

The Association of Corporate Treasurers

Briefing note:

UK Faster Payments Service

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The Association of Corporate Treasurers

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The ACT defines and promotes best practice in treasury and makes representations to government, regulators and standard setters.

We are also the world's leading examining body for treasury, providing benchmark qualifications and continuing development through education, training, conferences, and publications, including *The Treasurer* magazine.

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UK Faster Payments Service (FPS)

Introduction

In December 2005 the Office of Fair Trading (OFT) and the banking industry agreed to create a new payments capability for the UK. This will go live on 27th May 2008. For internet banking transfers and telephone transfers between banks the movement will be near real time, with standing orders being processed on a same day basis.

Bacs works on a D+2 time cycle, and does not itself cause float as both the debit and the credit occur on D+2. However, to avoid the bank incurring settlement risk with personal and small business customers, most banks' customers suffer the loss of 2 days float time, since payments are funded on day D even though the recipients only get value on D+2.

The banks have agreed that FPS will be introduced from May 2008 for sterling payments and that it will work on a near real time basis. For payments to a current account held with another FPS member the funds should be available within 2 hours, often this will be in matter of a few seconds. The initial priorities are the service channels where float has been suffered previously. The main beneficiaries here will be individuals and small business customers who make payments. Products and channels generally used by corporate customers will not be available for FPS until some later date, but corporates will potentially be receivers of Faster Payments into their bank accounts from the outset.

Direct access to the Faster Payments Service by corporate and agency customers is to be implemented in a second phase in 2009.

Features of FPS

From the payer's point of view there are three types of payment instruction.

- **Single Immediate Payments** - These are payments that the payer wants to make straight away (e.g. an immediate phone transfer to a son at university). These will operate 24 hours a day 7 days a week including bank holidays.
- **Diarised Payments** - These are single payments with a date for sending other than today (e.g. an instruction to pay a credit card bill in a week's time). These will operate 24 hours a day 7 days a week.
- **Standing Orders** - A mandate for the bank to make a payment of a specific amount to a specific beneficiary for a number of future dates or on a regular basis indefinitely. These will be paid on bank working days. They will be scheduled to run between midnight and 14:00 on the day of payment with an industry target that 90% should be complete by 06.00.

There will initially be a £10,000 transaction limit on immediate and diarised payments and £100,000 on standing orders. The intent is that assuming all goes well these limits will be raised.

For Single Immediate Payments the beneficiary bank must acknowledge receipt within the 15 second real-time transfer window indicating that the payment will be applied to the beneficiary account. Customers can thus seek near real time feedback on whether the payment has successfully reached the beneficiary account.

The payee's bank may then apply the payment either in real time or within two hours of receipt, to allow a short window for fraud detection. Payments will only be made if there are funds available to meet the payment, and will be irrevocable so that the recipient should have certainty and availability within 2 hours.

There are 13 Member Banks of the Faster Payments Service and this will provide circa 95% coverage when fully implemented. Full coverage will depend upon non-member Banks entering into Agency arrangements with Member Banks.

Costs

Charging for faster payments is a commercial matter that will be determined by market forces.

For corporate customers there is an expectation that the market pricing will come out much closer to current Bacs payment pricing than current CHAPS pricing, dependent on volumes and delivery channel. Corporates will need to be aware that the service attributes (provision of advices, notifications, repair, sort code addressability) may differ from their current CHAPS experience.

The infrastructure

An entirely new infrastructure processes payment information in near real time. This system is provided by Immediate Payments Ltd, owned by VocaLink (the infrastructure provider for Bacs and Link). The CHAPS Clearing Company will be responsible for scheme management and will enforce the rules for the new service. This new infrastructure appears robust and powerful in its capabilities and if successful has the potential to become the model for a wider service across national boundaries.

Banks who settle directly at the Bank of England can connect directly to the service as Members of the Faster Payments Service.

In Phase 2 expected in 2009, banks sponsored by a Member can connect as Direct Agencies. Corporates and Bureaux providing services to corporates, can submit files of payments directly, and must be sponsored by a Member or Direct Agency. Additionally there is a class of participation called Third-party Beneficiaries (for example Credit Card Companies) who are identified by one or more sort codes unique to themselves and receive notification of payments to their own customer's accounts. This category may perhaps be adapted to be useful for corporates receiving in payments which need to be further allocated within their own business.

Settlement and Risk controls

Settlement is via a multilateral Deferred Net Settlement model with three settlement points per (business) day across settlement accounts at the Bank of England, or with an ad hoc settlement cycle should the need arise eg if operational reasons dictate.

Settlement risk is managed in real-time by central infrastructure – each transaction is checked against a cumulative net sender (bank) cap – failing payments being rejected in real time with a warning to sending bank. All agency and corporate input is credit checked with sponsoring Member through an “authorisation” message.

Corporate file submission

There is no plan for a forced migration of Bacs file payments to Faster Payments because these payments do not incur float. However, a corporate will be able to choose to submit a file of same day payments using the Faster Payments Service. Bacs Direct submitters (i.e. using the Bacstel-IP) service will be offered a very similar service but for submission to the FP Service via Direct Corporate Access (DCA). The technical model would be very similar to the Bacstel-IP setup. The business model would also be similar with a corporate being sponsored by a member bank. This DCA proposition will not initially be available whereas individual member bank offerings are likely to be available earlier.

Implications for users

Receipts:

Payments initiated via the internet will be virtually immediate. This could have significant impact on how individuals manage their internet accounts, moving balances to higher interest accounts or making bill payments. For purchases the seller has immediate certainty of payment with obvious benefits for credit control. There is no risk of a payment bouncing, as with a cheque.

Corporates currently receiving credit card or debit card payments from consumers may see FPS as an alternative mechanism subject to how the comparative costs work out, and subject to being able to cope with the systems issues of receiving payments continually 24 hours a day seven days a week.

Internal accounting systems will need reviewing to ensure they can cope with rapid updating. If payments are coming in on a real time basis your customers' expectations will be that the company reacts equally quickly. This could be critical in sensitive situations like collection of overdue amounts or bad debt recoveries.

Receipts via standing order could be received 2 days earlier than in the past, since the payer's bank will typically be driven by the debit date and making a change to this data would be a major task

Payments cannot be recalled by the sender so FPS will have a role where certainty is required.

Cash forecasting and balance management could become far more difficult if payments are arriving in real time with no warning, and indeed are even arriving over the weekend. (With the current Bacs and cheque clearing cycle current day clearings are known at start of business.) Of critical importance will be the type of sweeping arrangements that can be made available by the clearing banks so that cash balances can be put to good use immediately, even over the weekend.

Payments:

Payments via FPS are not initially generally available to corporates but will in time still need to be thought about.

For business critical payments it will provide a real alternative to CHAPS and in fact will give better feedback from the beneficiary confirming payment. Perhaps for payroll it will allow last minute calculation of overtime to be fed into the payment run; within a customer complaints department "immediate" refunds could be made; and it may help in a weekend trading environment.

To an extent one could ask why Faster Payments are needed for regular creditor payments, after all the current Bacs set up simply means that a company must get its

approval and processing timescales organized to be finished two days prior to an invoice due date. Use of Faster Payments would be more costly and may imply poor organisation. So for normal supplier payments the expectation is that Bacs will continue to be used.

On the other hand for a company finding its suppliers are holding up deliveries until overdue accounts have been settled, the ability to pay two days faster could be commercially important.

The initial cap of £10,000 means that FPS is not a real alternative to large CHAPS payments so that a speedy increase of that limit will be important. That said the current average for CHAPS payments is surprisingly low at around £10,000.