HM Treasury

Speeding up cheque payments:

summary of responses

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You can download this publication from www.gov.uk

ISBN 978-1-909790-73-5
PU1680

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1 Introduction

Background to the consultation

1.1 The Government is committed to ensuring that the UK's payment systems are innovative, efficient and effective, and that they meet the needs of end-users. Cheques continue to form a vital part of the British payments landscape, accounting for ten per cent of all payments made by individuals in 2012, and forming over a fifth of all outgoing payments made by sole traders, other micro businesses and small businesses.

1.2 The Government has already taken a number of steps to ensure that the banking industry provides individuals and businesses with a choice of payment methods that meet end-users' needs. Following pressure from the Treasury Select Committee and the Government, the banking industry reversed its decision to close the central cheque clearing system, and agreed to provide cheque services for as long as customers needed them. In 2013, the Government legislated to introduce a new Payment Systems Regulator, which will be equipped with a full range of powers to promote competition and innovation in the payment systems market, and to ensure that systems are operated in the interests of end-users.

1.3 The Government is now taking a further step to support ongoing innovation in UK payments and to secure the future of cheques. On 7 March 2014, the Government published a consultation document, *Speeding up cheque payments*. This invited responses on proposed legislation to allow for the introduction of cheque imaging, an innovation that will speed up cheque clearing times by sending an electronic image of the cheque for clearing, rather than the piece of paper itself. Cheque imaging is already established in the USA, France and parts of Asia.

1.4 The Government received over 60 responses to the consultation. Submissions came from banks, building societies and credit unions, payment scheme companies and other firms providing services in the cheques industry, business and consumer groups, charities and private individuals. A full list of respondents can be found at Annex 1).

1.5 This document summarises the submissions received in answer to the consultation questions, and sets out the Government's response, indicating where the final policy has been adjusted to take respondents' contributions into account. The Government is grateful for all of the contributions made by stakeholders during the consultation process.

Key themes

1.6 The Government welcomes the widespread support across stakeholder groups in response to the proposal to legislate for cheque imaging. It was clear from the contributions that cheque imaging will offer a wide range of benefits, both to end-users and the payments industry.

1.7 Respondents preferred the option of the industry moving as one to a new cheque imaging infrastructure, given the customer benefits of consistency and certainty about the availability of imaging and clearing times.

1.8 The Government has carefully considered the views put forward on the subject of liability. The legislation will enable the Treasury to make regulations in due course to place liability on the payee's bank for designated types of fraud and error. The new framework will improve the clarity of the existing law, and tailor liability so that it satisfactorily reflects the different roles being performed by beneficiary and paying banks.

1.9 The Government aims to ensure that UK payment systems and services meet the current and future needs of consumers, businesses and other users. The Government's expectations for the new cheque imaging model are as follows:

- customers will still have chequebooks and will continue to write cheques exactly as they do now
- customers will have choice over how they deposit cheques. Any new options to pay in remotely by smartphone or scanner will be in addition to, and not instead of, paying in paper cheques at bank branches, cash machines, Post Offices and by post
- customers will have greater certainty about when money actually moves from one account to another
- the payment system will facilitate competition by permitting open access to participants or potential participants on reasonable commercial terms
- the payment system will be stable and reliable; the Government expects the banking industry to implement tough measures to mitigate any new fraud and security risks

Next steps

1.10 The Government will support the introduction of cheque imaging in the UK by legislating a suitable framework in the forthcoming Small Business, Enterprise and Employment Bill. As is discussed in Chapter 5, the timings for industry implementation of the measures are currently being finalised. The Government is working with industry to identify the most appropriate date for implementation, and will bring the new legislation into force to meet the identified timetable.

2 The case for cheque imaging

2.1 This chapter looks at the principal question of why cheque imaging should be introduced in the UK, and includes a summary of the key costs and benefits identified by respondents.

