

Proactive release of Cabinet documents related to the Reserve Bank of New Zealand Bill

28 July 2020

This package of documents – relating to **Managing cash quality in New Zealand** - has been proactively released by the Reserve Bank on behalf of the Minister of Finance. The package is available on the Reserve Bank's website at <https://www.rbnz.govt.nz/research-and-publications/information-releases>

Other Cabinet documents relating to the Reserve Bank of New Zealand Bill are available on The Treasury website at <https://treasury.govt.nz/news-and-events/reviews-consultation/reviewing-reserve-bank-act>

The documents are:

DEV-20-SUB-0091 Summary: Managing cash quality in New Zealand, and substantive paper; without redaction.

DEV-20-MIN-0091, Minute of Decision, Managing Cash Quality in New Zealand; without redaction.

CAB-20-MIN-0265, Minute of Decision confirming DEV-20-MIN-0091; redaction of minutes of unrelated items of business.

Impact Summary: Standards for devices testing the quality and authenticity of New Zealand bank notes. Section 4.1; one redaction of Cash in Transit companies' estimated operating costs (Official Information Act 1982, S.9(2)(b)(ii) and S.9(2)(ba)(i), refer.)

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Cabinet Economic Development Committee

Summary

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Managing Cash Quality in New Zealand

Portfolio

Finance

On 18 March 2020, DEV agreed that the Reserve Bank Institutional Bill include an expanded mandate for the Reserve Bank in relation to the oversight of the system of bank notes and coins [DEV-20-MIN-0041].

This paper seeks agreement to a number of supplementary proposals, specifically to enable the Reserve Bank to set standards for devices that prepare cash for distribution to the public. This would capture automated note dispensers such as ATMs and automated self-check-outs, as well as note counters and sorters used by cash handlers, banks, and large retailers.

The Minister of Finance recommends that the Committee:

- 1 agree that the Reserve Bank Institutional Bill provide that the Reserve Bank of New Zealand (Reserve Bank) have the authority to set mandatory standards for devices that test the quality and authenticity of banknotes, such as ATM machines and self-service checkouts and note sorters;
- 2 agree that such mandatory standards be secondary legislation for the purposes of the Legislation Act 2019;
- 3 agree that the Reserve Bank may by notice require the operator of a device to demonstrate that its machine complies with the standard by testing it against the standard;
- 4 agree that the Reserve Bank may by notice require an operator of a device to cease operating the device if it does not comply with the standard;
- 5 agree that an operator who does not comply with a notice as referred to in paragraph 4 above, or who operates a machine that does not comply with the standard, be liable for an infringement fee of \$3,000, with a maximum fine of \$9,000;
- 6 agree that in the event of repeated non-compliance with notices issued by the Reserve Bank, the Reserve Bank be given the ability to apply to the District Court for an order to seize or disable the banknote handling machine;
- 7 authorise the Minister of Finance to further clarify and develop policy matters relating to the above paragraphs in a manner not inconsistent with the policy proposals outlined in the paper under DEV-20-SUB-0091;

- 8 invite the Minister of Finance to issue drafting instructions to the Parliamentary Counsel Office to give effect to the above paragraphs.

Janine Harvey
Committee Secretary

Proactively Released

In Confidence

Office of the Minister of Finance

Chair, Cabinet Economic Development Committee

Managing cash quality in New Zealand

Proposal

1. This paper seeks agreement to an addition to the Reserve Bank Institutional Bill, which would enable the Reserve Bank of New Zealand – Te Pūtea Matua (the Reserve Bank) to set standards for machines that test the quality and authenticity of bank notes.

Background

2. Cabinet agreed in December 2019 to replace the Reserve Bank of New Zealand Act 1989 with two new pieces of legislation: a Reserve Bank institutional Act and a Deposit Takers Act [CAB-19-MIN-065]. The Economic Development Committee agreed in March 2020 that the Reserve Bank Institutional Bill recognise an expanded mandate for the Reserve Bank in relation to oversight of the cash system [CAB-20-MIN-0120].
3. This report addresses a number of supplementary decisions in relation to the Reserve Bank Institutional Bill, specifically the Reserve Bank's ability to set standards for devices which prepare cash for distribution to the public.

