



Reserve Bank
of New Zealand
Te Pūtea Matua

Proposal to recommend the designation of the High Value Clearing System

Consultation Paper

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CONSULTATION
PAPER



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Executive Summary

The Reserve Bank of New Zealand – Te Pūtea Matua (**RBNZ**) is proposing that the Minister of Finance designates the High Value Clearing System (**HVCS**). This proposal is made under the Financial Market Infrastructures Act 2021 (**Act**).

The HVCS is a pure payment system operated by Payments NZ Limited (**Payments NZ**). It plays an important role in New Zealand's financial system by making sure that large payments, such as house settlements, are cleared and able to be settled. In 2024, the HVCS cleared more than the equivalent of New Zealand's GDP every month on average (\$420 billion).¹ In addition, the HVCS cannot be easily substituted by another system and disruption to its activities could damage New Zealand's financial system. The HVCS is not currently regulated by us.

Designating HVCS would allow us to regulate and supervise the HVCS. This would require it to comply with the Act and FMI Standards and this would help us to achieve the following purposes of the Act:

- ensure financial market infrastructures (**FMI**s) are operating in a way that promotes a sound and efficient financial system;
- reduce the damage that could arise from a failure of an FMI or other financial system distress; and
- promote confident, informed, fair, efficient and transparent financial markets.

Designating the HVCS would also allow us to review how it complies with the FMI Act and Standards and gives us power to require it to make any changes needed to comply. We acknowledge that Payments NZ already chooses to apply some international best practice principles in how it operates the HVCS.

Finally, designating the HVCS would provide stronger legal protections for its rules. These protections include ensuring the HVCS settlement instructions and the basis for determining settlement obligations are valid, legally enforceable and cannot be reversed. This “finality of settlement” would help promote confidence in the financial system.

Our proposal considers the requirements under the Act including the matters that the regulator may have regard to for its recommendation. It also sets out what HVCS rules would be included in a designation notice.

We welcome feedback on this proposal from all participants or interested parties of the HVCS. Please send your feedback to FMIconsultation@rbnz.govt.nz or by writing to us at FMI Supervision, Reserve Bank of New Zealand, #2 the Terrace, PO Box 2498 Wellington 6140.

Submissions will close on 30 September 2025, and we will consider all submissions before we decide whether to make a recommendation to the Minister of Finance.

¹ GDP as at September 2024. Payments NZ reported a total transaction value of \$15,256.4 billion for the HVCS in 2024. This value which includes ‘on us’ transactions is, on average, more than three times the amount of New Zealand's GDP per month in 2024. We have only considered the interchange value of \$6,280.8 billion that the HVCS cleared, which is, on average, more than 1.2 times New Zealand's GDP per month in 2024.

1 The High Value Clearing System

This section explains what the HVCS is and sets out the key components for making a recommendation to designate it. In this section we define the HVCS as an FMI and a pure payment system, we also define the operator of the HVCS, and its rules. These definitions are set out in the draft designation notice.

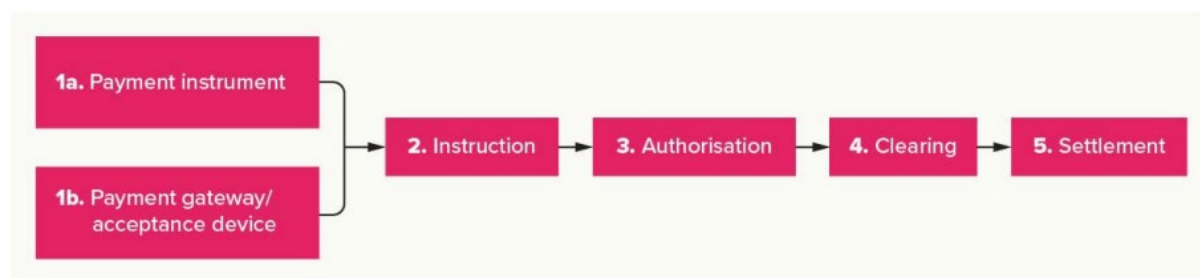
The FMI – The HVCS

This proposal and the draft designation notice specify the FMI as the HVCS.

The HVCS is a multilateral system for clearing payments. Under section 5 of the Act, clearing means the process of transmitting and reconciling transactions that are intended to result in settlements including the confirming of the transactions (that is, verifying their terms with the parties or other relevant persons).

Figure 1 provides a general explanation of an electronic payment process and shows where clearing fits into that process. It emphasises that several systems, services and products are needed to complete the payments process. Clearing is a distinct and important step in this process. A range of different entities provide the systems, services and products required to complete each step, and differ depending on the type of payment being processed.

Figure 1: The payment process



Source: *Dudson et. Al. 2022. New Zealand's Payment Landscape: A Primer. Reserve Bank of New Zealand*

The HVCS is one of the clearing systems operated by Payments NZ. The HVCS is a set of rules, standards, and procedures that allow participants to confirm information about high-value payments. For example, the HVCS sets out what payment information must be sent between the payer and payee. It also sets out the timeframes for completing the transaction. The HVCS rules are multilateral, this means they apply to all system participants. Therefore, the HVCS meets the definitions of clearing and of an FMI under section 5 of the Act.

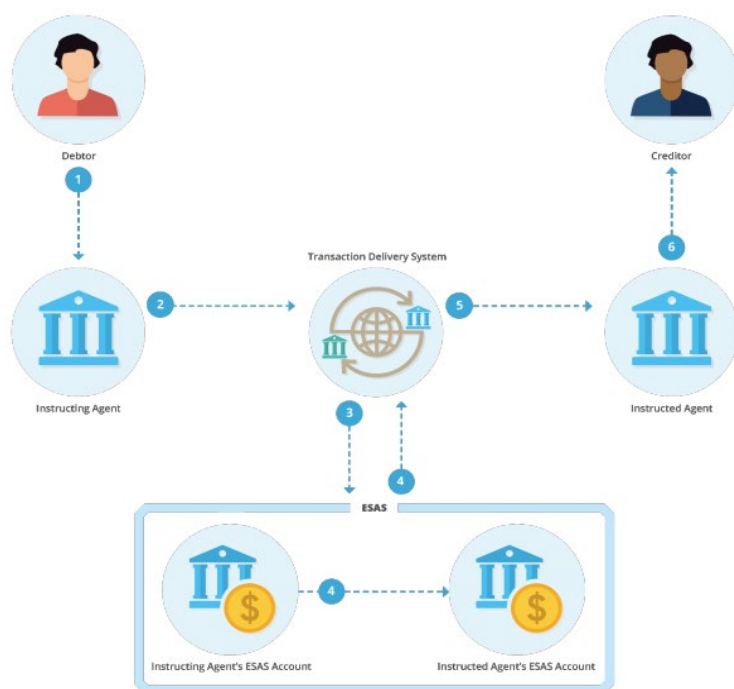
The HVCS participants use the Society for Worldwide Interbank Financial Telecommunications (SWIFT) transaction delivery system to send messages that confirm payments.² The payments are then settled in a different FMI called the Exchange Settlement Account System (ESAS). As depicted in figure 1, settlement is a separate action to clearing. Settlement is the making of a payment as per the definition in section 5 of the Act.

The HVCS steps to clear a high-value transaction are depicted in Figure 2:

² The SWIFT system is widely used by other FMIs and financial institutions globally for the purposes of exchanging values and messages for a multitude of transactions including the HVCS payments.

1. The debtor sends a payment instruction to the instructing agent.
2. The instructing agent sends a payment message using the Assured Value Payment (AVP) closed user group (CUG) in SWIFT's transaction delivery system.
3. SWIFT's transaction delivery system sends a settlement request to the ESAS.
4. Settlement then occurs. The ESAS settles the HVCS payment by debiting the instructing agent's settlement account and crediting the instructed agent's settlement account with the amount of the HVCS payment; and then notifies SWIFT's transaction delivery system of settlement of the HVCS payment.
5. SWIFT's transaction delivery system confirms the settlement has occurred in a message to the instructed agent.
6. The instructed agent credits the creditor's account.

