

## National Payments Plan

Consulting on change in  
UK payments

## **How to Respond**

Responses to this Consultation are requested by 4th February 2008.

An order line is available for printed copies of the Consultation paper on 020 7638 5760.

Electronic responses are preferred. They should be sent to:

**[consult@paymentscouncil.org.uk](mailto:consult@paymentscouncil.org.uk)**.

Paper responses should be sent to:

National Payments Plan Consultation Response  
Payments Council  
5th Floor  
Mercury House  
Triton Court  
14 Finsbury Square  
LONDON EC2A 1LQ

## **Confidentiality and Data Protection**

It is the Payments Council's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure. Please advise of any confidential material in your response.

In responding to this consultation you are taken to have consented to the use of your personal data for the purpose of assisting in the development of the National Payments Plan. All personal information submitted with your response will be processed solely for this purpose.

# Foreword by Brian Pomeroy, Chairman of The Payments Council Board

Payment systems are essential to all our lives, and are rightly regarded as part of our critical national infrastructure. Without them, economic life would be next to impossible. It is a testament to the reliability and efficiency of the existing systems that so little is heard about them day to day, despite the crucial role that they play.

How should these systems evolve? How could innovative ways of making payments be further developed? What is the future of more traditional methods of making payments, such as the cheque, which are now in decline?

The Payments Council has been established to set all these developments and trends in their strategic context and to work with all those involved in payments – both users and providers – to drive payments forward.

This consultative document is an important part of this process. It seeks your views on the key issues which will shape the future direction of payments.

We hope for responses from as wide a range of bodies as possible. We have identified some especially significant areas for consultation but are happy to receive views on any aspects of payments.

Our focus is primarily on UK payment systems; but these are set in the context of developments elsewhere, especially in the Single Euro Payments Area, and we seek comment on how we can best help providers and users take advantage of them through our work.

## **How do we see the payments sector evolving?**

The overall forecast for payments is for change and a growing variety of payment methods, as technology opens up new means of making payments securely and efficiently. We believe that it is important to exploit these efficiencies fully as they contribute to overall economic well-being. We are consulting on where collaborative action is needed to maximise these benefits.

Where are these new developments emerging? The new faster payments service will, in particular, play a significant part in its own right and also in facilitating other developments. There are also significant initiatives already under way in the areas of contactless and prepaid cards and payments through mobile telephones.

We also want to ensure that we have the right framework in place to foster future innovation. The principles of open access and open standards in the development of new technology seem the key to this as they can spread the benefits of innovation as widely as possible. So we start from a position of supporting these principles.

# Foreword

A likely consequence of all these innovations is a continuing decline in some traditional forms of payment, especially those which are paper-based such as cheques. We are keen to have your views on how this decline can best be handled. We believe that there needs to be a strategic approach which will involve both informing all users of what alternative forms of payment are available and ensuring that these alternatives are accessible and attractive to use. Without such a strategy, it will be difficult to actively encourage moves from less to more efficient means of payment.

If users are to feel comfortable with new payment methods, work has to be done on informing and educating them. This is another important theme of our consultation.

But our emphasis on innovation and efficiency does not imply that we have no regard for other factors.

Payment systems are so core to our economic life that special account must be taken of the needs of minority and disadvantaged groups so that they can share in the benefits of innovation. We are asking what can be done to ensure that all sectors of our society can benefit from the move to more efficient means of payment.

We also want to maintain our excellent record for the reliability and security of payment methods. The consultation asks what, if any, additional steps are needed in these areas.

## **How can the Payments Council play a part in realising these benefits?**

We see our role primarily as that of a facilitator; payment systems require a degree of collaborative work if they are to be available to all users and we operate in that collaborative area. We can help create the circumstances in which innovation and efficiency can flourish and the Payments Council can play an important role in bringing together expertise from within the industry and from users. But there are many aspects of payments which are best left to competitive forces in the market place and we do not seek to interfere there.

This is an important consultation on an important topic. I look forward to your contribution to the debate.

**Brian Pomeroy**

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# SECTION 1

**Consultation on the  
National Payments Plan**

## 1.1 THE PAYMENTS COUNCIL

The Payments Council, which was created in March 2007, is the organisation that sets strategy for UK payments.

The Payments Council has three core objectives:

- to lead the future development of co-operative payment services in the UK in order to ensure that the payment system as a whole meets the needs of payment service providers, users and the wider economy;
- to ensure that the payment system is open, accountable and transparent;
- to ensure the operational efficiency, effectiveness and integrity of payment services in the UK.

The Payments Council Board comprises 11 directors from organisations that are members of the Payments Council, alongside four independent directors and the Bank of England as an observer. It is chaired by an independent chairman, Brian Pomeroy<sup>1</sup>.

The Payments Council works closely with a number of schemes – the bodies responsible for the common operating procedures, rules and technical standards of the UK’s main domestic payment systems. These comprise Bacs, CHAPS Clearing Company, Cheque and Credit Clearing Company, the LINK ATM Scheme, the UK Domestic Cheque Guarantee Card Scheme and the Currency Clearings Committee. The Board is able to make decisions that are binding on scheme members in order to implement its strategy. Visa and MasterCard are international in scope and have no formal contractual link with the Payments Council. Neither they nor their members are obliged to implement decisions of the Payments Council Board.

The Payments Council has set up three User Forums, covering consumers, small and medium-sized enterprises (SMEs) and large corporates to consider and discuss proposals and offer advice to the Board. Each Forum is chaired by an independent director.

## 1.2 THE NATIONAL PAYMENTS PLAN

Why a National Payments Plan? In payments, unlike many other sectors, there may need to be co-operation between participants if users are to have full benefit of new developments. The Plan will outline those areas where collaboration can deliver such an outcome. The Plan will be periodically revised and updated, and is intended to provide a framework for the development of payments in the UK over the next five to ten years.

<sup>1</sup> The composition of the Board and further details on the Payments Council is given on the Payments Council’s website at <http://www.paymentscouncil.org.uk/>

# Consultation on the National Payments Plan

Co-operative action can be needed:

- to introduce common standards so that business is made easier to transact;
- to create a network between participants which maximises the reach of payment services;
- to address market inefficiencies.

There are, of course, many areas where innovation will be taken forward by individual institutions or groups of institutions, and where action at industry level would be unnecessary or counter productive, as it could stifle competition and innovation. The Payments Council recognises that the best outcomes may often be achieved through the operation of market forces alone.

The Plan will reflect the Payments Council's core objectives so there will be a particular emphasis on innovation, efficiency, integrity and responsiveness to user requirements. This will include, for example:

- identifying gaps in the services offered by UK payment service providers and assessing how they can be plugged;
- facilitating an environment that supports innovation and competition;
- moving the UK to more efficient methods of payment and more efficient delivery channels;
- seeking to ensure that current and emerging payment methods continue to operate securely and that effective methods of fraud control are adopted;
- identifying and responding to the needs of all categories of payment service users, and, in particular, ensuring that the payment requirements of financially disadvantaged sections of society are adequately met.

The Plan will lead to further action, including statements of principle and agreements to undertake more detailed reviews of specific issues. Actions will be measurable, with clear timeframes and deliverables.

The Payments Council recognises that the prices charged to users by payment service providers are key determinants of the levels of demand for different payment methods. However, as this is a competitive matter, issues relating to pricing policies are not within the scope of the National Payments Plan. Interchange fees in the international card schemes are also not in scope; these are currently the subject of scrutiny by competition authorities at the UK and European Union levels. The Plan also excludes issues around money laundering, as this is a matter for regulation by government, and around branch sharing, as this is not directly payment related.



## 1.3 PROCESS AND TIMETABLE FOR CONSULTATION

### Introduction

This public consultation is a crucial part of the process of developing the Plan.

The issues being consulted on draw heavily on meetings of the three User Forums and also take account of discussions with other key stakeholders in the public and private sector. The starting point for these discussions was an analysis of the **needs** of payment users for different categories of payments, distinguishing, for example, face-to-face and remote payments; the type of user and recipient (e.g. consumers, SMEs, clubs and societies, larger corporates); regular and one-off payments etc. The output from these discussions has been most helpful in shaping the issues and questions covered in this consultation.

The paper covers some 19 topics grouped under three headings: efficiency, innovation and cross-cutting issues (including integrity). Each of the topics is divided into two parts: a context section introducing the item and a section with the questions for consultation. The questions capture the main issues raised in the preliminary discussions with the User Forums and other parties but are not exhaustive or restrictive: feedback on other relevant issues would be welcome.

### Timetable

A Conference on the National Payments Plan is being held on the morning of 23rd January 2008. Further details are available at [www.paymentscouncil.org.uk](http://www.paymentscouncil.org.uk).

