Submission to APRA

Financial Claims Scheme

December 2012

Australian Payments Clearing Association

20 YEARS Improving Australian payments

About this document

This is APCA's submission to APRA responding to the Discussion Paper, '*Financial Claims Scheme for authorised deposit-taking institutions: proposed requirements for payment, reporting and communications*' dated November 2012.

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I. Introduction - Issues addressed in Submission

APCA represents a large number of financial institutions and their payment service providers in respect of matters relating to the payments system. The focus of this submission is therefore on those matters that relate to the payments system - clearing and settlement of payment transactions.

This submission addresses two key aspects from the November 2012 Discussion Paper[1]:

- Pay-out Options, in particular:
    - Alternative ADI Account facility;
    - Access to accounts via the failed ADI – the so-called 'Zombie' bank option;
    - Centralised mechanism for transfer of account balances to new ADI – either using 'zombie' ADI systems or using a central facility;
    - Deposit account transfer; and
- End of Day Balance Calculations.

We understand that many of our members will be providing their own submissions in addition to APCA's submission, which may well cover a broader range of the issues raised in the Discussion Paper. We have restricted our comments to those matters directly relevant to the payments system.

II. Pay-Out Options

We understand from discussions at the recent industry workshop (6 December) that the objectives of the preferred pay-out options are:

- to produce a (relatively) cost effective approach;
- that enables customers to obtain necessary funds quickly; and
- that enables customers to obtain the entire protected balance within a reasonable time.

As a general point, we recognise the difficulty of determining an appropriate pay-out option. Each option has implementation difficulties and short-comings. However, with the above objectives in mind, we consider that there may be better approaches than the currently-stated preferred options – EFT and cheque, particularly considering the proposed pre-positioning requirements for the latter.

APCA seeks clarity as to whether APRA will be adopting a 'one size fits all' approach. Our members have been considering the options presented by APRA on the basis that all ADIs will be required to undertake the same pre-positioning for the same pay-out options. However comments made at the workshop suggest that APRA may have been considering different approaches depending upon the size of the ADI. If this is the case, then it would be helpful to make this express and to determine in advance which pre-positioning requirements would apply to which type/size of ADI.

Pay-out by cheque

We understand from comments made at the workshop that this is seen as the default option, where other options cannot be easily used. Obviously as with all options, cheque pay-out has its limitations – discussed in earlier submissions – not least of which that this is a

[1] 'Financial Claims Scheme for authorised deposit-taking institutions: Proposed requirements for payment, reporting and communications

declining payment method. In the medium term it may be an effective way of making the payment of the protected funds but will not enable immediate access to necessary funds.

EFT pay-out

Of more concern to APCA members is the proposal for pay-out by EFT. The EFT option as currently described requires the development of the proposed alternative ADI account facility. Discussions with members indicate significant difficulties with this option, as discussed below.

Alternative ADI Account Facility

Concerns are mainly in relation to the significant pre-positioning costs that would be incurred for development and maintenance of the proposed alternative ADI account facility. The issue is not the complexity of the facility required, but the level of capacity and robustness that such a facility would require (particularly for a major FI), potentially enabling a large proportion of its customers (several million) to access the facility within a short window.

ADIs at the workshop committed to providing more fully costed estimates of developing such a facility, but initial costings from one major indicate this is likely to be in the order of $10 million for end to end build, maintenance and testing.

The current proposal requires each ADI to develop such a facility, leading to an unnecessary multiplication of costs to develop a facility that will not be used in the vast majority of cases. Further, this approach would not enable fast pay-out for customers without an alternative FI account who would then need to open an alternative account.

If the EFT pay-out option is to be furthered (and as we discuss below our members believe there may be more desirable approaches), our members consider that there may be better ways of implementing this. We see two potential scenarios:

- either the failed ADI remains within the payment system (for certain payment purposes); or
- the failed ADI is removed from the payment system and the payment of the protected balance is made through a centralised facility.

In both scenarios we envisage the need for a centralised single facility to assist with the transfer of the protected balances. Taking each option in turn:

'Zombie' Bank Option

The so-called 'zombie' bank option maintains the failed ADI within the payment system. This approach enables it (under the supervision of a statutory manager) to progress the orderly transfer of accounts over a period of time *and* the ability for customers of the failed ADI to access at least a part of their funds immediately through normal low value retail channels.

The statutory manager could re-open low value retail channels for a period of time. This would enable access to ATM, EFTPOS and online DE (with a lowered transfer limit).

As discussed at the workshop, we consider that the key to the success of this approach would be to retain low value channels within the failed ADI (potentially with reduced daily limits) over a more substantial period of time – potentially several weeks. This would provide a reasonable time for customers to open new accounts without creating administrative failures within the failed bank's systems and could alleviate the effect of a 'run'. This approach could be combined with the ability for customers to transfer the protected balance through a centralised mechanism discussed below.

Changes to APS910, the RITS Regulations to facilitate settlement of interbank payments, and a guarantee of the settlement obligations for such payments (as a minimum) would be needed for this option to be viable. Effective communication to its customers would be essential to maintaining order.

We recognise that this approach has its limitations, but may be a better option than several of the other approaches proposed in meeting the objectives of cost-effectiveness and immediate access to customer funds. Limitations include:

- There is a risk of customers breaching the protected balance limit. However, this may be an acceptable risk given that only low value payment channels will be open, with potentially lower daily limits – it would be time-consuming to remove large sums of money even over several weeks;
- A longer period where the failed bank is maintained within the system also throws up issues in relation to the point of calculation of the protected balance;
- Further issues in relation to this approach have been previously identified in APRA's discussion paper, submissions and at the workshop, particularly the logistical challenges (eg filling ATMs). However, we consider that having several channels open for a longer period with a strong communications effort to reassure customers may alleviate these issues to some extent.

