Barclays Government Relations
and Public Policy
One Churchill Place
London
E14 5HP

www.barclays.com

PRIVATE & CONFIDENTIAL

FAO: chequeimaging@hmtreasury.gsi.gov.uk

7th April 2014

Cheque Imaging Consultation
Banking & Credit Team
Floor 1, Red
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Dear Sirs

Speeding up cheque payments: legislating for cheque imaging

Please find attached Barclays' response to the Government's consultation on cheque imaging.

We welcome the constructive dialogue we have already established with HMT, and look forward to this continuing as the enabling legislation is drafted.

We are happy for the attached response to be made public.

We trust that you find Barclays contribution of assistance and would be happy to discuss our views in further detail. If you have any follow-up questions please contact me by email: alan.ainsworth@barclaycard.co.uk.

Yours sincerely

Alan Ainsworth
Director, Government Relations and Public Policy

BARCLAYS RESPONSE TO HM TREASURY CONSULTATION

SPEEDING UP CHEQUE PAYMENTS: LEGISLATING FOR CHEQUE IMAGING, APRIL 2014

Executive Summary

Barclays is committed to continuing to enable customers to pay and be paid by cheque, and fully supports HMT's initiative to legislate for a move to image-based cheque processing.

Customers would benefit from speedier payment and also more choice and convenience as to how to pay in their money. Customers will still be able to pay cheques in in-branch as they do today, and will have additional choices such as being able to pay in using ATMs, through smartphone/tablet apps and using specialist scanners. All customers would be able to use the funds from the cheques they deposit more quickly.

This is an opportunity to move cheques into the 21st century, reduce costs and make banking even more convenient. A move to image could also open up cheques to further innovation from both existing and new providers.

Legislative change: enabling image

HMT is now familiar with the legislative changes required to improve the current system for customers so that images, rather than paper, are exchanged between the banks. Barclays supports these changes, and the sooner the better. The US system, Check 21, has been in operation for 10 years so we can be confident that we now have stable and tested imaging technology, enabling the new UK cheque scheme to minimise fraud and maximise reliability.

A New Scheme: how to replace the current system with one based on image

The image-based cheque scheme will need to look significantly different from the current paper-based scheme. In some respects, its rules will need to become more akin to a scheme such as the Faster Payments System, as it will be responsible for:

- Determining the standards and rules around what constitutes a "compliant image", in line with existing legal guidelines. This may extend to setting out certification practices, approved vendor lists, etc.
- Agreeing the process and timescales for dealing with both settlement and exceptions (e.g. high value, potential fraud, anti-money laundering concerns) and agreeing clearing and settlement timescales for "standard process" compliant images.

Barclays believes that our ultimate objective should be for a compliant cheque image to be processed in near real time, i.e. akin to the two hour window currently used for Faster Payments. This will require further consideration by the industry with the Cheque and Credit Clearing Company. Banks will need to be given sufficient time to invest in new upgraded systems in order to complete both collecting and paying bank duties, and to align with the new scheme rules and process described above.

Depending on the precise nature of the scheme that the industry chooses to adopt, we believe that it will be possible to move the entire industry to an image-based system within 2-3 years. Barclays believes that early changes to the legislation would enable those that choose to invest earlier to move more quickly, and that the legislative framework and scheme rules should encourage speedier migration and the agreement of bilateral arrangements between banks. For example, Barclays could partner with other banks so that our customers could deposit those banks' cheques into their account through our smartphone app or other image-based deposit facilities.

Barclays believes that in order to remove costs from the system and to guarantee the speeding up of the clearing cycle for all customers, there should be a regulatory requirement to introduce a shorter clearing time with effect from a date to be agreed. This will ensure a clearer proposition for customers, and help realise the economic and social benefits of a universal move to image more quickly.

CONSULTATION QUESTIONS

> Question 1: The current cheque system faces a number of challenges, and legislation to introduce cheque imaging will help resolve these and deliver a set of wider benefits, as set out above. Do you agree with this analysis?
>
> Specifically, we are interested in views and evidence on the following points:
> - the costs (quantifiable or non-quantifiable) of the current system
> - the benefits (quantifiable or non-quantifiable) of introducing cheque imaging
> - the costs (quantifiable or non-quantifiable) of introducing cheque imaging
> - the appetite (among both payment service providers and customers) for adopting smartphone technology for the paying in of cheques
> - the experience of other countries in introducing cheque imaging

Costs of current systems

Barclays' costs under the current paper-based system come under the following headings:

- *Costs that would be removed or substantially reduced*, such as transporting physical cheques from place of deposit to the paying bank, centralised clearing processing costs and storage of paper cheques
- *Costs which are less easy to separate out,* such as back office processing, IT maintenance, branch costs etc

Benefits of introducing cheque imaging

Barclays believes that a move to image will not only enable banks to significantly reduce costs, but that the benefits to customers will be significant.