Responses to this Consultation are requested by 4th February 2008.

It is planned to publish the National Payments Plan in Spring 2008. An analysis of the response to the Consultation will also be published.

# Consultation on the National Payments Plan

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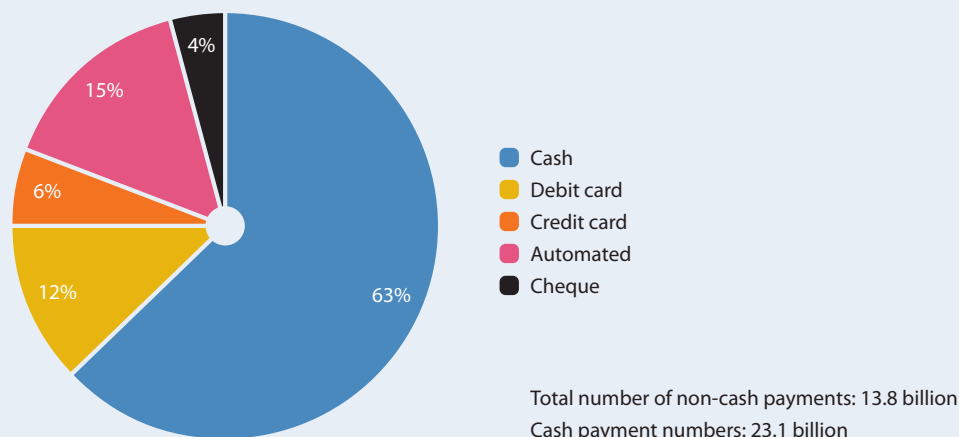
# SECTION 2

## The UK Payment Markets

# The UK Payment Markets

## 2.1 RECENT TRENDS

The UK Payment Markets – volumes by method in 2006



The main ways to pay in the UK market are the traditional paper methods of cash and cheque, and electronic payment by plastic card or automated means. Automated methods include direct debits, direct credits and the CHAPS same-day system.

It was nearly a generation ago, in 1990, that the use of **cheques** peaked in the UK, with 4.0 billion cheque payments in that year. In the intervening years individuals and businesses have increasingly adopted electronic methods of payment. In 2006 cheque volumes declined at their fastest-ever rate of 8.0% to 1.8 billion transactions. Cheques represented one in 25 of all payments in 2006. Only a small and declining minority of payments in retailers, for regular bills and for cash withdrawals, are made by cheque and most larger businesses prefer to pay their suppliers by automated means. However, there are some major areas where cheques remain heavily used, often those where electronic alternatives are not always available or do not fully meet the needs of payers or payees. These include payments made by small and medium-sized businesses and some payments made by individuals, such as those to other individuals or to small companies. In 2006, around 26 million consumers made a payment by cheque.

**Automated payments** are critical to the smooth functioning of the UK economy. Consumers and smaller businesses use direct debits to pay many of their regular bills. Businesses use direct credits for payroll and to pay their suppliers, and the government uses direct credits to pay social security benefits and state pensions. Corporate treasurers, the financial markets and the housing market rely on the CHAPS service for same-day and high-value payments. Automated payment numbers are seeing solid growth and in 2006 there were 5.6 billion automated payments, 4.5% more than in 2005.

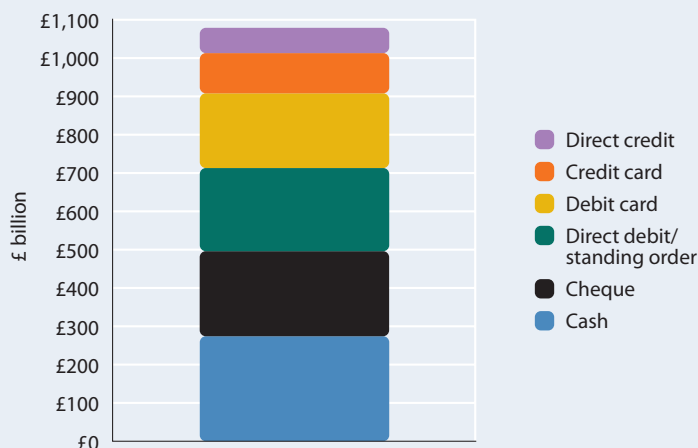
# The UK Payment Markets

The personal **credit card** market is more cyclical than other sectors of the UK payment markets. The nine years from 1995 to 2004 saw sustained and rapid expansion with demand supported by the benign economic environment and intense competition and innovation from established card issuers and new entrants. However, over the last three years the market has experienced a prolonged slowdown. Demand for credit card credit has slackened, cardholding has seen a modest decline and consumers have shown an increasing preference for debit cards to make payments. In 2006 there were 2.0 billion credit card payments.

2007 saw the twentieth anniversary of the launch of the **debit card** in the UK. Over that period debit cards have grown to become the most used non-cash payment method. Use was fuelled initially by consumers shifting away from cheques in retailers and more recently by cash migration. Debit cards account for over 40% of retail spending in value terms and their use is expanding rapidly away from the high street into the service and other sectors of the economy. Last year 4.5 billion payments, or one in three of all non-cash payments in the UK, were made by debit card.

**Cash** is the dominant method in terms of the number of payments being made. Over six in ten of payments are made by cash, almost everybody uses it on a regular basis and one adult in five still makes all of his or her day-to-day purchases by cash. However, due to the increasing availability and popularity of electronic payment, both the number and the share of payments made by cash have been declining steadily. In 2006 we made 23.1 billion cash payments, or nine per adult per week. Most cash use is for lower value payments, with two-thirds of payments being five pounds or less, but cash still accounts for a substantial proportion of personal spending. In 2006, personal cash use in value terms was higher than that by any other personal payment method.

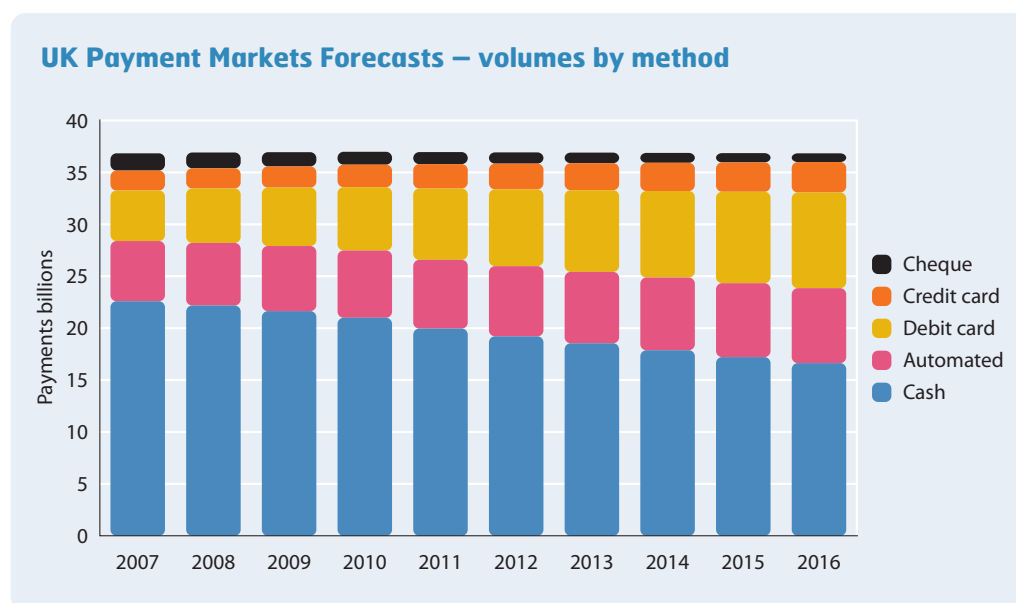
Consumer Payments – values by method in 2006



# The UK Payment Markets

There is also continuing change in the way in which we get our cash. Businesses and government have shifted away from the payment of wages and state benefits by cash. Cash machines have become more widely available and there is a strong preference for their use among younger people. As a result, the proportion of personal cash demands met by cash machines has doubled over the last ten years to nearly two-thirds in 2006, when cash machines dispensed £180 billion in 2.8 billion transactions.

## 2.2 FORECASTS



The Payments Council produces forecasts for the UK payment markets. These are based upon the historical trends within different market sectors, together with the impact of emerging developments, such as contactless cards and of known structural change, such as changes to the state benefit system.

It is forecast that, on current trends, **cheque** volumes will fall at an average of over 7% per annum over the next ten years, leading to transaction volumes of 840 million in 2016 when cheques will account for only one payment in 50 in the UK market. The strongest decreases are expected in bill payment and in payments in the retailer, travel and entertainment sectors. However, cheques may remain popular for person-to-person payments and payments to and from smaller businesses.

