



iPSL Response to the HMT Consultation - Speeding up cheque payments: legislating for cheque imaging

Title	iPSL Response to the HMT Consultation - Speeding up cheque payments: legislating for cheque imaging
Author	Dick Simmons
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About Intelligent Processing Solutions Limited (iPSL)

iPSL Limited is a Unisys company that provides UK Cheque Clearing and related services to all UK Clearing banks with the exception of Royal Bank of Scotland Group whose processing is currently undertaken by HP Enterprise Services (HPES). iPSL processing includes circa 300 'Agency' customers via relationships with the parent clearing banks.

The company was established in 2000 as a joint venture between Unisys, Barclays and Lloyds to benefit from the efficiencies of scale in a declining cheque market. HSBC joined the venture as a shareholder in 2001.

iPSL is managed by an independent Board of Directors, the majority of whom are non-bank employees and there is an independent chairman. iPSL also has independent Audit, Remuneration and Nomination Committees managed by non-bank and non-iPSL personnel.

iPSL currently operates nine processing sites and employs circa 1,800 Full Time Equivalent (FTE) personnel undertaking a number of services for clients and their associated Agency customers:

- Clearing processing
- Fraud Detection
- Payment Activities
- Settlement and Reconciliation processes
- Exceptions handling, including Research & Adjustment functions
- Returns Processing
- Signature Mandates

iPSL has initiated a number of image-related processing enhancements over the past 6 years, which have paved the way for industry legislation discussions to be instigated.

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

4th April 2014

Dear Sirs,

**iPSL Response to the HMT Consultation - Speeding up cheque payments:
legislating for cheque imaging**

iPSL welcomes the HM Treasury 'Speeding up cheque payments: legislating for cheque imaging' consultation document and are grateful for the opportunity to comment on this. We have set out the response from iPSL within the attached document.

iPSL has long been committed to provisioning innovations to drive efficiencies within Cheque Payments and has already implemented cheque imaging solutions, in so far as current legislation allows, within its client base in order to leverage technological advances deployed in other markets.

We would welcome the opportunity to meet with you to discuss our response in more detail, and would like to stress our support for this proposed move to an image-based cheque clearing process, which we believe will deliver significant benefits to all stakeholders and will ensure that cheque remains a suitable and viable payment instrument for the foreseeable future.

We hope this contribution will be of interest as you seek to progress with the associated changes in legislation. Should you have any questions regarding the content or wish to partake in further dialogue with iPSL, please contact Dick Simmons, iPSL Business Strategy Director, on 07590 390040 or dick.simmons@ipsl.co.uk.

Yours faithfully,

Dick Simmons,
Business Strategy Director, iPSL

Royston Hoggarth,
Chairman, iPSL

Executive Summary

Since the inception of iPSL, cheque volumes have continued to decline and iPSL has been working in collaboration with its shareholders, HPES and Cheque & Credit Clearing Company (C&CCC) to define how process improvements could be made through use of image technology that has been implemented widely in other geographies.

Cheque clearing in the United Kingdom consists of processes which take place over four distinct processing days. The eleven clearing banks undertake processing on days one, two, three and four via services provided either in-house, by iPSL or via outsourced suppliers. Day three and four processes are also undertaken by the circa four hundred other financial institutions that issue and receive cheques, these can also be effected in-house or via services provided by third parties, including iPSL.

The current process is designed around the movement and processing of the physical items at all stages. Current legislation allows for any consumer to demand the return of their physical items, and the paying bank to receive the paper in order to undertake day two clearing processes and subsequent payment activities.

Whilst not impacting the customer proposition ever decreasing volumes, coupled with the underlying legislation, make it increasingly difficult to contain unit costs. Unless changes are made to the legislation it is inevitable that unit costs will continue to rise.

The highest proportions of costs are related to the transportation of paper through the process and the number of times the paper is handled / processed.

Wider utilisation of image technology presents an opportunity to reduce the end to end cheque processing costs and improve the customer proposition from the current T+246 customer promise. Capturing images at the earliest opportunity, and removing the need for further transportation of paper, also presents an opportunity to significantly reduce the associated carbon footprint.

iPSL would recommend the introduction of a new legislative framework to support the 'electronic' exchange of data to replace existing paper based processes which, allied to increased industry collaboration within fraud detection, will provide a cost effective future for cheque as an important payment mechanism.

iPSL has already deployed image processing solutions that leverage existing technology to facilitate processing efficiencies within the boundaries of current legislation which are extendible to support the introduction of a new framework for exchange via image. Such an extension would reduce the risk of migration and minimise impact to existing accounting systems.

