

National Payments Plan

Consulting on change in UK payments

These questions must be read in conjunction with the National Payments Plan Consultation document, available from http://www.paymentscouncil.org.uk/national_payments_plan/

Issues for Consultation

Response from HSBC Bank plc 1 February 2008

HSBC Bank plc's response to Payments Council's National Payments Plan consultation document is attached.

CHEQUES

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. Based on the premise within the question – that cheques are in irreversible decline - it would be sensible and appropriate, for the good of the industry and its customers, to develop a plan to manage the decline of cheques, before lower volumes begin to challenge the economics of the cheque processing business.

Cheque volumes have been falling in the UK since 1990 and last year HSBC saw its largest ever decline in percentage and absolute terms. This trend will increase as more retailers join the list of major high street names which refuse to accept cheques for retail sales.

In addition, the European Commission's stance is strongly pro-electronic payment. Although no firm proposals have emanated from the EC to date, the Payment Services Directive, due to come into force across the EU from November 2009, is concerned principally with electronic payments, and the EC's task force for business-to-business electronic-invoicing is looking at automating the supply chain with commensurate efficiency gains from straight through processing. It seems quite possible that the EC, as some future date, may aim to demise paper payments across the EU, using e-invoicing as the catalyst.

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

In many cases, alternatives already exist, in the form of credit and debit card payments, direct debits, credit transfers and standing orders.

The areas where cheques (or cash), are commonly used are for person-to-person, person-to-small business and business-to-personal payments, together with payments to/from clubs, societies, charities and schools.

A gap analysis is required to understand the features that users (both payers and payees), value in cheques, and the extent to which these features (flexibility, tangibility, ability to make payment where payee's bank details not known, perceived cash flow benefits, for example), are available in existing alternatives. In addition, work should be undertaken to understand the extent to which user education could make up any perceived shortfall. Finally, user take-up of the new Faster Payments same-day credit transfer service (due to launch May 2008), and its use in some of the payment scenarios outlined above, should be evaluated before planning significant new payment services/amendments to existing payment methods.

Finally, Payments Council should review the alternatives to cheques available in other cheque-free societies, before recommending the best approach for the UK.

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)?

A clear target date for demise of the cheque is a sensible way forward. 2018 is a reasonable 'stake in the ground', to be evaluated against the views of all relevant stakeholders – the payments industry and its customers.

Issues to be considered include:

- The long-term contracts Cheque & Credit Clearing member banks have with their outsourced cheque processors.
- Demise of the cheque must be agreed with all stakeholders – customers, member banks, infrastructure providers and government, thereby allowing all users to plan for cheque removal.

- Any plan must set out milestones for cheque demise, matched to the availability and widespread acceptance of alternatives to cheque payments. This will ensure that cheque volumes are reduced (or possibly eliminated), before clearing services are removed. It should also ensure that cheque payments are not replaced by greater usage of cash.
- Agreement of all stakeholders and endorsement by government (HM Treasury, OFT), will be essential to ensure that co-ordinated cheque demise by the payments industry is not seen as anti-competitive, or as a cost reduction initiative purely for the benefit of the banks.

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

Clearly this depends upon the alternatives to cheque use identified by further research/gap analysis. Much will depend upon whether cheque functionality is replaced by further development of existing payment services, education of users in the greater use of existing payment types, or the development of completely new payment services.

Some additional comments on 'user education':

- The person-to-person and person-to-business users identified in Q2 are likely to benefit from appropriate education to encourage switching to other payment services.
- Big business issuers/recipients of substantial cheque volumes require not so much 'education', as much as early engagement with their service providers to identify and plan for switching to non cheque payments.
- As much thought needs to be given to cheque recipients as to issuers of cheques.
- Communication of the new Faster Payments service, to be commenced shortly, should cover not only the core service features, but also promote greater usage of the service in substitution for cheque and cash services. A key issue here is to tackle public concern re disclosing bank account details.