Underlying rates of growth in **automated** payments are expected to remain steady. By 2016, it is forecast that direct debits will be used for two-thirds of all personal bills, that 93% of the UK workforce will be paid by direct credit and that 57% of business-to-business

# The UK Payment Markets

payments will be made by automated means. Some of the main opportunities to substantially boost automated payment volumes come from the faster payments service. Total volumes are expected to grow to 7.2 billion in 2016.

There is considerable uncertainty as to when the **credit card** market will return to growth. Credit cards provide a flexible tool for short-term borrowing and the challenge for issuers will be to innovate around that core functionality to grow the market and differentiate their cards from their competitors. It is forecast that credit card payment volumes will grow from 2.0 billion last year to 3.0 billion in 2016.

**Debit card** transaction volumes are projected to more than double over the next ten years to 9.2 billion in 2016. Over and above the existing market momentum towards debit cards, much of the growth will come from lower value payments. Chip and PIN has already enhanced the customer experience and the introduction of contactless cards will make low value payment at some points of sale a simple matter of putting the card in the proximity of the till. In 2016, debit cards will represent 46% of all non-cash payments.

The rate of decline in **cash** volumes is expected to pick up with the introduction of new technologies such as contactless cards. It is forecast that 2013 will be the first year in which there are more non-cash payments in the UK payment markets than cash payments. However, cash will still represent 43% of payments in 2016. The total demand for cash in value terms is projected to see a very modest decline with cash machines meeting an increasing proportion of that demand, reaching 81% in 2016.

# SECTION 3

## Efficiency



## 3.1 CHEQUES AND THE CHEQUE GUARANTEE CARD SCHEME

### Market trends

As discussed in Section 2, cheque volumes have been in decline in the UK since 1990. In recent years the rate of decline has accelerated, especially in the retail sector, with many leading retailers and chains of petrol stations no longer accepting payment by cheque. Retailers perceive cheques as expensive to handle and prone to fraud. But, in other parts of the economy, especially the SME sector and among older consumers, cheques continue to play an important, though still declining, role. Cheques now comprise 13% of UK non-cash payments compared with 64% at their peak in 1990.

### Processing costs

As cheques require physical processing and transport, they are costly to handle and innovation is difficult and expensive<sup>2</sup>, even though the industry has recently undertaken a successful project to introduce greater certainty into cheque clearance. The Payment Systems Task Force's Cheques Working Group considered and rejected a number of options for greater investment in more change<sup>3</sup>. There are substantial fixed costs associated with cheque processing, so declining volumes increase the unit cost of cheque processing, widening the already substantial cost differential with other payment instruments. A number of studies have already suggested that the replacement of cheques by automated and plastic alternatives would have substantial economic benefits<sup>4</sup>. There are also environmental benefits of migrating from paper to electronic payments.

### Managing decline

Many believe that the use of cheques will be discontinued in the UK at some point in the future and that a point will eventually be reached when industry-wide cheque clearing is no longer sustainable. This has already happened in a number of European countries, including the Netherlands and Sweden. Before this could happen in the UK viable and accessible alternatives would need to exist for all current cheque uses.

<sup>2</sup> In contrast to other payments cheque authentication takes place at the end of the process. This creates an exposure to fraud and makes innovation more difficult.

<sup>3</sup> The report concluded that "while the demand for speeding up the core clearing cycle, as demonstrated in the consumer and business research, was not significant, and the broad cost-benefit analysis of building a wholly new central system was not convincing, the demand for greater transparency, certainty of payment and for otherwise improving the existing system, was compelling." The full report is available at [http://www.ofc.gov.uk/advice\\_and\\_resources/publications/reports/financial/ofc868](http://www.ofc.gov.uk/advice_and_resources/publications/reports/financial/ofc868).

<sup>4</sup> Various case studies are described in Sections 4.61 - 4.82 of the Cheques Working Group report: [http://www.ofc.gov.uk/shared\\_ofc/reports/financial\\_products/ofc868.pdf](http://www.ofc.gov.uk/shared_ofc/reports/financial_products/ofc868.pdf). They show that cheques are comparatively expensive and that electronic transactions are relatively inexpensive.

# Efficiency

There are two ways in which the industry could respond to these circumstances.

**Either** the industry can stand back and allow changes in customer behaviour and market forces to determine the rate at which cheques decline. This will be protracted and costly. Whilst we expect cheque volumes to continue to fall significantly over the next few years, there will be a long tail of cheque payments. These will be difficult to eliminate but the cost of processing each cheque will keep on rising.

**Or** there can be a more proactive effort to phase out cheques, within a reasonable timescale. This timescale would be entirely dependent on there being alternatives, covering all the circumstances in which cheques are used; and on good evidence that cheque users were finding that they met their needs and were understandable and accessible. This approach would be consistent with the view of the Cheque and Credit Clearing Company that there should be a clear future direction for cheques, with a definite planning horizon, in order to maintain integrity in a declining market.

The Payments Council is minded to pursue the second, more proactive option but would particularly welcome comments as to whether this is reasonable. We are encouraged to pursue this line by the development of so many innovative forms of payment, such as the faster payments service, increasing use of new technologies such as mobile and contactless payments, and opportunities to enhance existing payment methods to provide alternatives to cheques.

Taking a proactive stance, the Payments Council believes that a two-prong approach would be appropriate.

- The first prong would focus on those parts of the market, such as the payment of utility bills, where electronic payment mechanisms are already well established, and where the users themselves are keen to see further substantial reductions in cheque usage. Large cheque payers and recipients, including banks, insurance companies, registrars and government, would be encouraged to take the lead in moving the market from paper to electronic payments. For instance, consumers' choice of payment methods is driven to a significant extent by businesses' acceptance of particular types of payment. To provide focus, a target end date would be set for ending cheque use in these sectors. An education campaign would be run to support the migration.
- The second prong would focus on sectors where electronic alternatives to cheques are not yet widely available, and/or where the uptake of the current alternatives is relatively low. This would include person-to-person payments, payment of subscriptions to clubs and societies and payments to micro-businesses (such as window cleaners). The emphasis would be on developing, and/or enhancing, alternatives to cheques which are cost-effective and acceptable for users, and on informing and reassuring cheque users about the alternatives that already exist.

Research on how and why cheques and other payment methods are used and on the barriers to moving from cheques to alternative payment mechanisms will be required. The lessons that can be learnt from similar initiatives, such as the introduction of Direct Payment to recipients' accounts of state benefits and state pensions, will also need to be taken on board.

If this approach is adopted, the Payments Council envisages that in seven to ten years' time the vast majority of users will no longer require cheques, and the cheque clearing could be closed.

## **The Cheque Guarantee Card Scheme**

The UK Domestic Cheque Guarantee Card Scheme was established in 1969 to create easily identifiable design features and common procedures to enable cheques to be guaranteed for face-to-face payments.

The environment for face-to-face payments is now very different from when the scheme was set up: the use of cheques in retail outlets and for other face-to-face payments has been declining for 17 years, with the rate of decline increasing in recent years; debit card holding and acceptance is extremely widespread and a growing number of leading retailers no longer accept cheques at their outlets. In 1990 there were over 1.1 billion guaranteed cheques written in the UK, in 2006 there were 174 million. Currently, around 41 million adults have a card which, among other possible functions, may be used to guarantee cheques that they write. Only 12% of these cardholders use it to guarantee cheques once a month or more often and 56% never use the cheque guarantee function.

The scheme is administered by the Cheque Card Management Committee (CCMC) which believes there should be an immediate review of the scheme. CCMC believes that an orderly and planned withdrawal would be most appropriate and avoid a protracted period of declining use and acceptance. The withdrawal of the scheme would have the advantage of encouraging migration from cheques to more efficient methods in an area where there are ready alternatives. It would also close off an opportunity for point-of-sale fraud which has not been addressed by the introduction of chip and PIN. CCMC believe that without commitment to such a review within a reasonable timeframe it is highly likely that individual providers will consider taking unilateral action, risking a degree of confusion for customers on the status of the guarantee.

The Large Corporate User Forum also supported an early review of the future of the scheme. The Consumer User Forum felt that, provided suitable alternatives exist and consumers have a choice, there is no overriding requirement for the continuation of the scheme. The SME User Forum commented that the future of the scheme should be market-driven and that the scheme should continue as long as it is required.

# Efficiency

The Payments Council believes there to be a strong case for undertaking an early, objective review of the future of the Cheque Guarantee Card Scheme. The terms of reference for the review should cover the costs and benefits of the scheme, the impact of closure on consumers and merchants, access to alternative payment mechanisms, the continuing viability of the scheme if no action is taken, competition law considerations (if relevant) and fraud.

