regulations may be amended at meetings of the participating members, provided such amendments have been recommended by the management committee. However, such amendments do not become effective unless approved by the APCA Board. The committee of management is responsible for determining the procedures/standards relating to the clearing cycle. Any significant amendment to such procedures/standards must accord with amendment of the Regulations or otherwise be approved by the chairman of the management committee, APCA's Chief Executive Officer or APCA Board. Disputes regarding a clearing system are determined by the management committee, although a participating member may refer a dispute to the APCA Board or request the Board to review a management committee's determination of a dispute.

2.18 There are a maximum of nine votes that can be cast at general meetings of the company, and at meetings of the APCA Board (each director has one vote). At such meetings, six votes are required to be cast in favour of a resolution for it to be passed; except when the Board is reviewing a decision of a management committee when five votes are required to be cast in favour of the resolution for it to be passed.

2.19 The composition of the management committees of APCA's clearing systems is similar to that of APCA's Board, ie, such committees are comprised of a nominee of each member of the clearing system being an ordinary share member of APCA (ie, the RBA, ANZ, CBA, NAB and Westpac) and a person nominated by each of the groups who may hold redeemable preference shares in APCA (ie, by clearing system members of the state or regional bank group, other bank group, building society group, and credit union group). Voting rights of each member of the Management Committee are weighted to reflect the transaction volume held by its nominee institution or group of institutions. Questions arising at Management Committee meetings are decided by a simple majority of votes.

Australian Paper Clearing System (APCS)

2.20 As noted, the TPC authorised the APCS Regulations and Procedures in September 1993. The APCS Regulations provide for three levels of participating membership - Tier 1A (direct clearer and direct settler), Tier 1B (indirect clearer and direct settler) and Tier 2 (indirect clearer and indirect settler). To qualify for membership a company must be a provider of payment services and meet a number of other criteria. In addition, to become a Tier 1 member a company must satisfy criteria as to prudential supervision and financial standing, and must provide for the settlement of obligations incurred by it as a result of the exchange of payment instructions (in practice, by the debiting or crediting of its exchange settlement account with the RBA). New Tier 1A members are also required to meet minimum clearing volumes. Entry fees, which are indexed annually, are $400 000 for Tier 1A, $6000 for Tier 1B, and $1000 for Tier 2 participating members.

2.21 Tier 1A and Tier 1B members settle directly to the system and are required to provide liquidity support and ultimately to share any residual settlement shortfall should another Tier 1 member fail to settle.

Bulk Electronic Clearing System (BECS)

2.22 The BECS Regulations and Procedures were authorised by the TPC in October 1994. The BECS Regulations provide for two levels of participating membership - Tier 1 (direct clearer and settler), and Tier 2 (indirect clearer and settler). Membership criteria is similar to that of APCS, and similar rules are in place in respect of failure to settle. Entry fees, which are indexed annually, are $25 000 for Tier 1 members, and $1000 for Tier 2 members.

Consumer Electronic Clearing System (CECS)

2.23 The Commission issued a draft determination on 20 August 1997 in respect of applications for authorisation of the proposed CECS Regulations and Procedures. The draft CECS Regulations provide for one level of membership, and do not include loss sharing arrangements among CECS Members in the event of a failure to settle. Each member must pay an entrance fee of $15 000, which is indexed annually.

High Value Clearing System (HVCS)

2.24 The proposed HVCS Regulations and Procedures are the subject of the current applications for authorisation, and are outlined in some detail in section 4 of this determination. Briefly, the HVCS Regulations provide for one level of membership. Members must settle high value payments through the Real Time Gross Settlement (RTGS) System. Each member must pay an entrance fee of $25 000, which is indexed annually.

Existing settlement arrangements

2.25 Australia has a deferred settlement payment system, that is, one in which the settlement of clearing obligations between financial institutions occurs at some interval after the transfers of the payment messages underlying settlement have taken place. Deferred settlement systems carry the inherent risk of an institution paying away and then not receiving due settlement - known as "settlement risk". APCA advises that settlement risk is regarded as being small within the world's major financial systems but institutional failure can and has occurred and is of very substantial consequence when it does. When there is such an occurrence, the impact is usually felt by all participants in the system and, potentially, can adversely affect the ability of a number of participants to meet their obligations - recognised as "systemic risk".

2.26 Inter-institutional obligations between direct clearing members for paper, direct entry, consumer electronic and high value electronic transactions, are settled through the settlement accounts of the RBA. Settlement between banks is achieved through transfers of their Exchange Settlement Account (ESA) balances held with the RBA. The RBA has also provided settlement accounts to two Special Services Providers (SSPs)[3], one representing the building society industry and the other representing a majority of the credit union industry.

2.27 In particular, following the exchange of paper on day one, members determine their resulting obligations to each other. These figures are provided to

[3] A Special Service Provider (SSP) is an organisation that provides financial services to building societies or credit unions, and is registered by the Australian Financial Institutions Commission (AFIC) under the national scheme for the regulation and prudential supervision of building societies and credit unions.

the APCA national collator in the RBA by early day two. Separately compiled are obligations arising from BITS, direct entry and consumer electronic transactions, and these figures are provided directly by members to the national collator. RITS and Austraclear provide details of members' obligations directly to the national collator. The collator then compiles a net owed or owing figure for each member by 7:00am on day two. Banks have a trading window between 7:00am and 8:45am to ensure their ESAs will be in credit when adjusted at 9:00am.

2.28 Settlement between direct clearing members and their appointor members is finalised outside of the above procedures.

Wallis Inquiry

2.29 The Financial System Inquiry (Wallis Inquiry) report was released by the Commonwealth Treasurer on 9 April 1997. The report canvasses a wide range of issues, including issues relating to the operation of Australia's payments system, and contains 115 recommendations.

2.30 When releasing the report the Treasurer announced the Government's response to recommendations of the report relating to mergers which required an immediate response to address market speculation. On 2 September 1997, the Treasurer announced the Government's comprehensive response to the Wallis Inquiry report, substantially endorsing the recommendations of the report.

2.31 In preparing this determination, the Commission has taken into account the relevant recommendations of the report concerning the payments system, and particularly high value payments which are the subject of the current applications for authorisation.

3. The High Value Clearing System

3.1 The RBA, APCA, Austraclear and participants in the payments industry are working together towards the establishment of Real Time Gross Settlement (RTGS). APCA's HVCS forms an important part of the establishment of RTGS in Australia. The RTGS system is comprised of several components, as discussed below.

High value payments

3.2 APCA's HVCS will provide the regulatory framework within which participating members will electronically exchange high value payments with each other - for themselves beneficially, and on behalf of their customers.

3.3 There is no precise definition of what constitutes a high value payment; rather, use of the HVCS will depend on whether the particular circumstances giving rise to a payment instruction make the HVCS the most appropriate payment delivery mechanism. It is generally envisaged that any payment considered sufficiently urgent and/or of high enough value to warrant the speed and security of the HVCS will be sent through that system.

3.4 High value payments in Australia currently pass through a number of disparate systems. Settlement of payment obligations arising in those systems occurs on a net deferred basis. The existing high value systems are:

- *BITS* (Bank Interchange & Transfer System) - BITS is used to exchange high value payments between its owners, being the four major banks and Colonial State Bank. It is a real time, high value system used for effecting irrevocable payments domestically. The system is based on common gateway software and is structured around bilateral links between the BITS owners. Settlement is on a deferred net basis at 9.00am on the business day following exchange.

- *RITS* (Reserve Bank Information & Transfer System) - RITS is owned by the RBA, and allows Commonwealth Government securities to be transferred and settled simultaneously. RITS also provides a facility for "two sided" cash transfers between members. Payment obligations undertaken in the system are irrevocable.

- *FINTRACS* - This system is operated by Austraclear Limited, an unlisted public company the members of which are the major participants in the money market. Austraclear provides central depository and registry facilities for non-Commonwealth Government money market securities and cash transfers between members. They are two-sided and are multilateral netted at end of day. Transactions are not irrevocable until members' positions are confirmed by their banks at end of day.

3.5 These high value payment systems handle relatively few payments compared to the other payment systems. However, as noted in Table 1 above, the high value systems account for two-thirds of the value of non-cash payments.

Real Time Gross Settlement

3.6 RTGS essentially means that payments between participants are settled across exchange settlement accounts (ESAs) held with the RBA prior to the delivery of the payment to the recipient. The intended effect is that where a payment is settled on an RTGS basis the recipient of the payment is assured of receiving value for it, even in the event of a failure of the financial institution which sent the payment.

3.7 The RBA, which will own the RTGS system, is sponsoring legislation which, once operative, should effectively give an RTGS payment the same status in terms of finality as a cash payment.

3.8 Under RBA requirements, only institutions with an ESA at the RBA can participate directly in the RTGS system. At present, organisations authorised to carry on banking business in Australia and the building society and credit union special services providers (AAPBS Settlements Limited and Credit Union Services Corporation Australia Limited) have been granted ESAs by the RBA.

3.9 The RTGS system consists of a central RTGS settlement platform, and a number of feeder systems which provide payments to be settled across that platform. APCA advises that the overall RTGS project involves a number of constituent or allied projects.

- The SWIFT Payment Delivery System (SWIFT PDS), which incorporates SWIFT's FIN Copy product[4] to facilitate the electronic exchange of payments containing customer details between HVCS participants. The SWIFT PDS forms the basis of the HVCS.

- The RITS/RTGS project to create a system to settle payments in real time by enhancement to the existing RITS system to produce the RTGS settlement platform.

- Enhancements to RITS for real time gross settlement of cash transactions and Commonwealth Government securities trades initiated in RITS.

