

GOVERNMENT RESPONSE TO PAYMENTS COUNCIL CONSULTATION ON NATIONAL PAYMENTS PLAN

JANUARY 2008

1. Introduction

This is the Government's response to the issues raised in the consultation paper published by the Payments Council on 26 November 2007 on a National Payments Plan. The Government understands that this consultation is intended to inform the direction of the Payments Council's long-term strategy for the UK payment systems for which it is responsible. This response is focused on those proposals considered to have a bearing on Government policy objectives and concerns.

The Government welcomes the open and consultative approach employed by the Payments Council, in line with the objectives of the body, and will be interested to see the responses of stakeholders in this process, and the final Plan in Spring 2008.

2. Cheques: Questions 1-6

The consultation paper

Cheques now account for 13% of UK non-cash payments, compared with 64% in 1990, and cheque volumes are forecast to decline by over 7% per annum over the next 10 years. However, there are still areas where usage is heavy, often where alternatives are not available or do not meet the needs of users, e.g. payments by SMEs, person-to-person, and person-to-small business payments.

Since there are substantial fixed costs associated with cheque processing, declining volumes increase the unit cost of processing. The consultation paper notes, "*it is generally accepted that the use of cheques will be discontinued in the UK at some point in the future and that a point will eventually be reached when industry-wide cheque clearing is no longer sustainable*". It is suggested that before cheques could be withdrawn in the UK, "viable and accessible alternatives would need to exist for all current cheque users". Significantly, the consultation asks **whether a target date of 2018 would be acceptable for the complete withdrawal of cheques**. This is based on the assumption that alternatives have been developed.

The Government's response

The Government has serious concerns a) that the proposed date for withdrawal of cheques comes in the absence of any certainty that alternative payment methods will be found in all circumstances in which cheques are currently used in the UK, and b) at the assumption that a payment system such as cheques will be discontinued. The Government welcomed the reforms agreed in the Payment Systems Task Force report in November 2006 to deliver guaranteed maxima for: earning interest against a cheque paid (by T+2); being able to withdraw against a cheque deposited (T+4); and being certain that a cheque will not subsequently bounce at a later date (T+6). The Government was pleased at the introduction of these reforms on schedule in November 2007. The Government's policy approach towards cheques is strongly supportive of improving the proposition for cheque

users, and questions the presumption that cheques will be disbanded. While the Government is supportive of the efficiency gains that can be achieved through innovations in electronic payment systems, the Government supports continued user choice between different payment methods.

The impact on **small businesses** of the withdrawal of cheques needs to be better understood. SMEs tend to be heavy users of cheques both for receiving and making payments. Much more work is required with the SME sector to identify viable alternatives to cheques, in particular in instances where cheque is currently the only viable method of payment. Without work to develop a viable alternative, such payments may revert to cash rather than be made electronically.

Small **charities, societies and other third sector** organisations are, like small businesses, likely to be relatively heavy users or recipients of cheques. It would be helpful if the Council could articulate the extent to which it has engaged with third sector organisations. In this context, the third sector, particularly small organisations, should be an area (alongside the small business sector) for particular focus for the Payments Council's two-pronged approach of developing and/or enhancing alternatives to cheques, and informing users about alternatives that already exist.

Basic bank accounts, which the Government and banking industry are promoting as the main tool for bringing financially excluded people into the banking system, do not provide the facility to make cheque payments. However, basic bank account holders can pay cheques into their accounts. From a **financial inclusion** perspective, therefore, there could well be issues around people vulnerable to financial exclusion no longer being able to pay cheques into their accounts, particularly if there was evidence that a higher proportion of this group received payments in this form. The available research needs to be investigated on this point.

3. Direct Debits: Questions 11-13

The consultation paper

The consultation paper emphasises that direct debits are now a well-established means of payment. Around two-thirds of utility bills are now paid by direct debit, which currently come with a guarantee that if an error is made, the customer is guaranteed a full and immediate refund. Within the business sector, SMEs use direct debits extensively for a variety of uses. It is noted that several suggestions have been made in the large corporate and SME user forums for changes to the proposition on direct debits, namely:

- to replace the currently open-ended guarantee with a time-limited guarantee, to reduce the costs and risks arising for direct debit originators;
- to make it easier for small businesses to set up as direct debit originators.

