

Central Bank Oversight and the Changing Retail Payments Landscape

Commentary

Jonathan Williams

I'd first like just to say how honored I am to be invited to comment on such an insightful paper. I'd also like to say that like Dickson Chu I am not an economist. So that did prompt a question in my mind when I was invited. Why me? Because I don't represent a bank at all. We're not a payments institution. We are not an operator of payments. In fact, we are not even under oversight. What's worse, I suppose, I'm a European.

One thing I do bring to the table is I bring a different perspective. We sit outside typical payments operations, as a vendor of technology services and a provider of the data which helps you make payments transactions day in and day out. So I hoped by stepping outside, I'd be able to give you a slightly different look at the issue of oversight from a central bank perspective.

I have to say it's been a real pleasure to comment on this insightful paper. I hope to be able to share some of my viewpoints and observations, and illustrate them with some examples from Europe and the UK.

My first observation is this particular paper is unlike a lot of papers or publications on oversight. It is not utopian. It actually takes a pragmatic view of how you can really implement central bank oversight with all the different pressures we have, including the changing landscape of payments. I suppose I ought to point out these are my views brought from experience, so don't hold me to them.

First, look at how we do oversight and the question of the scope. Ron, in this paper, said it needs to be a broad scope and needs to encompass all those different entities, those different targets for oversight, which could have a significant effect on the systemic or systemwide risk of the payments within your individual target location.

There is a good question of where to draw the line and whether, for example, Experian, as provider of lots of payments data, should be included within the oversight of a central bank somewhere. I do definitely agree with Ron when he talks

about making a clean assessment against assessment standards, because it will give a good objective view of whether that organization, whether that target of oversight, is actually compliant or not. Only by actually having proper well-defined assessment standards and the proper assessment methodology can you actually get a good answer to that question.

But there is also another thing we need to bear in mind when we are looking at central bank oversight and that is also the user voice—the voice of the users of the payments system—and what their problems are. It may well be that we don't see from a banking perspective there is a particular issue with one particular payment type. The users on the ground really understand that. That is an important part of the overall understanding of how oversight can be implemented. Understanding and getting information from the users of payments systems is as important as being able to assess those against independent standards.

There is also an interesting question of multinational organizations that offer different services around the world and whereabouts those organizations should be overseen. One good case in point is the SWIFT cooperative, of course based in Belgium, but they provide services worldwide and not necessarily all the same services in different locations. In some locations, they very much provide services for the real-time gross settlement systems.

Ron in his paper brings up a good question of prioritization. There is never enough time to be able to oversee all the different targets for assessment we would want to look at. Therefore, there needs to be a pragmatic approach taken to exactly which ones we look at first. Ron also makes the point we have to be pragmatic and react to changing events in the payments industry. And certainly with the changing landscape it does affect that quite considerably.

One of the things we need to bear in mind is something which is really outside oversight and that's looking at the payments policy or payments strategy on how that might help our prioritization of which targets we look at first. Certainly, if we know where we are in terms of the systems we view as legacy and those systems we view as “the to-be systems” then maybe concentrating on those two different ends—the ones we want to end and the ones to encourage—maybe that helps us prioritize oversight of those different types of organizations.

Ron asks a couple of very good questions on *why* we do oversight. There are three things which sit within the environment around oversight. First is the payments strategy, so where are payments going in our territory and our region, what are the things we want to try to encourage, what are the problems we foresee over the next few years? Then there is the other side, which is the regulatory side. So, once we've overseen a particular target organization, if there are consequences associated with noncompliance, how do we encourage regulation to be able to tackle those particular issues?

There is also the issue of separation of operators from scheme owners. We've already heard about the Chinese walls within the Federal Reserve Bank of Kansas City. But, over the last five or six years, we've seen a number of different scheme owners set up completely separately from the operators of those payments systems.

There are a couple of good examples. There is Currence obviously in the Netherlands. In the UK, we split our clearinghouse, Bankers' Automated Clearing Services (BACS), into a scheme company, BACS Payment Scheme Limited and VocaLink, the operator of that ACH. In the UK, we've also given the ownership of the Faster Payments scheme you've heard about earlier on to the CHAPS Clearing Company that operates the real time gross settlement (RTGS) system, which is an interesting decision. I can completely understand now why it was done.

What role to safety and efficiency? To a large extent, in his paper, Ron points out it's the confidence of the users of the payments system in that payments system. So when in the UK we replaced our clearinghouse access mechanism for corporates, which is called Bacstel with an IP-based version innovatively called Bacstel-IP, there was a lot made of the change in new technology.

What was interesting was they completely changed the way their security worked. Historically, we used to have calculator-like devices for putting authorization numbers on individual sets of payments. With Bacstel-IP, we moved to smart cards, which was much, much better. Of course, the message wasn't that the security wasn't good enough before, it is just now a lot better.

This is the sort of thing we need to encourage—the improvement in overall systems—and try to avoid the systemwide failure the Bank of England has been talking about in some of their payments systems. In the UK, we have a systemwide flaw potentially in the direct debit system, so that if, for example, I gave somebody else's bank details to pay one of my bills, then there aren't typically systems to be able to detect that type of payment fraud.

In fact, a journalist famously said, "Well, you can't use my account details. If you're going to use my details, pay me some money. So go ahead."

