

Wholesale Banknote Market

Making Banknote Currency Sustainable

“Float the Notes”

Executive Summary

- Cash Distribution system in Australia is not viable in its current form.
- Cash notes are a 'promise to pay' financial instrument issued by the RBA like many other financial instruments.
- The B4 banks already trade banknotes with each other under the Auspaynet system. These trades are not necessarily at face value.
- The proposed 'Wholesale Banknote Market' is a daily buy/sell market for bank notes made by Participants in each Authorised Cash Centre location.
- Participants include Banks, RBA and Market Operator and any licenced entity.
- The RBA offers new and recycled banknotes at the price which clears the Banknote demand. The clearing price may not be the face value.
- The RBA regulates the operation of the market.
- No intervention or cost to Government. Australia could be the first western democracy to solve the CIT crisis by letting the Bank Notes find their own value just like government Bonds.

The Issue

- Digital platforms have increased in popularity globally including Australia.
- In Australia Cash useage as a form of settlement has fallen to 13% and could fall further. This results in much less cash being required at points of useage such as Banks, Supermarkets etc.
- Cash is still a form of approved method for settlement of transactions and debts. Some consider the availability of cash an essential service.
- The cash infrastructure system was built around a higher level of useage and has significant fixed costs. The result is that the cash distribution system is high cost on lower volumes making it expensive. Banknote distribution is by agreement between the RBA & big4 banks and ACC operators.
- CBA reports that it costs it over \$300m p.a. to handle cash each year.

The Issue

- In recent publically available information, Armaguard has warned that the Cash distribution system is not viable and could collapse.
- The Banks, ABA have been granted exemption by the ACCC to collective negotiations with Armaguard/Prosegur and have provided a funding amount of \$50m (The terms unknown).
- Is there a way to restructure the Cash Distribution System which provides
 - A viable system for Cash Distribution,
 - Supports all existing Participants,
 - User Pays,
 - Govt Budget Neutral.

The Issue

- The RBA conducts a review of cash distribution arrangements each 3 years. The most recent review in 2021.
- Many other countries are dealing with similar cash distribution issues and are exploring pathways to sustainability. The RBA monitors these developments and a summary can be found in the Review of Banknote Distribution Arrangements 2021/2.
- Many commodities and currencies are traded globally each day. Financial institutions including the RBA, Banks already trade many commodities and currencies including the AUD. Indeed, many market participants create markets in currencies including the AUD and at a retail level this includes the Notes of those currencies. A Banknote is a promise to pay upon presentation in the same way as many other financial instruments.
- Many financial instruments are traded using markets and tenders and will change hands at a price equal to a discount or premium to the face value. This includes Fixed interest securities, Bank accepted bills and Bonds etc.
- Banks, under the AusPayNet system trade AUD banknotes located in AC Centres between themselves.

Float the Notes

- **Wholesale AUD Banknote Market**
- The proposed Wholesale Banknote Market is where Banknotes are traded as a financial instrument in a daily market between participants including RBA, the operator, BDA Banks and any licenced third parties. Trade in Banknotes may not be at face value.
- The existing systems are merged into an open market combining
 - The Bank to Bank secondary market in banknotes (developed from the AusPayNet system), and
 - The sale of new and recycled banknotes by the RBA, and
 - The operation of ACCs including RBA and intra ACC to ACC CIT functions.
- A critical component of the proposal is the role of the RBA;
 - becomes a participant by offering its banknote stock for sale at a market clearing price,
 - the RBA will always repurchase notes at face value as promised on the banknote,
 - As a Participant, the RBA can hold Banknote stock in ACCs.
- The market can only be for homogenous banknotes that meet quality standards. Sorted substandard banknotes would continue to be returnable to the RBA at face value.

Float the Notes

Participants could consequently include;

- Banks
- Market Operator
- ACC/CIT
- RBA
- Any licenced new entrant such as Post.

The market operator could be drawn from existing stakeholders;

- RBA,
- AusPayNet or derivative,
- ACC/CIT participants such as Armaguard,
- A new entity or entrant such as a payments focused entity.

Float the Notes

The proposed market is a version of a regulated open market much like national power markets, NBN etc. This market is one form of partially consolidated structure referred to in the 2021-2022 RBA review of banknote distribution arrangement (Cl 5.1 Consolidation).

Although significant there is already in existence considerable frameworks. As such, the market builds on existing frameworks rather than a major substitution.

