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Australian Payments Network
Connect Inspire Thrive

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By email only to: cashreview@rba.gov.au

Dear Ms Hope

Review of Banknote Distribution Arrangements: Issues Paper

Australian Payments Network (AusPayNet) welcomes the opportunity to respond to the *Review of Banknote Distribution Arrangements: Issues Paper* published by the *Reserve Bank of Australia*.

AusPayNet Membership and Role

AusPayNet is the industry association and self-regulatory body for the Australian payments industry. We manage and develop regulations, procedures, policies and standards governing payments in Australia. Membership of AusPayNet is open to participants in, and operators of, Australian payments systems. AusPayNet currently has over 140 members, including financial institutions, the Reserve Bank of Australia (RBA), merchants, operators of Australian payment systems, and other payments industry stakeholders.

AusPayNet's responsibilities include:

- controlling and managing risk in the Australian payments system;
- coordinating the operation of effective payment systems through facilitating industry collaboration, adherence to rules and system-wide standards; and
- developing industry policies and rules for the regulation of payment systems relating to cheques; direct entry (i.e. direct debit/credit); cards, and accepting devices (i.e. cards used for in-store purchases at Point of Sale (POS) terminals, ATMs, or mobile/online purchases); high-value payments (e.g. between financial institutions); and the distribution of cash in Australia.

AusPayNet administers the Australian Cash Distribution and Exchange System (ACDES) where rules are agreed that cover the buying, selling and packaging of notes and coins, audit requirements and cash movements between the four ACDES banks. The primary object of ACDES is to facilitate the distribution of cash to the general community and the efficient exchange and distribution of cash between the four ACDES banks as necessary to ensure there is an adequate supply of cash to meet demand. The four ACDES banks are: Australia and New Zealand Banking Group, Commonwealth Bank of Australia, National Australia Bank, and Westpac Banking Corporation.

AusPayNet works closely with the cash industry on major initiatives. For example, through our Next Generation Banknote Support Project we coordinated the industry wide introduction of new series Australian banknotes.

In preparing this submission AusPayNet has reached out to several of its Participant Members and Affiliates, including the four ACDES banks, Australia Post, and the two largest national cash management / cash in transit (CIT) companies, Linfox Armaguard and Prosegur Australia.

Not all organisations chose to participate in these discussions and the comments provided are therefore made by, and in the name of, AusPayNet, informed by the feedback provided by those organisations that chose to contribute. We understand that many of the organisations that have contributed to our response, and AusPayNet members more broadly, also intend making their own submissions.

Rather than answer each question posed in the issues paper directly, we have structured our response around a number of key themes and considerations.

Context: Record levels of banknotes on issue, yet a significant fall in cash use

Uniquely among mainstream payment methods, cash serves both as a store of wealth and as a means of settlement. The onset and continuation of the COVID-19 pandemic in Australia has had a profound impact on cash use and more widely the broader payments landscape, in many cases dramatically accelerating a number of already emerging long-term payment trends. These include:

- A continuing reduction in the use of cash as a transactional payment method. RBA data[i] shows that the share of total retail payments made with cash has fallen, from 69% by number of transactions and 38% by value when first surveyed in 2007, to 27% by number and 11% by value when surveyed before the COVID-19 pandemic in 2019. It is anticipated that the planned 2022 survey will show further, possibly significant, declines.
- A dramatic decline in cash withdrawals at ATMs at the height of the COVID-19 restrictions. While ATM withdrawal levels have recovered somewhat, the value of ATM withdrawals at all ATMs[ii] has fallen from $129.6 billion in the 12 months to November 2019 to $100.8 billion in the 12 months to November 2021, a fall of more than 22%.
- A growing trend towards digitisation and contactless payments, including significant growth in debit card use, digital wallets and faster payments using the New Payments Platform, all at the expense of more traditional forms of payment such as cash and cheques.
- Notwithstanding the fall in use, there has been a continued upwards growth in banknotes on issue, particularly in higher denomination ($50 and $100) notes, reflecting the important and enduring use of cash as a store of wealth, safeguard and contingency payment. Australian dollar banknotes on issue stood at a record $102.8 billion[iii] at the end of December 2021, up by $18.8 billon (22%) since December 2019.
- A more than 20% decline[iv] in the number of Authorised Deposit-taking Institution branches between 2007 and 2021, with further temporary closures or restricted branch operating hours due to the ongoing pandemic.
- A reduction in the number of ATMs and changes in ownership of several ATM networks. The number of ATMs[v] has fallen from 32,275 in September 2017 to 24,949 in September 2021, a near 23% decline.
- While RBA research[vi] concludes "that Australians generally do not have to travel far to reach their nearest cash access point", cash access and acceptance is greatly enhanced by, and in some regional areas reliant upon, Australia Post's branch network and Bank@Post service. Availability of cash out at some supermarkets is also an important access point for Australians.

