

paymentsnz



Strengthening Statutory Payment Oversight Powers

Submission to the Reserve Bank of New Zealand
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1. INTRODUCTION

- 1.1 Payments NZ Limited ("**Payments NZ**") is the key stakeholder in the governance of New Zealand's payment system, with primary responsibility for setting payment standards in New Zealand for "pure payment systems".¹ Payments NZ is made up of a team of industry specialists. It oversees the main payment systems in New Zealand and, in that capacity, provides thought leadership, change management and ensures compliance with relevant payment standards.
- 1.2 This submission focuses predominantly on the respective roles of the Reserve Bank of New Zealand ("**Reserve Bank**") and Payments NZ in relation to pure payment systems. It does not specifically address the elements of the Reserve Bank's Consultation Document "*Strengthening Statutory Payment Oversight Powers*" ("**Consultation Document**") relating to securities and settlement systems, which are jointly regulated or specific to the over-the-counter derivatives market.

2. EXECUTIVE SUMMARY

- 2.1 Payments NZ notes that during the global financial crisis there were no failures in New Zealand's payment systems, or indeed any hint of it. While metrics are hard to find, New Zealand is widely regarded as one of the soundest and most efficient payment systems in the world. For example, it has the lowest per capita cash in circulation and highest usage of electronic transactions. With the introduction of Settlement Before Interchange ("**SBI**"), the introduction of real time gross settlement (in the 1990s), and the fact that the New Zealand dollar is one of only 17 currencies in CLS Bank,² New Zealand must also have one of the soundest payment systems in the world.
- 2.2 Even internationally, IOSCO and the Committee on Payment and Settlement Systems ("**CPSS**") acknowledge that payment systems did not fail during the global financial crisis. There is no market failure or regulatory failure in New Zealand that urgently needs addressing.
- 2.3 Nonetheless, Payments NZ acknowledges the fact that there is movement internationally to ensure that regulators have more powers to effectively oversee and deal with failings in payment systems. This is detailed in the *Principles for financial market infrastructures*³

¹ In this submission, "pure payment systems" refers to systems that provide solely for the transfer of funds – this is wider than the use of "pure payment system" in the Reserve Bank of New Zealand Act 1989, which only uses the term in the context of a "designated" system.

² See <http://www.cls-group.com/About/Pages/Currencies.aspx>.

³ The PFMI's were published by CPSS and IOSCO in April 2012 and are available at: <http://www.bis.org/publ/cpss101a.pdf>.

("PFMIs") issued by CPSS and IOSCO, and the Financial Stability Board's ("FSB's") recent peer review report in respect of the *Key Attributes of Effective Resolution Regimes for Financial Institutions* ("Key Attributes"). Payments NZ accepts that, in this international context, some strengthening of statutory powers for the Reserve Bank and the Financial Markets Authority ("FMA") is warranted. However, it believes that any exercise of powers by the Reserve Bank needs to be limited to situations of crisis management or material concerns in relation to a payment system. This needs to be on the basis of a clear specification of the statutory grounds for exercising the powers, the purposes for exercising the powers and the scope of the powers, together with a strong degree of transparency and accountability by the Reserve Bank and FMA in respect of any exercise of the powers.

- 2.4 Many jurisdictions are currently in the process of reviewing their oversight powers in respect of their payment systems, although relatively few have actually adopted the relevant international principles yet, which, in the case of the FSB's Key Attributes, are barely two years old (with the PFMIs being even newer). New Zealand has a valuable opportunity to assess, and learn from, the approaches that jurisdictions such as Australia, the UK or Canada take, rather than moving too quickly to implement reforms. The process for designing the proposed statutory reforms needs to be a considered and consultative one.
- 2.5 Given there is no market or regulatory failure, and New Zealand is not lagging behind the world in considering payment system powers, there is no need for haste in making change or in truncating the consultation process. Sufficient time should be taken to ensure New Zealand gets the policy and implementation right. With this in mind, the short timeframe for consultation on the Reserve Bank proposals through to implementation is questioned. A longer period for consultation is justified given the magnitude of the statutory proposals, the lack of detail in the current set of proposals, and the benefit of being informed by parallel developments in other countries.
- 2.6 Payments NZ believes that it is important that the statutory powers are developed in a way that is appropriate to the New Zealand payment and settlement systems and the New Zealand regulatory environment. This development should recognise the valuable role Payments NZ plays in ensuring the safety and efficiency of the payment system. Payments NZ, with their participant organisations and their team of specialists, provide leadership on many of the payment industry's issues. Its oversight of the payment system, management of compliance, and promotion of important industry changes have undoubtedly contributed to the current stability of the New Zealand payment system. Payments NZ believes that proposals should recognise the current efficiency of market-led initiatives in the New Zealand payment system, which is supported by the ability of entities (like Payments NZ) to be pro-active in an environment of "self-governance", rather than being reactive in accordance with Reserve Bank or Government led mandates.
- 2.7 Payments NZ accepts the important role that the Reserve Bank should and does play in overseeing the payment system. However, this role and associated statutory powers need to be developed in the context of Payments NZ's existing responsibilities and

successes as the “frontline” standard-setter and compliance monitoring agent in the payment system. The proposed reforms should build on, and not detract from, this existing model. The proven success of the current self-governance model reduces the need for an extensive regulatory regime.

2.8 With regard to the development of oversight powers, Payments NZ particularly stresses the need for:

- (a) greater clarity on the rationale for the proposed powers – i.e. the market failures and externalities that the powers are intended to address – this is a prerequisite for any proposals for new powers;
- (b) more information on how the proposed powers would fit within the regulatory architecture applicable to the payment and settlement systems and, in that context, the intended nature and scope of the regulatory and supervisory framework that the Reserve Bank would like to develop;
- (c) a more focused discussion on how the proposed powers fit within the three “pillars” that characterise financial system architecture in New Zealand – i.e. “self-discipline”, “market discipline” and “regulatory discipline” – and, in particular, how the proposals sit with the role of Payments NZ as the standard-setting body for a major part of the payment system;
- (d) greater clarity as to the precise statutory purposes for which the proposed powers may be exercised (possibly modelled on those in Part 5C of the Reserve Bank of New Zealand Act 1989 (the “**Reserve Bank Act**”)), and the importance of clear and conceptually well-founded definitions of “system”, “soundness” and “efficiency”;
- (e) greater clarity as to whom each of the powers would apply (noting the differences suggested in this submission) and to what events (especially given the potential for conflict between regulators), as well as the grounds on which the powers may be exercised, the processes applicable to the exercise of the powers, the rights of affected parties, and the precise scope and nature of the powers. In particular, powers should be exercised against entities within systems, rather than against the systems themselves. Moreover, Payments NZ does not understand why some systems and entities have been included, while others have been excluded, from the proposed scope of the powers. Clarification on this is requested; and
- (f) the legislation to require the Reserve Bank and the FMA, respectively, to clearly set out their proposed approach to the exercise of the powers, and to consult with affected parties in the course of doing so, consistent with international principles relating to the transparency and accountability of regulators.

2.9 While the submission's primary focus is on pure payment systems, Payments NZ believes that there should be robust coordination between the Reserve Bank and the FMA throughout this process and that this is important in relation to the development of supervisory arrangements and the exercise of regulatory and crisis resolution powers.

Although this might not (currently) be a significant issue for the systems overseen by Payments NZ, it is nonetheless a key issue in the architecture of the new regime. At some future point, aspects of FMA-regulated settlement systems might have implications for "pure" payment systems and thereby affect Payments NZ.

