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# ESAS Access Review: Risk Assessment Framework for ESAS

Payments NZ Limited  
submission

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27 July 2023

## Introduction

1. This submission is made by Payments NZ Limited (Payments NZ). Payments NZ believes that this consultation provides an important opportunity to define roles between it and the Reserve Bank of New Zealand (Reserve Bank) in relation to access to, and managing risks in, the payments system.
2. A key operational requirement for participation in Payments NZ's clearing systems is the ability to use ESAS to send, settle, and receive files. Therefore, all applicants must engage with the Reserve Bank in relation to access to ESAS as part of their application to become a participant in Payments NZ's clearing systems. We note that the Reserve Bank must undertake a risk assessment when deciding whether to grant an ESAS account. But Payments NZ also assesses applicants to ensure that they do not introduce significant risk into its clearing systems or undermine the integrity or reputation of the clearing systems. This includes a prudential and operational risk assessment, because existing participants must bear any settlement and operational risk when dealing with a new participant.
3. Payments NZ believes that there is an opportunity to streamline and coordinate the process for organisations wishing to become participants in the payments system to ensure that all risks are identified and appropriately assessed and, where practicable, mitigated.
4. In light of this, and indeed more generally, the consultation is timely to discuss the correlation between the Reserve Bank's requirements and Payments NZ's own requirements for admission to clearing systems.

## Risk Assessment Framework for ESAS

5. We note the Reserve Bank's view that access to ESAS should not be an unnecessary barrier to participation in New Zealand's payments system, subject to maintaining the integrity and robustness of the ESAS system. The Reserve Bank notes that the review of its access policy and criteria for ESAS accounts could result in ESAS accounts being more readily available to a broader range of institutions.
6. We support the Reserve Bank's view that opening access to a wider pool of participants could be consistent with the purpose and objectives for ESAS outlined in the consultation document to "support the efficiency of the payments system by being open to innovation and supporting competition without adding undue risk to the payments system." The Reserve Bank has identified a number of benefits, including removing reliance on agency banks. When Payments NZ was established, there was a view that it would be beneficial for all banks to operate an ESAS account to enable the Reserve Bank to more closely monitor the payment flows of the banks and to be better informed about the financial position of non-settlement banks.

7. We note that the Reserve Bank of New Zealand Act 2021 has removed the requirement for an ESAS account holder to be a “financial institution” (as previously required by the Reserve Bank of New Zealand Act 1989). We assume that the policy reason for the removal of this requirement had been to further open up access to ESAS and enable more competition in our payments system.
8. We acknowledge that new entrants may introduce risk into the payments system and that an efficient system must be safe. In terms of the risk categories set out in the consultation document, we note that some of these are more likely to impact other ESAS account holders rather than the Reserve Bank e.g. risks arising from financial, liquidity or operational issues. It is therefore essential that there are clear and risk based requirements for access to ESAS and that appropriate mitigants are put in place. We accept that if an ESAS account holder were to experience financial, liquidity or operational failures then this could give rise to a reputational risk for the Reserve Bank. However, these risks may still exist in the system, even if an ESAS account is not granted. Therefore, given that the Reserve Bank has oversight of the financial system as a whole, it is quite feasible that reputational risks could well arise even if participants in the payment system do not have ESAS accounts.
9. In the past, the Reserve Bank stated that the fact that someone had an ESAS account did not suggest in any way that the Reserve Bank had assessed or would be assessing their financial or operational capabilities. As the Reserve Bank reviews its access criteria, we believe that there should be a clear understanding of thresholds that need to be met. This would allow others, particularly Payments NZ, to take account of the assessments that are undertaken by the Reserve Bank.
10. While Payments NZ has throughout endeavoured to encourage wide participation in the payments system, ultimately one of the key issues for any new entrant has been the obtaining of an ESAS account.
11. The current consultation suggests that the Reserve Bank may take a conservative view on who will be granted an ESAS account, and that access may be confined to banks and NBDTs when they become deposit takers under the new regulatory regime. This appears to reflect an approach which favours the safety and stability of the payments system, as opposed to innovation and efficiency. Payments NZ believes that these competing interests can be accommodated through appropriate access requirements and mitigants, for example:
  - performance guarantees where required;
  - the introduction of a licensing regime for payment service providers;
  - different categories of ESAS account – e.g. push payment only.
12. The PFMI are also relevant when considering access, in particular, Principle 18 which states that an “FMI should have objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access”. The word “open” is important and

does underscore what is contemplated by the PFMI, in particular, not to unnecessarily restrict the range of newcomers to the payments system. We think this should be an important consideration for current purposes.