Cheques are here to stay for as long as our customers and our customer's customers want them. Some of these customers prefer to write cheques than use other forms of payment and they remain the preferred form of payment for charities and some types of small business. However, people and businesses that receive cheques often find them inconvenient, and the delay between receiving a cheque and being able to draw on it can be considerable.

The old argument suggested that there would never be a viable business case to invest in cheques, as volumes were reducing and it made more sense to invest in digital forms of payment. Barclays now believes that digital technology enables us to resolve the current problems customers have with cheques (namely, inconvenience of paying in and delay in accessing funds), whilst reducing costs.

The benefits of cheque imaging to customers are substantial:

- Increased convenience and accessibility.
  - Consumers receiving cheques will be able to pay in their cheques in a variety of ways: in a bank, at a post office, at an ATM or even on their tablets or smartphones.
  - Business customers will also be able to benefit, by depositing bulk volumes of cheques by image on their own premises.
  - Customers won't have to spend time unnecessarily in bank queues as they can pay in at home or in the office

- Improved cashflow. People will get their money more quickly, not only because the clearing cycle will reduce from the current 2-4-6 timescale to at least a 1-2-2 timescale, but because they will be able to pay in much more quickly too. We believe that this will particularly benefit small and medium sized businesses who frequently receive cheques for goods and services.
- Cheques become more sustainable. At the present time, the cost of moving paper around the country is expensive, with unit costs increasing as cheque usage reduces. Taking paper out of the system and automating manual processes considerably reduces cost.
- Customers of banks which do not have a high street presence will have greater accessibility and more options for depositing cheques, particularly if their service provider offers smartphone, tablet or other functionality.
- Improved service stability. Today's paper-based system is vulnerable to the effects of adverse weather conditions and transport problems, which can delay the processing of customer payments. Moving to image removes this risk to service.
- Making it easier for business customers to reconcile their cheques because they would be able to access the data derived from the cheque items. This will help them to resolve problems quicker. Potentially, this could extend to all customers.

In addition to the customer benefits, cheque imaging has the potential to allow the industry to improve the interbank settlement risk position (through the introduction of caps on exposures). In addition to changing the risk profile, and thereby making entry to the cheque clearing system easier, such a development would also reduce the costs that arise from the current default arrangements. Currently the settlement members pledge collateral (held at the Bank of England) to provide a pool that can be monetised in the event of a settlement member's default. Taken together with the extant loss sharing arrangements, that should allow settlement to complete by mutualising losses. If exposures can be capped it should be possible to move towards a "pre-funding" model as is being introduced for BACS and Faster Payments. In that construct the settlement members would be able to "ring-fence" part of their regulatory liquidity reserves to ensure that they can always meet their payment obligations. That increased, frictionless certainty not only has benefits to financial stability generally, but also allows current and prospective settlement members full self-determination in managing their settlement obligations whilst at the same time releasing the requirement for the current and separate pool of collateral assets. This should then make direct membership of the scheme less risky and cheaper for new members.

Cost of introducing image

Barclays estimates that the costs of introducing image will be outweighed by the financial benefits, and that is before the customer benefits are taken into account. Exact costs will depend on the detailed specifications of the new image-based cheque scheme.

Appetite for introducing smartphone technology

Barclays will be piloting cheque paying-in via smartphone in May. It is difficult to pre-judge the results of the pilot, but it is clear that customers are increasingly looking for digital – and by this we mean smartphone and tablet – based banking and payments services. We plan to integrate image paying-in within our Barclays Mobile Banking (BMB) software, so core issues such as security and identification are dealt with immediately.

Barclays does not believe that the main benefits of cheque imaging will arise through smartphone/tablet paying-in. This will only be of benefit to occasional receivers of cheques, such as individuals, small charities and micro-businesses. Large and medium sized businesses will be able to use scanning devices in their own sites or may use branches or ATMs that already have scanning facilities. The key benefits to them will be reduced costs associated with paper transportation, reduced transaction times but, more importantly, speedier access to funds paid in.

Experience in other countries

First, it is encouraging to note that since going live in the United States, remote deposit limits for cheque have continued to rise. Banks set out with initial daily limits of $1,000, whereas now they have more than doubled, as illustrated in the below table:

	Current limits				Previous limits (where found / applicable)		
Bank:	Single transaction	Daily	Monthly limit		Single transaction	Daily	Monthly limit
Wells Fargo	2500	2500	5000		1000	1000	3000
Chase	2000	2000	5000		1000	1000	3000
Simple (2012)	3000	5000	-		-	-	-

Barclays understands that during the move to cheque imaging, the United States acknowledged – whilst not all banks would be ready to implement at the same time – the importance of providing effective incentives for them to make the change. The banks were given a period of 2 years to be ready to comply with the new legislation.