3. KEY RECOMMENDATIONS – FURTHER CONSULTATION REQUIRED

3.1 As the Consultation Document is lacking in many key details, and given the importance of getting policy and practice in this area right, Payments NZ recommends that:

- (a) The Reserve Bank engage in a further round of public consultation on the proposals in the Consultation Document. This is on the basis that Payments NZ strongly believes that a more detailed set of proposals needs to be constructed and tested. This further round of public consultation might appropriately be coordinated with the FMA, with a view to achieving a consistent approach from both regulators.
- (b) As part of the next stage of the consultation process, Payments NZ believes that industry workshops, with both the Reserve Bank and the FMA, would be appropriate.

3.2 In the further round of consultation, greater thought should be given to the following issues:

- (a) Given the important role Payments NZ has in pure payment systems, and the expertise and resources it has, specific consideration should be given to clarifying Payments NZ's role in relation to the Reserve Bank's role (especially in terms of market and industry-led initiatives versus Reserve Bank-led initiatives in respect of standard-setting, monitoring and enforcement), with consideration given to models such as:
 - (i) the role of trustees with the Reserve Bank in relation to Non-Bank Deposit Takers ("**NBDTs**");
 - (ii) NZX's role with the FMA;
 - (iii) the Gas Industry Company's role with the Ministry of Business, Innovation, and Employment ("**MBIE**"); and
 - (iv) other relevant international models (to be identified during further consultation).
- (b) Rather than simply replicating the powers that the Reserve Bank has in respect of banks, NBDTs and insurance companies for the payment system participants, greater thought needs to be given to the justification for the proposed powers and their proposed scope and nature, and also to which legal entities would be subject to the powers (as opposed to which systems they apply to). This is especially relevant given the very different nature of many participants in payment systems. Any exercise of powers by the Reserve Bank needs to be limited in scope to crisis management or material concerns in relation to a payment system.

- (c) Whether amending the Reserve Bank Act is even the best tool to implement reform for the payments system. A number of similar jurisdictions, such as Canada and Australia, have separate legislation to cover payment systems.

3.3 Payments NZ also believes that a regulatory impact statement should be provided with these proposals.

4. THE CURRENT STATE

Payments NZ's objectives

4.1 While all of this background will be familiar to the Reserve Bank, Payments NZ feels that it is helpful for this public submission to provide a background on its current role and its relationship with the Reserve Bank.

4.2 Payments NZ was established on 1 October 2010 with the objectives of (amongst other things):⁴

- (a) managing the payment system rules;
- (b) promoting inter-operable, innovative, safe, open and efficient payment systems; and
- (c) encouraging and facilitating new entrants to become participants in payments systems, based on fair and reasonable public access criteria.

4.3 The objectives of promoting a "safe" and "efficient" payment system are very similar to the Reserve Bank's objectives in relation to key financial systems generally of "promoting a sound and efficient financial system". Payments NZ believes that the alignment of the Reserve Bank and Payments NZ's objectives is important, as it will enable Payments NZ to facilitate key Reserve Bank policy objectives in relation to the payment system. However, it is important that unnecessary duplication of functions, and any inconsistency of standards, between Payments NZ and the Reserve Bank (and the FMA), be avoided.

Payments NZ's decision making powers and what Payments NZ has achieved

4.4 Payments NZ has been established with a Board that includes three independent directors. The combination of those three independent directors, with the ability of the Board to make decisions by majority, means Payments NZ can operate much more effectively than historically was the case with the New Zealand Bankers' Association ("**NZBA**"). Under the NZBA constitution, all changes had to be unanimous.

4.5 Payments NZ believes that this has already resulted in a dramatic improvement in the time it takes to effect change in the payment system. Since Payments NZ has been established it has:

- (a) delivered the SBI project (which was a market-led, rather than a Reserve Bank mandated, project);

⁴ See clause 2.2 of the Payments NZ constitution.

- (b) introduced common standards for domestic EFTPOS transactions in New Zealand;
- (c) introduced transparent access criteria for admission to the payment system (including in relation to testing and technical requirements, the allocation of interchange numbers, and providing for access decisions to be made by the independent directors only);
- (d) agreed a common set of business requirements to operationalise the Reserve Bank's Open Bank Resolution ("**OBR**") policy;
- (e) introduced improved resilience requirements and an industry incident management plan, responding to the payments problems that occurred on ANZAC Day 2012; and
- (f) largely completed standards for ATMs.

4.6 In many instances, changes have been made in response to conditions or reservations expressed by the Reserve Bank (for example in relation to the Consumer Electronic Clearing System ("**CECS**") not being a clearing system, allocation of interchange numbers, and the lack of transparency in relation to access criteria). All of these changes have occurred dramatically faster than had previously been the case through the NZBA. Payments NZ already has a substantial record of deliverables, and its effectiveness is increasing as it becomes more experienced and integrated into the fabric of the payments system.

4.7 Accordingly, Payments NZ believes one of the key concerns raised in the Consultation Document, relating to the pace of change within the industry, has already been delivered. Therefore, Payments NZ believe it more productive – and indeed, far more relevant – to focus on international developments and principles, and any real and identified deficiencies in New Zealand's capacity to respond effectively to payment system market failures or crises, as the rationale for new statutory powers.

5. INTERNATIONAL CONSISTENCY

5.1 As stated, an important consideration in the development of the payment and settlement system regulatory proposals is their degree of consistency with relevant international principles. The increasing scrutiny of compliance with international standards and codes, and the risk of being seen as a non-compliant jurisdiction, are also important considerations.

5.2 Notwithstanding these considerations, there is equally a need to ensure that any proposed regulatory framework is fit for purpose for New Zealand, having regard to New Zealand's market structure, institutional arrangements and public policy objectives. A sensible balance needs to be struck, such that international principles are applied in ways that cost-effectively meet the particular circumstances of payment and settlement system arrangements in New Zealand.

- 5.3 As noted in the Consultation Document, the most relevant international principles are those developed by CPSS and IOSCO, particularly the CPSS/IOSCO PFMLs, as well as the FSB's Key Attributes. These provide the main international reference points for the responsibilities of payment and settlement system regulators, and for crisis resolution in respect of financial market infrastructure.
- 5.4 Of equal pertinence, but not mentioned in the Consultation Document, is the International Monetary Fund's ("**IMF**") *Code of Good Practices on Transparency in Monetary and Financial Policies* (the "**IMF's Code of Good Practices**").⁵ The IMF's Code of Good Practices sets out some fundamental principles that apply to the transparency and accountability of financial sector regulators. These principles are applicable to the Reserve Bank and the FMA in respect of payment and settlement system regulation, particularly regarding the need for clarity and transparency of regulatory objectives, policies, principles and practices, consultation with affected parties, and accountability arrangements in the discharge of regulatory functions. These principles are also relevant with regard to the need to establish and maintain a clear delineation between the responsibilities of the regulatory agencies (especially the Reserve Bank, the FMA and the Commerce Commission), the identification of a lead authority in each functional area, and robust and transparent coordination arrangements.
- 5.5 Consistent with the international principles above, Payments NZ would make the following points:
- (a) It is important that the regulatory proposals are developed transparently and in consultation with affected parties, taking into account the views and legitimate interests of all stakeholders. A second round of consultation, over an appropriate time-frame, is essential in that regard. The current consultation document does not provide sufficient information for meaningful consultation on the rationale for, and nature of, the proposed regulatory and supervisory arrangements for the payment and settlement systems, and for crisis resolution. With that mind, some affected parties may not even be aware that they are affected, due to the current lack of certainty and detail in the Consultation Document.
 - (b) The proposals need to establish clarity with respect to the roles and responsibilities of each regulatory agency on a transparent and accountable basis, and how those roles and responsibilities sit with the responsibilities of private sector overseeing bodies (such as Payments NZ). Duplication of function and any inconsistency of approach to regulation, information-gathering, supervision and crisis resolution should be avoided where practicable.
 - (c) There is a need for clarity as to the precise nature and scope of all proposed statutory powers, the statutory purposes for which they may be used, to whom they would apply, the statutory grounds for invoking specific powers, the processes to be required under law for the exercise of the powers, and protection of the rights of affected parties. In particular, we draw the FSB's Key Attributes principles relating

⁵ See <http://www.imf.org/external/np/mae/mft/index.htm>.

to the safeguards applicable to crisis resolution powers to the Reserve Bank's attention.