## **Access to Payments NZ clearing systems**

13. Payments NZ is responsible for developing and managing payment system rules and standards in New Zealand and encouraging and facilitating new entrants into its clearing systems.
14. The establishment of Payments NZ in 2010 opened up direct access to the payments system to non-banks for the first time. Before then, access to the payments system was limited to settlement banks who were members of the New Zealand Bankers' Association.
15. On the basis that Payments NZ had been established to enable wider access to the payments system and that access should not be confined simply to banks, it has spent considerable time developing and refining its access criteria. This has evolved over the last decade based on the experience we have had dealing with applicants and having regard to the PFMI.
16. We continue to review our access rules to ensure that they remain objective, fair and risk-based, without imposing any unwarranted barriers to access. In determining appropriate requirements, a risk-based approach has been taken. Payments NZ recognises that:
  - liquidity/credit risk can be mitigated through the requirement to have adequate support from a third party where necessary;
  - a key area for reputational risk is operational failure; and
  - the rules need to ensure that the independent directors can be satisfied that an applicant has the operational capability to participate in the payments system.
17. The access rules require an applicant to satisfy one overarching access criterion, namely, that an applicant will not, if it becomes a participant in a clearing system:
  - adversely affect the integrity or reputation of the clearing system; or
  - introduce significant risk into the clearing system.
18. The rules specify prudential, operational risk management, and operational requirements in relation to clearing systems and the process of determining whether an applicant satisfies the access criterion is holistic. While the procedures specify explicit requirements which must be met (e.g. an applicant must have adequate risk management policies and systems), there are other matters which the independent directors need to evaluate e.g. whether the jurisdiction of the place of incorporation of an applicant is likely to introduce risk.

19. In assessing an applicant's ability to meet the prudential and operational risk management requirements, the independent directors must:
- seek advice from a "qualified person" (an expert); or
  - get an independent report by a qualified person.

(An outline of the assessments undertaken is set out in **Appendix A** to this submission.)

20. The access rules accommodate a wide range of institutions.
21. It is noted that Payments NZ's clearing systems (settlement before interchange and high value) operate using a decentralised model, and there is no clearing house. All direct settlement participants connect directly with the Reserve Bank's ESAS system via SWIFT. High value clearing system participants are members of the AVP closed user group (owned by the Reserve Bank) and SBI/BECS participants are members of the SBI closed user group (owned by Payments NZ).

## Integration of roles

22. As the Reserve Bank appears to be looking at separate assessments when determining whether to grant an ESAS account, Payments NZ believes there is an opportunity to give serious consideration to the integration of the work of the Reserve Bank and that of Payments NZ. This might involve the following:
- a gap analysis between what the Reserve Bank is proposing to do and what Payments NZ is currently doing so that any duplication between the two can be identified;
  - expansion of the legal risk assessment being proposed by the Reserve Bank to a full risk assessment and which could encompass issues or matters which Payments NZ currently assesses as part of its criteria when evaluating new entrants (noting that there may be particular matters specific to payments clearing that Payments NZ may still wish to assess);
  - the Reserve Bank's operational risk assessment being focussed on linkages between the new application and the ESAS system solely. It would be sensible for Payments NZ to continue with the testing that it does, given the testing requirements that have been developed and our experience with these. The relationships with participants over the years are also extremely valuable.
23. On this basis, Payments NZ could then consider admissions to the payments system subject only to operational testing requirements (and any specific matters relating to clearing systems), where an applicant had already been granted an ESAS account by the Reserve Bank. In these circumstances, the granting of an ESAS account by the Reserve Bank would, effectively, be a "passport" into the payments system. As understood, this would also be similar to the approach which is employed in Australia.
24. Overall, Payments NZ is concerned to avoid duplication between Reserve Bank processes and its own processes, in particular, so as to not to slow down applications

and so as to minimise costs for new applicants. But more pertinently, it would be in the interests of efficiency.

## Concluding comments

25. The ESAS consultation raises important matters we believe between the Reserve Bank and Payments NZ and we would be open to further discussion on what could be done to better align what each of us should be doing. We think this would be more constructive and worthwhile rather than responding to the specific questions in the consultation. Our objective should be to avoid overlap and to harmonise the requirements for each of our purposes. This also may be important with the approach of designation and the need to specify the rules under section 29 of the Financial Market Infrastructures Act 2010.

A handwritten signature in blue ink, appearing to read 'S. Wiggins', followed by a horizontal line.

Steve Wiggins  
Chief Executive  
Payments NZ Limited

## Appendix A

# Applications to participate in Payments NZ clearing systems

### *Prudential assessment*

1. Payments NZ currently undertakes a prudential assessment of applicants wishing to join its clearing systems as part of the access process. This is primarily because of the risks that may arise when new participants will be dealing with existing participants. While much of the settlement risk has been reduced through settlement before interchange and half hourly settlement, there is still some residual financial risk in relation to the settlement of EFTPOS and ATM transactions borne by participants.
2. Payments NZ has also taken the view that there are efficiency and reputational issues for the payments system if a participant should fail. On this basis, for example, Payments NZ has options for requiring standby liquidity facilities and guarantees before permitting access to parties that are not prudentially regulated or that do not have a sufficiently strong credit rating.

### *Operational risk assessment*

3. Payments NZ does a comprehensive review of an applicant's operational risk management systems. This risk assessment is not confined to legal risk. Indeed, we do not regard legal risk as a particularly significant risk as it can be mitigated relatively easily (and as the Reserve Bank does in relation to access to NZClear where it simply requires a legal opinion on the status of new entrants). Furthermore, much of the legal risk is also mitigated because of the designation status of ESAS. Significantly, its rules prevail over any laws to the contrary and particularly any clawback risk that might otherwise exist with the financial failure of an institution.

### *Operational assessment*

4. Importantly, Payments NZ undertakes a comprehensive operational assessment which ultimately involves the testing of the new participant's systems with those of existing participants. This is done to ensure that files can be transmitted, settled and interchanged without error.