It is suggested that the introduction of a time-limited guarantee could make it more attractive for SMEs to become direct debit originators, by reducing the level of financial exposure involved. The consultation asks what improvements would lead

to greater take up by users, and **whether there should be a time-limited guarantee for direct debits.**

The Government's response

The Council should explore with the **small business** sector what changes would be necessary to increase usage of direct debits. This is particularly pertinent in the light of the Council's proposed withdrawal of cheques. Alternative methods of making and receiving payments need to be viable, straightforward and cost effective in order for them to be workable. Failure to ensure viable alternatives are in place will lead to a backwards step for SMEs.

In line with the Government's approach on **financial capability**, the Council could consider ways of integrating information and education into the strategy to promote further take-up of direct debits. This could help increase:

- users' confidence in paying by direct debit;
- their understanding of the advantages of direct debit; and
- their understanding of how direct debit differs from other payment methods such as cheques, meaning that therefore paying by direct debit – i.e. not actively 'making' the payment each time – makes it especially important to keep track of payments and manage account balances.

Factors around loss of control are believed to be even more relevant for people vulnerable to **financial exclusion**. The Financial Inclusion Task Force is already undertaking work with BACS to understand the role of originators and banks in promoting direct debits to their customers. BACS has conducted research into low-income attitudes to direct debit, and is now conducting a promotion campaign with an element focused on low-income and financially excluded customers, and working with banks to pilot approaches to increasing take-up. The Government will continue to monitor developments in this area.

The Payment Services Directive (PSD) is a maximum harmonisation directive on which political agreement was reached in April 2007, and formally adoption by the Council and European Parliament in November 2007. The PSD aims to create a Single Market in payment services, and it includes new standardised, EU-wide conduct of business rules which must be introduced in every Member State by November 2009.

Notably, the PSD establishes an 8-week period within which a refund for a correctly authorised direct debit must be received, and a 13-month period within which a user can complain about an incorrectly authorised direct debit. While UK legislation will need to reflect these maxima, the Directive includes an overarching provision that providers can always do better for their customers than the standards prescribed in the Directive. The Government would encourage the industry to retain the Direct Debit Guarantee scheme, as set out in the Government's recent policy consultation document on implementation of the PSD, published 19 December 2007. As noted in the Payments Council consultation paper, this may be supportive of widening the use of and increasing confidence in direct debits.

4. Enhancing User Efficiency: Question 22

The consultation paper

The consultation paper notes that in the past efficiencies have been considered such as standardisation of account numbers, but was rejected because indicative analysis suggested that it was not a cost effective solution.

The Government Response

The Government believes that the Council should explore further the possibility of standardising account numbers. This would have the potential to reduce the costs to businesses, as highlighted by the Large Corporate Forum, but more broadly also provide a means of improving account switching between institutions.

5. Innovation: Questions 23-30

The consultation paper

The consultation paper notes some recent developments in payments, including the launch of contactless cards, which have the potential to replace the use of cash in cash-dominated sectors such as convenience stores. Payment solutions offered by prepaid cards are also referred to in the paper, for instance, in enabling the unbanked to purchase goods and services by card, and person-to-person remittances. The consultation paper suggests that prepaid cards have the potential to spread usage and acceptance of cards into parts of the economy where they have thus far played little or no role. Nonetheless, the consultation paper suggests that, **given these innovations are still at an early stage of competitive development, they are best left to market initiatives** rather than Payment Council intervention.

In relation to mobile phone banking, the consultation paper notes that mobile payments have been as a possible alternative to cash for consumers without bank accounts. It is further suggested that the **Faster Payments service could provide a platform for a near real-time mobile payments service**, which could be used for person-to-person transfers, and consumer-to-business payments, and that fast and secure mobile payments could prove attractive in areas where payments are made by cheques or cash. The consultation asks **whether the Plan should support the development of mobile payment services between bank accounts**.

