

# WESTPAC ECONOMIC BULLETIN

## ESAS Access Review.

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## Risk Assessment Framework for ESAS Consultation Paper.

The Reserve Bank of New Zealand (RBNZ) issued a consultation paper on 15 June 2023 discussing their intention to review the policy and criteria the RBNZ applies when granting firms access to the Exchange Settlement Account System (ESAS) used for wholesale New Zealand dollar payments. Westpac Economics decided to provide a submission for the Reserve Bank's consideration and this Bulletin contains our submission.

### Introduction.

1. The RBNZ's review of the criteria used to assess access to New Zealand's Exchange Settlement Account System (ESAS) is welcome and timely given advancements in the development of global payments systems and the increasing role of non-bank financial institutions in payments systems and financial market intermediation more generally. A root to branch review of ESAS access criteria has not been conducted for decades – hence this review is well overdue. We note that other central banks are conducting similar reviews – for example in the United States where the Federal Reserve is reviewing the framework for allowing access to its “Master Accounts” and in the United Kingdom the Bank of England has decided to allow some categories of non-bank payment service providers access to its RTGS system.<sup>1</sup>

### Key submissions.

2. Westpac broadly supports the description of the objectives of the ESAS payments system. Westpac agrees that system resiliency should be at the core of the RBNZ's strategy for managing ESAS. However, in Westpac's view resiliency of the system is affected by more than the structure and operational processes and features of ESAS itself. To this end, we consider that the described objectives should be more broadly defined to encompass the principle that ESAS participants should have strong risk management arrangements and be subject to robust regulatory and supervisory oversight. In widening access to ESAS beyond traditional market participants there is a risk that new entrants are not as robust from an operational and risk management perspective, as the banks that have historically participated in ESAS.

<sup>1</sup> See Bank of England (2017) [bankofengland.co.uk/news/2017/july/boe-extends-direct-access-to-rtgs-accounts-to-non-bank-payment-service-providers](http://bankofengland.co.uk/news/2017/july/boe-extends-direct-access-to-rtgs-accounts-to-non-bank-payment-service-providers) and Federal Reserve Bank of St Louis (2022) [stlouisfed.org/en/on-the-economy/2022/sep/fed-guidelines-master-account-access-payment-services](https://www.stlouisfed.org/en/on-the-economy/2022/sep/fed-guidelines-master-account-access-payment-services) for discussions on innovations in payments system access in the UK and US.

3. In addition, and consistent with the above, we would suggest that the first bullet point of the stated objectives for ESAS be amended as follows:  
 “... without creating undue risks to the payments system”,  
 be adjusted to reflect a more conservative stance of:  
 “... without creating any significant risks to the payments system”.
4. Consideration should also be given to potential reputational risk issues that might arise because of new payments service providers being conferred with ESAS access. There is a risk that such access may be viewed by consumers and the wider public as an endorsement of such providers by the RBNZ. It is also likely that firms will utilise ESAS access as a selling point for their services. Accordingly, we would encourage the RBNZ to carefully consider the extent to which it wishes to be viewed as endorsing these new participants (for example in respect of crypto asset payments service providers or custodians).
5. Additionally, there are risks associated with the interconnectedness of new ESAS participants. On the face of it, the criteria as specified appear to emphasize standalone risk management considerations which we think should be broadened to reflect the degree of interconnectedness of potential new entrants. If highly interconnected participants are granted access to ESAS, then these participants should be strongly regulated and supervised to prevent the accumulation of systemic risks.
6. We would encourage the RBNZ to consider its capacity to supervise and regulate any new participants given their jurisdiction and business models may be very different to the entities currently supervised by the RBNZ.

## Response to consultation questions.

### Question 1. Do you have feedback on how we have described our objectives for ESAS?

7. Westpac supports the high-level exposition of the objective. However, we consider that there is a need for the stated objectives to recognise that resiliency is related to more than the structure of ESAS itself. Participants need to have strong operational processes to successfully operate within ESAS and not create risks that might transmit to the wider system. Other factors that may also determine resilience may include:
  - strength of risk management arrangements of participants;
  - supervisory arrangements participants are subject to; and
  - participants’ ability to access backup liquidity buffers in the event of idiosyncratic or systemic stress.
8. It is important that the proposed policy considers the above factors, as it is likely that some potential new ESAS participants may not have robust operational, liquidity, risk management and risk mitigation arrangements and are not subject to the same supervisory oversight as traditional participants. Without such policy considerations, it is likely that increased systemic and operational risks will be placed on the ESAS system as well as RBNZ’s balance sheet. Examples of this could include the need for the RBNZ to increase access to its discount window or open market operations, the need for overdraft arrangements, or adjustment of collateral requirements and eligibility.
9. Accordingly, we submit that the proposed ESAS policy and objectives statement should emphasise that robust risk management and mitigation processes should be in place for any potential ESAS participant. In addition, and more specifically, we would suggest that in specifying the objectives of ESAS in the first bullet point of those objectives, the following amendment should be made:  
 “... without creating undue risks to the payments system”,  
 be adjusted to reflect a more conservative stance of:  
 “... without creating any significant risks to the payments system”.

