

Faster Payments Implementations in the United Kingdom and the United States

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Countless commissions have formed across the globe with the objective of planning and executing payments systems improvement. The Committee on Payment and Settlement Systems (CPSS)¹ was instrumental in framing today's payments systems issues by publishing [*Core Principles for Systemically Important Payment Systems*](#) in January 2001. This paper identified 10 issues, or core principles, that central banks and payments systems must accomplish with the purpose of embracing technology innovations for safer, faster payments systems. Central banks were deemed responsible for defining and overseeing their own payments system compliance with core principles, providing no single approach. In constructing their principles, the CPSS took into account views from the G10 as well as developing economies.

Strategies for payments improvement have advanced at varying rates. What can we learn by comparing each approach? The United States and United Kingdom are two leading financial centers with similar goals to improve payments systems. Even though the population of the United States is nearly five times the size of the United Kingdom's, the systemically important payments systems within each are similar. Since the United Kingdom has been able to implement core principles at a faster rate, it is worthwhile to examine the effects of their evolution in light of similar drivers in the United States. This background document provides an overview of each country's payments structure and approach to increasing the speed of payments (see the table). Additionally, industry stakeholders will be able to use this comparison to discuss the effects of payments systems improvements on community financial institutions.

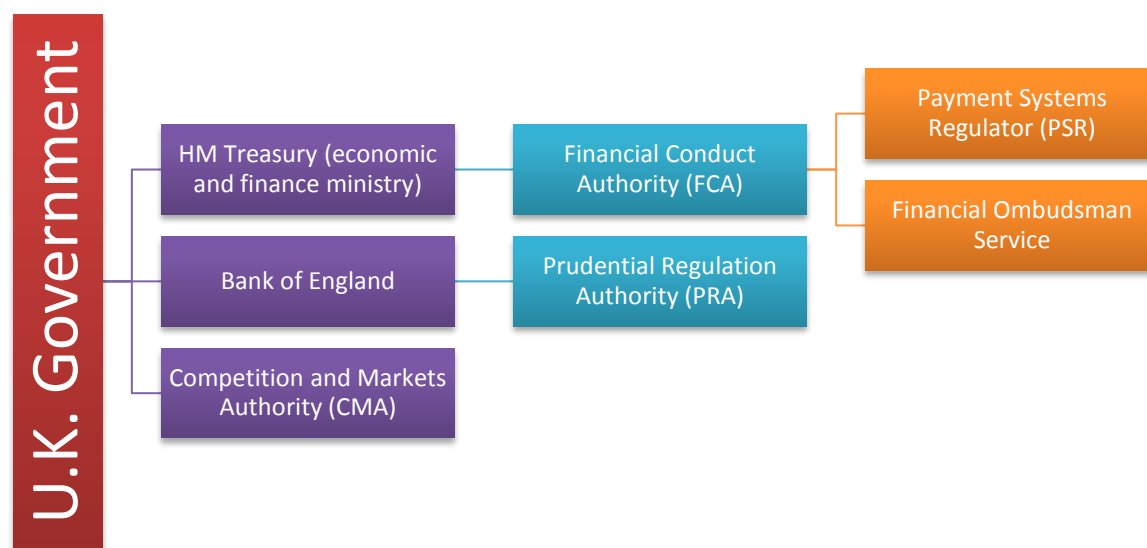
¹ CPSS, formed in 1998, was an established task force with members from G10 members' central banks.

Payment System Type	United Kingdom	United States
High value	CHAPS	FedWire/CHIPS
Low-value bulk (ACH)	Bacs	NACHA
Low-value real-time	Faster Payments	n/a
ATM	LINK	various