- Enhancements to Austraclear's FINTRACS system to enable securities trades and cash transfers to be settled across the RTGS system.

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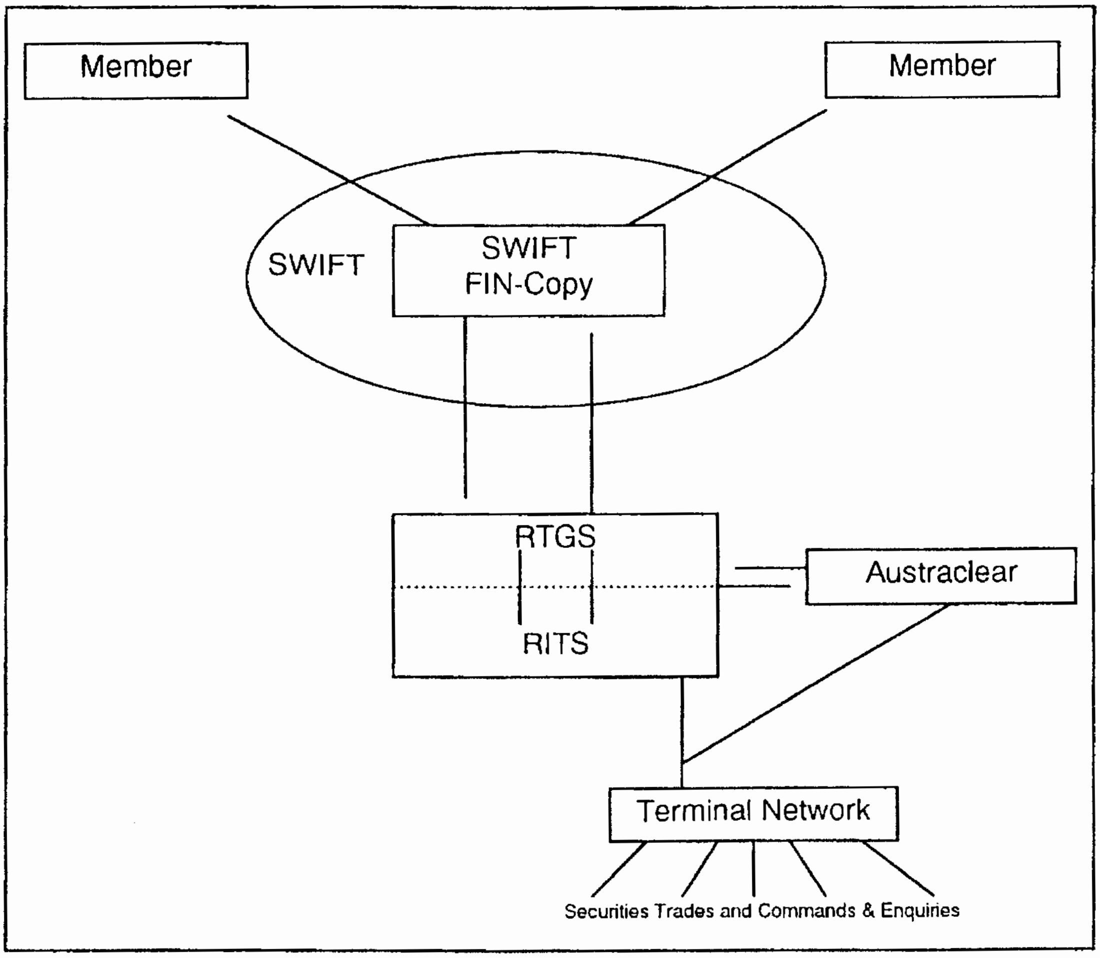
[4] SWIFT is the Society for Worldwide Interbank Financial Telecommunication. The SWIFT Fin-Copy service is a service provided to the HVCS's participating members pursuant to the SWIFT Service Agreement.

3.10 The feeder systems to the central RTGS settlement platform are APCA's SWIFT PDS, RITS and Austraclear's FINTRACS system (Feeder Systems). The following diagram from APCA's submission shows the various system components and links that will exist to facilitate the settlement of high value payments in real time.



3.11 The Feeder Systems will copy settlement information to the RBA's RITS/RTGS system for authorisation, prior to completing a payment. The RTGS system will only provide that authorisation if the sending member's ESA has sufficient funds to make the payment. If sufficient funds are not available, the payment will be queued in the system awaiting their availability. Once funds become available, the sending member's ESA is debited, and the payment can be completed.

4. The applications

4.1 APCA has applied for authorisation of its Regulations and Procedures for the HVCS.

4.2 The HVCS Regulations are modelled on the APCS and BECS Regulations that were granted authorisation by the TPC in September 1993 and October 1994 respectively, and the CECS Regulations which are currently the subject of applications for authorisation.

4.3 If there is inconsistency between a provision of the HVCS Regulations or the HVCS Procedures and a provision of APCA's Articles of Association, the provision of the Articles prevails. If there is any inconsistency between a provision of the HVCS Procedures and a provision of the HVCS Regulations, the provision of the Regulations prevails.

4.4 HVCS Members agree to be bound by and comply with APCA's Articles and the HVCS Regulations and Procedures. The HVCS Regulations and Procedures have the effect of a contract under seal between APCA and each HVCS Member, and between the HVCS Members.

HVCS Regulations

4.5 The HVCS Regulations have been adopted by APCA's Board, and are to take effect on a date to be specified by APCA's Chief Executive Officer.

4.6 The primary object of the HVCS is to co-ordinate, manage and ensure the implementation and operation of effective systems, policies and procedures for the exchange by electronic transmission and settlement of irrevocable payments between Participating Members, using an APCA payment delivery system. The essential characteristics of the HVCS are that:

- individual payments are exchanged by HVCS Members, using a highly secure electronic system in which all payments are irrevocable at the time of settlement; and

- no minimum dollar amount applies to such payments, rather they are usually characterised by their large size relative generally to payment instructions exchanged in other clearing systems, the need for robust security, and/or the time critical nature of the payments.

4.7 The HVCS Regulations and Procedures do not apply to the clearing and settlement of payments denominated in a currency other than Australian dollars or payments which are for exchange outside Australia. The Procedures may also stipulate that additional payments of a particular description or type are unacceptable for processing by the HVCS.

HVCS membership

4.8 In order to be a HVCS Member, a person must:

- be a body corporate which carries on business at or through a permanent establishment in Australia;

- be a 'provider of payment services' (a body corporate that provides or is willing to provide financial deposit and/or credit facilities to members of the public whereby its customers are provided with the means of transferring value to and receiving value from another person, irrespective of whether that person is a customer of the body corporate or not), or a Special Services Provider registered under the Australian Financial Institutions Commission Code;

- be able to comply with all applicable laws, the Articles of APCA, the HVCS Regulations and the minimum applicable technical, security and operational standards in the HVCS Procedures;

- obtain appropriate System Certification;

- if applicable, be authorised under section 88 of the Trade Practices Act to be a party to the contract, arrangement or understanding otherwise in breach of that Act;

- not impair the overall efficiency of the HVCS, and not adversely affect the integrity of payments or settlement between members or otherwise introduce a significant new risk into HVCS;

- be able to comply with all applicable requirements of any relevant Service Provider (in practice, this means compliance with SWIFT's requirements that each HVCS member must be a SWIFT User - ie, the organisation must join SWIFT as a member, sub-member or participant, or otherwise be granted the right to use the SWIFT network);

- agree to pay all relevant fees, costs, charges and expenses; and

- be subject (whether by legislation, mutual agreement or otherwise) to prudential supervision by the RBA, AFIC, or a State Supervisory Authority; or fall within one or more other categories involving criteria as to prudential supervision and financial standing.

4.9 Each applicant for HVCS membership proposing to use the SWIFT PDS to send and receive payments must also enter into a confidentiality agreement.

4.10 Applications for HVCS Membership are considered by the Management Committee, or by the APCA Board in limited circumstances. Unsuccessful applicants may, within three months, request the Board to review the decision, or may lodge a fresh application at any time.

Suspension and termination

4.11 The Management Committee may suspend the membership of a HVCS Member for a specified or indefinite period of time following - a request from the member's prudential supervisor, agreement with the member concerned, the member ceasing to satisfy any applicable requirement for membership, a disabling event, various insolvency events, or a breach of obligations by the member without satisfactory explanation. Membership may also be suspended automatically in the event of a failure to settle.

4.12 HVCS membership ceases upon a Member resigning, becoming insolvent or making an arrangement or composition with creditors generally, or being wound up, dissolved or otherwise ceasing to exist. In addition, the APCA Board, in consultation with the Management Committee, may terminate the membership of a HVCS Member. However, the Board may not do so unless a 'suspension event' has occurred and not been remedied, the Board has consulted with the relevant prudential supervisor, and the member has had the opportunity to make submissions to the Board regarding such termination. The Board is not obliged to give any reasons for its decision (although, as noted, the proposed Regulations provide substantial procedural safeguards against the termination of HVCS Membership).

Fees

4.13 Each HVCS Member must pay to APCA an entrance fee of $25 000 (indexed on an annual basis) in respect of the HVCS. Such fees are to be applied by APCA towards pro rata reimbursement of initial HVCS Members for their contribution towards the development costs of the HVCS. After development costs have been completely recovered, any entrance fees collected will be reimbursed to existing members on an equal basis.

4.14 APCA will also charge each HVCS Member transaction fees for sending SWIFT PDS payments through the HVCS. These fees will be used to recover development costs, and will be levied in arrears over an estimated five year period, up to the point of full recovery of those costs.