2.2 The consultation document set out how the current physical transportation of cheques across the UK causes unnecessary delay and expense. The Government identified four key benefits that cheque imaging will offer to end-users and the banking industry: speeding up clearing times, increasing consumer convenience, reducing operational costs and helping challenger banks to compete with incumbents.

Summary of responses

2.3 Consumer organisations, business groups and charities from across the UK welcomed the key benefit of speeding up cheque clearing times from six days to two. Submissions reported that customers generally regard cheque clearing times to be too slow, and that the current 2-4-6 standard is rarely understood and makes it difficult for people to budget and manage their finances[1]. Contributors welcomed that the Government's proposals would allow money to move more quickly and efficiently through the payment system and the wider economy. Small businesses groups highlighted the detrimental effects caused by late payments. Research from one small business stakeholder showed that 77 per cent of smaller businesses report that being paid late leads them to fail to pay their suppliers on time. As smaller businesses tend to depend more heavily on the use of cheques, they stand to gain from this reform.

2.4 Respondents agreed that the proposals for mobile deposit would help some people in the UK to overcome barriers to financial inclusion. Contributors saw that the measure would benefit customers living in areas without ready access to a bank branch, people with limited mobility or people who, due to work or other reasons, find it difficult to visit a branch during banking hours. It was also pointed out that, by providing recipients of cheques with greater convenience in how they deposit, cheque imaging will cut down the time it takes for the payment to complete: today, finding a physical branch and paying in during banking hours can lead to delay. Respondents also appreciated that cheque imaging will reduce the risk of paper cheques being misplaced or physically damaged, both before and after a customer deposits the cheque.

2.5 Cheque users also welcomed that the measure, by increasing the efficiency of operating the payment system, will improve the sustainability of the cheque as a payment option that banks and building societies can continue to provide. Submissions from retail and consumer groups and the third sector reiterated the continued importance of cheques as the primary means by which many in the UK transact, either through preference or because this is the only method of payment open to them.

[1] The 2-4-6 standard means that a customer paying a cheque into their account starts to earn interest on the money no later than two days after depositing the cheque; no later than the fourth day, the customer is able to withdraw the money from the deposited cheque, but the cheque can still be dishonoured ("bounce"); only on the sixth day can the customer be certain that the money is theirs and that it will not be reclaimed from their account without their consent, unless they are a knowing party to fraud.

2.6 Service providers shared their experience of the rollout of imaging in other countries, conveying high levels of customer interest for smartphone deposit in the USA. They also noted that the biggest take-up of remote deposit has been by corporate customers, who are able to image large volumes of cheques at their own premises using desktop scanners. The Government also noted that not all stakeholders have the same appetite for depositing cheques remotely. Some end-users and financial institutions explained their preference was not to use smartphones and scanners, and they supported the Government legislating in such a way that the choice remains open to them.

2.7 On the costs associated with introducing cheque imaging, respondents anticipated the need for infrastructure investment, to allow financial institutions to quickly and securely exchange electronic cheque images and data. Some submissions also referred to the cost of new fraud prevention measures, though the Government also noted that software and hardware for image-based fraud detection is already in use in some parts of the industry. Smaller banks and building societies raised questions about what the initial set-up costs would be and how they would be distributed across the industry. It was generally expected, however, that these initial costs would be recovered in the near term, given the scope for substantial savings in the very high annual running costs of the existing cheque infrastructure. Evidence was submitted for cost savings experienced in countries where cheque imaging has already been implemented. For example, Federal Reserve analysis of the impacts in the USA concluded that the cost of processing a cheque could be reduced by more than 70 per cent.

2.8 A number of contributions, from large incumbent banks, challenger banks and third party service providers, commented on the opportunities for imaging to lower barriers to entry for small or new players in retail banking. Many noted that the option of customers paying in cheques by smartphone or other mobile device will help to level the playing field by reducing the need for challengers to acquire a physical branch network. Respondents with direct experience of implementing cheque imaging in other countries reported that remote deposit capture resulted in an increase in competition and account switching.

