

## Statement of principles: payment system oversight

Financial Stability Department  
Document PS1  
Version 1.0  
Issued: 11 August 2005

This document explains the Reserve Bank's payment system oversight role.

### 1. Introduction

A key role of the Reserve Bank is to oversee the payment system. This document sets out the Reserve Bank's payment system oversight powers and policies. It explains:

- the Reserve Bank's payment system oversight objectives,
- the scope of the Reserve Bank's payment system oversight, and
- how the Reserve Bank carries out payment system oversight.

A payment system is defined in section 2 of the Reserve Bank Act as a system or arrangement for the clearing or settlement of payment obligations or the processing of payment instructions and includes any instruments, rules, and procedures that relate to these matters.

The Reserve Bank's payment system oversight powers are set out in Part 5B of Reserve Bank Act, which was added to the Act in 2003. (Unofficial versions of New Zealand statutes, including the [Reserve Bank of New Zealand Act 1989](#), are available on the New Zealand legislation website, [www.legislation.govt.nz](http://www.legislation.govt.nz).)

### 2. The Reserve Bank's Payment System Oversight Objectives

The Reserve Bank oversees payment systems for the purpose of promoting the maintenance of a sound and efficient financial system. How those broad objectives translate into more specific objectives and more specific policies may evolve over time, particularly as processes and technology change or as new issues emerge. This section sets out the Reserve Bank's current thinking on how "soundness" and "efficiency" translate into more specific objectives.

For the financial system to be sound and efficient, its core infrastructure, of which payment systems are a major part, must be sound and efficient. A sound and efficient payment system is one:

- that does not generate high levels of risk to participants or to users of financial services, and in which any risks that are generated are managed appropriately by system participants;
- that can continue to operate without disruption in the event of the sudden financial or operational incapacity of a participant, or following other types of financial crises or natural disasters, etc;
- that incorporates delivery-versus-payment arrangements where appropriate, and especially with respect to high-value transactions;

- in which the status of payments is certain at all times, and, in particular, in which the attributes of "finality" and "irrevocability" are supported;
- in which payment services are efficient and reliable, and are responsive and relevant to customer needs; and
- that is open, flexible and competitive, with no unwarranted barriers to entry.

As noted above, how "soundness" and "efficiency" translate into more specific objectives may evolve over time. As such the above list is not exhaustive.

Expanding on the first of these points, a guiding principle for the Reserve Bank's engagement with the industry has been and continues to be that risks and costs should be borne by those best placed to manage them. This approach maximises the market incentives to manage and appropriately price risks, and reduce costs. Where payment system risks and costs are borne by payment system operators and participants, the Reserve Bank is interested in seeing that those risks and costs are managed appropriately. Where payment system risks and costs are borne by parties other than payment system operators and participants, the Reserve Bank views it as important that the payment system operators and participants have sufficient regard to those risks and costs in the design and operation of the payment system, and that there is a high level of transparency relating to the incidence of those risk and costs.

These matters have been the basis of the Reserve Bank's stated payment system objectives for a number of years. They continue to be relevant and overlap substantially with the CPSS Core principles for systemically important payment systems.

### ***The CPSS Core principles for systemically important payment systems***

The Committee on Payment and Settlement Systems (CPSS) serves as a forum for the central banks of the Group of Ten countries (G10) to monitor and analyse developments in domestic payment, settlement and clearing systems as well as in cross-border and multicurrency settlement schemes. Increasingly, non-G10 central banks are also participating in the work of the CPSS. The CPSS Core principles for systemically important payment systems are a comprehensive statement of soundness and efficiency objectives for payment systems. The Core Principles (which are set out and extensively discussed in *CPSS Core principles for systemically important payment systems, CPSS Publications No. 43 (January 2001)*, on the website of the Bank for International Settlements, [www.bis.org/publ/cpss43.htm](http://www.bis.org/publ/cpss43.htm)) are:

- I. The system should have a well-founded legal basis under all relevant jurisdictions.
- II. The system's rules and procedures should enable participants to have a clear understanding of the system's impact on each of the financial risks they incur through participation in it.
- III. The system should have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and the participants and which provide appropriate incentives to manage and contain those risks.
- IV. The system should provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day.
- V. A system in which multilateral netting takes place should, at a minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participants with the largest single settlement obligation.
- VI. Assets used for settlement should preferably be a claim on the central bank; where other assets are used, they should carry little or no credit risk and little or no liquidity risk.
- VII. The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing.
- VIII. The system should provide a means of making payments which is practical for its users and efficient for the economy.
- IX. The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.
- X. The system's governance arrangements should be effective, accountable and transparent.