4.15 Each HVCS Member must also pay to APCA an annual fee of $1000 for membership of the HVCS. Such fees are to be applied by APCA towards payment of the operating costs of the HVCS.

4.16 The operating costs of the HVCS will be borne by each HVCS Member in an amount represented by a formula under which:

- the 'corporate governance' costs (which include costs associated with APCA's Board, APCA's administration and compliance matters) element of the clearing system costs apportioned by APCA's Board to the HVCS will be shared equally by all HVCS Members; and

- costs not attributable to corporate governance will be shared by HVCS Members in proportion to their share of national transaction volume (NTV) of payment instructions sent through the HVCS.

4.17 A dispute resolution fee of $1000 (indexed on an annual basis) is payable to APCA by each HVCS Member which is a party to a dispute referred to the Management Committee or to APCA's Board (either initially or by way of review). The parties must also pay to APCA any costs and expenses incurred by APCA in relation to the referral of a dispute. Such fees are to be applied by APCA towards payment of the operating costs of the HVCS.

Management of the HVCS

4.18 The day-to-day operations of the HVCS will be supervised by a Management Committee consisting of the following persons:

(a) a person elected by the directors of APCA to act as chairman;

(b) a nominee of each HVCS Member which has at least 5 per cent of HVCS national transaction volume;

(c) a nominee of each HVCS Member being the holder of an ordinary share in APCA (ie. the RBA, ANZ, CBA, NAB and Westpac);

(d) a person elected by each of the following groups - state and regional bank HVCS Members, other bank HVCS Members, building society HVCS Members and credit union HVCS Members; and

(e) a person nominated by the RBA, if no representative of the RBA has been appointed under any other provision.

A HVCS Member entitled to appoint a member of the Management Committee under (b) above cannot appoint a second person under (c) or participate in an election under (d).

4.19 The Management Committee is responsible for the effective operation and management of the HVCS, including:

- admission of HVCS Members, and the suspension of such membership;

- technical and efficiency standards;

- amendment of the fees and charges payable by HVCS Members;

- operating procedures and policies;

- subject to any HVCS Member being entitled to refer any dispute (whether initially or by way of request for a review) to the APCA Board, the resolution of disputes between Members;

- supervision of the observance by HVCS Members of the HVCS Regulations and Procedures;

- estimation of NTV for each HVCS Member on the basis of statistical information collected; and

- such other matters as the APCA Board may consider necessary, desirable or expedient for the better and more secure, efficient and equitable operation of the HVCS.

4.20 The quorum for a meeting of the Management Committee is 75 per cent of the number of members of the Committee. Questions arising at such meetings are decided by a simple majority of votes. Each member of the Committee (other than the chairman nominated by the APCA Board, who has no vote) is entitled to cast one vote for every 1 per cent (or part of such percentage) of NTV held by the HVCS Member which nominated, or the HVCS Members of the group which elected, that member.

Meetings of HVCS members

4.21 Meetings of HVCS Members must be held at least annually. The purpose of the annual meeting is to receive a report on the operations of the HVCS during the preceding financial year, and to provide a forum for HVCS Members to discuss any aspect of the operations of the HVCS, the current level of fees, and any other matters relevant to membership of the HVCS.

4.22 A quorum for any meeting of HVCS Members is 50 per cent of the total voting entitlement and each resolution requires more than 50% of the total votes cast to be cast in favour of the resolution in order for it to be passed. Each HVCS Member is entitled to one vote for every 0.1 per cent of NTV held by that Member. Procedures exist for HVCS Members with small percentages to exercise a collective vote.

Transitional arrangements

4.23 The introduction of the HVCS, SWIFT PDS and RTGS in Australia is planned to occur in a phased manner over a certain period (Transitional Period). APCA advised that the migration plan for the HVCS transactions involves the following:

- participants will join the HVCS at or prior to the start up of the SWIFT PDS;

- participants will become operational in the system progressively, exchanging with other participants high value payments which might previously have been made using other means such as using BITS or interbank warrants. Settlement of interbank settlement payment obligations initially will be on a net deferred basis at 9.00am on the next settlement day following exchange of the payment message;

- on a date to be determined by the RBA limits will be imposed on the within-day exposures of participants in the system having regard to their net deferred settlement payment obligations, for the purposes of introducing liquidity management techniques among participants and effecting a controlled transition to the new settlement regime. These limits will be progressively reduced to zero at which point the Transitional Period will end and all HVCS settlements will be in real time.

4.24 APCA advised that during the Transitional Period not all participants initially will be operational in the system; that is, although they all will be HVCS Members, not all will be ready to use the SWIFT PDS from the commencement of that period. The order in which members will become operationally active will be determined primarily by the preparedness of individual members to commence operations.

4.25 During the Transitional Period, transaction volumes used for determining cost and loss sharing and voting entitlements of Management Committee members are based on Provisional NTVs, which are based on a 1995 survey of RITS, BITS and Austraclear transactions. After the Transitional Period, once the necessary actual transaction volume data is available, adjustments will be made in respect of any loss sharing payments previously contributed by participants on the basis of the 1995 survey.

4.26 APSC advised in its 1996/97 annual report that the HVCS commenced operation in August 1997 (the Commission granted interim authorisation to the proposed HVCS arrangements in June). RTGS is planned to commence live operation in June 1998, and it is expected that the SWIFT PDS will be the primary vehicle through which wholesale payments, currently made using BITS, are delivered to the RBA for real-time settlement. It is also anticipated that high-value paper warrants and cheques will migrate to the HVCS. APSC also advised that by mid November 1997, the HVCS was carrying around 1900 payments each day with a total value of around $20 billion.

Settlement

4.27 HVCS Members must settle payments through the HVCS in real time, by using the RITS/RTGS System, and by exchange of value by the debiting and crediting of ESAs at the RBA. These arrangements apply except during contingencies when the RITS/RTGS System is unavailable, in which case the SWIFT PDS may be switched to "Bypass Mode" to enable payment exchanges to continue. In Bypass Mode, payments are onforwarded to the receiver without authorisation from the RTGS system. In Bypass Mode settlement of payment obligations is on a net deferred basis at 9.00am on the following settlement day. (The HVCS Procedures set out arrangements which are to apply if a contingency occurs.)

Failure to settle

4.28 Because settlement occurs on a net deferred basis during the Transition Period and any period during which the SWIFT PDS is switched to Bypass Mode, the risk of a failure to settle arises. (No such risk exists when payments are settled in real time - ie, under the RTGS system - as the exchange of a payment is not completed until after settlement.) APCA has sought, and the Commission granted, confidentiality for the failure to settle provisions of the proposed Regulations. In general terms, these provisions include automatic suspension of future exchange of items with the defaulter under the HVCS, and obligations on surviving HVCS Members to share the burden of any losses arising as a result of a failure to settle.

SWIFT indemnity

4.29 As noted above, the HVCS membership criteria include a requirement that in practice each HVCS member be a SWIFT User, ie, the HVCS member must join SWIFT as a member, sub-member or participant (there are many different categories of participant).

4.30 APCA advises that under arrangements between it and SWIFT, APCA will be in control of admission of institutions to the group of SWIFT Users entitled to use SWIFT's FIN Copy service in the HVCS. APCA will also be in control of suspension and termination of access of those SWIFT Users to FIN Copy in the HVCS. APCA also advises that it is a contractual condition on which SWIFT agrees to make its FIN Copy service available to APCA, and APCA members, that APCA indemnify SWIFT in relation to any claims against SWIFT arising from decisions made by APCA to allow, suspend or terminate access to FIN Copy in the HVCS.

4.31 Under the proposed HVCS Regulations, if SWIFT makes a claim against APCA under that indemnity, certain HVCS members must in turn collectively indemnify APCA in connection with that SWIFT claim rateable in accordance with their transaction volumes. The HVCS members that must indemnify APCA under these arrangements are those that were HVCS members at the time at which the decision or other act or omission by APCA (whether by the Management Committee or otherwise) which gave rise to the SWIFT claim was made. If in the unlikely event that there is no clearly identifiable decision or other act or omission by APCA giving rise to that SWIFT claim, all those that were HVCS members on the date of service on APCA of SWIFT's claim must contribute to indemnify APCA.

Fraud and loss sharing

4.32 HVCS members are obliged to report actual or suspected fraud within the HVCS, unless confined to within a member's own operations. Losses resulting from fraud are borne by the members involved where the fraud can be shown to be confined to those members' operations. Otherwise, the resulting losses are shared by all HVCS members in proportion to their HVCS transaction volumes.

Disputes

4.33 A dispute is defined as a difference between the APCA Board, the Management Committee, any delegate of the Management Committee and any one or more HVCS Members; or two or more HVCS Members; concerning the APCA Articles, HVCS Regulations or HVCS Procedures.

4.34 Disputes must be referred to the Management Committee for determination. However, a HVCS Member who is party to a dispute has the right to refer the dispute direct to the APCA Board for determination, or to request the Board to review the Management Committee's determination of the dispute. As noted in paragraph 4.17 above, each HVCS Member which is party to a dispute referred to the Management Committee or to APCA's Board (either initially or by way of review) must pay a fee of $1000 (indexed on an annual basis) to APCA. The parties must also pay to APCA any costs and expenses incurred by APCA in relation to the referral of a dispute.

4.35 The Regulations also include a means of enforcing the dispute determinations of the Management Committee and the APCA Board.

Amendment of the Regulations

4.36 The HVCS Regulations may be amended by a resolution passed at a meeting of the HVCS Members, provided that the amendments have been recommended by the Management Committee. However, such amendments do not become effective unless approved by the APCA Board (which may refer an amendment to the Management Committee and the HVCS Members for reconsideration).

