

Facilitating a central account switching & mass account migration solution for the UK banking industry:

How to achieve the interlocked objectives of consumer choice & financial stability

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A paper by Intellect, the trade association for the UK technology industry

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Executive Summary

The Intellect Proposition

In short...

*A **Central Utility**, developed in two phases, that will allow for the competitive switching of current accounts by consumers and then the facilitation of mass migration of accounts in the event of a failure of a retail bank. The Central Utility will consist of a central mandate facility, unique identifiers to differentiate individual consumers across the banking system and will be scalable to accommodate the mass migration of up to 30 million accounts in a short time frame. Each Phase of the Central Utility will be built with the next in mind, so that the ability to expand it to fulfil these dual objectives, is not limited by design.*

*The development of this Central Utility will be guided by an **‘Overall Vision’**, which need not necessarily represent an actual intended goal or even an aspiration to be planned for in detail. Rather, it provides a delineation of what is technologically possible and beneficial to banks, consumers and the wider economy under current circumstances and that can serve as the theoretical reference point for specific decisions.*

This paper sets out how the implementation of a **Central Utility** could facilitate easier account switching by consumers and the mass migration of accounts in the event of the failure of a bank – guided by an **‘Overall Vision’** of how technology could, conceptually, transform the operations of banks and the provision of customer services. It is, in effect, an argument for policy makers and regulators to consider these dual objectives together, rather than unilaterally.

The Central Utility would fulfil two key objectives that are currently being examined separately by policy makers and regulatory authorities. These are:

- Competitive switching of current accounts between UK retail banks that would fulfil the recommendations set out in the Independent Commission on Banking’s (ICB) Final Report

AND

- The mass migration of accounts from a failing bank to a healthy bank (or number of healthy banks) over ‘a weekend’ which would fulfil a key facet of the Financial Stability Board’s financial stability objectives

Intellect believes that to approach these dual objectives separately would be both a duplication of effort/resource and counterproductive to the timely reform of the financial system. This paper puts forward the case for addressing the solution to account switching and mass account migration as phases of a single industry solution and approach.

This phased approach will see account switching, as currently envisioned by the Payments Council (PC) and the ICB Report, being delivered by the 2013 deadline as **Phase 1** of the solution, thereby meeting existing commitments and consumer concerns. **Phase 2** would be the enablement of mass account migration – which will follow and use the architecture, operational and technical infrastructure created in Phase 1 as its basis.

In essence, each phase and introduction of additional capability, such as the scale required for mass account migration, will be delivered by building on what was put in place by earlier phases. The fundamental principle is that of “keeping doors open” through the adoption of standards, infrastructure and operational guidelines that facilitate scalability and applicability across a range of usages that is broader than that required to cater only for account switching requirements. Phase 1 and Phase 2 make up the Central Utility.

This has the considerable advantage of providing all stakeholders with significant implementation and operational savings whilst achieving both the respective goals of greater industry competition and reduced systemic risk.

Intellect also believes that this approach could be extended beyond the currently envisioned two phases and objectives so as to provide UK banks with a means to further their return on investment in the Central Utility – ‘the Overall Vision’. Due to the inherent centralisation of customer information that the solution provides, a host of additional potential phases could be subsequently implemented to address emerging industry opportunities and challenges, such as those arising from increasing customer delivery channels, the perpetual issue of fraud, the internet and the provision of quasi-banking and payments services by non-traditional suppliers.

It is important to note that whilst the ‘Overall Vision’ is in essence theoretical, the Central Utility is not – it is a realistic proposition based on the benefits it poses, the problems it solves and the technology and systems that are required to implement it.

As well as the increased benefits of greater competition and increased certainty around the continued provision of banking services even in periods of financial turmoil, there are a number of benefits for banks that will be reaped through the development of a Central Utility – primarily around the savings that will be accrued from a reduction in fraud. However, establishing a Central Utility would require a significant investment of time and resource from the banking sector.

For a description of the Overall Vision, go to page [13](#).

For details on the specific characteristics of the Central Utility go straight to page [17](#).

For a description of the stages in achieving the Central Utility and the Overall Vision, go to page [26](#).

Overview & Context

The financial crisis has prompted an unprecedented wave of reform, aimed at addressing the perceived failings of the financial system accumulated over the course of 15 years of almost continuous, exceptional expansion in activity, complexity and change in the role of financial institutions within economies. These reforms have been, and are continuing to be, put in place on global, regional and individual company levels, with the complexities involved in compliance coming to pose considerable costs and potential operational disruptions.

Concurrent to the issues of cost and operational disruption, there is however urgency in achieving a financial system and financial system participants that are best able to withstand and deal with potential future risks while providing consumers with appropriate market competition. Therefore, any opportunity to leverage or combine individual efforts to address perceived failings, whether mandated by regulatory requirement or imposed to maintain shareholder value, should be taken.

This applies especially to increasing the level of coordination between regulatory authorities and the industry in putting in place specific solutions required. It is important to avoid mitigating each perceived risk individually when multiple risks could be mitigated simultaneously or by marginal changes to individually planned solutions. In short, financial market participants will derive the most cost effective and timely outcomes when setting or meeting compliance requirements in a holistic manner so as to avoid replication of work in implementing individual solutions for “overlapping” or “near-field” target areas to be improved.

The current effort in the UK banking industry addressing improved competition through easier account switching, is a case in point.

On the back of the recent Independent Commission on Banking (ICB) recommendation (the “Vickers Report”) that a perceived lack of competition within the retail banking sector be resolved through easier and faster account switching for consumers, the Payments Council (PC) has initiated efforts to lead the implementation of a solution to make account switching between banks easier, faster and less costly. With oversight from HM Treasury and the Treasury Select Committee, the PC and its members have committed to delivering this solution by the September 2013 target date set by the ICB recommendations, with the additional aim that consumers will begin to see the benefits of the proposed solution by the end of 2012.

Almost simultaneously to the ICB report, in July 2011, the Financial Stability Board (FSB) published a consultative document on the “Effective Resolution of Systemically Important Financial Institutions (SIFIs)”. This set out a number of policy recommendations that will allow the continuation of the crucial economic functions of SIFIs in the event of actual or perceived insolvency.