- Protocols for operation of the banknote market used in the AusPayNet system exist,
- Protocols for the operation of ACCs and CIT already exist,
- Published Banknote distribution protocols and Agreements already exist.
- Likely initial participants already exist and are licenced or bound by agreements.

Pricing Tension

Factors which may effect the price in the market include.

- Time value of money (TVM) – The date by which a Banknote can be converted into value in an RBA account is the next business day.
- The urgency or need for the banknote at each ACC by respective Participants.
- The desire to acquire banknotes at a discount to face value to offset costs of distribution.
- The desire to hold stock of banknotes ‘just in case’ of unexpected demand or supply issues.
- The costs of transport of banknotes between RBA store Victoria and ACC locations.
- The interest rate paid by the RBA on Verified Cash Holdings.
- Uncertainty in markets such as COVID-19, war, issues effecting digital systems etc.

Float the Notes

- **AusPayNet System**
- Implemented in 2022, the Auspaynet system provides the framework for Banks to trade banknotes between each other.
- Participants include
 - B4 Banks,
 - ACC operators
- Banks can buy and sell banknotes for stocks held at Authorised Cash Centres (ACC). Thus bank participants can transfer banknote ownership between each other on pre agreed terms. The settlement price may not necessarily be the face value of the banknotes traded.
- Outside the AusPayNet system banks may also transact at face value with the RBA
 - purchase new or recycled banknotes from the RBA stocks held at RBA stock locations predominantly in Melbourne (but a stock is also held in Sydney).
 - Return sorted banknotes to the RBA as surplus or below quality.

EXAMPLE ACC – MELBOURNE (ARMAGUARD)

[date]								
Bank		BUY \$	BUY Vol	\$	SELL \$	SELL Vol	\$	
B1	#2	99.95	5,000,000	4,997,500	1.00			
B2		99.90			1.00	3,000,000	3,000,000	#2
B3	#1	99.99	10,000,000	9,999,000	99.995	2,000,000	1,999,900	#1
B4		99.80						
Part 1		99.75						
Part 2		99.50						
				14,996,500			4,999,900	
RBA	Melb				1.00	100,000,000		
Total Available						105,000,000		
Market Fee	0.05%			7,498.25			2,499.95	

Float the Notes

- **Participants**
- Make a daily Buy/Sell bid into the wholesale market based on its own needs for Banknotes in each Region.
- All participants have responsibility for note sorting but can be contracted to Market Operator.
- All Participants have Verified Cash Holdings.
- Market is open and visible.
- Banks can be expected to create a spread between buy/sell to impute a margin for the handling of Bank notes.
- Market Operator Fees are calculated based on the settlement price.
- After a transition period, Participants are allowed to offer a buy/sell quotes in smaller markets (eg 2 years for Business customers).

Float the Notes

- **Market Operator**
- Licenced by RBA as Market Operator.
- Operates the daily Banknote Tender for a fee.
- Operates the Authorised Cash Centres.
- Has note sorting responsibility.
- Moves Cash between ACCs for a fee.
- Offers to distribute cash to third parties in competition with others.
- Entitled to recoup its cost and a reasonable profit.
- Must meet protocols and guardrails eg insurance.
- Participants can have shares in Operator but not control.
- Able sell Notes into the market.

Float the Notes

- **RBA**
- The RBA has the statutory responsibility to provide Banknotes into the economy.
- Regulator of Wholesale Banknote Market
- Monitors Market daily.
- Maintains design and printing of new Banknotes as required.
- Supplies new or existing notes from its stock held at RBA locations.
- Offers to repurchase any Banknotes at Face Value including substandard Notes. The RBA promises to honour the bank note at face value.
- RBA will sell notes at less than face value in tenders at the price that clears the market demand for banknotes.
 - Proceeds from sale of Banknotes can expect to be less than that of face value with a recognition of a potential Unrealised loss. The Loss is only realised if and when the notes are actually returned to the RBA. Bank note float continues to rise as the public uses cash as a store of wealth.
 - The RBA earns a significant return on banknote issuance called Seignorage. This is \$1Bn to \$3Bn p.a. The Seignorage recognised by the RBA is based on the interest earned on issued Banknotes and can expected to be reduced accordingly.
- Significant amendment of the Banknote Distribution Arrangements required.
- Interest payments on Banknote stock held by market participants would need to be maintained.