2.9 The Government also noted that cheque imaging will offer sort code flexibility in line with the electronic payment schemes. By allowing for the electronic exchange of cheque images and data, cheques can be sorted using the full six digits of the sort code, rather than simply the first two digits as happens today with mechanical sorting. Today, agency banks can be discouraged from switching between providers of access because moving to a new sponsor can mean being allocated a new sort code. With cheque imaging, switching between providers of access will be easier as agency banks seeking to move from one sponsor provider to another will be able to retain the same sort code, account details and documentation for their customers.

2.10 Several challenger banks also expressed keen interest in the opportunity for the new infrastructure to be designed as a central platform offering institutions the ability to "plug and play", with easier and more transparent access for small or new entrants in the retail banking market.

Government response

2.11 The Government welcomes the comprehensive backing for the proposals to provide for cheque imaging, and is pleased to note that support was consistently high across all stakeholder groups, from the banking and payments industry, to representations from businesses, consumers and charities. It notes the opportunities that cheque imaging presents to help challenger banks and competition in retail banking, and expects the new model to reflect the principles of fair access set out in Chapter 1. The Government is including a clause for introduction in the Small Business, Enterprise, and Employment Bill to allow for cheque imaging in the UK.

3 Proposed legislative measures

3.1 This chapter sets out the key legislative changes that will be needed for cheque imaging to be introduced in the UK.

3.2 The consultation document explained that elements of the existing statute are standing in the way of cheque imaging. In particular, under the current legislation, a paying bank has the right to demand that it is presented with the physical cheque before deciding whether to honour the payment. The Government proposed to remove this right of the paying bank, and to render an electronic cheque image as equivalent to the original where a cheque is presented for payment.

Summary of responses

3.3 Respondents were widely in agreement that it will be necessary to amend the rights of the paying bank. Contributors thought that, without this key legislative reform, financial institutions would be obliged to continue collecting physical cheques from customers and to deliver them through the traditional, paper-based infrastructure. The benefits of cheque imaging for the industry and end-users would, therefore, be largely negated.

3.4 A very small number of submissions (provided by banks, cheque service providers and end-user groups) thought that the paying bank should be able to request the paper instrument in exceptional cases, such as suspected fraud. However, in the other responses received, several banks observed that the sophistication of technology is now such that it can support a paying bank making a "pay/no pay" decision on the basis of a high quality electronic image alone. It was also pointed out that the collecting bank will be well positioned to carry out checks for fraud on the physical paper it receives, as it will continue to receive many deposits over its branch counter. As is set out in more detail in Chapters 4 and 7, higher risk customers and higher value transactions may be excluded from mobile capture.

Government response

3.5 The Government welcomes the extensive support among stakeholders for the key legislative changes proposed. The Government intends to include the following core features in the legislation, which will enable the industry to introduce cheque imaging:

- to allow for a cheque to be presented by providing an electronic image that clearly reproduces the front and back of the cheque
- to remove the right of the paying bank to require physical presentment and delivery of the original paper cheque
- to provide for banks to permit their customers to create these electronic images themselves – this will allow for customers to capture cheque images by smartphone, scanner or other devices and pay them in remotely

Beyond these core features to facilitate the introduction of cheque imaging, the Government is making several further legislative provisions – extending the new method of presentment to other paper instruments, as well as ensuring robust protections for financial inclusion and for fraud and security. These are set out in Chapters 4-7.

4 Customer choice in depositing cheques

4.1 This chapter considers how to protect customer choice to deposit cheques using traditional channels, including branches, cash machines, at the Post Office and by post.

4.2 In *Speeding up cheque payments*, the Government made clear its expectation that banks and building societies must continue offering the current options for customers to deposit cheques, and that the new option of paying in cheques remotely by mobile device must add to, not displace, these existing channels. The Government proposed to legislate to enforce this.