One of the key recommendations was a requirement for regulatory authorities to have at their disposal tools to quickly intervene and ensure the continued performance of systemically important functions. Specific reference in respect of these functions was made to the need to ensure prompt payout of insured deposits and prompt access by consumers to their transactions accounts so as to minimise the potential consequential impacts of a bank failure, on the wider functioning of the UK economy.

These two objectives are currently being addressed separately. While the PC is devising a solution singularly to achieve the account switching objective, regulatory bodies are considering how a mass account migration solution could be put in place. The respective solutions are being approached as separate operational and technological solutions, each with its own implementation timescale, cost and potential disruptive impact on the ongoing operations of UK retail banks.

Discussions in the industry have noted that there is significant overlap in the aims of these two objectives, as the solution that will provide facilitation of account switching to consumers could be used as a means to achieve mass account migration in the event of a bank failure. In this context – in its simplest form – mass account migration can be considered as account switching on a larger (in terms of volume) or faster (in terms of execution) scale.

In its role as the trade association for the UK technology industry, Intellect used its position to instigate informed discussion amongst its members as to how a single approach to both these aims could be achieved and so bring considerable benefit to the UK retail banking industry, regulators and consumers

alike. This involved not only the conceptualisation of a solution, but discussion of the practical realities, technologies and processes that will be required.

The fundamental finding was that it is technically, operationally and economically feasible to adopt a Central Utility approach to meeting both account switching and mass account migration requirements and that this can best be delivered in a phased approach. Enabling the adoption of a phased approach was found to primarily require the introduction from the outset of a key set of principles, methodologies and technologies that can act as terms of reference for each phase.

The difficulties in arriving at terms of reference (on the one hand specific enough to provide practical guidance in arriving at functional and technical specifications, while generic enough to maximise re-use to what are presently potentially unknown future requirements) was also addressed, and specific principles arrived at. These were considered firstly in the context of the known mass account migration requirement and secondly in the context of potential future regulatory requirements or market driven opportunities that the retail banking industry faces or can come to face in next 3 to 5 years.

In respect of these potential future requirements, considerable attention was made to current industry trends, new entrants providing quasi-banking services, as well as wider technological and social trends that are likely to have direct impact on shaping both the demand and form of retail banking services. New types of services that could become reality as a result of technological innovation were also considered in line with the technological trends identified.

The group also considered the business case for the industry's adoption of the prescribed approach. It was noted that the key concerns in approaching account switching from a phased approach perspective will be:

1. Additional initial cost;
2. Additional potential delivery risk for the planned account switching solution; and
3. Additional potential delivery time required in Phase 1 to adhere to the required set of principles to make subsequent phases possible.

Each of these was addressed in turn and the overwhelming conclusion was that, even limited to account switching (Phase 1) and mass account migration (Phase 2), approaching these dual objectives separately will represent a considerable duplication of effort and resource. The group also identified specific measures required to mitigate all three concerns to a level that is fully outweighed by the resulting benefits accruable to the industry, regulators and consumers alike.

It is hoped that this paper will contribute to ongoing deliberation over account switching and financial stability issues in the wider context of the reform of the financial system, and demonstrate that the technological 'art of the possible' is an important consideration in determining what makes durable and effective policy.

Starting point: Defining competition and financial stability objectives

The starting points for Intellect's considerations were the respective objectives of the ICB and the FSB.

These were understood to be:

For the ICB, that:

- The introduction of account switching has the aim of increasing competition within the retail banking sector
- The solution implemented represent minimal additional cost for banks and other concerned bodies
- There be early introduction of a current account redirection service as a step towards the achievement of full account switching capability
- The full process of switching an account for a consumer occur in seven days or less
- Account switching include the migration of the following payment forms:
 - All credits accruing to an account;
 - All debits chargeable from an account;
 - All direct debits; and
 - All standing orders.
 - Recurring debit card transactions
- The account switching be seamless for the consumer
- Account switching be problem-free so that the consumer is not unduly inconvenienced by errors in the account switching process
- Seamless redirection of any post-account switching postings to the old account occur for at least 13 months following the switch of accounts;
- The account switching process provide consumers with reminders and include support to direct debit originators
- The account switching process be supported by guarantees from banks that consumers will not suffer loss if mistakes occur so that account switching is "risk free" from the customer's perspective
- Account switching and the associated redirection service does not impose disproportionate costs on new entrants and banks that access payments systems through agency arrangements; and
- Account switching is accompanied by improved transparency

However, there was a comparison made within the ICB's report on the similarities between switching in the mobile phone and utilities markets and the likely dynamics of switching within the current account market. Intellect would point out that the comparisons made within the report between account switching and the communications and utilities markets may not provide the best basis to derive account switching objectives. This is because:

- There are differences between mobile phone tariffs – based on provider and indeed based on the handset they are attached to – these differentiate certain suppliers. However, in the current account market, tariffs are very similar between suppliers (especially during periods of low interest rates) and there is little to choose between suppliers. What transparency may be required may be supplied by existing comparison web sites (see below)
- There are no 'in-flight' transactions when a mobile phone contract or utility is switched. In the case of mobile, there is a down time as the account is moved from one provider to another (it may be a matter of hours, but it is a break in service nonetheless). With banking, there might be transactions associated with the accounts that are up to six months old (e.g. cheques), there may be 'in-flight' payments (BACs, etc) and instructions that were given months before hand to be enacted (e.g. standing orders, direct debits etc). Therefore, the dynamic of account switching, compared to switching of mobile phone or utility provider is different and should be approached as such

For the FSB, that:

- A national resolution regime should provide regulatory authorities with the tools to intervene safely and quickly to ensure the continued performance of a bank's systemically important functions
- Prompt payout or transfer of insured deposits to consumers is achieved
- Prompt access to transactions account information is available, including in respect of segregated client funds, irrespective of location of such funds
- The adopted approach facilitates the transfer or sale of viable portions of the bank
- The adopted approach achieves accurate apportioning of losses, including to unsecured and uninsured creditors, in a manner that is fair and predictable and so avoids panic or destabilisation of financial markets
- A system be in place that will ensure the continuation of economically critical banking services in the event of a failure of major deposit taking financial institution
- The need for government financial support or direct intervention to protect wider economic activity is minimised

Identifying the challenge: key shortcomings of the status quo

In respect of retail banking competition through account switching

Consumer inertia in the current account market is a well documented shortcoming in UK retail banking and the ICB has set this out as a key issue that needs addressing. Since the Cruickshank Report of March 2000, account switching has been a reform option but was never acted upon as the retail banking sector grew in strength and influence.