## Issues for Consultation

- Q1** The Payments Council is minded to develop a proactive industry plan to manage what it sees as the irreversible decline in cheques. Do you agree that a plan for cheques should be developed?
- Q2** For which types of payment currently made by cheque do new alternatives need to be introduced?
- Q3** Would it be acceptable for the National Payments Plan to include a target date of 2018 for the closure of the cheque clearing (on the assumption that acceptable alternatives to cheques have been developed)?
- Q4** What sort of education of users is needed to support the migration away from cheques?
- Q5** Do you agree that, as part of the National Payments Plan, there should be an objective review of the future of the Cheque Guarantee Card Scheme?
- Q6** What other actions, if any, should there be in the National Payments Plan in relation to cheques?

## 3.2 THE CREDIT CLEARING

The credit clearing processes paper credit items between banks. So, for instance, if a consumer is paying a utility bill by cash or cheque at their own bank, the paper credit originally attached to the bill is sent to the utility company's bank through the credit clearing, to enable the consumer's account to be credited. Around 90% of the items processed through the credit clearing arise from bill payments by consumers or businesses. The remaining items are used for a variety of purposes, such as transfers between accounts.

The volume of items processed through the credit clearing has been falling rapidly in recent years as users have migrated to alternative payment methods for their regular bills. These alternatives include direct debits, payments made through internet and telephone banking and third-party bill payment services such as those provided by the Post Office and PayPoint. In 2006, credit clearing volumes fell by 12% to 108 million items.

The Payments Council believes that there should be an industry plan for paper migration and that there should be an objective review of the future of the credit clearing, as part of the National Payments Plan. The review would consider whether there is a case for its closure and, if so, what enablers need to be put in place as part of a managed withdrawal, including alternative means of handling bill payments made in bank branches and the other existing uses of the credit clearing.

## Issues for Consultation

**Q7** Do you agree that, as part of the National Payments Plan, there should be an objective review of the future of the paper credit clearing?

### 3.3 CASH

The importance of cash is declining gradually and steadily in the UK payment markets. But it still is used by individuals to make low value payments and accounts for 37% of consumer expenditure. Around one adult in five makes all of their day-to-day purchases by cash. Businesses use cash less and prefer alternative methods of payment. On current trends, it is forecast that in 2016 cash will still account for 43% of all payments in the UK.

The User Forums stressed the benefit of cash as a budgeting tool, providing anonymity, allowing an instant exchange of value, and being a convenient method for person-to-person payments. Cash was also recognised as the fallback payment method if other methods are not available for whatever reason.

The supply and quality of the £5 note was reported in the SME Forum to be an issue for many small retailers.

Studies have shown that cash processing accounts for a substantial proportion of bank operating costs. For instance, a recent study by the European Central Bank<sup>5</sup> found that cash deposits and withdrawals accounted for a greater proportion of direct processing and transaction costs for banks than any other payment method.

However, cash can be an efficient method for low value purchases. Studies by the central banks in the Netherlands, Belgium and Sweden into the costs of payment methods at the point-of-sale found that cash has lower fixed transaction costs than current electronic payment methods and is less expensive than debit cards for small value payments.

<sup>5</sup> The Economic Impact of the Single Euro Payment Area. ECB Occasional Paper 71, August 2007.

# Efficiency

Against this background, the National Payments Plan needs to be developed on the assumption that cash will continue to play a major part in daily life for the foreseeable future. The emphasis needs to be on ensuring maximum efficiency in the handling of cash. The Plan will support the development and implementation of innovative means of payment such as contactless cards and mobile payments, which have the potential to improve the economics and reach of non-cash payment methods; and it will recognise the benefits to consumers, such as safety and security, in not having to operate in the cash economy.

## Issues for Consultation

- Q8** The Payments Council believes that the National Payments Plan should be developed on the assumption that cash will remain a major payment method for the foreseeable future. Do you agree?
- Q9** Should the issues of the supply and quality of notes and coin in circulation be within the scope of the National Payments Plan? If so, how should they be addressed?
- Q10** What other actions, if any, should there be in the National Payments Plan in regard to cash?

## 3.4 DIRECT DEBITS

### Functionality and use

Direct debits are used by both consumers and businesses to pay their regular bills. They are usually taken monthly; allowing payments to be spread over the year, making budgeting easier and taking the effort out of bill payment. They come with a guarantee that if an error is made by the originator, or a customer's bank or building society, they will receive a full and immediate refund from their account provider of the amount paid.

Direct debits are well-established with high penetration rates for almost all regular bills. Nearly nine in ten of all satellite and cable subscriptions and mortgages are paid by direct debit, as are around two-thirds of utility bills (excluding pre-payment meters). They are also widely used for personal commitments, such as life insurance, personal pensions and mobile phone contracts.

Within the business sector, direct debits are most extensively used by SMEs, as most large businesses prefer to pay their suppliers by automated credit. They are used for a variety of commitments by SMEs, including utility bills, subscriptions, business rates and insurance. For businesses of all sizes, paying by direct debit may be part of the terms of trade; including for leasing arrangements, mobile phone subscriptions and charge cards.

## Potential changes

A number of suggestions were made in the Large Corporate and SME User Forums for changes to the current operation of direct debits, including:

- one-off direct debits (i.e. direct debits which are used for a single payment rather than on a regular ongoing basis) may be an alternative to cheques for some high value transactions in the insurance sector and other areas;
- replacing the current open-ended direct debit guarantee with a time-limited guarantee, in order to reduce the costs and risks which arise for direct debit originators;
- making it easier for small businesses to set up as direct debit originators.

The issue of a time-limited direct debit guarantee is an important one on which the Payments Council Board believes there should be consultation. Bacs are also examining this issue. If the consultation on the National Payments Plan shows that there is support for introducing a time-limited guarantee, Bacs will undertake a detailed review of the pros and cons of the various options available and the timescales for introducing any changes. The introduction of a time-limited guarantee may help to make it more attractive for SMEs to become direct debit originators by reducing the level of financial exposure involved. Other changes to rules and procedures may be possible to lower the barrier to direct debit origination. As they would have to be balanced against the need to maintain the integrity of the scheme, this would seem to be an issue for Bacs to progress in consultation with relevant stakeholders.

Bacs are also conducting a SEPA-alignment project which may result in some features of the domestic Direct Debit Scheme and rules becoming more closely aligned with those of the SEPA scheme.

### Issues for Consultation

- Q11** What improvements would lead to the greater take-up of direct debits by users?
- Q12** Would you support the introduction of a time-limited guarantee for direct debits in place of the current unlimited guarantee?
- Q13** If so, what time limit do you think would be appropriate?<sup>6</sup>

<sup>6</sup> In order to comply with the Payment Services Directive, the time limit would need to be at least eight weeks in length.

## 3.5 DIRECT CREDITS

Direct credits are used by businesses and government for a variety of purposes including payroll, pensions, state benefits and trade payments. Over 95% of recipients of state benefits and of private pensions are paid by direct credit, as are 93% of full-time and part-time employees.

Telephone and internet banking are the main channels used by consumers to initiate payments by direct credit, although some banks also allow them to be initiated at cash machines. Consumers use direct credits for purposes such as credit card bill payments and transfers to other individuals.

Direct credits are likely to receive a further boost in May 2008 when the faster payments service goes live. The service will provide a 24 x 7 near real-time capability for single payments made through internet or telephone banking. It will also process forward-dated internet and telephone banking payments and, on a bank working day basis, standing orders. A future stage of the service rollout will allow businesses that make large volumes of payments to submit files of payments directly into the service, that will be processed the same day on bank working days. It also has the potential to be the payment engine in a mobile payment service, where users can initiate faster payments through their mobile phones. This would boost the number of users of the service and extend its use into new payment areas such as person-to-person and person-to-small business payments, providing an alternative to cash and cheques.

In some circumstances direct credits are accompanied by reference data, explaining the purpose of the payment or providing other supporting information. Problems can arise if the reference information is entered inaccurately or incompletely, or if it is not fully transported from the initiator of the payment to the end recipient. The Large Corporate and SME Forums suggested that the consultation should canvass views on the scope for potential improvements in these areas.

Improved education of users on the benefits of direct credits may lead to greater uptake by addressing barriers to growth arising from inertia, a lack of confidence in use of electronic systems, and an unwillingness to share bank account details.



## Issues for Consultation

- Q14** What measures to improve the accuracy and end-to-end delivery of reference information, with internet and telephone banking payments and with other direct credits, could usefully be introduced?
- Q15** Are there any other enhancements you think should be made to direct credits?

