

Second annual progress report of the Payment Systems Task Force

May 2006

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FOREWORD

By Jonathan May, Task Force Chairman

This is the second progress report of the Payment Systems Task Force, set up following the Chancellor's pre-Budget report of November 2003. The Task Force is chaired by the OFT, and brings together banking industry, retail, consumer and business representatives. The Bank of England and the Treasury act as observers.

The Task Force was set up to consider the issues identified in the Cruickshank report of 2000 and to try to secure agreement to putting in place the conditions necessary for an innovative, user-facing industry. As a result of the extensive research and consultation undertaken by the Task Force and its Working Groups, the arrangements stemming from this process will be sustainable in terms of both the products and processes and in new governance provisions put in place.

The first of the two big stories for the Task Force in its second year has been the successful conclusion of the discussions on implementing the new scheme for faster payments for internet and electronic banking, and the improved service for standing orders. As I said when announcing agreement on the new scheme, this is good news for personal and business customers, and it proves that the Task Force approach can work effectively.

The second area is still being discussed. As a result of the publication of the BACS Access and Governance Working Group report in February 2006, the industry has proposed a new, high level, body with responsibility for governance across the payment systems market. If implemented, the body would also be responsible, among other things, for driving forward innovation in payment schemes. The new body would include independent directors from outside the banking sector and would operate in a transparent manner. This proposal has the potential to short-circuit some of the work of the Task Force. However, discussions continue as at May 2006.

I said at the time of announcing the agreement on implementing faster payments that I was pleased with the way the banking industry and the other organisations on the Task Force had been able to work together to secure these changes. I am happy to reiterate that view: I continue to be impressed with the way all the organisations involved have worked together. I thank them for the commitment they have all made in terms of their input and their determination to achieve the results we are able to report here.

Jonathan May

Chairman, Payment Systems Task Force

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1 EXECUTIVE SUMMARY

- 1.1 This progress report covers the second year of the operations of the Payment Systems Task Force, the year to April 2006. In the course of the year, agreement has been reached on implementing faster clearing of electronic payments. The Task Force has published two Working Group reports (BACS Access and Governance and LINK Access and Governance), and set up a new Working Group to look at Cheques. Significant progress has been made on a potential new 'Governance model' covering payment systems.

BACS Payment Schemes Limited Innovation Working Group: update on progress

- 1.2 The Task Force's BACS Payment Schemes Limited (BPSL) Innovation Working Group report led to an agreement by the banking industry to introduce faster payments for internet and telephone banking, as well as an improved service for standing orders. The industry has agreed that this new service will be in place by the end of 2007 and has proposed that customers will be able to transfer funds in a matter of hours and, potentially, in near real time. This is a significantly better proposition than that originally requested by the Task Force (the so-called ELLE system of 'Early Late, Late Early'). Progress continues to be made on other innovations identified in the report.

BACS Access & Governance Working Group report

- 1.3 This Working Group recommended that BPSL should establish an Affiliates Interest Group so that users could raise issues directly with the BPSL Board; that a formal consultation process should be introduced for potential major changes; and that a broader, more user-based objective for BPSL should be introduced. All three recommendations have been adopted by BPSL. The publication of the BACS report was delayed by several months to ensure that the report was consistent with the ongoing work on the new 'Governance model' (see Chapter 3).

LINK Access & Governance Working Group report

1.4 The LINK Working Group recommended that:

- the LINK card scheme should report back to the Task Force on the success of the recently introduced changes to the voting arrangements following the previously agreed 12 months' review of these arrangements
- the LINK card scheme should reinforce its existing objectives to promote innovation, efficiency and the interests of consumers, responding to user and market needs in an efficient and cost-effective manner. The card scheme has now reviewed and updated the scheme objectives, taking into account the views of the Task Force, and
- members of the LINK card scheme and Post Office Ltd should continue negotiations to establish, within a reasonable timeframe, whether a commercial arrangement could be found that was acceptable to all parties that would allow free cash withdrawals at Post Office counters for all consumers holding a current account with a major financial institution. Negotiations continue. Agreement was not reached by the Working Group on whether current arrangements to access the LINK card scheme were sufficiently wide.

1.5 The Working Group welcomed the LINK card scheme's agreement to create a Standing Committee on Consumer Issues to represent the interests of consumers, which has now been put together by LINK. The Working Group also welcomed the LINK card scheme's commitment to continue regular consultation with consumer bodies.

1.6 The Working Group recommended that the LINK company should open up ownership to bodies that were not currently owners (that is, that ownership should not be limited to banks and building societies); introduce independent directors to its Board; and make the new Board

structure more efficient and streamlined. The LINK company is currently reviewing and, where necessary, working to reform its governance arrangements in line with the recommendations in this report. Work is already under way to increase the degree of separation between the LINK card scheme and LINK company, as recommended by the Working Group, including introducing a Service Level Agreement between the two, and separating the reporting lines of the scheme executive.