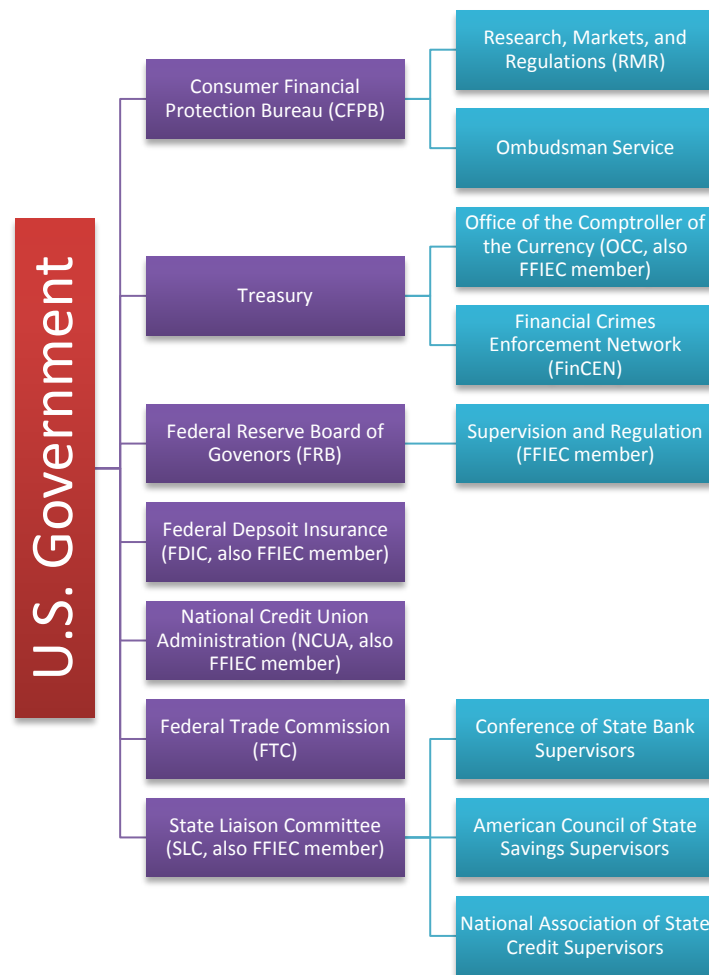
We will focus the discussion on recent events in increasing the speed of low-value payments in the United Kingdom and the United States. The United States has the largest annual payment volume for a single country, and the United Kingdom ranks fourth. However, the United Kingdom outranks the States in per capita electronic payment volume, perhaps because of the latter country's history of higher check usage. This background document provides a comparison of these two countries based on the similarities of their modern payment infrastructures, regulatory regimes, and the features of their interbank payments systems.

Comparing Payments Systems' Regulatory Structures

The flow charts below outline the entities responsible for the oversight of payments processing in the United Kingdom and the United States.



Source: Federal Reserve Bank of Atlanta



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The Dodd-Frank Wall Street Reform and Consumer Protection Act (commonly known as Dodd-Frank) recently overhauled the U.S. governance structure for payments and financial markets, and the Consumer Financial Protection Bureau (CFPB) came out of Dodd-Frank. The CFPB has consumer protection jurisdiction over any company—not just banks and credit unions—that is involved in offering or providing a consumer financial product or service as well as companies who are service providers to those that offer or provide consumer financial products or services. In terms of functionality and collaborating partners, the CFPB is most aligned with the United Kingdom's Financial Conduct Authority (FCA). The exceptions between the two are in funding and accountability.²

The Federal Trade Commission (FTC) is a federal agency with a mission to protect consumers and promote competition, a role similar to what the Competition & Market Authority (CMA) does in the

² The CFPB is a government agency that receives funding from the Federal Reserve Board of Governors and is accountable to Congress. The FCA, on the other hand, is an independent public body funded entirely by fees paid by the firms that it regulates. The FCA is accountable to the Treasury, which is responsible for the United Kingdom's financial system and answerable to Parliament.

United Kingdom. The FTC has consumer protection jurisdiction over nearly every U.S. business, except for a few significant exceptions—among them, financial institutions regulated by federal banking regulators, insurance companies, and telecommunications companies.

In the United Kingdom, supervision and regulation of the financial sector is shared by the FCA and the Bank of England's Prudential Regulation Authority (PRA), though the PRA regulates only financial institutions. The financial services' *payments sector*, in the United Kingdom, has a dedicated agency in the form of the Payments Systems Regulator (PSR), which is accountable to the FCA. In the United States, financial *sectors* are regulated somewhat separately. Financial institution supervision and regulation is shared among the federal and state regulatory agencies of the Federal Financial Institution Examination Council (FFIEC).³ . The United States does not have an analogous dedicated agency with specific payments authority, although the CFPB exercises payments authority over both bank and nonbank firms in addition to mortgage, lending, liquidity, collections, and deposit markets.

At the core of the United Kingdom's recent regulatory overhaul is the theory that effective competition drives innovation and offers greater choices, better quality, and lower prices for consumers. The stated goal of these changes is to provide a level playing field for participants so they may compete further down the value chain. Both regulation and commercial interests have driven change in the United Kingdom.

The United Kingdom's governance structure for payments and financial markets was recently overhauled.⁴ It took three years to create the world's first dedicated PSR from conception to introduction.⁵ What led to this reform?