Figure 2: The HVCS process



Source: Payments NZ

The HVCS is a pure payment system

This proposal and the draft designation notice specify that the HVCS is a pure payment system.

The HVCS is a multilateral system. It is solely for the clearing of payment obligations between participants as described above. As the HVCS is a multilateral system solely for the clearing or settlement of payment obligations, it is a pure payment system under the definition in section 10(2)(b) of the Act.

The operator – Payments NZ Limited

This proposal and the draft designation notice specify Payments NZ as the operator of the FMI.

Payments NZ maintains or administers the rules of the HVCS. It is the operator of the FMI as defined in section 5 of the Act.

The documents that set out the FMIs rules

This proposal and the draft designation notice specify the documents that set out the HVCS rules.

We have identified the HVCS Rules as set out in Annex B. We consulted with Payments NZ on which documents set out the HVCS rules. This is discussed in more detail in section 5 of this proposal.

2 The HVCS is systemically important

This proposal and the draft designation notice specify that the HVCS is systemically important.

We conducted an initial assessment of the systemic importance of the HVCS in October 2023 in line with our Systemic Importance Framework.³ This assessment considered the definition of “systemically important” in section 28 of the Act and the elements required under section 24 of the Act and concluded that the HVCS is systemically important. The systemic importance assessment is summarised below and set out in more detail in Annex D.

Size of the FMI (section 24(a))

- The HVCS clears a significant value of New Zealand’s payments. Over 2018 to 2022, on average, the HVCS cleared the equivalent of New Zealand’s GDP (\$380 billion), every quarter.⁴ This value has increased. In 2024, the HVCS cleared on average, the equivalent of New Zealand’s GDP (\$420 billion) 1.2 times a month.⁵ There are 14 direct participants in the HVCS and 14 indirect participants.

Types of participants (section 24(b))

- The direct participants of the HVCS consist of multiple systemically important banks and FMIs.⁶ Three direct participants also allow several indirect participants to use the HVCS through agency arrangements. Indirect participants consist of banks and other financial institutions such as credit unions and building societies.

Nature and scope of activities (section 24(c))

- The HVCS plays a fundamental role in clearing high-value payments in New Zealand to facilitate settlement of these transactions.
- The HVCS rules set out how participants exchange payment instructions in a decentralised settlement model. This is where there is no central clearing house. The HVCS is interconnected

³ See <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/financial-market-infrastructure-oversight/regulatory-developments/fmi-systemic-importance-framework-january-2022.pdf>.

⁴ GDP as at December 2022.

⁵ GDP as at September 2024. Payments NZ reported a total transaction value of \$15,256.4 billion for the HVCS in 2024. This value which includes ‘on us’ transactions is, on average, more than three times the amount of New Zealand’s GDP per month in 2024. We have only considered the interchange value of \$6,280.8 billion that the HVCS cleared, which is, on average, more than 1.2 times New Zealand’s GDP per month in 2024.

⁶ Systemically important banks are defined as per requirements set for them under the Banking (Prudential Supervision) Act 1989.

with the ESAS as high-value transactions that are cleared in the HVCS are settled in the ESAS. This is described in Figure 2 in section 1 of this proposal.

- The smooth processing of the HVCS transactions depends on participants complying with the HVCS rules and procedures. It also depends on the rules being fit for purpose. The HVCS participants are bound by the Payments NZ rules that cover the following:
 - access to clearing systems
 - risk management
 - security and operational reliability
 - system resilience
 - participant default
 - certainty in relation to end to end clearing and settlement of transactions, and when debts are created and discharged
- The HVCS also demonstrates interconnectedness with the external critical service providers. This includes the SWIFT messaging service.
- If the SWIFT infrastructure is unavailable, the HVCS payment system would operate under its third level contingency model (3LC) and bypass the SWIFT infrastructure. However, operating under a back-up model for an extended period is likely to affect efficiency and settlement within the financial system.
- In summary, the HVCS is important for high-value payments in New Zealand. It is a multilateral model with standard agreed rules between all parties and improves the efficiency of high-value transactions. This is more efficient than correspondent banking or bilateral agreements that require individual transactions and agreements between parties.

Concentration of financial risks (section 24(d))

- The HVCS is a rules body operated under Payments NZ that supports the interoperability of high-value transactions in New Zealand, with the market share reflected in the net interchange volumes and values of the HVCS participants. The data provided by Payments NZ is based on the calculated national interchange volumes advised. The HVCS's New Zealand market share is significant given the number of exchanges between participants, and the value of the transactions is considerable. The average annual value of the HVCS transactions over three years from 2018 to 2020 was \$5.37 trillion.⁷
- There is no credit or liquidity exposure in the HVCS as it is a clearing system. No funds are exchanged in the HVCS.
- Participants are vulnerable to contagion risk. That is the risk of being disruption due to the disruption from other participants of the same FMI. Data provided to us by Payments NZ indicates that there is substantial concentration in the five largest HVCS participants. These five participants represent approximately 89% of settled volumes. This means contagion risk may be large. Any issues with these participants could have a flow-on effect to direct and indirect participants and their customers. Systemic issues could lead to liquidity pressures with delayed

⁷ See <https://www.paymentsnz.co.nz/resources/articles/new-zealand-payments-stats-2020-in-review/>

settlements, incurring costs for direct and indirect participants, as well as their customers who are unable to meet payment obligations on time.

- It should be noted that because settlement of the HVCS transactions occurs in the ESAS, the impact of any contagion amongst the HVCS participants would be felt in that system.

Substitutability of the HVCS (section 24(e))

- The HVCS is not easily substitutable by another FMI. Financial institutions would need to use correspondent banking or bilateral arrangements if they did not have HVCS rules. This would require separate negotiations that could take considerable time. During this time, New Zealand participants may face a risk of payment failure. This could impact the stability of the New Zealand financial system.
- If Payments NZ were to stop operating, then another operator would need to govern and administer the HVCS. This could be a slow transition and would require the participants of the HVCS to agree to the new arrangements. A change of operator could undermine the validity of the HVCS rules and existing agreements between Payments NZ and participants. This could cause uncertainty and loss of confidence in the financial system until a new operator or system is set up.

Disruption of the FMI (section 28(1)(a))

- Disruption of the HVCS could threaten confidence in the New Zealand financial system. High-value transactions would then need to be cleared using an alternative arrangement. This may introduce operational risks and delays. Particularly if participants use untested or unfamiliar processes. Delayed or unsettled high-value payments have the potential to threaten the soundness and confidence in the New Zealand financial system.

Engagement with Payments NZ on the systemic importance of the HVCS

We shared our systemic importance assessment with Payments NZ in October 2023. Payments NZ responded to us in a letter on December 2023. It acknowledged the importance of the HVCS to the financial system and put forward several arguments related to our assessment. We considered their arguments and remain of the view that the HVCS is systemically important as per the definition in section 28 and having considered the matters specified in section 24 of the Act. Our reasons are explained below in relation to each point raised. Payments NZ:

- Put forward its view that volumes in the HVCS are relatively small and stated that Payments NZ does not process, clear or settle any transactions. However, we consider that the total value and volume of transactions that go through the HVCS are significant and that the HVCS meets the definition of a pure payment system as defined in section 5, being a multilateral system solely for the clearing of payment obligations.
- Agreed that there are 14 direct participants of the HVCS but stated that there are not 14 indirect participants based on what they considered to be an uncertainty in the definition of the term "indirect participant" in the Act. However, we consider that the definition of "indirect participant", provided in section 5 of the Act, is sufficiently clear, and that there are 14 indirect participants based on information provided by Payments NZ (in response to our information request under section 14 of the Act to determine the number of indirect participants).