- (d) The regulatory proposals should be developed in liaison with relevant international regulators, particularly in Australia, to avoid unnecessary and undesirable inconsistency in approach. A degree of coordination between New Zealand and Australia regarding the design and implementation of supervisory and crisis resolution arrangements will be important when drafting the Bill. The implementation of a similar provision to section 68A of the Reserve Bank Act (regarding "Trans-Tasman co-operation") should also be considered.
- (e) Once the matters above are developed and clarified further, they need to sit within a clear statutory framework. The framework should require the regulators to regularly publish their policies, principles and practices with respect to payment and settlement system regulation, supervision and crisis resolution, and to do so after full consultation with affected parties in accordance with international best practice. The statutory framework should be underpinned by robust coordination arrangements between the Reserve Bank, the FMA and the Commerce Commission, again with these being developed in consultation with affected parties and documented transparently. The regulators should be subject to appropriate scrutiny by Treasury, ministers and Parliament.
- (f) The adoption of key statutory terms, such as "system", "systemically important", "soundness" and "efficiency" need to be clearly defined in consultation with affected parties, and broadly aligned to international principles.

5.6 Payments NZ would like to see further details in relation to all of these areas in a second consultation document, with a view to having a high-quality, transparent, collaborative and accountable process for policy development in all of these areas.

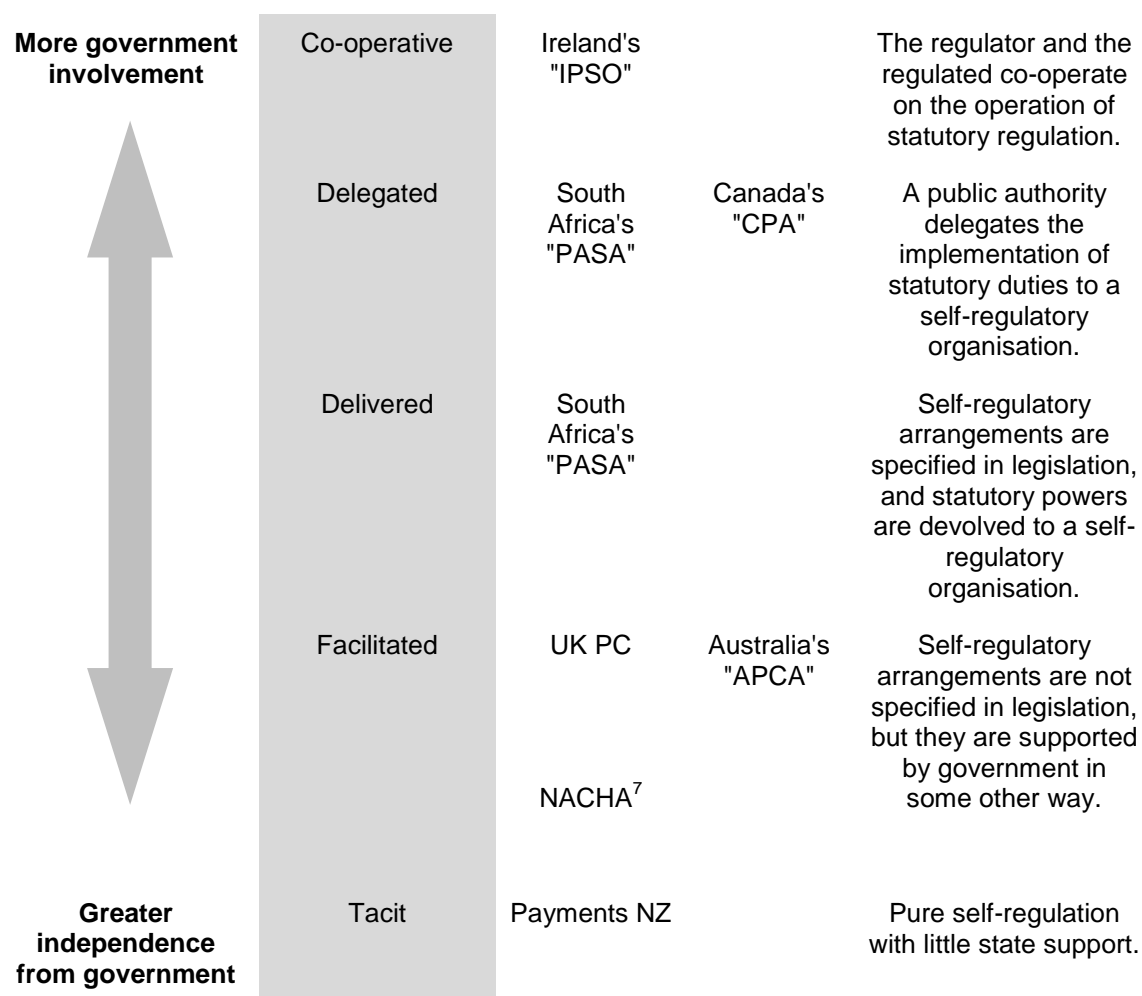
International Payment Standards Bodies

5.7 Payments NZ is a member of the International Council of Payments Association Chief Executives ("**ICPACE**"). The members of ICPACE are:

- (a) Australia;
- (b) Canada;
- (c) Ireland;
- (d) New Zealand;
- (e) South Africa;
- (f) United Kingdom; and
- (g) United States of America.

5.8 ICPACE undertook a comparative survey of its members in 2011 (the "**ICPACE Survey**"), looking at payment system oversight and governance, retail clearing system structure and governance, retail clearing and settlement operations and efficiency and innovation in retail governance. The results of the ICPACE Survey were reported in April 2012 and reinforced the Reserve Bank's view that New Zealand currently has the most "light handed" approach to payments industry oversight and governance. However, it also concluded that the degree and scope of oversight varies widely amongst members – as can be seen in the ICPACE Survey's diagram that shows payment systems' self assessment of the role of their various oversight bodies:⁶

Figure 1: Spectrum of Self-Governance



5.9 Payments NZ believes that it is important that the Consultation Document explicitly considers the role of a payment standards body, such as Payments NZ, in light of New Zealand and international experience. The Reserve Bank has a valuable opportunity to draw from the experience, strengths and weaknesses of the models (shown in Figure 1) adopted in the various ICPACE countries in this respect. Wider and more extensive consultation will allow for a better evaluation of the different options available to New

⁶ Adapted from the ICPACE Survey at p2 and the ICPACE "Principles of Payments Industry Self-Governance" (November 2007) at 6.

⁷ National Automated Clearinghouse Association, which oversees the development, administration and governance of the Automated Clearing House system.

Zealand – a proper assessment is not possible in the short time frame for the current consultation.