Summary of responses

4.3 There was unequivocal support for the principle that, under the new model, customers should be able to continue paying in cheques in the ways they are used to. This was seen as vital because cheques are so important for many members of society who may already face barriers to financial, digital and social inclusion. While the uptake of smartphones and online/mobile banking has been significant in recent years, respondents did not generally expect to see all types of cheque user wanting to deposit cheques in this way.

4.4 The Government's proposal to legislate to protect customer choice was firmly welcomed in submissions representing the views of businesses, consumers and charities. A number of contributions from third party cheque service providers also supported the Government's intention to legislate on this. Some of these firms, with experience of the rollout of cheque imaging elsewhere, noted that in any case, banks and building societies will want to continue receiving some paper cheques by traditional channels. They anticipated that not all customers will be permitted by their bank to deposit remotely via mobile device; for example, customers making high value transactions or with a high risk profile may be required to pay in paper cheques over a branch counter, to allow for extra scrutiny of the instrument itself.

4.5 Nearly all of the smaller banks, building societies and credit unions approved of the Government's proposals. They reiterated the importance of customer choice and the need to preserve the features of the cheque that make it such an inclusive method of payment. A number of these financial institutions expected that many of their customers will prefer to continue paying in by traditional channels.

4.6 Many of the large, incumbent banks responding to this question also agreed that customers must have choice under the new model. However they did not agree with the Government explicitly legislating to enforce this. They thought this was unnecessary, and some were concerned that legislation would be overly prescriptive and inflexible. Several commented that the Financial Conduct Authority (FCA) or the new Payment Systems Regulator will have powers to act if financial institutions try to restrict customer choice in channels for deposit and that this would be sufficient.

Government response

4.7 The Government believes it is vital to ensure that customers can continue to pay in cheques using the channels they find most familiar and convenient to use. The Government has made it clear that the option of depositing by smartphone or other mobile device must broaden customer choice, not restrict it.

4.8 As set out in the Chapter 3, a bank will be able to authorise a customer to create an electronic image to present a cheque for payment. In addition to this, the legislation will specify that a bank is unable to authorise the creation of this image where it is offering the customer no other means of paying in the cheque. Therefore, in the event that a bank attempts to force a customer to pay in exclusively by electronic image – refusing to accept a cheque deposit in paper form – then that bank's authorisation of the creation of the image would be defective. The Government will also provide in regulations that any bank that attempts to do this would be liable for any loss arising from this situation.

4.9 This does not mean that banks and building societies need to have their own bank branches. The legislation is open as to whether, for example, shared counter services or postal deposits are provided as alternatives for customers depositing by paper.

4.10 The Government also notes the position of the FCA, Financial Ombudsman Service and the Payment Systems Regulator in protecting the interests of financial services customers and end-users of payment systems. The regulators have robust powers to step in if customers are treated unfairly, such as being denied the option of paying in cheques in paper form.

5 Implementation

5.1 **This chapter considers the question of how and when the banking industry will implement the move to a cheque imaging model.**

5.2 The Government's consultation document outlined how, once the legislation removes the right of a paying bank to demand delivery of the original paper cheque, all relevant financial institutions would need to be ready to accept digital cheque images. *Speeding up cheque payments* observed that there was a strong case for the industry moving as one onto a cheque imaging model, but it invited views on a second option, which would allow financial institutions to continue to receive cheques in paper form, known an Image Replacement Document (IRD). The consultation document also asked for stakeholder views on whether speeding up the clearing cycle to two days was both a desirable and realistic target.

Summary of responses

5.3 On balance, respondents were clearly in favour of the whole industry moving at the same time to a new cheque imaging infrastructure. Financial institutions, firms providing cheque processing and other services, and end-user groups all registered the disadvantages of a fragmented transition to the new system. These responses emphasised the importance of a common service standard, so that customers can be sure when items will clear and be certain that they are able to deposit by image, regardless of who either they or the drawer of the cheque bank with. Disjointed migration to the new infrastructure could leave a legacy of a two-tier system that could continue for several years.