Centralised Mechanism

Our members propose considering the feasibility of the development of a centralised facility to be used to capture alternative account details – ie this facility would be built and maintained once only centrally, rather than by each ADI. The RBA would need to assume a central role in this approach.

Where the failed ADI is maintained in a 'zombie' state, the failed ADI could receive and process alternative ADI requests for protected balance transfer via such a centralised facility.

Where the failed ADI is not kept open, this approach operates as a variation of the EFT pay-out option – but with a centralised facility developed to provide the data capture for alternative ADI accounts to which protected balances could be paid.

Although this would have a development and build cost, it would be done once only. Whereas detailed logistics of this approach need to be managed, our membership has expressed enthusiasm for giving serious consideration to this proposal, based upon the cost-effectiveness of the approach.

Broadly, we propose something along the following lines:

1	At the time of appointing a statutory manager or liquidator an FCS media release will advise account-holders to open new accounts at an ADI of their choice.
2	An SCV will be generated by the failed ADI.
3	Account-holder opens a new account with an alternative new ADI to receive FCS payment or already has existing alternative ADI, and

	authorises new ADI to request SCV/FCS data on its behalf and draw on RBA for the its protected balance. . New ADI identifies account-holder.
4	New (or other) ADI sends request in a secure manner to the proposed central facility (providing BSB and account number) to request the FCS payout amount (and potentially receive the list of regular payments). Note: sufficient details should be provided by the new ADI for the customer to be identified in the SCV (e.g. full name, date of birth and at least one valid BSB/Account number that matches within the SCV).
5	Failed ADI (if in zombie state) or RBA (as central processor of requests) alerted through central facility to action request.
6	Failed ADI (if in zombie state) or RBA (as central processor of requests) creates response with SCV/FCS payout amount and sends to new ADI through central facility.
7	Receiving new ADI credits FCS payout amount to account-holders account.
8	New ADI makes drawing on RBA for FCS payout amounts credited to customer accounts.

We would be happy to establish a working group of our members to consider how an approach along the lines set out above would be managed. We stress that, at this stage, this is an idea, rather than a fully resolved proposal.

Deposit Account Transfer

Members raised significant concerns as to the feasibility of this approach. It was broadly agreed that this option was not promising, given the difficulties involved in the partial transfer of a failed ADI's deposit book ie protected accounts up to the protected balance only. This option is seen as viable only on the transfer of the whole business of the failed ADI, given the operation of the business transfer legislation.

In order to keep the protected accounts at the failed ADI operational within the payments system these would need to be transferred with the BSB and account numbers of the failed ADI and those parts of the failed ADI's banking system necessary to operate that part of the ADI's business. How these accounts (or partial accounts) would then be treated in the failed ADI and what systems would be necessary to manage them would then be in issue.

Our members consider that this approach would require a great deal of pre-positioning and would not be cost-effective, if indeed it was possible to do so at all. The difficulties lie in the level of integration of many ADIs' banking systems and how these could be effectively separated for the purposes of transferring a specific part of the failed ADI's business.

III. EOD Balance Calculation Issues

We raise below several issues of detail that we consider may need to be addressed to facilitate the calculation of the EOD balances. As discussed at the workshop, we consider that it would be useful to work through a number of scenarios that address these and other issues with a smaller working group. APCA would be happy to participate in or facilitate such a working group.

Cheque

- To clarify that the operation of section 70A Cheques Act applies to all cheque transactions regardless of their status within APCS ie applicable also to Tier 2s;
- To clarify what happens to purchasing customer accounts in relation to bank cheques deemed to be dishonoured by operation of section 70A;

DE

- To determine mechanisms to enable a failed ADI to identify which files have been posted at another ADI (since these are not reversed) NB same for BPay;
- To determine mechanisms to enable a failed ADI to identify whether a DE payment file is from a protected account – not possible to distinguish from DE file message format – what if only part of the payment file is protected?

Impact of Intraday Settlement in BECS

- RITS Regulations and BECS procedures provide for ‘rollover’ of File Settlement Instructions to next multilateral intraday settlement if intraday liquidity is an issue;
- RITS Regulations require removal of unsettled FSIs from the queue upon an Insolvency Event[2];
- Therefore failed ADI will not be able to roll-over;
- If the failed ADI has exchanged (but not yet settled) credit files that the receiving ADI has posted, under APS 910, these would stand;
- If the FSI for such credit file has not been received by RITS or it is queued in RITS at the time of the declaration – it will be removed from RITS. This could happen after a credit item has been posted by the receiving ADI;
- Such transactions are therefore excluded from the settlement system in accordance with RITS Regulations, but stand for the purposes of APS 910;
- How is it settled? Bi-lateral cash transfer is not possible – removed from RITS;
- Some ADIs may post before the FSI is settled;
- Also, if non-failed ADIs have rolled over FSIs where funds due to failed ADI, how are these settled as failed ADI cannot put in another FSI? Bi-Lateral cash transfer in RITS not available.

IV. Way Forward

Our members consider it is important to determine the pay-out method before getting too far advanced on other matters dependent upon this.

We would be able to co-ordinate an industry working group to consider feasibility and development requirements of the centralised facility discussed in our submission.

In relation to detailed issues in respect of EOD balances, we support the establishment of a small working group to resolve issues of detail.

[2] NB we need to ensure this would also cover a FCS pre-insolvency event, in the event that changes are made to the Banking Act in relation to FCS triggers;