The Payments Council, established in 2007, was a volunteer, self-regulating, membership body⁶ responsible for setting payment strategy for U.K. payments systems. When the Council decided to phase out checks, the government heard from enough concerned consumers and small business to spur an investigation. The investigation criticized the Council for failing to consider end-user needs and failure to communicate effectively. The phasing out of checks was overturned⁷. Further reports⁸ indicated that the Council was plagued by a conflict of interest (at least a perceived one), given that the large banks were

³ <https://www.ffiec.gov/agencies.htm>

⁴ This was one of four options proposed by HM Treasury's in *Setting the Strategy for UK Payments*, January 2012.

⁵ The PRA has authority over the United Kingdom's retail payments systems and their direct members: checks and credit, Bacs, CHAPS, Faster Payments, the LINK, NICC, MasterCard, and Visa Europe.

⁶ Membership details available on page 12 of HM Treasury report:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81567/setting_strategy_uk_payments190712.pdf

⁷ http://www.cfg.org.uk/Policy/archive/~/_media/Files/Policy/Banking/Payments%20Council%20to%20keep%20cheques%20and%20cancels%202018%20target%20FINAL%202012%20July%202011.ashx

⁸ Independent review of governance and performance of the Payments Council 2009-11, Martin Cave, January 2012.

Available at: http://www.paymentscouncil.org.uk/files/payments_council/governancereview/governance_review-martin_cave_report-february2012.pdf

the dominant decision making force on the Council while they also owned the payments systems. In addition, the Council was criticized for being slow to produce or make decisions effectively. The membership was large and a consensus was needed for decisions, which meant any single member could block or slow progress. The analysis resulted in proposed options for changes to the regulatory regime—hence, one powerful payments regulator.

Another major regulatory development was the creation of the Competition and Markets Authority (CMA)⁹, which consolidated two agencies for the purpose of promoting competition for the benefit of consumers, both within and outside the United Kingdom. CMA's reports to the government have proved influential and will be discussed later. At the same time, the new Financial Conduct Authority (FCA)¹⁰ formed, accountable to HM Treasury. Currently, the FCA has authority over virtually all financial markets¹¹, including the PSR and the Financial Ombudsman Service, an independent body that settles financial (including payments) services complaints.

The PSR is responsible for the United Kingdom's annual £75 trillion payments system industry. Its powers include setting and implementing guidance, rules, standards, agreements, and supervision and regulation of all participants in the payments systems. The Bank of England¹² has the PRA, which is responsible for the prudential regulation and supervision of around 1,700 banks, building societies, credit unions, insurers, and major investment firms. In addition to the Bank's regulatory arm, the Bank operates CHAPS¹³. It also provides final multilateral net settlement facilities to Bacs, Faster Payments Service, LINK, and the Cheque and Credit Clearings. On October 21, 2016, the PSR announced the seven members of a Payment System Operator Delivery Group to oversee the proposed consolidation of Bacs, Faster Payments Service, and Cheque and Credit Clearing Company.¹⁴

⁹ On April 1, 2014, CMA took over many of the functions of the Competition Commission and the Office of Fair Trading.

¹⁰ FCA replaced the Financial Services Authority in 2013 with an added objective to promote greater competition over more markets.

¹¹ FCA's authority extends to 56,000 firms made up of banks, building societies, credit unions, consumer credit firms, electronic money institutions, financial advisers, fintech and innovative businesses, insurers and intermediaries, investment managers, mortgage lenders and intermediaries, mutual societies, payment institutions, pension providers, sole advisers, and wealth managers.

¹² The Bank of England is the United Kingdom's central bank and has been given statutory oversight over payment systems under the Banking Act of 2009.

¹³ CHAPS also sets the rules for the real-time gross settlement system, the technical infrastructure operated by the Bank of England. Payment instructions are sent and received via SWIFT, the international payments network.

¹⁴ <https://www.psr.org.uk/psr-publications/news-announcements/PSR-appoints-PSO-delivery-group>

U.K. Low-Value Payments Systems

Bacs Payment Schemes Limited¹⁵ and Faster Payments Limited (FPSL) set rules for their low-value clearing networks based on a community consensus of their bank members. Both systems have a single agreement on behalf of bank and corporate members that provides access to a central infrastructure that is powered by a commercial technology provider, VocaLink¹⁶. All participants must also have an agreement with VocaLink¹⁷. Financial institutions with direct access are required to have a settlement account with the Bank of England. Settlement for Bacs and Faster Payments moved from a collateralized loss-sharing agreement to full prefunding model for all participants with Bank of England reserve accounts. Why do the two systems have so much in common?