5.4 A very small number of submissions argued that financial institutions should start offering cheque imaging as soon as they were ready, regardless of the position of the rest of the industry. However, one of these contributions - from a business group - acknowledged that while this would bring the benefits of imaging to users earlier, an uneven provision of core cheque imaging services could create a further barrier to businesses switching accounts.

5.5 There was strong support for the Government having a role in identifying a date and setting the pace for the industry's transition, which came from a cross-section of banks, cheque service providers and end-users of cheques. However, most of the large incumbent banks, as well as some challenger institutions and end-users, raised concerns about the Government doing this by means of fixing a date in primary legislation. Responses from the banks stressed the need for further analysis and industry negotiation to define the final model of the new system, after which point it will be possible to scope the work and timings for migration to the new infrastructure. Both incumbents and challenger banks proposed that a separate agreement between Government and industry in due course would the best means of securing a date. One bank suggested the Payment Systems Regulator could have a role in this.

5.6 On the question of how long should reasonably be expected for the industry to prepare itself for cheque imaging, stakeholders replied with a variety of suggested different dates, albeit with the caveat that more detailed analysis would need to be undertaken before drawing up the timetable for implementation. At one end, several banks (both large and small), service providers and end-user groups, suggested a timetable of one year to 18 months would be achievable. The average proposed period was approximately two years. Across all types of stakeholder there were contributions that put forward three to five years as an upper limit.

5.7 There was very little interest in the Government providing for Image Replacement Documents (IRDs) to be exchanged as a paper alternative to electronic files. The overwhelming consensus was IRDs were unnecessary, adding little or no benefit, and would see some banks clear cheques on a slower and more expensive basis, maintaining a parallel paper infrastructure. A small number of service providers, and one end-user contribution, stated that IRDs could be permitted for an interim period, to allow banks to move to full cheque imaging at their own pace. However, other responses pointed out that, unlike in the USA (where IRDs were seen as a useful stepping stone to full imaging), here IRDs would not provide the key benefits of original paper instrument. In contrast with the USA, in the UK the original cheque has inbuilt security features (special ink, paper, holograms) that would be lost in the re-conversion process from digital image into IRD. Submissions also agreed that the IRD approach would be counter to the Government's objectives of modernising and rationalising the payment system, and one service provider pointed out that it would reduce the carbon footprint benefits offered by cheque imaging.

5.8 The banking industry, retailers, consumers and charities were all in support of a new timescale of two days, potentially structured as 1-2-2, replacing the existing 2-4-6 standard.[1] This was regarded as a significant step forward, giving a superior customer proposition that would also be easier to understand than the current "2-4-6" standard. Customers would earn interest earlier, receive notification of unpaid cheques sooner, and reduce their exposure to the risk of a "bounced" cheque.

5.9 Many of these contributions did note that the advantages of speeding up the clearing cycle would need to be balanced against the need for financial institutions to carry out robust checks against fraud and error. The new clearing window will need to leave sufficient time for these to be performed.

5.10 Some banks – mainly larger financial institutions, but also several challengers – thought that the industry could be more ambitious and aim to bring the entire process within one day or even nearer to real-time. However, other financial institutions and third party cheque service providers observed that it could be more difficult for small or new entrants in retail banking to meet a requirement to clear in near real-time.

Government response

5.11 There was widespread support for the Government to set the pace of the industry's transition to the new model. The Government recognises that there is further work to be carried out by the banking industry to define the infrastructure for the operation of the new payment system. The Government will now work with the industry to identify a suitable date for migration, to ensure that the benefits of cheque imaging are delivered to a clear, fixed, and timely schedule. The Government will ensure that any outstanding decisions are made quickly and with regard to the principles set out in Chapter 1. Once the timetable is agreed, the Government will make a commencement order to "switch on" the legislative provisions from a prescribed date.