Executive summary

4. Throughout the country, numerous privately owned machines check bank notes for authenticity and/or quality. New technologies and the changing nature of the cash system introduce new opportunities for efficiency, as well as new risks to the overall quality of bank notes in circulation and the incidence of counterfeiting.
5. This paper proposes that the Reserve Bank be given the authority to set standards for devices which check the authenticity and/or quality of a banknote in preparation for its distribution to the public. These regulations would capture automated note dispensers such as ATMs and automated self-check-outs, as well as note counters and sorters used by cash handlers, banks, and large retailers to test the fitness of banknotes before they are distributed by machine or over-the-counter.

Problem definition

6. Throughout the country, numerous privately owned machines check bank notes for authenticity (whether notes are genuine Reserve Bank notes or counterfeits), and/or quality (whether notes are faded, damaged, or dirty).

These include ATMs, automated self-check-out machines, and professional note sorters, such as those operated by banks, casinos, and cash-in-transit operators (CiTs). Bank notes processed by ATMs or other public-facing machinery are regularly transported to and from CiTs' depots, where large high-speed note-sorting machines process banknotes, confirming that they are genuine and inspecting them for wear and tear before returning them to the public. If a note is deemed unfit for any reason it is returned to the Reserve Bank, where it is processed again before being destroyed and replaced with a new note.

7. This is not the only model of banknote quality assurance available, and is not necessarily the most efficient. In Norway, for example, all quality assurance, note processing, and destruction is carried out by licensed cash-in-transit operators. This eliminates the need for dual processing, but raises the risk of poor-quality notes re-entering circulation or good notes being destroyed if a cash-in-transit operator's processes and equipment are not sufficiently accurate.
8. Furthermore, new technology is available which employs "cash recycling" technology, whereby notes are accepted from the public, checked for quality and authenticity, and then recirculated back to the public, without needing to be transported back to a CiT. This has potential to greatly improve the efficiency of the cash system, but also increases the risk of distributing counterfeit, damaged or dirty banknotes. A number of ATMs in New Zealand already have this capability, although it is currently not in use, partly due to concerns about the risk of distributing counterfeits.
9. Private agents' incentives are not perfectly aligned with public incentives in relation to authenticating and fitness-testing banknotes, particularly when it comes to detecting low-quality, faded, damaged, or dirty notes. There is no cost to large cash system participants of accepting a low-quality note – these can be repatriated to the Reserve Bank and exchanged for new notes at the Reserve Bank's expense, and there is little cost of distributing a low quality (but genuine) bank note, as customers will generally be satisfied as long as their note can be spent. However, there is a social cost to distributing low-quality banknotes. If low-quality notes stay in circulation longer than desirable, the overall quality of cash in public use degrades. Fading and damage could make it harder for machines to recognise banknotes, and greater variability in the appearance of genuine banknotes in circulation could make it harder for people to distinguish between genuine and counterfeit banknotes.
10. The Reserve Bank is currently working with the cash industry to improve the resilience and sustainability of the cash system, and this work could result in considerable change to the cash industry. There is a risk that, as new technologies are introduced which enable greater automation and efficiency for individual cash system participants, the overall quality of cash in circulation is reduced, resulting in worse outcomes for all participants. On the other hand, concerns about these risks could constrain innovation and prevent otherwise efficient developments in the industry.

Proposal: Enabling standardised testing of banknote processing devices

11. This paper proposes that the Reserve Bank be given the authority to set standards for devices which check the authenticity and/or quality of a banknote in preparation for its distribution to the public. These regulations would capture automated note dispensers such as ATMs and automated self-check-outs, as well as note counters and sorters used by cash handlers, banks, and large retailers to test the fitness of banknotes before they are distributed by machine or over-the-counter.
12. The purpose of such regulation would be to prevent worn, damaged, or counterfeit notes from staying in circulation, and to lower the costs of banknote quality management and counterfeit detection through standardisation. This would support public confidence in banknotes and coins. Under the proposed regulation, the Reserve Bank could set standards in relation to desired attributes, testing regimes and outcomes for such devices during and after manufacture.
13. To ensure compliance with the standard, the Reserve Bank could issue a notice to require a machine operator to test the machine against the standard and produce the test results to the Reserve Bank. If a machine were found to be non-compliant, the Reserve Bank would issue a notice to cease operation of that machine until it could be satisfied that the machine was compliant. Any person operating a non-compliant device after being issued a notice to cease operations would be liable for an infringement penalty of up to \$3,000, with a maximum fine of \$9000. In practice, the Reserve Bank would employ a risk-based approach to supervision, concentrating its attention on the largest cash handlers, or in areas of particularly high risk.
14. There is a risk of repeated non-compliance if machine operators see the infringement fee as a cost of doing business, or if they simply refuse or neglect to remedy the machine. In such cases, I propose the Bank have the ability to seek an order from the District Court to remove or disable the machine.