- Noted that the RBNZ and some other organisations that clear high-value payments without being a member of the HVCS. However, we do not consider this aspect negates the overall assessment as to the systemic importance of the HVCS as an FMI.
- Noted that the HVCS direct participants are regulated entities themselves. However, this does not address the systemic importance of the HVCS itself.
- Noted that participants' compliance with the HVCS rules would not guarantee smooth end-to-end high-value payments process. We do not disagree with this view, but we also note that the HVCS plays an important role in the process.
- Noted that the HVCS payments are settled in the ESAS, and that the RBNZ effectively controls access to the HVCS by owning the closed user group that all participants must join. Although we did not respond to this point at the time, we do understand that due to operational arrangements, HVCS participants are members of the AVP CUG. However, this does not detract from the systemic importance of the HVCS as a clearing system.
- Stated that Payments NZ as an operator it is easily substitutable and the HVCS could be taken over by another operator to manage the rules if required. However, our concern is not whether the operator is substitutable, but whether the HVCS is substitutable.
- Disagreed that disruption of the HVCS would threaten confidence in or the stability of the New Zealand financial system through increased settlement risk and uncertainty in the interchange of high-value payments for New Zealand financial institutions and the domestic market. Our views on this are provided above under the heading "Disruption of the FMI".
- Put forward additional arguments relating to how access to the HVCS is determined, its reliance on SWIFT as a critical service provider and in setting messaging standards, the fact that RBNZ is not a member of the HVCS, and the fact that the HVCS does not settle transactions. These matters have been noted and taken into account but are considered to have limited weight in the systemic importance assessment and the matters required to be taken into account under the Act.

Our letter to Payments NZ in October 2023 only related to our assessment of the systemic importance of the HVCS. Further issues around designation of the HVCS were considered after that assessment. However, Payments NZ in its December 2023 letter also put forth arguments for why it should not be designated. This was not suggested by us in our October 2023 letter and is not reflective of our current process that focuses on the HVCS (the FMI) rather than Payments NZ (the operator). Payments NZ's arguments focused on the role of Payments NZ as a rules body, and their views on the benefits of designating a rules body:

- Payments NZ stated that designating a rules body would not enable the RBNZ to achieve the objectives of the Act. However, this argument does not consider the fact that it is the HVCS rather than Payments NZ that would be designated. In terms of achieving the objectives of the Act in designating the HVCS, this is considered in section 4 of this proposal.
- Payments NZ was also concerned that the RBNZ had not considered the matters set out in section 23 of the Act in its systemic importance consideration of the HVCS. However, we had not considered these matters at that time. As required under the Act, we must first determine if the HVCS is systemically important. We then consider the matters under section 23 related to our assessment on whether to propose to recommend that the Minister designate the HVCS. These matters, and other requirements in the Act, are now being taken into consideration and are reflected in this proposal.

3 Additional specifications for the designation notice

Personal Property Securities Act 1999

This proposal and the draft designation notice do not specify that section 103A of the Personal Property Securities Act 1999 (PPSA) applies to an operator as a specified operator.

Application of subpart 5

This proposal and the draft designation notice specify that subpart 5 of Part 3 applies to the HVCS.

Class or classes

This proposal and the draft designation notice specify that the HVCS falls within the pure payment system class for the purposes of any standards issued under section 31 of the Act.

4 Designation meets the purposes and principles of the Act

This section outlines how and why designating the HVCS meets the purposes and principles of the Act and how they benefit New Zealand. Under the Reserve Bank Act 2021 (RBNZ Act), we also have a purpose to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy. We are to further the purposes of the RBNZ Act under section 9 of that Act. This includes performing the powers and functions given to us by the FMI Act.

This section explains that designating the HVCS meets the purposes of the Act as follows:

- Designation promotes the maintenance of a sound and efficient financial system in New Zealand. This is because it imposes regulatory requirements to Payments NZ and we could then supervise and monitor it against these requirements. Regulatory requirements would require the Payments NZ to manage risks effectively, maintain operational resilience, and support financial stability. These requirements can strengthen oversight, reduce systemic risk, and enhance confidence in the financial system.
- Designation avoids significant damage to the financial system. This is because it provides legal protections to the HVCS rules around settlement and would allow us to act in a crisis to support the HVCS.
- Designation promotes the confident and informed participation in the financial markets. It also promotes and facilitates the development of fair, efficient and transparent financial markets.

The HVCS would be required to comply with the Act and FMI Standards

We do not currently regulate the HVCS. If designated, the HVCS would be required to comply with the Act and FMI Standards. The FMI Standards achieve the purposes of the Act by imposing requirements in line with international best practices. The FMI Standards are based largely on the Principles for Financial Market Infrastructures (PFMI) issued by the Committee on Payments and Market Infrastructure (CPMI) and the International Organization of Securities Commissions (IOSCO). These FMI Standards would impose specific requirements on Payments NZ as the

operator of the HVCS around areas such as governance, operational risk, access, and contingency planning.⁸

Designating the HVCS means it would receive legal protections under the Act for settlement finality and the enforceability of the FMI's rules relating to settlement.⁹ Currently, HVCS payments are only final once the funds have been exchanged in the ESAS. Participants, using the HVCS messaging standards, send settlement instruction to the ESAS. Designating the HVCS would ensure its rules are valid and enforceable to the extent that the rules provide for the matters set out in section 54 (2). This means payments can be irreversible once they have been cleared in the HVCS.

Without the enforceability of HVCS rules, any disruption to high-value payments could play out in the ESAS. This could impact the settlement of other transactions in the ESAS. For example, the cash leg of securities trades settling in NZClear, and the settlement of the net value of Settlement Before Interchange files could be disrupted due to a disruption in the HVCS.

Designating the HVCS also means that participants must notify Payments NZ if a participant becomes insolvent. This would allow Payments NZ to take appropriate steps such as excluding the insolvent participant from the HVCS to ensure smooth functioning of the system. These designation protections would provide confidence to participate in the HVCS and support the purpose under section 3(1)(c) of the Act.

Designation also means that the HVCS would be required to operate in a manner consistent with the requirements of the Act, which supports the purpose under s 3(1)(d) of promoting and facilitating the development of fair, efficient, and transparent financial markets.

Designating the HVCS also provides us with the authority to supervise and monitor Payments NZ's compliance with the FMI Standards. As well as, with any other requirements imposed under the Act. For example, we could review how the HVCS' contingency plans comply with the FMI Standards. To do so, we would review whether its plans identify essential services, address significant disruption risks, outline recovery and settlement procedures, and establish financial recovery tools, management procedures, and testing protocols. We would also ensure its plans can be followed when needed.

The Act provides powers for us to address failures of an operator of a designated FMI to comply with its requirements. This means we can take appropriate action when we identify non-compliance. Subpart 1 and 2 of Part 5 of the Act, set out the penalties for which a person is liable on conviction of an offence under the Act and pecuniary penalty orders. Our ability to supervise, monitor, and enforce Payments NZ's compliance with the Act and FMI Standards promotes the maintenance of a sound and efficient financial system and meets the purposes under section 3(1)(a) of the Act.

Designation would allow us to review key aspects of the HVCS in furtherance of the purposes of the Act. For example, Payments NZ is currently not required to comply with any requirements in determining the access to the HVCS. If designated, we would be able to review the HVCS access requirements against the FMI Standards to ensure that access to the HVCS is fair and open to promote and facilitate the development of fair, efficient, and transparent financial markets meeting the purpose in section 3(1)(d) of the Act.

⁸ See <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/financial-market-infrastructure-oversight/fmi-standards/guidance-for-fmi-standards.pdf>

⁹ Legal protections around settlement finality and enforceability of FMI rules are covered under Subpart 5 of Part 3 of the Act.

We would also be able to review the governance of the HVCS against the FMI Standards to ensure it is transparent, promotes efficiency and supports the stability of the broader financial system. In recent years, we have encouraged Payments NZ to ensure its governance better reflects the payments industry. Currently, eight founding shareholders are entitled to appoint directors (alongside the three independent directors), and each director has one vote. Designation allows us to formally assess whether Payments NZ's governance over the HVCS complies with the FMI Standards and require changes if it does not. This would promote the confident and informed participation of businesses, investors, and consumers in the financial markets (section 3(1)(c) of the Act).

