

## Chapter 3 Payment Methods

### 3.1 Introduction

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Payment methods refer to the mechanisms, procedures and organisations that are used to enable parties to discharge their payment obligations. They sit at the heart of the economy, allowing money to continually flow between individuals and businesses. Payment methods enable individuals to, among other things, withdraw money from a cash machine, pay a deposit on a house, pay a mobile phone bill by direct debit, write a cheque to a charity, receive a monthly salary directly into a personal account, and send money using a mobile banking app. In 2019, these payment systems were used to process 40 billion transactions worth over £92 trillion.<sup>1</sup> From 1 April 2015, retail payment systems<sup>2</sup> became subject to regulatory oversight by the new Payment Systems Regulator (PSR), a subsidiary of the Financial Conduct Authority, created by the Financial Services (Banking Reform) Act 2013.

### 3.2 Cheques

#### 3.2.1 Introduction

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##### DELETE Box 3.1

The past three decades have seen a clear downward trend in the use of cheques as a payment method by both business and consumers.<sup>3</sup> In 2020 a total of 195 million cheques, worth £257 billion were used to make payments, compared to 1.2 billion in 2009.<sup>4</sup>

**DELETE:** Box 3.1 offers some key statistics on the use of cheques in 2017.

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<sup>1</sup> UK Finance, *UK Payments Markets Summary 2020* (2020) available at <https://www.ukfinance.org.uk/system/files/UK-Payment-Markets-Report-2020-SUMMARY.pdf>

<sup>2</sup> Payment systems include, Payment Systems Operators, Interbank payment systems (including Bacs and CHAPS) and Card payment systems (including MasterCard and Visa). See PSR Policy Statement 'A new regulatory framework for payment systems in the UK' PSR PS15/1 available at <https://www.psr.org.uk/media/nbsheygt/psr-publications-consultations-psr-ps-15-1.pdf>

<sup>3</sup> In fact, in 2009 the (then) Payments Council voted in favour of abolishing the use of cheques as a means of payment and set a target date of 31<sup>st</sup> October 2018 to close the central cheque clearing system. However, in July 2011, following lobbying from the charity sector and criticism from the Treasury Committee, the Payments Council took a U-turn, announcing that cheques will continue for as long as customers need them. The previous 2018 closure deadline was cancelled. See The Treasury Committee, *The Future of Cheques* (18 July 2011) at <https://publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1147/114702.htm>

<sup>4</sup> Pay.uk *Annual Summary of Payment Statistics* (2020): <https://www.wearepay.uk/wp-content/uploads/Annual-Summary-of-Payment-Statistics-2020.pdf>

### 3.2.3 Clearing

#### 3.2.3.1 The clearing process

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##### NEW TITLE 3.2.3.1 The previous paper-based clearing process

The process through which a cheque moves from the bank at which it is deposited (the collecting bank), to the bank at which it is drawn (the paying bank), and the movement of money in the opposite direction, is known as clearing. Until cheque imaging was introduced in late 2017, discussed below, cheques, as paper items, were physically transferred between banks, meaning that the cheque clearing process was non-instantaneous and took several days. The paper-based cheque clearing process was managed by the Cheque and Credit Clearing Company, a non-profit making industry body funded by its members. The process involved the physical exchange of items and the settlement of payments, as outlined in Box 3.2.

In November 2007, an industry-wide agreement, known as 2-4-6 (for current accounts) and 2-6-6 (for savings accounts), was introduced to set the maximum timescales for the clearing of customer's cheques.<sup>5</sup> Pursuant to the 2-4-6 commitments, customers would start earning interest on money paid into their account no later than two working days after presenting a cheque for payment. After four working days the money was made available for withdrawal, and by the end of six working days the customer was reassured that the cheque would not be dishonoured. The 2-6-6 commitments were broadly similar, except banks only committed to allowing customers to withdraw funds from the account from the sixth working day following the cheque being presented.

These industry-wide timescales provided a common set of expectations regarding the timeliness of the clearing process and they provided customers with the assurance that by the end of the sixth working day following presentation of the cheque the funds were theirs and they were protected from loss even if the cheque subsequently bounces. These were maximum timescales and in practice, banks could and often did compete by offering to accrue interest or allow funds to be drawn earlier than the two, four or six working days.