- 5.10 The Organisation for Economic Co-operation and Development's ("OECD") *Guiding Principles for Regulatory Quality and Performance* (the "**OECD Guiding Principles**") also provide further insight on industry governance and regulation:⁸

Good regulation should: (i) serve clearly identified policy goals, and be effective in achieving those goals; (ii) have a sound legal and empirical basis; (iii) produce benefits that justify costs, considering the distribution of effects across society and taking economic, environmental and social effects into account; (iv) minimise costs and market distortions; (v) promote innovation through market incentives and goal-based approaches; (vi) be clear, simple and practical for users; (vii) be consistent with other regulations and policies; and (viii) be compatible as far as possible with competition, trade and investment-facilitating principles at domestic and international levels.

- 5.11 Looking to Figure 1, above, and based on the OECD Guiding Principles, Payments NZ believes that a "facilitated" model could potentially be appropriate for the New Zealand market. This would recognise the important role Payments NZ has in delivering soundness and efficiency in the pure payment systems for which it sets standards (as reflected in the success of self-governance thus far), without undermining the Reserve Bank's ability to intervene in the event of systemic soundness issues, or interfering with the ability of the Reserve Bank to set an agenda for the industry in close consultation with the industry (much as the Reserve Bank has done to date). A "facilitated" or a "delivered" model could strengthen Payments NZ's ability to deliver and would avoid the need for the Reserve Bank to increase its resources and operational expertise in order to give it the ability to intervene at a detailed level in the market (especially as evidence suggests that this tends to adversely affect efficiency).

- 5.12 The short time frame for consultation means that it is premature at this point to settle on one specific and optimal model as the best fit for industry governance in the New Zealand market. The options available need to be assessed after consultation with key industry players – including Payments NZ and its members. Once again, this highlights the need for a second round of public consultation and industry workshops.

Consistency of the Reserve Bank standards with the PFMI

- 5.13 Payments NZ notes that the Reserve Bank has acknowledged that it has not updated the Reserve Bank's current payment standards (currently *PS1*)⁹ to align itself with the CPSS/IOSCO principles, in light of the release of the PFMI.
- 5.14 Given that much of what the Reserve Bank is proposing in the Consultation Document is referenced to the PFMI, Payments NZ believes that it is important that the Reserve Bank's current payment standards are updated to reflect these and that this is done as part of the next consultation phase. Payments NZ notes that the Consultation Document

⁸ OECD Guiding Principles (2005) at 3.

⁹ Statement of Principles (PS1), Reserve Bank of New Zealand, August 2005: <http://www.rbnz.govt.nz/finstab/payment/1911038.pdf/>.

states that the Reserve Bank will be consulting on this later in the year. However, Payments NZ questions why this is not occurring before, or at least contemporaneously with, any legislative change to the Reserve Bank's statutory payment oversight powers. Payments NZ already acts to align itself with the CPSS/IOSCO principles by operating to the PFMLs, with all rule changes presented to the board being assessed against them and accompanied by a reasoned legal opinion.

- 5.15 Payments NZ believes that a significant factor in ensuring that New Zealand adopts global best practice in relation to governance and oversight of its payment systems is being able to ensure consistency with the PFMLs (or at least understanding and having good reason for departing from them).

6. SCOPE OF THE OVERSIGHT

Recognised Systems

- 6.1 Payments NZ accepts that the Reserve Bank may need greater oversight over systemically important payment systems. We favour the "recognition" regime which the Reserve Bank is suggesting. However, Payments NZ stresses the importance of developing transparent criteria for determining when a system is systemically important. This should, ideally, be done in consultation with the affected parties; legislation should require this. It is also important that such criteria are developed in a manner that draws from the international principles, such as those of CPSS/IOSCO, as those bodies already provide clear guidance in this area. As stated above, Payments NZ believes that consistency with international principles is important (within the context of the New Zealand payment industry) unless there are clearly articulated and convincing reasons for departing from them.
- 6.2 Payments NZ notes that the Reserve Bank's approach to ensure greater oversight over the financial system is broadly consistent with Payments NZ's core approach – Payments NZ's approach is to maximise the coverage of its rules and standards to ensure end-to-end coverage within the payments system. Therefore, Payments NZ agrees that the Reserve Bank should act similarly to ensure that they have appropriate oversight of clearing and settlement systems.
- 6.3 In relation to what systems will be "recognised" – Payments NZ notes that the Consultation Document refers to the SBI system as a system that is likely to be brought in as a "recognised system" (along with wholesale systems). Payments NZ notes that, in Hong Kong, for example, retail payment systems are not regarded as systemically important and are not covered by the Hong Kong Monetary Authority's oversight. This acts to reinforce the need for clarity on what is systemically important and what is covered by the recognition regime. The impact of the recognition of SBI on Payments NZ itself is discussed below.
- 6.4 Payments NZ also believes that, because of the high values transacted through the High Value Clearing System ("**HVCS**"), it is one example of a system that should be seen as systemically important. However, for reasons that are not clear to us, HVCS is not

mentioned in the Consultation Paper. Payments NZ would like to understand what criteria were applied, and how, in order to exclude HVCS.

- 6.5 Furthermore, in terms of other issues in relation to recognising systems, CECS is becoming increasingly important as the primary system for clearing (and ultimately settling) consumer-to-merchant payments. If not systemically important (which arguably it is), CECS is likely to be politically and socially important, given the disruption caused to millions of customers if it were to fail.
- 6.6 Again, the above examples reinforce the need for consultation over what constitutes "systemically important" and how that term is to be applied in the context of payment and settlement systems.
- 6.7 Payments NZ also believes that any definition of a systemically important system needs to be broad enough to potentially cover not only domestic EFTPOS but also, in future, payment systems and infrastructure provided by the global payment card companies such as Visa and MasterCard.
- 6.8 There are a range of other participants in the payment system who are likely to be equally as important, if not more important, than some specifically referred to in the Consultation Document (such as Poli and Snapper). Some of those systems listed in the Consultation Document are potentially smaller and more minor players than some organisations that are not listed – there appears to be a lack of consistent criteria for inclusion.
- 6.9 Therefore, with the rapidly evolving nature of the payment system in New Zealand in mind, Payments NZ does not agree with the Reserve Bank's definition of "system". It is too wide and a lack of detail means that it does not currently capture the appropriate entities. Payments NZ believes it is important to be particularly clear on the criteria for recognising payment systems and that such criteria do not to allow regulatory arbitrage to occur. More detailed definitions could be broken down as follows:
- (a) clearing system;
 - (b) settlement system;
 - (c) payment system operator;
 - (d) payment system participant;
 - (e) payment system standards body; and
 - (f) payment system clearing house.
- 6.10 Alongside this, Payments NZ believes that certainty is necessary regarding the applicability of the Financial Services Providers (Registration and Dispute Resolution) Act 2008 (the "**FSP Act**") to payment system entities, in terms of any new regulatory powers. The various payment and settlement systems participants and service providers should be listed in ways that clearly differentiate their respective responsibilities under any new regime. Given the importance of the network nature of the payment system,

Payments NZ believes that a list of participants would also be particularly helpful to ensure greater transparency. In that regard, who is and is not on that list should be subject to a clear and transparent set of criteria. The Reserve Bank is the appropriate body to have the list, given that they will be primarily responsible for those on it (as opposed to the FMA). Payments NZ also believes that a list rather than a "register" may be more appropriate and more practical.