Cheque Clearing Current Processes

The current cheque clearing process is undertaken to support the customer promise that was introduced in 2007 to provide clarity to consumers paying in cheques. The customer promise is known as T246 (T+246) and defines the minimum proposition a consumer can expect when paying in a cheque.

T – the transaction day – i.e. the day the cheque is paid in.

2 – the day the value of the cheque will begin earning interest. Note for an item deposited on Monday, this is Wednesday.

4 – the day the consumer can withdraw the value of the cheque. Note for an item deposited on Monday, this is Friday.

6 – The last day a bank can debit the customer back for a cheque that is unpaid (unless later identified to be fraudulent). At the end of T+6 the consumer has certainty that the funds are theirs and will not be reclaimed as a result of a dishonoured item. Note for an item deposited on Monday, this is the Tuesday of the following week. As stated, if the customer has been involved in a fraudulent act, certainty does not apply.

This customer promise applies to all cheques deposited into current accounts and applies regardless of how the cheque is deposited.

Feedback indicates that the customer promise is not widely understood and, in general, cheque users believe that the process takes three days. Banks can also choose, in certain circumstances, to offer an improved proposition which can inadvertently add to consumer confusion.

Certainty is something that does not impact the majority of customers, as the volume of unpaid items is low.

Cheque User Forum¹ feedback suggests that the current cheque clearing process is considered to be safe, secure and reliable. The current processors complete the daily processes seamlessly. The consumers do not voice concerns about the process, rather (in some cases) the time taken to have access to funds.

iPSL believes that any changes should be introduced in a way that does not adversely impact the consumer's view of the process, and that post migration to an image process, the perception of cheque is only improved. It is imperative that changes ensure that all entities within the market are represented and accommodated.

¹ C&CCC User Forum 19th September 2013

All risks in the migration should be mitigated by comprehensive planning and testing. Due to a 14 year history in the market place, and an innovative approach to the use of image technology in its current client base, iPSL is ideally placed to take a leading role in the development and implementation of the proposed changes.

Image Based Processing - Considerations

Legislation

iPSL recommends any legislation that is introduced to permit image as a legal replacement to exchange of physical paper should be a framework and avoid being overly prescriptive.

Examples from other countries that have already enacted such changes show that their legislation generally sanctioned that images of cheques could be considered to be the equivalent of the original paper item. This allowed banks to effectively manage the cessation of the physical exchange of paper with additional support from Image Quality and Image Usability Analysis features ensuring sufficient quality of images.

Consideration could be given to the image migration currently being undertaken in Canada, as their current operating model is closely aligned to that of the UK, with a comparable number of clearing banks, a similar agency model, a cheque processor (Symcor) and an equivalent of C&CCC (CPA – the Canadian Payments Association).

It is iPSL's recommendation that the framework should be based on two defined dates to allow for the smooth transition from paper to image-based processing:

- A date to be set when the physical paper need not be returned to the customer and the collecting bank can no longer demand return of the paper within the unpaids process
- A date to be set for when the paying bank can no longer demand physical presentation of the paper to undertake payment activities

To assist with migration, the date for removal of the ability of the consumer to have cheques returned, and the date for the removal of the paper being returned for unpaids processing should be aligned and precede the removal of the paying bank receiving the items. iPSL would suggest that this change is effected at least six months prior to the cessation of paper exchange.

Physical items are currently returned to consumers where an item is unpaid. This allows the consumer to represent the item a second (and possibly further) time where permitted by the Financial Institution. Consideration should be given as to whether this facility should be retained or if the cheque is to become a single presentation vehicle.²

² Some FIs do not currently allow representation of unpaid items

iPSL would recommend that the option to represent is retained, and that banks introduce facilities for the consumer to request an 'automated' representation.

Customer Proposition

By removing the need to exchange physical paper, an improved customer promise can be achieved. iPSL believes that a T+122 customer promise could be offered based on the processes happening on three separate business banking days.

There are a number of points that iPSL recommend be taken into consideration:

- Other countries do not offer the same type of promise, with banks providing access to funds deposited dependent upon a customer risk assessment and the payment channel utilised.
- In the US, some banks treat items deposited via a smart phone as higher risk and delay access to these funds compared to items paid in over a branch counter or through an image-enabled ATM.
- Charging for using smart phone deposits also exists in some countries. Those banks see this as a charge for convenience. However, this is a decision for each FI.