The strategy used in the US was to allow banks to continue to process paper (and some still do this today), but this was by the use of the Image Replacement Document (IRD), and those banks that chose to use IRDs were – and still are – charged for relying on this method. These charges have increased over time, to further encourage banks to adopt the new and improved system. To promote the best facilities, some of the larger US banks formed a joint venture, a company with the sole purpose of clearing cheques.

Additionally, one of the key learnings from the US is that we should fully consider the process and timeframes for resolution of returns, disputes and adjustments under an image-based system. In the opinion of colleagues in the US, this needs to be supported by two things, which are:

- a very clear definition of all aspects and dimensions of the image, including format and quality, and
- the right of the collecting bank to deny funds if the image is sub-quality.

Question 2: Do you agree that the legislation should be amended to remove the right of the paying bank to demand delivery of the original paper cheque, and require a certified, digital image of the cheque to be treated as equivalent to the original paper cheque for the purposes of presentment?

Yes, although it may be preferable to future-proof the legislation by finding a form of words that would allow any form of data-based digital file to be presented, rather than only an image.

We agree that the right of the paying bank to receive the physical cheque should be removed as it acts as an impediment to electronic clearing of cheques.

Electronic clearing of cheques was introduced in the UK in 1996 by the Deregulation (Bills of Exchange) Order 1996 which amended the Bills of Exchange Act 1882 to allow a banker to present a cheque by presenting the 'essential features' of the cheque. However the legislation retained the right of the paying bank to demand that the cheque be presented physically, in which case electronic presentment would be disregarded and the physical cheque would have to be presented.

This is one of the main reasons electronic presentation was not fully utilised – the right to demand physical presentment meant any attempt to present a cheque electronically could be disregarded by the paying bank.

This right to demand physical delivery or physical presentment of a cheque needs to be removed for the industry to move to a cheque imaging model. This will allow banks to present cheque images in the confidence that the initial presentation will not be disregarded at the discretion of the paying bank. Crucially, in a cheque image model, customers (or their bank) will retain the original cheque while the image is sent for payment allowing the industry to move to faster clearing times without exchange of paper.

The advances in image software and quality of images mean that banks can make pay/ no pay decisions based on the image. Where the paying bank or the drawer wants evidence of payment, the collecting bank can provide a certified copy of the image as a true copy under s2 of the Cheques Act.

Question 3: Do you agree that the government should legislate to protect the choice of customers to deposit paper cheques in branch, even where there is the option of paying in via smartphone?

Barclays believes that smartphone is one of several ways in which customers will be able to pay in cheques once images, rather than paper, are exchanged between collecting and paying bank. The proposed changes to legislation are *enabling* and will provide *additional options* for customers over and above more traditional means such as branches offering a counter service.

We believe that there is customer appetite for smartphone technology and we support the case for change to enable cheque image. However, there will continue to be customers (e.g. smaller businesses paying in multiple cheques and those who are unfamiliar with smartphone technology) who will pay in cheques using branches, automated image-reading devices (similar to ATMs) and using specialist scanning devices. There is always likely to be a need for community-based banking, such as traditional branches offering a counter service. Smartphone technology represents an exciting new innovation for those customers who want it, but it is only one element of the wider suite of services that we will continue to offer our customers.

We therefore do not believe that it is necessary for the legislation to specifically preserve the continuation of a counter service. Also, it may not be appropriate to be this prescriptive in primary legislation which is essentially enabling.

Question 4: Should the government legislate for a date by which all financial institutions must be ready to accept cheque images? If so, what is a reasonable period of time to allow the industry to prepare for cheque imaging? Or should the legislation provide the option for financial institutions to accept an Image Replacement Document (IRD) as an alternative? A new model of “1-2-2” has been put forward as a desirable and realistic target for the

industry. Do you agree?

The key requirement of the enabling legislation is that collecting banks should no longer have to retain paper cheques, instead transmitting only images to the paying bank. If a paper version of the cheque is required by either the collecting or paying bank, that bank should be responsible for creating a paper version of the cheque by reference to the exchanged image.

Barclays recognises the benefits of the whole UK banking industry moving to an image-based scheme by a certain date. Only by doing this can the industry make a consistent promise to customers about the length of time it will take to clear a cheque. However, depending on how quickly the entire industry can develop the design of the new scheme and agree new standards, and implement the new technology, it will take some time before an image-based cheque system will be universal in the UK. Barclays anticipates a period of 2-3 years will be required (assuming a reasonable level of co-operation throughout the industry). Having said this, a statutory end date might help incentivise migration, and we suggest that HMT include the power for the Payments Systems Regulator to set an end-date, subject to further consultation with both HMT and the payments industry, within the necessary primary legislation.