5.12 The Government will not be making provision in the forthcoming legislation for banks and building societies to receive Image Replacement Documents. The Government believes that a clearing cycle of two days would be a significant improvement. It expects the industry to establish a new maximum standard for clearing times, guaranteed in scheme rules, taking into account the responses to this consultation.

[1] In line with the 2-4-6 standard, a 1-2-2 cycle would mean that a customer paying a cheque into their account would start to earn interest on the money no later than the first day after depositing the cheque; no later than the second day, the customer would be able to withdraw the money from the deposited cheque, but the cheque could still be dishonoured ("bounce"); and no later than the second day, the customer could be certain that the money was theirs and that it would not be reclaimed from their account without their consent, unless they are a knowing party to fraud.

6 Other paper instruments

6.1 This chapter covers the legislative provisions for paper instruments other than cheques.

6.2 *Speeding up cheque payments* set out the Government's intention to legislate so that relevant paper instruments, which are currently cleared through the same infrastructure as cheques, can also be cleared in image form. The document gave two reasons for this. First, many of these paper instruments are similar in appearance to cheques, and without uniform changes, there would be a risk of customer uncertainty about clearing times and the ability to pay in by image. Second, if these instruments could not be cleared in image form, then the old, paper-based infrastructure would need to continue running in parallel, undermining the key benefit of cost savings to the industry.

Summary of responses

6.3 Consultation responses generally accepted this proposal with little comment. A few stakeholders expected that applying the reforms to all these types of instrument could add some complexity, expense and time to the process. Overall, respondents agreed with both the points raised in the consultation, highlighting the need for a clear and consistent customer proposition and for operational efficiencies. Several providers of cheque imaging services mentioned that technology has already developed the capability to recognise and differentiate between types of document, allowing them to be imaged successfully. One payment scheme company and several banks pointed out that bank giro credits are not currently provided for in statute and, likewise, will not require specific provisions under the new legislation.

Government response

6.4 The Government acknowledges that including other paper instruments within the legislation could add some work and cost to the process of migration. However, the Government is persuaded that excluding these items from the option of clearing by electronic image would be detrimental as high fixed costs would continue for these other paper instruments. It would also confuse the customer proposition. The Government will therefore ensure that the legislation covers all types of paper instrument which need to be presented and which indicate the bank which is to pay, to allow them to be presented and cleared by electronic image. These would include:

- bankers' drafts
- postal orders
- government payable orders
- warrants;
- travellers' cheques

7 Security and fraud

7.1 This chapter looks at how the new cheque payment system will be made secure. It sets out a new framework for liability that will incentivise all parties to implement robust safeguards against fraud and error.

7.2 The Government's consultation document noted that a faster clearing cycle could reduce the incidence of certain types of cheque fraud, and listed a number of new defences that the banking industry is likely to implement to ensure the new system is safe to use. The Government also set out its intention to amend the legal liability of paying and receiving banks in respect of the new imaging model, since the payee's bank will now be better placed to carry out certain checks against fraud and error. The consultation document also invited views on the ideal allocation of liability in agency arrangements and whether additional due diligence obligations should be imposed in legislation.

Summary of responses

7.3 Submissions from almost all stakeholders included comments on the importance of making the new payment system secure and reliable to use. Many responses focused on the risks connected with a customer being able to deposit remotely via image and therefore not having to hand over the actual paper instrument for scrutiny by a bank or building society.

7.4 However, many respondents also described a range of protective measures that the payments industry will be able to implement to mitigate any new risks in the system. Some of these measures have already been developed for use in countries where cheque imaging is well established. The Government noted that the vast majority of fraud detection already takes place using the digital image captured at the processors, with a very small proportion of paper cheques inspected manually on an exceptional basis. Moreover, respondents noted that scrutiny of the physical cheque itself will still be possible, because in many cases paper cheques will continue to be deposited over branch counters, at cash points, Post Offices or by post. As referenced in Chapter 4, the payee's bank will have discretion over which customers it permits to pay in cheques remotely. Similarly, financial institutions are likely to specify thresholds limiting the value and frequency of transactions that customers can make by mobile deposit.

