

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2009	PV Base Year 2014	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 627.64	High: 978.71	Best Estimate: 805.13

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	10	0	9.5
High	50	0	47.5
Best Estimate	30	0	28.5

Description and scale of key monetised costs by 'main affected groups'

In order to implement cheque imaging, the banking industry has said that they will need to invest in a network for the central exchange of cheque images and data. The impact here will extend to all banks and building societies that provide cheque payment services in the UK; the distribution of this cost across individual financial institutions has yet to be determined by the industry.

Other key non-monetised costs by 'main affected groups'

N/A

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	82.3	675.1
High	0	123.2	988.2
Best Estimate	0	103.0	833.6

Description and scale of key monetised benefits by 'main affected groups'

Cheque imaging will allow the banking industry to operate a much more efficient and cost-effective payment system, bringing the cost of cheque payments closer into line with the cost of fully electronic payment systems. The impact here will extend to all banks and building societies that provide cheque payment services in the UK; the distribution of these savings across individual financial institutions has yet to be determined by the industry.

Other key non-monetised benefits by 'main affected groups'

Speeding up cheque clearing, meaning consumers and businesses receive funds more quickly; greater customer convenience and choice in ways to pay, including helping customers in rural areas or with limited mobility; by making cheque processing more cost-effective, future-proofing the cheque as a sustainable payment option that banks can afford to continue to provide; reduced barriers to entry, encouraging greater competition in retail banking.

Key assumptions/sensitivities/risks

N/A

Discount rate (%) 3.5%

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:	In scope of OIOO?	Measure qualifies as
Costs: 3.3	Yes	OUT
Benefits: 96.8		
Net: 93.5		

Evidence Base (for summary sheets)

Background

1. Payment systems sit at the heart of the economy. They are the mechanisms that allow money to flow continually among and between financial institutions, households and businesses. 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. Nearly £840 billion of cheques were processed in 2012, accounting for ten percent of all payments made by individuals.¹ While there has been a decline in cheque volumes in recent years, over nine in ten businesses and other organisations continue to use them.²
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 adequately serve their needs. In 2009 the Payments Council, the industry body responsible for setting payments strategy, announced a target date of 2018 for closure of the central cheque clearing system. Many stakeholders felt this decision would lead, in practice, to the abolition of cheques. This decision caused considerable anxiety for many people in the UK, particularly those who are elderly, housebound or rely on cheques to conduct their day to day business (such as many charities, clubs and small businesses).
3. Following pressure from the Treasury Select Committee (TSC) and the Government, the Payments Council reversed its decision and the banks undertook to provide cheque services for as long as customers needed them. In its response to the TSC cheques report, the Government also accepted the case for bringing the UK's payment systems strategy into formal regulation. In 2013, the Government legislated to introduce a new Payment Systems Regulator to address imperfect competition and to challenge under-investment and a lack of innovation in the UK's payment systems. The Regulator 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.
4. The Government is now taking a further step to support ongoing innovation in UK payments and to secure the future of cheques. Specifically, it is passing legislation to enable UK banks and building societies to introduce cheque imaging, an innovation that cuts down cheque clearing times by sending an electronic image of the cheque for clearing, rather than the paper cheque itself. Cheque imaging is already established in the USA, France and parts of Asia.

The problem under consideration

5. Consumers and businesses rely on payment systems to move money around the economy quickly and efficiently. In both respects there is scope for the cheque system to move more into line with the standards of electronic inter-bank and debit and credit card schemes. Today, cheque clearing operates on a maximum "2-4-6" timescale. This 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.

¹ Payments Council publication, *UK Cheques* (August 2013), p.5.

² Payments Council publication, *UK Payments Markets* (June 2013), p.11.