Recognised systems – effect on Payments NZ

- 6.11 While Payments NZ generally supports the Reserve Bank approach of recognising payment systems, it is not entirely clear from the Consultation Document what this means for Payments NZ. Payments NZ is not specifically referred to in any of the diagrams contained in the Consultation Document. It does, however, set and monitor enforcement of standards for three key clearing systems. The most important of these is SBI, which the Reserve Bank has suggested should be included within the recognition regime.
- 6.12 Payments NZ currently governs and oversees SBI. SBI is an example of self-governance driving and delivering market-led initiatives, in this case led by Payments NZ, rather than needing to be led by a Reserve Bank mandate. Payments NZ sets the Rules and Standards for SBI, as well as being responsible for its resilience and for managing the industry incident management plan. Participants in the payment system gain access to SBI through and via Payments NZ. Payments NZ is also the closed user group administrator for the SBI system. In terms of how SBI works, Payments NZ also defines the service expectations from both SWIFT and ESAS.
- 6.13 Therefore, at least in relation to SBI, it would appear that Payments NZ would be regarded as a systemically important payment "system" or system overseer. Whether SWIFT would also be covered as a systemically important payment "system" in relation to SBI and how, or in respect of whom, the Reserve Bank would exercise its powers even though it has only a relatively limited operational role, is not clear.
- 6.14 Payments NZ would also fall within the definition of "systems" used in the Consultation Document on the basis that it is involved in:
- (a) the design and operation of the payments system;
 - (b) business continuity arrangements;
 - (c) the availability of data and information from, or relating to, payment systems (possibly);
 - (d) the rules;
 - (e) governance structures; and
 - (f) market practices and behaviours (possibly).
- 6.15 While it is unclear from the Consultation Document, Payments NZ assumes that the impact of the inclusion of Payments NZ as a system will be in relation to clearing systems

governed by Payments NZ's rules and standards, and that Payments NZ is likely to be subject to the application of additional powers from the Reserve Bank in relation to:

- (a) information gathering;
- (b) directions; and
- (c) in an extreme case, statutory management.

6.16 Nonetheless, Payments NZ would like to clarify the above with the Reserve Bank. Payments NZ reiterates the earlier point that there is a need for greater clarity as to the role of the Reserve Bank in setting and enforcing standards, and monitoring payment systems that are overseen by Payments NZ, as opposed to Payments NZ's role in this regard. Importantly, we wish to clarify the extent to which the Reserve Bank is looking to rely on Payments NZ as the standard-setting and supervisory body (for example, on things like governance, operational robustness requirements, crisis preparedness, testing arrangements, etc) for the systems under the Payments NZ umbrella, with the Reserve Bank predominantly focusing its supervision on Payments NZ itself.

6.17 Therefore, in relation to potential effect on Payments NZ, further clarity is required as to:

- (a) the nature of the standards and conditions that the Reserve Bank has proposed it would specify, versus the (more detailed) rule setting by Payments NZ;
- (b) the nature of the monitoring that the Reserve Bank proposes to undertake of the payment systems under Payments NZ's jurisdiction, as opposed to relying on Payments NZ to do this; and
- (c) the distinction to be drawn between the Reserve Bank's enforcement and intervention, and that of Payments NZ, in respect of the systems overseen by Payments NZ.

Recognised systems versus current designation system powers

6.18 Payments NZ agrees with the Reserve Bank that the recognition system is more appropriate than extending the current designation system to additional clearing systems and extending the powers to compulsorily designate systems.

6.19 The designation system powers, as the Reserve Bank point out, were initially included to ensure that key settlement systems, such as the Exchange Settlement Account System ("ESAS") and the Continuous Linked Settlement System ("CLS"), could provide for irrevocable settlement (i.e. settlements could not be done either because of ineffective netting requirements or because of the susceptibility of settlements to "claw backs"). These goals remain valid for these settlement systems. However, the goals are less relevant or important to clearing systems that use a designated settlement system to settle through. Accordingly, Payments NZ favours retaining the designation approach for the purposes for which it was originally intended.

6.20 Overall, while designated systems are also likely to be recognised systems, the reverse is not necessarily appropriate. Certainly Payments NZ agrees that each of:

- (a) ESAS;
- (b) CLS;
- (c) the NZ clear system; and
- (d) the NZCDC system,

should all also be recognised systems.

6.21 Payments NZ accepts that the Reserve Bank should have oversight of the clearing and settlement systems, and the infrastructure associated with those systems. Payments NZ also believes that this should be the Reserve Bank's primary focus. However, while oversight at the secondary product and membership level is still potentially relevant, the Reserve Bank should be able to rely on Payments NZ to ensure that there are appropriate standards in place to deliver a sound and efficient payment system at a product level and to more easily keep pace with rapid developments in the payments area at the product level.

7. APPLICATION OF OVERSIGHT AND CRISIS RESOLUTION POWERS

7.1 Payments NZ assumes that the Reserve Bank's intention is that powers sought in relation to payment systems will be based on equivalent powers that the Reserve Bank has in respect of banks when exercising its prudential supervision responsibilities.

7.2 Many of the powers sought have an equivalent in the powers that the Reserve Bank currently has in relation to banks, NBDTs and insurers. Payments NZ does not believe it is appropriate for the Reserve Bank to have the same powers over payment systems as it has in relation to banks and insurers. The rationale, purposes and required scope of the powers are very different for the different industries. For one, insurers and banks tend to have substantially larger balance sheets than the key infrastructure providers or standard setters in relation to payment systems. While soundness and efficiency are still primary considerations in respect of banks, protecting the interest of the depositors is often critical to this objective. A similar position applies in relation to policy holders of insurance companies.

7.3 The powers required to intervene in these circumstances are also very different from the powers required, or necessary, to intervene, or indeed to require disclosure, in respect of the payment system. For example, Payments NZ believes it would be inappropriate for the Reserve Bank to have powers in respect of key infrastructure providers or standard-setters to:

- (a) require public disclosure;
- (b) impose conditions;
- (c) publish warnings and/or publish non-compliance;
- (d) direct operators to take actions; and

(e) remove or replace directors.

- 7.4 A model based on the supervision of banks may not be appropriate where Payments NZ already oversees payment system participants, unless the standards set by the Reserve Bank are broad-based enough in nature to allow for Payments NZ to set more specific rules and standards (using the Reserve Bank's broad standards as a foundation for those).

Application of powers

- 7.5 Payments NZ notes that the powers proposed in the Consultation Document are purported to be expressed over "systems" or "systemically important" systems. Although it is not always clear which power applies to which, Payments NZ believes it is inappropriate and impracticable to have powers that apply to "systems". Powers can and should only apply to legal entities. A system is not a legal entity. Rather, it comprises a number of connected legal entities.

- 7.6 Overall, Payments NZ accepts that it may still be appropriate to have a definition of "Payment System" and "systemically important" for the purposes of the Act. However, it is important to specify the entities to which the powers could be applied, including:

- (a) participants;
- (b) key infrastructure providers; and
- (c) why it is also potentially important to differentiate between clearing systems and settlement systems.

- 7.7 To the extent that definitions have international equivalents, Payments NZ believes that these should be adopted and only modified if there are good New Zealand regulatory or market reasons to do so.

8. RELATIONSHIP WITH OTHER REGULATORS

- 8.1 Payments NZ believes that it will be important to be very clear about which party is the primary regulator in certain key circumstances. Two obvious examples are:

- (a) access and pricing issues, where there is overlap with the Commerce Commission; and
- (b) statutory management, where there is overlap with the FMA (the setting of standards, monitoring of compliance with standards, information gathering, conducting investigations and enforcing compliance are also areas where there may be overlap, and potential inconsistency in approach, between the Reserve Bank and the FMA).