### 3.6 CREDIT CARDS, DEBIT CARDS AND CASH MACHINES

Plastic cards are the most popular non-cash payment method with UK consumers. They allow cardholders to make purchases at over 800,000 outlets, including retailers and other shops on the high street, internet and telephone merchants, and a wide range of other service providers. 41 million consumers, or 82% of adults, have a debit card and 66% have a credit card. In 2006 debit and credit cards represented nearly half of all non-cash payments made by consumers.

The card market is characterised by a high degree of innovation. Recent developments have included the introduction of chip and PIN and the ongoing rollout of 3D Secure for internet payments. As discussed in Section 4.1, the current initiatives on contactless card payments and prepaid cards may have a major impact on the future shape of the UK payments landscape. The strong influence of the international card schemes both drives and constrains the scope and direction of innovation in the UK.

Cash machines (or automated teller machines, ATMs) play a vital role in the UK economy, being the largest single source of cash to the public. The proportion of all cash acquired through ATMs has been growing steadily and reached 65% in 2006. Over 70% of adults now use cash machines.

There may be opportunities to exploit the ATM infrastructure, for instance to process non-cash transactions, and the Payments Council could help support these innovations. One example of such a development was the introduction by LINK of facilities for mobile top-ups at cash machines.

# Efficiency

## Issues for Consultation

- Q16** What opportunities would you identify to exploit the ATM infrastructure for non-cash transactions? How should these be reflected in the National Payments Plan?
- Q17** Which other, if any, actions should there be in the National Payments Plan in relation to credit and debit cards and cash machines?

## 3.7 CHAPS AND THE WHOLESALE MARKETS

CHAPS Sterling is the UK's same-day value sterling payment system. The system provides users with a high level of security and each individual payment is settled in real time at the Bank of England. It is used for high value payments such as those associated with the wholesale markets. It was originally set up to process these payments and completion payments in the housing market, where a same-day service is required. CHAPS Sterling has been increasingly used for other payments, either where same-day funds transfer is required or as the UK leg of a cross-border payment. CHAPS Sterling is the dominant UK payment method in value terms. In 2006 CHAPS Sterling accounted for 90% of non-cash payment values, but for only 0.2% of all non-cash payment volumes.

In the future, the vast majority of low value non-wholesale CHAPS traffic is expected to migrate to the faster payments service, and the service may also be an option for low-value wholesale financial transfers. Another payment system development of relevance is that the Land Registry will be extending its e-conveyancing service to include electronic settlement of housing transactions. CHAPS may be restricted to the small proportion of current volumes that require secure real-time settlement.

Given that much of this document is about the retail market and that issues to do with wholesale payments are usually technical, the Payments Council has set up a special investigation into the payment needs of the wholesale markets and will be talking directly with participants. This work will run in parallel with the main consultation on the National Payments Plan and will report to the same timescales. But we are happy to hear from any respondent on wholesale market subjects.

## Issues for Consultation

- Q18** What improvements should be made to the way in which payments in the wholesale markets are carried out?

## 3.8 SEPA AND CROSS-BORDER PAYMENTS

### SEPA

The Single Euro Payments Area (SEPA) envisages consumers and businesses being able to make and receive payments in euro within Europe, between or within national boundaries, under the same basic conditions, rights and obligations, regardless of their location. SEPA is the largest payments initiative ever undertaken within Europe. It has been championed by the European Commission and the European Central Bank, with the support of the European Payments Council (EPC), which brings together banks from across the European Economic Area.

The Payment Services Directive provides the legal foundation for the creation of a European Union-wide single market for payments. It aims at establishing a modern and comprehensive set of rules applicable to all payment services in the European Union, and provides the legal platform for SEPA. The Directive will be implemented in domestic legislation by all EU member states by November 2009. Specifically in regard to SEPA, the EPC has developed schemes for euro credit transfers and euro direct debits, a framework for euro card payments, and a framework for the clearing and settlement of SEPA payments. Launching of the new SEPA products will begin in January 2008 with the expectation that a critical mass of transactions will have migrated by the end of 2010. The National Payments Plan will need to be consistent with SEPA and comply with the provisions of the Payment Services Directive.

### Cross-Border Payments

Cross-border payments, in simple terms, are those where the payer and payee are in different countries. Cross-border payments can be made for a variety of purposes, including tourists or business people travelling abroad, consumers purchasing from foreign web sites, and businesses paying their overseas trading partners. There is also growing demand for cross-border remittances from migrant workers and immigrants and UK nationals, including those of foreign origin.

Cross-border payment volumes are significant in their own right but are small compared to domestic volumes. In 2006, cross-border card purchases (either using a UK card abroad or a foreign card in the UK) totalled around 350 million, or 5% of domestic card purchases. Government estimates are that there are around 10 million remittances per annum from the UK.

# Efficiency

The government has established a UK Remittances Task Force which aims to promote greater transparency, competition and better information within the UK remittances market. So, whilst the Payments Council considers that remittances are an important topic, to avoid duplication the National Payments Plan needs to take account of the work of the UK Remittances Task Force at this stage.

## Issues for Consultation

- Q19** What should the Payments Council do to ensure that users in the UK can take best advantage of SEPA?
- Q20** What issues does SEPA raise for your use of payments?
- Q21** What improvements should be made to cross-border payments?

## 3.9 MEASURES TO ENHANCE USERS' EFFICIENCY

In addition to reviewing ways to improve the efficiency of existing types of payment, the Payments Council will also consider cross-cutting measures with the potential to enhance efficiency for users as well as payment service providers.

Ways of promoting greater standardisation in the format of account numbers, and enhanced reconciliation and error checking of payment data, have been discussed at various points in time in the past. The issue of standardised account numbers was looked at under the Payment Systems Task Force. The Task Force noted that “the conclusion from indicative analysis suggested that universal standardisation was not a cost-effective solution, due to the hundreds of financial institutions affected”. More recently, members of the Large Corporate Forum have made reference to the problems and costs that can arise with direct credits and direct debits if the user enters incorrect account details. It was suggested that substantial savings might result from the adoption of standardised account number formats.

## Issues for Consultation

- Q22** What measures to enhance users' efficiency should be considered by the Payments Council?

# SECTION 4

## Innovation

# Innovation

There are several points in this document that refer to the development of the faster payments service, which will allow internet and telephone banking payments to be made in near real-time and speed up the processing of standing orders. The new service, to be launched in May 2008, will be a major enhancement to UK payments capability with potentially wide-ranging implications. The role of faster payments has a bearing on a number of sections of this consultation, including those on mobile payments, direct credits and cheques.

## 4.1 CONTACTLESS AND PREPAID CARDS

### Contactless cards

A major recent innovation in payment technology is the introduction of contactless chips. These can be embedded in a variety of devices such as plastic cards, mobile phones and even key fobs to enable payment to be made by placing the device on or near a payment terminal. In the card world, contactless technology provides a new and additional way to pay with existing credit, debit and prepaid cards. Contactless Visa and MasterCard cards have been introduced in a number of overseas markets. The UK card industry is keen to exploit the potential of contactless technology and has launched new hybrid cards in the London area, with rollout nationwide beginning in 2008. Hybrid debit and credit cards will support contactless payments for transactions up to £10 and contact chip and PIN payments for transactions over this value. In the case of contactless payments there will be no requirement for the customer to enter a PIN.

The target markets for contactless cards are cash-dominated sectors such as convenience stores, fast food, vending and transport. Merchants already accepting cards may also provide the facility for contactless payment.

In the Large Corporate User Forum, the need for the standards for contactless cards to meet the requirements of all users was stressed.

### Prepaid cards

Prepaid cards provide innovative payment solutions for users in a wide range of areas. A variety of prepaid cards have been brought to market, targeting different sectors and with different pricing models. Some major retail chains now sell branded gift cards, and other retailers have migrated their in-house gift vouchers to plastic. Visa or MasterCard badged gift cards have been launched by several shopping malls in partnership with financial institutions. There are a number of products aimed at those who do not hold a debit or credit card such as teens and the unbanked. Prepaid cards can also be used by businesses for promotional or incentive purposes or for payroll, replacing cash and giving a card-based solution to pay staff who do not have a bank account.

Prepaid cards can also be used for cross-border payments. They provide an alternative to travellers' cheques and foreign currency, and can be utilised for person-to-person remittances.

Transport for London's Oyster card is an example of a contactless prepaid travel card and there is continuing innovation in contactless and prepaid solutions to provide alternatives to cash and cheques in areas such as ticketing and retail vouchers.

Prepaid cards have the potential to provide innovative payment solutions to existing cardholders and merchants and to spread cardholding, use and acceptance into segments of the population and sectors of the economy where cards have to date played little or no role.