#### 3.2.3.2 Cheque imaging

In recognition of the need to improve the speed and efficiency of the cheque clearing process, in 2013, the Cheque & Credit Clearing Company began extensive research to find a method of clearing cheques that utilised modern technology. This research culminated in the introduction of an image-based method of clearing cheques which was launched on 30 October 2017 on a phased-out basis.<sup>6</sup> The new Image Clearing System (ICS) was fully rolled out by September 2019 meaning that the previous paper-based system is now obsolete. Now, the images of cheques are exchanged between banks, rather than having to physically transfer the paper-based cheque. Cheques are still written out by the drawer as before, but when they are presented by the holder to the collecting bank, the collecting bank will create an image of the cheque and transfer it electronically to the paying bank.

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<sup>5</sup> For a useful video which explains this process, see <https://www.chequeandcredit.co.uk/information-hub/history-cheque/original-2-4-6-video>

<sup>6</sup> This new system is given a statutory footing by Part 1, s13 Small Business, Enterprise and Employment Act 2015, which adds a new Part 4A into the Bills of Exchange Act 1882, eliminating the need for cheques to be physically transported and allowing for the presentment of instruments by electronic means.

Interestingly, customers now have new ways of presenting a cheque for payment. If the collecting bank offers this service, personal or small business customers can image cheques they receive themselves using a secure imaging tool accessed via a mobile banking app and then upload the images for processing by the collecting bank. Businesses and charities can scan cheques to create images and then upload them for processing.

The introduction of the ICS means that cheques can be cleared much quicker than under the previous paper-based system. When a customer presents a cheque for payment, they are able to withdraw the funds by 23.59 the following working day. Again, this is a maximum timescale, so it may be the case that banks will allow customers to access their funds before this time.

The introduction of cheque imaging is a welcome and much needed change. The new system means that funds can be transferred in a more-timely manner. Importantly, customers can still present cheques in the same way as before, via a branch, by post, or at an Automated Teller Machine (ATM) but it also provides customers with new options for paying in cheques that are in line with modern technological developments.

### 3.3 Payment Cards

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Box 3.3 provides some interesting facts and figures on card usage in the UK.<sup>7</sup>

**REPLACE BOX 3.3** with:

#### <START> **Box 3.3 Plastic Cards: UK Facts and Figures**

- On June 29 1988 Barclaycard launched the first credit card in the UK
- In 2016, for the first time ever debit card payments overtook cash
- In 2019 debit cards accounted for 42% of all payments made in the UK (17 billion payments in total)
- As of 2019 68% of all adults in the UK have a credit card
- At the end of 2019 there were a total of 132 million contactless cards in circulation
- In 2019 nearly ten million people registered for mobile payments via e.g. Apple Pay, Google Pay and Samsung Pay
- Total spending on credit and debit cards reached £829 billion in 2019

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<sup>7</sup> See UK Finance, *UK Payments Markets Summary 2020* (2020) available at <https://www.ukfinance.org.uk/system/files/UK-Payment-Markets-Report-2020-SUMMARY.pdf>

One of the biggest problems posed by the use of these plastic cards is fraud, as demonstrated by the statistics in Box 3.4.<sup>8</sup>

**REPLACE Box 3.4** with:

**<Start> Box 3.4 Payment Card Fraud Statistics>**

- Fraud losses on UK issued cards totalled £620.6 million in 2019 (an 8% decrease from 2018)
- In real terms, overall card fraud losses as a proportion of the amount being spent has fallen from 8.4p per £100 spent in 2018 to 7.5p per £100 in 2019 (in 2008 it was 12.4p for every £100 spent)
- A total of £999.2 million in card fraud was stopped by banks in 2019
- Payment card fraud losses are split into five categories: remote purchases (76%), counterfeit, lost and stolen, card not received, and card ID theft

**<End>**

Further, the finance industry is tackling card fraud by investing in advanced security systems, including real time transactional analysis and behavioural biometrics on devices. Strong Customer Authentication, discussed in section 3.4.4.1, is also being rolled out, and fraud screening detection tools have been developed for retailers to use, such as 3D secure technology which protects card purchases online.<sup>9</sup>

They must also abide by the Standards of Lending Practice, which set out standards of good practice in relation to credit cards,<sup>10</sup> and the relevant aspects on the Financial Conduct Authority's *Consumer Credit Sourcebook* (CONC).<sup>11</sup>

### 3.3.4 Debit Cards

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**DELETE** final paragraph

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<sup>8</sup> See UK Finance, *Fraud- The Facts 2020. The definitive overview of payment industry fraud* (2020) At <https://www.ukfinance.org.uk/system/files/Fraud-The-Facts-2020-FINAL-ONLINE-11-June.pdf>

<sup>9</sup> Ibid.

