



**BANK OF ENGLAND**

# News release

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## **The case for more CHAPS settlement banks - speech by Chris Salmon**

In a speech delivered at a breakfast hosted by the Yorkshire and Humberside Network of the ifs School of Finance, Chris Salmon, Executive Director of Banking Services and Chief Cashier, explains why the Bank of England believes that the currently rather limited direct membership of CHAPS should expand. He reflects on the key design features of CHAPS and CREST, and why those features enabled the payment systems to operate reliably during the financial crisis. And he summarises a number of technical reforms for payment systems that the Bank is championing which will have benefits for financial stability.

To provide the context for the changes the Bank would like to see, Chris Salmon discusses how payment systems have developed over time, and how their resilience has been seen to be of vital importance, particularly in recent years. The adoption of a real time gross settlement (RTGS) method by CHAPS and CREST in the late 1990s, allowed individual payments to be settled across the settlement banks' accounts throughout the day in real time (as opposed to an end-of day net basis). These changes eliminated credit risk and represented a significant step forward in securing the robustness of the UK payments infrastructure.

In large value payment systems, banks can participate either directly or indirectly, Chris Salmon explains. If they participate indirectly, they will make use of a correspondent bank who will submit and receive payments on behalf of its customer. Indirect membership is the norm in the UK. However, Chris Salmon describes several costs of having indirectly settled payment systems, perhaps the most important of which is that intraday credit risk is reintroduced. He argues that there is a clear case for an increase in direct membership of CHAPS: "CHAPS currently has 18 members that serve the entire sterling banking industry. Over 50% of CHAPS payments are made by correspondent banks on behalf of customer banks, implying they are subject to the risks outlined above. Moreover, the risks that some banks are running to provide intraday liquidity are very large: the Bank estimates that some intraday credit lines are in excess of 10% of the correspondent bank's core tier 1 capital."

Chris Salmon states that the Bank will be engaging with the correspondent and customer banks to encourage greater direct membership of payment systems. More formal actions will be taken if necessary.

Finally, Chris Salmon outlines the technical reforms the Bank is championing. The Bank is working with the CHAPS settlement banks to implement a liquidity savings mechanism (LSM) into RTGS which will mitigate against the risk of delayed payments. Together with the operator of CREST, the Bank is working to modify the system so that intraday liquidity for securities settlement is extended only when necessary. The Bank is also supportive of the efforts to modify the centralised settlement of collateralised loans in CREST. These modifications will reduce demand for intraday liquidity from the settlement banks, and thereby minimise operational risks.

Chris Salmon concludes that the UK payments infrastructure proved resilient during the crisis, but lessons learnt from the crisis indicate that extensive indirect membership means the infrastructure is not as robust as it could be.

### **Note to Editors**

1. CHAPS and CREST are both high value payment systems. The CHAPS payment system is designed for making instant, high-value sterling transfers. Typically, members of the public will initiate payment using CHAPS only rarely, for example when buying a house. Financial institutions will make many large CHAPS transactions daily, regularly settling inter-bank loans worth hundreds of millions of pounds. The CREST system plays an equivalent role for securities transactions and is used intensively by financial institutions for the exchange of loaned funds and associated collateral.

### **Key Resources**

**The case for more CHAPS settlement banks – Full speech**