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?

In recognition of the continuing decline in cheque volumes, together with the tendency for major retailers to stop accepting cheques, we would support an objective, industry-wide review of the Cheque Guarantee Card Scheme, undertaken through Payments Council, with the involvement of all stakeholders. An orderly and planned withdrawal of the Scheme would avoid a protracted period of declining use and confusion over acceptance for all users.

Any recommendation to demise CGCS must take full account of parties who most rely upon it (small businesses which don't take cards/their personal customers), with alternatives identified and implemented before actual demise.

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

The following are mostly additional thoughts regarding cheque demise – comments which do not fit neatly into the preceding questions:

- Whilst we support cheque removal, while paper payments continue, they must be processed in the most efficient way possible and preserve the integrity of the cheque payment method.
- Cheque & Credit Clearing has undertaken initial research to investigate various 'scenarios' for the future of the paper clearings (gradual demise, 'big bang' withdrawal etc). In addition to the all-important customer consultation, attention must be given to industry capacity planning and orderly withdrawal.
- Whilst the sterling, domestic cheque is the principal paper payment instrument in the UK, it should be noted that Cheque & Credit Clearing also process euro debit clearings, and other service providers process dollar instruments. The National Payments Plan should address all such paper payments.

- Although Cheque & Credit Clearing made significant systems and operational changes in November 2007 to introduce greater certainty into cheque clearing (the '2/4/6' project to standardize certainty of value, withdrawal and fate for customers), it should be recognised that a National Plan to demise the cheque will see future developments in other clearings, rather than Cheque & Credit.

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 logical to consider demise of the paper credit clearing at the same time as reviewing the future of the cheque.

CASH

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?

We agree with this statement, based on current and forecast use of cash.

The plan should consider the impact of alternative payment methods such as contactless cards, mobile and Faster Payments in payment situations where cash is most used, but regardless of this, the assumption must be that cash will continue to be the major payment method for the foreseeable future.

Deloitte's research suggests that half of all transactions with value below £15 are accounted for by just eight spending categories:

- Top up groceries
- Spending at confectionary, tobacco and newsagent outlets
- Pubs and bars
- Fast food
- Taxis
- Mobile top-up
- Transport
- Off-license sales.

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?

The overall view within the Bank is that the present industry structure is broadly appropriate to address these issues, i.e. the industry (banks, service providers and the Bank of England) meets as the Cash Services Group, an independent 'interest group' under the Payments Council structure. As such, whilst the use of cash as the major payment method must of course form a key part of the National Payments Plan, issues such as the supply and quality of notes and coin are largely technical matters which should be part of the industry's response to meeting user needs expressed within the Plan.

That said, we have some comments to make on cash:

- With the exception of the £5 note, where certain major retailers have entered into agreement with the Bank of England to act as issuer of new £5 notes, we are not aware of any quality issues. In due course we believe there will be pressure to replace the £5 note with a coin.
- There should be some clear goals for the percentage of notes issued by the Banks with a degree of tolerance built in. The issue of ATM fit £50s should be reviewed along with the issue of keeping up the levels of £5 notes in circulation. There is also the issue of the rate of circulation... notes (£5 in particular) are just wearing out.
- The Bank of England has firm policies regarding English Sterling notes in circulation and interacts regularly with members of the Note Circulation Scheme both directly and via APACS. Scottish and Irish notes are not managed by this framework and APACS plays no part in management of these. Coin is controlled by the Royal Mint. The existing framework of relationships is believed to work satisfactorily and we see no immediate need for change. If the Payments Council/National Payments Plan foresees a role for itself in the cash environment, it should consider the interrelationships with the existing framework very carefully.

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

Given the dominance of cash as a payment method, research should be undertaken similar to that required in connection with the (potential) demise of the cheque, to understand all the features of

cash as a payment method that users value and which must be present in any (partial) replacement. Any research must give careful thought to the 'financially excluded' - users for whom cash is (almost) the only payment method and for whom a substitute may reinforce their exclusion.

