BANK OF ENGLAND

CHAPS

CHAPS Strategic Advisory Forum

Monday 8 October 2018

The third CHAPS Strategic Advisory Forum was held on 8 October 2018. A summary of the meeting is provided below.

Attendees: Kevin Brown (Chair) – Independent member on the RTGS/CHAPS Board
Michael Jones – Head of Market Services, the area that operates CHAPS

External members[1]
Angus Scott (CLS)
Chirag Patel (Rabobank)
Graeme Middleton (corporate treasurer)
John Lyons (TSB)
Jo Oxley (ex-officio: Head of Government Banking Service)
Jo Towers (HSBC)
Julian Richings (JP Morgan Chase)
Scott Johnson (Chas Smith)
Simon Eacott (Royal Bank of Scotland)
Sriram Iyer (Deutsche)
Thair Hanif (Al Rayan Bank (UK))
Thom Wilkinson (Monro Wright & Wasbrough LLP)

Secretariat, presenters and other Bank attendees

Apologies: Douglas Peel (Goldman Sachs)
Julian Sawyer (Starling)

Item 1: Introductions

1. The Chair welcomed members to the third CHAPS Strategic Advisory Forum meeting (the Forum). The Chair confirmed that all actions taken at the last meeting were closed with the exception of running the first CHAPS Security Forum. This would be held before the end of the year and fourteen nominations for attendees had been received.

Item 2: Cost recovery for CHAPS

2. The Bank set out the background and principles for how the Bank charges for RTGS settlement.[2] The current RTGS infrastructure is over 20 years old, and the capital costs had long since been recovered. The Bank fully recovers RTGS operating costs, smoothed over a number of years. The cost of renewing the RTGS infrastructure is due to be recovered once the new core ledger has been implemented. However, the Bank expects it will increase the tariff to recover the investment costs over a defined period.

3. The Bank was, therefore, considering how to manage the CHAPS settlement tariff between now and the implementation of the new core ledger under RTGS renewal. Three options had been generated to discuss with the Forum, as the Bank wants to benefit from external input. The first two options were to a) do nothing (which might see the tariff reduce) or b) apply a floor (which would see the tariff likely baselined at the current level, or a modest increase). The third option c) would see a pro-active increase to reduce the size of any step-up between the current tariff and

[1] External members, with the exception of Jo Oxley, are appointed on an individual basis. Their respective organisations are shown for information. A number also have links to trade associations such as the Association of Corporate Treasurers, Association of Foreign Banks, London Money Market Association, and the Law Society of England and Wales.
[2] See https://www.bankofengland.co.uk/-/media/boe/files/payments/rtgstariffs.pdf for background.

the post-renewal tariff. Options b) and c) would build up a surplus that would be allocated to each CHAPS Direct Participant rather than shared. The Bank invited views on these options.

4. In terms of options a) – do nothing and b) – apply a floor, members expressed a preference for minimising volatility where possible. Any further tariff reduction should be avoided. Mike Jones confirmed that full detail on the 2019/20 tariff (effective 1 April 2019) would be available in Q1 2019 once the information required to run the process was available.

5. On option c) – a proactive increase, members raised a number of questions that would need to be addressed before an approach of this sort could be used. A material increase would require advance notice.
   - Members asked about the governance for the management of costs. The Bank said the RTGS renewal programme was developing cost estimates for the Programme as part of the business case – these would be reviewed by the Bank's Court of Directors. Input on programme costs had been sought from the External Advisory Body, but the programme will not be in a position to share cost estimates with industry until after a supplier has been appointed in order to protect the Bank's commercial position.
   - Members also asked about the amortisation period. The Bank said the RTGS renewal Blueprint stated this would be seven years, but that there would be a review of the amortisation period to confirm that it was still appropriate.
   - The accounting treatment would need to be clear for any built-up funds. The Bank confirmed this was one of the next steps it would be undertaking if the Forum felt there was benefit in exploring a build-up of funds.
   - Members noted that the likely size of any increase would be a factor, with significant advance notice required. Members highlighted that it was common for Financial Institution and corporate clients to be on multi-year contracts.

6. The Chair thanked members for their contribution, noting that the steer for 2019/20 was to apply a floor. The Bank will continue to seek industry input on the approach to recovering RTGS renewal costs.

Item 3: Update on RTGS renewal programme

7. The Bank provided an update on the RTGS renewal programme. The Bank is coming towards the end of the Plan-Analyse-Design phase. The two main activities have been further work on the business case and the procurement strategy. On the business case, the team have spoken to several current and prospective CHAPS Direct Participants to understand the costs and benefits. These conversations have highlighted that some of the most tangible benefits for CHAPS Direct Participants come from easing the change management and testing burden, but that costs remain difficult to quantify. The Bank will start procurement for its main technology supplier in the coming months.