HVCS Procedures

4.37 The Procedures apply to the domestic high value clearing system only with respect to payment instructions sent and received electronically using the SWIFT PDS. Additional separate procedures will be required for the implementation of any APCA PDS other than the SWIFT PDS.

4.38 Clearings effected between HVCS members and the settlement of balances arising as a result of exchanges of payments between members must be undertaken in accordance with the practices, procedures, standards and specifications established by the Management Committee.

4.39 The Regulations provide the Management Committee with the power to determine practices, procedures, standards and specifications relating to all or any aspects of the clearing cycle. Any amendments to fundamental terms dealing with practices, procedures, standards or specifications must accord with amendment of the Regulations, or otherwise be approved by the chairman of the Management Committee, APCA's Chief Executive Officer or Board. Amendments of a grammatical, cosmetic or minor nature may be made by APCA's Chief Executive Officer if he/she is of the opinion that the amendment will not prejudice any HVCS Member or the conduct of exchanges of other HVCS operations. The Regulations also provide for the suspension of the Procedures by APCA's Chief Executive Officer with the approval or by the direction of the Management Committee, and for the conduct of exchanges and settlement during periods of such suspension.

4.40 HVCS members must also abide by the provisions of the SWIFT User Handbook, and, to the extent of any inconsistencies between the Procedures and the Handbook, the Handbook will prevail except where the Procedures impose more rigorous obligations on HVCS Members, or removes or limits any discretion available under the Handbook. (The SWIFT User Handbook was not provided to the Commission with the APCA applications for authorisation.)

4.41 APCA requested, and the Commission granted, confidentiality to certain parts of the HVCS Procedures; namely, Message Content Specifications (Appendix D), SWIFT PDS CBT Security Requirements (Appendix E), and Message Preparation Guidelines (Appendix I).

4.42 The HVCS Procedures contain a large number of day-to-day operational requirements, including provisions relating to:

- General Operating Requirements - eg, session times, start-up requirements, procedures for return of settled payments sent in error.

- SWIFT PDS Closed User Group (SWIFT PDS CUG) - eg, a requirement that HVCS Members be SWIFT Users to be able to use the SWIFT PDS to send and receive payments, content specifications for SWIFT payments messages, SWIFT PDS CUG fees.

- Technical Requirements - HVCS Members must meet specified operational and security standards in respect of their primary computer site and back-up computer site (which house the equipment used to access the SWIFT PDS), payments operation area, and availability and throughput requirements. Some of these requirements are noted below.

    - The level of back-up computer support that a HVCS member must have is dependant upon the value of SWIFT PDS payments sent and received by the member.
    - Each HVCS member's primary computer site and back-up computer site hardware and software configurations must be capable of processing a minimum of 50 per cent of that member's average daily SWIFT PDS transaction volume in one hour, and must meet a minimum of 99.7 per cent up-time during core business hours on an annual basis.
    - HVCS members must exchange authentication keys every 12 months.

- Each member's SWIFT PDS system must be certified, prior to the initial use of the SWIFT PDS to send and receive payments. Members must also obtain and provide to APCA annually a yearly audit compliance certificate to evidence that members continue to met the requirements of the HVCS Regulations and Procedures.

- SWIFT PDS Message Content Specifications - which include requirements that all inward payments conform to the message content specifications, and that all members using the SWIFT PDS have a BSB number; and a recommendation that the Message Preparation Guidelines be followed.

- Contingency Procedures - which include provisions designed to enable orderly operation of the SWIFT PDS during contingencies. A 'contingency' is defined as a 'disabling event' (ie, any processing, communications or other failure of a technical nature, inaccessibility to facilities by means of which payments are sent and received, or manifestation of industrial action, that affects or may affect the ability of a HVCS member to participate to the normal and usual extent in sending and receiving payments), and any other event or circumstance determined by the Management Committee as being a 'contingency'.

- Transitional Arrangements - which include provisions that apply during the Transitional Period only, and which are designed to bring about a gradual migration of HVCS members on to the SWIFT PDS and the RITS/RTGS System within a controlled environment.

5. Statutory tests

5.1 These applications were made under sub-section 88(1) of the Act (in respect of arrangements, provisions of which may be exclusionary provisions, or may have the effect of substantially lessening competition, within the meaning of section 45 of the Act), and sub-section 88(8) of the Act (in respect of conduct that would or may constitute exclusive dealing). The Act provides that the Commission shall only grant authorisation if the applicant satisfies the relevant tests in sub-sections 90(6), (7) or (8) of the Act.

5.2 Sub-sections 90(6) and (7) provide that the Commission shall grant authorisation only if it is satisfied in all the circumstances that:

- the provisions of the subject arrangements or conduct have resulted or would result or be likely to result, in a benefit to the public; and

- that the benefit outweighs the detriment to the public constituted by any lessening of competition that has resulted, or would result or be likely to result, from the arrangements or conduct.

5.3 Sub-section 90(8) provides that the Commission shall grant authorisation in relation to an application under sub-sections 88(1) or 88(8) only if it is satisfied in all the circumstances, that the exclusionary provision or exclusive dealing conduct has resulted, or is likely to result, in such a benefit to the public that the arrangements should be allowed to be given effect to, or the conduct should be allowed to take place.

5.4 Whilst there is some variation in the language between sub-sections 90(6), (7) and (8) the Commission adopts the view taken by the Trade Practices Tribunal (the predecessor of the Australian Competition Tribunal) that in practical application the tests are essentially the same.[5]

5.5 In deciding whether it should grant authorisation, the Commission must examine the anti-competitive aspects of the arrangements or conduct, the public benefits arising from the arrangements or conduct, and weigh the two to determine which is the greater. Should the public benefits or expected public benefits outweigh the anti-competitive aspects, the Commission may grant authorisation or grant authorisation subject to conditions.

5.6 If this is not the case, the Commission may refuse authorisation or alternatively, in refusing authorisation, indicate to the applicant how the applications could be constructed to change the balance of detriment and public benefit so that authorisation may be granted.

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[5] Re Media Council of Australia (No. 2) (1987) ATPR at page 48-418.

6. Submissions

From APCA

6.1 APCA notes that the payments clearing system is the core of the financial system and is vital to the functioning of the overall economy. It is therefore essential to preserve and enhance the integrity of the system and minimise risk. Subject to this primary objective, APCA's aim is to establish a more open and competitively neutral system, while taking into account the need for a co-operative and co-ordinated approach to the system's development and the promotion of operational efficiency and security standards.

System integrity

6.2 APCA submits that because it is essential that the integrity of the payments clearing system is maintained and protected, the highest prudential standing is required of payment service providers who are members of the HVCS. However, the Regulations set objective entry criteria which are not referable to the institutional status of applicants.

6.3 Further, it is fundamental to the HVCS that settlement be effected on a real time basis, which effectively negates systemic risk. The HVCS Regulations require settlement of HVCS transactions to be effected using the RBA's RTGS system. APCA advises that there is no other settlement mechanism available to settle HVCS transactions on a real time gross settlement basis. In addition, because the RTGS system is only accessible through RITS (the RBA's RTGS arrangements are an integral part of RITS), HVCS members must also be members of RITS. APCA advises that entry to and use of RITS is governed by regulations and conditions of operation promulgated by the RBA.

6.4 APCA also advises that an ESA is necessary to allow an organisation to settle payments in real time, prior to delivery of payments to the recipient. It is the only satisfactory mechanism currently available for achieving finality of payment for settlement purposes generally and is necessary to settle using the RBA's RTGS system.

6.5 APCA notes that to some extent HVCS eligibility may be determined by RBA policy in relation to availability of ESAs and membership of RITS. APCA submits that should access to ESAs (and RITS) be expanded, as a result, for example, of the Wallis Inquiry recommendations, the proposed HVCS Regulations already accommodate wider HVCS membership than may be currently possible in practice given existing RBA policy.

Competitive neutrality

6.6 APCA submits that as its role is to oversee payments clearing and settlement arrangements, there is an expectation that clearing and settlement between institutions will occur within APCA's framework of regulations. However, there is nothing in its Memorandum and Articles of Association, or the HVCS Regulations and Procedures, that prevents payments clearing systems developing and operating outside of APCA. The expectation that this is unlikely to arise is based on a number of factors:

- payments clearing arrangements in an economy must form an integrated whole if they are to do their job properly;

- all providers of payment services have been represented in the process of reform leading to the establishment of APCA; and

- APCA's regulations do not erect barriers to entry other than to the minimum extent necessary to ensure the continuing integrity and efficiency of payments clearing and settlement arrangements.

6.7 APCA notes that the HVCS conditions of access and participation do not favour one kind of payment services provider over another, purely on the basis of their institutional status. Banks, building societies and credit unions are all contemplated as potential members of APCA and participating members of APCA's clearing systems. Entry is also potentially open to payment service providers outside of those institutional groupings on the terms set out in the APCA's regulations.

6.8 However, this does not mean all payment service providers have equal ability to participate, in all capacities, in payments arrangements. In this regard APCA notes that the provision of ESAs is a matter for the RBA, not APCA. It further notes that existing RBA policy in relation to operation of ESAs by HVCS members requires settlement of HVCS transactions to be effected by debiting the paying member's ESA and crediting the receiving member's ESA (ie, HVCS members must settle using their own ESAs and not those of other members pursuant to any form of agency arrangement).

6.9 APCA also submits that nothing in its Memorandum and Articles of Association, or in the HVCS Regulations and Procedures, restricts the ability of participants to compete for the business of end users of payment services of the type contemplated in the HVCS. It advises that entry fees for participation in HVCS have been determined having regard to the cost of establishing the system, and the level of such fees are considered to be both low and fair and not a barrier to entry.