- 8.2 There needs to be close and transparent coordination between the regulatory agencies. Consistent with international principles, a lead agency should be established for each regulatory function. Processes should also be put in place to avoid duplication of function and inconsistency of standards and regulatory approach. The draft of the Bill could

include requirements in this regard, including requiring the development of a memorandum of understanding between the relevant agencies, developed through a transparent process and on the basis of consultation with affected parties.

Commerce Commission

- 8.3 Open and transparent access to the payment system is important for a dynamic and efficient payment system. Equally, that needs to be balanced against risks to the soundness of the payment system from unsound operators, who can significantly undermine the confidence of the payment system to the detriment of all participants. This can for example, in a small way, be seen in relation to security standards for PIN entry devices and ATMs. When PIN and ATM security is compromised it tends to have a disproportionately adverse effect on the confidence in the payments system as a whole.
- 8.4 While the Reserve Bank has taken an active role in monitoring access to the payment system, issues relating to competition are primarily matters that come under the purview of the Commerce Commission. However, the Commerce Commission's threshold in some of these areas is different from those applied by the Reserve Bank. The test is whether or not competition has been substantially lessened and soundness issues have only been considered peripherally.
- 8.5 As has occurred in Australia, Payments NZ believes that it is important for there to be clarity between the roles of the Reserve Bank (and the FMA) and the Commerce Commission. Ideally this would be through a memorandum of understanding, required by statute, and done in a manner that is transparent to all affected parties. Given the importance of collaboration in the payment system, it is also important for participants to have legal certainty about when each of the different legal tests (i.e. substantially lessening competition versus soundness and efficiency) apply to industry decisions. These are matters which require further careful consideration, in consultation with all affected parties.

FMA

- 8.6 Currently the Reserve Bank can appoint statutory managers in relation to banks and insurers and the FMA is the body responsible for administering the Corporations (Investigations and Management) Act 1989 ("**CIMA**") under which a statutory manager can be appointed to any other entity. CIMA would ordinarily apply to key infrastructure providers and operators of systemically important payment systems.
- 8.7 We assume that the Reserve Bank is seeking the power to expand the circumstances in which it is responsible for the appointment of statutory managers to include key infrastructure providers and operators of systemically important payment systems.
- 8.8 Given the differences between the Reserve Bank's statutory management framework and the FMA's statutory management framework, it will be very important to ensure that there is no ambiguity as to who is responsible for the appointment of a statutory manager in defined circumstances. Furthermore, it would be appropriate to review the current Reserve Bank statutory management powers, which are designed specifically for banks,

to determine whether those powers are also equally applicable to, for example, infrastructure providers (this is acknowledged in the Consultation Document).

- 8.9 For instance, a statutory manager under the Reserve Bank Act has no personal liability. This is probably not appropriate for the statutory management of an infrastructure provider, where the regime under CIMA is likely to be more appropriate. Therefore the Reserve Bank should consider adopting an equivalent statutory management regime to that under CIMA for those entities.
- 8.10 It is clear that the way in which a statutory management regime would work in relation to systems needs to be clarified. The proposals and the Bill need to specify the types of entities to which a statutory manager may be appointed, given that a statutory manager cannot be appointed to a 'system' per se. Logically this same point is applicable to the details in respect of powers of direction, inspection, etc.
- 8.11 Furthermore, a number of key infrastructure providers identified by the Reserve Bank operate in New Zealand through branches or representative offices, or, in the case of SWIFT, through its head office in Belgium or regional office in Australia. While it may still be possible to appoint a statutory manager over the New Zealand business of those providers, the business in New Zealand may well be very limited and not include key infrastructure that is located offshore. For banks, this has been dealt with through conditions of registration relating to outsourcing and local incorporation. Without the equivalent protections for key infrastructure providers there will be real limitations on the effectiveness of any such increased powers in protecting the payments system. These issues require further consideration, in close consultation with affected parties.
- 8.12 The Consultation Document provides very little information on the details of what a statutory management regime would look like in the case of payment and settlement systems – although the Reserve Bank acknowledges in the Consultation Document that it may be quite different from that applying to banks. Nonetheless, much more detail is required, along with consultation with affected parties, before legislation is prepared on this matter, including in relation to the grounds for appointing a statutory manager, the powers of a statutory manager, the duration of statutory management, the powers of the Reserve Bank to issue directions to a statutory manager, the moratorium provisions and duration of these, the rights of affected parties, the scope to terminate statutory management, etc. These proposals need to be developed having close regard to the relevant provisions of the FSB's Key Attributes, which contain much relevant guidance in this area.
- 8.13 Payments NZ wishes to see further consultation on all of these matters.

9. EFFICIENCY

- 9.1 Payments NZ notes the comment in paragraph 77 of the Consultation Document that:

"the Reserve Bank has tended to view the pursuit of soundness through prudential regulation as the key objective, while viewing the efficiency mandate mainly in terms of minimising or avoiding excessive compliance costs."

9.2 Payments NZ recognises that the Reserve Bank has a role in the monitoring and promoting of efficiency in payment systems, but that this should be done on the basis of:

- (a) further clarity as to what "efficiency" means, through transparent policy guidance;
- (b) clear differentiation between the role of the Reserve Bank and the role of Payments NZ in this area; and
- (c) avoidance of duplication of function or inconsistency with the role of the Commerce Commission.

9.3 While Payments NZ has contributed to the stability and efficiency of New Zealand's payment system through providing thought leadership on many industry and market issues, along with its management of compliance and industry change, Payments NZ also sees one of its most important roles as promoting the efficiency of the payment system. This is particularly consistent with the PFMI (principle 21) which the Reserve Bank states as:

"an FMI should be efficient and effective in meeting the requirements of its participants and the market it serves."

9.4 On this basis, Payments NZ sees particular value in stronger and more formal recognition of its role in working with the Reserve Bank to improve the efficiency of any New Zealand payment systems (i.e. that it should help the Reserve Bank in achieving the Reserve Bank's efficiency objective). Payments NZ believes that, as an industry leader with a proven record of deliverables, and as a rules and standards body, it can (and should) put in place objectives and Rules and Standards that:

- (a) facilitate allocative efficiency by seeking to ensure that payment systems operators allocate resources in a manner consistent with sound cost/benefit analysis, taking into account efficiency outcomes for the system;
- (b) encourage technical efficiency by working at the forefront of industry to establish standards that keep pace with technology and enable new technologies to be introduced into the market as rapidly as possible, and at least cost to users (as, for example, Payments NZ is doing in relation to mobile payments); and
- (c) encourage dynamic efficiency by constantly working to remove barriers to entry to the payment system, including by providing openly available technical standards in an easy to understand format, and by encouraging and fostering innovation and the adoption of new technology in ways that meet customer needs.

9.5 As the Reserve Bank will also appreciate, the efficiency of the payments industry relies heavily on the establishment of networks within the industry. A new payment instrument is only of value if it can be accepted. Cooperation is essential – possibly even more so than other network industries such as electricity markets and telecommunications markets. This should be formally recognised.