The low level of account switching undertaken by consumers in the UK market is largely attributed to concerns amongst consumers in respect of:

- The complicated and protracted nature of the process for switching accounts, perceived by consumers to be an inconvenience to undertake
- The perceived high potential for errors in the course of transferring accounts, especially in respect of direct debits, standing orders as well as incoming credits, such as from one's employer
- The resulting high risk of disruption to the smooth running of an individual's or business's personal finances and the consequential effects this could give rise to

In short, the status quo is a perception by consumers that switching an account represents a higher risk than is warranted by vis-à-vis any inherent motivation to do so that may arise from specific instances of financial benefit or improved customer service, that could be achieved from such switching.

In respect of systemic risk from retail bank failures

Currently, if a SIFI were to fail, the Government is likely to have little option but to directly intervene with a view to ensuring the continuation of services that are critical to consumers and perpetuate "business as usual" within the economy. In view of the burden this will impose on UK public finances, it is unlikely that this could happen on any large or sustainable scale, without wider economic impact on the UK from international financial markets.

More pertinently, it is likely that the overwhelming majority of account holders of such a SIFI will be entitled to receive FSCS compensation for any losses. As this will need to be paid by the FSCS to the consumer, it follows that the consumer will require a bank account in which to receive such funds. This makes the requirement for the opening of a new account by each consumer concerned an inherent and tautological component of any FSCS intervention and payout, as the payment will be received as a consequence of the consumer's original account no longer being accessible.

An individual consumer in this position will then have to personally re-instate each direct debit, standing order or other instruction relating to their original account, as well as inform each party paying into his/her account, such as an employer or provider of benefits, of a change of payment destination. This will not only entail considerable effort, but it is likely to be exacerbated by the non-availability to the consumer of all pertinent information required to implement such re-instatements. It is also a fact that any such re-instatement will itself be contingent on the consumer first having opened a new bank account, itself representing a time consuming step in the process of returning to "business as usual".

Further to the actual loss of aggregate economic productivity that will need to be diverted to account re-instatement activities, the natural and likely behavioural result will be for individual consumers to significantly curtail any expenditure, perhaps even turning to cash as a primary means of transacting, for the length of the re-instatement period. This period will potentially be considerable and, in any event, is unlikely to be less than one financial cycle. In the case where the individual consumer is paid on a weekly, rather than a monthly, basis and who therefore has weekly financial cyclical, re-instatement could span several cycles and therefore have even more significant adverse impact.

The disruption is only marginally less for the relatively small number of consumers with more than one current account. Although they would not have a need to open a new account, thereby reducing the timescales involved to some extent, it remains that all instructions to and from the defunct account would still need to be re-instated. This would entail similar effort and would be likely to have a similar impact on spending patterns thereby resulting in analogous disruption of “business as usual” economic behaviour.

The prospect of multitudes of consumers affected in this way would, on aggregate and on a UK wide basis, result in a massively disruptive adverse impact on wider UK economic activity.

As these events unfolded, popular perception or the prospect that further SIFIs may “go the same way” could also result in changes in the consumer behaviours of those holding accounts at all potentially impacted banks. The fact that a friend or acquaintance has found themselves in the situation of the consumer described will result in those hearing of the consequences altering their own “business as usual” economic activity, even if they are still holding operating accounts at a functioning bank. The financial scale of impacted activity would therefore not be limited to those directly involved in FSCS compensation, further compounding the impact on overall economic activity.

Significant additional economic disruption would similarly accrue from impacts arising from the behaviours of small and medium sized (SME) businesses which would likewise lose the ability to pay suppliers, employees, rents and ongoing operating costs. Additionally, they would lose the capability to receive or safely deposit receivables. This would represent a sizable, if not even greater, adverse impact to the UK economy than that derived directly from consumers. The financial “domino effect” this could create between businesses would certainly contribute considerable additional economic disruption.

Similarly, large corporates may struggle to pay salaries/bills, etc, if the accounts that these are normally paid from cease to exist as a bank fails. Aside from the fact that large corporates are not covered by the FSCS and the loss of available funds may inhibit cash flow in the short term, the time it takes to make alternative provisions to pay employees and contractors will have a knock-on impact on these individuals, businesses and the wider economy.

As a final point, the impact on other retail banks (SIFIs or not) would also be considerable, as it is likely that mortgage, insurance and other larger financial payments would be missed or delayed. This could potentially place such institutions under short term liquidity or funding pressures which could themselves come to be triggers for further market tension, if not specific failures.

In view of the concentration of the UK retail banking sector, where the largest four banks account for 77% of personal current accounts and 85% of SME current accounts, it is not inconceivable that the trigger for sustained economic dis-activity in the UK economy from a SIFI failure would be a direct result of the inability to achieve current account availability and “business as usual” economic activity. It is therefore probable that the consequential economic impact of the disruption caused by the lack of operational current accounts would be greater than the economic impact of the failure of the SIFI in the first instance.

Current approaches to addressing the challenge

In respect of account switching

The Payments Council (PC) has announced plans to introduce an account switching service by September 2013 and is therefore taking the lead in ensuring the ICB's recommendations are implemented. This is being approached as an industry wide initiative, supported by the PC's members, and reflecting the wider UK retail financial industry.

This is welcomed by all stakeholders, although it is anticipated that the proposed approach will not address two key issues:

- A lack of transparency in the current account market and in particular making available the capability for consumers to compare accounts on a like for like basis so as to inform account switching decisions
- The potential use of the solution deployed for any other purpose value adding purpose, including mass account migration

As industry wide discussions are still ongoing, final functional and technical specifications were not available for Intellect to consider in greater detail. However, it is understood that the proposed account switching solution may:

- Leverage existing assets available in the UK banking industry, such as those available from the VocaLink infrastructure
- Increase the security of the overall account switching process
- Provide retail banks with options as to the level of automation of account switching they individually wish to adopt

It is also understood that the PC initiative will be directly monitored by HM Treasury on a quarterly basis so as to ensure delivery against projected timescales

In respect of mass account migration

The FSCS has taken the lead in considering the operational aspects of delivering financial compensation in the case of the failure of one or more banks covered by the FSCS guarantee, currently set at £85,000 per account holder. This has involved discussions with industry participants, representative bodies as well as relevant regulatory stakeholders and the BoE.

