

National Payments Plan consultation

The change in UK payments

4 February 2008

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Introduction

This paper responds to the National Payments Plan consultation paper on change in UK payments. It is a comprehensive response, covering all topics, which reflects VocaLink's wish to support the work of the Payments Council and to play an active part in helping to implement the changes in areas, where consultation has been sought.

This response is written from the following perspective.

The advent of the Payments Council is extremely welcome: the industry needs such a body to help drive it forward. We have worked continually and successfully with APACS, the clearing banks and the scheme companies for many years but are aware of the limitations of this arrangement. The key limitation is that we are bank-owned bodies, and banks which do not always get a fair press are not trusted to make decisions which are in the interests of the customer – be that a retail account holder, a corporate or another financial institution.

The Payments Council is an independent body, representing all stakeholders in the industry. This puts it in an ideal position to arbitrate and achieve the changes needed by the industry. VocaLink would simply like to offer its support to the Council in making these changes happen – at the pace and to the extent that those changes are agreed by the whole market.

As the opportunity to comment here is free, we would like to add two further general sets of comments, overlaying the detailed answers to the 49 questions asked in the consultation.

First, the range of topics covered is wide. We believe that the Council should initially focus on a few of the issues, for two reasons:

- Being seen to be getting a good grasp on the key issues facing the industry will enable the Council to be more effective as it increases its authority.
- Some of the issues addressed in the consultation paper are best left to free market competition, where oversight and the agreement of standards are the key activities to be facilitated by the Council.

Second, we would concentrate on four topics.

Cheques: Now is the right time to eradicate them. Although this would have caused great controversy in the past, it is right to ease the path for consumers, corporates and banks to remove the use of the cheque and to replace it with mechanisms, most of which are already in place in the market today. A successful initiative to remove cheques would be the most positive 'quick win' to establish the value of the Payments Council. And we see no reason why such a plan could not be rolled out in five years from start, as opposed to the ten years suggested in the questions.

SEPA: The standards set by SEPA, and the regulation imposed by the Payment Services Directive are as valid for sterling as they are for the euro. Avoiding these changes for the Credit Transfer, the Direct Debit and cash transactions will be tantamount to isolating the UK sterling market from its closest trading partners in the Eurozone and keeping distant from the international moves to accept the standards recommended in the SEPA initiative. The Payments Council is probably the only body that can provide meaningful leadership here.

Fraud: This is the largest concern facing banks and their customers today. Ensuring that payment products, services and infrastructures are safe to use is of paramount importance as the dominance of

electronic payment processing increases. And many of the issues faced here are best resolved by a community approach, where buyers and suppliers agree what they each need.

Faster Payments: This service is the most important new payment service offered in the UK for many years. It could become the cornerstone of payment processing as banks and their customers move towards real-time operation. Ensuring that the service is properly implemented, that it is open for community applications that benefit customers, whether these are corporate, government or retail initiatives is vital to ensure its success. Keeping the pressure on banks, VocaLink as the infrastructure and the Scheme company to deliver the Single Immediate Payment in particular for widespread use, will help the payments industry achieve the reputation for speed, immediacy and service which is needed. In addition it will encourage independent service providers to develop and implement the innovative payment services, which are required to drive down the cost of money transfer, dominated as it is by cash, and encumbered as it is by a stubborn rump of cheque usage.

Of all of the many topics which are covered by the consultation questions – and our responses – these seem the most urgent. Our industry needs to encourage changes in attitudes towards banks and payments. The foundation for this change is confidence from all stakeholders that the UK payments infrastructure and the services which use it are modern, secure and headed in the right international direction.

The Payments Council needs to succeed, and VocaLink is delighted to offer support in research, community working and the straightforward discussion of infrastructure issues.

Issues for consultation: cheques

2.1 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?

Yes. The Payments Council is precisely established to represent the interests of the industry in this type of matter. The future (or lack of it) of the cheque is one of the key issues that it is ideally suited to address because:

- There are consumer, retailer and business interests to protect
- Cheques represent an increasingly high-cost service, and banks and their processors cannot justify the cost.

To address this, the Payments Council should make a clear and unambiguous statement of its intention about cheques - setting out the genuine problems to be addressed, and debunking the myths which surround cheque clearing. Doing this, alongside a target date for the phased withdrawal of cheques, provides a tangible target against which commercial organisations and innovators can design new solutions. Without this defined end point or a statement of ambition with indicative timelines of the phased withdrawal, there is no incentive or commercial case for the market to invest in solving the 'problem' of cheques. Innovators will continue to focus instead on the more certain rewards in the growing retail POS market which is already clearly changing through the influence of market forces – solving only part of the cheque problem, and leaving the bulk unaddressed.

The plan should promote an early phase-out of all cheque transactions which don't risk the social or financial exclusion of consumers i.e. business to business cheques. According to figures from APACS, of the 1.8bn cheques written in 2006, some 40% were business cheques.

The key anomaly, which usually relates to SMEs, needs to be eradicated - the use of the cheque as a way of managing cash flow. Governments of the past 20 years have repeatedly asserted that the cheque hurts small business because it provides a ready excuse for payers wishing to delay their payment of bills: "the cheque is in the post".

The Faster Payments Service could be the industry's solution to the problem. It will offer certainty of timing and speed of settlement to allow a payer to give value to the payee exactly when he or she wants, using a bank's electronic banking or telephone banking services. Thus, the excuse is no longer valid.

In this, and other cases, cheques sustain a level of inefficiency that the Payments Council has an obligation to address.

The remaining consumer cheque payments (less than 400m by 2016 according to APACS figures) can be addressed by the market. In order to avoid market failure, and the associated exclusion of a particular segment of consumers, the Payments Council can catalyse change through a more open approach to the sharing of market information about the behaviour and preferences of segments of consumers, and about bank motives and preferences in serving them.

