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**CHANGES TO CASH DISTRIBUTION  
AND PROCESSING ARRANGEMENTS IN  
AUSTRALIA**

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# CHANGES TO CASH DISTRIBUTION AND PROCESSING ARRANGEMENTS IN AUSTRALIA

## 1. Introduction

Cash distribution and processing arrangements in Australia have changed significantly over the last twelve months or so and further change is under way. For this reason, it is necessary to give some background on how things operated in the past, why they have evolved to their current stage and why further change is occurring.

## 2. Background

The Reserve Bank of Australia is responsible for the distribution, processing and destruction of currency notes through the Cash Services areas of its branches located in Australia's largest capital cities, Sydney, Melbourne, Brisbane, Adelaide and Perth. (The Bank also has a branch in Canberra but this is limited to a Banking Services operation. The Bank recently closed its branches in Darwin and Hobart.) Historically, different distribution arrangements applied for capital cities and regional areas. Distribution arrangements for regional areas are not discussed in depth in this paper but the multiplicity of systems currently used is being reduced and the primary method in the future will be similar to that which we plan to have in place for capital cities.

Up until July 1998, the Bank distributed cash to banks in capital cities via a "retail service" called the **Centralised Cash System (CCS)**. Over time the Bank had moved to recover more and more of the costs of providing this service.

The Bank also supplied cash in bulk or on a "wholesale" basis to armoured car/cash in transit companies (ACCs) to service their non-bank commercial customers (which included branches of other financial institutions) and bank branches that required special services such as the loading of off-site ATMs or notes of higher than normal quality. The Bank charged for the provision of bulk cash (3 cents per \$1000), but also allowed ACCs access to limited amounts of cash on the Bank's account through early draw and late lodgement facilities. The Bank also introduced rules in 1990 to encourage ACCs to use their commercial collections today to meet their orders for tomorrow, thus reducing turnover and processing by the Bank. Such rules did not apply to the CCS.

In the CCS, individual bank branches placed orders for notes with the Bank, the Bank made up bags containing notes to meet those orders, and the bags were delivered to bank branches via ACCs. The ACCs also collected surplus and unfit notes from bank branches and returned them to the Bank for processing. In general, the ACCs were required to use separate vehicles for the delivery or pickup of CCS bags and commercial deliveries or pickups.

(CVCS) systems manufactured by Recognition Equipment Incorporated USA were installed in the Bank's branches. The systems were upgraded in 1990 to provide a more open architecture and the installation of improved detectors.

### 3. Recent developments

The main driving forces behind recent changes to distribution arrangements have been:

- to reduce excessive processing by the Bank. During the 1980s the Bank was experiencing an increase in the rate at which it was seeing notes. By the late 1980s the Bank was seeing the average note in circulation more than five times a year. This was judged to be excessive and much greater than many other countries considered necessary to keep the circulation clean and free of counterfeits. Most of the growth in turnover was a result of the commercial operations of ACCs. As noted above, the Bank introduced rules in August 1990 that encouraged ACCs to use some of their commercial note collections each day to make up orders for notes the following day.

By the mid 1990s, turnover had dropped to around three times per annum but it was judged that still more needed to be done with the aim of getting turnover down to around two times a year (this would involve processing levels dropping from around 1.5 billion notes to 1.0 billion notes per year ie by around 30 - 40 per cent).

Pressure to reduce turnover also strengthened following the introduction of polymer notes. It was clear that these notes were lasting much longer than paper notes and counterfeiting was declining. Therefore, it was decided that the Bank did not need to see notes as often for the purpose of culling unfit notes and checking for counterfeits;

- operating within a "competitively neutral" framework. The Bank, like many other government enterprises, began to look at the costing of those services it provided in competition with others from the private sector. What surfaced from that study was a realisation that the Bank's CCS service was generating insufficient revenue to cover the cost of providing the service. Furthermore, if charges had been increased to a level to fully cover costs, plus generate a small surplus, the service would not have been competitive with bag services offered commercially by ACCs;
- improving the efficiency of the cash distribution system. The Bank was particularly concerned with excessive churning of notes. For example, on any given day an ACC may deliver to a bank branch a bag made up by the Bank containing a particular denomination and on the same visit the ACC would pick up a bag containing that same denomination for return to the Bank. The banks and

Consequently, the decision was taken to exit the CCS bag business by mid-July 1998.

The Bank initiated a consultative process with the banks and ACCs to come up with a new system. The process moved slowly to start with but eventually the banks and ACCs suggested a system in which the CCS would be replaced with an almost identical system, but with the ACCs providing the old CCS bag make-up service rather than the Bank. This proposal envisaged that one ACC company would provide the service to all banks in a capital city from a 'pool' of notes held by the ACC but on the Bank's account.

The Bank proposed that a variation of the 1990 turnover rules that applied to notes needed by ACCs to service their commercial customers should also apply to notes needed to service banks. The Bank's push for this and more significant changes was questioned by banks on the ground that it involved pushing significantly higher costs onto the banks for no net benefit.

In the old CCS system, the Bank was a net issuer of notes, whereas the Bank was a net receiver of notes from the ACCs' commercial business. If ACCs were able to use surplus commercial cash to supplement bank needs, then the Bank would have been unlikely to achieve the turnover it was looking for of around a billion notes per year.

