



Reserve Bank
of New Zealand
Te Pūtea Matua

Summary of Submissions and Next Steps

on the ESAS Access Review (Risk Assessment Framework)
Consultation Paper

October 2023

UNCLASSIFIED

Contents

Background	2
Consultation Process	2
Main Messages	3
Feedback on the Description of the ESAS Purpose and Objectives	3
Feedback on Our Considerations for Opening up ESAS	4
Feedback on the Draft Risk Assessment Framework	5
Our Response	6
Next Steps	7
Appendix 1 Consultation on ESAS Risk Assessment Framework	8

Background

The Reserve Bank of New Zealand – Te Pūtea Matua (we/the Reserve Bank) published a Consultation Paper, “ESAS Access Review: Risk Assessment Framework for ESAS”, on 15 June 2023, with the submissions period closing on 27 July 2023. This CP sought feedback on our initial thinking around opening up access to our Exchange Settlement Account System (ESAS), by presenting our proposed purpose and objectives for ESAS and our Risk Assessment Framework.

The Consultation Paper first provided an overview of the issues that the Reserve Bank needs to consider as we contemplate allowing new participants into our ESAS. It outlined the sorts of issues we will need to weigh up in considering opening up access, and also presented our objectives for ESAS and where these objectives may be further supported by a wider access policy. We then consulted on the Risk Assessment Framework (RAF) for use in assessing future ESAS membership applications.

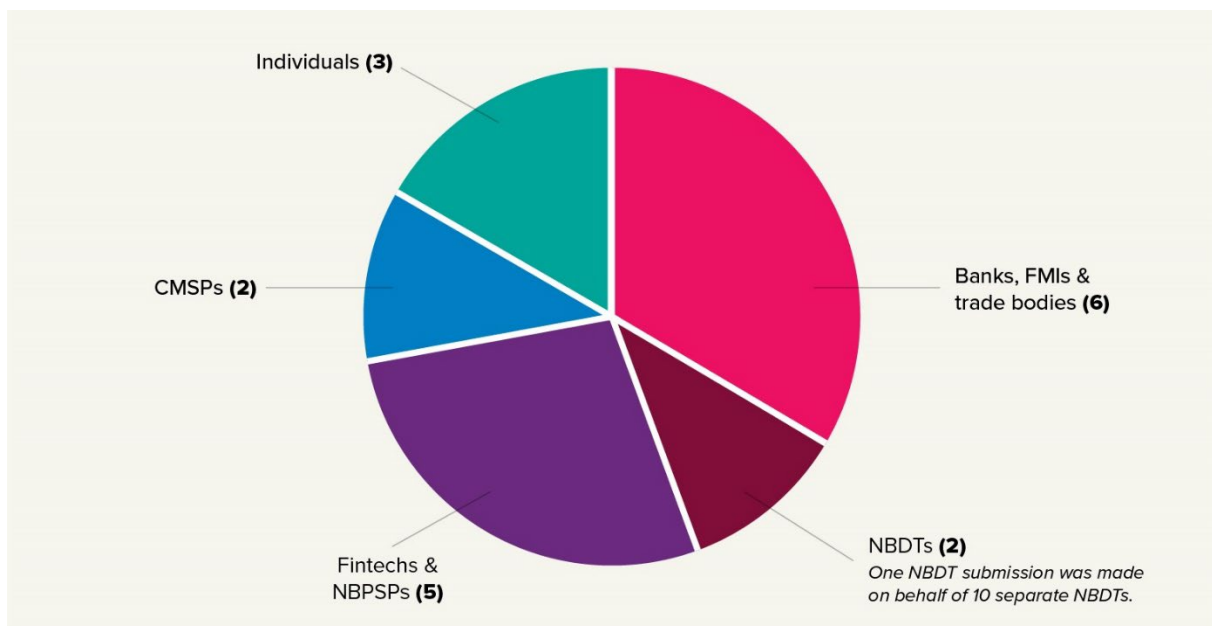
In this Consultation Paper, we did not consult on whether or not to allow new participants into ESAS; this will be the subject of consultation in the next Consultation Paper, to be published later this year or early next year.