The Government response

In broad terms, the Government welcomes efficiency gains and innovative reforms to payments. The Payments Council's position that innovation should be an outcome of market initiatives, while considering the potential gains from developments in mobile banking and using Faster Payments to harness these gains, is also welcome.

Some of the innovations may benefit UK consumers with bank accounts, reducing reliance on the presence of physical infrastructure such as ATMs. However, from a **financial inclusion** perspective, while prepaid cards may at first glance be helpful to the unbanked, contactless cards and mobile technologies are not a perfect

substitute for a bank account. For some individuals they may prove to be a stepping stone to a bank account; for others, they could reduce the incentive to have one. Furthermore, some products carry a purchase fee, which is not recovered by the cardholder, while there can be fees for re-loading cards (i.e. topping up the stored funds). The Financial Inclusion Taskforce will feed into Payments Council work on payments innovation and inclusion.

From a **financial capability** perspective, the Government welcomes innovation as a positive development for consumers, offering greater choice and flexibility, and is keen to ensure consumers have the knowledge and confidence to choose the most appropriate way to pay. The Council should, in supporting innovation in payments, also consider how to inform and educate consumers about payment options and their suitability for different kinds of transactions, as well as supporting consumers in keeping track of outgoings and keeping payments secure.

6. Financial Education: Questions 35-36

The consultation paper

The consultation paper notes that the three user forums have emphasised the role of education in payment services. Particular areas included helping allay fears of ID theft when sharing account details for electronic payments, helping to increase the use of electronic payments, and raising SME awareness of the advantages of electronic payments. The consultation asks what role the Council can play in educating consumers about the choice of methods available to them and what aspects of payments need to be the focus of consumer education.

The Government's response

The Government set out its long-term approach for financial capability¹ in January 2007; this will be followed by an action plan in spring 2008. In terms of education about payment services, the Government sees capable consumers as those able to: weigh up the options and decide on the most appropriate payment methods for them in different circumstances; use payments systems confidently; and understand how to keep track of payments. The Government would strongly support measures led by the Payments Council to educate consumers about the choice of payment methods available to them and would welcome further dialogue with the Council to ensure that this complements other consumer education initiatives and works towards financial capability goals. In summer 2007 the Government announced a boost for financial education in schools, with a more secure place for financial capability in the curriculum and a £11.5m package of support.

The Government launched, alongside *Financial Capability: the Government's long-term approach*² in January 2007, an independent feasibility study into a national approach to generic financial advice, led by Otto Thoresen of AEGON UK. Generic financial advice (GFA) can be described as information and guidance (as opposed to regulated advice) available to consumers on their financial affairs. The Thoresen

¹ HM Treasury (January 2007): Financial Capability: the Government's long-term approach

² As above

Review set out guiding principles for a GFA service in its interim report in October 2007 and is expected to publish its final report early in 2008³.

The Government does not wish to pre-empt the final Thoresen recommendations by making commitments on what a GFA service could deliver in terms of consumer education about payments systems. A GFA service could, however, be envisaged which supported consumers in explaining payment options and the pros and cons of different ways to pay, and provided an independent, trusted source of information on, for example, fraud and ID theft risks.

7. Financial Inclusion: Questions 37-38

The consultation paper

The consultation refers to the Financial Inclusion Task Force and describes how a number of the issues it is working on are of direct relevance to the payments industry. For example, it is noted that BACS has been working with the Financial Inclusion Task Force to find ways to ensure that direct debits are seen as a suitable payment for all. The consumer user forum has stressed that the National Payments Plan should take into account the needs of disadvantaged and excluded consumers, and that innovation should not increase exclusion. Options identified for supporting the use of electronic payment methods included mobile payments for the unbanked, and wider issuance of debit cards with basic bank accounts. The consultation asks what gaps there are in current financial education initiatives in regard to payment matters and what role the Council should play in promoting financial inclusion.

The Government's response

As announced in the Government's action plan for financial inclusion in 2008-11⁴, published in December 2007, the Government will work with the Financial Inclusion Taskforce and the Payments Council to ensure that financial inclusion issues are appropriately reflected in the National Payments Plan.

