

## **BANK OF ENGLAND RESPONSE TO RELEVANT QUESTIONS SET OUT IN THE NATIONAL PAYMENTS PLAN CONSULTATION DOCUMENT**

The Bank of England (hereafter ‘the Bank’) welcomes the Payments Council’s public consultation on the National Payments Plan (NPP). A number of issues raised in the proposed NPP are directly relevant to the Bank: specifically in the context of the Bank’s financial and monetary stability responsibilities, as overseer, operator and user of payment systems, and as issuer of banknotes. More details explaining the Bank’s interests in these areas are available from the Bank’s website (<http://www.bankofengland.co.uk/>). Among other things, the Bank’s website includes links to the UK Tripartite Authorities’ *Memorandum of Understanding* (<http://www.bankofengland.co.uk/financialstability/mou.pdf>) in which the Bank’s responsibility for payment systems oversight is set out; and there are other pages specifically relating to financial stability / the oversight of payment systems (<http://www.bankofengland.co.uk/financialstability/paymentsettlementsystems/oversight.htm>) and to banknotes (<http://www.bankofengland.co.uk/banknotes/index.htm>).

The responses given below are a consolidated response from several areas of the Bank. As a general comment, based on the NPP consultation document, the Bank agrees with the broad direction that the Payments Council is aiming to steer the UK payments industry in. It also welcomes the consultation on the NPP as a concrete example of the recent governance changes leading to improved engagement between the UK payment industry and its users on issues of efficiency, innovation and integrity.

The Bank is not providing responses to each of the 49 questions posed in the NPP consultation document, but rather has focused particularly on those issues that are most relevant to the Bank’s payment systems interests / responsibilities.

### **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?**

The Bank supports any developments that help to make the UK financial system more efficient, where such efforts do not conflict with its monetary and financial stability responsibilities (or the responsibilities of other public bodies). In this context, the Bank is supportive of the Payments Council consulting on the case for a proactive plan for phasing out cheques to a timescale “entirely dependent on there being alternatives, covering all the circumstances in which cheques are used; and on good evidence that cheque users were finding that they [i.e. the alternatives] met their needs and were understandable and accessible”. If the consultation supports the phasing out of cheques subject to the provision of (an) acceptable alternative(s), then it will be important for the development of such alternatives to be an integral part of the NPP, so as to avoid the situation that insufficient alternatives have been developed by the time (e.g.) any indicative phase-out date for cheques is reached. Also, it will be important to consider contingency responses in any cases where there could be an event that affected the UK’s (retail) electronic payment systems simultaneously – e.g. a co-ordinated denial-of-service attack on the majority of these payments systems.

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

There are a number of reasons why individuals and companies currently use cheques. It will be important to assess these, with a view to identifying user requirements that cheques meet, and which need to be met by other, alternative payment instruments. The user needs that cheques currently meet include (a combination of) the following:

- to allow the payer to make payments without needing to know the payee's account details; and
- to allow the payee to control the settlement date (e.g. for payments in relation to goods / services / assets that become available in the future – subscriptions relating to a future period; retail purchase of shares during privatisations, etc.).

Specifically, cheques are used in circumstances when payee account details are unknown, including large volume issuances such as premium bond prizes and forms of government loans using the 'social fund' (where cheques in these cases can also be cashed at Post Offices). However, given the issues of fraud and production timelines associated with this type of payment, an alternative (preferably one with shorter lead times for its production) should be considered in advance of cheques being phased out.

**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)?**

The Bank does not object to a target date in the NPP regarding the closure of the cheque clearing on the assumption that acceptable alternatives to cheques have been developed. See the responses to questions 1 and 2 (above).

**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?**

The Bank would support such a review, given the link to personal cheque usage.

**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?**

The Bank would support such a review, particularly as there are some areas where information on a paper credit cannot currently be accommodated in an electronic payment, such as change of address details.

**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?**

The Bank aims to meet demand for its notes, seeking neither to promote nor discourage their use. Over the past ten years, the value of Bank of England notes in circulation has roughly doubled, from around £20 billion to around £40 billion. Whilst historical demand need not be a guide to the future, it would seem to be appropriate to develop the NPP on the assumption that cash will remain a major payment method for the foreseeable future.

**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 Bank has been involved in a number of workstreams that demonstrate that financial institutions and other stakeholders, such as retailers, have important roles and responsibilities in the cash cycle. The workstreams include the shortage of £5 notes in the economy, the denomination mix more generally, the identification of counterfeit cash and its timely return to the issuing authority, and flu pandemic planning. We would suggest that the NPP is used to encourage relevant stakeholders to work with issuing authorities to identify and fulfil these roles and responsibilities.

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

The Bank aims to meet the public's demand for different denominations of banknotes. We are aware that the current circulation system tends to result in an under-supply of the lower denominations, particularly the £5 note. We are unsure whether the supply of coin denominations meets public demand, as this is a matter for HM Treasury and the Royal Mint. We would like to see the NPP act as a vehicle to obtain a more precise picture of public demand for different denominations.