6. Under the current model, cheques are transported from bank branches to clearing centres where the essential details of the cheque (the amount, sort code, account number, and cheque serial number) are read and this data is exchanged electronically between banks. But as, under current arrangements, the paying bank takes responsibility for detecting cheque fraud, cheques need to be taken from the clearing centre of the collecting bank to an exchange centre, and then to the clearing centre of the paying bank. Here the paying bank can undertake an examination of the paper cheque to determine that it is genuine, has not been fraudulently altered, to establish that there are sufficient funds and that the cheque has been signed, dated and written correctly.
7. These aspects of the cheque system add delay and expense, contributing to the time it takes for cheques to clear, and the high fixed costs faced by banks and building societies in running the various centres and transporting paper cheques between branches, processors and exchanges. The Government wants to speed up cheque clearing times and welcomes the introduction of efficiencies to the process; innovation in the form of cheque imaging will help to deliver these efficiencies and will bring real customer benefits.

Rationale for intervention

8. The banking sector has undergone significant transformation since much of the legislation on cheques was written. The legislative requirements for a paper-based system in the UK are outdated and no longer fit for purpose, as they currently stand in the way of innovation and modernisation of the sector. Existing provisions in the Bills of Exchange Act 1882 and the Cheques Act 1957 prevent cheque imaging from being used. Under the existing legislation, a paying bank has the right to demand that it is presented with the physical cheque before deciding whether to honour the payment. Therefore, the Government needs to amend the legislation, to remove this right and render an electronic image of a cheque as equivalent to the original paper instrument for the purpose of presentment. If the Government does not intervene, banks will not be able to offer quicker chequer processing to their customers.
9. Amending this legislation will set a new, universal standard and place cheque imaging on a clear, statutory footing. Changes to primary legislation will give the banks the certainty they need to plan ahead for their payment systems. Lack of clarity about the legal status of any cheque images exchanged has already contributed to industry planning blight and would continue to do so without intervention. Primary legislation will also give payers and payees certainty that they can use the cheque imaging service, regardless of who they bank with.

Policy objectives

10. The Government wishes to create an environment where the cheque payment system can be innovative, efficient and operated for the benefit of end-users, including small businesses, charities and the elderly. The Government also wants the payment system to develop in a way that facilitates competition by permitting open access to participants or potential participants on reasonable commercial terms.

Description of policy options

Option 0: Baseline scenario – do nothing

11. In the baseline scenario the Government would take no action. The baseline is used to measure the costs and benefits of taking the action described in the Government's preferred option (Option 1). The costs and benefits of the option to take no action are zero as nothing will change. Banks and

building societies would continue to present cheques in paper form for payment. The Government has made it clear that cheques are here to stay, and that banks must maintain cheque services for as long as customers need them. The new Payment Systems Regulator will be equipped with powers to intervene if banks attempt to close the central cheque clearing system, given the impact this would have for many people in the UK, particularly those who are elderly, housebound and charities, clubs and small businesses.

12. In the absence of intervention, the counterfactual would in practice be that the unit cost for processing a cheque would rise each year. In time, there would be a risk that financial institutions start to charge end-users for cheque services, or the possibility that individual banks and building societies attempt to withdraw cheque services, if the operation of the payment system became prohibitively expensive.