7.5 Other new safeguards that will be available include banks and building societies using instant messages to confirm a customer's intention to pay the given holder and amount. Financial institutions will also be able share real-time information about cheques that have already been paid into the system, so that no cheque can be paid in more than once.

7.6 On the question of liability, opinions were varied. In particular, there were conflicting interpretations of the current law on liability. Many respondents accepted the rationale behind the Government's proposal to place some liability on the payee's bank. Stakeholders also tended to agree upon the high-level principle that different banks (collecting, beneficiary, paying) occupy different positions in the payment journey and therefore have their own particular areas of responsibility in helping to reduce fraud and error. Respondents concurred on the point that, where an incorrect payment occurs, the liability should sit with the party that was best able to prevent the fault. However, responses diverged on the question of how these principles should be translated into a legal framework for liability.

7.7 Submissions from a cross-section of stakeholders recognised that, under the new model, where cheques are deposited over the counter or by cash machine, the bank which collects these will be best positioned to scrutinise the original paper instrument. Except in situations where there are three parties (for example, in the case of agency arrangements), this "collecting" bank will also be the payee's bank. Paragraphs 7.10 and 7.14 focus on situations where there are three parties involved. The existing framework, which in practice sees the paying bank absorb the cost of fraud or error, would not provide clear incentives for the payee's bank to take precautions against fraud and error. The following points were also cited by respondents as reasons for liability to shift, to a greater or lesser extent, to the payee's bank:

- the payee's bank introduces the cheque into the system, and is best placed to implement front-line measures to prevent fraud or error at the earliest stage
- the payee's bank will need to invest in good quality hardware and software, and meet image quality standards, to prevent poor-quality or tampered-with images entering the system
- the payee's bank will be able to ensure that only lower risk customers deposit cheques using a mobile device; the same would apply for high value transactions
- based on its direct relationship with the receiving customer, the payee's bank has a role to play in preventing account opening fraud, including carrying out know your customer and anti-money laundering due diligence
- the payee's bank can also carry out ongoing analysis of the account of the recipient of the cheque, to identify unusual or suspect activity; paired with its knowledge about the channel for deposit (ATMs and remote deposit being favoured by fraudsters), this bank will have a richer picture of risk
- the payee's bank will need to educate its customers about appropriate retention and destruction (e.g. shredding) of the original paper instrument; this can be enforced in the terms and conditions of the account relationship

7.8 However, many of the same responses were clear that responsibility could not sit exclusively with the payee's bank. One cheque service provider commented that, while it accepted the rationale for the payee's bank having greater culpability, they were uncertain about going so far as changing the legal liability. Respondents urged that any change to the legislation must not have the unintended consequence of discouraging paying banks from continuing with the rigorous safeguards they currently put in place. A variety of large banks, challengers and service providers all noted that there are certain checks that only a paying bank can currently carry out, including:

- based on its direct relationship with the paying customer, the paying bank will need to carry out basic technical and credit checks: validating the signature of the drawer, confirming it is within mandate and that there are sufficient funds available
- because of its role as issuer of the original cheque, the paying bank is arguably best placed to confirm the validity of the cheque itself and that it is not a counterfeit item; for example, the paying bank can check the authenticity of the cheque layout and the cheque number is a real one
- the paying bank will be able to analyse and compare the transaction against the wider account activity of the drawer

- the paying bank will be able to contact the paying customer to confirm their intention to pay the given amount and the payee, and also confirm the cheque number is correct

7.9 Some of the differences in opinion about the allocation of responsibility arose in part from uncertainty or ambiguity about the precise measures that will be available to the industry for tackling fraud and error. For example, some respondents argued that the detection of counterfeit cheques was the duty of the paying bank; others believed the responsibility sat with the payee's bank. If the final design of the new infrastructure provides banks with the capability to centralise more cross-industry information, then, for example, it could change the traditional logic of the paying bank needing to validate the authenticity of the cheque layout. It may be that the banking industry develops a database with information not only about cheques that have already been paid in, but also all cheque and account numbers, and genuine signatures, for example.