Disaster recovery and business continuity

- 9.6 Another key factor in the efficiency of a payment system is the quality of its disaster recovery and business continuity arrangements.
- 9.7 Given the critical nature of payment systems, any sustained outages can have a disproportionately disruptive effect on the economy and financial system. Disaster recovery and business continuity plans can go a long way towards addressing this risk. They also have an impact on payment system efficiency.
- 9.8 Payments NZ believes that it has an important role to play in relation to crisis management within the payment system. Payments NZ sees that as a "second line of defence" role as between the participants and the Reserve Bank (with Payments NZ participants being the "first line of defence" themselves) and therefore a role that involves undertaking the detailed planning.
- 9.9 Payments NZ, however, understands the need for the Reserve Bank to have powers to intervene if the industry arrangements prove ineffective. It sees these Reserve Bank powers as potentially operating as a "back-stop". However, the proposals need to clarify the division of responsibility between the role of the Reserve Bank and the role of Payments NZ, especially regarding:
- (a) overseeing the development of recovery and resolution planning in payment systems;
 - (b) undertaking resolution testing exercises; and
 - (c) responding to an operational or financial crisis if it occurs.

10. APPLICATION TO PAYMENTS NZ

- 10.1 Payments NZ has a unique role in the New Zealand payment system. It is, however, a role which has a number of counterparts overseas – primarily amongst the ICPACE countries.
- 10.2 Payments NZ currently operates very collaboratively with the Reserve Bank. For example:
- (a) it gives particular priority to matters which the Reserve Bank has expressed to Payments NZ as concerns (for example, CECS Rules, interchange numbers, clearer access criteria, and the process for approving new entrants); and
 - (b) it has adopted a policy of providing all rule changes to the Reserve Bank and seeking a "no objections" letter.
- 10.3 However, the lack of clear direction or priorities from the Reserve Bank is something that has regularly been raised as an issue with Payments NZ by its participants.

10.4 Payments NZ believes that the better option could be for:

- (a) The Reserve Bank to establish and maintain an up-to-date New Zealand payment policy statement, as well as a strategic plan for the next three years, in relation to the payment system. This should occur in consultation with Payments NZ and market participants in much the same way as, for example, happens in the gas industry, where MBIE issues such a statement; and
- (b) Payments NZ to have responsibility for delivering the efficiency of the payment system based on foundational requirements set by the Reserve Bank (set in consultation with the industry) and to report on that to the Reserve Bank annually. This in turn would require clarity in respect of the Reserve Bank setting standards and monitoring, in respect of both soundness and efficiency. However, details of operational standards and monitoring etc at that level would fall to Payments NZ (with the Reserve Bank focussing its attention on Payments NZ at the higher level).

10.5 Consequentially, we believe that Payments NZ's standard-setting and supervisory role should be recognised by the Reserve Bank when formulating its final approach to payment system oversight powers.

The three "pillars" and the two mandates

10.6 As set out in many Reserve Bank documents, the promotion of a sound and efficient financial system relies on a combination of three "pillars": "self-discipline", "market discipline" and "regulatory discipline". Payments NZ shares this view and sees the three pillars as being equally relevant to payment systems as to other parts of the financial sector.

- (a) "Self-discipline", through sound governance and risk management, is critical to achieving a sound financial system, given that it provides the foundation for the effective identification, monitoring and management of risks within financial institutions. Payments NZ provides an important element of self-discipline to the payments industry by developing and overseeing compliance with rules in a way that encourages sound governance and risk management. This fosters greater accountability within the member payment systems and entities for the prudent management of risks.
- (b) "Market discipline" is exerted through channels such as member banks (in respect of reliability, security and cost considerations), customers (in respect of reliability, speed, certainty and cost), and the news media (in respect of the pressures that, rightly, are applied to the industry as a result of payment system disruptions). Consumer groups provide a further important source of market discipline, particularly in respect of costs, efficiency and reliability of service. Payments NZ seeks to enhance the effectiveness of market discipline through its collection and publication of payments data. This provides external parties with improved information with which to assess the performance of the payment systems.

- (c) Payments NZ is supportive of the need for an effective regulatory underpinning of the payments industry – the pillar of "regulatory discipline". However, Payments NZ believes that any exercise of powers needs to be limited to crisis management (or, to put it another way, material concerns about a payment system). Given the Reserve Bank's statutory responsibility for overseeing the industry, and for promoting a sound and efficient financial system, it is appropriate that the Reserve Bank has powers to address these issues effectively. Payments NZ acknowledges that the Reserve Bank currently lacks some powers required, particularly regarding crisis management. Nonetheless, powers should be developed appropriately and not in a way that encroaches on any other areas. Powers should also be implemented within a regulatory framework that recognises the role of Payment NZ as the industry standard-setter and overseeing agency. The Reserve Bank's role should not duplicate or weaken Payments NZ's responsibilities in this regard – this would undermine both self-discipline and market discipline and create risk of moral hazard. The regulatory discipline pillar should reinforce, but not detract, from the self-discipline and market discipline pillars.

10.7 As has been set out throughout the submission, Payments NZ can contribute strongly towards both of the Reserve Bank's mandates, soundness and efficiency, especially given Payments NZ's proven effectiveness in the "self-discipline" and "market-discipline" spheres. The relationship between the Reserve Bank and Payments NZ and the soundness and efficiency mandates can be summarised as follows:

	"Soundness"	"Efficiency"
Reserve Bank	<ul style="list-style-type: none"> – Priority mandate. – Policy setter. – Powers to execute and step in. – Proactive. – Pursuit of "regulatory discipline". 	<ul style="list-style-type: none"> – Secondary mandate. – Primarily act via discussion and "suasion" with Payments NZ – Powers to step in if there is clear evidence of gross inefficiency. – Reactive to proven inefficiency. – Sustaining "self" and "market" discipline with the "regulatory discipline" back-stop.
Payments NZ	<ul style="list-style-type: none"> – Both proactive in setting requirements and reactive to the Reserve Bank's policies. – Engage to shape/refine approach. – Co-ordination of participants – Once defined, use as an execution vehicle – For example: OBR rules. – Technical expertise to assist with "regulatory discipline". 	<ul style="list-style-type: none"> – Proactive ("self-discipline"). – Market led change management ("market-discipline"). – For example: mobile payment standards.

12. THE CONSULTATION DOCUMENT QUESTIONS

Set out below are Payments NZ's responses to the questions expressly set out in the Consultation Document. They are included for convenience. For more information, please see the body of the submission.

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

Payments NZ accepts that, having regard to relevant international principles and the Reserve Bank's statutory role of promoting a sound and efficient financial system, there are gaps and deficiencies in the statutory powers available to the Reserve Bank in relation to payment and settlement systems.

However, Payments NZ does not accept that there has been any significant market or regulatory failure or instability in the New Zealand payment system thus far. If anything, there has been improvement in both soundness and efficiency – this includes, for example, the replacement of ISL (Interchange and Settlement Limited, a system that was 40 years old) with the SWIFT system. Payments NZ believes that, from both a governance and an operational point of view, the New Zealand payment system is substantially more sound and efficient than it was prior to the global financial crisis.

There have been significant advances in the efficiency, effectiveness and soundness of the payment system over the last three years without the intervention of regulation. Payments NZ has also been a far more effective mechanism than its predecessor, the NZBA. The Consultation Paper does not recognise these factors and that the New Zealand payment system is actually currently in a stronger situation than it was 3 years ago.

Nonetheless, particularly in light of international principles and the growing focus on regulation in the international sphere, Payments NZ agrees with the conclusion that the Reserve Bank should:¹⁰

"...focus on developing a well-designed set of graduated powers for the oversight of these systems, which will support the effectiveness of its oversight function and ensure the right incentives for industry and participants to act prudently, cooperate and progress in a timely manner."

Much of the development and the execution of those powers should be in conjunction with or through Payments NZ. The design of the regulatory framework needs to explicitly take into account the role of Payments NZ as the frontline standard-setting agency in the payment system and the means by which standards are monitored and enforced.