Two days later he found himself paying £500 to a charity by direct debit. What was interesting was not the fact he was extremely opinionated and had to eat humble pie, but the fact that it highlights a problem—there is no safeguard for that type of fraud. Therefore, there is a need, a potential opening, a potential chink in the armor of the direct debit scheme in the UK which can be exploited.

In the UK, we also looked at how payers perceive how secure systems are. We are very keen on the direct debit system, as you are probably aware. So much so, when we started off moving consumers across the direct debit payments, we assess an unlimited guarantee. If they disagreed with a direct debit coming out of their account, they had an unlimited time to recall that payment back.

Under the tenets of the payments services directive, all of the countries were

asked to look at that recall period to work out whether that should be shorter. In the UK, we very much looked at it, talked to all the corporates, and we said, “Maybe a little over a year,” and then proceeded not to change it at all. So it was then kept as an unlimited guarantee, which is important. It means no direct debit payment in the UK is ever final. It always might possibly be called back in 50, 100, 150 years’ time, which is a problem.

Ron also talks about efficiency, as part of the banker BIS definition of what oversight should look at. Of course, the easiest way to identify efficiency is to look at the *user* interest in the things which may help them. In the UK, one of the inefficient parts of the system was that payments that failed would occasionally be returned, not by the electronic system they had been paid out by, but a paper system, typically missing a lot of the reference information. In fact, that was done by one of our larger banks in the UK and not particularly helpfully. I hope they were subject to interesting discussions with the central bank about that.

In terms of efficiency and payments, it’s to some extent the strategic view of where our payments are going that helps us look for those efficiency improvements. In the UK, the Payments Council, which is the strategic body looking at payments over the next 10 years or so, has set up a number of different projects. Two of which I’ve been involved with are around payments records information—how you reconcile the individual transactions back to the customer accounts and the standardization of account numbers.

Unlike you, our account numbers vary from 70 digits to 12 digits, including alphabetic characters. In some cases, there is no particular pattern. It is a problem in the UK. It is a problem if you’re trying to pay into the UK as well. For efficiency goals, we suggest asking users.

Matthew Bennett was talking earlier about the issues of transferring accounts between banks. I hope I’m able to offer him a potential insight on these questions why that doesn’t work particularly well. In the UK, bank transfers of things like direct debits and standing orders work very well. There is a system called ToDDaSO, transfer of direct debits and standing orders, which actually does that particular process, but it relies on the corporates that own the direct debits, the recipients of those payments I suppose, to be able to change their records and their business systems. Not all corporates do that, which is one of the problems caused by the direct debit system. I am sure Matthew is already aware of that.

Some efficiency savings actually come by talking with users of payments systems and finding out what the problems are. That particular interaction is quite useful to shed light on where we can improve and where the targets of our oversight can help.

We talked a little bit about new initiatives and new entrants to the market. Really, the reason why those new entrants are, I suppose, challenging—like the

overlay payments system mentioned by Ron earlier—is they challenge the assumptions that were originally made. The assumption of online banking is you have the user in front of you and they directly enter data into that online banking system. With the overlay system, that's not the case. It sits in the middle in intercepting some information.

Therefore, when we're looking at new entrants and they are challenging those assumptions, we should consider whether those assumptions are still meant to be valid or whether we need to change those assumptions and potentially change the assessment standards for which we are doing oversight.

I do have a question on new entrants and their willingness to be overseen. Ron has obviously had a very positive experience dealing with new entrants into the market. I'm slightly concerned, but in some cases we don't get the degree of transparency from those new payments service providers that we do from historical financial institutions. There is always a question of what the consequences are if that new entrant does not want to play ball with oversight.

In the case of the competition in the paper, Ron talks about how competition may drive down safety. Actually I have an example where competition drove up safety or at least complicated it anyway. In the UK when they moved to this new Bacstel-IP system and they looked at how individuals might identify themselves, each bank went for a completely separate trust scheme and set of smart cards and set of standards—all interoperable, but ever so slightly different. Therefore, there was no single point of failure in terms of the trust scheme.

Of course, it caused a lot of problems for corporates, which were dealing with multiple banks, but that wasn't the problem. It was arguably slightly more secure. And there was a very technical issue, which was called split siding, which if you're interested in I'd be happy to discuss later on. It was a very deep technical issue, which again was a risk-averse way of looking at it.

So the question is, if fees go down, does that drive a lack of innovation? We would probably all agree, if there is less money around, there is less money for investment. I suppose the corollary isn't always the case. If the fees go up, the innovation doesn't suddenly come in. Just the profits go up and the shareholders get happier.

Finally, looking at the common infrastructure, it is certainly a question of economies of scale versus stability. If you're using multiple infrastructures, which still make economic sense, then arguably there is some greater strength associated with that.

In the UK, the Faster Payments scheme actually relies on the Bacstel-IP interface window to be able to submit payments from corporates. Instead of having two completely separate systems—so if Bacstel-IP failed you would be able to use Faster Payments—they run across the same piece of hardware and, therefore, there is a good question as to whether they are giving the level of stability required.

In conclusion, this is a great paper. It is extremely pragmatic and takes a number of steps forward in how to really implement oversight. There are some questions it poses over the central bank levers over new entrants to the payments market. My personal view is we should be using the user voice more when we are trying to assess those individual targets against their assessment goals.