Back from the brink

INITIALLY DUE TO BE PHASED OUT BY 2018, CHEQUES RECEIVED A STAY OF EXECUTION IN JULY. THE IMPLICATIONS FOR TREASURERS ARE ASSESSED BY **JOHN SALTER**.

Rumours of the cheque's demise have been greatly exaggerated. Previously scheduled for extinction in October 2018, the humble cheque was granted a reprieve in July when the UK Payments Council announced: "Cheques will continue for as long as customers need them and the target for possible closure of cheque clearing in 2018 has been cancelled."

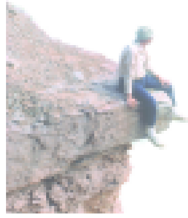
So why the U-turn? As the cheque's end date edged closer, it became clear that the decision hadn't factored in the human impact of removing what continues to be an important method of payment for many individuals and businesses in the UK. While cheque volumes have declined in recent years from four billion in the 1990s to 1.2 billion in 2010, they continue to have a role to play. Last year, 44% of adults in the UK wrote a cheque. For over-55s, the figure was more than 60%. And more than 90% of businesses wrote a cheque in the last month alone. Critics of the planned abolition argued that eliminating cheques was unfair and unreasonable – and that it effectively established an exclusion category for the heaviest users of the payment instrument, such as pensioners and charities.

While many consumers welcomed the Payments Council's decision, the reaction from businesses – and the financial services industry – has been more of a mixed bag. Indeed, for the majority of UK treasurers, the recent announcement will not have been particularly welcome.

The incentives of cheque cessation were highly attractive. For UK corporates as a whole, the net saving in not having to process cheques was estimated at something like £750m a year. Cheques require physical signatures; they are harder to reconcile than electronic payments; they are more time-consuming to issue and more susceptible to fraud. As such, businesses tend to use them for occasional payments rather than as a core payment instrument. And corporate cheque values tend to be low: the value of the average corporate cheque is £1,600.

Consequently, many treasurers feel that the regulatory U-turn represents a missed opportunity to get paper out of the office and take away the need for physical reconciliation.

For banks, the situation is also more complicated. While relatively little progress had been made by most in developing plans for the cheque-free future prior to the



How payment habits change

	1999	2009	2018
Proportion of workers paid in cash	1 in 8	1 in 20	1 in 50
Transactions using cash	73%	59%	45%
Cash spending in pubs	90%	40%	25%
Debit card spending	£65bn	£264bn	£490bn
Cheque transactions as % of all personal payments	6%	2%	0.8%*
Faster Payments transaction volumes	n/a	294m	836m**

Source: Payments Council report, The Way We Pay 2010
* Forecast for cheques before the December 2009 decision to manage the decline of cheque clearing and close it in 2018
** Includes volumes of standing orders and one-off phone/internet banking payments

announcement, the Payments Council's decision presents some practical difficulties. The challenge for banks is that the cheque-processing infrastructure is expensive to run. The infrastructure was developed to support volumes over three times the size of what we are seeing today – but the costs of maintaining that infrastructure are still almost as high as they would have been for processing four billion cheques a year. The economics simply don't work and the challenge for banks is how they can continue to support cheques without passing the costs on to their customers.

PAYMENTS INNOVATION In its press release, the Payments Council asserted: "Innovation must be at the heart of what we do." It is clear that the decision to keep cheques presents interesting opportunities for banks. There are two contrasting approaches that may be adopted in the future: banks may continue to focus on initiatives to make cheque processing more streamlined, while focusing on providing more attractive alternatives to cheques. On the other hand, now that cheques are here to stay, there may be an opportunity for banks to look at ways of gaining market share in this area.

Whichever way banks decide to go – and at this point discussions are still at a very early stage across the industry – it is clear that they will be forced by pure economics to find a different way of approaching cheques. While the decline of the cheque is likely to continue, the process could have a very long tail and usage will probably stall at around the 300–700 million mark.

Cheques are not going to disappear by themselves – regulation would be needed to stop their use completely, and the recent U-turn implies that this is unlikely to happen for the foreseeable future. If the number of cheques declined to the 300 million mark that would be a suitable moment to revisit the cheque's continued existence – but that moment is likely to be many years away.

In the meantime, banks will continue developing the payment instruments that were until recently being lined up as the cheque's replacement. Undoubtedly, customers are very clear in expecting banks to be at the forefront of the development of any alternatives to the cheque – and in guiding them safely into that new world. This is a matter of high importance at a time when the strengthening of customer trust is rightly so prominent on all our agendas.

Cards are going to have a massive role here, and the really

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interesting opportunity is in the development of the debit card, where growth is currently already at double the rate of credit cards. Whereas direct debits were once seen as the instrument that would replace the cheque, saturation levels across the market are now high and it is unlikely that this area will grow significantly.

However, plastic cards present some interesting opportunities – particularly the prepaid card, which is likely to result in some attractive product offerings in 2012. While this type of card is currently in the early stages of adoption it might emerge as an alternative to cheques, particularly for businesses that tend to use them for ad hoc payments rather than as a core instrument.

In brief, the announcement that cheques are back from the brink is already prompting some interesting discussions. It is likely that this development will eventually lead to the more efficient processing of cheques as banks look to reduce the costs inherent in maintaining the associated infrastructure. And if the economic factors can be reconciled, the banks could end up supporting cheques more effectively than in the past. If that happens, there is even a possibility that the number of cheques in use could start to rise again.

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