8. Members asked about the Bank's interaction with the New Payment System Operator. The Bank explained that the NPSO's CEO attended the Bank's External Advisory Body for RTGS renewal. There was also regular interaction at various levels of seniority. Current topics of discussion included working through sequencing of respective activities, including procurement activity.

   ISO 20022

9. The Bank's ISO 20022 consultation closed in July. Responses confirmed support for sharing a Common Credit Message with the NPSO's New Payments Architecture (NPA) and that while the move to ISO 20022 would be a big change, it also had the potential to deliver real and significant benefits. As there is a cost associated with the change, it was important to deliver tangible benefits, including to the ability to screen for financial crime. There was also more work to do to explain, and justify, some of the changes.

10. There was broad support for the new governance structures proposed, including a Bank/NPSO shared advisory group on standards. This, and other arrangements, would work towards providing detailed guidance on the implementation of messages to industry by end 2019. The Bank will publish a response to the consultation input by end November, with an industry event to explain this and provide further details on the next phase on 6 December. Recognising much of the work to ensure delivery of the benefits will be collaborative, and following an interest from the July Forum on wanting to understand the international picture and how the UK fits in, the Bank has invited a range of stakeholders, including other central banks, to participate at the December event, and share their perspectives on ISO 20022 implementation.

11. Forum members confirmed that the themes from the consultation matched their expectations. In the subsequent discussion, the importance of improving the ability to detect financial crime was noted as a key benefit. The Bank also confirmed that it was engaging with software providers, recognising that this was key to support corporate implementation of ISO 20022.

Transition

12. The Bank described the planned transition approach and outlined four transition states: foundation and quick wins; participant data channels; core RTGS ledger replacement; and further enhancements. The Bank expected to share indicative timelines for the transition states in December. In response to questions, the Bank noted that no hard dependencies with the NPA had been identified – the focus was on sequencing the two change programmes to ease the burden on industry and other users.

13. Members highlighted a number of experiences to be learnt from, including the transition for the Image Clearing System, and other industry changes to bear in mind (any CREST changes, the CLS convergence programme). **Action: Members to inform the Bank of any other future external change events to factor into planning for RTGS renewal.**

Item 4: Operational resilience

14. As previously advised, the UK financial authorities had published a discussion paper on operational resilience.[3] Given the criticality of payment services, this was an early focus for the authorities. The Bank outlined key points from the proposed approach including a focus on outward facing business services, rather than just the supporting IT services. A key development was asking firms to consider how much disruption can be tolerated for their key activities. Firms should assume that failure is inevitable and plan for it. It is also important that firms' Boards and senior management are considered responsible for operational resilience.

15. Members confirmed that the business services approach seems sensible. A member noted the interconnected nature of the payments space, with many regulated firms and FMIs providing services to each other. In this context, members discussed whether a collective mapping would be more efficient than firms doing individually for the existing relationships between vendors and customers, as well as identifying dependencies which would affect the delivery of business services. Members discussed whether collectively defining business services would be appropriate. Members also encouraged a joined up approach across central banks/supervisors – this would help align supervisory expectations over firms' operational resilience.

16. For end-users, communication is key in the event of disruption – such as the likely recovery time, and advice on when it is appropriate to start using alternative processing arrangements. Having pre-prepared contingency plans and messages is helpful. While the focus of the stress test that will follow the discussion paper is a firm-specific test, cross-firm incident management and

[3] https://www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper

communications are tested through sector exercising, often based on market-wide disruption. Social media was increasingly a channel that drew near-immediate publicity to any disruption.

Item 5: CHAPS role in the payments landscape

17. The Bank provided an update on the working group held in September on the role of CHAPS in the payments landscape. Key points had been how speed, cost and customer practices all influence the choice of payment instrument. Material convergence between CHAPS and other the retail schemes was not expected until the ISO 20022 Common Credit Message is introduced as well as downstream implementation by corporates.

18. The Chair added that many banks still use CHAPS even for low value payments because of how their internal systems were configured. For end-users, it is Faster Payments that is generally considered instantaneous whereas CHAPS payments could take a number of hours to complete processing from one end-user to another. The Forum identified a number of myths, and frictions, around different payment instruments. There would be benefit in providing more transparency on the individual characteristics for end-users and payment service providers, as well as the benefits associated with screening. One member noted that the combination of RTGS Renewal and the NPA provides a once-in-a-generation opportunity to get the strategy right.