It is, however, worth remembering that cheques and cash are the two physical mechanisms users know and trust, to the point where they are often the payment mechanisms of last resort. And a last resort option should always be there. So, if the cheque is to be phased out then the alternative that replaces its "last resort" function, needs to be in place.

The Payments Council is the right forum to address this – where user representatives and banks can agree a fair and reasonable plan.

2.2 Q2: For which types of payment currently made by cheque do new alternatives need to be introduced?

Business and consumer bill payment in particular are well served by the electronic banking services offered by banks, where Bacs and the Faster Payment service offer alternative speed mechanisms to replace the cheque with a direct credit transfer. Direct Debit is already the widely used method of consumer bill payment.

Financial institutions, billers and payment service providers have been working to engineer new ways to pay, anyway. Much of the change required ought to be achievable by light encouragement and some public education of the plan to remove the cheque. It is only in those areas where the market fails – primarily for the socially or financially excluded – which require a more organised response.

2.3 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)?

Yes. This seems generous, and there is no obvious reason why the bulk of cheques cannot be removed in five, rather than ten, years.

2.4 Q4: What sort of education of users is needed to support the migration away from cheques?

Sound education on cheque substitutes, and awareness of end date are the key elements of public education, as the migration from cheques will be led by recipients' refusal to accept them.

2.5 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?

Yes - to speed up eradication. The cheque guarantee card scheme has served its purpose and has had its day. It is a real risk management issue for banks, which is getting in the way of more efficient and controlled payment methods. However, the withdrawal of the scheme would cause a public perception issue that the Payments Council would need to manage through an extensive programme of communication and education for consumers and businesses alike.

2.6 Q6: What other actions, if any, should there be in the National Payments Plan in relation to cheques?

There should be a review of how the Special Presentation System works to devise a more efficient method for the Industry.

2.7 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?

Yes. It is time this clearing was closed and Direct Debits and electronic bill payment promoted as better alternatives. Paper clearing was only introduced in the 1960s to compete with the new National Giro System and now serves no real purpose.

The Council should set timelines for phased withdrawal and invite proposals from payment service providers to address the most difficult issues of social exclusion. It should also take account of those lessons learnt in countries which have already phased out the cheque.

Issues for Consultation: cash

3.1 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?

Yes. Cash will be king for many years to come but the Council should consider the changing role of the Central Bank in the cash market and look to make the provision of cash into the economy as efficient as possible. This includes the trend for the Central Bank to subsidise the cost of note and coin circulation (the Bank of England's legal responsibility) by passing costs on to the commercial banks.

The Council should also promote the adoption by the Bank of England and the Scottish and Irish banks of polymer banknotes. This type of note is now issued by many central banks and has proven to enhance the durability, fitness and security of banknotes in circulation. As an ATM service company, this is of real importance to VocaLink.

It would also assist the industry, when designing the National Payments Plan, for the true cost of cash processing to be brought into the public domain. The Bank of England should be encouraged to reveal details of how much seigniorage income is generated for the benefit of HM Treasury from the note issue.

3.2 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?

Yes. Our comments in response to the questions above refer to this point. Notes and coins are by far the most expensive payment methods supported by the Payments Industry and the Council should have an explicit plan to reduce the UK's dependence on them as a means to improve efficiency within the UK economy.

3.3 Q10: What other actions, if any, should there be in the National Payments Plan in regard to cash?

There could be a review of the current mix of notes and coins with special attention given to the role of the £5 note, which has become a major problem for the Payments Industry and could be retired to be replaced with a coin. The role of the Cash in Transit Industry in note and coin circulation could also be reviewed as it has a recent history of processing problems.

Issues for Consultation: direct debits

4.1 Q11: What improvements would lead to the greater take-up of direct debits by users?

While banks and direct debit originators are major beneficiaries of Direct Debit, it offers substantial benefits to consumers, for example: it supports budgeting, it removes the need for consumers to remember to pay bills, and some originators pass on some of the benefits to consumers in the form of discounts. Direct Debit is now used in a much wider range of payment situations. It is no longer just used for household bills such as the payment of insurance and utility bills where there is an intrinsic link between the debtor and the debtor's identity such as their address.

Consumer trust is vital for Direct Debit's continued success. Recently, there have been several articles in the press questioning the security of the Scheme, which have arisen largely because of the broadening of the scope of Direct Debit usage. The Jeremy Clarkson issue was one of the highest profile and most recent. If consumers start to lose confidence in the Scheme they may switch to less efficient payment products. Although consumers are able to get their money back if an error or fraud occurs, they are often genuinely shocked that wrong collections can happen at all. VocaLink believes that the overall Direct Debit system needs to be enhanced in at least two areas to take account of the new ways in which Direct Debit is being used:

- Improved authentication of Direct Debit instructions to ensure that the consumer is the holder of the account being quoted. This is needed principally to cater for situations where customers sign up to Direct Debit over the phone or via the internet. However, it also has relevance to paper Direct Debit mandates as most of these are transmitted electronically to the paying bank and so there is no opportunity to check the signature. There are several ways of doing this, which link to questions 39 to 46
- Better policing to prevent further Direct Debit collections after the customer has cancelled a Direct Debit instruction.

Faster clearing cycles and facilitating a Fast Debit through the Faster Payments service may also add value in the future.

4.2 Q12: Would you support the introduction of a time-limited guarantee for direct debits in place of the current unlimited guarantee?