Consultation Process

We emailed around 3,400 recipients. This included subscribers to relevant email distribution lists: money, cash and payments policy, ESAS and NZClear, along with prospective ESAS applicants known to us. We also publicised the consultation through several social media channels.

We received 18 submissions when the consultation closed. These submissions came from a cross-section of stakeholders, including banks, financial market infrastructures (FMIs), trade bodies, Non-Bank Deposit Takers (NBDTs), Non-Bank Payment Service Providers (NBPSPs) and fintechs, Cash Management Service Providers (CMSPs) and individuals. Graph 1 below illustrates the make-up of the submitters. One NBDT submission was made on behalf of 10 separate NBDTs.

Graph 1: Make-up of submitters



Main Messages

In this section we highlight some key messages from the submissions. This is not exhaustive. The submissions, subject to necessary redactions, will be published on the RBNZ website.

Feedback on the Description of the ESAS Purpose and Objectives

We sought feedback on our description of the purpose and objectives of ESAS.

There was strong broad support for the importance of ESAS within the financial system and its overall purpose, with submitters providing comments on the relative priorities of the different purposes and objectives.

Several bank respondents emphasised ESAS's priority in ensuring a high level of integrity and reliability given the importance of its role in the transfer and settlement of funds in the New Zealand market.

Role of ESAS in Supporting Innovation

In discussing the objectives, several submitters remarked on the reference to innovation. The objectives referred to ESAS contributing to payments systems by being open to innovation and supporting competition without creating undue risks.

One respondent commented that the ESAS objectives must firstly align with the Reserve Bank of New Zealand Act 2021 in regard to financial stability, and questioned how reliability, efficiency, innovation and inclusion are measured.

One non-bank respondent saw the need to align the ESAS objectives clearly with the Council of Financial Regulators' (CoFR's) vision for the future of New Zealand's payments, including the objective that "New Zealand has reliable and efficient money and payments systems that support innovation and inclusion". In this regard, the respondent suggested that the wording of the ESAS objectives as "being open to innovation" did not carry the same level of commitment to innovation as stated by CoFR.

An NBPSP respondent, whilst agreeing that ESAS largely delivers on the objective of having a high level of integrity and reliability, did not consider the objectives relating to innovation and competition to have been met. Another respondent cautioned against assuming that innovation will only arise from the payment channel.

Wider Use of ESAS (Beyond Settlement of Payments)

We received substantial feedback on opening up ESAS for uses beyond payment settlements.

A respondent representing a group of NBDT clients noted that enabling NBDTs to gain access to ESAS accounts would close a gap that exists within the Reserve Bank's stated financial stability objectives of protecting and promoting the stability of New Zealand's financial system. They submitted that ESAS has an additional purpose of providing high-quality liquid assets to the financial system.

Submissions from those in the cash-management industry also submitted on access to ESAS for the purpose of purchasing New Zealand currency directly from the Reserve Bank.

There was a suggestion that the ESAS payments system is a subset of financial market systems. As such, the objective should recognise that resiliency is related to more than the structure of ESAS itself. By restating Objective 1 to reflect this fact, the respondent contended that the purpose of ESAS as set out in the Consultation Paper would align more closely with the restated objectives, namely to “support the soundness of the *financial system*”, the “implementation of monetary policy” and the “carrying out of the central bank functions” more broadly. This respondent also noted that given the importance of Objective 2 (monetary policy implementation), the wording of Objective 1 (which refers to the payments system) should not, when read together, limit the extent of the ESAS access review to opening ESAS accounts solely for the purpose of settling transactions from the Settlement Before Interchange (SBI) Payments NZ authorising system.

Feedback on Our Considerations for Opening up ESAS

The Consultation Paper also discussed the risks and benefits of opening up ESAS and sought feedback on these considerations and any we may have missed.

Many submitters agreed that opening up ESAS to a broader range of participants would potentially enhance competition and support further innovation.