Stakeholder Consultation

15. Consultation which has informed these proposals has taken place through surveys in 2017 and 2019 regarding cash use in New Zealand as well as through the following Bank consultation papers:
 - 15.1. The Future of Cash Use – Te Whakamahinga Moni Anamata.
 - 15.2. The Future of the Cash System – Te Pūnaha Moni Anamata.
16. The Reserve Bank received more than 2,700 public submissions to these consultations, including submissions from key industry stakeholders. The Reserve Bank has engaged in extensive consultation with the banking sector in particular. In addition, we also conducted engagements with interest groups, community groups, and iwi throughout New Zealand.

17. General submitters from the New Zealand public demonstrated an ongoing need for cash for some parts of society, and were supportive of the measures proposed.
18. From key cash system participants, including banks, no major objections were raised to the introduction of standards for devices which check the authenticity and/or quality of a banknote in preparation for its distribution to the public. Some cash system participants, including a major manufacturer of ATMs and cash processing equipment, were supportive of the recommendations.

Departmental Consultation

19. The following agencies have been consulted :
 - 19.1. Parliamentary Counsel Office
 - 19.2. Ministry of Justice
 - 19.3. The Treasury
 - 19.4. Ministry of Business, Innovation, and Employment (MBIE)
 - 19.5. Department of Internal Affairs
 - 19.6. Ministry for Primary Industries
 - 19.7. Office for Disability Issues, Ministry of Social Development
 - 19.8. Human Rights Commission
 - 19.9. The Privacy Commissioner
20. The concerns and interests of the above departments have been addressed and incorporated into this paper, with the following exception:

The Office for Disability Issues asked that accessibility issues be addressed by any standards setting mechanism. The Reserve Bank considers that accessibility along with other “front of machine” issues are beyond the narrow scope of this proposal focused on preventing counterfeit and poor quality banknotes being returned to the public. The Reserve Bank will ensure that banknote machine accessibility issues are considered in consultation with stakeholders as part of its expanded stewardship role for the cash system.

Financial Implications

21. The proposals in this paper do not require additional funding for the Reserve Bank or any other agency. Any costs associated with future implementation and monitoring under the new legislation will be considered within the Reserve Bank’s wider operating costs.

Legislative Implications

22. These proposals will be included in the Reserve Bank Act which is already currently under review. The bill does not yet have a slot in the Legislative Programme, but introduction is expected in 2020.

Impact Analysis

23. A Summary Regulatory Impact Statement has been prepared and is attached.

24. A Quality Assurance Panel with representatives from the Regulatory Quality Team at the Treasury and the Reserve Bank of New Zealand has reviewed the 'Standards for devices testing the quality and authenticity of New Zealand bank notes' Regulatory Impact Assessment (RIA) produced by the Reserve Bank of New Zealand in March 2020. The Panel considers that the RIA meets the Cabinet requirements to support its decision.
25. The RIA contains clear criteria to assess a range of options identified. Alongside the non-monetised costs benefits analysis, it also attempts to quantify costs and benefits of the preferred option, with assumptions clearly laid out. The proposal has been well consulted and stakeholders' views have been addressed. It has developed a workable approach to give effect to the new arrangements and monitor the impact of the new arrangements.

Human Rights

26. These proposals are in no way inconsistent with the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

Gender Implications

27. There are no significant gender implications for this policy.

Disability Perspective

28. Cash provides an important equaliser for economic and social inclusion for some people with intellectual/neural (remembering PINs, managing apps or online services), physical (finger dexterity or general mobility), or vision related disabilities.

Publicity

29. The Minister of Finance would announce the policy decisions by speech or media release in conjunction with proactive release of this cabinet paper, subject to any OIA redactions. The Reserve Bank would provide prior confirmation in confidence to commercial bank stakeholders in keeping with its relationship charter and close working relationship with banks on Future of Cash matters. The policy announcement is likely to draw a mix of positive reaction (from groups representing vulnerable cash user communities/demographics) and a muted response from the banking, retail and banking equipment manufacturers.