Whilst an image replacement document might be used by some paying banks as the basis for a pay/no-pay decision (due to their inability to process images), we do not believe that legislation would be needed to enable this. Instead, the legislation needs to simply enable images – rather than paper – to be exchanged. Banks that prefer paper can then contract with a supplier to convert these images to IRDs as an interim step. The same process needs to be applied to other parts of the process too, such as unpaid cheques, to ensure that only images or data files are exchanged.

Clearly, if pay decisions are to be made shortly after images are received by the paying bank, such decisions will need to be made based on the data received electronically rather than on paper. Barclays believes that there needs to be a requirement to make such a pay/no pay decision promptly so as to enable quick payment (subject to exceptions and rules governing fraud etc). We are agnostic as to how this is done, but believe that continuing to use paper in any form would make the paying bank unable to comply with such requirements. Such requirements would need to be set by the scheme (subject to oversight by the Payment Systems Regulator) rather than legislation.

Finally, Barclays agrees that a model of 1:2:2 is realistic. We believe that a new image-based cheques scheme could improve upon this in certain circumstances, particularly in changing the "1" to a "0", and would expect the 1:2:2 to be a minimum requirement. If minimum pay/no pay decisions and minimum settlement times were built into the new scheme – i.e. requiring paying banks to act speedily once compliant images/ data are received – there would be a built-in incentive for collecting banks to submit files quickly. This would benefit their customers – to whom they could pass on value more quickly –

and reduce settlement risk (as cheques are settled within the day rather than collectively at the end of the day).

To summarise, we believe that if 1;2;2 (or a similar timeframe) was mandated, each bank should have the flexibility to further accelerate this where it is possible. For example if a Barclays customer pays in a Barclays cheque, or a cheque drawn on a bank with whom Barclays has agreed an accelerated model.

Question 5: Do you agree that the proposed legislative changes should apply to all of these paper instruments, to allow them to be cleared in image form?

Yes. In order to make clearing as sustainable and cost-efficient as possible, we agree that legislative changes should apply to all paper instruments.

Question 6: Do you agree that liability should be with the collecting bank, rather than the paying bank? For agency arrangements, should the liability be with the collecting bank, or the beneficiary bank, or shared between them? Should the government impose specific due diligence obligations on the collecting and/or beneficiary bank, as well/instead of transferring the liability?

Collecting or paying bank?

Our belief is that the underlying principle in creating a new image-based cheque system must be that innocent victims of cheque fraud should be protected.

As the detailed scheme rules and technical specifications have yet to be determined, we cannot be definitive at this time on how liability should be split between the collecting and paying banks, so the below points represent high-level thoughts only.

In general, liability needs to sit with the party that is most appropriate to be responsible for checking for fraud. This may evolve over time as fraud-reduction technology develops and new standards emerge.

In other words, liability should be shared between the collecting or beneficiary bank and paying bank. The collecting bank should be liable where an item is not collected for the benefit of the named payee(as written by the drawer) or where it has accepted an item which bears a visible alteration to the payee line and or amount and it is subsequently found to be a fraudulent alteration.

The collecting bank should not be held liable for non-visible alterations or items accepted that are counterfeit or bear a forged signature. A clear distinction needs to be made between what a collecting bank can be expected to identify as being suspicious or incorrect when viewing an image of a cheque or a paper cheque and what it cannot.

Barclays would suggest that there should be a maximum period during which a collecting bank can be charged back for an altered item after it has been paid i.e. the paying bank can only make a claim on the collecting bank within 6 months of when it was paid. This limitation could also include items accepted for accounts which do not match the named payee.

Paying Banks should remain liable to their customers for ensuring that a valid item is paid in accordance with the customer's mandate and in line with existing Bankers duties (date, words and figures, signature) and for any counterfeit items and non-visible alterations.

Agency arrangements

The liability for agency banks as the collecting / paying bank should be consistent with the above – in other words, those agency banks acting as the collecting bank should therefore take on their liabilities.

In addition for agency arrangements a distinction should be made dependent on how the items are delivered into the clearing. For example, where the physical items are collected over the agency banks' own counter or offices and subsequently delivered to their settlement bank for submission into the clearing, the agency bank should bear any liability for fraudulent alterations etc. Similarly if the agency bank allows their customers to scan the images and deliver these to the clearing via their settlement member they should also retain liability. However, where the items are physically deposited over a counter other than their own by the agency bank's customers, the bank that operates that counter should accept liability as the collecting bank for visible fraudulent alterations as outlined in the response to Q6A.

Agency banks should also bear the liability where the payee's name differs from the name on the credit, but the beneficiary bank should remain liable for ensuring that the details recorded on the credit (name and account number) match the details of the account.

It is also essential that the liabilities are clearly defined in each scenario to ensure that all banks (agency and settlement banks) operate to the same standards.

Finally, an agency bank acting as paying bank should remain liable to their customers in the same way as we have stated above