DIRECT DEBIT

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

Direct debit usage is widespread amongst personal customers. In the business community, direct debit usage is greatest amongst utilities, local authorities and insurers, for which direct debit is the cheapest and most efficient form of payment. The greatest scope for increasing take-up of direct debit could come from small and medium enterprises becoming BACS issuers, or using the services of bureaux to use the BACS service. Simple, packaged solutions would encourage take up by smaller businesses.

Consideration should also be given to recurring payments made by cards. This is becoming more prevalent, particularly where the initial payment is made on the Internet.

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

We recognise that the current 'unlimited' (non-time limited) UK direct debit guarantee is a valuable payer benefit, instrumental in driving up direct debit acceptance among personal customers. It is important to be fair to both sides however – an unlimited refund for the personal customer (payer) is an unlimited liability for the business (payee) – businesses need certainty of payment.

We are aware that the BACS scheme is currently reviewing the direct debit guarantee, in light of the forthcoming Payment Services Directive, due to come into force across the EU by 1 November 2009. This imposes a time limit, although we are also aware that HM Treasury, in leading the UK's consultation on implementation of the Directive, is inviting the industry to retain the existing unlimited guarantee.

It should also be noted that the major UK banks are members of the European Payments Council (EPC), and will probably participate in the EPC's Single Euro Payments Area (SEPA) direct debit scheme. Whilst this offers direct debits in euros only, if SEPA DD becomes the pan-European standard and offers only a time-limited guarantee, the UK industry will come under increasing pressure to align to European standards.

Customer views should be sought, both payers and payees, business and personal, before deciding on such a fundamental change to the direct debit scheme.

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

As suggested above, the UK time limit and current unlimited guarantee should be reviewed and aligned to the SEPA direct debit scheme and related Payment Services Directive legislation.

CREDIT TRANSFERS

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?

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

We have a few general comments on this question:

- In keeping with the comments re direct debit above, the UK should increasingly align to SEPA Credit Transfer rules and standards, including remittance information, field size, and other related standards – XML, ISO 20022.
- Faster Payment credit transfers will become increasingly important as usage and volumes ‘ramp up’ following launch in May 2008.
- It is important to liaise with corporate and small business user forums to ensure that changes to credit transfers meet industry-wide requirements and achieve straight-through-processing (STP).

ATM/SELF SERVICE

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 ATM should be primarily a “cash and dash” facility – this is what the majority of users want from a “hole in the wall” machine. Too much additional functionality will increase queue wait times unacceptably.

Given that the key elements of the ATM scheme and infrastructure are in place, additional functionality should be left to the ‘competitive space’ for individual organizations to develop as a point of competitive advantage.

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

- 83% of adults have debit cards but "only" 70% use cash machines – it would be good to have a strategy to bridge that gap. Such a strategy would increase efficiency and increase the utility of card ownership for the 13% of non-users.

WHOLESALE PAYMENTS

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

The wholesale bank-to-bank payments market is a universe in itself, deserving its own consultation exercise rather than a single question in a retail dominated questionnaire. We strongly recommend a separate exercise to ascertain the views and needs of this important market.

For the purposes of the National Payments Plan, given its scope as defined by the 49 questions in this consultation paper, we recommend that at the very least the initial output is reviewed by the Liquidity Managers Interest Group which meets at APACS/Payments Council. Wholesale payments and the institutions which make payments have concerns/priorities which are different to those in the retail market, including: risk, liquidity, time zones, cut offs, settlement, legal certainty etc. Any changes to the CHAPS system must take account of the views of the wholesale market.

In this connection we note HM Treasury's consultation paper dated 30 January 2008 'Financial Stability and Depositor Protection', which proposes a new regulatory regime for UK payments. Clearly the UK industry, particularly the systemically important wholesale systems such as CHAPS, must engage with the Treasury regarding these proposals.