Yes. And the introduction of the Payment Services Directive may require this. The UK's unlimited money back guarantee under the Direct Debit indemnity scheme is unique in Europe. It is a key factor in giving consumers confidence in the scheme. In our view, there are several issues around the guarantee:

- There is a popular misconception that it is unconditional and that consumers have an automatic right to ask for their money back without giving a reason. It is not. Consumers have to specify a reason for requesting a refund. They have to specify the rule broken by the originator irrespective of whether it is true. The burden of proof then lies with the creditor's bank or originator once the money has been refunded. So, for consumers, there is a difference between what the rules actually say versus how it is presented to them. In addition, because money should only be refunded if the rules have not been followed, this has, in the past, led to disputes between banks and originators in circumstances where money has been refunded by the debtor's bank, but the creditor and/or the creditor's bank denies any rules have been broken and hence refuse to refund the debtor's bank which has already paid the consumer. The introduction a genuinely unconditional guarantee for a set period would clarify and simplify this area.
- The unlimited nature of the guarantee has meant that UK businesses rarely use Direct Debit for business to business payments unlike their counterparts in other countries. This is because creditors are concerned that there is never a point at which a payment is irrevocable. A time-limited guarantee would address this concern. Indeed, the duration should be shorter for B2B Direct Debits as compared to C2B Direct Debits, because generally businesses check bank statements more thoroughly than consumers.
- Historically, the number of indemnity claims after 6 months is low and after 12 months represents only a fraction of a percent. Arguably therefore, the time period does not need to be unlimited. VocaLink supports the introduction of a time-limited guarantee where the period is based on appropriate consultation and research.
- The SEPA Direct Debit has a time-limited guarantee and this would align the UK scheme more closely with SEPA. See also our responses to question 19.

In summary, we believe that unconditional time-limited guarantees would clarify a confused situation, would make Direct Debit more attractive for B2B payments, would align UK Direct Debit with SEPA and would have minimal impact on consumers.

4.3 Q13: If so, what time limit do you think would be appropriate?

Different times may be required for C2B versus B2B Direct Debits. The Payments Council should consult and undertake research to determine an optimal period. A period of 7 months might be appropriate for C2B. The time limit will need to be aligned with PSD and SEPA practices.

Issues for Consultation: direct credits

5.1 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?

The adoption of modern message formats (probably based on ISO 20022 standards) would allow more data to be passed with the instruction from the customer. These standards set out information requirements for the payer and the payee as well as the payer and payee banks, and are the technical foundation upon which SEPA Direct Debits and Credit Transfers are built. Adoption of these standards over time is close to inevitable and the Payments Council could take a leadership role here.

5.2 Q15: Are there any other enhancements you think should be made to direct credits?

The shortening of the clearing cycle should be considered. This should be approached carefully as the current clearance-before-settlement approach allows huge volumes to be processed with few errors. And this has benefit to both banks and their customers. We believe the clearing cycle can be shortened without damaging this.

The above two answers (14 and 15) are in line with the recommendations which are, in effect imposed on the UK banking industry and sterling by the Payment Services Directive and encouraged by the acceptance of SEPA standards. (See also our answers to Q19-21.)

Issues for consultation: cards and ATMs

6.1 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?

The provision of services to the Monilink mobile banking platform is closely aligned with services available through the Link ATM service - both being driven from the same platform. The provision of additional functionality through the ATM could therefore provide an efficient mechanism for providing richer services to mobile banking customers.

The ATM is a useful and convenient channel, which should be exploited to its maximum potential, where this is economically viable. Current applications of cash withdrawal, balance, limited statement provision and mobile phone top-up services are viable and useful services.

The use of ATMs for simple non-cash transactions in addition to their use as cash machines is to be encouraged. In particular, the proliferation of the following transaction types may be viable over time:

- Mobile phone top-up
- Online payment
- Faster Payment initiation
- Foreign currency dispense
- Oyster card top-up

Bill payment
Stored value card top-up

The ATM channel has gained wide acceptance by consumers in the UK and there has, and continues to be, consistent growth in ATM deployment. In contrast to the rest of Europe, the UK has seen growth in the number of ATMs, and the usage of those ATMs, largely because of a stable network. The LINK network is self-regulated by the banking industry with the interchange for ATM transactions being set based upon an annual cost study that balances the often conflicting needs of both acquirers and issuers. This has delivered a market where bank ATMs are generally “free to use” at point of delivery. The UK model also supports surcharging ATMs (where the customer is directly charged for usage) and there has been a significant growth in the deployment of these machines (now representing around 50% of all ATMs in the UK) by non-banking organisations in convenient locations. Although surcharged transactions account for less than 5% of total transaction volume, their introduction has increased the degree of choice for consumers.

The LINK scheme has recently extended the UK ATM transaction set to support the general processing of non-cash transactions. Until now, non-cash transactions, for example the top-up of prepaid mobile phones, has required specific developments by the infrastructure and individual banks. This change will facilitate the deployment of non-cash transactions at ATMs. However, there may be some constraints on how these transactions can, and might, be used and deployed across the network:

- a) The cost of development, deployment and administration of any new transaction sets and the balance against likely income.
- b) Customer Service. Although in Europe ATMs can provide a wide range of transactions (SIBS in Portugal is a good example) the role of the ATM in the UK is primarily seen as a ‘cash and dash’ service where the customer is provided easy access to cash with short transaction times and limited queuing. The ‘free’ nature of the service and the number of ATMs deployed by banks has encouraged this behaviour. Moving the ATM towards a kiosk service could significantly change the usage profile of ATMs, creating queues and adversely affecting consumer perception of the service. If banks are able to build services that embrace the ‘cash and dash’ principle for non-cash transactions then it is more likely that the consumer will also embrace such a service.
- c) Given the increasing reach of the internet to a broad range of devices (notably mobile phones) it is likely that consumers will use ATMs in a more limited way, with its inherently restricted user interface, in preference to more customer ‘friendly’ service delivery channels.

The changes introduced by the LINK ATM scheme deliver the potential to provide non-cash transactions at the ATM. This capability may also create a market for kiosk services should they prove popular with the UK consumer. Anything that provides the consumer with access to ATMs at reasonable or no charge and the growth of non-cash transactions should continue to be encouraged.