## Role of the Payments Council

Contactless and prepaid cards offer considerable benefits to a range of users and recipients. These markets are at an early stage of development with competition and innovation at the forefront. A key question is whether the Payments Council should play a role in this arena over and above initiatives from individual payment service providers and the card schemes. It would be consistent with the role of the Payments Council for this sector to be left to market initiatives at this stage.

### Issues for Consultation

- Q23** Do you agree that at the present stage of market development the contactless and prepaid card sectors are best left to initiatives from individual payment service providers and the card schemes?
- Q24** What support, if any, could the National Payments Plan offer to the development of contactless cards? In particular, is further action needed to ensure that the standards for contactless cards meet the needs of all sectors of users?
- Q25** What support, if any, can the National Payments Plan offer to the development of prepaid cards?

## 4.2 MOBILE PAYMENTS

Mobile phone ownership in the UK is near saturation point and mobiles have now overtaken personal computers as the most ubiquitous networked device. They are most heavily used for voice and text messaging, with a growing number of holders accessing data services, downloading ringtones, picture messaging and making payments. It has long been recognised that mobile phones have the potential to be used as an integral part of a payments service, for example to initiate, authenticate or authorise a payment. To date however progress has been limited except in some specific niche areas such as digital downloads (e.g. paying for ringtones), entering TV quizzes, parking and so on. At present, most mobile payments are processed via the customer's phone account, although services using card, bank or other accounts also exist (e.g. PayPal Mobile). Although it is still early days for mobile payments, the pace of change is increasing and the potential to expand the reach of mobile payments is becoming more widely acknowledged.

Mobile phones may potentially be used to initiate the transfer of funds between bank accounts or other stored value accounts ('account-to-account' payments), and to make credit or debit card payments where the payee accepts card payments. In the context of this consultation we define mobile payments as being "payments for products or services between two parties for which a mobile device plays an integral role during initiation or completion".

Mobile payment featured in the input from the User Forums. In the Consumer Forum mobile payments were identified as a possible alternative to cash for consumers without bank accounts. The need for a standard and simple-to-use approach with mobile payments was emphasised, as consumers let down or confused by new systems can lose confidence and revert to tried and tested methods. In the SME Forum it was felt that mobile phone payments might be a future alternative to cash.

There are opportunities for making mobile account-to-account payments widely available in the UK by building on existing payment infrastructures. For example, the faster payments service could provide a platform for a near real-time mobile payment service that could be used for person-to-person transfers as well as consumer-to-business payments. An ability to make fast and secure payments through a mobile phone may prove attractive in several areas where most payments are currently made by cheques and cash, and thus provide an effective and attractive migration route away from these methods.

There is also growing interest in the potential to add contactless card payment functionality into mobile phones to enable card payments, which is being taken forward by the card schemes and other parties outside the Payments Council.



As well as presenting an opportunity, mobile payments also represent a challenge in that close engagement and agreement between a variety of stakeholders, including payment service providers, mobile phone network operators and equipment and system vendors, is likely to be necessary in order to implement an attractive and widely available service.

## Issues for Consultation

- Q26** What role should the Payments Council play in the development of mobile payment services, including setting the standards for mobile payments?
- Q27** In particular, do you agree that the National Payments Plan should support the development of mobile payment services between bank accounts?
- Q28** What principal characteristics would users find attractive in a mobile payment service?
- Q29** What role do mobile phone payments potentially play in providing alternatives to traditional forms of payment?
- Q30** What other actions, if any, should there be in the National Payments Plan in regard to mobile payments?

## 4.3 SUPPLY CHAIN

The supply chain has many links: payment is one and procurement and invoicing are others. If these links are integrated and automated there is the potential for substantial cost savings. While the prize is large, the practical difficulties of realising these savings are formidable. Many different stakeholders are involved, the cost of change is substantial and current practices are deeply embedded in companies' operating procedures. Activity in this area has a global, as well as a European and UK, dimension; its scope is determined by the reach of the organisations involved.

Within Europe, the European Commission intends to establish a European e-invoicing Expert Group by the end of 2007 to manage the creation of a common conceptual framework to support the provision of European e-invoicing services in an open and interoperable manner across Europe. This framework will address legal, authenticity and standardisation issues which currently create barriers to the adoption of e-invoicing. It is proposed to work with international standardisation bodies to develop an international e-invoicing standard. The UK payments industry has been actively involved in the preliminary work already undertaken by the European Commission.

# Innovation

The User Forums identified two areas where the National Payments Plan could assist in the automation of supply chains:

- the first concerned standards. The Large Corporate User Forum stressed that getting the standards right was of key importance in automating the supply chain. The SME User Forum also stressed the importance of credit referencing and other supporting standards;
- the second theme concerned facilitation. The Large Corporate User Forum suggested that the Payments Council might play an enabling role to help the various stakeholders in the UK and elsewhere move forward.

We believe that there are clear benefits from the UK, under the auspices of the Payments Council, continuing to play an active role in the development of e-invoicing standards and supporting frameworks.

## Issues for Consultation

**Q31** Do you agree that the Payments Council should indicate support for the work of the European Commission Steering Committee on e-invoicing and associated activity, including the development of international standards that facilitate supply chain efficiency?

**Q32** What role should the National Payments Plan play in moving this agenda forward?

**Q33** What other actions should be included in the National Payments Plan?

## 4.4 OTHER INNOVATIONS

In Section 4 we have covered what we see as the major innovations in the payments arena. The Payments Council also welcomes suggestions for other payment innovations where co-operative action is needed to benefit users.

## Issues for Consultation

**Q34** What other payment innovations requiring action at industry level should be considered by the Payments Council?

# SECTION 5

Other issues

# Other issues

## 5.1 EDUCATION IN PAYMENT MATTERS

All three User Forums placed heavy emphasis on the role of education. The areas where it was felt that education could play a helpful role included:

- helping to allay consumer fears of ID theft when sharing their account details for electronic payments;
- helping to increase the use of electronic payment methods;
- raising awareness among SMEs of the advantages of electronic payments.

Whilst innovation in payments was seen as welcome, it was strongly felt that all users had to feel comfortable with new payment services in order to make best use of them. Education could help in that regard.

There are numerous organisations and initiatives in the field of financial education for consumers and businesses, and the Payments Council intends to draw upon their experience in developing its role in education on payment matters.

### Issues for Consultation

**Q35** What gaps are there in current financial educational initiatives in regard to payment matters?

**Q36** What role can the Payments Council play in promoting the education of consumers about the choice of payment methods available to them?  
What other bodies should it work with to deliver this role?

## 5.2 FINANCIAL INCLUSION

The government's financial inclusion strategy identifies a number of issues of direct relevance to the payments industry. It includes ensuring that everyone has access to a transactional bank account and has the confidence to make full use of it. The government is currently engaging with the financial services industry to work towards an agreed action plan to promote financial inclusion further.

The independent Financial Inclusion Task Force (whose Chairman is Brian Pomeroy) monitors progress towards financial inclusion and advises government. The Task Force's members have been drawn from across the financial services sector, the voluntary and community sector and academia.

There are a number of other organisations in the payments sector working to increase financial inclusion. LINK member banks and ATM operators are part of industry-wide efforts to support financial inclusion by working to provide free-to-use ATMs in lower-income areas. Bacs are working with the Financial Inclusion Task Force to find ways to ensure that direct debits are seen as a suitable payment for all. This includes the development of consumer material specifically addressing the financially excluded, and research with non-users of direct debits to understand the issues and barriers to take up.

The Consumer User Forum was concerned that the National Payments Plan should take into account the needs of disadvantaged and excluded consumers, including the need for intermediaries such as carers to make payments, and stressed that it was important that innovation did not increase exclusion. A number of options for supporting access to, and use of, electronic payment methods were identified including mobile payments for the unbanked and wider issuance of debit cards with basic bank accounts.

The Payments Council considers it important to raise the issue of financial inclusion in the context of the National Payments Plan, and to consider what role it might play.

## Issues for Consultation

**Q37** What role can the Payments Council play in promoting financial inclusion?

**Q38** What other bodies should it work with to deliver this role?

### 5.3 PAYMENT SYSTEM INTEGRITY AND CONTINGENCY

Payment system integrity relates to the assurance that the system will operate correctly and reliably. It requires the availability of effective contingency measures to respond to system failures. It is an objective of the Payments Council to ensure the integrity of payment services in the UK, with a particular focus on issues which cross payment schemes. The current UK payment systems have a track record of a very high level of reliability, and when new services such as faster payments are brought into operation their integrity is tested to the highest standards.

Standardisation can enhance integrity through delivering interoperability and increased straight-through-processing rates. Some corporates attending the Large Corporate User Forum also suggested a need to increase the auditability of automated payments.