Proactive Release

30. This paper will be released proactively, in full, subject to redaction as appropriate under the Official Information Act.

Recommendations

The Minister of Finance recommends that the Committee:

1. **Agree** that the Reserve Bank Bill provide that the Reserve Bank shall have the authority to set mandatory standards for devices which test the quality and authenticity of banknotes, such as ATM machines and self-service checkouts and note sorters.
2. **Agree** that such mandatory standards are secondary legislation for the purposes of the Legislation Act 2019.
3. **Agree** that the Reserve Bank may by notice require the operator of a device to demonstrate its machine complies with the standard by testing it against the standard.
4. **Agree** that the Reserve Bank may by notice require an operator of a device to cease operating the device if it does not comply with the standard.
5. **Agree** that an operator who does not comply with a notice as referred to in recommendation 4, or who operates a machine that does not comply with the standard is liable for a an infringement fee of \$3,000 with a maximum fine of \$9,000.
6. **Agree** that in the event of repeated non-compliance with notices issued by the Bank the Bank be given the ability to apply to the District Court for an order to seize or disable the banknote handling machine.
7. **Agree** that the Minister of Finance is authorised to further clarify and develop policy matters relating to the proposals in this Cabinet paper in a manner not inconsistent with the policy recommendations contained in the paper.

Authorised for lodgement

Hon Grant Robertson

Minister of Finance



Cabinet Economic Development Committee

Minute of Decision

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Managing Cash Quality in New Zealand

Portfolio **Finance**

On 3 June 2020, the Cabinet Economic Development Committee:

- 1 **agreed** that the Reserve Bank Institutional Bill provide that the Reserve Bank of New Zealand (Reserve Bank) have the authority to set mandatory standards for devices that test the quality and authenticity of banknotes, such as ATM machines and self-service checkouts and note sorters;
- 2 **agreed** that such mandatory standards be secondary legislation for the purposes of the Legislation Act 2019;
- 3 **agreed** that the Reserve Bank may by notice require the operator of a device to demonstrate that its machine complies with the standard by testing it against the standard;
- 4 **agreed** that the Reserve Bank may by notice require an operator of a device to cease operating the device if it does not comply with the standard;
- 5 **agreed** that an operator who does not comply with a notice as referred to in paragraph 4 above, or who operates a machine that does not comply with the standard, be liable for an infringement fee of \$3,000, with a maximum fine of \$9,000;
- 6 **agreed** that in the event of repeated non-compliance with notices issued by the Reserve Bank, the Reserve Bank be given the ability to apply to the District Court for an order to seize or disable the banknote handling machine;
- 7 **authorised** the Minister of Finance to further clarify and develop policy matters relating to the above paragraphs in a manner not inconsistent with the policy proposals outlined in the paper under DEV-20-SUB-0091;
- 8 **invited** the Minister of Finance to issue drafting instructions to the Parliamentary Counsel Office to give effect to the above paragraphs.

Janine Harvey
Committee Secretary

Present: (see over)

Present:

Rt Hon Winston Peters
Hon Kelvin Davis
Hon Grant Robertson (Chair)
Hon Phil Twyford
Hon Andrew Little
Hon Nanaia Mahuta
Hon Stuart Nash
Hon Iain Lees-Galloway
Hon Jenny Salesa
Hon Damien O'Connor
Hon Kris Faafoi
Hon Shane Jones
Hon James Shaw
Hon Eugenie Sage

Officials present from:

Office of the Prime Minister
Officials Committee for DEV

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Cabinet

Minute of Decision

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Report of the Cabinet Economic Development Committee: Period Ended 5 June 2020

On 8 June 2020, Cabinet made the following decisions on the work of the Cabinet Economic Development Committee for the period ended 5 June 2020:

DEV-20-MIN-0091 **Managing Cash Quality in New Zealand**
Portfolio: Finance

CONFIRMED

Out of scope

Out of scope

Michael Webster
Secretary of the Cabinet

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Impact Summary: Standards for devices testing the quality and authenticity of New Zealand bank notes

Section 1: General information

Purpose

The Reserve Bank is solely responsible for the analysis and advice set out in this Impact Summary, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing Cabinet decisions in relation to regulation of devices that test the quality and authenticity of bank notes.