Option 1: Preferred measure

13. The Government will introduce primary legislation to allow for the introduction of cheque imaging in the UK. The legislation will provide for an electronic image of a cheque to be equivalent to the original paper instrument for the purposes of presentment, and will not include a right for a paying bank to demand that it is presented with the physical cheque before deciding whether to honour the payment. The legislation will also enable electronic presentment of other similar paper instruments (such as bankers' drafts, postal orders, government payable orders and travellers' cheques), which are all currently cleared through exactly the same infrastructure. It is important that these can be cleared in image form too, otherwise the old infrastructure would need to continue running in parallel, leaving an inefficient, two-tier system.
14. The Government's legislation will address existing provisions in the Bills of Exchange Act 1882 and the Cheques Act 1957 that prevent cheque imaging from being used. Amending this legislation will set a new, universal standard and place cheque imaging on a clear, statutory footing. Changes to primary legislation will give the banks the certainty they need to plan ahead for their payment systems. Lack of clarity about the legal status of any cheque images exchanged has already contributed to industry planning blight and would continue to do so. The legislation will also give payers and payees certainty that they can use the cheque imaging service, regardless of who they bank with.
15. The legislation will thereby amend statutory provisions that have thus far blocked innovation; the legislation will not prescribe particular image capture solutions that the industry must adopt. There will be private commercial decisions for individual banks and building societies to consider, for instance, on potential customer offerings via smartphone (indeed, some financial institutions have already opted to develop these, and are poised to bring them to market – see paragraph 20); and cross-industry decisions will need to be taken about collaboration on a new central infrastructure for the exchange of cheque images.
16. Cheques will still have to be written on paper chequebooks issued by banks and building societies (or, for business customers, printed in an agreed format); it will not be possible for a customer to "write" a cheque digitally, on their phone. The customer who receives the cheque then has a choice of options for paying in the cheque:
 - take the paper cheque (or send it in by post) to their bank branch, where it is scanned by staff and an image sent electronically;
 - deposit the paper cheque at an image-enabled ATM, where it is scanned automatically and an image sent electronically; or

- use a smartphone, scanner or other mobile device to capture an electronic image of the cheque and pay this in to their bank, possibly via their bank's mobile banking app.

17. It is important that financial institutions continue to provide a choice of methods for deposit, including the option of depositing the cheque in paper form. Banks and building societies will not, therefore, be able to require customers to pay in exclusively by smartphone. This means that customers wanting to deposit by paper will be able to take a paper cheque to their bank branch (or to another bank's branch where shared counter services exist), to an image-enabled ATM, or they will be able to send in a paper cheque by post.

Costs

18. The policy is deregulatory. The Government's legislation will reduce the scope of Government regulation, by removing the express provision for, and emphasis upon, the presentment of paper cheques in the old cheques legislation. The amendments will remove outdated statutory provisions that stand in the way of innovations and efficiencies that the banking industry is keen to make. There will be significant beneficial effects for banks, businesses, consumers and the voluntary sector.

(i) Transitional costs for financial institutions: capability for image capture

19. The essential cost of meeting the policy objectives here is **zero**. Financial institutions who are direct members of the cheque payment system already have in place the minimum technology required for image capture. The other banks and building societies in the UK access the payment system indirectly via these member banks. As the direct member banks already have access to or own the requisite technology to capture and store cheque images, there are no costs associated with banks' capability for image capture. Whether to invest in new technology will be a commercial decision for each bank, if they believe it is necessary to deliver additional benefits.

20. In addition, any such changes could be voluntarily introduced by banks as part of their ongoing upgrade programme. For example, the latest counter terminals and ATMs already come equipped with image capturing capabilities. Software for image capture via smartphone is already in use by banks and processors in other parts of the world, and most of the suppliers of such software already have relationships with the member banks. In the UK, Barclays bank has already developed their mobile app for this service and have been piloting it for a sample of staff and customers since spring 2014.

(ii) Transitional costs for financial institutions: capability for image exchange

21. There is an existing dedicated network that banks use to exchange electronic data consisting of the "essential features" of a cheque (sort code, account number, serial number). However, it will not be practical to use this network as it stands to send both cheque images and data due to the size of the files being transmitted. Therefore, the UK banking industry has said that it will need to enhance the current network or introduce a new network in order for cheque imaging to be implemented.

22. The final design of this network has not been determined yet, and the precise cost will depend on the functionality – a decision which will be taken by the banks. The Payments Council has stated that total setup costs will be "tens of millions of pounds".³ Following the consultation process, banking industry respondents have focused this estimate further, specifying that this cost will be in the region of **tens of millions of pounds, and at the lower rather than higher end of this scale**. This will be

³ www.paymentscouncil.org.uk/.../cheque_imaging_fact_sheet_-_26_dec_13.pdf

one-off and spread across the UK banking industry as a whole. It is important to emphasise that this is an early estimate, as the contract for this infrastructure has yet to be put out to tender.