# Other issues

The Bank of England believes that the Plan should address cross-system integrity, including the need for co-ordinated planning of contingency arrangements in the case of serious disruption or failure of a payment system. It has commented that there is a need to improve understanding of and, where appropriate, to act to alleviate the constraints in the current environment, to facilitate decision taking in the event that a problem arises, and to consider the implications of changes, such as the introduction of faster payments.

Integrity cuts across several of the issues for consultation considered in other sections of this consultation document. Cross-scheme contingency is a topic that is not addressed elsewhere.

## Issues for Consultation

**Q39** What are the main challenges to the integrity of payment systems that need to be addressed collaboratively?

## 5.4 FRAUD AND SECURITY

All payment systems are subject to fraud and other forms of criminal attack. In 2006 plastic card, cheque, online banking and other UK payment fraud cost the banking industry £565 million.

The payments industry, collectively and individually, is already engaged in an extensive programme of activity to tackle payments fraud and to enhance security. Much of the work is cross-sectoral, in co-ordination with government and law enforcement agencies. International co-operation is also crucial: fraud is often perpetrated by criminals operating across national boundaries and security measures may need to be introduced on a global basis to be fully effective. Action in one area has a knock-on effect elsewhere, strengthening the case for a holistic approach and broadly based co-operation.

One critical dimension to fraud detection and prevention is that of intelligence, including sharing data on alleged and known fraud.

The User Forums and other parties identified the following key issues.

### Designing security into new payment systems

Fraud and security need to be explicitly considered from the design stage onwards, as part and parcel of any new payment developments. It is always easier to design security into a new system than to attempt to retro-fit it at a later stage. This principle has been adopted with the faster payments service.

## **Authentication of remote transactions**

The authentication of remote transactions (i.e. internet and telephone transactions) is a key issue. The User Forums emphasised the benefits for users of adopting a consistent approach to authentication, possibly involving two-factor authentication<sup>7</sup>, rather than static passwords, while allowing companies sufficient time to introduce changes to their systems and operating practices. There are a number of other approaches that could be adopted, including monitoring the strength of authentication levels used and/or setting minimum standards, for example mandating the use of two-factor authentication for relatively high risk transactions such as setting up new beneficiaries for online banking transfers.

## **Sharing the burden**

The SME Forum felt that the costs of security measures fell disproportionately on SMEs, which could restrict their ability to do business, e.g. over the internet. There were also comments that not enough was being done by the authorities to combat payment fraud and that the Payments Council could act as a focus to lobby government and the public authorities.

## **Biometrics**

The National Payments Plan could include a review of the possible future role of biometrics and other emerging technologies.

## **Education and Usability**

It is important that enhanced security and fraud measures are acceptable to, and manageable by, users and do not increase financial exclusion. The introduction of new measures may also need to be supplemented by an effective information campaign. This relates to the education initiative.

## **Benchmarking and sharing best practice**

The National Payments Plan could, in addition to its focus upon customer identification and fraud, consider ways and means of benchmarking UK payment system security and processes against the best global standards and where appropriate enabling the sharing of best practices between peer organisations.

## **Data sharing**

Wider data sharing of fraud information could be investigated and the Payments Council may have a role in facilitating cross-sectoral discussions. There may be opportunities for greater co-operation between financial institutions and government agencies on sharing data.

<sup>7</sup> The two factors are something in the possession of the user as well as something that the user knows.

# Other issues

## Issues for Consultation

- Q40** How should consideration of measures against fraud be included in the assessments which the Payments Council makes of proposals for innovation?
- Q41** How can the National Payments Plan assist with issues of customer authentication? To what extent do these need to be addressed across the payments sector?
- Q42** Should minimum standards be introduced for authentication of remote transactions? If so, should a common measure of authentication be recommended/mandated?
- Q43** How should the National Payments Plan address new technologies, such as biometrics, which may contribute to customer security?
- Q44** What actions, if any, should the National Payments Plan include in regard to data sharing?
- Q45** How can the National Payments Plan help ensure that the burden of fraud prevention is shared equitably across payment service providers and users, including SMEs?
- Q46** What role should the Payments Council play in raising the profile of fraud and security issues and in lobbying government and the public authorities?

## 5.5 STANDARDS

Standards play a key role in almost all aspects of payment systems and have a major impact on providers and users of payment systems. Without agreed standards, interoperability would be impossible.

Payment standards operate at domestic, European or global levels; they can be open or proprietary; they can operate in different domains, such as the bank-to-bank domain or bank-to-customer domain, or across domains.

The Payments Council has agreed a number of high-level principles in this area:

- wherever possible, to adopt Global, European, or domestic standards, in that order, over proprietary standards;
- the UK should seek to play an active role in developing new global/European standards relevant to the banking and payments industry, and where appropriate engage with corporate representative bodies;



- standards should be designed to cover the complete end-to-end payment transaction chain, including customer initiation and notification/reconciliation, as well as identification and authentication;
- convergence between different standards organisations should be encouraged as part of a wider consolidation process;
- standards development must result in practical solutions that seek to minimise business impact on the adopters, with due consideration given to legacy migration issues.

The User Forums emphasised the importance of standards and the benefits of adopting a common approach wherever practical. The benefits were seen to include: reducing cost and enhancing efficiency; facilitating competition; making education easier; and benefiting users who were multi-banked or wished to switch accounts. It was also noted that standards are costly to change, as they are deeply embedded in bank and corporate systems, so it is important to get them right. Strong emphasis was placed on the importance of aligning UK and international standards wherever possible. It was noted that a lack of standards for new developments could stifle innovation.

The importance of messaging standards was stressed, particularly in relation to carrying invoice and other reference data in the message format, where there is significant standards development activity at the European level. It was suggested that there was scope for greater standardisation and that an expanded format might facilitate straight-through-processing and the automation of the supply chain.

The Large Corporate User Forum emphasised the scope for standards to facilitate competition between payment service providers.

## Issues for Consultation

- Q47** What should be the role of standards in the National Payments Plan? Are the current principles as agreed by the Board a suitable base from which to start? What role should the Payments Council play in influencing international standards developments?
- Q48** What, in particular, should the National Payments Plan say about messaging standards?

# Other issues

## 5.6 PAYMENT COSTS

A number of studies have shown that the total cost of payments for payment service providers and users of payment systems are very large and that the cost of different payment instruments varies significantly<sup>8</sup>. The choice of payment method can significantly affect the associated costs for payers and recipients in initiating and reconciling payments. Consequently, substantial economic gains are generated by migration from relatively expensive payment methods to relatively inexpensive payment methods.

The Payments Council believes that, while pricing will remain a wholly competitive matter, there would be a general benefit to regulators, users and providers alike in making the full economic costs of payments as transparent as possible and developing a shared understanding of the costs and economics of UK payments. One way of developing a better understanding of payment costs would be to facilitate an economic debate, under the auspices of the Payments Council, drawing on existing sources of information where available, and involving a broad cross-section of stakeholders.

### Issues for Consultation

**Q49** Would you support an initiative, led by the Payments Council, to establish a better understanding of the costs of UK payments? If so, how do you think this should be taken forward? What supporting information do you think would be relevant for such an exercise?

<sup>8</sup> Various case studies are described in Sections 4.61 – 4.82 of the Cheques Working Group report: [http://www.oft.gov.uk/shared\\_oft/reports/financial\\_products/oft868.pdf](http://www.oft.gov.uk/shared_oft/reports/financial_products/oft868.pdf). They show that cheques are comparatively expensive and that electronic transactions are relatively inexpensive. As the cost of a cash transaction increases with the value of the payment, the position of cash is less clear-cut. Recent studies by the Belgian, Dutch and Swedish central banks suggest that cash is more cost-effective than current payment methods for low value transactions.

# GLOSSARY

# Glossary

## **3D Secure**

A method of authenticating online remote card payments which requires the cardholder to enter a password at the time of purchase.

## **ATM (automated teller machine)**

Also known as a cash machine or cash dispenser. A computerised self-service device permitting the holders of an appropriate card and personal identification number (PIN) to withdraw cash from their account and access other banking services.

## **ATM card**

Any plastic card with ATM functionality.

## **Automated payment**

Payments made between accounts by direct credit, direct debit, standing order, CHAPS or the new faster payments service.

## **Bacs**

The Company that sets the business rules that govern the operation of the direct debit and direct credit payment schemes and standing orders.

## **Basic bank account**

An account designed for those who may not meet a bank's criteria for opening a standard current account and/or who need to ensure that they cannot be overdrawn. Features typically include the ability for payments, e.g. pensions and benefits, to be credited direct to the account, withdrawals by plastic card through cash machines and the facility to pay bills by direct debit. It does not provide overdraft or cheque book facilities.

## **Card issuer**

A bank or building society issuing payment cards, ATM cards or cheque guarantee cards to its customers. For payment and ATM cards, the card issuer undertakes responsibility to settle transactions made with the card (except in some cases where fraud is present).