Cheques Working Group: progress report

- 1.7 The Cheques Working Group will report in the summer of this year on what improvements, if any, may be needed to the current cheque and credit clearing systems in order to provide greater efficiency and user benefits. This may include changes to the clearing cycle, the customer proposition (regarding value, withdrawal or fate), or other aspects of cheque and credit processing.

The 'Governance model'

- 1.8 APACS (the UK trade association for payments and for those institutions that deliver payment services to customers) has proposed to the Task Force that a new high-level, strategic body with responsibility across the payment systems market be created (the 'Governance model'). This body would include independent directors from outside the banking sector and would have responsibility for driving forward innovation in payment schemes, for taking a strategic view on the future direction of payments and for maintaining the integrity of payment schemes as a whole. The affairs of the Governance model would be conducted in a wholly transparent manner, including public consultation, the production of published cost benefit analyses on proposals for innovation, and published Board minutes.
- 1.9 Both the Task Force and the OFT Board are considering this proposal, and progress will be monitored as it evolves over the second half of the year. If the OFT Board is convinced that the proposal could potentially resolve outstanding governance issues, without itself creating further

competition or innovation issues, the OFT Chairman may write to the Chancellor of the Exchequer setting out the Board's views and recommendations for further action.

2 INTRODUCTION

2.1 The Task Force, which first met in April 2004, was established to take forward concerns about payment systems raised in the March 2000 report by Don Cruickshank to the Chancellor of the Exchequer (the Cruickshank report) and in the OFT's report of 2003, *UK payment systems* (OFT658). These concerns included the governance, access, wholesale pricing, innovation and price transparency of payment systems. The Task Force brings together payment systems industry, retail, consumer and business representatives and is chaired by the Office of Fair Trading. More detail about the background and approach of the Task Force can be found in the first annual progress report.¹ A full list of Task Force member organisations is at Annexe A, and the Task Force's Terms of Reference are at Annexe B.

Developments in the last 12 months

2.2 Since the publication of the first annual progress report, there has been a shift in the emphasis of the work of the Task Force. The Task Force originally planned to examine the access and governance arrangements of the individual payment schemes, and recommend changes where necessary. The Task Force has already completed this process with both the BACS and LINK schemes, both of which are reported here. Following an initiative led by the payment systems industry, the Task Force is now examining potential changes which could bring the governance of payment schemes under one body. This could remove the need for the Task Force to look at individual payment schemes. The Governance model is discussed at Chapter 3. The changes recommended to both BACS and LINK will be implemented as planned.

¹ *First annual progress report of the Payment Systems Task Force* (OFT789a), available at www.of.gov.uk/NR/rdonlyres/B5CF9020-4F89-49A6-A1C8-580A2BD8A878/0/oft789a.pdf

- 2.3 As a result of this proposal, the Cheques Working Group, designed to look at innovation and access and governance issues, has concentrated on innovation to the system, rather than its governance. As the CHAPS scheme will fall within the Governance model, the proposed CHAPS Working Group has been suspended until at least such time as the future of the Governance model is known. The new timeline, which reflects the possible changes which would result from the Governance model, is at Annexe D. Depending on whether the Governance model is implemented, this timeline may be significantly altered further.

Results of the Task Force

- 2.4 The Task Force, although only halfway through its four year remit, has already scored some major successes, which are explained in more detail in Chapter 9. The Government remains committed to introducing legislation to regulate the payments industry if the Task Force approach fails to bring significant improvements. However, the achievements of the Task Force to date have been welcomed by the Government.

3 THE GOVERNANCE MODEL

Background

- 3.1 One of the concerns highlighted in the Cruickshank review of payment systems was that of governance. Recognising the importance of this issue, the Task Force set up Working Groups to consider the governance arrangements of payment schemes. The reports produced by the BPSL Access and Governance Working Group and the LINK Access and Governance Working Group have further highlighted the significance of these issues in the overall work of the Task Force.
- 3.2 APACS concluded that there would be merit in looking at access and governance arrangements across all payment schemes, rather than on a scheme-by-scheme basis. An outline proposal to reform the governance structure across all payment schemes has therefore been put to the Task Force.
- 3.3 The proposal is that a new high-level, strategic body should be created. This body, the Governance model, would include independent directors from outside the banking sector and would have responsibility for driving forward innovation in payment systems, for taking a strategic view on the future direction of payments and for maintaining the integrity of payment systems as a whole. The affairs of the body would be conducted in a wholly transparent manner, including public consultation, the production of published cost benefit analyses on proposals for innovation and published Board minutes.
- 3.4 The industry has put forward these ideas in the belief that they offer a long-term, stable framework for the future development of the sector, in a manner compatible with expected levels of accountability and transparency. It has also suggested that the work of the Task Force could be truncated if the new body were set up.