<sup>10</sup> The standards for personal customers were revised most recently in April 2021 and are available at <https://www.lendingstandardsboard.org.uk/wp-content/uploads/2021/04/The-Standards-of-Lending-Practice-for-personal-customers-April-2021.pdf> The standards for business customers were revised most recently in August 2020 (and contain temporary provisions relating directly to Covid) and are available at [Standards-of-Lending-Practice-for-business-customers-August-2020-Covid-update.pdf](https://www.lendingstandardsboard.org.uk/wp-content/uploads/2020/08/Standards-of-Lending-Practice-for-business-customers-August-2020-Covid-update.pdf) ([lendingstandardsboard.org.uk](https://www.lendingstandardsboard.org.uk))

<sup>11</sup> At <https://www.handbook.fca.org.uk/handbook/CONC.pdf>

### **INSERT new 3.3.7 Contactless payment systems**

A recent innovation in the payment services industry is the introduction of contactless payment systems. These systems mean you can pay for something by tapping or waving a contactless device, such as a debit or credit card, smart phone or smart watch, over a reader. Contactless is designed specifically to provide a quick and convenient way to pay in any environment where the speed of the transaction is essential for the consumer. Contactless cards were first introduced in 2007 and they currently allow cardholders to pay for purchases up to the value of £45<sup>12</sup> without having to enter their PIN. Contactless cards contain an antenna, allowing the cardholder to simply touch their card against the contactless reader to allow the relevant information to be transferred securely across. At the end of 2019 there were 132 million contactless cards in circulation, with 85% of debit cards and 75% of debit cards having contactless functionality.<sup>13</sup>

As well as contactless cards, other devices such as smart phones and smart watches can be used to make a payment. For example, Apple Pay allows users to initiate a contactless payment using an iPhone or Apple Watch, where the customer's debit or credit card details are stored in its digital wallet.<sup>14</sup> Payment via these contactless devices do not have a cap on the cost of transactions like a credit or debit card has, though some retailers may choose to set a lower transaction limit.

## **3.4 Electronic transfer of funds**

### **3.4.3 Clearing giro transfers**

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The process of exchanging payment orders between participating banks is known as clearing. There are currently four main clearing methods when funds are transferred, a paper-based method and three electronic methods namely BACS, CHAPS Sterling and CHAPS Faster Payment Service. Each will be discussed in turn, followed by an analysis of the New Payments Architecture (NPA), which is set to change the future of clearing in the UK.

#### **3.4.3.2. BACS**

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BACS is by far the largest payment system in the UK in terms of volume. In 2020 there were over 6.5 billion payments effected through the BACS system with a value of over £4.8 trillion.<sup>15</sup> While this

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<sup>12</sup> In the 2021 budget, and in response to the Covid-19 pandemic which has accelerated a move away from cash, the Treasury confirmed that the contactless card payment limit would rise from £45 to £100 in 2021. See HM Treasury *Budget 2021* (March 2021) at paragraph 2.54.

<sup>13</sup> UK Finance, UK Payments Markets Summary 2020 (2020) available at <https://www.ukfinance.org.uk/system/files/UK-Payment-Markets-Report-2020-SUMMARY.pdf>

<sup>14</sup> Google Pay and Samsung Pay offer a similar service.

<sup>15</sup> Pay.uk *Annual Summary of Payment Statistics* (2020): <https://www.wearepay.uk/wp-content/uploads/Annual-Summary-of-Payment-Statistics-2020.pdf>

constitutes a 1% and 4% fall in terms of volume and value respectively from 2019, the alternative CHAPS Faster Payments system, for example, is experiencing a steep rise; in 2020 payments through this method rose 17% and 8% in volume and value respectively.<sup>16</sup>

### 3.4.3.3 CHAPS Sterling

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In 2020 44 million payments were effected through the CHAPS Sterling system with a value of over £91 trillion making it by far the largest payment method in the UK in terms of value.<sup>17</sup> Most of the value processed by CHAPS is from wholesale transactions but it is most commonly known in the UK as being the payment method for property purchases. The system is used by 34 domestic and international direct banking participants and thousands of other participants who process the payments through agency arrangements with the direct participants.