Additional discussions are also occurring at inter-governmental level, focusing on the management of systemic risks with potential cross-border impacts to the wider global financial services industry. These discussions include attempts to arrive at a coordinated approach to mitigation of retail bank failures with the aim of achieving a coordinated and consistent approach among major economies.

These discussions have highlighted an appreciation of the value of "in-country" mass account switching in the mitigation of the systemic risk posed by a failure of a SIFI, although the specific means of arriving at a viable mass account switching solution have not been clearly identified. As a result, Intellect is not aware of any specific clearly defined plan to implement a mass account switching capability in the UK.

Intellect notes that the approach to mass account migration seems to be viewed as a disaster contingency plan. However, there is already a rationale for viewing this requirement as "business as usual" because of the need to transfer large tranches of accounts as part of the sell-off of parts of banks (e.g. RBS and Lloyds Banking Group). Had the Central Utility been in place now, this would have significantly aided the process of divestment of parts of these banks, but as it is not, its capacity to assist will be restricted to any future divestment requirements.

On a broad level, the aim is to relieve the UK Government of the burden of bailing out an institution that is too systemically important to fail. The logical conclusion is that once this comes to pass, a bank failure would reduce from being a catastrophe to an inconvenience, which could in itself spur competition and better risk management within individual institutions.

The Intellect proposition

Overview

Based on their experience in the financial services industry, Intellect's members believe that approaching the dual aims of increasing the ease of account switching for consumers and implementing an operational special resolution regime as two separate endeavours, represents a duplication of effort and expenditure for all stakeholders. Such an approach is also deemed to be counterproductive to the timely and effective achievement of the aims mandated, especially in respect of mitigating systemic risk from a potential SIFI failure and achieving a functioning FSCS regime that consumers will have confidence in.

Intellect firmly believes that it is viable and clearly advantageous to approach the achievement of both these aims within a single initiative, and has examined how this could be operationally and technically achieved. This examination has highlighted that a Central Utility, implemented through a phased approach represents the most cost effective and time efficient means to achieve both aims.

Intellect further believes that in view of the realistic opportunity such an approach facilitates in respect of systemic mitigation and increased market competition, the continued pursuit of these objectives as separate initiatives will be short sighted and ill-advised.

On a practical basis, the approach proposed will:

- Enable achievement of both account switching and mass account migration for a reduced cost to the industry, consumers and the public purse of implementing the same on a separate basis
- Not adversely impact existing implementation timescales for account switching, while enabling realistic achievement of mass account migration thereafter
- Could ultimately provide additional benefits to consumers not currently envisioned in either of the initiatives
- Could ultimately provide retail banks with a basis for the cost effective provision of additional revenue generating consumer services (if the banking system were to go further down the route for the 'Overall Vision')
- Facilitate more effective means through which retail banks could participate in quasi-banking and technology driven advances in the area of online payments
- Increase security and thereby lower the costs associated with fraud for both retail banks and consumers
- Provide greater transparency of economic, financial and individual identity based activity within the UK economy to all relevant stakeholders, including enforcement and regulatory bodies.

The proposed approach will also serve to address the widely discussed concern that current regulatory frameworks in the UK see different bodies having sometimes overlapping responsibilities. The demonstration of a "joined up" approach to implementing reform of the UK financial system will become a reality.

As a final point, the approach mandated will not only provide a Central Utility to arrive at resolution of the immediate account switching and mass account migration goals, but it will in the process have created the basis for achievement of additional benefits for the UK retail banking industry. It is from this perspective of "the art of the possible" that Intellect has approached this issue and derived its Overall Vision of what could feasibly be achieved for banks and the wider UK economy.

This Overall Vision – whether ultimately implemented or not – is important as it provides the terms of reference for the thinking that comes to define the design and implementation of the Central Utility approach and the benefits achievable for consumers, retail banks, regulators and the wider UK economy. In that respect Intellect believes that there is an argument for this approach in order to achieve the prescribed account switching and mass account migration objectives is to approach these "top-down", commencing with the Overall Vision and working down to the specific phased implementations of, first, account switching and then mass account migration. This approach in turn mandates the achievement of these aims through the conceptual model of a Central Utility.

The 'Overall Vision'

In a nutshell

The Overall Vision represents the technological “art of the possible”, using existing and available technologies for the retail banking sector. It is what technology could facilitate were there full understanding of the available benefits to policy makers, regulators, retail banks and consumers in general. In line with Intellect’s belief that its principle role as the primary IT industry association is to inform the development of policy by setting out what technology can facilitate and what it cannot, the Overall Vision is, in effect, the conceptual “end game” or ultimate point of reference to facilitate thinking and innovation in addressing current challenges.

As such, the Overall Vision need not necessarily represent an actual intended goal or even an aspiration to be planned for in detail. Rather, it provides a delineation of what is technologically possible and beneficial to banks, consumers and the wider economy under current circumstances and that can serve as the theoretical reference point for specific decisions. In that context the proposition of a Central Utility model is directly derived and aligned to the Overall Vision, as in turn is the phased delivery of account switching and mass account migration. The latter practical results constitute practical implementations of the former conceptual reference model.