Progress to date

- 3.5 The banking industry presented the Governance model proposal to the Task Force at the 2 March 2006 meeting. Members of the Task Force agreed that the work was worth pursuing further. Progress on the industry's work into the Governance model will be monitored by the OFT and other bodies as it progresses over the second half of this year.
- 3.6 The latest version of the model was also presented to the OFT Board meeting of 6 April 2006.

Next steps

- 3.7 Following the OFT Board meeting, the industry has agreed to carry out further work on the proposal, including resolving remaining legal issues. A further report will be made to the OFT Board in the summer. If the Board is convinced that the proposal could potentially resolve outstanding governance issues, and the other concerns about payment systems raised in the Cruickshank report and in the OFT's report of 2003,² without itself creating further competition or innovation issues, the OFT Chairman may write to the Chancellor of the Exchequer setting out the Board's views and recommendations for further action.
- 3.8 The Task Force will also receive more detailed proposals for its meeting on 22 June 2006.
- 3.9 Given the potential for unnecessary work, it was decided by the Task Force to postpone the start of the CHAPS Working Group, since it would be one of the schemes directly affected by the new arrangements.

² *UK payment systems* (OFT658), available at www.of.gov.uk/NR/rdonlyres/10DB2458-FBD9-4B5C-9EE7-CEB7ACA472BB/0/oft658.pdf

4 BPSL INNOVATION WORKING GROUP: UPDATE

- 4.1 The BPSL Innovation report, published in May 2005, set out criteria based on access, coverage, payment types, revocability and capacity, against which the banking industry should consider its proposals for a faster electronic payments service. The banking industry agreed to form an Implementation Group to consider how the recommendations could best be put into practice. The Implementation Group was required to report back to the Task Force within six months of publication of the report.
- 4.2 APACS and/or BPSL were also required to report back to the Task Force within 12 months of the report on other innovations suggested by heavy users and observed in the international case studies.

Faster payments

- 4.3 On behalf of the Implementation Group, APACS presented proposals on the faster payments project, including confirming the implementation date and setting out the customer proposition to the Task Force, in December 2005. This new service will be in place by the end of 2007 and customers will be able to transfer funds in a matter of hours and, potentially, in near real time. This is a significantly better proposition than that originally put to the Task Force (the so-called ELLE system of 'Early Late, Late Early').
- 4.4 Since then, the Task Force has been kept informed of progress by APACS but is not involved in the details of its development. The contract for the building of the new system has been placed by APACS with a joint venture company whose shareholders are LINK and Voca. It appears that at least eleven banks, including all of the major high street banks, will be members of the system from its inception so the vast majority of bank customers will have access to the service. Again, there is much detailed work to be done, both on systems development and on the rules under which the new scheme will operate. The Task Force has noted the industry's positive response to the challenge set.

4.5 The faster payments service, if implemented, would allow customers to initiate payments by telephone or internet; the money would then be transferred within about two hours, 24 hours a day, seven days a week, rather than the current three working day system. Under the proposal, payment of standing orders would be processed in the course of a single day, five days per week, eliminating the float³ that currently arises on these payment instruments.

Other innovations/changes

4.6 The Working Group identified a number of other potential innovations to the BACS system. These emerged from Working Group consultation with heavy users of BACS and from the Working Group's comparison of automated payment systems in different countries. The Task Force recommended that these other innovations should be considered by APACS and BPSL, recognising that some raised industry-level issues and that others were specific to the BACS system. Both APACS and BPSL committed to reporting back to the Task Force within one year of publication of the Task Force report.

4.7 The following industry-level innovations are being considered by APACS:

- **standardisation of customer statement information** - some users commented that customers can be confused because there are differences in the way that originators' names, and other information, are presented on bank statements. They argued that there could be certain mandatory standards for information presented on bank statements

³ Float currently arises with internet, telephone banking and standing order payments where the paying customer's account is debited at day one of the process, and the receiving customer's account is credited on day three of the process. In the meantime, the paying bank will earn interest on the float generated.

- **standardisation of account numbers** - some heavy users said that eliminating non-standard account numbers might simplify their processes
- **payment message standards** - the general standards issue was raised of improving international straight-through processing, by providing common standards for ordering, invoicing, payment and reconciliation
- **seven days a week clearing for BACS payments** – some users suggested that BACS could operate at weekends and bank holidays, and
- **business customer identification numbers** - some heavy users suggested that a standard business customer identification number may make it easier for businesses to transfer accounts between banks and may overcome the resistance some customers have to sharing account details.

