

# Recent developments in UK payment clearing systems

*The past three years have seen a major reorganisation of the administration of the London-based payment clearing systems. The most significant and far-reaching development has been a change from a system run by a small number of large 'clearing' banks to one owned and controlled by a wider membership and open to any appropriately regulated financial institution which meets explicit and objective criteria for entry. This article describes this new structure, and touches upon some other payment system developments in the United Kingdom.*

## The need for change

A payment clearing system has existed in London for some two hundred years and for much of that time it has been based in premises known as the Bankers' Clearing House. For many years this institution was owned and controlled by the major retail banks through the Committee of London Clearing Bankers (CLCB). Participation in the clearings was also granted to other banks, including the Bank of England in 1864, the Co-operative Bank and the Central Trustee Savings Bank in 1975 and the National Girobank in 1983, but these banks did not share in the ownership of the Clearing House nor did they have any direct role in the control of the clearings.

Although, as the above examples show, the Clearing House members were prepared to extend participation in the clearings to other banks, as well as providing access by means of agency facilities, the arrangements whereby ownership and control remained firmly in the hands of the CLCB banks were questioned in a number of quarters. The 1978 Price Commission Report,<sup>(1)</sup> while accepting that the CLCB did not attempt to control the admission of new entrants to the money transmission market by restricting membership of the Bankers' Clearing House or by imposing unreasonable terms of entry, nevertheless proposed that regulation of admission to the Bankers' Clearing House should lie in the hands of the 'authorities'. Moreover, the report recommended that those banks which were admitted to membership be offered board representation and shares in Bankers' Clearing House Ltd, thereby giving them a stake in ownership and control. In 1980, the Wilson Report<sup>(2)</sup> recommended that the Bank of England should become more closely involved than it had been in the past in regulating admission to the Clearing House, in order to avoid any suspicion that the clearing banks were abusing their position. In 1983 a report by the National Consumer Council<sup>(3)</sup> concluded that the government should 'announce its intention to review the development of money transmission services within two to three years. If the institutions which wish to provide

money transmission services have not been able to enter the market on equitable terms, the government should then consider whether the joint ownership of the clearing systems for cheques and electronic payments by the members of the CLCB . . . is still appropriate'.

The outcome of this growing pressure was agreement, in March 1984, by all ten participating banks<sup>(4)</sup> in the Bankers' Clearing House to set up a working party of senior bankers under the chairmanship of Denis Child, Director and Deputy Group Chief Executive of National Westminster Bank, to review the organisation, membership and control of the payment clearing systems in the United Kingdom. During the course of the review, extensive consultations were held with a range of interested parties. In its deliberations, the working party sought the development of a structure that would retain the essential integrity and effectiveness of the clearings, while accommodating criticisms of the then current arrangements. At the same time they sought to create a robust and flexible structure that could accommodate possible future changes in membership of the clearing systems themselves, in banking technology, and in the payment industry as a whole. What is now widely known as the Child Report<sup>(5)</sup> was published in December 1984 and recommended bold and far-reaching changes to the organisation of the payment clearing systems, principally in the creation of a new structure and new rules for obtaining membership of the operational clearings.

## The new structure

At the pinnacle of the proposed structure was to be an umbrella organisation to oversee the development of the operational clearings and of the payment industry as a whole. Beneath that umbrella there were to be individual clearing companies, set up as companies limited by shares, covering initially three groupings of operational clearings. Control and ownership of the organisation and of the individual companies was to be in the hands of all participating member institutions.

(1) *Banks: Charges for Money Transmission Services*. HC 337 (1978).

(2) *Committee to Review the Functioning of Financial Institutions*. Cmnd 7937.

(3) *Banking services and the consumer*.

(4) Bank of England, Barclays Bank, Central Trustee Savings Bank, Co-operative Bank, Coutts & Co, Lloyds Bank, Midland Bank, National Girobank, National Westminster Bank and Williams & Glyn's Bank.

(5) *Payment Clearing Systems: Review of Organisation, Membership and Control* (now published by the Association for Payment Clearing Services).