In essence, the collecting bank can give customers access to funds in any timeline according to an assessment of risk. It is conceivable that banks could agree between themselves to provide (near) immediate payment decisions but iPSL does not believe that legislation should make this mandatory. Whilst supporting the view that banks should be free to enter into bi-lateral arrangements, in the interest of the consumer, we believe an obligation to do so could marginalise smaller FIs who are not well placed to provide 24/7 decisioning services. Hence, it is iPSL's belief that a framework suggesting T+122 as the minimum service offering should be the recommended approach.

Image Replacement Documents / Cheque Replacement Documents

Whilst not an ideal long-term solution, iPSL believes that to effect a timely migration to image processing, legislation should allow for institutions to use Image Replacement Documents (IRD) where it suits them to do so. It is clear that other countries that have implemented processing via image have often planned to use such a facility to smooth the migration.

In other countries, a date has been set by which the replacement document can no longer be used, or market forces have been leveraged to make it a less attractive option as time progresses.

iPSL would suggest that replacement documents are not produced and printed centrally as has happened elsewhere. Rather, the onus should be placed on the organisations using the replacement documents to print them for use within their own processes; thus the cost, and subsequent incentive to migrate, is borne within their operation.

Large volumes of replacement documents require specialist printing and other equipment to prepare them for processing through a reader / sorter. Experience suggests these items have been subject to a higher than normal exception rate, with 'piggy backs' being particularly prevalent. This should act as a disincentive for long term use of replacement documents.

iPSL does not believe that paying banks (for inclearing) or collecting banks (for returns in processing) should be able to insist on receiving physical paper after the dates referenced above have been reached. iPSL recommends that there should be a mandate to process electronically, and a timely migration to be facilitated by allowing banks to produce paper replacement documents.

Fraud Detection

Fraud is a major consideration in the removal of the physical exchange of paper. This was reflected in the Cheque User Forum³ where attendees considered that image-based cheque clearing could become similar to Card processing, which has a perception of much higher instances of fraud.

All banks currently resort to the use of UV and other mechanisms to review suspected fraudulent items. It is unlikely that this process will be possible or feasible if banks choose to truncate paper at source after the image has been captured.

It is therefore essential that other processes are introduced to maintain the high level of fraud detection recognised and expected by the consumer and to leverage the investment made by most Clearing banks in image-based fraud detection tools over the past decade, which have significantly reduced fraud levels.

iPSL believes that industry collaboration with respect to the sharing of relevant data will be an essential method of reducing suspected fraud items. iPSL and HPES are already working collaboratively developing solutions to better understand the beneficial impact that data sharing would have on preventing fraud in the UK. This includes, but is not limited to:

- Sharing beneficiary data to build a profile of 'known good' transactions.

³ C&CCC User Forum 19th September 2013

- The use of image survivable security features such as unique code numbers to further improve detection rates.
- Enterprise-wide duplicate detection capabilities

For items deposited via a smart phone it will be necessary to ensure any attempt to deposit the item a second time through the same or another channel, whether maliciously or otherwise is flagged. There was a prevalence of this in the US where consumers were not annotating the item to show they had already deposited.

Greater reference to the consumer in confirming payment decisions, as per processes undertaken within Card processing, will be another mechanism that could be used to mitigate the risk of increased fraud.

The collecting bank should undertake various checks when receiving an item, including checking for alterations. However, the sophistication of some fraudulent attempts are making these items difficult to detect.

Consideration also needs to be given to how alterations will be detected when items are deposited using a remote channel with no recourse to the paper. For example items deposited via smart phone will never be received by the Financial Institution. Similarly, items deposited through an ATM might not receive the scrutiny currently given by a counter clerk. This is not significantly different from today, although the physical item is still remitted to a processing centre under current processes.

Current practise has resulted in the paying bank accepting liability for all frauds and some have invested heavily in solutions as paying banks. Whilst, to date, few non clearing banks have afforded themselves similar fraud mitigation services iPSL is now working closely with a number of FIs to provide tiered service offerings via their clearing bank.

Consideration needs to be given that if 'alteration' liability is switched to the collecting bank there would be an implied requirement for all FIs to invest in processes to mitigate the risk of fraud. It is possible that the associated clearing member may have a different appetite to risk and force smaller banks to undertake a significant investment they may not be able to justify.

Open Access

Any FI should be able to procure services from any provider and should not be restricted to taking services from their 'host' bank.

It should be noted that in some cases current processing arrangements are complicated with FIs undertaking their core banking with one settlement member and processing cheques via another settlement member.