Crisis management powers

Designating the HVCS would also provide us with crisis management powers. These powers enable us to act in an event where there are reasonable grounds to believe the HVCS is distressed (as defined under section 5 of the Act) and its contingency plans have become ineffective, inadequate, or threaten stability or confidence in the financial system. For example, we could issue directions to Payments NZ and instruct participants to comply with the HVCS's rules.

Payments NZ noted in its letter to us on December 2023, that if SWIFT infrastructure was unavailable, the ESAS operator and participants themselves would be best placed to resolve the issues. However, the crisis management powers that designation brings would empower the RBNZ, as the regulator, to ensure that participants follow SWIFT messaging standards (as an example) and ensure high-value payments are cleared.

These crisis management powers would allow us to minimise or mitigate the impact of a failure of the HVCS on high-value payments. This would support stability of, and confidence in, New Zealand's financial system and avoid significant damage to the financial system, which promotes the purposes set out in sections 3(1)(a) and 3(1)(b) of the Act.

Principles of exercising powers under the Act

In recommending designation, we have also considered the principles of the Act under section 13(2) as follows:

- In proposing to designate the HVCS as a systemically important FMI, we recognise the key role of the HVCS within the financial system. This meets principle (a) of section 13(2) of the Act. Please refer to section 2 for our discussion on the systemic importance of the HVCS.
- We also recognise that the primary responsibility for ensuring that the HVCS is sound and efficient rests with its operator Payments NZ, participants, and indirect participants and those who own or control its operators, participants, and indirect participants. This meets principle (b) of section 13(2) of the Act.
- We recognise that the HVCS's rules need to provide, to the extent possible, certainty and predictability about the rights and obligations of the HVCS's participants and indirect participants, especially in the event of a participant default or an indirect participant default. This meets principle (c) of section 13(2) of the Act.
- We take into account that designating the HVCS as a pure payment system would subject Payments NZ to applicable FMI Standards. This would allow us to regulate the HVCS in a way that is consistent with international standards where appropriate for conditions in New Zealand. This meets principle (d) of section 13(2) of the Act.

- The HVCS is a clearing system and not all FMI Standards applicable to a pure payment system would be relevant for the operation of the HVCS. In the supervision and monitoring of the HVCS, we would only consider FMI Standards that are relevant to the system. This takes into account the particular circumstances of the HVCS having regard to principle (e) of section 13(2) of the Act.
- We have considered the costs of compliance for the HVCS if designated. To avoid unnecessary compliance costs, we have reviewed and categorised the rules applicable to the HVCS from the Payment NZ Rules to circumvent a re-write of the HVCS rules in a separate document if designated. We have also considered the FMI's ability to comply with regulatory requirements if designated and we consider that this ability exists. This meets principle (f) of section 13(2) of the Act.
- We have also considered the importance of timely, accurate, and understandable information being available to participants, indirect participants, and potential participants or indirect participants, of the HVCS to assist them in making informed decisions about their interaction, or potential interaction, with the FMI. This meets principle (g) of section 13(2) of the Act.

5 Matters the regulator may have regard to for recommendation

In deciding whether to make a recommendation, and in deciding on the terms of the recommendation, we have considered the following matters set out in section 23 of the Act.

Purpose and scope of FMI

This consideration is made in section 1 of this proposal. Specifically, in the description of the FMI, its class, and its operator.

The FMI's rules

Payments NZ Limited Rules (**Payments NZ Rules**) is a document that sets out the rules and standards for access, participation, governance, and minimum standards that apply to all of the clearing systems operated by Payments NZ. Payments NZ operates the HVCS, Bulk Electronic Clearing System (**BECS**), Consumer Electronic Clearing System (**CECS**), and Settlement Before Interchange (**SBI**). Payments NZ Rules sets out that rules for each system under broadly defined categories called 'Parts'.

We sought Payments NZ's view to identify the subset of Payments NZ rules that form the HVCS rules for the purpose of designation. Payments NZ identified a subset that only related to material aspects of the HVCS' functions. However, this subset excluded other rules that apply to the HVCS. Therefore, we identified a larger subset of Payments NZ Rules that apply to the HVCS. We did this by specifying any 'Part' of the rules that applied to the HVCS. We refer to this proposed broader selected as the **HVCS Rules**. Both our list and the list identified by Payments NZ are set out in Annex B.

In identifying the HVCS Rules at a broader level, we aim to reduce any future complications arising from amendments to the HVCS Rules or Payments NZ Rules if the HVCS is designated. We expect that the HVCS rules would continually evolve as with most FMI rules. The HVCS Rules would be subject to the requirements of subpart 3 of Part 3 of the Act with respect to rules of designated FMIs. For example, Payments NZ would need to seek approval from the regulator for any change

of the HVCS Rules if the HVCS is designated. Payments NZ would not be required to seek approval for rules that apply to its clearing systems that are not designated.

In addition, we have not asked Payments NZ to rewrite the rules applicable to the HVCS as a separate document if the HVCS is designated. This is to reduce the costs to Payments NZ if the HVCS is designated. However, we acknowledge that Payments NZ may need to control for any variation between the HVCS Rules and updates to rules that apply only to other systems.

The Guidance Note – Designations provides guidance on the requirements for the rules of designated FMIs. We have considered the proposed HVCS Rules against this guidance and our high-level findings are summarised below:

- The HVCS Rules, except for the section on Access Procedures, are not readily available to all stakeholders.
- Further consideration is required to determine if the mechanisms to manage financial problems and default of participants limit the operational and financial impact on the system and participants.
- The effectiveness of the HVCS Rules on participant compliance, compliance monitoring, managing potential breach, and alleged breaches are unclear.

The Payments NZ Rules are not publicly available. If designated, as per section 36 of the Act, Payments NZ would be required to publish the HVCS Rules, except for any information that the regulator agrees could be redacted. In addition, if designated, we would review the HVCS rules against the Act and FMI Standards. Payments NZ would then be required to address any compliance gaps identified in that review.

Laws or Regulatory Requirements

The HVCS is not subject to other laws or regulatory requirements that replicate the requirements under the Act and FMI Standards or that impact Payments NZ's ability to comply with the Act. If designated, the HVCS would be required to comply with the Act and FMI Standards.

FMI Standard 1 also requires the FMI to have a well-founded legal basis under all relevant jurisdictions in which it operates, and a designated FMI must comply with all relevant laws, regulations, and standards that apply to it.

Payments NZ has indicated that the HVCS rules have been drafted according to New Zealand law and have been extensively reviewed by Payments NZ's external legal counsel.

Capability and capacity of the FMI and its operator

We believe that Payments NZ has the capacity to comply with the Act and FMI Standards, if it is designated. This is because Payments NZ already acknowledges the PFMI and has informed us that the HVCS Rules comply with the PFMI (which the FMI Standards are largely based on). In addition, Payments NZ already seeks non-objections from us on material changes to the HVCS Rules. However, Payments NZ's compliance with the PFMI has been voluntary and not assessed by us.

Despite acknowledging the PFMI, Payments NZ indicated that it views itself as a "a rules body" and noted that "designating a rules body will not enable the Reserve Bank to achieve the objectives set

out in the FMI Act". As the operator of the HVCS, Payments NZ would need to comply with the applicable FMI Standards if the HVCS is designated.

Following designation, a gap analysis of the HVCS's operation and rules against the Act and applicable FMI Standards would consider the appropriateness of Payments NZ's:

- Processes, controls, and monitoring of compliance.
- Monitoring and management of risk including the framework adopted for overall risk management and oversight purposes.
- Existing risk management framework for comprehensively managing legal, credit, liquidity, operational, and any other relevant and material risks.
- Arrangements with critical service providers, contingency plans, process for management of conflicts of interest, and past performance of the FMI.
- Leadership, including the integrity, reputation, and individual skills and experience of the directors and senior managers of the operator with responsibility over operating and overseeing the system.