The recommendations contained in the Child Report were accepted in full by the ten banks and the task of implementation was spread over the next year. The umbrella organisation was set up as an unincorporated association—the Association for Payment Clearing Services (APACS)—in October 1985. The three clearing companies, set up in December 1985, were as follows:

- Cheque and Credit Clearing Company Limited—responsible for the bulk paper clearings of cheques and credits in England and Wales (the paper clearings in Scotland and Northern Ireland have not been included in the new structure).
- CHAPS and Town Clearing Company Limited—responsible for the high-value (currently £10,000 and over), same-day settlement, clearings. CHAPS (Clearing House Automated Payment System) has since 1984 provided an electronic guaranteed sterling credit transfer service to its members and is available throughout the United Kingdom. The Town Clearing covers only high-value cheques drawn on and paid into members' branches within the designated town clearing area of the City of London.
- BACS Limited (formerly Bankers' Automated Clearing Services Limited) provides an electronic bulk clearing for direct debits, standing orders and other automated credit transfers. Unlike the other two clearing companies, BACS had been in corporate form since 1971 and operating since 1968.

A fourth company, EftPos UK Limited, has subsequently been set up to cover transactions to be cleared through the national EFT-POS scheme after its inauguration.

Each individual clearing company is responsible, with a high degree of autonomy, for the day-to-day operation of its clearings. All settlements are carried out over accounts maintained by the members at the Bank of England. Settlement membership of each company is open to all banks and building societies that meet explicit and objective criteria. (See the table below for details of current membership.) These criteria cover complying with the technical and operational requirements of the clearings, paying a fair share of operating costs and a fair entry price, meeting a minimum volume requirement of at least 0.5% of the total of items passing through the clearings covered in that company, and having settlement account facilities at the Bank of England. Provision has also been made for settlement membership to be open to groups of eligible institutions which may not, individually, achieve the minimum volume criterion but which, by joining together, can meet that requirement. Furthermore, under this new structure it is possible for an institution to join a single clearing company, whereas, in the past, membership of the Bankers' Clearing House required settlement membership of all the clearings.

#### Membership of APACS and the operational clearings: July 1987

Members	APACS	Cheque and credit clearing	CHAPS and Town clearing	BACS
Abbey National				
Building Society	X	—	—	X
Bank of England	X	X	X	X
Bank of Scotland	X	X	X	X
Barclays Bank	X	X	X	X
Citibank	X	—	X	—
Clydesdale Bank	X	—	X	X
Co-operative Bank	X	X	X	X
Coutts & Co	X	—	X	X
Girobank	X	X	X	X
Halifax Building Society	X	—	—	X
Lloyds Bank	X	X	X	X
Midland Bank	X	X	X	X
National Westminster Bank	X	X	X	X
Royal Bank of Scotland	X	X	X	X
Standard Chartered Bank	X	—	X	—
TSB England and Wales	X	X	X	X
Yorkshire Bank	X	—	—	X
	17	10	14	15

All settlement members of the individual clearing companies have automatic membership of APACS, which has the task of overseeing the payments industry as a whole and co-ordinating developments in the individual clearings. Associate membership of APACS is available to banks and building societies which only use the clearing on an agency basis, and which do not therefore qualify for full membership.

In addition to the clearing companies, two operational groupings have also been brought under the APACS umbrella to manage certain functions that do not require such a structured approach: the Currency Clearings Committee, which operates the London US dollar clearing and the London Currency Settlement Scheme; and the Cheque Card Policy Committee, which has responsibility for the operation of the domestic cheque guarantee card scheme and the participation by UK institutions in the Uniform Eurocheque community.

As well as its responsibilities towards the clearing companies and the operational groupings, APACS provides a forum for a very wide range of committees and working groups to enable its members to examine and consider new developments in money transmission matters, as well as to ensure the continued day-to-day smooth running of the existing systems. APACS is also closely involved, with its members, in considering how to meet the rapidly evolving requirements of participants in the different financial markets; and is assisting its members in preparing evidence to the Committee to Review Banking Services Law (the Jack Committee) on the legal aspects of the payment systems. It is assisted in these various tasks by a substantial research and planning division, the former Inter-Bank Research Organisation, which APACS absorbed from the CLCB.

In parallel with the formation of APACS, and the transfer to it of responsibilities for payment systems from the CLCB, the latter body was reorganised in 1985 and renamed the Committee of London and Scottish Bankers (CLSB), as a trade body representing the interests of the major retail banks.

## Implementation of the changes

The first banks to take advantage of the new open structure were Citibank NA and Standard Chartered Bank plc, both becoming founder members of the CHAPS and Town Clearing Company in December 1985.