Finally, there may be a key enabling role for ATMs in enabling mobile commerce. As bank-owned/trusted real-estate, they are uniquely placed to provide secure installation and upgrade of payment applications to the handset via near field communication (NFC). The same infrastructure would allow e-money accounts on the handset to be topped up more securely than other channels.

The old arguments about ATM pooling are relevant here, as common ownership of ATMs cuts costs for banks and enables the quicker universal introduction of new services and innovations. But this is an argument which is likely to be solved over time as banks continue to define whether the ATM is a channel or a competitive asset.

6.2 Q17: Which other, if any, actions should there be in the National Payments Plan in relation to credit and debit cards and cash machines?

The operational model around credit and debit card processing dates back to the 1960s and reflects the computing and network capability of that period. There have been incremental changes in the market during the last 40 years but the basic business model has not changed. This model is cumbersome and has inherently high costs and charges which have led to an increase in the number of disputes between the cards industry and the competition authorities across the world.

The complexity of the current debit and credit card business model makes it extremely difficult for new entrants to enter the UK and other European markets as pricing is driven solely by volume and not as a result of innovation or the ability to change the market radically. This increases the dominance of the major players and removes choices from both the consumer and the retailer. The National Payments Plan could actively review the current debit and credit card services model and tender to the payments industry for alternative business models that could revolutionise the processing of retail and consumer transactions in the UK.

Issues for consultation: high value

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

High-value transactions and wholesale transactions are not the same thing. Assuming that the take-up of Faster Payments is widespread and successful the Single Immediate Payment has huge potential to help with the processing of high-care urgent payments for business and consumers above the initial £10,000 limit. There will be significant benefits in being able to raise the £10,000 transaction limit as soon as the service has been proven to work.

The Faster Payments Service and the CHAPS Clearing Company will be careful to implement the right levels of service and care for systemically important payments and critical payments (where the fast transfer of intraday value between two customer accounts is the key attribute, irrespective of value) and to develop the two services to meet market needs over time.

CHAPS works very well for high-value, wholesale, systemically important payments and should not be changed more than necessary. It seems likely that banks will wish to harmonise the CHAPS and Faster Payments Services over time.

Issues for consultation: cross border

8.1 Q19: What should the Payments Council do to ensure that users in the UK can take best advantage of SEPA?

SEPA is intended to unify the use of payment instruments for all euro-denominated transactions. Furthermore, the Payment Services Directive (the PSD) is a piece of legislation to be enacted in all EU member states and currencies, including the UK and sterling, which enshrines the principles surrounding SEPA (including regulation on the shortening of the clearing cycle). As a result of both SEPA and the PSD, UK banks processing euros must establish SEPA-compliant systems and processes to process

credit transfers, direct debits, ATM and card transactions for their euro operations, as well as maintain the current UK equivalents.

The Payments Council should agree and recommend the way forward, such that a consistent view and approach is established by individual banks and scheme companies. The Payments Council should consider the following steps to ensure that users in the UK can take best advantage of SEPA:

- Identify and adopt, where possible, the elements of SEPA compliance, which improve upon the existing UK schemes.
- Promote the benefits of common standards and formats
- Encourage processing and clearing cycles compatible with the European standard
- Ensure that the UK banking industry is fully compliant with the Payments Services Directive
- Ensure that scheme companies are mindful of and accountable for ensuring SEPA compatibility, if not full compliance
- Seek to work more closely with the SEPA payment scheme companies to ensure alignment such that UK banks are not disadvantaged and non-UK banks working in the UK experience fewer barriers to entry
- Provide an environment for payments which does not differentiate between, discriminate against or financially penalise the difference between euro and Sterling payments.
- Consider appointing a market infrastructure to provide a common cross-border service for all UK cross-border transactions – even if this is just a fallback for those who already have their own arrangements in place

8.2 Q20: What issues does SEPA raise for your use of payments?

VocaLink is a provider of payment services to banks.

In a wholly standardised Eurozone market, where national boundaries are superseded and an infrastructure's volume of payments ultimately dictates its competitiveness, a small number of large-scale infrastructures will subsume the national clearings. It is reasonable to assume that VocaLink's business will be vulnerable to propositions from these other clearings if VocaLink is restricted in terms of pursuing its own growth strategy. Whilst the differences in the UK and SEPA schemes may make this seem unlikely in the short term, as will the differences in currency, the PSD, which comes in to force across the EU from 2009, has pan-European applicability and will open the UK market to non-UK entrants. This effect is already being felt by banks in other euro-out markets, such as Switzerland and Sweden, where local banks are experiencing increasing competition and challenging operational costs.

Although VocaLink has been recognised primarily as a provider to the UK market, the requirements of the PSD (and their applicability to UK processing) as well as the increased threat of competition from non-UK entities have convinced us to address the opportunities and the challenges posed by SEPA. In response, we have developed a range of SEPA-compliant propositions for banks that include:

- A SEPA-compliant clearing and settlement mechanism
- A competitive reach proposition, which makes use of a range of market channels to achieve 100% reach on behalf of banks
- A single channel for SEPA and non-SEPA processing
- A routing capability, which allows banks to reach any other mechanism via a single channel
- A reformatting capability, which allows banks to submit a broad range of agreed formats via a single channel

- Facilitated bilateral clearing between banks and other financial institutions
- A single price per financial institution for euro clearing, and
- Access to a range of additional and value-added processing services as corporate and public sector SEPA requirements evolve and mature.

As a consequence, SEPA represents a significant growth opportunity for VocaLink.