Key Limitations or Constraints on Analysis

1.1 Scope of this document

This document has been prepared in support of proposed legislative amendments to the Reserve Bank Act 1989 ('the Act'), which is currently under review. It is limited to issues relating to bank note quality and its implications for cash recycling, and does not address other sources of inefficiency in the cash system.

1.2 Policy proposal

This regulatory impact summary is prepared in support of a proposal to develop a legislative framework within the Reserve Bank Act by which the Reserve Bank can set standards for devices that test the quality and/or authenticity of bank notes. The proposal is developed further in section 3.1.1.

1.3 Evidence base and key assumptions and limitations

The Reserve Bank has had access to a wide range of data for identifying the problem and undertaking the impact analysis contained in this review. Data sources include:

- Two public surveys in relation to people's use of and attitudes towards cash
- More than 2,700 public submissions in response to two consultation documents on the topic
- Data collected from banks about their cash transaction volumes over time and the cost of providing cash services

- Data from several major retailers, small surveys conducted by Retail NZ and Hospitality NZ, and a range of other sources about trends in cash use over time.
- Engagement across a large number of community groups and iwi throughout the country

A key assumption of this assessment is that the cost of complying with the new standard is similar to the costs already incurred by the industry for their own testing and due diligence around note processing machines. Some participants may be required to adhere to a more stringent testing regime, and therefore will face higher costs. Others, with stringent existing regimes, will benefit from standardisation and clarity, and therefore will be able to deliver the same quality of assessment at lower cost.

Responsible Manager (signature and date):

Graeme Denny

Denny 17/3/2020

Manager, Planning and Business Performance

Banking Department

Reserve Bank of New Zealand

To be completed by quality assurers:

Quality Assurance Reviewing Agency:

A Quality Assurance Panel with representatives from the Regulatory Quality Team at the Treasury and the Reserve Bank of New Zealand has reviewed the 'Standards for devices testing the quality and authenticity of New Zealand bank notes' Regulatory Impact Assessment (RIA) produced by the Reserve Bank of New Zealand in March 2020.

Quality Assurance Assessment:

The Panel considers that the RIA meets the Cabinet requirements to support its decision.

Reviewer Comments and Recommendations:

The RIA contains clear criteria to assess a range of options identified. Alongside the non-monetised costs benefits analysis, it also attempts to quantify costs and benefits of the preferred option, with assumptions clearly laid out. The proposal has been well consulted and stakeholders' views have been addressed. It has developed a workable approach to give effect to the new arrangements and monitor the impact of the new arrangements.

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

2.1.1 Quality Assurance of Bank Notes

Throughout the country, numerous privately owned machines check bank notes for authenticity (whether notes are genuine Reserve Bank notes or counterfeits), and/or quality (whether notes are faded, damaged, or dirty). These devices include ATMs, automated self-check-out machines, and professional note sorters, such as those operated by banks, casinos, and cash-in-transit operators (CiTs).

2.1.2 Incentives for Quality Assurance

Private agents' incentives are not perfectly aligned with public incentives in relation to authenticating and fitness-testing banknotes, particularly when it comes to detecting low-quality, faded, damaged, or dirty notes. There is no cost to large cash system participants of accepting a low-quality note – these can be repatriated to the Reserve Bank and exchanged for new notes at the Reserve Bank's expense, and there is little cost of distributing a low quality (but genuine) bank note, as customers will generally be satisfied as long as their note can be spent. However, there is a social cost to distributing low-quality banknotes. If low-quality notes stay in circulation longer than desirable, the overall quality of cash in public use degrades. Fading and damage could make it harder for machines to recognise banknotes, and greater variability in the appearance of genuine banknotes in circulation could make it harder for people to distinguish between genuine and counterfeit banknotes.

2.1.3 Efficiency of Quality Assurance

Furthermore, the current system is less efficient than optimal. Because machine operators have limited information about the ability of the machinery they operate to detect unfit notes, and even less information about machinery operated by others, banknotes are regularly transported to and from CiT depots to be sorted by their high-speed note sorters. While these machines perform quality assurance to a high standard, the CiTs and their customers incur high costs from repeated movement of the notes.

2.1.4 Existing Technological Alternatives

New devices are available which employ "cash recycling" technology, whereby notes are accepted from the public, checked for quality and authenticity, and then recirculated back to the public, without needing to be transported back to a CiT. This has potential to greatly improve the efficiency of the cash system, but also to increase the risk of distributing counterfeit, damaged or dirty banknotes. A number of ATMs in New Zealand already have

this capability, although it is currently not in use, partly due to concerns about the risk of distributing counterfeits.