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CHAPS subjects member banks to a number of obligations which are found in the CHAPS Reference Manual, the most recent version of which was published 31 March 2021.<sup>18</sup> The Manual performs two principle functions; first, it forms a core part of the legal basis for the Bank of England's operation of the CHAPS system; and second, it aims to provide a clear and comprehensive description of the rules, requirements and key procedures relevant to the Bank of England's operation of the CHAPS system in a document that is publicly disclosed.<sup>19</sup>

### INSERT NEW SECTION 3.4.3.5 The future of interbank payments

In October 2015 the Payments Strategy Forum (the forum) was established by the Payment Systems Regulator to create a new strategy for payments in the UK. It was recognised that the current payments landscape, which consists of a variety of payment methods including real-time payments on the Faster Payments System and Direct Debits on the BACS system, was too complex, making it increasingly difficult for the industry to innovate to meet the needs of end-users. In short, it was no longer fit for purpose in the 21<sup>st</sup> century. The vision was to create a UK retail interbank payments

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<sup>16</sup> Although their respective values are much lower; in 2020 2.8 billion payments were made with a value of £2.1 trillion. Ibid.

<sup>17</sup> Pay.uk *Annual Summary of Payment Statistics (2020)*: <https://www.wearepay.uk/wp-content/uploads/Annual-Summary-of-Payment-Statistics-2020.pdf>

<sup>18</sup> At: <https://www.bankofengland.co.uk/-/media/boe/files/payments/chaps/chaps-reference-manual.pdf?la=en&hash=7E5E1353D9B19B63CA1DD936160C2F8954675932>

<sup>19</sup> Ibid, p 6.

system that would provide simpler access, ensure ongoing stability and resilience, encourage greater innovation and competition, and enhance adaptability and security.<sup>20</sup>

As such, the forum proposed solutions across four key areas, as set out in Box 3.9.

**<START> Box 3.9 Payments Strategy Forum Solutions**

- Responding to End-user Needs (EUN): Solutions to address current and future end-user needs
- Improving Trust in Payments: Solutions to engender trust in the safety and certainty of payments
- Simplifying Access to Promote Competition: Solutions to simplify access and enable participation in the market for Payment Service Providers in order to foster competition and innovation
- Building a New Architecture for Payments: Solutions to enable the development of the future payments architecture

**<End>**

The forum proposed that the New Payment Architecture (NPA) would consolidate the interbank operator governance of BACS, Cheque and Credit Clearing, and CHAPS Faster Payment Service into a single consolidated Payment Services Operator. Core principles that would underpin the NPA would include the creation of a single set of standards and rules with strong central governance, the universal adoption of an internationally recognised messaging standard, ISO20022 and a 'thin' collaborative infrastructure, which would allow multiple users of overlay infrastructure services to compete on the market simultaneously.<sup>21</sup>

In December 2017 the forum published an 'NPA Design and Transition Blueprint'<sup>22</sup> and work on realising the vision of this blueprint was passed to Pay.UK, the New Payment Services Operator, in October 2018. When implemented, the market will use a core infrastructure which utilises a common messaging standard, the existing schemes will be consolidated and new overlay services, which will be developed by the payments industry for the benefit of end users, will be available. Pay.UK has already developed two such overlay services, Confirmation of Payee, and Request to Pay.

*Confirmation of payee:*

This is a new name checking service that has already been successfully implemented by a number of UK banks, building societies and other Payment Service Providers (PSP) from 2020. Previously, when effecting a payment transfer online, a payer would give the name, sort code and account number of the recipient but it was only the account number and sort code that the bank used to route the payment. The bank did not check and confirm the name on the account the funds were being sent to.

Confirmation of Payee gives payers greater assurance that their payment is being directed to the intended recipient by allowing the payer to check that the name they give for the payee is the same

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<sup>20</sup> Payments Strategy Forum, *A Payments Strategy for the 21<sup>st</sup> Century, Putting the needs of users first* (November 2016) at p 5. Available at [https://www.psr.org.uk/media/0jmkqwwa/a-payments-strategy-for-the-21st-century-putting-the-needs-of-users-first\\_0.pdf](https://www.psr.org.uk/media/0jmkqwwa/a-payments-strategy-for-the-21st-century-putting-the-needs-of-users-first_0.pdf)

<sup>21</sup> *Ibid*, p 12.