8.3 Q21: What improvements should be made to cross-border payments?

Full adoption of and compliance with the PSD and SEPA, where applicable, will improve the cost and efficiency of cross-border payments for the UK banking and business community. Payments to and from other countries and economic areas can only be improved by the adoption of initiatives like SEPA, and ideally the same as SEPA. It is highly unlikely that the UK will try to enforce national standards such as the standard 18 message format on international markets. As a result, the UK banks should consider a move in the near future towards ISO20022 based standards. These standards have been adopted not just for SEPA, but increasingly for other markets such as North America and those in the Far East that are seeking to increase competitiveness.

The changes required to improve cross-border payments are vast, complex and will require the full buy-in and support of each bank and financial institution in the UK. All but the very largest will consider any large investment as irrelevant, given that cross-border accounts for 2% or less of transaction volumes. It is therefore even more pertinent that the Payments Council consider appointing a single market infrastructure to provide a common cross-border service for all UK cross-border transactions – even if this is just a fallback for those who already have their own arrangements in place. A common infrastructure provider for cross-border payments will provide the following benefits:

- Significantly reduced cost of development for UK banking community (where the alternative is significant investment for each individual bank irrespective of volumes)
- Harmonised pricing for cross-border transaction processing
- A single channel for UK, SEPA and non-SEPA payments
- Facilitated bilateral clearing between UK banks and other financial institutions
- Group purchasing discounts for reach and connectivity services
- Consistent and common levels of cross-border service and application for UK consumers and businesses
- Access to a range of additional and value-added processing services that will meet the evolving SEPA needs of corporates and the public sector.

Issues for consultation: user efficiency

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

The Payments Council could have another look at the standardisation of account numbers to enable easier verification at the initial point of contact and, potentially, to allow customers to change banks without changing their account numbers (as they can, for example, with mobile phone numbers). One way of achieving this would be to have a national register of account numbers that could be used to

provide both online verification in real-time and to enable routing of payments to the correct destination bank.

Issues for consultation: prepaid cards and contactless

10.1 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?

Yes.

10.2 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?

The dominance of the international card networks means that UK contactless card infrastructures will be technically compatible – standards should not be an issue, and there are many industry forums which will address outstanding issues with key stakeholders.

However, the international footprint and market dominance of the major card networks does raise a question about the ability of UK banks, the Payments Council or merchant organisations to ensure that the UK contactless programme fully benefits all stakeholders. Technical standards are unlikely to be a barrier to market entry for new payment service providers, but the overwhelming market power of international card networks, exacerbated by the UK's relatively concentrated merchant acquiring market, are likely to restrict the emergence of innovative competitors.

The appearance of contactless as a cash-replacement technology is welcome, but should not be used simply to extend the life of legacy card payment processes and business models. Open technical standards for contactless payments could form the basis of new retail payment mechanisms. And the Payments Council should explore the opportunity to leverage Faster Payments as the infrastructural backbone for a contactless debit infrastructure, focused on more efficiently and transparently serving the needs of UK stakeholders.

10.3 Q25: What support, if any, can the National Payments Plan offer to the development of prepaid cards?

None, the prepaid market is well served.

Issues for consultation: innovation (mobile payments)

11.1 Q26: What role should the Payments Council play in the development of mobile payment services, including setting the standards for mobile payments?

Industry standards for mobile payments fall into two categories:

- a) Proximity payments. These will be primarily retail POS payments - through contactless card (NFC) replication on the mobile handset. Standards for these are nearing agreement by the industry. From a payment systems point of view, the standards will broadly adopt the technical processes of the underlying card networks – for pay before (prepaid), pay now (debit) and pay later (credit) payments.
- b) Remote transactions. This includes person-to-person, person-to-business and person-to-government transactions, which do not require physical collection. These 'over-the-air' transactions initiate the movement of funds from one account to another – between underlying bank accounts, card accounts and/or non-bank accounts.

Proximity payments do not require Payment Council involvement, beyond the exploration of a domestic contactless payment scheme (proposed in our response to Q24).

To support remote transactions fully, the UK payment community should provide more open access to clearing via Faster Payments. In the current model, consumers can only access Faster Payments via those few channels supported by specific banks. This essentially throttles the ability of innovators, infrastructure providers and the banks themselves to deliver secure, efficient account-to-account payments through new and innovative channels, as each must be developed as a point solution by each individual bank.

Widening access to Faster Payments for consumers and other stakeholders should not simply be addressed through a mobile-centric solution (for mobile read contactless, biometric and any host of future payment initiation tokens). Rather, the payment community should encourage the development of secure, bank-independent, access to Faster Payments clearing – in which banks maintain their commercial responsibility, control and authority, but no longer act as the technical gateway for the emergence of new and emerging account-to-account based payment mechanisms.

This is therefore a matter of more open access to Faster Payments clearing, not a question of mobile-specific standards or schemes.

11.2 Q27: In particular, do you agree that the National Payments Plan should support the development of mobile payment services between bank accounts?

Yes. The mobilisation of payments is an important development, but not an end point in itself. The ability to move money, in real time, from account to account is being developed within Faster Payments – it should be ubiquitously accessible through multiple channels – of which the mobile handset is currently front of mind.

Certain elements of the mobile 'ecosystem' are competitive – for example handset applications and technology provision are matters for banks and other stakeholders to take forward.

Other elements will benefit from framework agreements between participants to ensure the widest access, to the widest range of users to real-time clearing. This framework must enable accelerated roll-out of mobile services (and other remote technologies) rather than aim to be an all encompassing and overly prescriptive set of standards or protocols.

At its core, the framework should define the common standard by which trusted external participants can securely access real-time clearing, and provide this service to their consumer customers. Whilst a framework on this basis may initially be perceived to remove banks competitive advantage as gatekeepers to Faster Payments, it will in reality open the door to realising the full value of real-time account-to-account clearing to all stakeholders.

This common framework is best supported by a trusted and independent gateway service into real-time clearing, removing the technical dependence on individual member banks. This gateway service would also be likely to host a mobile number to bank account matching service (see also our response to Q28)

11.3 Q28: What principal characteristics would users find attractive in a mobile payment service?

As noted in our answer to Q26, there are two distinct types of payments.