Context: A complex cash 'ecosystem' under significant structural strain

The Australian cash 'ecosystem' is complex and comprises of several major organisations of scale and many other smaller companies that contribute to its operation.

While the RBA is the sole issuer of banknotes, as it acknowledges, it is only one participant among many in the overall cash ecosystem. Other than the Royal Australian Mint (RAM) – the sole coin issuer in Australia – and Australia Post, which are both government business enterprises and both critical to the functioning of the cash ecosystem, all the other participants are commercial entities.

As such, while all the organisations are committed to meeting their customer needs and fulfilling their contractual obligations, they are also accountable to their business owners and stakeholders. With differing business strategies and priorities, achieving universal industry agreement and support on change is challenging. Changes that may be beneficial to one organisation may not be for another, thus understandably influencing their desire, or not, to support change.

All the participants who provided input to this response agreed that notwithstanding the significant – COVID-19 precipitated – decline in transactional cash use, given the continued, critical reliance on the ready availability and acceptance of cash, it was essential that a robust nationwide cash infrastructure be maintained.

Several respondents expressed the view that the current cash distribution arrangements and commercial infrastructure are under severe strain and that while this RBA review was welcomed, 'time is of the essence'. Respondents pointed to a risk that it could take too long to make the changes necessary to ensure that Australia's cash ecosystem remains effective, efficient, sustainable and resilient.

In our approach to this submission we sought to draw a distinction between what is considered 'wholesale' or 'bulk' cash and what is viewed as 'retail' cash. We also sought to delineate between which of these matters are considered to be of an infrastructural nature, where collaboration could be deemed desirable, and which matters are considered to be commercially sensitive.

While there was broad consensus that on the one hand the wholesale movement of cash was largely covered by the scope of the RBA's Banknote Distribution Agreement (BDA), and that on the other hand retail cash products (especially those providing cash deposit services to businesses) are firmly in the commercial domain, it was agreed that neither 'wholesale' cash nor 'retail' cash can be considered in isolation and changes to one are likely to have consequences for the other.

The participant banks who provided input to this response were largely of the view that wholesale banknote distribution should be a shared activity underpinning the provision of wider cash services, but this view is not accepted by all: some banks may derive specific commercial benefit from their approach to wholesale cash activities.

The cash management (CIT) space is also highly competitive, including between the two major CIT companies – two of the four current RBA Approved Cash Centre Operators (ACCOs) – who provide comprehensive cash services to their bank, retail and other business customers.

A key feature of the economics of their operations, from both a vehicle/transportation and processing/depot infrastructure perspective, is economies of scale. Accordingly, both major CIT companies (and their other competitors) continue to compete for market share, with density of transportation activities (number of services on a given vehicle run) and depot utilisation (given many fixed overhead costs) being key considerations. Declining bank points of presence and associated reduced transportation work, coupled with lower transactional cash volumes / processing activity, are all having a material impact on the profitability and viability of these businesses, pressuring what are stated to be thin operating margins.

Context: International considerations

We observe that Australia is not alone in facing the challenges of ensuring that its cash distribution systems remain effective, resilient and sustainable in the light of reduced day to day cash use.

In the United Kingdom, during this issues paper's consultation period, the Bank of England has reported on the work it has led under the Wholesale Distribution Steering Group (WDSG). Over the past 18 months or so the central bank has convened stakeholders from across the cash supply chain to consider the future state for the country's wholesale cash distribution system. After detailed deliberation the group concluded that there was *"insufficient support for a utility model, and that at this time the actions of individual members, guided by the WDSG success criteria, are best placed to deliver the required modernisation of the UK cash infrastructure*[vii]". In the absence of a utility solution, the WDSG has agreed that a series of industry-wide commitments will help ensure that the wholesale cash infrastructure continues to support the effective provision of retail cash.

Drawing on the learnings of this earlier work, the Bank of England has asked each stakeholder in the wholesale cash supply chain to set out in detail how each of them will contribute towards the delivery of these industry-wide commitments. The Bank of England intends holding each bank or wholesale cash operator accountable for meeting its individual commitment and plan. To help support this, the U.K. Treasury will provide the Bank of England with the powers that it needs to keep the wholesale infrastructure sustainable and resilient into the future.