23. Based on the information provided by the banking industry, that cost of the facility for exchanging electronic cheque images will fall at the lower end of the spectrum of tens of millions of pounds, this means that the cost will be between £10 and £50 million. The best estimate for this cost (based on the median of this range) is **£30 million**.⁴
24. It should be noted that it is extremely difficult to separate out what proportion of this cost is essential to meeting the policy objectives, and what proportion consists of non-essential features or supplementary or enhancements that banking industry are opting to add, which go beyond the basic facility of exchanging electronic cheque images. Therefore, it should be noted that not all of this cost is directly associated with the Government's legislation, as some aspects will be commercial decisions open to banks and building societies, above and beyond the essential investment expenditure.
25. It is also very difficult at this stage to accurately define the timescale for implementation of cheque imaging by the banks, as this is still being scoped by the industry. However, the Government's consultation invited views on how long should reasonably be expected for the industry to prepare itself for cheque imaging, and the average proposed period was approximately two years. Based on this information, we have assumed for these purposes that the transitional costs of setting up this network are spread over **two years**. Once it is ready, the banking industry will move as one onto the new infrastructure for cheque imaging. In responses to the Government's consultation, this approach was overwhelmingly favoured over the option of individual financial institutions transitioning in a fragmented way to the new system.

Table 1.1:

Transitional costs: infrastructure for exchange of cheque images			
	Year 1	Year 2	Total
Cost (£m)	15	15	30

(iii) Transitional costs for end-users of cheques: capability for image capture

26. The essential cost of meeting the policy objectives here is **zero**. Where they already own them, consumers, businesses and charities may utilise smartphones, tablets, scanners or other devices to pay in cheques remotely. The prevalence of such devices means that in the majority of cases end-users will be able to leverage existing technology, meaning there is no cost. By the date of implementation, it will also be the case that such technology will have even greater penetration than at present. In the United States, some financial institutions voluntarily provided corporate customers with desktop scanners free of charge (again, such decisions will be commercial ones for banks and building societies to make). End-users without such technology will be able to deposit cheques at branches, ATMs, Post Offices and by post, and still benefit from a faster clearing cycle. Therefore, there is no cost imposed by the legislation.

Benefits

(i) Economic/financial benefits

⁴ Based on Better Regulation Guidance, p.78: "where information on the distribution ... cannot be provided, use the mid-point of the range. While information on the distribution is preferable, it may not be proportionate in every case to go into such a depth of analysis." The contract for this infrastructure has yet to be put out to tender, therefore the banking industry is unable to provide us with a more precise figure than given here.