2.1.5 Additional Risks

The Reserve Bank is currently working with the cash industry to improve the resilience and sustainability of the cash system, and this work could result in considerable change to the cash industry (though aspects of this work will be deferred to allow all participants to focus on Covid-19 planning and response). There is a risk that, as new technologies are introduced which enable greater automation and efficiency for individual cash system participants, the overall quality of cash in circulation is reduced, resulting in worse outcomes for all participants. On the other hand, concerns about these risks could constrain innovation and prevent otherwise efficient developments in the industry.

2.2 Who is affected and how?

2.2.1 Regulated Entities

The target entities for intervention would be manufacturers and operators of devices which test the quality or authenticity of banknotes. All major cash system participants, including banks, CiTs and independent ATM operators would be affected, as would some large retailers and operators of vending machines which give banknotes (not coins only) as change.

Some operators of devices which test the authenticity and quality of bank notes would face increased costs. However, if interventions were structured appropriately, standardisation could lower costs across the industry. Operators of such machinery would benefit from a higher quality of banknotes in circulation, as well as greater certainty about the standard to which notes processed by their own devices and others' had been tested.

2.2.2 The Public

The broader New Zealand public would benefit from intervention insofar as it would raise the overall quality of banknotes in circulation. Not only do higher-quality bank notes look and feel better, but they also make it easier to detect counterfeits. Maintaining public confidence in banknotes is crucial for the proper functioning of the cash economy, which Reserve Bank research shows is still vitally important for some people, particularly for more vulnerable part of the economy including people on low incomes, the elderly, rural communities, and people living with certain disabilities.

2.3 What are the objectives sought in relation to the identified problem?

2.3.1 Policy Objectives

The objectives of this policy are to:

- Promote public confidence in New Zealand's banknotes, by improving the overall quality of cash in circulation and making it easier to recognise counterfeit banknotes.
- Enable the cash system to utilise new technologies and support system efficiency in such a way that does not compromise the integrity of our bank notes.

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Section 3: Options identification

3.1 What options have been considered?

3.1.1 Options for standardizing quality assurance of bank notes

Option 1: Authorisation by the Reserve Bank

In this option, only authorised (makes and models of) machines may be used and operated, and either a manufacturer or potential operator can apply to the Reserve Bank to have a model authorised. The Reserve Bank may freely set and change the standards by which authorisation is granted. Attestation, audit, and compliance testing based regimes can all be employed, and authorisation can be linked to a particular standard or can be dealt with on a case by case basis. This is similar to the way the Reserve Bank authorises capital models for non-standardised banks, and is the option that is most similar to the system operated by the European Central Bank.

The Reserve Bank would keep a register of authorised machines, and the use of unauthorised machines would be prohibited for a list of cash related activities such as cash recycling, banknote sorting and quality assurance in banks, and sorting and quality assurance at currency processing depots.

Option 2: Regulatory compliance to standards set by the Reserve Bank

In this option, the Reserve Bank would set out minimum standards that all machines in use for a particular set of activities must meet. For example, each machine may have to pass a particular test at a regular frequency, or may have to demonstrate a particular capability.

Verification could be carried out in a number of ways, including using the Reserve Bank's broad information gathering powers, voluntary attestation, or Reserve Bank audit. Legislation would also need to provide the Reserve Bank with some enforcement power and sanctions.

This option is similar to the authorisation regime, except that rather than the obligation being on the Reserve Bank to authorise, the obligation is on the equipment operator to comply with the universal standards.

Option 3: Status quo (no legislative change)

If the Reserve Bank chooses to take no action, we accept the risk of higher incidence of counterfeit notes and lower note quality, to the likely detriment of public confidence in cash. This could also create barriers to innovation and efficiency that may impact cost saving measures such as cash recycling.

However, we will save some cost in the setting and maintaining of the standards, as well as any compliance monitoring, authorisation and verification activities carried out by both the Reserve Bank and the regulated entities.

This option relies on operator incentives and market discipline to maintain the quality of the stock of banknotes in active circulation. While market incentives may be sufficient to keep the risk of machines accepting and dispensing counterfeits at an acceptably low level, it is unlikely to support the maintenance of the overall standard and quality of genuine notes in circulation in the absence of alternative intervention.