6.10 Specifically, APCA does not perceive any barriers to admission to the HVCS because of the requirement that members be SWIFT Users. It is envisaged that prospective HVCS members would join SWIFT as "domestic clearing participants" if they are not already SWIFT Users and do not want full SWIFT membership or sub-membership (which categories have high entry fees than admission as a participant). APCA's selection of SWIFT's FIN Copy service as the basis of its HVCS followed and evaluation process based on functionality, technical criteria, capital and operating costs and investment risk. That evaluation process included as one of its important criteria the containment of costs across the industry as a whole.

6.11 APCA notes that the HVCS Procedures contain qualitative and quantitative technical and other requirements for backup systems of members, to ensure that members' in-house systems difficulties do not adversely affect the efficiency and integrity of the HVCS. In order to accommodate both small and large volume users of the SWIFT PDS, three levels of backup requirements are proposed based on transaction values. Tier 1 backup will apply to the highest value users and involves more rigorous disaster recovery and redundancy requirements. Tier 3 requirements are the least stringent and apply to the lowest value users. APCA submits that the proposed tiering structure should significantly assist in limiting the costs for smaller volume players joining the HVCS.

Co-operation and co-ordination

6.12 APCA claims that its reporting and decision making structure ensures a higher degree of co-ordination in the management and development of payments clearing arrangements than in the past, and a higher degree of accountability. The HVCS Management Committee will have responsibility for the effective operation and management of domestic high value payments clearing activities. The more general oversight of the APCA Board will provide, in addition, a perspective on developments across all clearing systems, and an avenue for appeals in the event of disputation, with participating members having the ability to request the Board to review any decision made by the Management Committee.

Operating procedures and technical standards

6.13 APCA notes that some participants may be better able to meet particular standards than others and this could, in some instances, give the appearance of fettering competition. However, the integrity and effectiveness of the payments system depends, in large part, on having both high standards of operational efficiency and robust security arrangements governing transmission of payment messages.

6.14 The HVCS Management Committee has specific responsibility for operating procedures and technical and efficiency standards, including security requirements. APCA advises that its policy is to implement new operational and security standards only after the issues have been thoroughly researched and canvassed among participants.

Public benefits

6.15 APCA advises that for the majority of high value payments (some RITS transactions excepted) settlement takes place on a net deferred basis. It notes that if an institution is unable to meet its end of day obligations, institutions due to receive funds are exposed (settlement risk), and there is significant potential for other parties to fail (systemic risk).

6.16 APCA submits that the introduction of the RBA's RTGS system will eliminate settlement risk and systemic risk for high value payments which are settled in real time. The key to RTGS is the irrevocable nature of payments settled in that system and the positioning of settlement as a pre-requisite to the completion of a payment transaction.

6.17 APCA advises that many countries are moving to introduce systems to exchange high value payments electronically and to settle them on an RTGS basis. APCA submits that without such a system, it is likely that international banks and corporations would find doing business in Australia involving settlement of high value transactions more risky that in those countries operating such systems, which would place Australia potentially at a competitive disadvantage.

6.18 The HVCS will enable all participating members of the system to both send and receive payments from all other members using the SWIFT PDS. APCA submits that considerable efficiency gains are possible for individual participants and the payments industry generally when all participants send and receive payments of the same nature through the same system. Such gains are in the form of decreased implementation, establishment and operational costs from institutions no longer having to deal with separate delivery systems. The HVCS is a multilateral arrangement using a centralised payment delivery mechanism, the SWIFT PDS, which has the potential to realise such gains.

6.19 In summary, APCA claims that the proposed HVCS Regulations and Procedures will:

- maximise to the extent practicable the security and integrity of the system;
- not discriminate between non-banks financial institutions and banks, and provide a framework within which non-bank financial institutions may be able to compete more effectively with banks;
- ensure the maximum cost/benefit efficiency; and
- fundamentally reduce the risks to participants of the system.

From interested parties

6.20 The Commission sought submissions from a range of interested parties. Four parties lodged written submissions, these have been placed on the public register maintained by the Commission in adjudication matters.

6.21 Colonial State Bank supported the applications as it considers the HVCS arrangements an essential foundation for significant improvement to the management and control of interbank settlement risk.

6.22 Westpac also supported the applications. It advised that systemic risks are at their most acute in high value payments. Participation in the clearing and settlement of such transactions must therefore be limited to those organisations which satisfy the most stringent criteria. Westpac considered that the HVCS participation criteria are equitable and not a barrier to entry or effective competition. It submitted that public benefit is derived through payment systems which deliver the highest levels of efficiency (both financial and operational), security, integrity and risk management. The APCA PDS will ensure a co-operative centrepiece for the exchange of payments and a direct link into the RBA for provision of finality of settlement. In Westpac's view, competition rightly belongs outside that co-operative arena and will be provided by participants in their proprietary approaches to the provision of products and services linking to the PDS.

6.23 The ASX Settlement and Transfer Corporation (ASTC) was broadly supportive of the proposed HVCS arrangements. However, ASTC raised a number of concerns regarding the potential effects of the introduction of the HVCS arrangements on the CHESS Client Bank User Group (which is part of the RITS facility) through which financial institutions provide payment services for settlement of securities transactions effected on the Australian Stock Exchange.

6.24 American Express referred to the significant changes, in terms of increased numbers of participants and product development, in the financial services industry in recent years. It submitted that the predominant exclusion of non-bank financial institutions from full membership of APCA (and therefore the payments clearing system) by virtue of not being classified as "providers of payment services", has placed them in a distinctly disadvantaged position. American Express argued that it is an impediment to the development of the financial services industry that participation in APCA should continue to be so restricted, and that the necessity for strict prudential and fiduciary controls (which it did not question) in no way requires or justifies such an exclusionary system. It referred to its experience as a prominent global travel and financial services provider, and submitted that:

- APCA's criteria that members be "providers of payment services" excludes all but banks, building societies and credit unions. This disenfranchises those organisations which, whilst participating in the payments system, are precluded from having any voice in the strategic development of the system and the setting of standards that will affect all participants.

- Industry associations for building societies and credit unions, who are not themselves 'providers of payment services', have been admitted to APCA membership. Why are other entities who do not strictly meet the criteria not similarly admitted?

- American Express credit products are not substantially different from those of Visa and MasterCard, as they currently require settlement and payment to be made. American Express is also involved in the ATM network (via Cashcard, Rediteller and ANZ networks). Additionally, the company provides POS (point of sale) terminals and a network which it shares with other merchant acquirers and card issuers. However, because of its lack of membership of APCA, American Express is forced to settle and clear through a third party. In addition, the American Express portfolio of foreign exchange and travellers cheques also requires that settlement must be through third party banks.

6.25 American Express noted with approval the recommendations of the Wallis Inquiry, and particularly the proposed establishment of a Payments System Board (PSB) to oversee certain functions including the determination of entrants to the payments system which "should not be controlled by industry participants". It agreed that if the Wallis Inquiry recommendations were implemented they would provide more consistent regulation and greater competitive neutrality across the financial system. It advised that until the role of APCA and the PSB has been clarified and that membership and qualifying criteria more accurately reflect all participants in the financial services industry and permit equal access to the settlement and clearing process, it opposes APCA's application for exemption from the Trade Practices Act.

Further submission by APCA

6.26 APCA provided the following comments in respect of issues raised by ASX:

- APCA understands that CHESS closed user group payment obligations which are settled as a batch in RITS will be upgraded automatically to RITS/RTGS as a result of the enhancement of the RITS system to provide the Reserve Bank's RTGS settlement platform.

- APCA's HVCS regulations do not address CHESS closed user group arrangements, and have no present relevance for CHESS client banks as such. APCA understands that CHESS settlements are, and will continue to be, regulated wholly under the RBA's RITS Regulations and Conditions of Operation.

- APCA is of the opinion that it is unlikely that any institution which is currently a CHESS client bank will not join the HVCS, and that CUSCAL and ASL will also be members of the HVCS.

- APCA understands that the CHESS closed user group will utilise the RBA's RITS/RTGS system to effect real time gross settlement, and not the HVCS. That aside, the only other alternatives to achieve real time gross settlement involve accessing the RBA's central RTGS platform through an approved feeder system. The RBA (through its RITS Regulations and Conditions of Operation) presently provides for two such feeder systems - APCA's HVCS and Austraclear. Importantly, to access the RTGS platform through a feeder system will still require both membership of RITS and an ESA, whether the party concerned is an HVCS member or member of any other system. Those elements of APCA's HVCS rules do no more than meet current RBA policy on settlement arrangements. APCA notes that members of the HVCS are also required to be SWIFT members and, as a technical matter, must demonstrate system compliance before being permitted to transmit HVCS payment instructions. Neither requirement could be said to be anti-competitive.

6.27 APCA also provided the following comments on the submission by American Express:

- APCA advised that its membership criteria for the HVCS incorporate, and are necessarily constrained by, the requirement that a participant must be able to provide for finality of payment through an ESA held at the RBA. In Australia the RBA is responsible for the provision of such settlement accounts and the prudential requirements on which they are based. The Wallis Inquiry recommended that the RBA should continue to determine the right to hold an ESA. Moreover, while as a general principle the Wallis Inquiry did recommend liberalising access to the clearing system, it also expressly acknowledged that the intensity of risks in the high value area justifies participants in high value settlement being intensely regulated. To date, the RBA has allowed only banks and the SSPs which represent credit unions and building societies to have access to ESAs or equivalent settlement accounts.