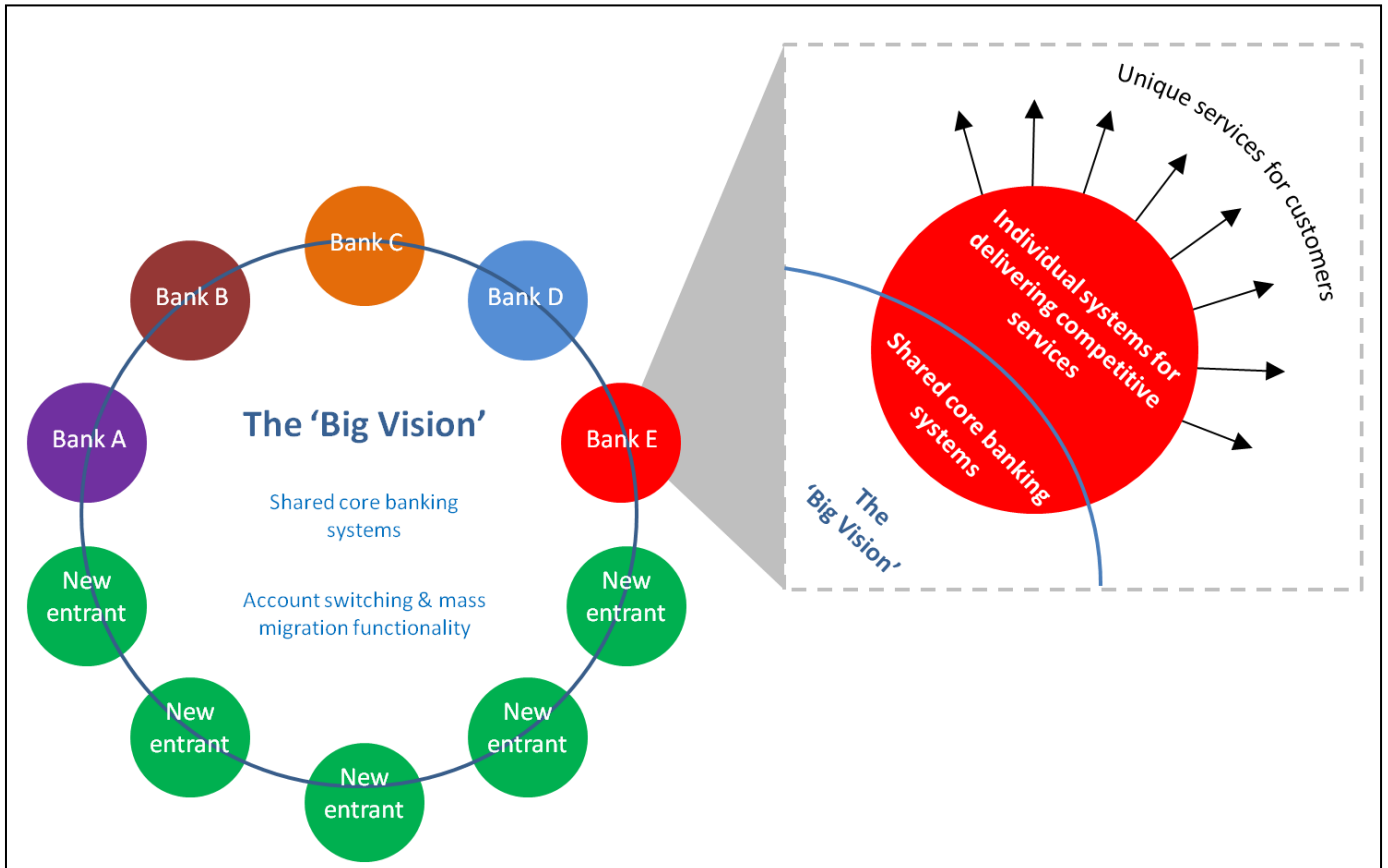
Intellect believes that the most appropriate Overall Vision is one in which non-competitive retail banking operations are delivered as a single shared service utility among all subscribing banks, potentially providing significant economies of scale in all non-competitive operational functions. This will have the advantage of focusing value add in retail banking to the provision of differentiated services to consumers, as well as providing retail banks with significant operational and infrastructure savings, as well as lowering the barrier to entry for new banks (thus furthering the aim of making the UK a more competitive banking market).

This theoretical end goal provides clear terms of reference for all subsequent consideration of approaches to the specific aims being addressed, such as account switching and mass account migration. It is also applicable to other areas of retail banking functions within the economy, should the industry choose to embrace what is in effect already gradually becoming a reality through technological facilitation. Google’s recent acquisition of a banking licence and PayPal’s concept of a “Single Identity Wallet” for use in all transactions, verifications and identifications are but two cases in point of where technology is inevitably taking the retail banking industry.

From this “10,000 foot” perspective, the current account switching requirements imposed on retail banks by regulation and the eventual requirement for mass account migration need to be seen as opportunities for the traditional retail banking industry rather than as potentially costly and burdensome requirements to be either resisted or implemented on a “de minimis” basis. From this perspective retail banks – with their significant inherent advantages – have an opportunity to use inevitable expenditures for compliance to regulatory requirements in a manner that generates new competitive advantage as new and changing market realities are faced.

The Overall Vision is therefore not singularly about the model of a shared utility approach to retail banking operations. It is also about the acceptance and realisation that existing retail bank legacy infrastructures that until recently were a deemed a competitive advantage, are increasingly becoming significant inhibitors to continued competitiveness. Concurrently there must be an appreciation that introducing structural change in the retail banking industry cannot be achieved overnight and that therefore any opportunity to advance the course of the change required should be taken.

From a functional perspective, the Overall Vision sees account switching and mass account migration as steps towards the realisation of retail banking operations and supporting systems that are utilised by multiple retail banks on a shared service model. These are in turn linked to individually differentiated operations and systems that provide competitive advantage to each specific retail bank, to their management’s own design and choosing, as depicted below.



Within the Overall Vision, the implementation of account switching and, as a further phase, mass account migration, become steps that move the retail banking industry toward the wider competitive goal of instituting a Central Utility model. Further to providing conceptual terms of reference for functional and technical specifications, this Overall Vision approach also facilitates clarity in respect of identifying opportunities for adopting Central Utility type functionality.

Why is an Overall Vision necessary?

The reality of meeting 2013 deadlines for delivery of account switching and the need not to compromise timescales through the introduction of a full simultaneous implementation of mass migration of accounts on the same solution necessitates that a phased approach be taken. This is also consistent with how the industry can ultimately come to move ever closer to the ultimate aim of deriving full advantage from a shared services utility model.

However, while phased approaches enable the prospect of segmentation of wider objectives into manageable and attainable deliverables, phasing deliveries carries the risk of discontinuity between phases unless clear terms of reference are imposed on the totality of all phases to be enacted, from the outset. That is not to say that the terms of reference cannot themselves be subject to change, but it does mean that there must be clear terms of reference in place to start with for a phased approach to succeed.