3.1.2 Criteria for assessment of options for standardizing quality assurance of bank notes

In order to determine which of the three options is best we evaluate each proposed option on three criteria:

- Improvement in bank note quality and the detection of counterfeits
- Reducing inefficiency in the cash distribution network
- Achieving the above at the lowest cost to the industry and government

3.2 Which of these options is the proposed approach?

	No action	Authorisation	Regulatory Compliance
Improve Bank Note Quality	0	+	+
System Efficiency	0	+	+
Oversight Costs	0	--	-
Overall assessment	0	0	+

On net both the intervention options increase bank note quality and system efficiency relative to no action, however the regulatory compliance option is able to do this with less oversight costs. It is more practicably workable and allows for greater flexibility in the approach to monitoring and enforcement and is therefore our preferred option.

3.2.1 Authorisation

The authorisation option will create an increase in system efficiency relative to the status quo. This efficiency gain will mostly be realised from improved quality assurance procedures. At present cash-in-transit companies regularly have to quality check cash in the system by transporting cash from the ATMs to CIT depots. Under the new regulation this quality management could largely be done by the ATMs that are considered up to standard. The new quality assurance technology will also likely improve the quality of the notes in circulation, making counterfeits easier to recognise in over-the-counter transactions. Under the authorisation option all makes and models of cash distributing technology would need to be individually authorised before they can be used. As a result this option will likely incur a higher compliance cost relative to the status quo.

3.2.2 Regulatory compliance through standards

The regulatory compliance option will create an increase in system efficiency relative to the status quo. This efficiency gain occurs for similar reasons outlined above. There may be some further benefits for cash system participants from having standardised requirements. The Reserve Bank would employ a risk-based approach to supervision for

compliance, monitoring most closely those cash handlers with the highest volumes processed, or those thought most likely to distribute unfit banknotes. Consequently, the implementation cost would be much lower for regulation through standards than through authorisation and as such, the oversight costs are lower.

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties	Comment:	Impact
Additional costs of proposed approach, compared to taking no action		
Regulated parties	We assume that the technology required to meet the regulatory standards already exists in most of the machines therefore the cost to the regulated parties is negligible.	\$0
Regulators	2 FTEs at \$80,000 to assess compliance from the regulated parties	Present value of \$1.3 million
Wider government		\$0
Other parties		\$0
Total Monetised Cost		\$1.34 million
Non-monetised costs		N/A

Expected benefits of proposed approach, compared to taking no action		
Regulated parties		\$2.4 million to \$3.1 million
Regulators		\$0
Wider government		\$0
Other parties		\$0
Total Monetised Benefit		\$2.4 million to \$3.1 million
Non-monetised benefits	Overall improvement in quality and reduction in counterfeit notes will improve public confidence in banknotes	Low

Enabling of cash recycling technology is expected to reduce the need for cash logistics services, thereby lowering overall operating costs of the system. We assume that CITs' operating costs ^[s 9(2)(b)(ii) & 9(2)(ba)(i)] will fall by 0.5% per annum over the 10-year projection. We then calculate the present value of this projected cost decrease using the 3.25% discount rate. The existence of a standard is expected to reduce quality management costs for some entities and increase it for others, with negligible net impact on costs.

4.2 What other impacts is this approach likely to have?

Since the policy largely incentivizes the use of existing technology to more efficiently and effectively perform a function which is current standard practice, it is not expected to have further material impacts.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?

5.1.1 Consultation Stages

Consultation which has informed these proposals has taken place through surveys in 2017 and 2019 regarding cash use in New Zealand as well as through the following Reserve Bank of New Zealand consultation papers:

- The Future of Cash Use – Te Whakamahinga Moni Anamata.

- The Future of the Cash System – Te Pūnaha Moni Anamata.

The Reserve Bank received more than 2,700 public submissions to these consultations, including submissions from key industry stakeholders. The Reserve Bank has engaged in extensive consultation with the banking sector in particular. In addition, we also conducted engagements with interest groups, community groups, and iwi throughout New Zealand.

The following government departments have also been directly consulted at various stages throughout the policy development process. Not all parties chose to provide comment.