- APCA submitted that it would be inappropriate for the issue of central bank policy on settlement to delay implementation of the HVCS.

7. Commission evaluation

7.1 The Commission's evaluation of the applications for authorisation is made in accordance with the statutory tests as set out in section 5 of this determination.

7.2 As noted, the HVCS arrangements, the subject of these applications, form one component of the Real Time Gross Settlement (RTGS) system which is being established in Australia. The RTGS system consists of a central RTGS settlement platform (the RITS/RTGS), and a number of feeder systems (the HVCS, RITS and Austraclear's FINTRACS systems) which provide payments to be settled across that platform. The various components of the RTGS system are illustrated in the diagram at paragraph 3.10 above.

7.3 The other components of the RTGS system - Austraclear's FINTRACS arrangements and the RBA's RITS/RTGS arrangements - are not the subject of these applications for authorisation. However, as the HVCS arrangements are inextricably linked to RITS/RTGS, relevant details of these RBA arrangements are discussed below. Austraclear's arrangements are not discussed in this determination.

HVCS - general

7.4 Under the HVCS arrangements, members electronically exchange high value payments with each other through the SWIFT Payment Delivery System (SWIFT PDS). However, in normal circumstances, such payments will be exchanged only after settlement in respect of the payments has taken place between the members.

7.5 The HVCS arrangements do not prescribe any minimum dollar amount for payments exchanged between HVCS members. Rather such payments are described broadly as being 'usually characterised by their large size relative generally to payment instructions exchanged in other clearing systems, the need for robust security, and/or the time critical nature of the payments'. However, the Commission notes that it is expected that wholesale electronic payments currently exchanged through BITS, and high value paper warrants and cheques currently exchanged through APCA's paper clearing system (APCS), will migrate to the HVCS.

7.6 BITS is owned by the four major banks and the Colonial State Bank, who currently use this electronic clearing system to exchange domestic high value payments. The exchange of high value paper warrants and cheques through the APCS is available to all APCS members (currently being various banks, some building societies and credit unions). Membership criteria for the HVCS is discussed below, however, it is apparent that the electronic exchange of high value payments will be available to a larger number of financial institutions following introduction of the HVCS than is currently the case under BITS. As previously noted, while cheque payments remain high in number, the relative importance of such payments in both volume and value terms has been in decline for some years. Introduction of the HVCS is likely to see an even further decline in the use of paper instruments for high value payments.

7.7 The Wallis Inquiry noted that in 1995, the average value of a cheque was around $7000, down from around $18 000 in 1990. However, anecdotal evidence suggested that small value cheques make up 80 to 90 per cent of total cheque payments so that the median cheque value would be much smaller. The Inquiry also estimated the cost of the payments system to suppliers of cross-institutional payments as at least $5 billion to $7.5 billion, of which around 80 per cent was attributable to paper clearing and over-the-counter cash. It further estimated that cheques could represent as much as 70 per cent of the total non-cash cost of the payments system. The Inquiry concluded that a migration from cheques to other payment mechanisms, such as the direct entry or high value systems, would yield significant cost savings.[6]

7.8 Based on the Wallis Inquiry's analysis of the cost of the payments system, the HVCS arrangements will result in public benefit through increased cost efficiencies if, as expected, high value warrants and cheques currently exchanged through APCA's paper clearing system migrate to the HVCS. It is noted however, that small value cheques make up the vast majority of cheque payments, so that the paper clearing system will continue to represent a significant proportion of the cost of the payments system.

7.9 The Commission also notes that payments exchanged through both BITS and APCA's paper clearing system are settled on a net-deferred basis - ie, at 9.00am on the business day following exchange. Under such deferred settlement systems, should an institution be unable to meet its obligations, other institutions due to receive funds are exposed (settlement risk) and there is significant potential for other parties to fail (systemic risk).

7.10 By contrast, payments exchanged through the HVCS are required to be settled in 'real time' under the RITS/RTGS platform as a pre-requisite to the exchange of the payment messages between HVCS members. Settlement and systemic risk are eliminated under real time settlement systems. The HVCS arrangements will therefore result in public benefit through reduced settlement and systemic risk in the payments system if, as expected, payments currently exchanged through BITS and through APCA's paper clearing system migrate to the HVCS.

7.11 The Commission notes APCA's submission that there is nothing in its rules, including the HVCS rules, that prevents payments clearing systems developing and operating outside of APCA. However, the Commission agrees with APCA's view that the development of payments clearing systems outside of the company's systems is unlikely.

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[6] Wallis Inquiry report, paragraphs 6.3.1 and 9.3.3.

7.12 The HVCS Regulations set out the requirements for membership of HVCS, and provide for the operation and management of the clearing system by members through a management committee. The management committee determines the HVCS technical and operating procedures and standards, which are incorporated in the HVCS Procedures. Although neither the HVCS nor other APCA rules require an institution to be a HVCS member to participate in the clearing system, all participants would have to comply with the HVCS Procedures in their clearing of relevant payments. (All participants will, in addition, have to comply with the RBA's requirements for real time settlement through the RITS/RTGS system. These requirements are discussed in paragraphs 7.27 to 7.36 below.)

7.13 Therefore, while the technical and operating requirements for clearing set out in the Procedures are vital to maintaining the security and integrity of the HVCS (which would benefit the public), it is important that such requirements are set at an appropriate level so as not to unnecessarily restrict participation in the clearing system (and thus competition in the provision of relevant payment services). As noted, HVCS members, through the management committee, both determine the HVCS Procedures and manage the operation of the clearing system. The criteria for HVCS membership are thus important in ensuring that the HVCS Procedures are appropriate and would be likely to result in net benefit to the public.

HVCS membership

7.14 Institutions that are members of one or more of APCA's clearing systems are 'participating members' of APCA. The criteria for HVCS membership are discussed below.

'Provider of payment services' requirement

7.15 One of the main criteria for membership of APCA's clearing systems (including the HVCS) is that a member be a 'provider of payment services', which APCA defines as - an organisation that, on the basis of credit and/or deposit facilities, provides its customers with the ability to transfer value to third parties, whether or not those third parties are also customers of the same organisation.

7.16 In its submission, American Express noted that APCA's requirement for its members to be "providers of payment services" excludes all but banks, building societies and credit unions. American Express was concerned that this disenfranchises those organisations which, whilst participating in the payments system, are precluded from having any voice in the strategic development of the system and the setting of standards that will affect all participants. It also noted with approval the recommendations of the Wallis Inquiry concerning improved access to the payments system.

7.17 The Commission notes that *clearing* and *settlement* is the core of the payments system. *Clearing*, which is only required where both parties to a payment transaction maintain accounts with different institutions, is the cross-institutional exchange of individual payment messages for the purposes of obtaining settlement. *Settlement* is the exchange of value between institutions providing payment services for the purpose of providing finality of payment for the obligations arising out of payments clearing.

7.18 In follows that provision by an institution to its customers of the means (payment instrument) of transferring value to third parties generally (and not only to third parties who are also clients of the institution), is the underlying activity giving rise to the need for such institutions to clear and settle amongst themselves. However, for an institution to provide its customers with a payment instrument that would be generally accepted by third parties, it must as a prerequisite have the means of settling its obligations with (passing value to) other participants in the payments system at this level.

7.19 Central bank money is generally regarded as the only practically available medium which provides payment which is free from default. In Australia, the RBA provides such settlement facilities through Exchange Settlement Accounts (ESAs), and the payment obligations between participants in the core of the payments system (ie, at the clearing and settlement level) are settled one to the other through the debiting and crediting of ESAs. Thus, an institution wishing to participate in the payments system at the clearing and settlement level must either have or have access to an ESA.

7.20 It is noted therefore, that whilst APCA regulates access to and conduct within its clearing systems, the critical criteria for an organisation to satisfy in order to participate in the core of the payments system (ie, at the clearing and settlement level) is whether or not the organisation has or has access to an ESA. It is only such an organisation which is able to provide its customers with the ability to transfer value to third parties generally (ie, whether or not those third parties are also customers of the same organisation). Such an organisation would satisfy APCA's definition of a 'provider of payment services', the primary criteria for membership of APCA's clearing systems (and thus participating membership of APCA).

7.21 APCA has previously submitted (in respect of the applications for authorisation of its CECS arrangements) that as its role is to manage clearing and settlement, and as only 'providers of payment services' generate the need to clear and settle, its membership criteria is inclusive of all payments clearers and settlers. APCA considers that it is quite reasonable to limit membership of its clearing systems to those organisations that participate in the process that it manages within those systems. It submitted that providers of payment services accept risk in respect of obligations owed by other providers of payment services (which arise from transfers of value to or from third parties which are not their customers) and therefore share a commonality of interest in ensuring the integrity of the clearing system, which would not necessarily be shared by other organisations.

7.22 The HVCS, like APCA's other clearing systems, in essence provides a forum within which members consider, agree and promulgate relevant clearing standards and procedures. The advantage of membership of APCA's clearing systems is that members have the ability to contribute to the setting of such standards and procedures. The Commission notes that organisations that need to clear and settle would not be excluded from membership of APCA's clearing systems (including HVCS) by the requirement that members be 'providers of payment services'. The Commission also considers that it is appropriate that membership of APCA's clearing systems, including HVCS, be limited to those organisations that participate in the process being regulated by APCA.

7.23 The Commission notes the following recommendations of the Wallis Inquiry that are relevant to the issue of access to the payments system.