27. **Recurring benefits for banks and building societies:** cheque imaging will reduce the cost of processing cheques, bringing the cost of running this payment system closer into line with the cost of electronic payment systems. The range of impact here will extend to all banks and building societies that provide cheque payment services in the UK.
28. Below are examples of current inefficiencies and indicative figures for the types of costs that banks could reduce or eliminate under cheque imaging. These are illustrative examples that the industry have been able to provide, it is not an exhaustive list.
- **Collection of cheques from each of 10,809 branches daily.** Each branch needs a collection at least daily for each of the 253 working days of the year. This equates to 2.74 million collections per year. The costs for these collections vary between banks and according to location, but for illustrative purposes, for a collection cost of £5 per collection, this results in total costs of £14m annually, while £10 per collection gives a cost of £28m annually.
 - **Corporate cheque delivery.** Large corporates will often deliver bulk cheque deposits direct to their bank's processing centre rather than delivering them to a local bank branch. We don't have details of these costs, which are local arrangements, but this is a significant cost and inconvenience for businesses under the present system.
 - **Cost of moving cheques from the processing centres to the exchange centres.** In 2010 the costs were collected for member banks for the current arrangements which include flights and courier networks for moving paper between the processing and exchange centres. The total for these costs were in the region of £4m annually.
 - **Cost of courier network.** This contract is managed centrally by the Cheque & Credit Clearing Company i.e. a cost borne by member banks, it totals £740,000 annually including Northern Ireland.
 - **Running costs of the two exchange centres.** This contract is managed centrally by the Cheque & Credit Clearing Company. i.e. a cost borne by member banks, it totals £77,000 annually.
29. It is possible to estimate the reduction in the cost of cheque processing, using evidence from other countries where cheque imaging has already been introduced. The USA introduced the Check 21 Act (which took effect in 2004), to allow a payee to create an electronic image of the original cheque, thereby eliminating the need for further handling of the physical document. The most authoritative review of cost savings since Check 21 was introduced was carried out by the Federal Reserve. It found that the central cost of processing under Check 21 using image was approximately **25%** that for paper.
30. If the UK's payment landscape was identical to that of the USA at the time of Check 21, then it could be expected that approximately **75%** of central processing costs could be saved if a similar system was introduced here. However, the UK already has an inter-bank data network for the exchange of electronic data, which the USA did not. On this basis, the banking industry has advised us that the estimate of 75% savings should be revised down to a best estimate of approximately **40%** savings.
31. In 2009 the Payments Council indicated that the full unit cost of a cheque to financial institutions was **£1 and upwards**.⁵ This is the most recent estimate; it is worth noting that, as cheque volumes decline, the unit cost to process a cheque would, if anything, rise each year.
32. In 2013, a total of **566 million items** were cleared through the Cheque & Credit Clearing payment system.⁶ Given the evidence that the unit cost per item is at least **£1**, then the total operating costs

⁵ Payments Council publication, *The future of cheques in the UK* (2009), p.25.

for the year can be estimated at **£566 million**. The best estimate for the **savings** delivered by the policy for the year would be 40% i.e. $0.4 \times 566,000,000 = \text{£226 million}$.

33. It is difficult for either the industry or the Government to predict the number of cheques that will be processed over the next ten years. In recent years cheques have declined at a rate of 12% per annum, and it could be assumed that this rate of decline would continue. However, cheque imaging will address the issues that have affected the current payment system and deterred end-users (for example, end-user concerns about slow clearing times and inconvenience in paying in cheques at branches). It is also fair to say that a higher frequency of cheques would be paid in per year because fewer would be lost or forgotten about than at present, given the increase convenience for recipients to deposit with cheque imaging. In addition, it is likely there is a "hard-core" of cheque users, for whom alternative methods would be unavailable or unattractive, which we could expect to limit the decline after a certain point. It could therefore reasonably be expected that the policy would result in a slowing of the rate of decline in cheque volumes, stabilisation at a constant volume or even an increase the number year on year.

For the calculations below, it is assumed that cheque imaging is implemented after two years, with an initial setup cost of £30m. These calculations are in relation to the counterfactual i.e. the costs and benefits that are additional to those that would have been incurred if no action were taken. The banking industry would already be paying to operate the payment system, therefore costs from Year 3 are zero.

34. **Lower estimate:** cheque volumes continue to decline at a rate of **12% per annum**. For example, the number of cheques in Year 1 is $566\text{m} \times 0.88 = 498\text{m}$.

The cost savings for the first year when cheque imaging is up and running (Year 3) are 40% of £386m = £154m.

Table 1.2:

Recurring benefits: operational efficiencies in running the payment system											
Year	1	2	3	4	5	6	7	8	9	10	Total
Cheque volumes (m)	498	438	386	340	299	263	232	204	179	158	
Costs (£m)	15	15	0	0	0	0	0	0	0	0	30
Benefits (£m)	0	0	154	136	119	105	93	81	72	63	823
Net (£m)											793

35. **Higher estimate:** cheque volumes stay **constant** after implementation in Year 3, at 386 million items per year.