Alignment with Wider Vision, Mandate

Some perceived that the Reserve Bank has until now prioritised integrity and reliability over all other objectives, with the result that the system has proven to be reliable, but at the expense of achieving material gains in efficiency, innovation and competition. They regarded that doing so would help align our purpose and objectives with the vision presented by CoFR for the future of New Zealand’s payments. Some respondents considered the proposed ESAS objectives as being insufficiently aligned with the financial stability mandate as stipulated in the Reserve Bank of New Zealand Act 2021.

Impact on Competition

Furthermore, some noted the recent reduction in competition for the supply of agency banking services in New Zealand, and that fewer ESAS members providing these services had led to there being less innovation and less competition in the New Zealand payments market. Another pointed to the various costs and limitations associated with accessing ESAS through agent banks, including the agent banks having visibility of firms’ payment flows through this arrangement. Understanding an applicant’s motivations for applying for direct ESAS access would help shed light on the risks associated with that applicant.

Some bank and non-bank respondents saw the benefit of allowing CMSPs access to ESAS, as one way of improving financial inclusion and addressing the needs of those end users reliant on cash. By enabling CMSPs to gain direct ESAS access they will be able to facilitate cash provision without incurring unnecessary intermediation fees.

In feedback on the RAF itself, some submitters noted the lack of exploration regarding the risks of upholding the existing barriers to entry and the associated stifling of innovation as a point to address.

Feedback on the Draft Risk Assessment Framework

We presented our draft RAF and the rationale behind it and sought feedback on omissions and misrepresentations and any other general matters.

Coverage of Risks

Many submitters were supportive of the Framework as comprehensive in its coverage of the main risks, regardless of whether they were existing ESAS members or otherwise. Of the three risk types, operational risk was identified as the most significant. One bank noted that participation in ESAS requires a certain level of operational capacity and ongoing investment as systems and technologies evolve, which may pose a challenge for smaller organisations that are resource-constrained.

Some respondents regarded the current taxonomy of these risks as set out in the RAF as being incomplete and overly simplistic. They contended that this misrepresented the underlying substance of these risks, how they interacted and the diverse ways in which they could manifest in practice. They recommended that if the framework were intended as a heuristic approach to dealing with the complexity, this should be clarified up front, and its logic explained accordingly. For example, operational risk as a category should be disaggregated in the way that most financial institutions now characterise this risk category. The added granularity would enable greater alignment with the frameworks of the existing ESAS participants and support the precise risk mitigation intervention at an individual participant level.

Entities' Risk Profiles Too Broad and Consequently Incorrect

One respondent considered the sweeping categorisation of NBPSPs as being engaged in inherently risky behaviour without any evidence as being subjective, discriminatory, and incorrect. As such, this respondent considered the draft RAF to be unsuitable for the modern payments system and that it would not deliver on the Reserve Bank's competition and innovation objectives. They commented that, for those NBPSPs that are subject to the FMI regime in particular, the requirements under the FMI regime should be sufficient to mitigate the risks.

Similarly, there was respondent caution against building an RAF around an assumption that all incidents by any members would have the same levels of consequence.

Some submitters commented that for participants who are not seeking to use ESAS for settlement of payments, a more limited risk profile should be applied and that this should be reflected in the RAF.

Inclusion of Mitigations or Controls

One submitter commented that the RAF could be strengthened by the addition of mitigations/special conditions or controls to support a transparent access policy. Another submitter commented that the RAF currently lacks references to any mitigating actions an NBPSP applicant could take to reduce risk.

Respondents Saw a Need for the Reserve Bank to Take Account of Various Regulatory Changes Affecting ESAS Participants

Respondents flagged various pieces of legislation that are either currently being considered or are coming into effect in the coming years, such as the Customer and Product Data Bill, Deposit Takers Act 2023 and Retail Payment System Act 2022. They were concerned about the cumulative impact of these regulations potentially thwarting the intended outcome of opening up ESAS participation to encourage greater competition and innovation, as envisaged by the Reserve Bank.

One submitter also suggested that, where possible, consideration should be given to streamlining the application/joining process with Payment NZ's application process for the clearing systems.

Our Response

We thank all respondents for their thoughtful contributions to the issues raised in this paper. We are assessing and considering these, with our initial responses outlined below.