Bacs's membership consists of the Bank of England, 16 retail banks and building societies with some 40,000 direct submitters and approximately 60,000 indirect submitters, and more than 100,000 businesses. For more than 40 years, Bacs has been responsible for the schemes behind the clearing and settlement of automated payments in the United Kingdom, maintaining the integrity of payments-related services. Members pay for the operating costs through a combination of fees and income through other services. In 2016, payments processed through Bacs reached a volume of 6.2 billion with a value of £4.8 trillion¹⁸. Bacs's direct debit volume saw 4.9 percent growth in 2016 and has been steadily increasing year over year for payments related to telephone billing, retail sales, subscriptions, and overall household bills¹⁹. Direct credit volume makes up about 35 percent of overall Bacs volume, and about half of that volume is from government payments, which are holding steady. Other direct credit applications such as payroll processing have been steadily declining since 2006. Another service offered by Bacs is the Current Account Switch Service, which provides customer hassle-free service that automatically transfers all or some payment arrangements to their new bank and if they choose to close an existing account. The switch service has been named by the PSR as a designated switching scheme, and all U.K. payment service providers must offer a switch service for payments accounts denominated in the same currency.

As result of a U.K. government mandate, the Faster Payments Service (FPS)²⁰ is a near real-time credit transfer that typically only takes a few seconds to post (for direct participants), with three net settlement per banking day. The initial phase of FPS enabled users to make payments with same-day clearing and

¹⁵ Bacs is an interbank system that processes payments through two principal electronic payment systems: direct debit, which is used for example by individuals to pay bills, and Bacs direct credit, used among others by businesses and government to pay salaries and pensions.

¹⁶ [“CMA to Consider Mastercard Offer Before Approving VocaLink Deal”](#)

¹⁷ U.S. financial firms currently have a choice for ACH operator/technology vendors: either the Federal Reserve or the Clearing House.

¹⁸ [Federal Reserve Payments Study Comparisons to ACH](#)

¹⁹ www.bacs.co.uk/DocumentLibrary/Bacs_processing_stats.pdf

settlement (compared to the three-day Bacs clearing cycle), and it was limited to credit transfers and lower monetary amounts. It is now possible to send individual payments of up to £250,000 using FPS, but individual banks and building societies can set lower limits depending on how the payment is sent and the type of account from which their customer is sending. All U.K. banks and building societies are now able to send and receive via FPS, with more than 400 of them connecting indirectly through one of the 17 direct access banks. Thirteen members must cover operating costs based on their volume. In 2016, FPS volume and value increased by 14 percent with a volume of 1.4 billion and a value of just under £1.2 trillion.²¹

What are the implications for legacy payments systems from FPS? The service made a significant impact on checks. In 2016, checks and credit decreased 15 percent annually, almost an offset to FPS's 14 percent growth and overall noncash payment types growth of 3 percent. The only other noncash payment scheme decline was Bacs direct credit, which fell 1 percent. Some suspect the value limits and credit-push model of FPS have protected CHAPS volume. Bacs allows for debit-pulls, and FPS does not. FPS transactions can occur outside of banking hours, whereas other schemes are limited to banks' operating hours. Businesses still need the ability to send large value amounts and set up batch payments in advance, and many have treasury operations already integrated with legacy systems. Consumers have been accustomed to paying households bills with Bacs. Will customer bill payments leave Bacs for FPS, or will FPS's opportunity be solely in the mobile and POS spaces? Another consideration is the possible acquisition of VocaLink by Mastercard. VocaLink owns the LINK scheme, which is the only ATM network in the United Kingdom. How will VocaLink's stake in the card rails, plus ACH, plus Faster Payments affect the future of retail payments?

What other drivers are exerting an impact on these payments system improvements? It is not surprising that FPS and Bacs have facilitated wider participation by nonfinancial institutions with a prefunding and direct access model, which makes payments systems and account information less exclusive to banks. It aligns with the wide-reaching legislative requirements of the Second Payment Services Directive (PSD2)²² and has been viewed as a major piece of legislation in the United Kingdom. The directive aims to ensure all payment service providers active in the European Union are subject to the same supervision and appropriate rules, whether they are banks or not. Brexit aside, further evidence of U.K. support of PSD2 is in the creation of the PSR, CMA, Financial Ombudsman, and PRA. Actions by these governing bodies are pushing for open banking infrastructure. Will retail payments transformations stay aligned with

²¹ www.fasterpayments.org.uk/sites/default/files/Monthly%20Payment%20Statistics%20Dec%202016.pdf

²² PSD2 aims to bring the European Union into a digital single market tailored to the digital age. See www.paymentsuk.org.uk/sites/default/files/PSD2%20report%20June%202016.pdf

customer value propositions, or could some participants face excessive expense and complexities to remain competitive?