4.8 The remaining innovations identified in the Working Group report are BACS-specific and are being considered by BPSL:

- **automated recalls and minimum standards for re-credits** - some heavy users indicated that they would welcome greater clarity and standardisation of these processes
- **account validity checking** - a number of separate issues were raised by heavy users. While BACSTEL-IP software provided modulus checking, some wished for greater front-end validation of the account details
- **verification of funds** - for some payments (mainly direct debits, but some users suggested it could apply also to direct credits), some heavy users commented that they would like to know that there were sufficient funds in the account at the time the payment was initiated, or have a guarantee of funds

- **one-off direct debits** - for many users, BACS was the most efficient form of receiving payments. As such, initiating a one off direct debit could be more cost effective for them than accepting payment via other methods
- **length of time required for direct debit notification** - once a direct debit was set up, a customer must be notified of the amount that they would be debited at least ten working days in advance of debiting. Although this notification period could be reduced with the consent of the sponsoring bank and the payer, some heavy users felt that the ability to reduce the notification period was not made sufficiently clear to them
- **mandatory completion of reference fields** - it was proposed that this might help with the reconciliation of payments received
- **remittance information accompanying payments** - sending remittance information with the payment might aid reconciliation by the beneficiary, and
- **international payments via BACS** - some users argued that allowing international payments to be initiated in BACS submissions would ease their processes.

4.9 In their evaluations of the innovations APACS and BPSL have adopted the following approach:

- a review of previous work and analysis, if any, on the topic
- consideration of the pros and cons of the innovation from the perspective of end users and banks
- if appropriate, consultation with end users via the BPSL Affiliates Interest Group to provide comment and input to the evaluation

- if appropriate, consideration of the costs and benefits of the innovation on the basis of the information collected, and
- drawing conclusions regarding whether further work on the innovation was merited and, if so, the recommended way forward.

4.10 The evaluations are now nearing completion, and reports and recommendations will be delivered by APACS and BPSL to the Task Force by the end of May 2006 for consideration at its meeting on 22 June 2006.

5 BACS ACCESS & GOVERNANCE WORKING GROUP REPORT

- 5.1 The report of the BACS Access and Governance Working Group, the second Working Group to be set up by the Task Force, was published in March 2006.
- 5.2 The Working Group was set up to look at issues of access and governance raised by the Cruickshank and OFT reports about restrictions on access to the BACS scheme, and the governance of the body responsible for the scheme, BACS Payment Schemes Limited (BPSL). The Working Group was required to report on the issues and options available, with recommendations to remedy any perceived detriments.
- 5.3 The key issues were perceived to be:
- that only major banks and building societies had direct membership of BACS
 - while governance changes already made to APACS and BACS were a step in the right direction, they may not have gone far enough
 - that common ownership of payment scheme and infrastructure negated possible benefits of a split
 - that mutual governance might provide important safeguards, but might also create a strong disincentive for competition, and
 - that innovation was still 'at the pace of the slowest'.
- 5.4 The Working Group's first task was to assess whether there were, in fact, any problems with the existing access and governance arrangements, and, if so, whether changes were necessary or desirable. Where there appeared to be no cause for concern, the Working Group suggested that no action need be taken.

Research carried out

5.5 Reference sources included:

- existing research into governance models
- the views on possible extensions to membership of, and access to, the BACS schemes of:
 - heavy users of the system (such as large corporates and Government departments who make or receive large volumes of payments)
 - banks not currently members of BACS, and
- the access and governance arrangements of:
 - particular payment schemes in Canada and Australia
 - the LINK ATM network in the United Kingdom, and
 - Euroclear, a clearance and settlement system for internationally traded securities.

Key recommended changes

5.6 The Task Force made three key recommendations for immediate change and identified a number of other areas where further work may be required.

Affiliates Interest Group

5.7 BACS users had expressed a desire for more active influence in BPSL. To address this and other user representation and transparency issues, BPSL recently established an 'Affiliates Interest Group' (AIG)⁴ which:

- any BACS user or other interested party can join
- acts as a two-way forum for BPSL and Affiliates to brief each other on current and forthcoming issues and to raise issues of interest or concern
- ensures that Affiliates are able to raise issues with the BPSL Board, and
- provides that the Chair of the AIG (elected from and by the Affiliates) is invited to attend appropriate meetings or parts of meetings of the Direct Debit and Direct Credit Steering Groups.

Consultation process

5.8 During the course of the work of the Working Group, a forum for 'heavy users' of the BACS system was established. While that forum was an effective source of views, it was essential that the views of the heavy users should not totally outweigh the views of other users of BACS, such as businesses that input lower volumes (typically small and medium-sized enterprises - SMEs), agency banks (who gain access to the system through a contractual arrangement with a member bank) and consumers.