ESAS Purpose and Objectives

We agree with the feedback on the purpose and objectives of ESAS and on the importance of ESAS having a high degree of integrity and reliability. We intend to review the language and frame the purpose to focus on the actual functions ESAS performs, namely payment settlements, and monetary policy implementation. We will also clarify what we mean by innovation and competition, and their priorities relative to other priorities such as integrity and reliability.

Opening Up ESAS

We acknowledge the different objectives that entities have for accessing ESAS and that not all entities seek ESAS for payments and settlements purposes. In particular some entities are seeking access to ESAS for the purpose of accessing high-quality liquid assets (HQLA) in order to meet regulatory requirements, and to earn interest on ESAS balances at the Overnight Cash Rate (OCR).

Granting ESAS accounts to participants for the sole purpose of holding HQLA (as opposed to a consequence of holding ESAS balances for settlement purposes) would represent a significant change from the way ESAS was originally designed to be used. However, further consideration of these issues is warranted and will be consulted on.

Risk Assessment Framework

Respondents by and large confirmed our view that, overall, the draft RAF was broadly appropriate. However, to incorporate feedback around making the framework entity neutral we intend to refine the draft framework by identifying all the implicit assumptions that may have been made in respect of the entities likely to apply for ESAS membership, and amending these to ensure that the framework focuses on the risks associated with the activities undertaken within ESAS, irrespective of their regulatory status (i.e. whether the RBNZ regulates them or not).

We will also consider what appropriate risk-mitigation measures and controls can be included, to provide for more permissive access requirements. This may be especially relevant where a regulatory framework does not already exist for an applicant in relation to a specific risk.

Furthermore, to provide greater transparency for those navigating ESAS access requirements, we will consider what guidance we can release to support the application process.

Other Feedback/Considerations

We agree that the access policy itself must be compliant with relevant regulatory standards. We will continue to consider how the FMI standards, while not yet in force, relate to the ESAS access policy and criteria.

We acknowledge the changing regulatory environment and agree that the revised access policy should be fit for purpose against this backdrop.

We will consider where improvements towards streamlining the ESAS application process with that of the upstream High Value Clearing System/Settlement Before Interchange (HVCS/SBI) can be made to reduce undue burden on applicants.

Next Steps

We will continue to work on the issues raised in the feedback and prepare a revised version of the RAF. We will also seek greater transparency to help ESAS applicants navigate access requirements and explore streamlined application processes with that of the PNZ-run clearing systems, where appropriate. Alongside this, we will release an updated ESAS purpose and objectives statement.

However, the main focus of the next consultation paper will be on the draft ESAS access policy. We envisage this to comprise the principles from which the access policy is derived as well as the process involved in the ESAS application. We will also set out our thinking concerning the use of an ESAS account as a solely interest-bearing reserve account, and how this would affect our access policy.

Given the substantive issues raised as part of submissions, we note there will be an impact on our timeframes; we are expecting to release a second Consultation Paper in late Q4 2023 – early Q1 2024. This will allow us time to work through the broader issues.

Appendix 1 Consultation on ESAS Risk Assessment Framework

We described our purpose and objectives as:

- The purpose of ESAS is to:
 - support the soundness of the financial system by providing for irrevocable, risk-free settlement in central bank money.
 - support the Reserve Bank's implementation of monetary policy.
 - otherwise support the Reserve Bank in carrying out its central bank functions.
- The Reserve Bank's objectives for ESAS are that:
 - ESAS has a high level of integrity and reliability, and contributes to payments systems being efficient by being open to innovation and supporting competition, without creating undue risks to the payments system.
 - ESAS provides effective support for the implementation of monetary policy.

We sought feedback on the following questions:

- Consultation questions
 1. Do you have any feedback on how we have described our objectives for ESAS?
 2. Do you have any feedback on our considerations for opening up ESAS?
 3. Please review the RAF and provide your views on the following:
 - i. Do you consider that there are any substantive risks that are not included in the RAF that should be included in order to safeguard the continued operation of ESAS?
 - ii. Do you consider that any of the risks set out in the draft RAF have been misrepresented?
 - iii. Is there any further feedback you would like to provide with regards to the draft RAF?