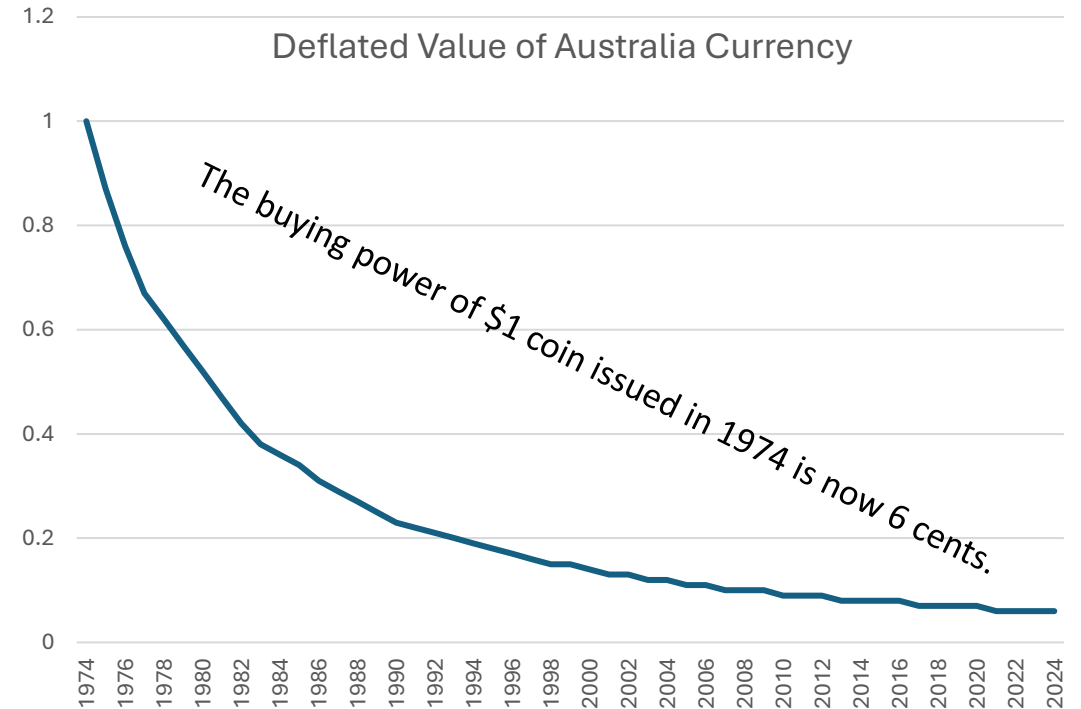
Float the Notes

Some of the matters which would need to be considered include

- Legal, competition policy, operational regulations.
- Competition policy assessments would be required, however the open market system could potentially provide an appropriate pathway.
- Participation by non banks including potentially Post if interested.
- Transparency with rules and guiderails.
- Pricing of functions within the market. Tender, secure holding, transfer, delivery fees etc.
- Market Operator costs to be made clear for transfer of Notes between ACCs.
- Third party competition CIT to be encouraged for distribution from ACC to third party customers of Participants. Cost of Distribution from ACC to third party customers of participants to be scheduled.

Float The Notes

- Currency Denominations
- Consider a rationalisation of denominations of coin and notes due to lower usage, costs and effects of inflation;
 - Banknotes - delete \$5 and \$20 notes leaving \$10, \$50 and \$100. Eventually also delete \$50 for a remnant decimal \$10 & \$100 note currency.
 - Coin – delete 5c, 20c, 50c leaving a remnant decimal of 10c and \$1.
 - Review coin in 10 years.



Source Inflation calculator

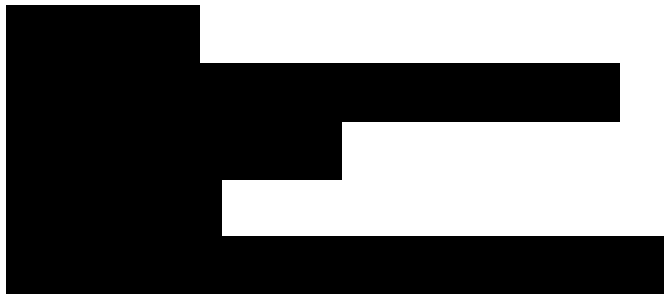
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Reference

RBA Banknotes: Australia's Banknote Distribution System
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Annexure 31 - RBB Economics Expert Report - 27.09.22 - PR
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Australia Post Annual Report 2024

Armaguard Australia