The current Settlement process requires all FIs to operate through a Clearing Bank and the Clearing Banks must meet the BoE collateral requirements. iPSL believe that to be truly open access the Settlement process should be available to all FIs and remove the requirement for a Clearing Bank to settle on behalf of another FI.

It is important to consider that many of the current processes are based on aging legacy infrastructure that interact with each FI's accounting systems. Changes to legacy infrastructure can be expensive and time consuming to effect.

iPSL already provides services to non clearing banks and is working to develop services and products that can be made available to any FI for current or future processing demands.

iPSL will also be in position to share data with any other service provider or FI to support their cheque processes.

Our specific answers to the questions raised in your consultation are detailed below.

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?

- We agree that the proposal will provide a more convenient way for consumers to pay in cheques by allowing innovation to provide more channels and possibly offering an alternative to having to visit a bank branch.
- With regard to the proposition for reducing the clearing times it is important that the consumer understands the change and that this will result in the payee receiving the benefit of earlier certainty (T+122). Similarly, the drawer of the cheque will need to understand that their cheque may be debited earlier than at present.
- It is important that the unique aspects of the cheque are retained, e.g. the ability to stop a cheque. Clearly, in a revised process the customer will have less time to request a 'stop'.

Specifically, we are interested in views and evidence on the following points:

The costs (quantifiable or non-quantifiable) of the current system

- The costs of processing at iPSL are managed tightly and historically operational costs have declined either in line or ahead of cheque volume decline.
- As volume continues to decline the fixed overheads will present an ever increasing challenge to maintain low cost of ownership.

The benefits (quantifiable or non-quantifiable) of introducing cheque imaging

- The benefits as a processor will depend upon how the legislation is framed and will vary depending upon which of the two options outlined in Section 2.3 are chosen and how the banks and associated Financial Institutions implement.
- Migration to a full image model will deliver benefits - from the removal of the need to physically handle and process the majority of paper, a reduction in the transportation of paper and the associated risks (traffic / weather). Benefits can be summarised as follows:
 - Simplified processes
 - Reduced courier requirements generating a positive environmental impact
 - Opportunity to accelerate the existing customer proposition
 - Increased longevity of cheque supporting future generations and increased customer flexibility owing to additional deposit channels
- There will also be a reduction in jobs associated with these processes.
- Existing investment in technology to support cheque imaging and image based fraud detection can be leveraged
- Consideration needs to be given to the 'smaller' banks who process a low volume of items and the costs of delivering systems to facilitate payment activities via electronic mechanisms.

The costs (quantifiable or non-quantifiable) of introducing cheque imaging

- Deployment costs will ultimately depend upon the selected solution, any use of 'central scheme infrastructure' and the approach and timeline to migration
- Note that iPSL has already deployed solutions fit for cheque imaging processing which can be leveraged depending on chosen approach

The appetite (among both payment service providers and customers) for adopting smartphone technology for the paying in of cheques

- As a processor iPSL can, and already does, accept images from multiple sources providing they meet a defined standard. iPSL would recommend that the image standard is agreed promptly and is based on those currently used. (Black & White 200 dpi).
- Existing investment in technology to support cheque imaging from smartphones or remote scanners can be leveraged in this space
- Consideration to increased risk of fraud through remote deposit channels needs to be given and iPSL would refer HMT to the points made, in the Fraud section, earlier in our response.

The experience of other countries in introducing cheque imaging

- We have recently visited the US and have gained a good understanding of the adoption of image processing in both the US and Canada. Based on our understanding we would recommend a controlled migration be adopted with the ability to retain paper processes through the use of an IRD.
- Suitable fraud detection solutions will need to be deployed and the increased risk of remote deposit channels needs to be considered. It is important that the investment made by banks in Fraud detection solutions is further leveraged to the benefit of all UK FIs.
- iPSL would refer HMT to the points made, in the Fraud section, earlier in our response.

Question 2

The current legislation preserves the practice of exchanging paper instruments, and does not accommodate the transmission of digital images. 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, this will offer opportunities for significant process improvements and a reduction in overall processing costs.

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?

- Yes, there should be no reduction in the number of channels open to the customer. Existing mechanisms can be supplemented via the introduction of direct remittance via smart phones or scanners but it is imperative that this is not at the detriment of pre-existing channels.

Question 4

The government believes there is a strong case for the industry moving as one onto a cheque imaging model with a central scheme infrastructure, but is willing to consider permitting banks to request paper substitute cheques as an alternative.