- Parliamentary Counsel Office
- Ministry for Business, Innovation and Employment
- Ministry of Justice
- The Treasury
- Ministry for Primary Industries
- Ministry for Social Development
- Department of Internal Affairs
- New Zealand Police
- Human Rights Commission
- The Privacy Commission
- Department of Prime Minister and Cabinet
- State Services Commission
- Inland Revenue Department
- Ministry for Women

Throughout the consultation process, a large number of public submitters, community groups and iwi demonstrated an ongoing need for high quality cash in some parts of society, and were supportive of the measures proposed.

From key cash system participants, including banks, no major objections were raised to the introduction of standards for devices which check the authenticity and/or quality of a banknote in preparation for its distribution to the public. However, some participants raised concerns about the additional compliance costs that may be imposed. Other cash system participants, including a major manufacturer of ATMs and cash processing equipment in New Zealand, were strongly supportive of the recommendations.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?

6.1.1 Legislative Vehicle

Phase II of the Reserve Bank Act review presents an opportunity to introduce legislative changes to address the problem and objectives outlined in Section 2 through the measures proposed in Sections 3 and 4.

These provisions would indicate a likely future direction towards standards for bank note quality assurance. Such standards will not be implemented immediately, and the Reserve Bank will continue to work with industry participants to develop a set of standards for note quality assurance technology which are appropriate in the New Zealand context.

6.1.2 Impact Assessment for Intervention

[Section 162AB](#) of the Reserve Bank Act 1989 requires the Reserve Bank to assess the expected regulatory impacts of regulatory actions that it intends to adopt, give reports on the assessments to the Minister of Finance, and publish the reports on the Internet. It is anticipated that similar provisions will be adopted in new legislation resulting from the current review of the Act.

6.1.3 Monitoring for compliance and enforcement

Under the proposed legislation, the Reserve Bank will have the legal authority to require the operator of a device for testing the quality or authenticity of bank notes to demonstrate a given machine is compliant by testing it against the standard. If the machine does not demonstrate compliance, the Reserve Bank may by notice require an operator of a device to cease operating the device. An operator who does not comply with a notice or who operates a machine that does not comply with the standard would be liable for an infringement fee.

The Reserve Bank is embarking on a project with the wider cash industry to improve the resilience and sustainability of the cash system. Part of this project will include a redesign of the Reserve Bank's data collection in relation to cash. If the policy proposal is supported by Cabinet, the Reserve Bank will ensure that this collection include sufficient information to monitor for compliance with any standards set.

6.1.4 Transitional arrangements

The introduction of the legislative vehicle will not automatically result in any standards being set or enforced. Instead the Reserve Bank intends to develop the standards alongside the industry, providing ample opportunity for affected parties to trial and provide feedback on the

proposed standards before implementation. Therefore, it is not envisaged that any additional transitional arrangements will be required at the time a standard is implemented.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

7.1.1 Current Oversight of Note Quality

The Reserve Bank is currently responsible for destruction of banknotes which are no longer fit for purpose. In addition, seasonal surpluses of banknotes are routinely returned to the Reserve Bank when they are no longer needed. The Reserve Bank already tests the quality and authenticity of these notes when they are received, and in doing so, keeps track of the overall quality of banknotes in circulation. Similarly, the Reserve Bank will have the authority to collect information about the quality of banknotes already processed by CiT operators. Therefore, no additional monitoring or data collection will be required in order for the Reserve Bank to gain comfort that the banknotes in circulation are of sufficient quality.

7.1.2 Machine Testing

In addition, the Reserve Bank already currently tests the high-speed note-sorters operated by CiTs on a commercial basis. While the commercial mechanism that forms the basis for this relationship is not suitable for the more-decentralised system that is emerging, the types of tests currently run provide a basis for the standards that might be set, as do the standards currently enforced in the Euro Area by the ECB.

7.2 When and how will the new arrangements be reviewed?

7.2.1 Regular 5 Year Review

The suitability of any standard implemented would be reviewed by the Reserve Bank at least once every 5 years. This would not be a statutory requirement but rather best practice by the Bank. As part of the review, the Bank would consider trends in the overall quality of banknotes in circulation over the review period and would seek feedback directly from industry participants through consultation.

7.2.2 Review on Degradation of Quality

Banknote quality and the incidence of counterfeits are already monitored by the Reserve Bank on a continuous basis. In the event that bank note quality were to degrade or

counterfeits in circulation were to rise significantly, the established standards for quality assurance technologies would be reviewed outside of the 5-year cycle.

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