⁴ See www.bacs.co.uk/bpsl/corporate/affiliates

5.9 While the AIG will, of itself, ensure wider consultation, the other non-'heavy users' are unlikely to have the resources to be able to contribute fully to all AIG discussions. The Task Force recommended that a consultation process should be developed, targeted to ensure that the views of these other sectors were taken into account in the decision-making process and to allow interested parties time to consider, and comment on, proposals made, or to be discussed, by members of the AIG and BPSL.

BPSL's objectives

5.10 BPSL is a membership body whose responsibility is to own, develop and enhance the integrity of automated payment and payment-related services. In the light of the issues set out above and taking account of comparisons with overseas schemes, the Task Force considered that a broader objective for BPSL,

'to promote efficiency and innovation in payments, responding to user and market needs in an efficient and cost-effective manner',

was desirable. The Task Force recommended that this objective should be implemented as soon as possible.

Other issues

5.11 The Working Group also looked at:

- the corporate governance of BPSL (whether, for example, the appointment of independent directors to the BPSL Board should be considered), and
- whether non-financial institutions and Government departments should be able to become members (currently there appears to be little enthusiasm for this, but that may change over time).

Next steps

- 5.12 The Task Force concluded that BPSL should report to the Task Force on progress against the three recommendations, and any developments that may have taken place on the other issues identified above, no later than twelve months from the date of publication of this report by the Task Force. The report by BPSL will include the views of the Affiliates and the wider consultees.

6 LINK ACCESS & GOVERNANCE WORKING GROUP REPORT

- 6.1 The LINK Access and Governance Working Group, which was set up to examine and, if necessary, to take forward work on various access and governance issues related to LINK, was published in April 2006.
- 6.2 The Working Group was set up to look at the ability of companies to access the LINK card scheme, the governance arrangements of LINK, the potential impact of increasing the separation between the LINK card scheme and the supporting infrastructure, and the representation of users (including consumers).
- 6.3 LINK has two constituent parts: the LINK card scheme and the processing company. The LINK card scheme, which currently has 49 members, determines the interchange fees and the Operating Rules and procedures. Its governing body, on which each Member of the LINK card scheme is represented, is the Network Members Council (NMC). The processing company, LINK Interchange Network Limited, (the LINK company) is owned by 22 of the United Kingdom's largest banks and building societies, each of which nominates a non-executive director to the board of directors.

Issues

- 6.4 The key issues looked at by the Working Group with regard to the LINK card scheme were:
- whether current voting arrangements in the NMC were the fairest, most efficient and most supportive of innovation
 - whether any wider changes to the governance of the LINK card scheme would be of value
 - whether access criteria for joining the LINK card scheme were as fair and unrestrictive as possible, and

- whether the LINK card scheme took into account the views of non-member stakeholders sufficiently, or whether additional mechanisms would be of benefit.

6.5 With regard to the LINK company, the Working Group looked at the possibilities for, and benefits of:

- opening up ownership of the company to bodies that were not currently owners
- the addition of a number of independent directors to the board of the LINK company, and
- changes to the structure of the LINK company board - in particular, breaking the automatic link between ownership of shares and membership of the board.

6.6 The Working Group noted that the LINK company board had already commenced work on the detail of governance changes that might address some of these potential issues. It also looked at the relationship between the LINK card scheme and the LINK company, and the benefits and drawbacks of greater separation between them.

6.7 In looking at these issues, the Working Group considered, first, the changes recommended in the Cruickshank and OFT reports, and the changes since then. These changes included, on the LINK card scheme side:

- the changed voting arrangements for the NMC
- the formal objectives introduced for the LINK card scheme
- the existing access arrangements (which were given careful consideration in light of Post Office Ltd's application to join the LINK card scheme), and

- the existing proposals to set up a Standing Committee on Consumer Issues and the associated consultation procedures.

6.8 With regard to the LINK company, the Working Group looked at the possibilities for, and benefits that may be derived from:

- selling shares outside the present limited ownership
- the appointment to the board of independent directors, and
- changing the board structure.

Key recommended changes

The LINK card scheme

6.9 The Task Force recommended that:

- the LINK card scheme should report to the Task Force on the success of the recently introduced changes to the voting arrangements following the 12 months' review of these arrangements to which it had committed when they were agreed,
- the LINK card scheme should reinforce its existing objectives to promote innovation, efficiency and the interests of consumers, responding to user and market needs in an efficient and cost-effective manner, and
- members of the LINK card scheme and Post Office Ltd should continue negotiations to establish, within a reasonable timeframe, whether a commercial arrangement could be found that was acceptable to all parties that would allow free cash withdrawals at Post Office counters for all consumers holding a current account with a major financial institution. Agreement was not reached by the Working Group on whether current arrangements to access the LINK card scheme were sufficiently wide.

6.10 The Working Group welcomed the LINK card scheme's agreement to create a Standing Committee on Consumer Issues to represent the interests of consumers, and the LINK card scheme's commitment to continue regular consultation with consumer bodies.