<sup>22</sup> Discussed at: <https://www.wearepay.uk/programmes/new-payments-architecture-programme/>

name as that on the account held at the payee's PSP. This will help to avoid payments being accidentally misdirected, and it will also help prevent certain types of Authorised Push Payment (APP) fraud- where a victim is tricked into sending a payment to a fraudster (discussed in more detail in Chapter 2.4.5.1).

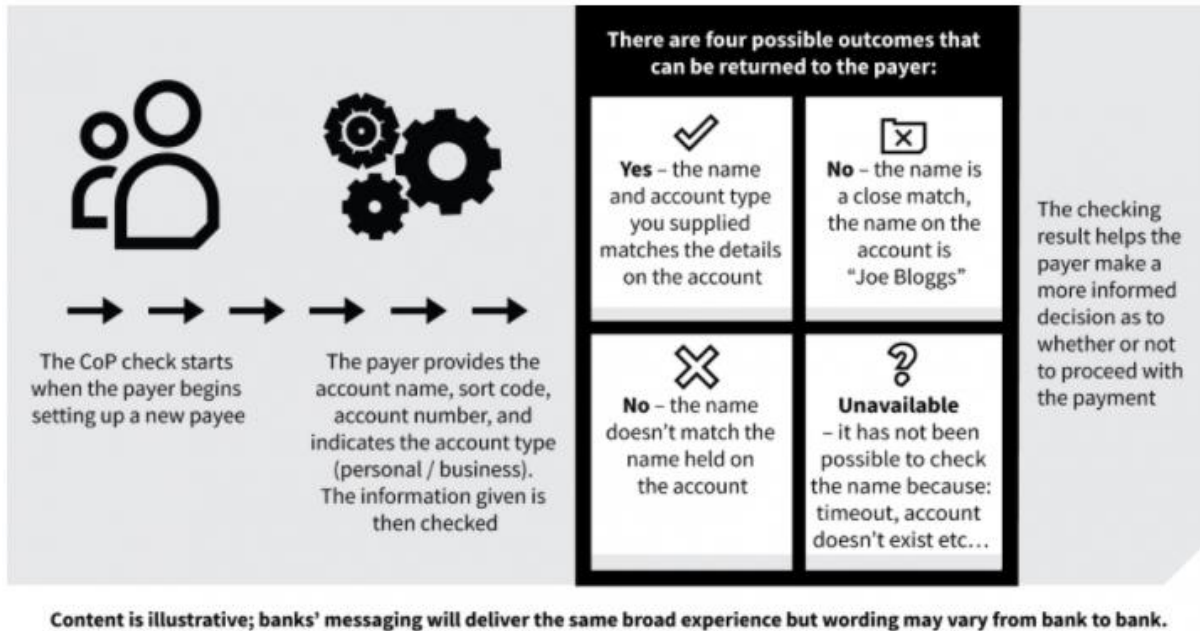


Figure 3.3 Confirmation of Payee<sup>23</sup>

### Request to Pay

Request to Pay is a new, flexible way for bills to be settled between people, organisations and businesses. As an alternative to invoices, it is a messaging service that gives billers the ability to request payment for a bill. When a customer receives a request to pay, they will have a variety of options including full payment, part payment, communication with the biller, or declining to pay. It will sit alongside other bill payment methods such as direct debits and give consumers additional flexibility and choice when it comes to managing their finances. Pay.UK estimate that it could save the UK economy £2-3 billion per year.<sup>24</sup> Customers should start to see this option in 2021.

