



RESERVE BANK OF AUSTRALIA

Speech

The Reserve Bank's Government Banking Business

Lindsay Boulton ^[*] Assistant Governor, Business Services

Business Banking Summit 2018 Sydney – 23 August 2018



Introduction

Thank you to the RFi Group for the invitation to speak to the 2018 Global Business Banking Summit. A key theme this year is the role that technology plays in servicing business banking customers. Few would disagree that technology plays a significant role. Its role, though, has changed over the past decade or so from supporting the provision of business services to also being a source of competitive difference. The change is particularly evident in payments, where advances in digital technologies and greater connectivity between networks are driving innovation in products and increased competition.

I would like to talk today about the banking services that the Reserve Bank provides the Australian Government as a business banking customer, highlighting the role that technology has played in an arrangement that is unique as far as government banking is concerned. I would also like to mention a couple of new payment-related services underpinned by advances in payments technology and how they may benefit business customers, including the government.

Let me start with some background on the Reserve Bank's banking services to set the scene.

Background

There are two components to the banking services that the Reserve Bank provides the Australian Government. ^[1]

The first is a core banking facility directed at maintaining a core group of accounts that the government is legally required to hold at the Reserve Bank. Maintaining central government core accounts is a service that almost all central banks provide, though arrangements vary from country to country.

The second component is a transactional banking facility. This is an account and transaction service available to government agencies to assist in undertaking their policy responsibilities and day-to-day operating expenses. [\[2\]](#)

Unlike core banking, transactional banking is not a service universally provided by central banks. In some countries it is the sole responsibility of the central bank, while in others government agencies must purchase these services under competitive pricing arrangements from commercial banks.

Arrangements in Australia are a unique mix of the two. While the Reserve Bank has authority to provide transactional banking services to the government under its charter, it competes with commercial banks under government competition policy to do so, submitting bids at tenders conducted by the agencies themselves. The Bank must cost and price its transactional banking services as a business that stands alone from its other activities, including its core banking service, and meet a prescribed minimum annual return on capital. The minimum is equivalent to the 10-year government bond yield plus a margin for risk of a few hundred basis points.

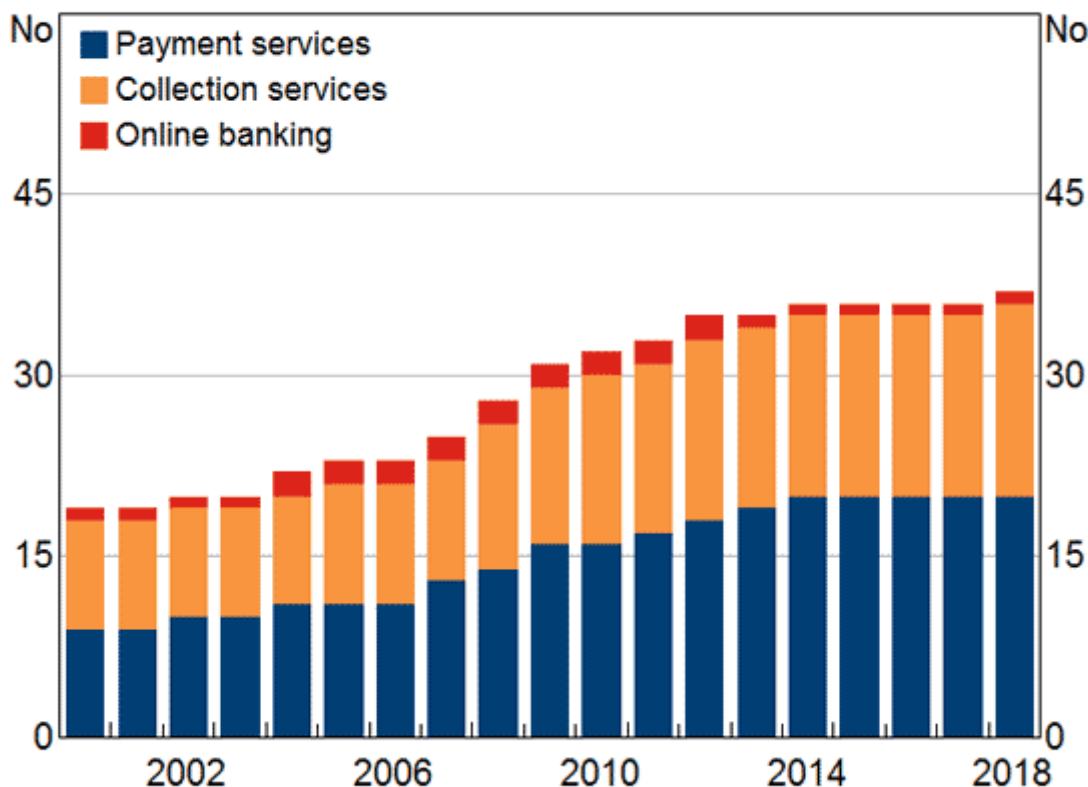
These arrangements have been in place since the late 1990s. Their objective has been to ensure, through competition, that government agencies get value for money for their transactional banking business as well as access to innovations in payments products. At the same time, maintaining core accounts at the Reserve Bank means that the government's core balances are not exposed to overnight credit risk and that the Reserve Bank can meet its responsibility to manage the impact of the government's daily cash transactions on banking system liquidity.