The HVCS closely relies on the ESAS for settlement and SWIFT for messaging and connectivity between participants. So, Payments NZ would need to manage the risks arising from these arrangements if the HVCS was designated.

Financial resources of the operator

The regulator applies a conservative approach to determining an FMI's capacity to withstand extreme but plausible market conditions and expects the FMI to have a financial resources policy consistent with the FMI Standards, particularly FMI Standard 4 (Credit Risk), FMI Standard 5 (Collateral), FMI Standard 7 (Liquidity Risk), and FMI Standard 17A (Contingency Plans).

The HVCS operates as a clearing system, with all settlements being finalised through the ESAS from pre-funded ESAS accounts. This indicates that the HVCS is not exposed to credit, collateral, and liquidity risks as these are managed through the settlement process in the ESAS. Also, as a pure payment system, the HVCS would not be subject to FMI Standard 6 (Margin). Therefore, FMI Standards 4, 5, and 7, are not relevant for the operation of the HVCS and Payments NZ would not be required to maintain liquid resources to effect settlement.

Payments NZ states that it runs on a cost recovery basis by imposing levies, charges, and fees to meet anticipated costs of clearing systems. If the HVCS were designated, Payments NZ would be required to have sufficient financial independence to operate, maintain, and develop the HVCS to the expectations of its participants and other stakeholders. This requirement is likely achievable for Payments NZ.

The importance of the FMI to the financial system

We have discussed the systemic importance of the HVCS to the financial system in section 2 of this proposal.

Impact on creditors of participants or indirect participants

Section 103A of the PPSA will not apply to the operator of the HVCS. This is because participants of the HVCS do not grant security interest on or transfer personal property to Payments NZ for the purposes of settlement. Settlement of transactions conducted through the HVCS occur in the ESAS through pre-funded ESAS accounts of participants.

6 Next steps

This section sets out the remaining steps in our process of recommending designation. It also sets out the initial steps if the HVCS is designated and the effect of designation.

Recommendation by regulator

1. Once this proposal closes, we will review the submissions and respond to Payments NZ and submitters.
2. Based on our full review of the submissions to this proposal, we may decide to make a recommendation to the Minister to designate the HVCS.
3. If the Minister agrees then the HVCS will be declared, by a designation notice, to be a designated FMI under section 20 of the Act.

If the HVCS is designated

The following steps are conditional on the Minister's decision to designate the HVCS.

4. If the HVCS is designated, Payments NZ will need to identify any compliance gaps against the Act and FMI Standards. We expect this to take 8 weeks.
5. Payments NZ would then seek agreement with us on the steps to resolve any identified compliance gaps.

The effect of designation

We take a risk-based approach to supervision and monitoring and will use the following powers provided to us under the Act:

- information gathering and investigative powers to enable monitoring of the wider sector
- issuing standards and guidance for designated FMIs
- oversight of FMI rules
- reviewing FMI contingency plans
- enforcement powers
- crisis management powers

7 We need your feedback

We invite feedback on our proposal to recommend that the Minister of Finance designates the HVCS. We are seeking your views on the designation proposal and reasons generally. We have set out consultation questions below to the extent that they are a helpful guide.

You can give us your feedback by responding with a written submission. You can email your written submission to FMIconsultation@rbnz.govt.nz or post your written submission to FMI Supervision, Reserve Bank of New Zealand, #2 the Terrace, PO Box 2498 Wellington 6140. The consultation is open until 30 September 2025.

Questions

1. Is the HVCS an FMI and pure payment system as per the definition in the Act?
2. Is the HVCS a systemically important FMI in New Zealand as per the definition in the Act?
3. Would designating the HVCS promote the maintenance of a sound and efficient financial system by allowing us to enforce requirements in the Act and FMI Standards?
 - i. For example, would designating the HVCS promote clear and transparent governance that promotes the interests of its stakeholders by allowing us to review the HVCS governance and ensure it meets the requirements under FMI Standard 2: Governance?
 - ii. For example, would designating the HVCS promote fair and open access to the system by allowing us to review its access policy and require that it complies with FMI Standard 18: Access and participation requirements?
4. Would designating the HVCS provide further certainty and confidence to participate in the system? For example, if a participant defaults, designation provides legal protections to the validity and enforceability of the HVCS Rules relating to settlement, and to the statutory obligation on participants to inform the operator.
5. Would designating the HVCS help us avoid significant damage to the financial system by using our crisis management powers in the event of a failure or disruption of Payments NZ or the HVCS?
6. Do you agree with the rules that we have identified as the HVCS Rules for the purposes of designation? Are there any rules that do not apply to the HVCS that can be excluded from the proposed rules in Annex B?
7. Do you have any comments on the capabilities and capacity of Payments NZ to comply with the Act and FMI Standards?
8. Do you have any comments on the next steps following the publication of this proposal?
9. Do you have any other comments or feedback related to the proposal and the reasons for the proposal?

Publication of submissions

All information in submissions will be made public unless you indicate that you would like all or part of your submission to remain confidential. Respondents who would like part of their submissions to remain confidential should provide both confidential and public versions of their submissions. Apart from redactions of the information to be withheld (i.e., blacking out of text), the two versions should be identical. Respondents should ensure that redacted information is not able to be recovered electronically from their documents (the redacted versions may be published as received). Respondents who request that all or part of their submissions be treated as confidential should provide reasons why this information should be withheld if requests are made for it under

the Official Information Act 1982 (**OIA**). These reasons should refer to the grounds for withholding information under the OIA. If an OIA request for redacted information is made, the RBNZ will make its own assessment of what must be released, considering the respondent's views. The RBNZ may also publish an anonymised summary of the submissions received in respect of this consultation.

Annex A: Draft designation notice

Below is the proposed content of the draft designation notice in line with section 29 of the Act.

Title

1. This is the Financial Market Infrastructures Act Designation Notice (HVCS) [year].

Effective Date

2. This notice comes into effect on [date].

Authority

3. This notice is issued under Section 20 of the Financial Market Infrastructures Act 2021 (the “Act”) by the Minister of Finance, and has legal effect.

Interpretation

4. In this notice:
 - a. references to “FMI” are references to the High Value Clearing System;
 - b. “High Value Clearing System” means the high value clearing system operated and managed by, or on behalf of Payments NZ Limited; and
 - c. any term that is defined in the Act and used, but not defined, in this notice has the meaning as in the Act.

Designation

5. The High Value Clearing System is declared to be a designated FMI.

Operator

6. Payments NZ Limited is the operator of the FMI.

Documents that set out the rules

7. The documents that set out the FMI’s rules are set out in Annex B.

Specified Operator

8. Payments NZ Limited:
 - a. is the specified operator of the FMI; and
 - b. is an operator to which section 103A of the Personal Property Securities Act 1999 does not apply.

Systemic Importance

9. The FMI is systemically important.

FMI is a pure payment system

10. The FMI is a pure payment system.

Application of subpart 5

11. Subpart 5 of Part 3 of the Act applies to the FMI.

Class or Classes

12. For the purposes of any standards issued under Section 31 of the Act, the FMI falls within the following class or classes: pure payment system.

Annex B: The HVCS Rules

Payments NZ in its letter to us dated 16 August 2024 identified the following subset of Payments NZ Rules that it believes relates to material aspects of the HVCS's functions (see the lefthand column). This subset of rules does not cover all the rules within the Payments NZ Rules that refer to the HVCS.

Following a discussion with Payments NZ, we identified the HVCS Rules that will be considered for the purpose of designation (see the righthand column). This is a wider set of rules than identified by Payments NZ as it includes all rules within each Part. The HVCS Rules capture references to the HVCS within Payments NZ Rules. This list of rules will be considered as the rules of the HVCS in our Proposal and draft designation notice.