For consumers using the mobile handset as a 'wallet of wallets' at the POS, the primary benefits are convenience (carry one device, not multiple cards), ubiquity (always with you) and perceptions of security (greater device intelligence). These are incremental benefits, rather than particularly disruptive or groundbreaking steps forward.

By far the greater benefit for consumers is enabling real-time account to account transactions. Vocalink research highlights the fact that consumers are, on the whole, broadly happy with the means of payment currently available in the market. Consumers identify the following benefits of real-time account to account payments, initiated by mobile phone:

- The payment is guaranteed once sent
- Ability to move funds 24/7
- Ability to move funds straight away
- Ability to make payments remotely, and to people you have not met previously

For many consumers, unlocking the value in mobile account-to-account payments will require the ability to "send money" to a mobile number – using the phone number as the recipient identifier, in place of sort code and account number. This model is well proven using email addresses, from services like Paypal, and would require a central service to match bank accounts to the mobile phone number. Recipients will also require an immediate receipt notification in order to fully capitalise on the benefits of real-time funds transfer.

Mobiles should be used as a virtual bank, ATM or POS. Two-factor authentication should be mandatory.

11.4 Q29: What role do mobile phone payments potentially play in providing alternatives to traditional forms of payment?

Mobile phones provide most benefit when providing 'anytime, anyplace' secure access to a bank account and the subsequent ability to initiate an account-to-account payment (person-to-person, person-to-business, person-to-government) seamlessly. Just as internet banking provided secure access to accounts and payments, independent of branch, so the mobile phone could provide consumers with 24/7, self-service access to secure and efficient clearing.

In this role, mobile phone payments have a significant role to play in moving P2P transactions from cash or cheque to a faster and more secure environment. This could happen through mobile banking platforms, mobile handset internet browsing or third-party platforms with approved access to Faster Payments clearing (subject to Q26). This highlights again the importance of widening access to Faster Payments (or of creating the ability to request a Faster Payment, akin to a real-time direct debit) in order to avoid reliance on already stretched bank IT resources for the development of mobile payments.

11.5 Q30: What other actions, if any, should there be in the National Payments Plan in regard to mobile payments?

The National Payments plan should establish a framework to enable certified third-parties to access Faster Payments clearing securely. This certification approach, taking lessons from other successful schemes (Direct Debit, Bacs Direct Credit) and ensuring security of schemes would catalyse payments innovation in the UK, and enable the full benefits of Faster Payments to be realised.

Issues for consultation: innovation (supply chain)

12.1 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?

Yes, although much could be done now, without waiting for the outcome of the work being carried out by the new EU Experts Group. Standards would be helpful but the existing standards are not a barrier to progress. The UK should be a leader in these areas in view of the potential economic value to UK business and the Payments Council would be a good forum from which to stimulate this.

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

Adoption of e-invoicing has been most successful in those countries where the national government has shown a lead through its own procurement activity and sought to create a stable environment which is supportive of e-invoicing. This has acted as a catalyst as well as removing potential barriers to take-up. The National Payments Plan should seek to promote collaboration between government and industry and promote standards in this area. The cost of making electronic payments in the UK is one of the lowest in Europe; this has been achieved through the early adoption of common standards, both in format and approach through the clearing and settlement of payments provided by Bacs. Much of this approach could be applied to invoices and related business activity.

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

There are still large numbers of cheques used in the B2B environment, mostly by SMEs. This is costly for those receiving payments and disrupts greater business process integration between buyers and their suppliers. The National Payments Plan should seek to remove cheques from the B2B environment by making it more attractive and easier for smaller businesses to use electronic payments.

Issues for consultation: other

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

13.1.1 Direct Debit e-mandates

The UK should move towards adopting a more secure and auditable mechanism for the establishment of Direct Debits via remote channels. This would ensure accuracy of account details, legitimacy of the

payment instruction, and an audit trail in case of subsequent query. Encouraging SEPA plans in the same direction would benefit all parties. There is a recognised model for doing so. This requires consumers to authenticate themselves and approve mandates via a secure, remote bank channel - phone, internet, mobile or ATM.

This low-overhead model would enhance the integrity and consumer perception of the Direct Debit scheme, and provide material benefits to all stakeholders.

13.1.2 Online payments

Card fraud via 'customer not present' transactions remains a major concern for the UK, especially over the internet, where transactions are growing at over 50% per year. Attempts to secure the cards infrastructure via 3Dsecure have largely failed to find favour with consumers or merchants. However, an alternative bank account-based model has successfully emerged around the world. The emerging model is based on the dual premise that:

- a) the internet bank is the most secure transactional environment online
- b) there is a very high correlation between internet shoppers and internet bankers

In this online payment model, the consumer has the option to pay for goods online using a Faster Payment. Once the consumer's bank is selected from institutions participating in the scheme, the user is redirected and prompted to log into the internet bank as normal, confirms a pre-populated Faster Payment to the merchant to pay for the goods, and is returned automatically to the merchant. This proven mechanism provides a guaranteed payment to the merchant and a secure transaction environment for the consumer and bank.

As a new scheme, the Faster-Payments based online model requires a critical mass of bank participants. VocaLink would like to accelerate its individual bank-level engagements through a wider industry-level steering body. This is an example of an opportunity, which it is hard for an individual bank to address, but where a community approach solves the problem well.

13.1.3 Request for a Faster Payment

In order to optimise access to Faster Payments clearing, the National Payments Council should explore the market requirement for recipient-initiated real-time payments. Akin to a one-time, immediate direct debit, but utilising the existing Faster Payments infrastructure, this would enable simple and secure access by accredited third parties to real-time clearing, in the same way that Direct Debit provides trusted originators with access to Bacs clearing. This 'request for a Faster Payment' model leverages existing Faster Payments infrastructures, and opens up the infrastructure - providing consumers, corporates and payment service providers with secure and non-repudiable clearing services, and banks with a new revenue stream.