U.S. Low-value Payments Systems

The United States has also manifested efforts towards achieving the core principles, such as advancing the safety, security, and resiliency of the payments system and by increasing end-to-end payment speed and security. Payment innovations have been a primary consideration for the private sector in the United States, and they have also been of interest to regulators. The U.S. payments infrastructure is largely decentralized with commercial outsourcing and indirect infrastructure access, which makes it particularly popular among small- and medium-sized institutions because it allows them to constrain costs while delivering services to their customers.

The Federal Reserve System's payments improvement strategies paper in 2010²³ led to the development of a cross-industry taskforce in search of further solutions. Since then, the Faster Payments Task Force has led the path to the U.S. path to faster payments and published the first part of the final report.²⁴ The second part is expected to be published in the summer of 2017.

Meanwhile, The Clearing House²⁵ is working on a real-time payments system that is expected to launch in 2017 and will serve more than 3,000 financial institutions.²⁶ This private-sector solution has contracted with technology platforms provided by VocaLink.

Although the United States hasn't yet implemented a new faster system, some major advancements to systemically important payments systems have been made.²⁷ The United States was largely dependent on paper checks until 2003, when the Check Clearing for the 21st Century Act (commonly known as Check 21) was signed into law. The transition of more than 11,000 financial institutions to an imaged-check solution was a significant undertaking that brought changes to the payment landscape. The next significant payments system improvement has been the implementation of same-day automated clearinghouse (ACH), which potentially connects all financial institutions in the U.S.

The ACH infrastructure in the United States is decentralized, with two operators providing direct access to banks that in turn sponsor smaller banks and payments service providers. The Federal Reserve and the Clearing House, owned by the largest banks, provide ACH technology, as VocaLink does in the United

²³ <https://fedpaymentsimprovement.org/wp-content/uploads/strategies-improving-us-payment-system.pdf>

²⁴ <https://fedpaymentsimprovement.org/wp-content/uploads/path-to-faster-payments.pdf>

²⁵ <https://www.theclearinghouse.org/payments/real-time-payments>

²⁶ www.theclearinghouse.org/

²⁷ </media/tch/press%20releases/the%20clearing%20house%20and%20fis%20submit%20joint%20proposal.pdf?la=en>

²⁷ There are four systemically important noncash payment systems in the United States: ACH, card, check, and wire.

Kingdom. And just as in the United Kingdom, those sponsoring institutions must have a settlement account with the Federal Reserve. For payments cleared fully through the the Clearing House, the Fed offers the National Settlement Service to make Clearing House members whole.

Low-value, real-time payments are also the key focus of improvement projects in the United States. NACHA, the ACH private-sector governance body similar to Bacs, passed same-day ACH in multiple phases. In the first phase, implemented in September 2016, all financial institutions must be able to receive same-day settlement for ACH credits, although sending same-day transactions by financial institutions and their customers is optional. The next phase will add ACH debits in September 2017. This approach could be perceived as a hybrid version of the United Kingdom's Bacs and Faster Payments. Both U.K. Faster Payments and U.S. same-day ACH offer three forward, daily, net settlements except for account posting, a benefit realized by the end user. Faster payments deliver messaging within seconds, and U.S. ACH remains once daily and, until implementation of phase three in 2018, will be only required by 5 p.m. on the day of settlement.²⁸

Conclusion

In both the United States and the United Kingdom, financial institutions are the guardians of the payments systems, if they choose to be. In those cases, economies of scale determine a business case for smaller financial institutions or firms that are not financial institutions to have access to the payments system directly or via a correspondent banking relationship. Has major regulatory change been successful in the United Kingdom in terms of providing a level playing field? Or has the incremental U.S. approach, such as pushing for same-day ACH settlement windows, provided necessary innovations? And can new faster-payments models level the playing field?

These rapidly evolving developments will merit continued scrutiny and analysis. A thoughtful analysis should question the continued relevancy of the 10 points identified in the 2001 study, *Core Principles for Systemically Important Payment Systems*? Sixteen years is a long time in the payments space.

²⁸ The benefits offered by faster settlement are debated in a paper from the Atlanta Fed: <https://www.frbatlanta.org/rprf/publications/2016/05/risks-in-faster-payments.aspx>