19. For payment service providers, a key aspect was the characteristics of liquidity management for the prefunded retail schemes relative to CHAPS. Another aspect was the additional AML/fraud screening typically undertaken for CHAPS payments. From an end-user perspective, the additional screening was often perceived as friction which slows down the speed of a CHAPS payment.

Contingency

20. At the working group, there had been a discussion over how CHAPS was used as a contingency channel for Bacs and FPS in certain circumstances for a reasonably low volume of payments. This would become easier over time with the ISO 20022 Common Credit Message. One member noted, drawing the link to the operational resilience work, that a pre-prepared contingency approach if there were disruption to, for example, CHAPS or Faster Payments would be useful. For example, should payments above or below a certain value be re-routed, or should there be defined arrangements for particular segments like housing.

Item 6: Any other business

21. The Chair thanked members for their contributions. The RTGS/CHAPS Board was meeting in the afternoon and the morning's discussion would provide input to a number of the agenda items.

22. The secretariat outlined the likely 2019 dates for the Forum: 25 January; 2 May; 25 June; and 17 October. The January meeting was likely to include an item on liability that the Bank had been considering; and at some point during the year, a discussion on potentially pausing CHAPS on-boarding as we approach RTGS renewal. The Bank is also likely to host a second working group in 2019 on the role of CHAPS within the payments landscape.

Log of actions agreed in the meeting

No.	Date	Action agreed	Action Owner	Date due	Status	Update
1	8/10/18	Inform the Bank of any other future external change events to factor into planning for RTGS renewal.	Members	End November	Open	Open

Annex – Summary of Working Group on the role of CHAPS in the payments landscape

On 13 September 2018, the Bank held a working group to discuss the position of CHAPS in the payments landscape. This working group was set up following July's CHAPS Strategic Advisory Forum, and is designed to inform the Bank's future strategy for CHAPS as a payment system. The list of attendees is provided in the annex. A summary of the meeting is provided below.

Characteristics of CHAPS payments and how they are perceived and valued

The Chair asked how Payment Service Providers (PSP)[4] and end-users currently perceive the features, benefits and disadvantages of CHAPS, both overall and among different customer segments. Several themes emerged from the discussion which are summarised below.

Current understanding of CHAPS characteristics

- Several attendees felt that the difference between CHAPS and other payment instruments was, for the most part, either unclear or immaterial.
- The main difference is on **cost**, particularly for end-users. Some attendees doubted their organisations would continue to use CHAPS if the transaction value limit of other payment types increased significantly, <u>and</u> were made available for those accessing payment systems indirectly. One attendee noted that they already only used CHAPS for payments above the value limit or if PSPs are not FPS-reachable.
- There was a range of views about the **speed** and **'guarantee'** associated with different payment instruments. Some attendees noted that FPS was valued for near real-time payments for end-users (and visibility of acceptance). However, while FPS payments were *normally* faster, their delivery was not guaranteed until the next day. One of the benefits of CHAPS payments was that timing is set out the CHAPS Reference Manual (i.e. that CHAPS Direct Participants should credit payments to the intended recipient's account within 90 minutes of the CHAPS Direct Participant receiving them).
- Several attendees noted that retail customers' focus was on funds moving from A to B, rather than exactly what payment system is used. Some attendees said that end-users do not necessarily expect to receive money immediately. However, others noted that for certain payments (e.g. buying a new car) a customer would prefer for the payment to arrive immediately as opposed to just same day.
- Others noted that CHAPS is less convenient than Bacs for corporates, given that there is no direct submission channel available.
- One area where CHAPS was typically more efficient was in the recall of payments. CHAPS payments typically take 3 -5 days to recall, compared with up to 30 days for Faster Payments. However, in both cases, payments can get stuck along the correspondent banking network. Comparisons were also made with card systems regarding speed of recalls/refunds (often a couple of weeks) and customer call-backs for suspected fraudulent payments (in some cases immediate and quickly resolved).
- Attendees discussed the **trade-off between convenience and safety** of different payments types. A few attendees noted that some customers choose to use FPS to avoid going to a branch or undergoing the additional checks which are usually applied to all CHAPS payments, regardless of value. However, several other attendees noted that end-users felt better protected by their PSPs if they went to a branch. End-users could tolerate longer payment processing time if there were a need for additional checks, though such frictions were often perceived as unwelcome by end-users.
- It was also noted that the additional information that can be carried in a CHAPS payment messages was useful for the receiving-PSPs' AML checks, and for reconciling payments for corporates/government, especially in relation to client funds.
- Some attendees mentioned **historical reasons** and current **customer practices in certain sectors** (e.g. such as legal and accountancy practices) as a reason CHAPS is used. One said that customers had **confidence** in CHAPS – it has been there a long time so feels predictable and has a 'gold standard' status. Those attendees noted that these reasons could change in the future due to changing payment messages and business practices. Conversely, as it is often costly to change practices, businesses would be unlikely to do so without a strong business case.