The cost savings for Year 3 and every year thereafter are £154m per annum.

Table 1.3:

Recurring benefits: operational efficiencies in running the payment system

⁶ Payments Council publication, *Clearing statistics: annual summary* (2013), p.3.

Year	1	2	3	4	5	6	7	8	9	10	Total
Cheque volumes (m)	498	438	386	386	386	386	386	386	386	386	
Costs (£m)	15	15	0	0	0	0	0	0	0	0	30
Benefits (£m)	0	0	154	154	154	154	154	154	154	154	1232
Net (£m)											1202

36. **Best estimate:** the best estimate takes the **mid-point or average of the range**. For example, for Year 4, the mean of £154m and £136m is £145m.

Taking into account the points made in paragraph 33, this is considered the most likely point in the range, as the most probable trend will be that cheque volumes continue to fall, but by a lower rate.

Table 1.4:

Recurring benefits: operational efficiencies in running the payment system											
Year	1	2	3	4	5	6	7	8	9	10	Total
Cheque volumes (m)	498	438	386	363	343	325	309	295	283	272	
Costs (£m)	15	15	0	0	0	0	0	0	0	0	30
Benefits (£m)	0	0	154	145	137	130	124	118	113	109	1030
Net (£m)											1000

37. **Recurring financial benefits for end-users of cheques:** cheque users will benefit from faster clearing times. Particular benefits will accrue to small and micro-businesses, charities, and the elderly, all of whom continue to depend heavily on cheque payments. Cheques are used by sole traders, other micro-businesses and small businesses to make a quarter of their outgoing payments.⁷ For many smaller charities and other voluntary organisations, cheques are the primary method of payment. Research shows that cheques remain the principal method of giving to charity, generating over 57% of volume of transactions and 66% of the donation value.⁸

38. Small business groups responding to the Government's consultation welcomed that the measure will allow money to move more quickly and efficiently through the payment system and the wider economy. These contributions highlighted the detrimental effects currently caused by late payments, in some cases attributable to slow clearing cycles. Research from one small business stakeholder showed that 77% of smaller business report that being paid late leads them to fail to pay their suppliers on time.

39. Evidence submitted in response to the consultation also reported that the current 2-4-6 standard is rarely understood and makes it difficult for people to budget and manage their finances. A new, simpler proposition with a single shorter clearing cycle will help alleviate this problem.

⁷ http://www.paymentscouncil.org.uk/media_centre/press_releases/-/page/2366/

⁸ Research from Institute of Fundraising in partnership with Valldata (2013). Represents over 10 million transactions and £150m of donations that they process. <http://www.institute-of-fundraising.org.uk/library/valldata-donation-trends-research/>