<sup>23</sup> From Pay.UK <https://www.wearepay.uk/programmes/end-user-deliverables/confirmation-of-payee/>

<sup>24</sup> See <https://www.wearepay.uk/programmes/end-user-deliverables/request-to-pay/>



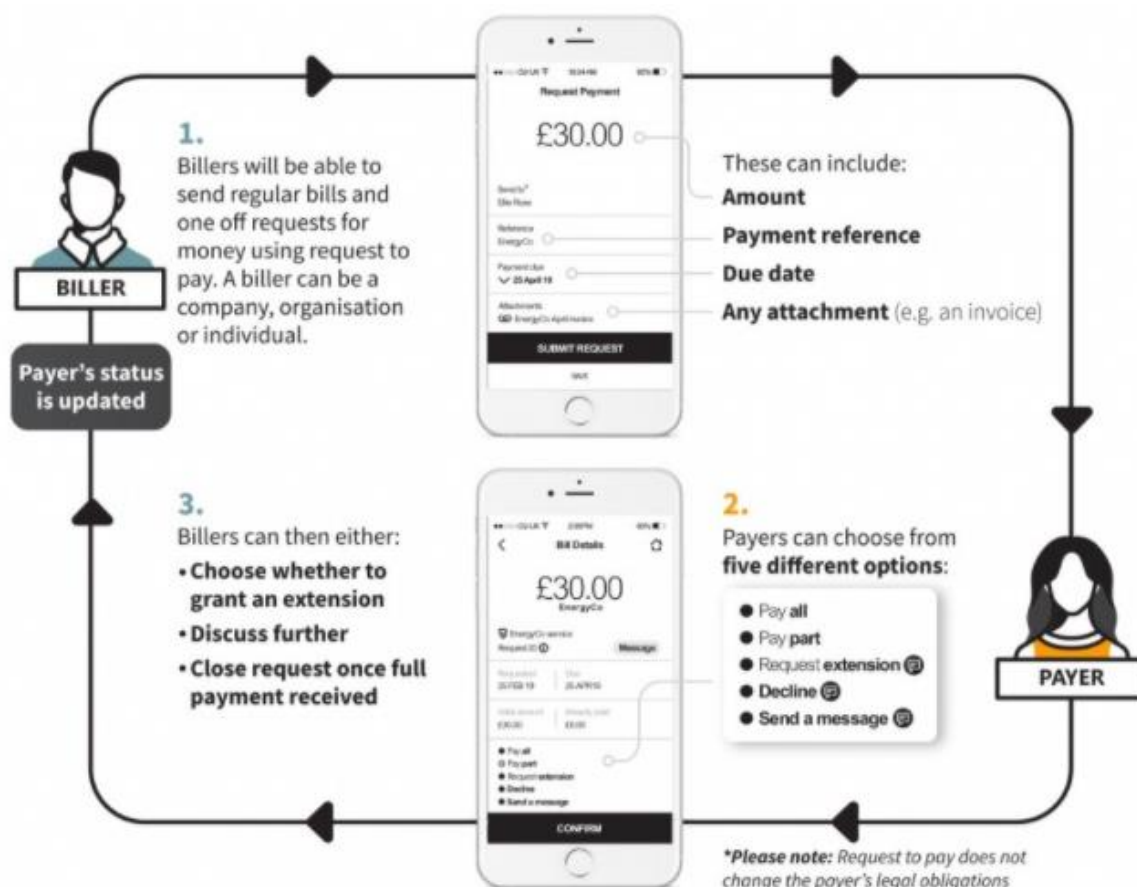


Figure 3.4 Request to Pay<sup>25</sup>

### 3.4.4 The Payment Services Regulations 2017

#### 3.4.2 The paying bank

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The RTS will be effective from September 2019, giving the payment industry 18 months to implement the measures. However, in response to concerns about industry readiness to apply SCA for card-not-present transactions for e-commerce, this deadline was extended in that context until March 2021. Given the impact of Covid-19, this date was revised again for e-commerce to 14 September 2021.<sup>26</sup>

### 3.5 Innovation in the payment services industry: open banking and third-party providers (TPPs)

#### 3.5.2 Account information service providers (AISPs)

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<sup>25</sup> <https://www.wearepay.uk/programmes/end-user-deliverables/request-to-pay/>

<sup>26</sup> <https://www.fca.org.uk/firms/strong-customer-authentication>

Established in 2010, by April 2021 more than 500,000 people have signed up to their service.<sup>27</sup>

**<START> Box 3.11 A case study: Revolut**

Revolut is a UK based Fintech that launched in July 2015. It is a digital banking alternative that describes itself as ‘truly global financial superapp’. As of April 2021, Revolut has over 15 million personal customers and 500,000 business customers.

Originally offering money transfer and exchange services, Revolut now offer a broad range of account, wealth and money transfer services to customers around who make more than 100 million transactions a month.

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<sup>27</sup> <https://www.moneydashboard.com/>