Allowing the Reserve Bank to provide transactional banking services to government agencies also provides a way for agencies to avoid conflicts that might arise between their policy responsibilities and their banking arrangements if they were to bank with a commercial bank.

Although it is unique for a central bank to compete to provide banking services to their central government, the Reserve Bank has been awarded business in three-quarters of the tenders for government banking business in which it has participated over the past 15 years and, reflecting a focus on meeting customer needs, more than doubled its available range of banking services (see Graph).

Graph

RBA: Government Banking Products and Services



Source: RBA

Customer numbers have also risen steadily. The Reserve Bank now has just under 100 government agency customers making in aggregate some \$1 trillion in transactions annually. Importantly, the customer base includes the largest spending and collection agencies – the Department of Human Services (DHS) and the Australian Taxation Office – which, together, comprise a significant share of the Bank's customer business.

The Bank has also met its minimum benchmark rate of return in line with the government's competitive neutrality guidelines.

Role of Technology

Several factors have contributed to these outcomes. One of these is the productivity of the Bank's service. As a rough measure, the number of Reserve Bank staff directly involved in providing transactional banking services to government customers has remained largely unchanged over the past 15 years (see Table) while, at the same time, the annual volume of customer transactions has risen by around 3¼ per cent per year.

Table: Transactions and Employment

	Average Annual Growth since 2004/05 (%)
RBA's Transactional Banking Volumes	3.2
Banking Sector Payment Volumes	5.3
Real GDP	2.8
RBA Banking Staff	0.1
Banking and Finance Sector Employment	2
Total Employment	2

Source: RBA, ABS

Another factor is the Bank's preparedness to contract and partner with third parties to provide specific payment services. In most instances, the Bank has done this to take advantage of a vendor's broader customer base. In other words, we have tapped economies of scale where, because of our customers' relatively low transaction volumes, it would not have been cost effective for us to provide a service using only our own resources. In these instances, too, our customers have generally preferred to deal with the Reserve Bank as a single provider of a bundle of payment services sourced from different providers rather than deal separately with each provider. Payment card acquiring services, for which costs are typically quite large, are an example of this.

Of course, a key factor, which, incidentally, has also underpinned our productivity, has been the application of payments technologies. To give just a few examples: online gateways have allowed the Bank to offer a virtual shopfront for receiving payments to the government without the cost of a physical branch network; increased network connectivity has meant that we can lodge the government's overseas pension payments directly into automated clearing houses in other countries rather than issue foreign currency cheques or money orders; and greater processing capacity and system resilience means that we can now process certain government payments with a tolerance of no more than 20 minutes of system downtime per year.

Not surprisingly, we now invest more in technology. The share of information technology in the total cost of the Bank's transactional banking business is now around 50 per cent compared with 25 per cent around 15 years ago.

Of course, developments in payments technology are ongoing. I would like to focus on three in particular because of their near-term potential for business banking customers: The New Payments Platform, known simply as NPP; open banking; and digital identity, which is still on the drawing board. All have benefits for business banking customers, including the government.

New Payments Platform

Launched in February, the NPP has been a collaborative effort over several years by a number of financial institutions, including the Reserve Bank. It enables individuals and businesses to make and receive payments in real time, 24 hours a day, 365 days of the year, and to send more complete

remittance information with payments. It also allows payments to be sent via a simple address, such as a mobile phone number.

Reflecting its complexity, the platform is still ramping up and additional services will come on line over the next few years. As far as the government's services are concerned, it will allow the government to make emergency payments at any time to assist individuals and households in distress. DHS currently makes in excess of 1,000 emergency payments each day across the country, more in the immediate wake of a natural disaster. Until now, given restrictions in the payments system, funds could only be fast tracked to recipients' bank accounts during business hours on Australia's south-eastern seaboard. NPP, instead, allows these payments to be made quickly at any time. The government's systems will communicate directly and securely with the Reserve Bank's, providing the government with certainty within seconds as to whether a payment has successfully reached a payee's bank account.

Similarly, the new platform allows payments by the government to be made on their scheduled dates, even if this occurs on a public holiday.

NPP also offers advantages for the government in the way its account funding arrangements are administered. Significantly, it will allow the government to undertake 'just-in-time' funding. Under protocols administered by the Department of Finance, balances needed by government agencies to fulfil their responsibilities are swept between agencies' transaction accounts and the government's core accounts at the Reserve Bank on a daily basis, with agencies required to provide up to 24 hours' notice for funds to be swept to transaction accounts. Under NPP, agencies could receive funding from the core accounts on the day they prepare the payments and, once received, make the payments in real time. Potential exists in these arrangements to minimise balances held in agencies' transaction accounts and, as a result, reduce the government's net funding costs.