Subset of Payments NZ Rules relating to material aspects of the HVCS's functions – identified by Payments NZ	The HVCS Rules for the purpose of designation – identified by the regulator
Part 1 Introduction Relevant rules: 1.2.3, 1.3, and 1.5.	Part 1 Introduction
Part 2 Access and participation Relevant rules (only insofar as they relate to HVCS): 2.2, 2.3, 2.4, 2.5, 2.6, 2.7, 2.8, 2.9(1), 2.9(2), 2.16, 2.17, 2.18, 2.19, 2.20, 2.26, 2.31, and 2.32.	Part 2 Access and participation
Part 4 Levies, charges, and fees Relevant rules (only insofar as they relate to HVCS): 4.1, 4.2, 4.19, and 4.20.	Part 4 Levies, charges, and fees
Part 5 Compliance Relevant rules: 5.2, 5.4, 5.9, 5.11, 5.16, 5.21, 5.22(1), and 5.23.	Part 5 Compliance
Part 9 HVCS clearing and settlement Considered material aspects of HVCS. Relevant rules: all.	Part 9 HVCS clearing and settlement
Part 10 Operational problems: HVCS and SBI Relevant rules (only insofar as they relate to HVCS): all.	Part 10 Operational problems: HVCS and SBI
Part 11 Liability Considered material aspects of HVCS. Relevant rules: all.	Part 11 Liability
Part 11A Undue enrichment	Part 11A Undue enrichment

Subset of Payments NZ Rules relating to material aspects of the HVCS's functions – identified by Payments NZ	The HVCS Rules for the purpose of designation – identified by the regulator
Considered material aspects of HVCS. Relevant rules: all.	
Part 12 Financial problems Considered material aspects of HVCS. Relevant rules: all.	Part 12 Financial problems
Part 12B Revoking suspension Considered material aspects of HVCS. Relevant rules: all.	Part 12B Revoking suspension
Part 12C Risk assurance documents: termination and non-compliance Considered material aspects of HVCS. Relevant rules: all.	Part 12C Risk assurance documents: termination and non-compliance
Part 12D Termination Considered material aspects of HVCS. Relevant rules: all.	Part 12D Termination
Part 13 Clearing system governance Relevant rules: 13.1.2, 13.1.5, 13.1.8, 13.1.10, 13.1.11, 13.1.14, and 13.1.19(a).	Part 13 Clearing system governance
Part 14 Disputes Not considered as a material aspect of HVCS. Relevant rules: none.	Part 14 Disputes
Part 15 Standards Not considered as a material aspect of HVCS. Relevant rules: none. Noted that rule relating to disclosure of standards would be superseded by the disclosure requirements in the FMI Standards, if they were to apply.	Part 15 Standards
Part 16 Clearing system data Highly operational and not considered as a material aspect of HVCS. Relevant rules: none.	Part 16 Clearing system data
Part 17 Clearing system registers Relevant rules: none.	N/A

Subset of Payments NZ Rules relating to material aspects of the HVCS's functions – identified by Payments NZ

The HVCS Rules for the purpose of designation – identified by the regulator

Part 18 Miscellaneous

Part 18 Miscellaneous

Relevant rules: 18.2, 18.3, 18.4, 18.5, 18.6, 18.8, 18.10, and 18.11.

Part 19 Interpretation

Part 19 Interpretation

Only definitions that relate to relevant rules should be considered by the Reserve Bank.

Annex C: The Legal framework for designating an FMI

This annex sets out the legal framework in respect of designating an FMI.

Purposes and principles under the Act

The section 3(1) purposes of the Act are to:

- (a) promote the maintenance of a sound and efficient financial system (including by responding to threats to the stability of, or confidence in, the whole or a significant part of the financial system); and
- (b) avoid significant damage to the financial system that could result from problems with an FMI, an operator of an FMI, or a participant of an FMI that threaten the stability of, or confidence in, the whole or a significant part of the financial system; and
- (c) promote the confident and informed participation of businesses, investors, and consumers in the financial markets; and
- (d) promote and facilitate the development of fair, efficient, and transparent financial markets.

Section 3(2) provides these purposes are achieved by:

- (a) establishing a system for designating systemically important FMIs and FMIs that apply for designation; and
- (b) imposing regulatory requirements on designated FMIs; and
- (c) providing for the supervision of compliance with those requirements by the Reserve Bank of New Zealand and the Financial Markets Authority (acting as the regulator); and
- (d) conferring certain powers on the regulator to gather information; and
- (e) conferring certain powers on the regulator to act in respect of distressed FMIs.

Section 13(1) provides the powers of the regulator (and the Minister) must be exercised for 1 or more of the section 3 purposes.

Section 13(2) provides that, in deciding whether to exercise its powers, and in exercising them, the regulator must take into account the following principles that are relevant:

- (a) the importance of recognising that FMIs can have a key role in maintaining a sound and efficient financial system;
- (b) the importance of recognising that primary responsibility for ensuring that an FMI is sound and efficient rests with its operators, participants, and indirect participants and those who own or control its operators, participants, and indirect participants;
- (c) the need for an FMI's rules to provide, to the extent possible, certainty and predictability about the rights and obligations of the FMI's participants and indirect participants, especially in the event of a participant default or an indirect participant default;
- (d) the importance of regulating FMIs in a way that is consistent with international standards for their regulation where those standards are appropriate for conditions in New Zealand;
- (e) the importance of recognising the diversity of FMIs and of taking into account the circumstances of particular FMIs (while recognising the importance of consistency in the treatment of similar FMIs);
- (f) the need to avoid unnecessary compliance costs and unnecessary constraints on innovation;
- (g) the importance of timely, accurate, and understandable information being available to participants, indirect participants, and potential participants or indirect participants, of an FMI to assist them in making informed decisions about their interaction, or potential interaction, with the FMI.

Under section 12(1)(a) it is the regulator's function to recommend the designation of FMIs and the amendment or revocation of designation notices.

While section 9 requires the RBNZ and FMA to carry out the regulator's functions acting jointly, section 10(1) provides the regulator's functions must be carried out by the RBNZ if an FMI is a pure payment system.

Under section 12(2)(a) it is the Minister's function, on the recommendation of the regulator, to declare an FMI to be a designated FMI.

Published statements of policies

In addition to the requirements of the Act, under section 152, the RBNZ and the FMA have published statements of policies for determining whether an FMI should be declared to be a designated FMI under section 20, as follows:

- Framework for Identifying Systemically Important Financial Market Infrastructures (**Systemic Importance Framework**).¹⁰
- Guidance Note – Designations under the Financial Market Infrastructures Act 2021 (**Guidance Note – Designations**).¹¹

FMIs, operators, participants and rules

Section 5 defines an **FMI** as:

- (a) a multilateral system for the clearing, settling, or recording of any of the following:
 - (i) payments;
 - (ii) personal property, or transactions involving personal property, within the financial system;
 - (iii) other transactions within the financial system; and
- (b) includes (without limitation) a system that is commonly regarded, within the financial system in New Zealand or elsewhere, as a financial market infrastructure, including a financial market infrastructure of any of the following types:
 - (iv) a payment system;
 - (v) a central securities depository;
 - (vi) a securities settlement system;
 - (vii) a central counterparty;
 - (viii) a trade repository;
 - (ix) a combination of 2 or more of the types of financial market infrastructure listed in subparagraphs (i) to (v).

Section 5 defines an **operator**, in relation to an FMI, as a person who is wholly or partly responsible to the FMI's participants (or any of them) for providing or managing services under the FMI, or maintaining or administering the FMI's rules.

Section 5 defines a **participant**, in relation to an FMI as any person who is bound by the FMI's rules, and participates, or has agreed to participate, in the FMI.

Section 5 defines an **indirect participant**, in relation to an FMI as any person who is not bound by the FMI's rules but participates, or has agreed to participate, in the FMI through an agency or other arrangement that the person has (directly or indirectly) with, as an operator of the FMI who

acts on the person's behalf in relation to the FMI, or a participant of the FMI who acts on the person's behalf in relation to the FMI.