The LINK company

6.11 The Task Force recommended that:

- ownership should be opened up to bodies that were not currently owners by implementing a mechanism that facilitated the sale of shares to such bodies from willing sellers
- a smaller, more effective, board should be introduced, which would include independent directors, and directors that had been voted on by the company's owners, and
- a number of independent directors should be introduced to the board of the LINK company (in addition to the independent Chair) to represent shareholders not present at the board.

6.12 Regarding the relationship between the LINK card scheme and the LINK company, the Task Force recommended that, subject to agreement on a robust Service Level Agreement between the company on the one hand and the scheme and its members on the other, the degree of separation between the two bodies should be increased, though falling short of a full legal split.

Next steps

6.13 Work has already started: the LINK card scheme executive and the independent chairman of the NMC have put together the Standing Committee on Consumer Issues, and the NMC has reviewed and updated the scheme objectives, taking into account the views of the Task Force.

- 6.14 Both the NMC and the Standing Committee will report to the Task Force on the effectiveness of the new governance arrangements within a year of their implementation. The effect of the more formal separation between the LINK card scheme and the LINK company will also be reviewed then.
- 6.15 Negotiations will continue between Post Office Ltd and members of the LINK card scheme in relation to a separate, voluntary scheme for Post Office Ltd. The Task Force recommended that the application by Post Office Ltd for membership of the LINK scheme should be on the agenda of the first meeting of the Standing Committee on Consumer Issues.
- 6.16 The LINK company is currently reviewing and, where necessary, working to reform its governance arrangements in line with the recommendations in this report. Work is already under way to increase the degree of separation between the LINK card scheme and LINK company, including introducing a Service Level Agreement between the two, and separating the reporting lines of the scheme executive.
- 6.17 The Task Force will be regularly updated about progress made in implementing these recommendations.

7 CHEQUES WORKING GROUP: PROGRESS REPORT

- 7.1 The Cheques Working Group was set up by the Task Force to investigate whether there was significant demand from, and benefits for, consumers and businesses in speeding up cheque clearance times. This work takes into account the costs and benefits of any changes to the system of cheque clearing and includes an examination of the costs and benefits to both consumers and businesses of using payment methods other than cheques.
- 7.2 Other important issues to be covered include customers' understanding of what 'cheque clearing' means, and the different practices of financial institutions and awareness of these practices regarding cheque clearing. The report will also look at the relative economic efficiency of paying (and receiving payment) by cheque compared to other payment methods.
- 7.3 Cheques and paper credits are cleared by the Cheque and Credit Clearing Company Limited (C&CCCL). Like BACS, C&CCCL has a two-tier membership structure whereby indirect members can access the clearing cycle via one of the 11 settlement members, of which all are banks or building societies.
- 7.4 The Cheques Working Group is utilising a number of different research methodologies, including:
- international comparisons with cheque clearing systems in other countries, including the use of image-exchange and electronification (truncation) of cheque processing
 - qualitative and quantitative market research, including focus groups and surveys into what consumers and businesses want from a cheque clearing system

- the views of heavy cheque users (both paying and receiving) through a forum for heavy users, and subsequent meetings with interested parties on an individual basis, and
- extant academic research looking at the costs and benefits of different payment methods, including cheques.

7.5 In addition to the possibilities for speeding up the cheque clearing cycle, the Working Group is researching a number of potential innovations to the cheque clearing cycle, including certainty of fate (a time beyond which money paid by cheque cannot be taken out of an account), streamlining the unpaids process (which could potentially have an impact on withdrawal times) and agreeing maximum times for clearing for value (when money starts to earn interest) and withdrawal.

7.6 The Working Group will report to the Task Force in summer 2006.

8 EUROPEAN DEVELOPMENTS

- 8.1 The Task Force decided at the meeting of December 2005 to suspend further meetings of the European Working Group. It was decided, instead, that Task Force members involved with Europe would brief the Task Force on developments and progress at each Task Force meeting. The Task Force did, however, reserve the right to convene any further meetings of the European Working Group as and when necessary.
- 8.2 There have been two key strands of development over the last 12 months:
- the New Legal Framework contained in the Payment Services Directive, and
 - the measures being taken by the European Payments Council to establish a Single Euro Payments Area (SEPA).

New Legal Framework/Payment Services Directive

- 8.3 The consultation paper, 'New Legal Framework for Payments in the Internal Market', was adopted as a formal proposal in December 2005 (known as the Payment Services Directive) by the European Commission. The New Legal Framework covers both domestic payments and cross-border payments.
- 8.4 The New Legal Framework addresses the key Cruickshank concerns of competition, transparency and efficiency regarding United Kingdom payment systems on a European level. Other issues covered in the proposal include protection of payment service users, security of payments, and legal certainty for all relevant parties in the payment process.