An Overall Vision is therefore of central importance as it provides the point of reference to which all phases should conform or otherwise make reference. This is especially important in the specific decisions – functional, operational or technological – that are made within each phase. An Overall Vision also provides clarity as to the intermittent steps required as well as simplifying the process of maximising return on investment in the short, medium and especially in the long term.

The benefits and requirement for a Central Utility approach in meeting the delivery of account switching is consequently most clearly visible in the context of the Overall Vision. Similarly, the opportunity to leverage the implementation of account switching to achieve mass account migration is most apparent when a Central Utility approach is understood. The Overall Vision provides the guidance to enable this understanding.

The need for an Overall Vision to be kept in mind when designing and implementing account switching and subsequently mass account migration through a Central Utility – regardless of whether or not the Overall Vision is a realistic proposition – will ensure that the phased approach required is successful. Without the Overall Vision and the Central Utility approach, a phased approach is therefore not tenable. The result would be that only account switching is delivered (possibly with sub-optimal results even for account switching) and all additional opportunities that could have been derived – mass account migration and beyond – is lost.

Why is this Overall Vision appropriate?

There are a number of common processes and supporting system functionality that all retail banks rely on for their day-to-day functioning and there are significant functional similarities between these systems across all retail banks. It is often the inflexibility of these common “legacy” processes and systems that are at the heart of the obstacles retail banks now face in implementing changes required by regulation, competitive pressures and wider market changes and which make it difficult for them to effectively implement change programmes or introduce new products and services.

The difficulty arises from the fact that, as retail banks have evolved, they have built layer upon layer of changes and customisations to accommodate new requirements. The result is an inability by retail banks clearly to differentiate layers of operation and system functionality, making the introduction of each additional further change increasingly complex to implement. While this did not represent an insurmountable issue to start with, each additional change implemented increased the complexity faced in implementing subsequent changes. The result is a current situation where the complexity involved in implementing even apparently minor changes is inhibiting, thus paralysing the competitiveness of long standing retail banks.

Adopting a Central Utility approach as part of the Overall Vision therefore affords retail banks a conceptual framework which ultimately works to move them towards the resolution of what is their most pressing competitive need. As retail banks adopt this Overall Vision and use it as a terms of reference for specific aims, such as the implementation of account switching, they are simultaneously commencing the required journey to unravel the inherent complexities that currently exist in their operations and systems. In so doing they are able to achieve the dual goal of succeeding in the specific implementation at hand (in this case account switching and, as a second phase, mass account migration) while simultaneously moving closer to achieving greater competitive standing.

The Overall Vision advocated therefore provides a means to gradually arrive at a dissection of non-core operations and supporting systems that serve to provide the same non-competitive capabilities required by all retail banks from those processes and supporting systems which should define the individual bank’s competitive advantage. It also provides a means to reduce redundancy within individual banks and – most importantly – across the retail banking industry as a whole.

The economies of scale achievable, and therefore the commercial benefits accruable to shareholders that can be derived by moving closer to the Overall Vision, as well as the benefits to bank customers in terms of better and possibly cheaper service, are considerable. They represent the most effective means available to the retail banking industry to release capital, as well as to face up to the challenges posed by non-banking providers of payment services and other new potential entrants. It is not a coincidence that the most successful of these are companies that are not burdened by the aforesaid legacy and who are therefore best placed effectively and rapidly to introduce operational and system changes.

From a competitive perspective, existing retail banks will not be able to use the considerable financial benefits attainable from both the economies of scale realised and the increased market agility afforded as a means to entrench their dominance and reduce competition. While providing significant benefits to incumbents, a Central Utility approach will simultaneously facilitate new retail bank entrants, as it will provide

core retail banking functionality on a variety of commercial models, thereby lowering barriers to entry.¹ The Overall Vision does not, therefore, constitute a way to entrench existing market structures, but instead provides the means whereby the retail banking market can be invigorated, while simultaneously providing stability through increased returns on investment for incumbents.

The Overall Vision and the move towards a Central Utility approach also provides for quicker, less risky and less resource-intensive implementation of future regulatory, competitive and market induced changes. Even if the Overall Vision is not achieved or a Central Utility model is never fully arrived at, each step in the conceptual direction of the Overall Vision is a step that in and of itself could provide inherent benefit to the retail banking industry as a whole, to consumers and the UK economy more widely.

It is also the case that the Overall Vision and the concept of a Central Utility is eminently feasible, using operational know-how and technology that already exists. The technology industry has significant experience in designing and implementing such infrastructures and the increased acceptance of “Cloud” based delivery models and software as a service frameworks, combined with long standing appreciation of the commercial value of business process outsourcing, makes what the Overall Vision entails a natural next step in the evolution of retail banking.

The eventual centralisation of core retail banking systems is therefore a natural progression. The Overall Vision is but the crystallisation of what is already in process. The question is more about whether the UK retail banking industry will use the opportunity afforded by account switching and mass account migration requirements to embark on achieving a Central Utility approach or whether it will be imposed on the industry by competitive pressures, probably from outside of the industry.

In completing the justification for *this* Overall Vision, the centralisation of core retail banking operations and systems may also have a positive impact by improving the transparency of retail banks and the effectiveness of regulators. For example, a Central Utility will very likely make the auditing of key functions within retail banks (e.g. ARROW visits) less resource-intensive for both regulators and the banks involved.

There is therefore a once-in-a-generation opportunity to address the problems and inefficiencies within the retail financial system. The Overall Vision for a Central Utility represent the most effective way to achieve the required change by providing a clear terms of reference for specific initiatives – such as account switching and mass account migration – which will form of a series of successive implementations driving the retail banking industry in the right direction for the future.