Section 5 defines a **rules** as:

- (a) the rules of the FMI:
 - (i) that are evidenced in writing:
 - (A) whatever they may be called; and
 - (B) whether contained in, or made under, a body's constitution, an agreement, a procedure, a contract, or any other document; and
 - (ii) that set out (among other things) the following:
 - (A) how the FMI is to be constituted (for example, as a set of arrangements between its participants or as a legal person with whom its participants are to interact);
 - (B) how activities under the FMI are to be carried out;
 - (C) the rights and obligations under the FMI of its operators and participants; and
- (b) if the FMI is a designated FMI, must be read in accordance with section 35

Pure payment systems and systemic importance

Section 10(2) provides an FMI is a **pure payment system** if:

- (a) the FMI is a designated FMI and the FMI's designation notice specifies under section 29(2)(c) that the FMI is a pure payment system; or
- (b) the FMI is not a designated FMI, but the FMI is a multilateral system solely for the clearing or settlement of payment obligations.

Section 28(1) provides that an FMI is **systemically important** if 1 or both of the following apply:

- (a) disruption to activities under the FMI could cause problems for 1 or more relevant persons that would threaten the stability of, or confidence in, the whole or a significant part of the financial system;
- (b) problems with 1 or more relevant persons could, because of the transactions or other interconnections under the FMI between relevant persons, cause problems for 1 or more other relevant persons that would threaten the stability of, or confidence in, the whole or a significant part of the financial system.

Section 28(2)(a) defines a relevant person as a participant or an indirect participant of the FMI:

Section 28(2)(b) states that threats or interconnections may be direct or indirect.

Statutory requirements to recommend designation

Section 20 provides the Minister may, in accordance with a recommendation made by the regulator under subpart 1 of Part 3:

- (a) by notice (a **designation notice**) declare an FMI to be a designated FMI;
- (b) by notice (a **further notice**), revoke or amend a designation notice.

Section 21(1) provides the regulator may recommend the Minister issue a designation notice on its own initiative under section 26.

Section 22(2) provides the regulator may only make a recommendation to issue a designation notice on its own initiative if the regulator is satisfied that the FMI is systemically important.¹²

Section 24 sets out matters that the regulator must take into account in deciding whether an FMI is systemically important.

Section 23 provides, in deciding whether to make a recommendation, and in deciding on the terms of the recommendation, the regulator may have regard to the following matters (without limitation):

- (a) the purpose and scope of the FMI;
- (b) the FMI's rules (including whether the rules are appropriate to support settlements that must not be reversed, repaid, recovered, or set aside);
- (c) any laws or regulatory requirements in New Zealand or elsewhere that relate to activities under the FMI and the extent to which the FMI complies with those laws or regulatory requirements;
- (d) the capability and capacity of the FMI's operators and the FMI;
- (e) the financial resources of the operators of the FMI;
- (f) the importance of the FMI to the financial system;
- (g) the impact on creditors of participants or indirect participants of the FMI of specifying under section 29(2)(b) that the specified operator is an operator to whom section 103A of the Personal Property Securities Act 1999 applies.

Section 26 states that, if the regulator proposes to make a recommendation on its own initiative, the regulator must do the following:

- (a) notify the operator of the FMI of the proposal, and of the reasons for the proposal;
- (b) require the operator to publish the proposal, and the reasons for the proposal, on an Internet site that is maintained by, or on behalf of, the operator; and is publicly available free of charge;
- (c) allow the operator and any participants or indirect participants of the FMI to make submissions to the regulator about the proposal;
- (d) consider any submissions that are made by the operator or those participants or indirect participants;
- (e) decide whether to go ahead with the recommendation;
- (f) notify the operator of the decision.

What a designation notice must contain

Section 29(1) provides that a designation notice must specify the following:

- (a) the FMI and its operators;
- (b) the documents that set out the FMI's rules (whether the documents are referred to by name or description);
- (c) if the notice specifies that section 103A of the Personal Property Securities Act 1999 applies to an operator as a specified operator (see subsection (2)(b)), which operator of the FMI is the specified operator;
- (d) that the FMI is systemically important if the Minister acts on a recommendation by the regulator that the FMI is systemically important.

Section 29(2) provides a designation notice may specify 1 or more of the following:

- (a) that a particular operator of the FMI is also a participant of the FMI:
-

- (b) that the specified operator is an operator to whom section 103A of the Personal Property Securities Act 1999 applies:
- (c) that the FMI is a pure payment system:
- (d) that the FMI is a central counterparty:
- (e) that subpart 5 applies to the FMI:
- (f) the class or classes within which the FMI falls for the purposes of any standards issued under section 31 that apply to a class or classes of FMI.

Annex D: The systemic importance of the HVCS

On 1 December 2022, the regulator, using a template based on the matters in Section 24 of the Act, requested the operator of the HVCS to provide information relevant to our assessment. Payments NZ, as the operator of the HVCS, responded on 24 February 2023.

To inform our assessment, we have used the five prescribed matters that we must take into account when determining systemic importance, which are elaborated on in the Framework for Identifying Systemically Important Financial Market Infrastructures, published on 20 January 2022 and available on the RBNZ Website¹³ (the **Framework**). In particular, we have considered:

1. The size of the HVCS's operations in New Zealand,¹⁴ including:
 - i. volumes and values cleared;
 - ii. volumes and values interchanged and settled by large New Zealand based HVCS participants; and
 - iii. the number of direct and linked indirect New Zealand based participants.
2. The types of New Zealand based HVCS participants.¹⁵
3. The nature and scope of the HVCS's activities in New Zealand,¹⁶ including:
 - i. which New Zealand markets the HVCS supports, and whether it is significant for the proper functioning of that market;
 - ii. whether the market the HVCS serves is significant for the proper functioning of the wider New Zealand economy;
 - iii. whether and to what extent the operations of the HVCS mitigates risk for New Zealand based participants;
 - iv. how the HVCS system interconnects with other FMIs or activities within the New Zealand financial system; and
 - v. how participants transact or otherwise interconnect with other HVCS participants.
4. The concentration of financial risks within the HVCS,¹⁷ as these relate to New Zealand, including:
 - i. the HVCS's volumes in New Zealand;
 - ii. the magnitude of credit and liquidity exposure; and

13 See <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/financial-market-infrastructure-oversight/regulatory-developments/fmi-systemic-importance-framework-january-2022.pdf>

14 Section 24(a) of the Act.

15 Section 24(b) of the Act.

16 Section 24(c) of the Act.

17 Section 24(d) of the Act.

- iii. the proportion of transactions represented by the five largest participants.
5. Whether another FMI could promptly and effectively take over the HVCS's New Zealand operations if they were to be disrupted.

Detailed Assessment

The sections below provide detailed support for the above assessment, in considering all elements required by section 24 of the Act.

1 Size of the FMI

Section 24(a) of the Act requires the regulator to consider the FMI's size, including the number of participants and the number of indirect participants. The Principles for Financial Market Infrastructures (PFMI), the international standard for regulation of FMIs, suggest considering the volume and value of transactions processed and the number of participants in determining whether an FMI is systemically important.¹⁸

Volume of transactions settled

Values processed by the FMI and the size of an FMI reflect the potential impact on financial stability if systemic risks to the FMI's operation materialise. An FMI that processes relatively larger volumes and values of transactions concentrates risk and has a more significant impact on the financial system and economy following a disruption to its operations. Therefore, a useful indicator for systemic importance is the gross volumes and values processed, cleared, or settled by the FMI over a period of time.