EUROPE/SEPA

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

Actions to 'ensure that users in the UK can take best advantage of SEPA' fall into two broad categories:

- Harmonisation
- Communication

Regarding harmonization, Payments Council and its members should ensure that in all industry strategy work (including this National Payments Plan), all potential developments are considered in the light of SEPA, its payment methods and standards, with a view to harmonizing the UK with Europe wherever possible. Users will ultimately benefit from this approach, in two ways:

- The ability to use the same payment instruments across Europe, under the same terms and conditions (execution time, value date, cut off times, etc) as domestic payments.
- The UK will be able to participate in the European payments market, bringing greater competition and innovation, particularly in the choice of service/infrastructure providers for payment services.

Payments Council should encourage its members to use SEPA standards without developing a UK variant (the 'mini SEPA' approach).

Regarding communication, to date industry communication in the UK regarding SEPA has been limited largely to the 'payments industry' itself: banks and their major corporate customers. As SEPA payment volumes increase, and particularly as domestic euro payment volumes within the eurozone migrate to SEPA payments, UK banks should communicate SEPA more to their customers. In this connection:

- Payments Council should continue to engage with the EPC, European Banking Federation (EBF), Euro Bankers' Association (EBA), European Central Bank (ECB) and EU bodies to bring UK influence to bear and to obtain up to date information on SEPA developments for its members. Members in turn will communicate SEPA developments to their customers.
- Payments Council should continue to press the EPC to improve its governance to include stakeholders/users (as per the UK's model), and to develop a clear plan for 'SEPA phase 2' – migration of eurozone domestic payment volumes to SEPA instruments and processors.

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

As a Plenary member of the EPC and as a major UK, European and international bank, HSBC has joined the EPC's SEPA credit transfer scheme and aims to offer SEPA direct debits when this scheme commences in November 2009 on implementation of the Payment Services Directive.

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

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EFFICIENCY

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

This question is probably best answered by the users themselves, through the three Payments Council User Forums: corporate, SME and consumers.

CARDS

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?

Given the intense competition within the card issuer, merchant acquirer and card schemes markets, together with their track record of innovation, the answer to this question is 'yes'. Note that, although both cards related, these are different products which should not necessarily be lumped together.

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 first part of this question is a repeat of Q 23.

Contactless card payments, launched in London in late 2007, have the potential to migrate large numbers of low value POS payments away from cash, especially coin, reducing the time and cost associated with handling cash within the UK economy. APACS Cards Payments Group, working with the card schemes, is constantly reviewing the progress being made towards national rollout and is prepared to consider any action that may be required to ensure success.

UK-issued contactless cards are based on the international EMV standards that ensure international interoperability. The UK card industry continues to work with EMVCo in order to ensure that the standards are fit for purpose and that they suit the UK market's needs.

Card displacement initiatives (i.e. the use of different form factors, some of which will be considered mobile) based on the EMV contactless payment model are likely to prove popular in the long term. It is therefore imperative that, from an interoperability and integrity point of view, providers adopt similar technical standards. It would therefore be appropriate for the National Payments Plan to include statements about convergence of technology and commonality of standards, though caution must be taken to ensure that such statements assist competition rather than stifle innovation.

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

It is expected that competition and demand from consumers and corporate customers will drive the prepaid market. As with contactless card payments, the availability of interoperable standards would be a distinct advantage for both providers and the retail community. As suggested above, it would therefore be appropriate for the National Payments Plan to include statements about convergence of technology and commonality of standards though caution must be taken to ensure that such statements assist competition rather than stifle innovation.

MOBILE PAYMENTS

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

Regarding standards, it will be important to ensure that standards are compatible with Europe/global standards, rather than UK specific. Similar considerations apply to those outlined in Q24 above re cards/contactless developments.