¹ For a more detailed discussion on the impact of sunk cost as a barrier to entry for new retail banks, see “Barriers to Entry, Expansion and Exit in Retail Banking”, Office of Fair Trading, 2010

A Central Utility for account switching & mass migration

As set out above, Intellect believes that a Central Utility will be undertaken in two phases, each fulfilling a separate objective. By way of overview, these are:

- Phase 1 – Competitive account switching – to fulfil the objectives set out by the ICB
- Phase 2 – Mass migration of accounts – to fulfil the objectives of the Financial Stability Board

The Central Utility will be designed to initially fulfil the objectives set out by the ICB for an account switching service. This first phase will provide a means for consumers to switch their accounts in a maximum of seven working days while being assured that there will be an absolute minimal incidence of errors, themselves backed up by guarantees by the retail bank of the consumer indemnity for any such occurrence. It is also anticipated that the utility will provide a centralised means for consumers to compare like for like accounts and undertake account switching online. Phase 1 will therefore meet the ICB requirements in full.

Operational information that will become available from Phase 1 is also of substantive importance for the retail banking sector and for account switching as, for example, any liability for errors on which compensation will be contingent will be readily available on a non-partisan basis. This will go a long way in advocating consumer rights in the retail banking industry, as well as attract positive popular appeal to a Central Utility approach.

Intellect also believes that it is feasible for the Central Utility to be able to facilitate the switching of significant numbers of accounts at once, so as to be able to cope with high levels of account switching activity by consumers within the Phase 1 delivery. Although not mass account migration, this will prove useful when there is public perception of the possibility of a specific retail bank failing, or significant response to poor customer service (move away) or new attractive offerings (move towards); and will act to both highlight the consequence of such perception to relevant authorities in real time, as well as provide public assurance of individual capability to overcome the situation.

It is therefore important that the Central Utility provides some scalability for the volumes of account switching it can handle from the outset. This scaling capability can be implemented to handle whatever volumes are deemed appropriate by the PC and pertinent regulators. So as to minimise incremental costs, delivery risk and ensure timely delivery of account switching by 2013, it is unlikely however, that the scalability implemented for a “business as usual” account switching focused solution will encompass the capability to handle mass account migration in the full sense of the required capability.

The delivery of mass account migration capability by the Central Utility will be implemented at the later Phase 2 stage, building on the infrastructures and operating processes delivered in Phase 1. What will therefore be important in the implementation of Phase 1 (account switching) is that the Overall Vision and resulting terms of reference are adhered to, so that expansion of the Central Utility to provide the added functionality involved to achieve mass account migration, is not hampered or would lead to the requirement for redesign or rework of the original account switching solution.

Once account switching is implemented as Phase 1 of the Central Utility, Phase 2 will therefore be able to focus on enabling the functionality required for mass account migration. The result of these two Phases will be a Central Utility that enables both “business as usual” account switching and mass account migration. Through a phased migration and testing approach, the solution for individual account switching is a lower risk approach to facilitating mass migration, than building a solution from scratch that would facilitate this.

Intellect expects that the required capacity of the Central Utility in respect of mass account migration needs to be such so as to be able to handle the mass migration of up to 30 million accounts in a relatively short period of time, ideally not longer than 48 hours. Although at first this may seem an optimistic target, Intellect believes that available technologies, when properly adopted within an appropriate design framework, can make this a reality within acceptable cost and delivery parameters. However, there is the additional consideration of individual banks’ own processes and procedures around taking on new customers (such as sending cards to new customers) that may have to be addressed and possibly streamlined in order to make this target achievable. Intellect’s point is that from a technology perspective, this is achievable, but the specific operational considerations of individual banks may challenge whether this is achievable in reality.

The 30 million accounts figure is derived from a relatively straightforward calculation based on the total number of accounts within the UK retail banking system and the ultimate aim of achieving minimal disruption in the provision of retail banking account services the event of catastrophic failure of one or more SIFIs. It is estimated by Intellect members that existing approaches would require about six months to achieve the same volume of account migrations as a result of disparity of data standards between banks, the current lack of accuracy of data held about individual consumers and the lengthy process of opening accounts.

The principle enabler facilitating the processing timescales, afforded by the Central Utility, is the centralised storage of payment (direct debit, standing order and recurring card transactions) mandate information and unique consumer identifiers that will be held in the Central Utility. Both account switching and mass account migration then become a case of simply changing the specific target current account data (i.e. where the consumer holds their current account) rather than a process of re-establishing all of the mandates associated with a consumer's account. Similarly, receivables directed to the consumer's account (such as their salary, pension or benefit payment) will not require alteration, as they will be referencing the unique consumer identifier, rather than the actual consumer current account, and will therefore continue to function normally when the underlying target current account associated with the consumer's unique identifier is switched to a new provider.

Account switching and mass account migration will therefore be seamless to the consumer, whichever route is taken to enacting it.

The approach afforded by a Central Utility will also make the opening of a new, alternate current account much faster as the identity of a specific consumer is already authenticated as part of the process of setting up the original account. This authentication information is also maintained within the Central Utility and provides the means to fully automate the process of opening a current account at an alternate retail bank. This is particularly useful in the implementation of mass account switching as new account establishment will be conducted at computer processing speeds, rather than requiring human or consumer intervention.

As a result, once Phase 2 of the Central Utility has been completed, the Central Utility will perform a crucial function within a special resolution regime and will allow the continued provision of economically critical functions by solvent retail banks. It will also ensure that failing banks can be allowed to fail in an orderly manner instead of requiring public expenditure to subsidise shareholder value, as is the current only option available to regulators in avoiding widespread contagion and economic impact.

Should implementation risks, timescales or costs considerations warrant it, the implementation of Phase 2 of the Central Utility can be further segmented into two stages. The first would focus on the migration of Personal Current Accounts (PCAs), and the second on Business Current Accounts (BCAs). It may also be the case that BCAs are given precedence given their economic importance. Notwithstanding, it remains that Phase 2 can itself be segmented so as to generate a Phase 2b, where whichever of PCAs or BCAs not catered to in Phase 2 becomes the objective of a subsequent Phase 2b. Such phasing would have the advantage of achieving earlier delivery timescales for whichever type of account is elected for Phase 2, while still enabling the delivery of the alternate account type in Phase 2b, rather than both account types having to be subject to the implementation timescales of Phase 2b.