7.10 On the question of agency arrangements and how liability should be distributed between a collecting bank and a beneficiary bank, again, respondents generally pointed out that each type of bank has a different part to play. Contributions also highlighted that there are multiplicity of different types of agency arrangement. In line with the arguments set out above, it was generally felt that a collecting bank taking a cheque over its counter should inspect the look and feel of the instrument for signs of fraud, but a beneficiary bank would be best placed to analyse the usual account activity of the payee and carry out know your customer checks to prevent fraudulent account opening.

7.11 Most contributors did not believe that the legislation should impose additional due diligence obligations on banks, though a small minority suggested that the Government could take this approach as an alternative to amending the liability framework.

Government response

7.12 The Government intends to set out a high-level framework placing liability on the payee's bank for losses arising out of designated types of fraud and error. The Government notes that the allocation of responsibility will, to some extent, be contingent upon the final design of the new infrastructure - for example, the technical capability for cross-industry data sharing. It is also crucial that the new liability framework is sufficiently flexible to adapt over time. Therefore, the new legislation will give the Treasury a power to make regulations to designate the specific matters for which a payee's bank is liable. The content of these regulations will be published in due course, when a clearer view on the final infrastructure design emerges.

7.13 For types of fraud and error not designated in these regulations, the position would remain as at present, and in the event of the paying bank or drawer suffering a loss they would not be able to rely on the new legislation to make a claim against the payee's bank. The paying bank would still be able to consider making a common law claim in restitution or conversion, subject to the existing defences.

7.14 By clarifying the responsibility for losses arising out of particular matters, the Government's approach aims to align liability more closely with each bank's actual capacity to prevent fraud and error. This is intended to provide each party with the right incentives to ensure that the system is secure and reliable to use. The Government also intends that these principles will help agency banks and their sponsor banks decide which party should be liable for what in their contracts. The scheme rules may set this out, taking the lead from the definitions set out in the legislation.

7.15 The Government intends that the regulations will be drafted with reference to the two relevant banks (for the drawer and payee) currently referred to in the legislation, and will not specify other parties involved in the payment journey. This means that third parties, for example, used by financial institutions to outsource processing and other services, will not be identified as liable under the legislation, and it will be for banks and building societies to negotiate and agree in their terms and conditions as appropriate to each case.

7.16 The Government does not consider it necessary to impose additional due diligence obligations.

A List of respondents

A.1 The following organisations submitted responses to the consultation:

ACI Worldwide

Age UK

American Express

Aperta

Association of British Credit Unions Limited

Association of Convenience Stores

ATM Industry Association

Bacs

Barclays

Belfast Bankers' Clearing Co Ltd

Burroughs

Campaign for Community Banking

Cancer Research

Capita Asset Services

Centrica

Charities Trust

Charity Finance Group

Chartered Institute of Payroll Professionals

Cheque & Credit Clearing Company

Citizens Advice

Clydesdale

Consumer Council

Coventry Building Society

Danske Bank

Experian

Financial Services Compensation Scheme

Financial Services Consumer Panel

Fiserv

Forum of Private Business

Government Banking Service

Handelsbanken

Hoares Bank

HSBC

ICSA Registrars’ Group

Institute of Fundraising

International Finance Data Services

iPSL

Jack Henry & Associates

Keep Me Posted campaign

Lloyds Banking Group

Metro Bank

Monitise

National Federation of Retail Newsagents

National Pensioners Convention

Nationwide

NCR Corporation

Payments Council

Post Office

Royal Bank of Scotland

Santander

Secure Trust Bank

Tesco Bank

The National Church Institutions

The TALL Group of Companies

TNT

Transact

Tusmor

Virgin Money

VocaLink

Yorkshire Building Society

HM Treasury contacts

This document can be downloaded from www.gov.uk

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