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

Yes, based on customer research. We would support bank account-to-bank account mobile payments.

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

We are aware that Payments Council's Mobile Payments sub-group is commissioning research into this question. We look forward to seeing the results of this research.

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

Potentially wide-reaching replacement for cash and cheque payments person-to-person and person-to-business. The research referred to in Q28 will provide a useful indication of the potential here.

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

Payments Council should be supportive of 'mobile payments', but should recognize that such payments are one amongst a number of potential replacements for cash and cheques.

E-INVOICING

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, particularly given the potential benefit to business customers from straight-through-processing of e-invoices. The industry needs to work in a collaborative manner on the framework and rules, and banks / vendors competitively on the services delivered within the framework.

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

Persuading the public sector to adopt e-invoicing. The public sector are significant users of payments services in Europe, as circa 29% of all European payments are sent by the public sector. Without the support of the public sector, e-invoicing initiatives will struggle to gain critical mass.

OTHER ACTIONS/INNOVATIONS?

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

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

- Payments Council should consider its response to HM Treasury's consultation paper of 30 January 2008 'Financial Stability and Depositor Protection' and the proposals in that paper for a new regulatory regime for payments.
- Payments Council should continue with its programme of user/stakeholder consultation in order to ensure that payment innovations meet customer needs.

FINANCIAL EDUCATION

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

HSBC is addressing one gap through its “What Money Means” programme aimed at primary schools.

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?

There is still a consumer perception challenge in terms of use of Self Service ATMs for aspects other than cash withdrawal (customers are used to paying a credit card bill in a certain way e.g. by cheque; used to making bill payments at the counter, wanting a 'stamp in the book' etc.). There is a related challenge to bank staff to change behaviour in a customer driven way.

FINANCIAL INCLUSION

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

Financial inclusion should form part of the National Payments Plan adopted by the Payments Council, and should be one of the tests present in any business case to make major changes to the UK payments market, such as demising the cheque or reducing cash usage.

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

PAYMENT SYSTEM INTEGRITY/SECURITY/FRAUD

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

Please see responses to the questions below...

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

As well as taking feedback from member organisations it would be wise to seek submissions and comments from APACS groups that have a particular responsibility for fraud. Whilst this may have an element of double counting given that HSBC is an individual member of Payments Council and then has representatives on APACS sub-groups, the debate within the APACS arena may allow for greater consideration of issues from an industry-wide fraud perspective. Fraud prevention is one area where collaboration between member banks, conducted through Payments Council, is to be encouraged, whilst remaining mindful of the competition issues.

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?

By encouraging benchmarking and sharing of best practice.

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

This is likely to be a competitive issue and whilst suggestions can be made this could be difficult to gain acceptance. An issue could be to decide what exactly is a common measure of authentication and do various product offerings merit/need different authentication methods?

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

The Payments Council should actively seek out new technologies and facilitate education and introduction to members. This is one of its stated aims.

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

I am not sure that the plan should do any more than encourage. With the clear exception of fraud prevention, this should be left to individual institutions.

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?

I am not sure that they can ensure the burden is shared equitably but they can highlight on whom the burden falls and what the issues are that have led to the need for such fraud prevention activities. They can then educate the public, including SMEs and encourage self help by those parties. Bringing

issues to the attention of government will also help in forming public opinion and galvanising action by both the public and government.

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?

This must be a leading role and one where the Council as best as it can emphasises its independent nature.

STANDARDS

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?

Payments Council should continue to play its current role of participating in standards related meetings and forums, acting as an intermediary between banks and customer representative groups.

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

TRANSPARENCY OF COSTS

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?

This is a difficult area to comment on, as costs and pricing are generally excluded from industry discussions (with the exception of cards interchange studies), in order to avoid competition law concerns.

Research into the relative costs of different payment methods would be of use in supporting industry cost benefit analyses for major payment system developments, based upon independent studies of end-to-end payment costs.