In New Zealand, where many of the major banks and one of the major CIT companies is under common Australian parent company ownership, the Reserve Bank of New Zealand is in current consultation seeking to develop its Future of Money strategies, elaborate on its role as a steward of cash and is seeking feedback on its proposals for cash system redesign[viii].

The Banknote Distribution Agreement (BDA) (questions 1 and 2 of the issues paper)

The current set of Banknote Distribution Agreements (BDAs) is the third major round of agreements dating back to 2011 (which in turn supersede other earlier contractual agreements such as the Cash Distribution Deed) that underpin the movement, processing and storage of cash between the RBA and the commercial marketplace.

While each BDA is bilaterally agreed between the RBA and each of the four current ACDES banks ('BDA banks'), in most cases the operational execution of these agreements falls to the bank appointed CIT company / companies that they use.

Given that the BDAs remain confidential between the RBA and each of the four BDA banks, save for those elements that need to be shared to fulfil servicing and audit responsibilities, we leave it to the individual banks and their service providers to provide a detailed response to questions 1 and 2 of the issues paper. However, in our feedback we would like to share the following general comments:

- Questions were raised as to why the negotiation of the BDAs is done on a bilateral basis, rather than being agreed transparently at an industry level. Any differences between one agreement and another has the effect that, where a service provider offers services to more than one BDA bank, it needs to negotiate and agree services (including any service changes) on an individual bank by bank basis. Further, any variations, or different interpretation of the agreement, have the potential to add administrative burdens on BDA banks and service providers that a common agreement might avoid. One suggestion was to make the bulk of the agreement transparently accessible to all under appropriate authority and to only bilaterally negotiate and agree any exceptions to the standard agreement.
- The CIT companies with which we spoke noted that, while not direct parties to the RBA BDAs, in practice they fulfilled the majority of the activities covered by the agreements. In particular they emphasised that when changes are being contemplated, the CIT companies are reliant on their BDA bank customers to share these changes and mutually understand their impacts. They therefore felt that a direct 'seat at the table' was required and that this would probably entail establishing a formal legal contract between the RBA and their organisation, although not necessarily requiring them (unless they separately sought to do so) to be a full BDA signatory.

Banknote Quality Sorting (question 3)

As we have already noted, those organisations who provided input to this response all recognise the importance of maintaining high quality currency in circulation, ensuring public confidence in Australian money and also ensuring the widespread acceptance of banknotes and coin in the many cash dispensing and acceptance devices in operation, including numerous retail self-service devices and vending machines.

Participants noted that it was important to have a banknote quality standard that was appropriate both in meeting the RBA's expectations and the demands of the public and that a clear single set of quality standards applicable to both offered greater operational certainty.

Additionally, it was noted by participants that the operation of the Note Quality Reward Scheme (a key component of the BDAs) may benefit from review to allow for flexible arrangements. For example, it was noted that the incentives paid by the RBA for banknote quality sorting could be paid directly to either the CIT processor or each BDA bank (according to their roles in provision of this service), with the RBA thereby being more directly accountable for its expenditure in this area, but that doing so would no doubt trigger a review of each bank's contractual and commercial agreements. Both CIT respondents indicated that this source of revenue was an important component of their overall business income.

Several participants commented on the proposed changes to the way in which Note Quality is measured, allied to the greater proportion of Next Generation Banknotes now in circulation. It was noted that the proposed changes require considerable banknote equipment modifications and, in some cases, full machine replacement. Given the current uncertainties faced by the industry, justifying these major capital investments is challenging. The temporary delay to the implementation of the new rules is appreciated, but further thought could usefully be given to the RBA's direct support in the implementation of the equipment / banknote sensor upgrades that are needed to meet the proposed new quality standards.

As part of these proposed changes, some participants sought greater clarity from the RBA as to the financial impact of the proposed simplification of defect categories and a better understanding of how these changes might impact their overall note quality sorting costs and credits earned.

