



BANK OF ENGLAND

# Speech

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## The future of payments systems: stability through change

Speech given by

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I would like to thank Joanna Bibby-Scullion and Tom Ludlow for their contributions.

Good morning. First of all, let me start by thanking the Westminster Business Forum for inviting me to speak here today.

### Change

To say there is a lot going on in the payments world at present would be an understatement. There is an atmosphere of real change, driven by the range of legislative, technological and regulatory initiatives that are underway. The current climate provides significant opportunities to make meaningful change to the industry, and it is right that we seek to maximise the positive impact that this change can bring, both in terms of benefits for those using payment systems and the stability of the wider financial system.

The Bank, too, is facing its own change. Our *Strategic Plan* – launched in March last year – set out a major transformation of the organisation including the creation of a directorate focused on financial market infrastructures (FMIs). This placed greater emphasis and devoted more resource to the Bank's work on FMIs, in recognition of the importance the Bank places on all systemic FMIs, including payment systems, and their increasing importance within the financial system.

And of course externally the Bank is also welcoming a new fellow domestic regulator with objectives covering competition, innovation and the interests of service users. I am pleased to say that the Bank and the Payment Systems Regulator (PSR) have already developed an extremely good relationship. My colleagues and I have worked closely with the PSR ahead of the publication of its first consultation paper; to which we have formally responded. And this close cooperation will continue up to and after the operational launch of the PSR in April this year.

### Stability

Today I am here to talk about stability, not change: in particular the Bank's role in maintaining financial stability through supervising systemically important payment systems in the UK.<sup>1</sup>

Safe and robust payment systems are fundamental to the smooth functioning of the UK economy. They underpin so many of the activities that people take for granted, from being paid their wages to buying their groceries. This is why the Bank's focus in terms of payment systems supervision – as set out by the Banking Act 2009 – continues to be protecting and enhancing UK financial stability. The importance of financial stability is reflected in the legislation creating the PSR. As I think we would all agree, it is impossible to have sustainable, effective competition and innovation without a stable base to build on.

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<sup>1</sup> A list of payment systems recognised by HM Treasury for supervision by the Bank of England can be found on the Bank of England's website:

[http://www.bankofengland.co.uk/financialstability/Pages/fmis/supervised\\_sys/rps.aspx](http://www.bankofengland.co.uk/financialstability/Pages/fmis/supervised_sys/rps.aspx)

This morning I would like to briefly outline some of the advances that have been made in recent years in pursuit of stable and robust payment systems, before sharing the Bank's thoughts on assessing future change to the payments landscape from a stability perspective.

A great deal of progress has been made on financial stability issues in recent years, in conjunction with many in the industry. Work is well underway on what we term 'detiering' in CHAPS – reducing the financial stability risks associated with banks accessing payment systems via other banks, by increasing direct participation. We are also working towards the introduction of cash prefunding in Bacs and Faster Payments. Cash prefunding will mean that all direct participants have to hold cash to the value of their net payments made, which means if they get into difficulties this money can be used to settle them without other banks having to contribute. We view these initiatives as important steps in ensuring a robust and resilient financial system going forward. Events over the past few months, even close to home, have shown the importance of payment systems being stable, highlighting that this must remain a constant area of focus. However the benefits of these and other initiatives go beyond increased stability; work on this front can also support competition, innovation and the interests of service users.

But of course, there is still a lot more to be done.

Some may think that change and financial stability are not necessarily compatible. I would disagree. Change can actually help support our financial stability objective and its benefits should not be underestimated. Of course change can also bring risks. It is important to make sure that the recent gains in financial stability are not lost when looking at shifts to the payments landscape in the coming years.

This is one of the reasons why it is so critical for the Bank and the PSR to continue our close working relationship and engagement with industry, to make sure that we can both advance our objectives at the same time.

But the need for cooperation and coordination stretches far broader than just the Bank and the PSR. The Prudential Regulation Authority (PRA) – which is a part of the Bank – and the Financial Conduct Authority (FCA) also have important roles to play in this sector, as the prudential regulator of banks and as the consumer facing regulator respectively. That is why the authorities will enter into a Memorandum of Understanding before the formal go-live of the PSR on 1 April.