In June of this year Halifax and Abbey National building societies and the Yorkshire Bank became full members of APACS when they took up membership of BACS. In addition, Abbey National Building Society will join the cheque and credit clearings at the end of May 1988.

To ensure that new settlement members are assimilated in an orderly manner and without disruption to the clearings concerned, it has been agreed that a period of at least 12 months (24 months in the case of the Cheque and Credit Clearing Company) must elapse between acceptance of an application and joining the operational clearings. This requirement enables existing members to adapt their systems to accommodate the new participants, and the applicants to develop their own systems. Applicant institutions which have been accepted for membership are required to pay an entry fee based on the costs incurred by the existing members of the relevant clearing in adapting their systems to accommodate the new institution, together with any central costs. The applicant also has to purchase a shareholding in the clearing company. In the case of BACS the asset value of the company is substantial, with the result that the cost of acquiring a shareholding (in proportion to the applicant's transaction volumes in that clearing) is material, while in the other two clearing companies the shareholding is only of nominal value.

The new and aspiring members of APACS have found that, apart from the entry fee and the acquisition of shares, there are also substantial in-house costs incurred in joining a clearing company. A consistently high level of technical performance has to be maintained to ensure that the activities of the new member do not in any way endanger the integrity, reliability and efficiency of the clearing they are joining. Moreover, resources have to be made available to meet the timetable and all the other requirements and extensive responsibilities detailed in the rules of the clearings concerned.

When the Child Report was compiled, it was not anticipated that the implementation of the proposed changes would coincide with the major deregulation of the building societies that was provided for in the Building Societies Act 1986. The coincidence has to some extent complicated the task of opening up the clearings. For in the past, banks joining the clearing house invariably had many years' experience of money transmission activities before they took up settlement membership, whereas for the building societies this is largely a new area of operation and there is consequently more to be done by way of preparation for this key role in the payment systems.

## Growth in payments

A notable feature of the payment systems in recent years has been the sustained growth in both volumes and values of items cleared. The table below gives these figures (inter-bank only, inter-branch items are excluded) for items processed in the London clearings in 1981 and 1986, together with an indication of the percentage changes registered over the period (during which the RPI rose by some 42%).

Clearing(a)	Volume (millions of items)			Value (£ billions)		
	1981	1986	Change	1981	1986	Change
Cheque	1,501	1,962	+31%	432	766	+ 77%
Credit	202	174	-14%	61	80	+ 31%
CHAPS(b)	—	3.2		—	4,144	
Town	4.8	4.3	+56%	4,404	8,173	+180%
BACS	489	944	+93%	42	151	+260%

Source: *Abstract of Banking Statistics*. Statistical Unit, Committee of London and Scottish Bankers.

(a) Excludes inter-branch items.

(b) CHAPS commenced operations on 9 February 1984.

The importance of BACS, the largest automated clearing system in the world, is evident from these transaction figures, but also noteworthy is the continued popularity of the cheque in routine money transmission activities. The average daily value of turnover in the CHAPS and Town Clearings in 1986 was some £49 billion, compared with £17 billion for the Town Clearing alone in 1981. Not included in the table are data for credit card and charge card transactions; these alone now number well over 500 million per annum. To put the volume figures into context it may be noted that the number of cash transactions for values in excess of £5 is estimated by APACS to be in the region of 4,000 million per annum.

## Electronic funds transfer at the point of sale

Over the past few years a number of EFT-POS experiments have been mounted by banks and building societies, but their impact in transaction terms has been limited. The incorporation, earlier this year, of EftPos UK Limited, under APACS rules, provides the framework for developing a single national electronic funds transfer scheme with an open and competitive membership and a wide card base, acceptable through a single terminal at each point of sale. Although the immediate effect of the national EFT-POS scheme on transaction volumes in the existing payment systems is unlikely to be very great, the picture could be markedly different in the longer term.

## Importance of payment clearing systems

While there is a tendency for payment systems to be taken for granted, the economic importance of their smooth functioning should not be underestimated. The Bank of England, in common with many other central banks, has become increasingly aware of the need to ensure that the payment clearing systems operate with integrity, efficiency and in an orderly manner. To this end the Bank was closely involved in the establishment of APACS and continues to play a full role in the development of the UK payment systems.