[4] Payment service providers (PSPs) captures banks, building societies, e-money issuers and payment institutions.

- A couple of PSPs noted that retail customers often used CHAPS because their **PSP required them to do so or because of the way the PSP's staff spoke about it.**
- Two attendees mentioned CHAPS' absolute **finality** as a perceived benefit i.e. when it is safe to release goods. However, they admitted that many retail customers did not fully understand (or value) this concept.
- It was also mentioned that from the settlement-level perspective the main benefit of CHAPS was that the money moved in **real time on Bank of England accounts**. However, this was not necessarily understood by end-users.
- **Banks wish to limit liquidity usage** was also discussed as a reason to drive the choice of payments channel. However, it was acknowledged that PSPs also needed to hold cash for settlement in other automated credit schemes. The current inefficiency with FPS prefunding was also noted, where prefunding is in a special account, that differs from the account where funds must be available for settlement.
- One bank also mentioned **ring-fencing rules** as a factor for using CHAPS i.e. direct access is a requirement.
- **International payments** were also discussed. One attendee did not see the difference between CHAPS and alternatives when it comes to international payments. Another attendee said that the payment channel for international payments is often chosen by the PSP and not the originator.

CHAPS characteristics in light of future changes

- Banks noted that their **decision to extend transaction limits** to agencies and end-users was driven by risk rather than liquidity considerations. It was unlikely that many direct participants would fully extend transaction limits to their clients if the FPS scheme transaction limit is increased. One attendee noted that initiatives to reduce authorised push payment scams will put more focus on limits, and could create more frictions in the future.
- It was noted that support for the SWIFT gpi service, and the additional **information in CHAPS messages** following the implementation of an ISO-based Common Credit Message (CCM) could be useful and drive further demand. At the same time, the adoption of CCM and other future changes would lead to the convergence of payment systems' characteristics. For example, Confirmation of Payee, even if offered across CHAPS and FPS, could indirectly create more confidence in FPS.
- Some attendees believed that the majority of customer needs can be met by FPS payments and doubted there was still a need for CHAPS to support low value payments. Any remaining differences could be eliminated by adjusting FPS offering (e.g. settling more frequently during a day, or having a tiered FPS system, where higher value payments could settle separately, and individually, across RTGS accounts).
- Conversely, others felt that the CHAPS service should not be designed to prevent certain types of payments, as this just limits options. And low value corporate payments were often sent via CHAPS because sending all payments via the same channel (be they multi-million pound, or pennies) assisted reconciliation and reduced risk.
- One attendee considered that e.g. changing working practices could result in more demand for bulk payments in real time – something that neither FPS nor CHAPS were designed to cater for at present.
- Several attendees suggested that a material change in how CHAPS is used versus other systems is not to be expected until businesses come to their own infrastructure renewal (compared it with contactless).

Potential use of CHAPS as a contingency channel

The Chair asked the attendees questions to understand how PSPs and end-users view CHAPS as a contingency channel in case of an outage of other automated credit schemes.

- A few attendees noted that CHAPS had been used as contingency channel for other credit transfers, mostly for high value payments. Obstacles to re-routing payments to CHAPS related to processing capacity and extra information being required for CHAPS payments. Furthermore, the message formats between FPS and CHAPS were very different and difficult to convert between the two formats. This should become easier with CCM.

- At the moment, using CHAPS as contingency for large volumes of FPS payments would also be problematic due to a lack of capacity for processing a very high volume of CHAPS payments within existing infrastructure. Beyond that, the PSPs would struggle to handle the receipt of payments – information required for screening, for example, may not be provided.
- One PSP mentioned manual payment schedules. These equated to manual inputting and could only handle a very low volume. In theory, however, a small number of manual payments in RTGS/CHAPS could be supported by a large number of retail payments – but information about these payments would need to be exchanged via a separate process between the relevant participants.
- One attendee asked whether/how much additional capacity would/should be needed to support very low probability contingency events.

Annex – Attendees

- Association of Corporate Treasurers
- Bank of England
- Barclays
- Citi
- CLS
- Deutsche
- Goldman Sachs
- HSBC
- JP Morgan
- Lloyds Bank
- Northern Trust
- Pay.UK
- RBS
- Santander UK
- Standard Chartered
- Transferwise
- TSB

The working group was chaired by Kevin Brown, in his capacity as an independent member of the RTGS/CHAPS Board.

Pay.UK (formerly NPSO) kindly hosted the meeting at their offices in London.