The Payments NZ HVCS activity report for February 2023 indicated the total value of transactions settled was NZD 1,109.28 billion, with an overall volume of 294,043 transactions, across 19 business days equating to an average volume of 15,476 transactions per day, for the month.¹⁹

Payments NZ provided the HVCS information on daily average volume and value of payments settled for the period of January 2018 to December 2022. The daily average transactions settled over the 5-year period from January May 2018 until December 2022 were:

- Daily Average Volume of 12,842
- Average Value (NZD) of \$6.43b

These numbers are significant when we put them in relation to other indicators in the New Zealand economy and the wider New Zealand financial system. On the basis of New Zealand GDP of about \$380 billion (as at December 2022), the HVCS settles NZD transactions equivalent to New Zealand's GDP in less than three months. This is a substantial number that highlights HVCS's importance for New Zealand and leads us to the conclusion that the HVCS, based on its settlement figures is affecting a very large share of the New Zealand financial system.

Number of participants

The number of participants also provides an indication of the systemic importance of an FMI. If an FMI has many participants, particularly systemically important participants, disruption of the FMI's activities may cause disruption to more financial markets participants, and the dispersion of

¹⁸ The Principles for Financial Market Infrastructures are international standards for financial market infrastructures that are issued by the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO).

¹⁹ See <https://www.paymentsnz.co.nz/connect/industry-dashboards/hvcs-report/>

impacts could significantly and adversely impact the wider financial system. There are 14 direct participants in the HVCS.

2 Types of participants

Section 24(b) of the Act requires the regulator to consider the types of persons who are participants and indirect participants. The PFMI suggest considering the types of participants in determining whether an FMI is systemically important.

As at 24 February 2023, the direct participants in the HVCS consisted of 11 registered banks, (including four Domestically systemically important banks - D-SIBs and two Globally systemically important banks - G-SIBs), and two systemically important FMIs. These institutions are systemically important to the functioning of the New Zealand financial system as per the Act and the Banking (Prudential Supervision) Act 1989.

Three banks also provide agent services for 14 indirect participants that consist of banks and other financial institutions such as Credit Unions and Building Societies

3 Nature and scope of activities

Section 24(c) of the Act requires the regulator to consider the nature and scope of the activities under the FMI, including the way in which, and the extent to which:

- the FMI interconnects (directly or indirectly) with other FMIs or other activities within the financial system; and
- participants and indirect participants transact or otherwise interconnect with each other (directly or indirectly) under the FMI.

The PFMI suggest considering:

- Interconnectedness with other FMIs and wider financial system
- Interconnectedness between participants and indirect participants

The HVCS rules set out how participants can exchange and clear payment instructions in a decentralised settlement model, where there is no central clearing house. The fourteen HVCS participants connect directly with the ESAS settlement system via SWIFT. HVCS participants are members of the Assured Value Payment (AVP) Closed User Group (CUG), which is owned by the RBNZ. The HVCS participants are bound by the Payments NZ rules that cover the following:

- access to clearing systems
- risk management
- security and operational reliability
- system resilience
- participant default
- certainty in relation to end to end clearing and settlement of transactions, and when debts are created and discharged.

The HVCS supports participants who need to interchange domestic high value payments such as house settlements, as well as facilitating cross border transactions. Direct HVCS settlement membership, and the rules that bind participants provide certainty and efficiencies.

There is a close link between the HVCS and the ESAS with the clearing of the transactions occurring in the former and the settlement of transactions occurring in the latter system. The smooth processing of the HVCS transactions depends on participants complying with the HVCS rules and procedures and on the rules being fit for purpose. Any disruption to the processing of payments originating under the HVCS rules would impact their ability to settle in the ESAS and potentially impact the settlement of other transactions in the ESAS including the cash leg of securities trades settling in NZClear and the settlement of the net value of the SBI files.

The HVCS uses SWIFT messaging and infrastructure to connect with the ESAS and to clear payments. If the SWIFT infrastructure is unavailable, the HVCS payment system will operate under the third level contingency model (3LC), which bypasses the SWIFT infrastructure. This can have ramifications for the payments system, as operating under a back-up model for an extended period is likely to affect efficiency and settlement within the financial system.

The HVCS also demonstrates environmental interdependency with the external critical service providers, including the SWIFT messaging service. The SWIFT system is widely used by other FMIs and financial institutions globally for the purposes of exchanging values and messages for a multitude of transactions including the HVCS payments.

4 Concentration of financial risk

Section 24(d) of the Act requires the regulator to consider the way in which, and the extent to which, financial risks are concentrated within the FMI. Factors that the regulator will consider in their assessment of the concentration of financial risk:

Market share

The HVCS is a rules body operated under Payments NZ that supports the interoperability of high-value transactions in New Zealand's, with the market share reflected in the net interchange volumes and values of the HVCS participants. The data provided by Payments NZ is based on the calculated national Interchange volumes advised. We see the HVCS's New Zealand market share as significant given the number of exchanges between participants, and the value of the transactions is considerable. The average annual value of the HVCS transactions over three years from 2018 to 2020 was \$5.37 trillion.²⁰

Magnitude of credit exposure of the FMI

The HVCS is not a settlement system, nor does it hold securities and/or collateral and so does not take counterparty credit risk in forms of margins or collateral. The system operator, Payments NZ, is not exposed to any credit risk.

Magnitude of liquidity exposure of the FMI

Settlement of the HVCS transactions occurs in the ESAS and there is no liquidity exposure to the HVCS.

²⁰ See <https://www.paymentsnz.co.nz/resources/articles/new-zealand-payments-stats-2020-in-review/>

Proportion of transactions by the 5 largest participants of the FMI

The HVCS participants are vulnerable to contagion risk, i.e. potential disruptions emanating from other participants of the same FMI. Contagion risk can lead to more severe impacts when the activities of an FMI are more concentrated in a small number of participants. The proportion of transactions by the five largest participants can indicate the extent to which risk is concentrated in the major participants of an FMI. The regulator may also consider the potential impact that an FMI may have on the financial system in New Zealand, given the volumes and values of interchanges concerned.

There is substantial concentration in the five largest HVCS participants, which include four D-SIBs and one G-SIB. These five participants represent **89.08%** of the HVCS volumes, which points to contagion risk being large. Any issues with these critical participants could have a flow-on effect to direct and indirect participants and their respective customers. Systemic issues could lead to liquidity pressures with delayed settlements, incurring costs for direct and indirect participants as well as their customers who are unable to meet payment obligations on time.

The proportionate value of the respective participants was not available, noting that the percentages of volumes does not equate to the percentage allocation in value. A participant may represent a lower volume than their counterpart, on a given settlement day, but may have a higher aggregate value, depending on the values of the transactions settled.

5 Substitutability

Section 24(e) of the Act requires the regulator to consider whether, activities under the FMI were to be disrupted, another FMI could promptly and effectively provide alternative services to replace those of the disrupted FMI. Questions that the regulator will consider in its assessment of the substitutability include:

- Can the range and scale of the services provided by an FMI be adequately substituted by available alternatives?
- What is the expected cost (both time and money) associated with switching to an available alternative?
- How much notice is required to switch to an available alternative?

The HVCS consists of a multilateral set of arrangements that participants can use after satisfying the Payments NZ access criteria rather than having to conclude multiple bilateral arrangements. Without the HVCS rules, financial institutions would need to resort to correspondent banking or bilateral arrangements, which would require separate negotiations that could take a considerable time.

If Payments NZ were to cease to exist for some reason, it is possible that the multilateral model could be taken over by another organisation, to function as the operator and manage the rules and the attendant committees. However, it may take some time for participants to agree new arrangements.

Conclusions

We consider that the HVCS is systemically important.

- The role of the HVCS as the rule set, standards, procedures and framework that support the clearing and settlement of the sizeable number of high-value transactions, within New Zealand, reduces settlement risk for NZD transactions.
- Disruption of this service and the functions that they provide could threaten confidence in or the stability of the New Zealand financial system through increased settlement risk and uncertainty in the interchange of high-value payments for New Zealand financial institutions and the domestic market. This is supported by the nature of the participants using the HVCS, consisting of eleven New Zealand banks and two systemically important FMIs, as well as global and domestic systemically important banks operating in New Zealand that use the HVCS to interchange high-value wholesale and retail transactions, and are reliant on settlement certainty.