### Question 2. Do you have any feedback on our considerations for opening up ESAS?

#### Understanding the motivations for why firms might seek ESAS access and considering the reputational risk implications.

10. We believe that the motivations for why an applicant may seek ESAS access is the key to understanding the benefits that ESAS access may confer to that applicant. Understanding an applicant’s motivations for applying for ESAS access may also shed light on the risks that may be associated with that applicant.
11. The consultation document rightly notes that most firms can already receive the benefits of payments system services associated with ESAS through an agent bank. However, access through an agent bank comes with various costs and limitations

which could motivate a firm to seek direct access. For example, firms may be incentivised to apply for access to ESAS to avoid sharing information on their payments flows with an agent bank.

12. It's important to note that ESAS access could in some way legitimise a firm and be used by the firm to market its services to the wider public. We think it would be useful for the RBNZ to recognise the reputational issues that might arise should the RBNZ be seen as somehow endorsing a new payments service provider by conferring ESAS access (especially if such access is conflated with perceptions of liquidity or deposit insurance support by the wider public).

#### **Clearly articulate whether ESAS access is to facilitate wholesale or retail payments.**

13. The policy considerations could be more clearly articulated with a description of the services the RBNZ considers might be better be facilitated by ESAS access. We would argue that the strongest case for ESAS access is that ESAS facilitates safer and more efficient wholesale market transactions. If the RBNZ agrees with this, then the policy could emphasise a wholesale market focus and include this consideration when examining the merits of individual applications. However, if there is a desire to consider applications from firms seeking to disintermediate the retail payments systems then some discussion of the advantages and disadvantages of this could be discussed in this draft policy.

#### **More focus on systemic risk considerations.**

14. The risk categories included in table 2 appear to be focused on the direct financial risks to the ESAS system as opposed to the much more interesting and important systemic risk considerations that might arise from the failure of an ESAS participant. We suggest that the current and potential future interconnectedness of a participant be expressly considered when evaluating the risks of its application.
15. We would encourage caution against putting in place a policy that might introduce a riskier set of more highly interconnected participants into the financial system. These concerns would be magnified should new interconnected participants not be adequately or easily regulated and supervised. In the absence of such considerations, the RBNZ may find that innovation is boosted at the costs of significantly increased systemic risks which may be difficult to contain.

#### **Consider the RBNZ's capacity to supervise and regulate new ESAS participants.**

16. We would encourage the RBNZ to consider its capacity to effectively supervise and regulate the new classes of entities which might become eligible for ESAS access. New entrants may not be well covered by existing regulatory frameworks and may have business models that vary significantly from the types of firms the RBNZ currently supervises. In addition, new entities might be predominantly based or operating offshore and not well covered by foreign supervisory regimes if for example, such entities don't have direct payments system access in offshore jurisdictions.

#### **Question 3 (A): Do you consider that there are any substantive risks that are not included in the RAF that should be included in order to safeguard the continued operation of ESAS?**

17. The risks set out in the consultation document seem comprehensive and we have no further comments on these.

#### **Question 3 (B): Do you consider that any of the risks set out in the draft RAF have been misrepresented?**

18. We do not consider that any of the risks have been misrepresented but believe that in assessing the risks it is important to take a comprehensive view of associated risks. A key risk issue that deserves consideration is the diversity in business models and regulatory frameworks that non-bank payment service providers and deposit takers are subject to. A good example might be crypto or stablecoin custodians or payment service providers who may not be regulated at all. Many of these entities may not be subject to robust liquidity regulation or regulatory supervision and may not have access to robust backup or emergency liquidity via a central bank or other committed facilities.
19. Adopting a very cautious approach to non-bank payment service providers would ensure a level playing field exists where all participants in ESAS are subject to equally robust supervisory and risk management requirements. Participants with more exotic business models should have the associated risks balanced by very robust liquidity backstops to ensure they do not import risk into ESAS, increase systemic risks or place the RBNZ in a position of having to offer emergency liquidity support.

#### **Question 3 (C): Is there any further feedback you would like to provide with regards to the draft RAF?**

20. We do not have any further feedback on the RAF but we would be happy to discuss any aspects of our feedback with the RBNZ at any stage.

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