40. In addition, consultation responses demonstrated that both large and small businesses benefit from the ability to pay in cheques remotely. Currently, large corporates will deliver bulk cheque deposits direct to their bank's processing centre, rather than deliver them to a local bank branch. This is a significant cost and inconvenience for businesses under the present system. Under the new legislation, such businesses will have the option of sending cheque images digitally for deposit.
41. In responses to the consultation, submissions reported on how sales people and installation engineers out in the field currently collect payments from customers by various methods, including a significant percentage by cheque. As things stand, the need to collect, transport and bank the paper cheque introduces risk of loss, cost and inefficiency. One submission commented that field based team members are already equipped with 3G enabled smart tablet devices and they said it would be ideal to be able to carry out image capture of cheques to collect payment.
42. The ability to deposit cheques by smartphone, tablet or desktop scanner has particular benefits for small and micro-businesses receiving large numbers of payment via cheque. In other countries, this easier remote deposit option has helped such businesses to scan cheques on their own premises, where in the past, for the smaller firms, it may have been necessary to close the business in order to take cheques to the bank to pay them in. This means premises can stay open and sales can continue uninterrupted during the working day. In countries where cheque imaging has been introduced already, the greatest demand for remote deposit appears to come from smaller businesses.
43. It is extremely difficult to quantify the benefits in monetary terms. However, the policy will clearly have beneficial financial effects for household and businesses, particularly those who currently experience cash flow difficulties, currently exacerbated by slow clearing cycles. As indicated above, positive consequences for other businesses and the wider economy can also flow from this as a result.
44. **Recurring benefits for smaller banks and building societies:** in addition to reducing the overall costs for financial institutions to operate the payment system, cheque imaging may particularly benefit challenger institutions, by reducing barriers to entry and opening up access to the payment system. This in turn can increase competition in the UK's retail banking market and improve end-user propositions and customer choice of payments and other financial services. It is difficult to accurately quantify these benefits in monetary terms. Therefore, the benefits are set out below in qualitative terms.
45. Cheque imaging can reduce barriers to entry and encourage competition in retail banking, by **putting challenger banks in a better position to compete even if they lack an established physical branch network**. The Final Report of the Parliamentary Commission on Banking Standards (PCBS) in 2013 included evidence indicating that the need to acquire a large-scale branch network can constitute a significant barrier to entry for small or new financial institutions.⁹
46. While the presence of a local branch is an important factor for many customers – and the Government is clear that cheque imaging must add to, not reduce options for customers in how they transact – the need to acquire a physical branch network is a contributing factor to the current concentration of the retail banking market. The option of paying in cheques via smartphone will make it easier for challengers to compete with the large, incumbent financial institutions, and will offer those institutions with a limited physical presence the opportunity to expand their customer base beyond their traditional brick and mortar footprint.

⁹ <http://www.parliament.uk/documents/banking-commission/Banking-final-report-vol-ii.pdf>, pp. 152, 206.

47. The PCBS Final Report also highlighted terms of access to payment systems as a barrier to entry in retail banking, commenting that:

*the current arrangements, whereby a smaller bank can only gain access to the payments system via an agency agreement with one of the large banks with which it is competing ... place small banks at a disadvantage, because the large banks remain in a strong position to dictate the terms on which indirect access to the payments system can be secured by smaller banks.*¹⁰

48. The measure has two beneficial impacts that are relevant here. First, cheque imaging can improve the effective operation of the market for indirect access, by increasing choice and ease of switching between providers of indirect access to the payment system. 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 will 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, **moving 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.

49. Second, the new central infrastructure for the payment system is expected to be designed as a central platform offering financial institutions the ability to “**plug and play**”, **making direct access easier and more transparent** for new players in the market. This can make direct access a viable option for challengers, who may wish to access the payment system without going through a large bank with which it is also competing. This will also reduce the “tiering” of the payment system, and therefore has financial stability benefits through the expansion of direct participation.

(ii) Social benefits

50. **Recurring benefits for end-users of cheques:** the measure will allow for the following, once cheque imaging is introduced in the UK.

- **Speed up cheque clearing times**, meaning consumers and businesses receive their funds more quickly.
- **Greater customer convenience and choice in ways to pay in cheques**, with new options to deposit by smartphone, scanner or other devices.
- For customers in rural areas or with limited mobility, this expansion of choice may **help overcome barriers to financial inclusion**.
- **Later last times of deposit** should be available due to a courier no longer being required. Users will also benefit from a common proposition for clearing times being available across the UK irrespective of weather.
- **Innovation opportunities** for financial institutions, enabling banks and building societies to add new value in customer propositions, for example, leveraging the widespread adoption of smartphone technology.
- **Voluntary sector benefits, contributing to wider social welfare.** Aside from the benefit of faster transmission of funds donated by cheque, charities have expressed their hope that the appeal of smartphone deposit captures the interest of younger generations and encourages greater charitable giving by cheque.

(iii) Environmental benefits

¹⁰ *Ibid*, p.214.