8. Payment System Integrity and Contingency: Question 39

The consultation paper

The consultation paper considers the issue of payment system integrity and the need for systems to operate correctly and reliably. Issues that cross payment system schemes and have the potential to impact integrity are of importance to the Council. It is noted that the Bank of England believe the Plan should address cross system integrity, including for contingency arrangements in the case of serious disruption or failure of the payment system.

The Government Response

The Government is concerned with ensuring consumer confidence and financial stability, and therefore, agrees with the Bank of England that it is important to

³ Thoresen Review of Generic Financial Advice (October 2007): Interim Report

⁴ Financial inclusion: an action plan for 2008-11 (December 2007), HM Treasury

ensure that contingency arrangements are in place in case of serious disruption or failure of a payment system.

9. Fraud and security: Questions 40-46

The consultation paper

The consultation paper notes that the industry is engaged in an extensive programme of activity to tackle fraud and enhance security. Specific issues identified by the user forums included:

- designing security into new payment systems, with fraud and security considered from the design phase, since this is easier than retro-fitting prevention measures later;
- lobbying the Government to do more to combat payment fraud, with a SME forum comment that the cost of security measures falls disproportionately on SMEs, reducing their ability to do business, e.g. over the internet;
- a possible review of the role of biometrics and other emerging technologies;
- an effective information campaign;
- benchmarking UK system security and processes against global standards and sharing best practice;
- wider sharing of data on fraud, with greater cooperation between financial institutions and government agencies.

Questions posed include the two issues referring to the role of Government in combating fraud and in data sharing.

The Government's response

The Payments Council is right to flag the opportunities for fraud created by changes to payment systems. The Government supports an approach which incorporates the design of security into payment systems at an early stage. The Government's financial crime strategy, '*The Financial Challenge to Crime and Terrorism*⁵ sets out the Government's high-level commitment to working in partnership with the private sector to improve the effectiveness of action against financial crime and limit the burden on citizens and businesses created by measures required to protect their security.

Changes in payment systems potentially create new opportunities for all forms of criminal abuse of the financial system - including money-laundering and terrorist financing as well as payment fraud. The Council should consider these threats, in addition to payment fraud, as part of their work to enhance security. In addition, the Payments Council might also consider where fraud losses should fall. The Government disputes the suggestion made in some user forums that it is not doing enough to combat payment fraud. All organisations are responsible for ensuring that their own systems are not vulnerable to fraud. The Government is supporting these efforts, including by encouraging closer cooperation between the industry and law enforcement through implementation of the recommendations of the fraud review.

⁵ Financial Challenge to Crime and Terrorism, HM Treasury, Home Office, FCO, SOCA (February 2007)

The Government would welcome a role for the National Payments Plan in ensuring that our work on fraud prevention is well-coordinated and shared equitably.

The Government recognises that public bodies; the criminal justice system, business and the public each have a role to play in rooting out fraud - and a stake in each others' success. Following a major government review of fraud policy, the Comprehensive Spending Review announced major new investment to develop a National Strategic Fraud Authority, which has a mission to deliver a coordinated national programme that attacks fraud through the entire pipeline of deterrence, prevention, detection, investigation, sanction and redress to victims.

The NSFA will have a key role in ensuring that:

- knowledge of fraud is built systematically to drive national improvement in tackling it;
- activity across the system is properly coordinated for maximum impact;
- law makers and law enforcers work together to radically change the balance of risk and reward against the fraudster;
- the system earns public confidence by delivering justice and redress for victims.

The NSFA programme includes the creation of a National Fraud Reporting Centre, expected to go live in 2009. Staffed by counter-fraud experts, the reporting Centre will radically streamline the way that the public and businesses report fraud to the police and will equip Law Enforcement agencies with a powerful intelligence tool to help hold the perpetrators to account. It will also help form the basis of better prevention advice and alerts to fraud threats for business and the public.

Like the complementary Money Laundering and Terrorist Finance strategy, launched in February, the national Fraud Strategy will rely on the closest possible collaboration with industry. The Government looks forward to working closely with the payments industry to help make the UK the world's hardest target for fraudsters.