Taking this further, it may be possible, in time, for government to dispense with agencies' transactions accounts and the associated daily sweep, allowing agencies to draw their daily spending requirements directly from the government's core accounts at the Reserve Bank. This could offer savings by avoiding fees currently applied on existing transaction accounts as well as increase administrative efficiency.

Finally, the ability to send more complete remittance information with a payment could reduce costs for Australian businesses making payments to the government by including remittance information within the payment message rather than sending the information via a separate channel. It could also reduce the amount of back office work required by government agencies in trying to align payments with relevant information.

Open banking

The government announced in May that it accepted the recommendations of a review into the design, operating model and regulatory framework for open banking in Australia, and will implement them in stages over the next few years.^[3] Like NPP, open banking represents a significant advance in banking arrangements, giving consumers of banking and financial services the right to access and

share their banking data with third parties, including other payment service providers. The changes will increase competition for services.

The Reserve Bank, as a banking service provider, will be participating in the open banking arrangements and is already considering ways by which our customers, along with third parties, can access their own banking data, consistent with the recommendations in the review.

It is, of course, a decision for government agencies as to how they will utilise open banking. As with any new service offering, the Reserve Bank is consulting its customers with regard to the potential advantages for their business. At the very least, government agencies may use open access arrangements to centralise the collection of their banking data, particularly where they hold accounts at more than one financial institution. This would help to streamline the flow of their banking data to their financial management systems and provide better reporting for analytical purposes.

Whatever the case, the Reserve Bank, as a service provider, intends to play a role as a holder of data that government agencies can access from services currently provided by the Reserve Bank and as a receiver of data from commercial providers of banking services to government agencies. This would reduce reporting and analysis costs for the government as well as for the institution from which the data is sourced.

Digital identity

The NPP and open banking are just two developments that offer significant benefits for business banking customers. As new payment services emerge, it will be important to manage the risks, particularly the risk of fraud and identity theft. Already in Australia, annual losses arising from payment card fraud amount to around \$600 million, much of which comes from online payments where the card is not physically present. [\[4\]](#)

The ability for individuals representing either themselves or their organisations to properly and reliably identify themselves online is essential for security as we increasingly move to online transactions. This is the case irrespective of whether the transaction is finance based, a licence application, a health insurance claim, or an application for some form of government assistance, to name just a few potential use cases.

The Australian Payments Council is currently underway with a program of work that will lead to the development and implementation of a digital identity framework in Australia. A focus of the Council's work is developing a framework that will support the creation of portable digital identities. In other words, a single framework that can be used by different organisations to verify and authenticate identity at the time transactions are taking place. This does not necessarily mean that the underlying identity system is owned and operated by a single entity, but that there is interoperability between identity services and a common set of rules by which identities are lodged, verified, authenticated, and shared. It is intended that the framework will extend beyond payments and financial services to include retail, government and the telecommunications sectors.

The Reserve Bank, through its membership of the Council, is supporting the Council's work. Whatever form it finally takes, it is important that the work to develop the framework is coordinated.

The benefits will not be fully realised if each identity service provider goes it alone, developing their own identity services with different standards, separate and unconnected to each other. This would likely result in inefficiencies, requiring individuals and organisations to maintain identities with different providers for different purposes, and leave security gaps.

Summing Up

In finishing, I would reiterate that technology has become a source of competitive difference in the payments industry over the past decade or so. The application of payments technology has certainly allowed the Reserve Bank to compete for the government's transactional banking business, delivering value for money services while, at the same time, allowing the Bank to perform its traditional role of banker to the government.

There will, of course, be more developments and further advances. The NPP, open banking, and digital identity are just three examples of technology supporting the provision of services while being a potential source of competition and innovation. It is the Bank's intention to continue providing its government banking customers with the services it needs, to make new products and services available where they offer a benefit to our business customers, and to do so in a way that is secure, reliable and provides value for money.

Endnotes

- [*] My thanks to Stephanie Connors (RBA) and Victoria Richardson (Australian Payments Network) for their contribution to this speech.
- [1] The Reserve Bank's authority to provide banking services is set out in the *Reserve Bank Act (1959)*. The Act empowers the Bank to act as banker to the Commonwealth insofar as the Commonwealth requires the Bank to do so.
- [2] The term 'agencies' refers to corporate and non-corporate Commonwealth entities as defined under the *Public Governance Performance and Accountability Act (2013)*. The term is used here for ease of expression. However, only non-corporate Commonwealth entities, which includes most government departments, are subject to the sweep arrangements.
- [3] The review was commissioned by the Treasurer in mid-2017. The Final Report – which included 50 recommendations – was delivered to the government in early 2018. See Australian Treasury (2018), 'Review into Open Banking in Australia', Final Report, February.
- [4] Data sourced from Australian Payments Network Fraud Statistics (2018), *Payment Fraud Statistics Jul 16 – Jun 17*. Available at <<https://www.auspaynet.com.au/resources/fraud-statistics/July-2016-June-2017>>. Figures updated as at April 2018.