- 8.5 Some of the articles have a direct impact on the work of the Task Force, for both past and future work:
- Article 23 concerns access to payment systems
 - Articles 60 and 61 set out maximum clearing times for payments, and
 - Article 65 looks at availability of funds.
- 8.6 Industry and Government bodies were consulted on the New Legal Framework through various fora organised by HM Treasury, which is responsible for the United Kingdom's response on the New Legal Framework and updates Working Groups and the Task Force on progress. Once implemented, Faster Payments will be consistent with the maximum clearing times for payments contained in Articles 60 and 61.

SEPA

- 8.7 SEPA is a proposal designed to bring about the creation of a single payments services market for the whole of Europe. The aim is to enable European citizens to make and receive payments within the Euro area as securely, quickly and efficiently as payments within national borders. When implemented, it will establish agreed schemes for SEPA Direct Debits and Credit Transfers and a framework for Card Payments. The timetable is for the first SEPA-compliant payment products to be operational by January 2008, with a critical mass of transactions to have migrated to the SEPA Schemes and products by the end of 2010.
- 8.8 The European Payments Council is responsible for the project and relevant members of the Task Force have been able to contribute to the consultation process through APACS.

Next steps

- 8.9 Task Force members will continue to contribute to the consultations on SEPA and will keep the Task Force informed through updates at future Task Force meetings.

9 IMPACT AND ACHIEVEMENT OF THE TASK FORCE

9.1 The Task Force has now reached the half-way stage of its planned lifespan and has published three Working Group reports: BPSL Innovation, BACS Access & Governance, and LINK Access & Governance. These reports have recommended a number of changes that, when implemented, will significantly improve the payment systems service to consumers and businesses, especially in relation to the key area of competition. The key impacts and achievements of the Task Force and the benefits they will bring are recorded below.

Impact on competition

9.2 Competition has been strengthened through the introduction of a Service Level Agreement (SLA) between the LINK processing company and LINK scheme, which should allow for increased competitive pressures on the LINK company-scheme relationship. Access to ownership of the LINK company is also being widened, which should address the problems of mutual governance and its impact on competition and innovation. The introduction of the faster payments service will also increase choice for consumers, and hence competitive pressures, in the UK payment systems market.

Faster payments

9.3 As noted in Chapter 4 above, the payment systems industry will introduce the new faster payments scheme at the end of 2007. This will allow consumers and businesses to make electronic payments within a matter of hours rather than within three days, which is currently the case. The BACS Innovation Working Group report contained research which indicated that, under the assumptions made (and as the 'ELLE' model), the value to the UK economy (when expressed as the value that it is worth to consumers and businesses) could be in the range of £748 to £1,340 million over ten years. We would therefore expect the significantly faster form of payment to be introduced by the end of 2007 to be worth even more to the UK economy.

Improvements to the BACS system

- 9.4 The Task Force will evaluate recommendations put forward by APACS and BPSL at its meeting of 22 June 2006, on industry-level innovations and on BACS-specific innovations. These recommendations will tackle many of the areas for improvement identified by heavy users of the BACS system.

BACS Access and Governance Working Group

- 9.5 BPSL now has a greater incentive to focus on the needs of its users because the users will, for the first time, be able to raise issues of concern, or potential improvements, directly with the BPSL Board through the recently established Affiliates Interest Group. The Group is backed up by a wider consultation process, which should ensure that all stakeholders in BACS have an opportunity to give their views on significant potential changes to the system. Lastly, BPSL has now adopted an objective to,

'promote efficiency and innovation in payments, responding to user and market needs in an efficient and cost-effective manner'.

- 9.6 The Task Force believes that the combined effect of these changes, as well as the changes to the BACS system to be discussed by the Task Force in June, will have the effect of making the BACS scheme much more receptive to the needs of both consumers and business users.

LINK Access and Governance Working Group

- 9.7 The changes already made and implementation of the recommendations made by the Task Force will reinforce the LINK card scheme's mechanisms for listening to and addressing the needs of consumers. The Task Force has welcomed LINK's plans for a Standing Committee on Consumer Issues, especially as it is allied with stronger consumer facing objectives.

- 9.8 The more formal relationship between the LINK card scheme and the LINK company, through a Service Level Agreement, will also give the LINK company a further incentive to provide an efficient and effective service.

Conclusion

- 9.9 The Task Force has led to significant improvements to the way that consumers and businesses make electronic payments. From having retail payments that take longer to clear than almost any other member of the G10, the United Kingdom will, from the end of 2007, have a service to rival the best in the world. Just as importantly, the changes made to the access and governance arrangements of both LINK and BACS mean that new products and efficiencies demanded by consumers and other interested parties will be considered and potentially introduced much faster than at present.