13.1.4 Identification and authentication

The Payments Council is well placed to outline a modular framework for consumer authentication and identity to be used and supported by banks, government and corporates. This framework, independent of individual technology standards and vendors, would enable the authentication adopted for banking and payments, to be used as a national standard for remote authentication.

Similar in principle to the BankID schemes operated in Scandinavia, this federated approach would support seamless and secure electronic commerce across the economy.

This approach would also provide an industry roadmap for the rollout of next-generation authentication technologies, such as biometrics, positioning their roles within the overarching framework.

Issues for consultation: education

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

As noted elsewhere in this response, the Direct Debit still has unfounded underlying consumer concerns associated with it and the availability of the Faster Payments Service in May is currently invisible to the public.

14.2 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?

General education of the public in the use of payment instruments and likely changes to them is always valuable. And the introduction of the Faster Payments Service should be accompanied with considerable public noise, to encourage its successful use.

In addition, the implementation of the Payments Services Directive (as distinct from SEPA), its intentions and benefits for consumers and businesses needs communication and promotion.

Please note that under a commercial agreement, VocaLink provides education and marketing capability to promote the usage of Direct Debit, Bacs Direct Credit and ATMs on behalf of the Bacs and LINK schemes. Its high-quality, knowledgeable marketing team understands the payments market and adapts its marketing appropriately with significantly high customer satisfaction ratings and customer penetration figures and is pleased to do more in this role as required.

Issues for consultation: financial inclusion

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

The Payments Council should encourage the moves taken by various banks to site free-to-use ATMs in locations that are currently underserved. It should support the initiative of the DWP to enable those in receipt of benefits to make use of limited banking facilities, such as the ability to draw cash from ATMs and to encourage others paying benefits, mainly local authorities for housing benefit, to adopt a similar position.

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

The Payments Council might work with the DWP and others to explore the potential use of prepaid cards that can be used in a similar way to debit cards, for the payment of welfare benefits to claimants without bank accounts.

Issues for consultation: industry collaboration

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

There are four main challenges: Fraud, security, anti-money laundering (AML) and the prevention of these prior to processing and the investigation of them after the event. This goes as follows:

- Security remains a bank issue, in that banks must put up their own defences in order to keep the fraudster from getting through the front door in the first instance.
- Once the fraudster has infiltrated the system, then the collaborative approach comes into play. By developing a shared fraud detection service which can identify potential fraud across multiple payment systems individual banks would enjoy a level of protection significantly better than any single institution could achieve on its own. A community approach is needed to protect the integrity of the service and the level of investment made by financial institutions. Collaboration between the banks at an early stage would give everyone the same benefit and therefore leave everyone with the same level of protection.
- AML is more of a compliance issue. However collaboration would still work here with the sharing of watch list data which would help in the identity of suspicious behaviour.
- The management, processing, security, resilience of and further investment in the technologies and operations of the infrastructures, which clear and settle the different instruments. This is clearly VocaLink territory, and represents an area where VocaLink is equipped and required to advise the Payments Council on key issues. Decisions made in changing Schemes' services are well handled now by the Scheme companies. However, the merger of Voca and Link was arranged by its banking owners in the expectation that the infrastructures could be rationalised and streamlined over time to provide greater security and resilience, more efficiency in communalising security schemes, communications links and message types used. All of these and other changes required by the industry need to be planned and managed strategically - and, with awareness of the long-term funding implications. Changes which are made by the industry have wildly differing effects on the cost base and, for this reason alone, VocaLink's participation in the UK Payment Plan is essential, since it is everyone's interests to keep down the costs and reduce the risks of change. This is partially a governance issue.

Issues for consultation: fraud

17.1 Q40: How should consideration of measures against fraud be included in the assessments which the Payments Council makes of proposals for innovation?

Fraud is the biggest single issue facing banks and payment systems today, where the use of payment systems and mechanisms is the key issue. Since we generally believe that setting standards is the key value that the Payments Council and APACS can add, the addressing of fraud and illegal payments comes close to the top of the Payment Council agenda.

This starts with new systems. Fraud and security must be explicitly designed-in before new payment systems are developed or significant changes to existing systems are considered. This risk assessment needs to address how the new system may be used, which could be different from existing systems and how this could affect customer behaviour. However, ease of use is at least as important and care must be taken to ensure that security measures do not act as a disincentive for legitimate users, which could cause them to feel financially excluded. This is more than a question of education, the systems should be designed to be easy to use and not encourage unsafe practices such as the need to write down

complex passwords. The assessment also needs to include the effect of fraud migration from one type of payment to another and, in an increasingly global payments market, the potential international threat.

So, for example, the decision by the participating banks to devolve the responsibility for fraud detection and after-the-event checking in the new Faster Payments Service to individual banks may represent a missed opportunity. Furthermore, with the trend for convergence within payments it is possible for a shared Faster Payments Fraud Detection system to be extended, in time, to cover other transactions such as ATM withdrawals and Point of Sale purchases.

With the current focus on financial crime, it cannot be long before the UK government at least queries the availability of data in payments systems. The recent CIA demand on SWIFT to open up its historical databases to enquiry is a signal of the changing attitudes by Governments to payment data.

VocaLink manages (or will manage) three key infrastructures – Bacs, the LINK Scheme and the Faster Payments Service where all of the data on 100 million daily transactions is available – virtually all of the interbank electronic payment transactions. We believe it is only a matter of time before Payment Service providers (and this must include SWIFT, MasterCard and Visa) are required to provide services in the fight against theft, and financial crime. The Payments Council is best positioned to guide this argument in a way which suits both banks and payment service providers in the interests of both government and the consumer.