As a result, the Bank suggested that the proposed new arrangements be modified to include "**Bank Note Pools**". These would be limited holdings of Bank cash at the premises of the ACC that had the business in each capital city and could be used to meet the needs of banks. Surplus notes would go into the Pools, subject to limits on the Pool holding. Unfit notes would be returned to the Bank and, when needed, the Bank would replenish the Pool. This would segment notes used by the ACCs to service banks from notes used to service other commercial customers. Arrangements for ACCs to access cash from the Bank for commercial needs would remain unchanged.

While the Bank was willing to hold more of its cash at locations outside of its own premises, it did not want additional cash going back onto its books each night. The Bank also stipulated in the negotiations that it would not meet any of the costs of operating the Pools.

Negotiations to finalise the proposed new arrangements proved difficult. At the last minute, the uniform/co-operative approach the banks had taken to that time broke down. A significant factor in this breakdown was the decision by one bank to use a new ACC in the Australian market place which sought to capture a significant market share through very aggressive pricing. In the event, and as a generalisation, each bank went its own way and contracted for one of the three ACCs to provide a retail bag service for that bank in all capital cities.

across a number of depots of the same ACC in the same city, and that turnover rules would not apply to the Pools. The Bank also agreed that the charges for bulk or wholesale cash would be dropped. This was seen as consistent with the Bank's public duty which was defined as provider of bulk cash to the community.

After 12 months of experience with the new system, the results have been:

- overall, the Bank believes that operationally the new arrangements have gone reasonably well after some initial teething problems especially with accounting matters;
- the Bank is comfortable with the general concept of ACCs having a limited pool of the Bank's notes held permanently at their depots as it is not much different to that which occurred with early drawing/late lodgement arrangements or with Note Issue Agencies which had operated in regional areas for some time;
- banks and ACCs are generally happy with the new arrangements;
- processing at the Bank is down by around 20 per cent as against a desired 30 - 40 per cent. In one centre processing is only down 5 per cent;
- there has been a slight increase in the amount of notes returned onto the Bank's account each night.

The disappointing reduction in the Bank's processing volumes was an inevitable consequence of the fragmented arrangements that arose from banks going their own way, combined with the fact that some banks are net drawers of cash while others are net returners. The Bank Note Pools at each ACC generally service the needs of one, or at best two, of the major banks. Consequently, there is generally no opportunity for surplus cash from one bank to be used to meet the needs of another. There has also been some leakage of what was previously commercial business for ACCs into Bank Note Pool activity.

In expectation of reductions of the order of 30 to 40 per cent in processing volumes and the elimination for the Bank of the preparation of notes stage of CVCS processing, the Bank restructured its Cash Services areas. The higher than expected processing volumes have, however, created significant strain on resources (overtime etc).

In addition, the unevenness of flows has led to ACCs visiting the Bank more frequently than expected (not just once a week) to return surplus note holdings or to obtain additional notes to top up Bank Note Pools. Also, Pool limits have been exceeded on occasion, something the Bank is not comfortable with and has sought to keep to a minimum. Reluctantly, however, it has agreed to limits being temporarily exceeded on some occasions.

#### **4. Future directions**

The Bank is well advanced with discussions with banks and ACCs about further changes to cash distribution so that the Bank's original objectives are more closely met. The Bank has proposed that each ACC will be able to have a single pool of Bank cash (in each State/Territory) that can be used for both bank and commercial business, and that the 1990 turnover rules on ACC's commercial activities will be removed along with early draw/late lodgement facilities. Further, the Bank is proposing that transfers between pools operated by different ACCs in the same State/Territory should occur. It is also proposed that Note Issue Agencies, Mobile Cash Units and other specialised arrangements in regional areas would cease and regional areas would be serviced by the ACCs from their State/Territory pool. This would minimise the number of different cash distribution systems.

A single note pool system is expected to provide the Bank with some flexibility in its note processing arrangements. The Bank still has a target of processing 1 billion notes per year and would, if necessary, instruct ACCs to return specific denominations notes at times so as to achieve this level. Such returns could also be in response to a serious counterfeiting threat or the need to "clean up" a particular denomination of regional area. The Bank has offered to meet any costs associated with this and of providing notes to replace those returned.

There is a concern that when this revised approach is implemented the volume of notes held at ACC depots on the Bank's account could rise. The Bank will monitor this and if volumes do rise above acceptable levels counteractive measures may need to be considered. These could include a reintroduction of turnover rules or other restrictions on access to Note Pools.

On balance, it is the Bank's view that the current arrangements have worked well and have gone some way to achieving the desired objectives. In essence, some changes still need to occur to further reduce the flow of notes back to the Bank and reach a situation where processing volumes move closer to what was originally envisaged when Bank Note Pools were first mooted.

The initial reaction of banks and ACCs to the future directions that the Bank has outlined to them has been positive so long as rules can be created and adhered to that cover discrepancies and ensure the quality of notes particularly those entering the pool from commercial collections. In the current and proposed systems, processed notes from a bank or ACC will be put in tamper evident packages. If notes move without the package having been opened by the previous recipient then they will not be recounted. Any discrepancy will be settled between the packing bank or ACC and the opening bank or ACC.