¹⁰ Consultation Document at 8.

Any powers also need to be proportionate in the manner that they are applied. There needs to be greater clarity as to:

- (a) the rationale for the proposed powers (e.g., the public policy reasons for it, as in a number of cases we do not believe the powers sought are necessary or relevant);*
- (b) how the powers fit with the proposed regulatory architecture for the payments system (especially where a degree of coregulation exists); and*
- (c) how the power fits within the three pillars of self-discipline, market discipline and regulatory discipline.*

Any redesign should also take into account the strengths and weaknesses displayed by existing international models (such as the ICPACE countries).

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

No. Payments NZ does not agree with the proposed definition and believes that it would be more appropriate and practicable for powers to be exercised against legal entities, and not "systems". The entities affected would also need to be defined appropriately.

Payments NZ is particularly concerned with the current scope and the ambiguity of what would be included under "system". Participants in a payment system need certainty with regard to the regulatory coverage that relates to them – in that vein, due to the lack of clarity in the Consultation Document some affected parties may not even be currently aware that the proposals may affect them. For example, it is also unclear whether, and to what extent, the proposals would apply to Payments NZ. It is concerning that it had to be assumed that Payments NZ fell within the definition, despite it being a key stakeholder in the payments industry. It may be useful to use "financial market infrastructure" (or "FMI") as a starting point for the definition given the importance of being consistent internationally, but even that may need to be modified for the NZ market.

With the rapidly evolving nature of the payment system in New Zealand, any definition also needs to clearly address and take into account future developments. There are also a range of participants that are likely to be equally as important, if not more important, than those explicitly listed in the Consultation Paper.

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

Payments NZ agrees with the adoption of the CPSS/IOSCO definition. However, as to the scope of the definition, Payments NZ also believes that there may be grounds to consider the potential for market or consumer disruption (in the event of a crisis). Even without meeting the other thresholds that were set out in the Consultation Document, an

entity may have the ability to make a substantial impact in the consumer market sphere (and thus may potentially be politically, if not solely "systemically", important).

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

The Government needs to ensure it is clear which agency is the primary regulator in certain situations, including as to the setting of standards, monitoring of standards, enforcement of requirements, information gathering, giving of directions and statutory management. There needs to be a formalised and transparent structure, possibly based on MOUs developed in consultation with affected parties, for delineating between the roles of the agencies in all these areas, establishing a lead agency, and facilitating coordination. Similarly, coordination with relevant foreign regulators is also essential.

If the Reserve Bank's powers to impose a statutory manager are expanded to include payments and infrastructure providers, as well as banks, the statutory management regime of the FMA under CIMA needs to be taken into account. The Reserve Bank framework as it relates to those additional entities, and how that would have to differ from how the framework relates to a bank (i.e. regarding personal liability) needs to be considered.

The relationship with the Commerce Commission also needs to be considered in relation to the competition issues around access to payment systems. As in Australia, there is a good case for a MOU.

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

As detailed above, Payments NZ believes that it is important that any exercise of power against an entity is appropriate and takes into account the nature of that entity. It also needs to be exercised reasonably. For example, there would be some powers that are appropriate in respect of a standards body but are not necessarily appropriate, or reasonable, in respect of a market operator (and vice versa).

Payments NZ also believes that, based on our assessment of the Reserve Bank's current powers in relation to banks, insurers and NBDTs, the powers proposed in the Consultation Document appear to be substantially the same regime that is in place against banks, insurers and proposed for NBDTs. However, these entities are very different to the entities that the current consultation addresses – therefore it is not necessarily appropriate that the proposed powers are identical in the current situation.

Therefore, further consultation is required on:

- (a) the precise statutory purposes for the powers;*
- (b) the statutory grounds for exercising each power;*

- (c) *the statutory process for exercising powers – e.g. will there be a consultation requirement, etc;*
- (d) *what entities the powers apply to;*
- (e) *the scope of the powers; and*
- (f) *the safeguards applicable (such as the consultation obligations before a power is exercised, rights of appeal, etc).*

Payments NZ is also particularly concerned with how the powers will affect, or not affect, infrastructure located offshore. If an operator's infrastructure is located overseas, and not subject to the regime, but domestic operators are, then the impact on the domestic operators could be greater and this is not necessarily fair, or in New Zealand's interests, if they are operating in the area or sphere of the New Zealand payment system. For example, Visa and Mastercard provide similar services to EFTPOS and Paymark – yet powers would affect them differently. The ability to have recourse to an entity with infrastructure located offshore needs to be addressed.

There is a need for a much more detailed set of proposals for statutory powers for consultation with industry and other interested parties. These should be developed having regard to, among other matters, the CPSS/IOSCO PFMI, the FSB's Key Attributes (with respect to crisis resolution powers), the IMF's Code of Good Practices, and the parallel reforms being undertaken in other countries, especially Australia. It is also essential that the development of the legislative framework imposes statutory obligations on the Reserve Bank and the FMA relating to transparency duties to consult, and accountability, in line with the relevant transparency codes of the IMF.

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

Yes. Payments NZ agrees with the Reserve Bank that the recognition regime is more appropriate than extending the current designation regime to additional clearing systems and extending the powers to compulsorily designate systems.

The designated system powers, as the Reserve Bank point out, were initially included to ensure that key settlement systems, such as ESAS and the CLS, could provide for irrevocable settlement (i.e. settlements could not be done either because of ineffective netting requirements or because of the susceptibility of settlements to "claw backs"). These goals remain valid for these settlement systems. However, the goals are less relevant or important to clearing systems which use a designated settlement system to settle through. Accordingly, Payments NZ favours retaining the designation approach for the purposes for which it was originally intended.

Overall, while designated systems are likely to also be recognised systems, the reverse is not necessarily appropriate.

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

Payments NZ accepts that the Reserve Bank has a mandate to promote efficiency in the payments system.. However, Payments NZ sees particular value in stronger and formal recognition of Payments NZ's role in working with the Reserve Bank to improve the efficiency of any NZ payments systems – Payments NZ can help the Reserve Bank achieve these objectives and is better placed to pursue those practically.

The payments industry is only as strong as its networks, and Payments NZ's Rules and Standards act to facilitate the efficiency of the operation of these networks from the ground level up. These Rules and Standards also ensure that payment instruments can work efficiently.

Therefore, Payments NZ supports a collaborative approach to efficiency considerations.

It is also important that the concept of efficiency is clearly defined, in consultation with industry and other interested or affected parties, so as to avoid the risk of misguided or poorly calibrated policy initiatives. The Reserve Bank therefore needs to provide considerably more public guidance in this area, and in so doing, clarify the relative weighting of soundness and efficiency in its policy objectives.

Given the respective roles of the FMA and the Commerce Commission, and their connection with efficiency objectives, there is a need to clearly differentiate the responsibilities of the Reserve Bank, the FMA and the Commerce Commission, with a view to avoiding duplication of role and inconsistency of approach.

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

Payments NZ believes that all payment system entities should be listed with the Reserve Bank. This means that the Reserve Bank can consider, and give clarity on, whether the entities are systemically important and whether or not the entity is subject to the recognition regime.

Given the importance of the network nature of the payment system, Payments NZ believes that a list of participants will be particularly helpful to ensure greater transparency. In that regard, who is and who is not on that list should be subject to a clear and transparent set of criteria.

The Reserve Bank is the appropriate body to have the list, given that they will be primarily responsible for those on it (as opposed to the FMA).