- The term 'central scheme infrastructure' needs clear definition.
- iPSL agrees that there should be a central infrastructure for the transfer of data and images between banks. This same infrastructure could and should be used to facilitate the 'Settlement' process.
- As identified above there will also need to be provision of central services to assist in detection of duplicate deposits across channels and entities.
- iPSL believes it is ideally placed to operate such services.
- However, we do not agree that there should be a single provider of solutions. To be truly 'Open Access' all banks and FIs should be able to procure services from any service provider or undertake the processes themselves.

- Consideration needs to be given to non-clearing banks who undertake payment processing (decisioning and unpaid execution). These entities might be reluctant to invest in infrastructure projects, which might have disproportionate costs compared with the size of their processes.
- Retaining the ability to process paper (via an IRD) or to purchase services from a service provider should be presented as an option to all Financial Institutions.

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?

- iPSL recommends that the government should legislate a date when images are to be exchanged and the requirement to exchange paper is removed. Providing the option to process from paper using an IRD is retained then this can be implemented sooner than an end-to-end image solution, as it allows banks to migrate to image processing at their own pace.
- If an IRD is not to be permitted then sufficient time needs to be allowed for all banks to upgrade their systems to accept and process images. It should be borne in mind that the time taken to make these changes will be governed by their current processing models.
- The underlying infrastructure used by iPSL differs for each client bank and is predominantly based on the original platforms that were inherited from the client banks.
- The government also needs to remove the ability for the consumer to have the physical item returned to them. The government needs to consider whether the ability to represent an unpaid item to clearing is to be retained or removed.
 - If it is to be retained the banks will need to agree suitable processes.
- iPSL's experience would suggest that a project of this size will take between two and four years to implement but this could be significantly impacted by the chosen solution.

Or should the legislation provide the option for financial institutions to accept an Image Replacement Document (IRD) as an alternative?

- Deployment of an IRD as outlined above would be a simpler migration and would allow banks / FIs to migrate at their own pace whilst supporting those who want to progress more quickly.

- We believe that IRDs should be permitted as detailed above.
- A date at which IRDs are no longer permitted should be set.

A new model of “1-2-2” has been put forward as a desirable and realistic target for the industry. Do you agree?

- Cheque Processing is currently completed on three separate business days. The day of the deposit, the day a payment decision is made and the day certainty is given. The process currently happens, generally, during normal banking hours.
- Providing “1-2-2” takes account of the day of deposit, i.e. T+1-2-2, then iPSL supports this as being the maximum time it should take to provide certainty.
- Consideration will need to be given as to whether this is a maximum or a standard. If banks / building societies are given flexibility to improve the proposition consideration needs to be given to how the proposition will be explained to the consumer. Receiving / removing money in different timescales depending on which bank a customer paid the item into could cause confusion.
- The consultation refers to two day clearing and the message through the media will need to be managed carefully as it could be perceived that “1-2-2” is indeed three day clearing. The media will need to be managed to ensure that any new proposition is measured against the current proposition and that “1-2-2” is a significant improvement against the current “2-4-6” customer promise.

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. All paper deposits should be addressed at the same time. Consideration should be given to standardising the physical paper formats. Cheques do currently have a standard but Credits do not and organisations can produce their own.

Question 6

Do you agree that liability should be with the collecting bank, rather than the paying bank?

- The levels of Fraud must not increase as a result of a change to image. Legislation should allow banks to agree liability based on the maxim that it should rest with the party most able to prevent the fraud in the adopted model.

For agency arrangements, should the liability be with the collecting bank, or the beneficiary bank, or shared between them? The government would particularly welcome comments from banks and building societies with agency relationships.

- The liability needs to be clear and should be consistent for all banks / building societies.
- iPSL believes that all banks / FIs should have access to the same solutions to identify fraud and that there should not be any barriers to sharing / utilising data to identify and prevent fraud.
- As outlined above, consideration needs to be given to the most effective parts of the process to detect fraud and where the solutions are deployed. There will need to be an agreement to share data in a timely and convenient manner.

Should the government impose specific due diligence obligations on the collecting and/or beneficiary bank, as well/instead of transferring the liability?

- Any transfer of liabilities to the collecting bank should involve Due Diligence to ensure that collecting banks minimise the risk of fraud within their account opening routines (Know Your Customer obligations).
- Consideration should also be given to the most appropriate process for detecting fraud and not necessarily aligning liability to the owner of the process. The banks should work together to reduce the level of fraud but the liability should be apportioned to the bank's customer deemed as responsible for the fraud.
 - For example, an alteration to a cheque may be best identified by the paying bank as they have the most information about their customer cheques. However, it is likely that the fraud will have been effected by the customer of the collecting bank, i.e. by altering a previously valid item.

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