Cash in Transit (CIT) operations (questions 4 to 7)

The Accredited Cash Centre Operators and others in the industry are best placed to answer some of the detailed questions about CIT company costs, revenues, operations and overall business conditions, but participants were keen to share some of the following key observations:

- The CIT industry is dominated by two major organisations – Linfox Armaguard and Prosegur Australia – who provide comprehensive cash transportation and processing services on a nationwide basis. Being able to offer full national coverage is important in meeting the needs not only of the major banks that they support, and to Australia Post, but the many retail business that have a national footprint.
- Several banks noted the importance of maintaining choice in the marketplace and would not wish to be beholden to a single CIT provider.
- The organisations who provided input to this response broadly agreed with the RBA's characterisation of the current market conditions, in particular acknowledging that based upon current cash volumes there is considerable spare capacity in many depots and that there are also more depots in total than needed. It was noted that there has already been some depot rationalisation undertaken by individual CIT companies in consultation with their bank and other customers and that the impact of these closures has largely been absorbed within current operating frameworks and without significant detriment to the service levels offered.
- CIT organisations indicated that further rationalisation of their own footprints was likely and indeed necessary for their economic wellbeing, but as distances between one depot (and its customer catchment area) and the remaining depots increase, the ability to meet current service levels and turnaround times will become increasingly difficult.
- Some participants outlined the opportunity for greater collaboration and rationalisation across CIT companies, detailing that in a number of locations, both major CIT companies had a presence. These matters are further discussed in our comments on the future state below.
- It was noted that the closure of bank branches, either permanently or temporarily due to the COVID-19 pandemic, is having a significant impact on cash distribution arrangements. As previously described, economies of scale are critically important to CIT operations. Historically, a CIT company could price and schedule its operations around a fully committed vehicle run that might include several bank branch services alongside other retail and commercial work. With fewer – typically higher value – bank cash services for which to cater, the economics of each run, particular a long-distance run serving regional and remote communities, have changed and the unit cost per service has increased. Competitive pressures and customer price sensitivities make it difficult to pass on these changed operating costs.
- Australia Post noted its reliance on CIT servicing of its Post Offices, especially its remotest branches, now often absorbing increased cash volumes displaced from closed bank branches. They are alert to further bank point of presence rationalisation and the challenges of maintaining their required CIT cash servicing levels.

Looking forward (questions 8 to 10)

Our contributing participants all recognised that the current cash infrastructure and operating rules, which were built and developed in earlier times when cash use was much higher, are increasingly no longer fit for purpose, and that without change the resilience of the Australian cash system will become increasingly fragile and strained.

There was common agreement among the contributing participants on the urgent need for detailed cross industry dialogue to address these issues in depth.

While the BDA banks have an opportunity to review certain aspects of the cash ecosystem under the auspices of the AusPayNet-led ACDES Management Committee, it was noted that there is currently no dedicated forum for the wider ecosystem (including the RBA, banks, CITs and any other relevant cash system stakeholders) to sit down together and deliberate change.

Options for addressing excess capacity in the CIT industry

In its issues paper the RBA highlights a number of courses of action that it believes could address excess capacity. These include:

Participants improve distribution efficiency through measures such as restructuring depot networks, increased use of automation and changed use of vehicles. Our CIT respondents reported that these measures are all already being actively pursued to varying degrees as part of their normal commercial activities and in order to maintain the viability of their businesses. There are already examples where within a CIT business some – usually smaller – regional depots have been closed and processing work transferred to a larger nearby processing depot that has adequate capacity. Given Australia's vast geography in most cases this requires considerable additional travel time, so that in many cases it is no longer possible to collect from a customer and fitness sort currency at an Accredited Cash Centre (ACC) on the same business day.

This potential delay to cash processing gives rise to a number of challenges. For example, the current designation and reporting requirements to meet Verified Cash Holding (VCH) requirements are that to be included in VCH for compensatory interest payment, deposits must be at a designated ACC and verified and fitness sorted by the VCH reporting deadline. While in the current low interest rate environment the extended time for transportation and the inability to meet the same day VCH reporting might be an acceptable trade-off, in a higher interest environment the lost compensatory interest costs would be material.

It is therefore recommended that a review of the VCH rules and reporting times be considered with thought given to paying interest compensation on a provisional or 'said to contain' pre-counted/fitness sorted basis, with subsequent accounting adjustments being made on final count. Consideration should also be given to the VCH status of cash in transit between one ACC and another, or under the control of an Approved Cash Centre Operator (ACCO) enroute to an ACC. Electronic reporting of data and other controls not available when VCH was first contemplated could be deployed to support the current assurance practice of periodic physical auditing of cash held.

A further challenge in delayed processing as a result of extended transportation is the risk of failing to meet, or incorrectly reporting cash deposits under, AUSTRAC Threshold Transaction Reporting (TTR) rules. This is particularly problematic for deposit values near the reporting threshold that on final count might differ from the 'said to contain' amount. Participants suggested that the RBA consider engaging AUSTRAC to potentially amend the TTR reporting deadlines to facilitate the option of delayed cash processing.