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

This question is set in the context of using ATMs for purposes other than withdrawing cash, such as mobile phone top-ups, and the potential for doing more in this area. The Bank suggests that another area is for ATM operators to consider giving consumers more choice about the denomination mix they can access from ATMs, including £5 and possibly £50 notes.

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

The Bank comes at this question mainly from the perspective of managing risks in payment systems. As a general statement, the Bank believes that action should be taken where the cost of proposed mitigants for risk events is proportionate to the materiality of the risk posed. Details of where the Bank considers there to be scope to make risk-reducing improvements to (wholesale) payment systems are set out in the Bank's annual Payment Systems Oversight Report (see <http://www.bankofengland.co.uk/publications/psor/index.htm>).

Specific current issues include improvements to reduce operational risk, such as:

- at the level of payment systems,
  - investigating – and (where appropriate) improving – the possibility of re-routing payments from one payment system to another, with a view to improving the resilience of the UK payment system;
  - further ensuring that sufficient capacity is available in all UK payment systems to meet changes in demand (n.b. this is especially important if re-routing of payments between different systems were to become more feasible);

- in a crisis situation, improving communication between both systems and the members of the system; and
- co-ordination of contingency arrangements between infrastructures where payments (including embedded payments) is one part of the trade / post-trade value-chain – for example between LSE, LCH and CREST in relation to the life cycle of share transactions – to ensure that each part of the chain acts appropriately and / or substitutes for another part if it is operationally disabled for a period of time;
- improving member-level resilience, e.g.
  - fostering greater understanding of interdependencies on other services / systems;
  - increasing the probability that both direct and indirect members of a payment system can successfully connect to it in the event of an outage (whether a market-wide outage; or a member-specific one that impacts on other members of the system);<sup>1</sup> and
  - promoting further thorough testing of contingency / business continuity arrangements – including stress-testing high volume events.

In addition, improvements to reduce settlement – including liquidity – risk should be encouraged, especially given that the increasing interlinkage between systems means that the crystallisation of settlement risk in one system may knock on to the smooth operation of other systems. Specifically, consideration might usefully be given to:

- incorporating into the *CHAPS Rulebook* the arrangements for faxed payments made in a contingency (e.g. when SWIFT is unavailable) – this would ensure that they are covered by the Settlement Finality Directive;
- reducing settlement risk arising from RTGS in bypass mode, by instigating the procedure of running an intra-day settlement cycle in CHAPS;
- undertaking further analysis to understand and manage appropriately (and where necessary<sup>2</sup> taking steps to reduce) the settlement risk arising from intraday exposures among CREST US dollar settlement banks / members;
- amending the current arrangements for concentration of US dollars among Protected Payment Scheme (PPS) banks in LCH.Clearnet Ltd – with a view to reducing the risks surrounding settlement in commercial bank money; and
- implementing a DBV-like term product within CREST, should this be the recommended outcome of a current Euroclear UK & Ireland (EUI) consultation.

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

See answer to question 49.

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

and

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<sup>1</sup> n.b. this issue is picked up also in the January 2008 Tripartite Consultation Document on “Financial stability and depositor protection: strengthening the framework” (paragraphs 4.79-4.81) – available at <http://www.bankofengland.co.uk/publications/financialstabilityanddepositorprotection080130.pdf>.

<sup>2</sup> e.g. if the values settled should rise significantly in future.

**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?**

In the last few years the Bank has made significant progress in improving education about banknotes through its website, leaflets and posters, a film and attendance at trade events for major cash users (e.g. retailers). The Bank is constantly reviewing how to improve these resources further and would welcome discussions with other stakeholders about possible joint work.

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

See response to question 18 above – in particular, the part relating to operational risk issues (for collaborative issues).

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

A range of fraud scenarios (including “worst case”) should be identified and assessed. As inputs to any subsequent cost-benefit analysis undertaken for anti-fraud innovation proposals, the assessment should include both (i) an estimate of the costs of the fraud (which in turn is the potential benefit of fraud reduction), and (ii) the identification and costing of a set of effective counter-measures to the fraud in each of these scenarios.

**Q47 What should be the role of standards in the National Payments Plan?**

and

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

There are likely to be a number of roles for (messaging) standards in the NPP. One relates to facilitating the re-routing of payments in order to give additional resilience to the UK payments system (see part of response to question 18 above): the more standardised payment messages among different payment systems, the easier it should be to re-route payments in contingency situations.

**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?**

From the Bank’s perspective, any study should seek to capture all relevant societal costs of different payment methods, not just those of a particular set of stakeholders. That would make any study as useful to stakeholders and decision-makers as it could be. It would also make the exercise more involved but we know it is feasible. For instance, in 2005 the Dutch central bank (De Nederlandsche Bank) published an Occasional Study into the costs of payments entitled “Payments are no free lunch”.<sup>3</sup>

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<sup>3</sup> See [http://www.dnb.nl/dnb/home/file/Occ%20stud3%2E2%20web\\_tcm47-146645.pdf](http://www.dnb.nl/dnb/home/file/Occ%20stud3%2E2%20web_tcm47-146645.pdf).