This is a complex and difficult area, where banks have been slow to recognise the value that the infrastructure providers can add, and APACS already provides significant value. The difficulties presented in finding a solution which are presented by issues such as data protection and privacy need to be managed carefully, both for banks and their customers. VocaLink believes fraud detection to be an industry problem – it is not a competitive issue best left to individual banks to address. A fraud problem suffered by one bank undermines confidence in the whole payments market.

We are certain that this is an area where the industry must drive a solution, before a solution is forced upon it. At the very least, the Payments Council must be seen to have addressed the question.

17.2 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?

Customer authentication is key to preventing fraud and maintaining the integrity of payment systems. Criminals will target the weaker points and so a common approach across the payments sector needs to be considered. This should start with customer identification (based on the FSA's KYC rules) and the issue of identity credentials that can be used for authentication in both an in-person and remote transaction mode. The issue of identity theft is a significant one, as is account takeover, and so it is critical that banks profile customers and investigate any unusual patterns of behaviour.

The value of addressing this for the industry has been clearly demonstrated in the implementation of chip and PIN.

It is worth noting that the VocaLink PKI security system used to secure Bacstel-IP is distributed to almost 100,000 customers and all major banks in the UK and has proven to be a reliable, secure and effective solution. Promotion of this framework as the *de-facto* standard would advance security of transactions and can be used for internet, mobile and private networks.

17.3 Q42: Should minimum standards be introduced for authentication of remote transactions? If so, should a common measure of authentication be recommended / mandated?

The responsibility for the standards to be applied to the authentication of remote transactions should remain primarily with the bank taking the liability for the transaction. Common standards, whilst they could help to ensure overall integrity and reputation of payment systems, could limit innovation and the ability of banks to create products aimed at different types of customer with quite different risk profiles.

17.4 Q43: How should the National Payments Plan address new technologies, such as biometrics, which may contribute to customer security?

The use of biometrics for authentication is still a developing field. Meaningful planning in this area is therefore challenging, however given the potential for the reduction in industry fraud levels a review from the Payments Council would be appropriate.

17.5 Q44: What actions, if any, should the National Payments Plan include in regard to data sharing?

Sharing of data on actual and potential fraud cases is the key both to preventing further fraud by the same individuals and to learning about how the fraud was committed. There is strong interest from the Government to share data to help reduce the risk of fraud committed against government agencies, but there are legal issues, such as the Data Protection Act, that need to be considered. At present, sharing of payment data to detect patterns of unusual behaviour has limited effect because there is no national register of bank accounts and so it is difficult to detect, for example, benefit payments going to a different account name from the claimant.

As infrastructure provider, VocaLink has the ability to access all bank data and anonymise the results of investigations. The community at large would get the benefit of the content of VocaLink's databases without infringing on data protection. Confidential customer data would not be shared – rather a system of risk “scores” would be developed leaving the actual decision making on particular transactions to the banks thereby allowing banks to adopt their own strategies for dealing with fraud and customer interaction.

This approach has the benefits of seeing payments that are made by all institutions. A bank can upgrade to the latest fraud technologies but this will only protect the bank for as long as it takes the other banks to catch up. If all data were pooled and they all shared the same results no one bank would have the competitive advantage, and, more importantly, the financial system as a whole would be safer.

17.6 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?

It is not clear why the burden of fraud prevention should not fall equally on payment service providers and users, unless they are contributing disproportionately to the incidents of fraud through their own business practices. For example, it may be that there is a higher incidence of fraud in certain market sectors and it would not be fair that those in that market sector not to bear more of the cost of fraud prevention.

17.7 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?

APACS already does a good job in raising the profile of fraud and security issues and in co-ordinating fraud prevention across banks, but could be enabled to be more proactive. As the thought leader in this

arena, APACS could lead all banks to join up in a community approach to combating fraud. Thus, the current position where banks view fraud as a competitive issue could convert to one where all banks could reach the same level of protection. This protects the integrity of the system, rather than the interests of individual banks.

The Payments Council could play a key role in reinforcing the APACS role here.

Issues for consultation: standards

18.1 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?

It will always be valuable for UK interests to be represented in the establishment of international standards and practices. Right now, the most important influences, where UK interests and rights to interest are in most need of representation, is in Europe. The European Payments Council, the European Commission and the European Central Bank are the organisations driving SEPA and the PSD, which are likely to have the most influence on the UK, as opposed to the other way around. Grasping this, so that the UK is helping to drive the European agenda (assuming that SEPA and PSD principles are accepted) is easily the most important activity the Payments Council should fulfil.

18.2 Q48: What, in particular, should the National Payments Plan say about messaging standards?

Again this is related to SEPA, in that ISO 20022 standards have been championed as part of SEPA. These standards will inevitably become the single international payment standard. Therefore ensuring they are used in the UK, where the option to do so exists, is the key single activity in this area. This will have a significant to benefit businesses, where businesses will be able to adopt common standards for euro and sterling transactions, as well as enabling them to take advantage of future developments in e-invoicing etc, where standards development centres around extensions to these XML standards.

Issues for consultation: understanding costs

19.1 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?

Yes and strongly.

Providing an unimpeachable and independent source of data against which to measure banking and billing initiatives and educating government and customers in the relative costs of usage, both to them, to banks and to the economy as a whole, would be valuable. Banks, customers, and payment service providers are right to be wary of business cases which are slanted to protect the interests of particular companies or groups.

As the debate about transaction charging begins within the banking industry, it will be very valuable for an independent body to hold an impartial view of costs, which affects issues such as:

- Cheque processing costs
- The extent to which banks actually benefit from float or are merely accused of it
- ATM and card interchange fees
- The costs of maintaining free-to-use ATMs
- The cost of cash movement and the actual costs of using cash for low value transactions.