- The payment system should be regulated by the RBA under a separate Payments System Board (PSB), whose role would include the improvement of payments system efficiency, enhancing the competitive framework, and general oversight of the clearing systems.[7]

- Access to clearing systems should be widened to include all institutions fulfilling objective criteria set by the PSB.[8]

- APCA should continue to be the coregulatory body responsible for the operational and technical efficiency of the various clearing systems, however, membership of APCA should be open to any organisation approved as a payment service provider by the PSB.[9]

- The PSB should provide and regulate two types of approval in the payments system, 'clearing and settlement approval' which would be available to entities meeting appropriate prudential guidelines, and 'clearing approval' which would be available to other entities involved in payments clearing by not in final payments settlement.[10]

7.24 Although the Government has substantially endorsed these and the other recommendations of the Wallis Inquiry, they have yet to be implemented. When the PSB is established and commences its regulatory role in respect of the payments system, including the setting of objective criteria for participants in the system, the Commission, and no doubt APCA, will need to consider whether APCA's definition of 'provider of payment services' continues to be inclusive of all organisations that clear and settle.

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[7] Wallis Inquiry Recommendation 61.
[8] Wallis Inquiry Recommendation 69.
[9] Wallis Inquiry Recommendation 70.
[10] Wallis Inquiry Recommendation 77.

Financial standing and settlement requirements

7.25 The HVCS Regulations provide for one level of membership. All HVCS members must be subject (whether by legislation, mutual agreement or otherwise) to prudential supervision by the RBA, AFIC, or a State Supervisory Authority; or fall within one or more other categories involving criteria as to prudential supervision and financial standing. (These criteria for HVCS membership are similar to the criteria for 'direct settler' membership of APCS or BECS, the APCA clearing systems previously authorised by the TPC.)

7.26 The HVCS Regulations also require that, except during contingencies when the RITS/RTGS system is unavailable, settlement of payments exchanged through the HVCS occur - in real time, by exchange of value by debiting and crediting of ESAs in accordance with RBA policy, by using the RITS/RTGS system, and otherwise in accordance with all applicable laws and regulations and the applicable RITS Regulations.

7.27 HVCS members must therefore be prudentially supervised by the RBA or under the AFIC arrangements, or otherwise satisfy financial standing criteria. They must also, under the HVCS settlement provisions, satisfy the ESA and RITS/RTGS requirements of the RBA.

7.28 APCA advises that the RITS/RTGS system is the only settlement platform available to settle HVCS transactions on a real time basis. In addition, because the RTGS arrangements are an integral part of the RBA's RITS system, HVCS members must be members of RITS. The RITS arrangements are not the subject of APCA's applications for authorisation, however, APCA attached a copy of the RITS Regulations and Conditions of Operation to its HVCS submission. From these documents it is apparent that the granting and suspension/termination of RITS membership is at the discretion of the RBA.

7.29 As noted, an ESA is the only practically available means by which participants in the payments system can provide finality of settlement of their obligations to other participants in general. The provision of ESA facilities is a matter for the RBA in its role as the central bank. To date, only banks (which are prudentially supervised by the RBA) and the SSPs of building societies and credit unions (which are prudentially supervised under the AFIC arrangements), have been granted ESA facilities. (It is noted that an organisation currently able to satisfy the prudential requirements for obtaining and ESA from the RBA, will also satisfy the prudential supervision/financial standing requirement for HVCS membership.)

7.30 APCA also advises that existing RBA policy in relation to operation of ESAs by HVCS members requires settlement of HVCS payment transactions through the RITS/RTGS system to be effected by debiting the paying member's ESA and crediting the receiving member's ESA. That is, HVCS members must settle using their own ESAs and not those of other HVCS members pursuant to any form of agency arrangement.

7.31 Thus, an organisation's eligibility for HVCS membership critically depends upon the RBA granting the organisation an ESA and membership of RITS.

7.32 The Wallis Inquiry considered the role of the RBA in respect of the RTGS system and the provision of settlement facilities.

- The Inquiry concluded that, given the RBA's role in managing the liquidity and stability of the financial system, there was clear public benefit rationale for RBA ownership and management of the RTGS system.[11]

- On the provision of settlement facilities, the Inquiry's general recommendation[12] was that the RBA should continue to determine the right to hold an ESA on the basis of clear and open guidelines determined by the PSB, and that there should be no presumption that banks and SSPs would be the only holders of settlement facilities. The Inquiry also recommended[13] that the PSB should provide clearing and settlement approval to all deposit taking institutions with a banking authorisation and to other institutions and entities subject to their meeting appropriate prudential guidelines.

- In respect of high value payments the Inquiry recommended[14] that when the RBA's RTGS system becomes operational, application for high value settlement facilities should be limited to financial institutions with an appropriate business case and extensive settlement business for high value transactions on behalf of non-associated third parties, and that participants offering settlement services in the high value payments system should be prudentially regulated to the intensity of the international standard for banks.

7.33 If, in accordance with these recommendations, ESAs are made available to organisations in addition to banks and the SSPs of building societies and credit unions, any organisation granted settlement facilities for high value payments under the RTGS system would also be likely to satisfy the prudential supervision/financial standing requirement for HVCS membership.

7.34 The Commission notes that the RBA's (current and proposed) role in respect of the RITS/RTGS system and the provision of ESAs is consistent with its responsibility for managing the liquidity and stability of the financial system. However, the RBA's requirements in respect of ESAs and the RITS/RTGS system are also vital to an organisation's eligibility for participation in the HVCS, and thus its ability to compete for the provision of relevant payment services. The Commission therefore supports the recommendations of the Wallis Inquiry that settlement facilities for high value payments under the RTGS system should be made available to all organisations with the need to settle third party (customer) high value payments, provided the organisations satisfy appropriate prudential

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[11] Wallis Inquiry Recommendation 64.
[12] Wallis Inquiry Recommendation 73.
[13] Wallis Inquiry Recommendation 77.
[14] Wallis Inquiry Recommendation 74.

requirements in order to ensure the stability and integrity of the high value payments system.

7.35 The Commission recognises that the integrity of the payments system rests primarily upon the prudential soundness of those participants that are responsible for the final settlement of obligations arising from the clearing of transactions through the system. It also accepts that requiring high value payments exchanged through the HVCS to be settled in real time will result in public benefit through reduced settlement and systemic risk in the payments system as payments previously settled on a net-deferred basis migrate to the HVCS.

7.36 The Commission is satisfied the requirements that a HVCS member - meets appropriate prudential standards, has an ESA, and is a member of RITS - are likely to result in public benefit sufficient to outweigh any anti-competitive detriment likely to result from these requirements.

7.37 Following release of the Commission's draft determination in this matter, the ASC wrote to the Commission seeking assurance that the HVCS arrangements will not put at risk the arrangements made by CHESS (ASTC) with the RBA to utilise the RITS system for clearing and settlement of ASX securities transactions. Similar concerns had previously been expressed in ASTC's submission to the Commission (see paragraph 6.23 above). APCA, in response to ASTC's submission (see paragraph 6.26 above), advised the Commission that the HVCS arrangements do not address current CHESS closed user group arrangements concerning settlement in RITS. Further, it was APCA's understanding that CHESS settlements are, and will continue to be, regulated wholly under the RBA's RITS Regulations and Conditions of Operation. Based on this advice from APCA, the Commission is satisfied that the HVCS arrangements will not affect the current arrangements between CHESS (ASTC) and the RBA concerning settlement in RITS of ASX securities transactions.

SWIFT User requirement

7.38 As noted, the SWIFT Payment Delivery System (SWIFT PDS) forms the basis of the HVCS. The SWIFT PDS incorporates SWIFT's Fin Copy product, and facilitates the exchange of payment instructions electronically between HVCS members.

7.39 Each HVCS member must be a SWIFT member, sub-member or participant (SWIFT User). Admission to SWIFT as a participant attracts a lower entry fee that either membership or sub-membership. APCA notes that some prospective HVCS members are already SWIFT Users, and use SWIFT to send payments internationally.

7.40 Admission to the group of SWIFT Users entitled to use SWIFT's Fin Copy product in the HVCS, as well as suspension and termination of access to Fin Copy in the HVCS, is controlled by APCA (under arrangements between APCA and SWIFT). APCA advises that each prospective HVCS member that has applied to join SWIFT as a SWIFT User in connection with the HVCS has been admitted as such, and SWIFT has not given any indication that there would be impediments to prospective HVCS members joining SWIFT as SWIFT Users.

7.41 APCA further advises that it selected SWIFT's Fin Copy product as the basis for the HVCS following an objective industry evaluation. Brief details of this process as advised by APCA are outlined below.

- Evaluation commenced in 1994 with the RBA and APCA jointly assessing tenders received from SWIFT, Logica and RBA/Austraclear in connection with a proposed high value payments clearing and settlement system (PRESS/PDS) which was to operate on a net deferred settlement basis. However, this tender process was abandoned in 1995 when the RBA announced it would proceed instead with a proposal to introduce a real time gross settlement system to be built around RITS.

- APCA subsequently established a project to determine the industry's business requirements and specifications for interface with the RBA's RTGS system. Feasibility options for an industry-owned PDS were identified as Logica, SWIFT Fin Copy and a hybrid SWIFT/BITS (proposed by the owners/operators of BITS). SWIFT and Logica (in respect of the proposed SWIFT/BITS hybrid) were invited to respond with revised proposals. An RBA direct access 'gateway' was also proposed by the RBA as a third solution, but this was not pursued because sufficient detail was not available.

- An industry-representative team compared the SWIFT and Logica (SWIFT/BITS) proposals on the basis of their functionality, technical criteria, capital and operating costs and risk. Both options were considered feasible and able to satisfy the business requirements, however, both the financial analysis and risk assessment identified the SWIFT proposal as the preferred option.