10 NEXT STEPS

- 10.1 Given the potential impact that some of the developments outlined in this report (particularly, if implemented, in relation to the Governance model) will have on the work of the Task Force, there has necessarily been substantial revisions to the original timetable of the Task Force. The CHAPS Access and Governance Working Group has been suspended (for the time being, at least). The timeline attached at Annexe D may require further substantial revision in the event that the Governance model is approved by the Task Force, by the OFT Board and then by Treasury Ministers.
- 10.2 The Task Force continues to monitor implementation of the new faster payments service. It also receives regular updates on the implementation of changes to the BACS system discussed in Chapter 4.
- 10.3 The Task Force will publish the Cheques Working Group report in summer 2006. The report will include recommendations for implementation. The Task Force will then monitor implementation and will report on it through its annual progress reports.
- 10.4 The Task Force looks forward to receiving a report from LINK's NMC and Standing Committee on the effectiveness of the new governance arrangements within a year of implementation. On the basis of those reports, the Task Force will decide whether to re-open the examination of the arrangements. The Task Force will also receive regular updates on the progress of the LINK Company's governance changes, and on the issue of universal access to cash from Post Office Ltd counters.
- 10.5 The Task Force will evaluate recommendations put forward by APACS and BPSL at its meeting on 22 June 2006, on industry-level innovations and on BACS-specific innovations. The Task Force will comment on the suitability of these recommendations and, if appropriate, will monitor their implementation.

ANNEXES

A MEMBERSHIP AND MAKEUP OF THE TASK FORCE

A.1 Office of Fair Trading (Chair)

Association of Payment Clearing Services

BACS Payment Schemes Limited

British Bankers' Association

British Chambers of Commerce

British Retail Consortium

Building Societies Association

Chaps Clearing Company Limited

Cheque and Credit Clearing Company Limited

Electronic Money Association

Federation of Small Businesses

LINK

MasterCard

National Consumer Council

S2Cards

Visa

Which? (formerly Consumers' Association)

Bank of England (sitting as observers)

HM Treasury (sitting as observers)

B TASK FORCE TERMS OF REFERENCE

- B.1 Establish and support the work of a representative committee (to be known as the Payment Systems Task Force) bringing together industry, retail, consumer, governmental and other relevant bodies with an interest in payment system issues. The Task Force will be chaired by the OFT.
- B.2 The Task Force to identify, consider and seek to resolve any competition, efficiency and incentive issues relating to payment systems, with particular, but not exclusive, emphasis on the network effects of the existing payment mechanisms. Generic subjects for discussion include issues of access, cooperation, innovation, governance, pricing and transparency but this is not an exhaustive list. Where appropriate, consumer facing issues deriving from, or associated with, features of payment systems will also be considered. The Task Force will take account of reports on payment systems, including the Cruickshank and OFT reports but will also be driven by ongoing research work (to be undertaken by the OFT with the assistance of Task Force members) consultation and market developments.
- B.3 A consensus of opinion will not necessarily be reached by the Task Force on all/any issues. Task Force participants shall have the right to request that a diverging view be noted in any meeting minutes and expressed in any annual report published by the Task Force such that the spectrum of opinions is reflected. Task Force participants shall only be named in any minutes/report with the permission of the participant.
- B.4 The Task Force will operate, at least initially, for a four year period at which time the Government will assess whether further action in this sector, including legislation, is required. The Task Force will meet on a regular basis and not less than four times a year.
- B.5 Where concerns are identified, the Task Force may establish and direct working groups to undertake detailed work on these, reporting back to the Task Force. Where such concerns are validated, the Task Force will

seek to resolve these on a negotiated and voluntary basis with the industry and other interested parties.

- B.6 To report, on an annual basis, the work programme, findings, proposals and achievements of the Task Force.
- B.7 The work of the Task Force will not affect or impede existing or future enforcement activity undertaken by the OFT's enforcement divisions in this sector.

C CHEQUES WORKING GROUP MEMBERSHIP

C.1 Office of Fair Trading (Chair)

Alliance and Leicester

Association of Payment Clearing Services

Barclays Bank

British Bankers' Association

British Chambers of Commerce

British Retail Consortium

Building Societies Association

Cheque and Credit Clearing Company Limited

Federation of Small Businesses

HBOS Plc

HMRC

HSBC

Lloyds TSB

MasterCard

National Consumer Council

Nationwide Building Society

Northern Ireland Bankers' Association

The Forum of Private Business

The Royal Bank of Scotland Group

Visa

Which? (formerly Consumers' Association)

Bank of England (sitting as observers)

HM Treasury (sitting as observers)

D PAYMENT SYSTEMS TASK FORCE TIMELINE

The timeline has been amended to incorporate changes resulting from discussion of the 'Governance model'. This may result in further changes.