51. The measure will digitise parts of the payment system. Cheques will still be written on paper chequebooks issued by banks and building societies (or, for business customers, printed in an agreed format) – because the essential characteristics that define the cheque system for users – and which make it such a vital payment method for millions – must remain intact. The policy must balance the objectives of innovation and efficiency, with those of financial and social inclusion, and therefore abolition of paper cheques is not an option under consideration. The Government takes seriously the needs and inclinations of individuals and businesses in the UK who prefer to use cheques and other paper instruments to transact. The policy will help **reduce carbon emissions on an ongoing basis**, as a result of the opportunity to scale down or eliminate courier transportation for physical cheques.
52. It is very difficult to quantify the reduction in carbon emissions, so this assessment expresses this impact in qualitative terms. This is because the industry has not been able to provide information about the number of courier vehicles and aircraft currently deployed across the UK. Furthermore, individual banks and building societies have yet to decide on exactly how they will implement cheque imaging, and therefore how such transportation is expected to be scaled back or eliminated.

One-in, Two-out (OITO) assessment

53. On 20 January 2014 a Regulatory Triage Assessment (RTA) was submitted for the measure. On 29 January the Regulatory Policy Committee confirmed that the measure is in scope of OITO and will have a direct net benefit to business (an “OUT”). The RTA explained that the policy will remove the burden arising from the old cheques legislation, which has thus far prevented the banking industry from moving away from the paper-based clearing system. This system currently imposes great financial cost, administrative inconvenience and unnecessary inefficiency on the banks.
54. Based on the evidence presented, the Committee concluded this was consistent with the current Better Regulation Framework Manual and provided a reasonable assessment of the likely direction of impacts. The Committee noted that the evidence supporting the estimated Equivalent Annual Net Cost to Business would have to be validated at final stage, and we agreed to submit this Impact Assessment for validation of the net savings to business.

Equalities impact

55. In complying with the Public Sector Equality Duty, we are required to show due regard for the needs of people with “protected characteristics”. Age and disability are protected characteristics. We have identified potential impacts on older and disabled persons, and have acted upon this analysis to ensure that the measure does not put such people at a disadvantage.
56. The Government is clear that people must still be able to write cheques as they do now, and any new options for mobile deposit must be in addition to, and not instead of, paying in paper cheques at bank branches, cash machines, Post Offices and by post. The legislation will therefore restrict the ability of banks to force customers to pay in exclusively by electronic image.
57. We have also identified a number of positive impacts for people with protected characteristics arising from the measure:
- by giving the option of paying in cheques remotely, without needing to physically visit a branch, cheque imaging will increase customer convenience, helping many older and/or disabled bank customers to deposit cheques; and
 - by making the operation of the payment system much more efficient and cost-effective, the measure will help secure the longevity of paper cheques as a payment method that banks can continue to provide.

Impact on small firms and micro-businesses

58. The Small and Medium Business Assessment (SAMBA) came into force on 1 April 2014. It is intended to ensure that all new proposals are designed and implemented so as to mitigate disproportionate burdens. This is a deregulatory measure and there are no regulations or costs falling on small or micro-businesses.
59. Cheques continue to be particularly popular amongst small businesses (defined as up to 49 FTE employees) and micro-businesses (up to 10 employees). The policy is therefore expected to directly benefit these categories of firm in particular (for example, as illustrated in paragraphs 38-40 and 43).

Conclusion

60. The banking sector, businesses, consumers and the voluntary sector will be impacted positively by this deregulatory measure, which will remove the onerous emphasis on the presentment of paper cheques in the existing legislation. The measure will allow banks to adopt innovative technology and make significant cost savings in providing cheque payment services. It will improve the customer proposition, offering greater choice in ways to pay – including for more vulnerable users – and allowing money to move more quickly through the payment system and wider economy. It will also help lower barriers to entry and encourage greater competition in the UK retail banking market.