- The SWIFT model had the advantage of lower cost and investment risk by avoiding high capital expenditure (ie, by enabling the majority of potential participants to use their existing SWIFT interfaces and infrastructure). It also had the further strong advantage of avoiding the dual delivery systems proposed under the SWIFT/BITS model. (APCA advises that dual systems are thought to create complexity and potential risks in areas such as controls, management of message flows and standards of connectivity, development and ongoing support and maintenance.)

- The SWIFT model was accepted unanimously by APCA's Board in December 1995.

7.42 The Commission notes that HVCS members must be SWIFT Users, and must use SWIFT's Fin Copy product to exchange HVCS payment messages with other HVCS members. This requirement prevents providers of alternative payment delivery products from supplying HVCS members, and prevents HVCS members from choosing an alternative payment delivery product to exchange HVCS payment messages. The Commission notes, however, that the anti-competitive effect of this requirement is somewhat lessen by the fact that SWIFT's Fin Copy product was selected as the basis for the HVCS following an objective evaluation of alternative payment delivery systems.

7.43 The Commission accepts APCA's submission that there are potential efficiencies when all participants in a payment system exchange message through the same payment delivery system, and considers that net public benefit is likely to result from the requirement that HVCS members be SWIFT Users.

Other membership requirements

7.44 The fees which HVCS members are required to pay could act as a barrier to access. It is noted that HVCS members will be charged transaction fees, and that such fees are not levied on participants in APCA's other clearing systems. However, the HVCS transaction fees will continue for a limited period of time (to full recovery of development costs, over an estimated five year period), and the Commission did not receive any submissions from interested parties that the transaction or other HVCS fees are unreasonable.

7.45 It is also noted that HVCS members 'must not impair the overall efficiency of the HVCS, not adversely affect the integrity of payments or settlements between members, or otherwise introduce a significant new risk into the HVCS'. These requirement appear to contain elements of subjectivity which could be used to deny access to the HVCS. However, the Commission is satisfied that APCA's procedural arrangements (see 'Control of HVCS and APCA' below) provide adequate safeguards against anti-competitive abuse of these membership requirements.

Suspension or termination of membership

7.46 The HVCS Management Committee may suspend the membership of a HVCS member in certain circumstances (see paragraph 4.11 above). Such decisions may be reviewed by the APCA Board. In addition, the Board may, subject to a number of prerequisites, terminate the membership of a HVCS member (see paragraph 4.12 above). The Commission is again satisfied that APCA's procedural arrangements provide adequate safeguards against anti-competitive abuse of these powers.

Control of HVCS and APCA

7.47 The responsibilities of the HVCS Management Committee include determining the HVCS operating procedures, the admission and suspension of members, the conditions of membership (including the technical standards and operating procedures with which members must comply) and the resolution of disputes. Although both large and small banks, building societies and credit unions will be represented on the Management Committee, voting entitlement at meetings of the Committee will depend on participants' share of national transaction volume. The four nationally operating banks are likely to continue to hold a majority of the national HVCS transaction volume, so that potentially the Management Committee will be able to be controlled by these banks. (Meetings of participating members would also be able to be controlled by the four nationally operating banks for similar reasons.)

7.48 Concentrating the wide powers of the Management Committee in the hands of one group raises the potential for such powers to be exercised in a discriminatory and anti-competitive way in relation to other participants or potential participants in HVCS. However, APCA points out that participating members may request the APCA Board to review any decision of the Management Committee.

7.49 The composition of APCA's Board is discussed in paragraphs 2.13 and 2.14 above. Briefly, the RBA, ANZ, Commonwealth Bank, NAB and Westpac may each appoint one director; and the state/regional bank group, other bank group, the building society industry and the credit union industry may each elect one director. At meetings of the APCA Board each of the nine directors has one vote and, normally, six votes are required to be cast in favour of a resolution for it to be passed. However, when the Board is reviewing a decision of a Management Committee, five votes are required to be cast in favour of a resolution for it to be passed.

7.50 The importance of this review power of the APCA Board was noted by the TPC during its consideration of the applications for authorisation of APCA's Memorandum and Articles of Association in September 1993. (The Management Committees of APCA's other clearing systems are also dominated by the four nationally operating banks.) In granting authorisation in respect of APCA's Memorandum and Articles of Association, the TPC in fact imposed a condition that the Articles be amended to provide that when the Board is reviewing a decision of a Management Committee, five (rather than six) votes are required to be cast in favour of a resolution for it to be passed. This condition was imposed so that the four nationally operating banks would not collectively command sufficient votes to block or veto the Board's consideration of any review of decisions by a Management Committee.

7.51 Apart from review of Management Committee decisions by the APCA Board as a means of guarding against the potential for discriminatory and anti-competitive decisions by such a Committee, the Commission notes that the RBA currently has responsibility for the overall stability of the financial system and the prudential supervision of banks. Although the RBA only has one vote on the APCA Board, the Commission would expect that the Bank will, in view of its wider responsibilities and to the extent that it is able, seek to promote competition in the payments system. (The Commission notes that the Wallis Inquiry recommendations include[15] - that the RBA should retain overall responsibility for the stability of the financial system; and that the payment system be regulated by the RBA under the separate PSB, whose

[15] Wallis Inquiry Recommendations 56 and 61.

role would include the improvement of payments system efficiency, enhancing the competitive framework, and general oversight of the clearing streams. Should these and related recommendations of the Wallis Inquiry be implemented, the RBA would have an increased regulatory role in respect of the payment system, including a role to enhance the competitive framework of the system.)

7.52 The extent to which the *Trade Practices Act* could influence the future behaviour of the major banks within the payments system will depend on the extent of any authorisations granted in respect of the system, including any conditions applied to such authorisations. Conduct which is not authorised would be subject to action under the Act. In addition, the protection provided to conduct under an authorisation can be revoked by the Commission if it is satisfied - that the authorisation was granted on the basis of information that was false or misleading in a material particular; or that any condition which applied to the authorisation has not been complied with; or that there has been a material change of circumstances since the authorisation was granted[16].

7.53 Any significant alteration in voting rights at the APCA Board level, either of individual institutions or between institutional groupings, as a consequence of mergers or takeovers between banks might, for example, provide grounds for the Commission to revoke any authorisation granted in respect of APCA's arrangements.

HVCS Procedures

7.54 The HVCS Procedures apply in respect of electronic clearing of high value transactions using the SWIFT PDS. The Procedures contain a large number of day-to-day operational requirements, some of which are outlined at paragraph 4.42 above. As noted, all participants in APCA's high value clearing system would need to comply with the Procedures. HVCS members must comply with the Procedures, and must also comply with the provisions of the SWIFT User Handbook. (The SWIFT User Handbook was not provided to the Commission with APCA's applications for authorisation, and has thus not been considered by the Commission. Any authorisation granted to the Commission in respect of the HVCS arrangements will not therefore extend to the provisions of the SWIFT User Handbook.)

7.55 The Commission recognises that the setting of operational and technical requirements which apply to all participants in a payments clearing system would be likely to result in benefits in terms of the efficiency, security and integrity of the clearing system. At the same time it is important for competition in the provision of relevant payment services, that the operational and technical requirements are set at an appropriate level so as not to unnecessarily restrict participation in the clearing system.

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[16] Sub-section 91(4) of the Trade Practices Act.

7.56 In terms of the likely effect on competition of the HVCS Procedures, the Commission would be most concerned if institutions that would otherwise be eligible to participate in the HVCS (ie, banks and SSPs, who would satisfy the ESA and RITS/RTGS requirements of the RBA for real time settlement), were prevented from participation because of the requirements of the Procedures. However, the Commission has not received any submissions to indicate that such is the case. The Commission may of course review any authorisation granted should circumstances change (including as a consequence of implementation of the Wallis Inquiry recommendations) so that organisations in addition banks and SSPs could satisfy the RBA's requirements for real time settlement, and the HVCS Procedures were found to unreasonably limit the participation of such organisations in the HVCS.

8. Determination

8.1 For the reasons outlined in section 7 above, the Commission is satisfied that in all the circumstances the arrangements and conduct the subject of these applications for authorisation:

- are likely to result in benefit the public which outweighs the detriment to the public constituted by any lessening of competition that is likely to result from the arrangements or conduct; and

- are likely to result in such a benefit to the public that the arrangements should be allowed to be given effect to, and the conduct should be allowed to take place.

8.2 On 4 March 1998 the Commission issued a draft determination proposing, subject to any pre-decision conference requested pursuant to section 90A of the Act, to grant authorisation to APCA in respect of the arrangements and conduct the subject of the applications for authorisation. No pre-conference was requested. The Commission therefore affirms its draft determination and grants authorisation to:

- APCA in respect of any exclusive dealing conduct contained in the HVCS Regulations and Procedures;

- APCA to give effect to the provisions of the contract, arrangement or understanding constituted by the HVCS Regulations and Procedures.

The authorisation also applies to or in relation to persons who become parties to the HVCS Regulations and Procedures at a time after the authorisation is granted.

8.3 This determination is made on 1 April 1998. If no application for a review of the determination is made to the Australian Competition Tribunal, the authorisation will come into force on 23 April 1998. If an application for review is made to the Tribunal, the authorisation will come into force:

- where the application is not withdrawn - on the day on which the Tribunal makes a determination on the review; or

- where the application is withdrawn - on the day on which the application is withdrawn.

8.4 The authorisation that the Commission grants in respect of applications A90617, A90618 and A90619 shall remain in force until 23 April 2008.

8.5 The interim authorisation previously granted by the Commission will continue until the date this authorisation comes into force in accordance paragraph 8.3 above, or until such further order by the Australian Competition Tribunal.