Coordination within the system. A small degree of outsourcing exists today where one of the major CIT companies sub-contracts another or uses a small local provider typically to complete remote cash servicing. Any significant increase in sub-contracting or service coordination (between competing companies) is likely to require Australian Competition and Consumer Commission (ACCC) approval and it is probable that even exploratory talks to consider such coordination may need specific clearance to avoid breaching competition laws. Here participants believe that the RBA could take a lead on facilitating appropriate discussions.

Consolidation within the system. While potentially leading to a more efficient model, participants felt that creating a single operating entity presented considerable concentration risk, and that negotiating a universally agreed model would likely be a highly complex and drawn-out process. There are many arguments to be made for and against such an outcome and these proposals require detailed analysis. While consideration of what a utility or single entity model – subject to all the necessary competition law compliance safeguards – could look like, could provide valuable insights into what system efficiencies could be achieved, participants felt that more urgent 'tactical' responses were needed in the short to medium term to safeguard the existing integrity of the distribution system.

Other Considerations and Recommendations

Participants shared a range of other considerations and recommendations. Of note we make the following comments:

- Some participants suggested, notwithstanding a careful consideration of the RBA's competitive neutrality obligations, the reintroduction of, or a form of, RBA owned Note (and Coin) pools at selected depot locations over and above the single access and return point of the National Banknote Site in Victoria (and in exceptional circumstances the RBA's Sydney drawing facility). Among the arguments for this approach is that it would, to some degree, mitigate the need for each BDA bank to – on their own account – draw and position cash stocks, especially for contingency purposes, which in aggregate are likely to be substantially higher than if a single RBA owned reserve stock was readily accessible. Another is that this would help reduce unnecessary transportation of physical cash, thereby improving transport efficiencies, saving in transport costs and reducing carbon footprint. It should be noted that the substantial increase in banknotes on issue since the start of the COVID-19 pandemic is in response to the public desire to hold banknotes as a safeguard but is also compounded by the need for banks to hold readily accessible additional stocks in case of further public demand and possible interruptions to the cash supply chain.
- Our participants provided some commentary on the recent structural changes to ATM network ownership and how many of the banks' offsite ATMs were now being operated under either Armguard's atmX or Prosegur's Precinct brands. The moves were seen as supporting resilience in ensuring public access to cash. It was also noted that while overall ATM cash requirements were broadly unchanged, these structural changes had resulted in considerable volumes of cash moving from the banks to the commercial ATM providers, which has led to some changes in longstanding cash trading patterns.
- Recognising that the RBA only has responsibility for banknotes, participants agreed that in any system redesign coin matters should also be considered and as such where appropriate the Royal Australian Mint should be party to the relevant discussions.
- Some participants noted, and Australia Post itself observed, the critical role it plays in providing retail and business cash access and acceptance across Australia. As a government business entity – with its own significant distribution capabilities – there is the potential for it to have a greater long-term involvement in the country's cash distribution ecosystem, in particular safeguarding cash distribution to more regional and remote parts of Australia that may be uneconomic to service by a commercial entity.

Conclusions

As the industry association and self-regulatory body for the payments industry AusPayNet stands ready to assist the RBA in achieving its goals of ensuring an effective, efficient, sustainable and resilient Australian cash system.

Although diminishing in transactional use, cash remains a vitally important payment option alongside a range of electronic alternatives. Moreover, as demonstrated in the response to the COVID-19 pandemic and seen elsewhere in times of adversity, cash remains an important store of value and backup payment mechanism. It is therefore essential, even if substantially reduced in transactional use, that if demanded cash is readily and reliably available.

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[i] Reserve Bank of Australia Consumer Payment Surveys

[ii] Reserve Bank of Australia, Total value of cash withdrawals in Australia, ATMs seasonally adjusted (C4)

[iii] Reserve Bank of Australia, Banknotes on Issue (A6)

[iv] Australian Prudential Regulation Authority (APRA) Authorised Deposit-taking Institutions points of presence Reduction in bank branches June 2017 5,816 to June 2021 4,491, down 1,325 (22.8%)

[v] Australian Payments Network, Device Statistics

[vi] How Far Do Australians Need to Travel to Access Cash? Reserve Bank of Australia Bulletin – June 2021

[vii] Update on the future of Wholesale Cash Distribution in the UK, Bank of England, December 2021

[viii] Reserve Bank of New Zealand, Future of Money – Te Moni Anamata