## **Card scheme(s)**

Card schemes set the business rules that govern the issue of the payment cards that carry their logo. Typically, these rules apply throughout the world to ensure interoperability of cards. In many countries, domestic schemes also operate. The schemes operate the clearing and settlement of payment card transactions. In the UK, banks and building societies must be members of the appropriate scheme to issue cards and acquire card transactions. Examples of international card schemes in the UK are Visa, MasterCard, American Express and Diners Club.

# Glossary

## **Cash machine**

See ATM.

## **CHAPS Clearing Company**

The Company that has responsibility for the operation of an electronic transfer system for sending real-time gross settlement same-day payments for CHAPS Sterling and CHAPS Euro.

## **Charge card**

A payment card, enabling holders to make purchases and to draw cash up to a pre-arranged ceiling, the terms of which include the obligation to settle the account in full at the end of a specified period. Cardholders are normally charged an annual fee.

## **Cheque and Credit Clearing Company**

The Company that has responsibility for the bulk clearing of cheques and paper credits throughout Great Britain. Cheque and credit payments in Northern Ireland are processed locally.

## **Cheque clearing**

An operational clearing for presenting and exchanging cheques between Settlement Members and their branches in order to transfer funds to named accounts.

## **Cheque guarantee card**

Also known as a cheque card. A card issued by a bank or building society for the purpose of guaranteeing payment by, or supporting the encashment of, a cheque up to a specified value (£50, £100 or £250). All cheque guarantee cards in the UK Domestic Cheque Guarantee Card Scheme depict the bust of William Shakespeare in either the cheque guarantee hologram or logo on the card. The Cheque Guarantee Card Scheme is administered by the Cheque Card Management Committee (CCMC).

## **Cheques Working Group**

A Working Group of the Payment Systems Task Force which examined what changes may be necessary to the cheque clearing system to provide greater efficiency and enhanced user benefits. It reported in November 2006.

## **Chip card**

Also known as integrated circuit card (ICC) or smart card. A chip card holds details on a secure computer chip that can store and process information; chip cards usually also have a magnetic stripe.

# Glossary

## **Chip and PIN card**

A payment card containing a chip that requires the use of a PIN as the preferred method of cardholder verification at the point-of-sale (not only at ATMs).

## **Contactless card**

Upgraded credit or debit cards which enable the holders to pay for transactions of £10 or under by simply holding their card next to a secure reader in participating outlets and vending machines.

## **Credit card**

A payment card enabling the holder to make purchases and to draw cash up to a pre-arranged ceiling. The credit granted can be settled in full by the end of a specified period or can be settled in part, in which case interest is normally charged. In the case of cash withdrawals, interest is normally charged from the transaction date. Cardholders may be charged an annual fee.

## **Credit clearing**

An operational clearing to distribute paper credits between banks in order to transfer funds to named accounts.

## **Current account**

A bank or building society account normally offering facilities such as a debit/multi-function card, ATM-only card, cheque book, overdraft facility, standing orders and direct debits. Such accounts may pay interest.

## **Debit card**

A payment card linked to a bank or a building society account, used to pay for goods and services by debiting the holder's account; usually also combined with other facilities such as ATM and cheque guarantee functions.

## **Direct credit**

An electronic credit to a customer's account initiated directly by the payer. Direct credits consist primarily of business-to-individual payments for wages, salaries, pensions, state benefits and tax credits, and payments initiated by businesses to pay their trading partners or by individuals to pay bills.

## **Direct debit**

A pre-authorised debit on the payer's account initiated by the payee (known as an originator). Direct debits are typically used to make regular payments for debts such as utility bills and insurance payments, and amounts may be variable.

# Glossary

## **Direct debit guarantee**

A guarantee offered by all banks and building societies that take part in the Direct Debit Scheme. If the amount to be paid or the payment dates change the organisation collecting the direct debit will notify the paying customer, normally 10 working days in advance of the account being debited or as otherwise agreed. If an error is made by the organisation or the customer's bank or building society, the customer is guaranteed a full and immediate refund from their bank of the amount paid. The customer can cancel a direct debit at any time by writing to their bank or building society.

## **Electronic banking**

A service enabling users to access banking facilities over the internet or other computer network. Also known as e-banking and, when the internet is used, internet banking (see also remote banking).

## **Electronic payment**

A general term to describe automated or card payments.

## **European Economic Area (EEA)**

The grouping of 30 countries, comprising the 27 EU member states plus Iceland, Norway and Liechtenstein.

## **European Payments Council (EPC)**

The European Payments Council (EPC) is the decision-making and co-ordination body of the European banking industry in relation to payments.

## **Faster payments**

A new system due to be introduced in May 2008 which will allow internet or phone banking payments to reach the recipient within two hours at any time and on any day of the week. The system will also be used to provide same-day delivery of standing orders on banking days.

## **LINK**

LINK Interchange Network Ltd is a company limited by shares that is wholly-owned by 22 of the UK's largest banks and building societies. LINK has two constituent parts: the Operating Company provides the services (including settlement) that make ATM sharing possible throughout the UK; the Card Scheme determines the operating rules that define the terms of trade between members. LINK-enabled cards are issued by all UK card issuers, and the cards can be used in virtually all ATMs in the UK except for a very small number of privately-owned cash dispensers.

# Glossary

## **MasterCard**

An international card scheme.

## **Messaging**

The exchange of structured information between senders and receivers in the course of a business transaction.

## **Mobile payment**

A payment involving the use of a mobile phone. The phone network can be used solely as the channel to authenticate the customer, or the payment can involve a debit to an account held by the customer with the mobile operator or other service provider.

## **Paper credit**

A paper instrument addressed to a bank branch instructing it to credit a specified sum of money to a named account at that branch. A paper credit cannot be used on its own to make a payment but must be accompanied by cash or cheque.

## **Payment card**

A generic term for any plastic card (credit, debit, charge etc.) used on its own to pay for goods and services.

## **Payment Services Directive (PSD)**

A major legislative initiative intended to create a legal framework to: facilitate the development of the Single Euro Payments Area (SEPA); provide a structure for the regulation of payment institutions (i.e. those institutions providing payment services which are not banks and are not currently regulated); enhance consumer protection; and increase competition. The Directive has been agreed at European level and is due to be transposed into national legislation by 1st November 2009.

## **Payment Service Provider**

An institution providing payment services, including the following:

- services enabling cash to be placed on a payments account;
- services enabling cash withdrawals from a payments account;
- execution of payment transactions, including transfers of funds on a payment account;
- execution of payment transactions where the funds are covered by a credit line;
- issuing and/or acquiring of payment instruments;
- money remittance.



# Glossary

## **Payment Systems Task Force (PSTF)**

A Task Force set up by the Chancellor of the Exchequer in March 2004 and run by the Office of Fair Trading (OFT). Its remit was to identify, consider and seek to resolve competition, efficiency and incentive issues relating to payment systems, particularly looking at network effects of the existing payment mechanisms. The PSTF was wound up at the end of 2006 with the announcement of the formation of the Payments Council.

## **PIN (personal identification number)**

A set of characters, usually a four-digit sequence, used by cardholders to verify their identity at a point-of-sale or at a customer-activated device such as an ATM. The number is generated by the card issuer when the card is first issued and may be changed by the cardholder thereafter.

## **POS (point-of-sale)**

A physical location where a customer makes a purchase.

## **Prepaid card**

Also known as an electronic purse. A stored-value payment card used to pay for goods and services. It is an alternative to cash. The card can be disposable or re-loadable. The stored value is reduced as payments are made.

## **Purchasing card**

A payment card issued to businesses, companies or government departments to make supplier and/or trade payments. Also known as a procurement card.

## **Remote banking**

A generic description for any type of service enabling users to access banking facilities remotely, e.g. by phone, internet or mobile phone.

## **Remote transaction**

Internet and telephone transactions where a payment card or other authentication device is not physically presented to the payee or bank involved in the transaction.

# Glossary

## **Single Euro Payments Area (SEPA)**

The Single Euro Payments Area (SEPA) envisages consumers and businesses being able to make and receive payments in euro within Europe, between or within national boundaries, under the same basic conditions, rights and obligations, regardless of their location. SEPA is the largest payments initiative ever undertaken within Europe. It has been championed by the European Commission and the European Central Bank, with the support of the European Payments Council (EPC).

## **Standing order**

An instruction from customers to their bank or building society to make regular automated payments of a specified amount to a named creditor. The term is also used to refer to individual payments arising from the instruction.

## **Visa**

An international card scheme.



[www.paymentscouncil.org.uk](http://www.paymentscouncil.org.uk)