The Reserve Bank's view is that the CPSS Core Principles are relevant for all payment systems. The Reserve Bank's expectation is that all payment systems operating in New Zealand should comply with the CPSS Core Principles, unless there are compelling reasons for non-compliance in the particular circumstances (e.g. taking into account specific New Zealand conditions). Where any CPSS Core Principles are not complied with, and where there are no compelling reasons for non-compliance in the particular circumstances, it would be expected that positive steps would be taken to remedy the non-compliance.

The Reserve Bank's expectation is that there are unlikely to be compelling reasons for non-compliance with the CPSS Core Principles by systemically important payment systems. For non-systemically important payment systems, the Reserve Bank's current thinking is that ongoing non-compliance with the CPSS Core Principles is only likely to be justifiable where the costs of compliance are disproportionately high and the public benefit from compliance is demonstrably low.

A sound and efficient payment system is also one that complies with all relevant laws. The Reserve Bank's expectation in this regard is that payment system operators and participants should comply with and monitor their compliance with all relevant laws.

Finally, part of having a sound and efficient financial system is about having payment systems that accommodate the Reserve Bank's various functions and activities including:

- formulating and implementing monetary policy,
- issuing currency,
- providing exchange settlement accounts for settling transactions in central bank funds,
- registering and supervising banks (including bank failure management),
- managing foreign reserves, and
- providing liquidity to the financial system.

The Reserve Bank needs to be satisfied that payment system arrangements are consistent with its responsibilities in each of these areas.

### **3. The Scope of The Reserve Bank's Payment System Oversight**

The Reserve Bank is not only interested in payment systems in a narrow sense, it is interested in a broader range of payment system issues. These may relate to:

- the design and operation of a payment system,
- how payment systems interconnect,
- payment system operators,
- payment system infrastructure providers,
- payment system participants,
- business continuity arrangements,
- the availability of data and information from or relating to payment systems,
- the rules of a payment system,
- the governance structure of a payment system, and/or
- market practices and behaviours.

The Reserve Bank's approach to payment system oversight has been and continues to be to prioritise and address what it sees as the most significant payment system issues.

### **4. How the Reserve Bank Carries Out Payment System Oversight**

As payment system issues are identified, the Reserve Bank seeks to work together with the industry to promote positive change. The Reserve Bank's role in this regard has not been a prescriptive one. The Reserve Bank's experience has been that its interests and those of the industry and other stakeholders have been sufficiently aligned to achieve good outcomes.

### ***Engagement on specific projects from time to time***

This is the main way in which the Reserve Bank promotes positive change in relation to payment system issues. Engagement on specific projects from time to time is complemented by more regular engagement with the industry and by the collection of information and data which assist in identifying issues that need to be addressed or might benefit from Reserve Bank involvement.

### ***Regular engagement with the industry,***

Through regular engagement with the industry, the Reserve Bank can be kept informed of current issues and developments and can also seek information to enhance its understanding of those issues and developments.

### ***Collection of payment system information and data***

The Reserve Bank collects information and data relating to payment systems from time to time to measure relative usage of different payment types, measure the relative usage of different payment systems, and to improve its understanding of the way payment systems operate.

### ***Publication in the Reserve Bank's Financial Stability Report of our analysis of payment system issues***

The Reserve Bank will be regularly publishing its analysis of payment system issues in its six-monthly **Financial Stability Report**. The Reserve Bank's analysis of payment system issues flows from its engagement on specific issues, its regular engagement with the industry, and from the collection of information and data relating to the payment system.

Such regular reporting will instil a degree of discipline both on the Reserve Bank in terms of making it more accountable, and on participants and operators of payment systems in terms of the incidence, magnitude, and management of risks and costs in relation to payment systems.