#### Criteria for assessing change

Openness between the authorities and with industry will be key to ensuring payment systems and their participants are regulated effectively and efficiently in the UK. It is in this spirit that I want to set out four key criteria for financial stability against which we will assess change to the industry. These criteria form the basis of the Bank's response to the PSR's first consultation which will be published in due course.

In keeping with a speech on stability, I would hope that none of what I am about to say will come as a surprise, but I see real value in reaffirming these views to provide absolute clarity on the Bank's position and to help feed into the ongoing debates.

#### *Settlement risk*

First, reforms to the UK payments landscape should not lead to an unacceptable increase in settlement risk. This has long been an area of focus for the Bank's payment systems supervision, with the future introduction of prefunding in Bacs and Faster Payments a good illustration of steps taken to address this risk.

The Bank itself plays an important role in minimising this risk too by using its own balance sheet to settle the obligations generated in a number of UK payment systems meaning that banks' exposures to other banks can be limited. Determining how settlement risk is addressed will be key to assessing the merits of reforms to the payments landscape.

#### *Robustness and resilience*

Secondly, changes must maintain or enhance the robustness and resilience of UK payment systems. The importance of payment systems to the broader financial system necessitates high standards here, and this also applies to the Bank in terms of its role as provider of critical infrastructure.

As an example, in recent years, the Bank has worked with other authorities to tackle cyber risk, both internally and through its supervision of systemically important payment systems. Several recent events, such as the Sony cyber-attack, highlight just how important effective cyber resilience can be and the unique challenges that cyber risk presents. In recognition of this in June 2013 the Bank's Financial Policy Committee recommended that the relevant authorities should undertake work to test and improve resilience to cyber-attack of the firms at the heart of the financial system.<sup>2</sup> Much has been done since then in response to this recommendation, not least the development of CBEST; the Bank's new bespoke, intelligence-led framework for testing cyber vulnerabilities that we are rolling out with all our supervised FMs. As a key area of focus, the impact of changes to the payments landscape on robustness and resilience will need to be assessed carefully.

#### *Continuity of payment services*

Thirdly, UK payment systems should facilitate the continuity of payment services in resolution. What do I mean by this? Well at the most basic level that when a bank is put into resolution and stabilisation powers are applied, customers should be able to continue to make and receive payments, and equally that payments can still be made during the financial failure of a payment system operator. This is crucial to minimising any adverse impact stemming from the failure of a systemically important firm. The Bank will

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<sup>2</sup> "HM Treasury, working with the relevant Government agencies, the PRA, the Bank's financial market infrastructure supervisors and the FCA should work with the core UK financial system and its infrastructure to put in place a programme of work to improve and test resilience to cyber-attack." The full FPC record can be found on the Bank of England's website: <http://www.bankofengland.co.uk/publications/Documents/records/fpc/pdf/2013/record1307.pdf>

closely consider the extent to which structural change impacts the resolution process and the ability to provide continuity.

*Effective supervision*

And finally, the Bank's ability to effectively supervise systemically important payment systems must be maintained. As a vital part of the UK's economic and financial infrastructure, it is essential that payment systems are designed and managed effectively. Shortcomings can present serious risks to financial stability, both through the impact on the banks that use payment systems and by acting as a mechanism for the transmission of disturbances from one part of the financial system to another.

The Bank's supervision uses internationally recognised principles, developed jointly by CPMI and IOSCO, as a basis for supervision. Any changes to the payment systems landscape must ensure that firms can continue to meet these principles and that the Bank can continue to regulate systems effectively.

Conclusion

What is the message I want to leave you with today? That when carefully considered and effectively managed, change can bring a wide range of benefits both to service users and to financial stability more broadly. At this current juncture there are significant opportunities to achieve this constructive change for the benefit of all industry stakeholders.

The criteria I set out earlier, covering settlement risk, robustness and resilience, payment continuity and effective regulation, provide a good starting place to consider how the payments landscape is shifting and make clear the areas the Bank considers to be of importance. The Bank is ready to support the PSR and other stakeholders in considering the financial stability implications of any future developments and is looking forward to actively participating in the debate on the future of the UK payment systems landscape. To that end I look forward to a number of interesting and lively discussions over the rest of the forum as well as in the coming months.

Thank you very much for your time.