While Intellect appreciates that the inclusion of mass account migration for BCAs in a special resolution regime is a decision that will be taken by the Financial Stability Board, the Central Utility approach provides this option with, it is expected, only marginal additional cost and effort. This is because once the Central Utility is established, the same processes, information structures and technology can be used to make this option available. The implementation of mass account migration for BCAs from a Central Utility perspective becomes an issue of scalability and achieving sufficient processing and information storage, both items of which are subject to Moore's Law² and decreasing in cost over time.

The Central Utility could, in later Phases and if deemed desirable to do so, also be utilised to handle the switching of liabilities, or other financial instruments held by consumers, such as loans, overdrafts, mortgages, etc. The entire account history could also come to be transferred so as to maintain historic continuity and eventual traceability and audit. Although in the former case, additional steps in the account switching and mass account migration will likely be required to handle required risk management and due

² Moore's Law states that the processing speed of computers doubles – on average – every 18 months. In the case of memory and information storage the relationship has been shown to be even more drastic, with corresponding cost decreases or performance increases per constant cost.

diligence of the liabilities target retail banks would be assuming in accepting such switching, it remains that a Central Utility would provide the basis for continuous value add to the financial services industry and its regulators at marginal incremental cost, as each Phase delivered would build on the previous.

An advantage of phased migration and testing the solution for individual account switching, is a lower risk approach over building it purely for mass migration of accounts.

The Central Utility approach therefore provides the UK retail financial services industry as a whole, and the regulating bodies involved, with the means to tackle current known risks in the retail financial system, as well as the being the basis by which current “unknown, unknowns” will be able to be managed in the future. This is irrespective of whatever retail financial instruments come to be offered to consumers as they will be manageable within the Central Utility framework as and when deemed most appropriate.

However, as this paper is aimed at providing a balance assessment of the possibilities and challenges of introducing a Central Utility, it is important to note that establishing the Central Utility is not the easiest way to achieve the singular account switching objectives set out by the ICB.

The Transfer of Direct Debits and Standing Orders service (ToDDaSO) is already in place to move standing orders and direct debits – and this works well in most cases. The problem with moving direct debits under the current system is largely down to a failure of originators to make changes to their systems to debit the new account and this is not always completed on time. It should be emphasised that in this case, this is not the result of any shortcomings within banks’ own systems. Adapting the ToDDaSO system to handle redirections could be achieved with limited disruption and change to banks’ systems (as ToDDaSO already provides all the data that is required) and can be implemented on a unilateral basis by each of the banks. Creating a Central Utility, as outlined below, would require agreements to be reached between all banks, standards to be put in place and potential changes to banks’ systems.

However, Intellect believes that merely pursuing an adaption of the existing ToDDaSO system would be short sighted and potentially more expensive in the medium term as banks will still have to implement a system that can fulfill the FSB’s mass migration requirements. By developing a Central Utility that is specifically designed to fulfill both objectives, and indeed allow for the potential development of the ‘Overall Vision’ in the longer term, the financial system will not be limited by constantly having to alter and add to existing legacy systems. These legacy systems, as set out below, impose significant limitations on banks’ abilities to quickly and efficiently adapt to changing business or regulatory imperatives.

Key components and characteristics of the Central Utility

Intellect’s members have spent considerable effort in looking at what would be required to make a Central Utility approach viable and workable. In the course of the considerations it was generally agreed that certain components and characteristics are intrinsic to the functioning of a Central Utility. These are therefore delineated below with the view of both supporting ongoing efforts to implement account switching and mass account migration, as well as to stimulate further thought and discussion which will hopefully bring the reality of a Central Utility closer:

- **Mandates stored in a central repository**

Without the creation of a central repository for holding current account mandates, the Central Utility will not be feasible. This was agreed to be the single most important aspect of establishing a Central Utility. Once this has been established, everything else can be designed and implemented around it. It is noteworthy that the know-how and underlying technology to make this a reality is already available and is not considered “innovative” or “leading edge”. The technology required is a tried and tested part of existing technological capability available to anyone requiring it.

In this context the mandate management function of the Central Utility envisioned for achieving account switching and mass account migration aims is the same and refers to the holding of the information required by a retail bank to open and operate a current account. Mandates for account opening currently reside within retail banks and are often subject to inefficient processes, are not always digitised and contain different information from bank to bank. This means that, as they currently stand, they are not

interoperable. By creating a Central Utility that holds all mandates, these inefficiencies would be removed from the system.

The primary role of the Central Utility will therefore be to provide a single repository for mandate information. In the process of achieving this, mandate information will also be standardised to a minimal set of data that is required to support the mandated transaction or financial operation. Any additional consumer information that a specific bank may additionally wish to hold for its own purposes would be held by the individual bank separately.

It was agreed by the Intellect membership that to achieve account switching (and similarly for mass account migration), the starting point should be to incorporate all mandates relating to Direct Debits, credit orders, card payments, standing orders and bill payments into the Central Utility. These would then be updated by the Central Utility in response to specific consumer instructions so that if and when an account is switched the most up to date version of these mandates and instructions is available for actioning by the destination bank.

It was also noted that it will be very important to select data storage and management technology that is linearly scalable, having only hardware capacity as the boundary. This is currently technically available to scalability level that far exceeds any data storage requirements the Central Utility may have presently and in the foreseeable future. The fact that the limits of existing scalability are themselves continuously expanding implies that, once the appropriate information storage and management solution is identified, there will be no scalability issues in data management, storage and retrieval.

- **Unique identifier / “Customer Address”**

It was accepted that enabling consumers to keep the same account number as they switch account provider represents considerable complexity that would potentially require the complete re-numbering of all bank accounts across the UK industry, if not also internationally. However, in order to achieve account switching objectives, a Central Utility need not adopt this approach as it is not the specific account number that is important, but it is rather what a consumer’s unique identifier is linked to that matters.

This is an important distinction as it clearly imposes that each consumer has a unique identifier throughout their lifetime, irrespective of with which provider they hold their current account. This unique identifier can be automatically generated and assigned to each consumer having an account with a UK retail bank as Part of Phase 1 of creating the Central Utility. It is this unique identifier which it then linked to specific bank account details and mandates which are subject to potential variation over time.

Existing consumer unique identifiers, such as one’s National Insurance (NI) number, could be used but there are both advantages and disadvantages in pursuing such a course of action.

As an advantage, NI numbers already exist and it would not add to the scope and cost of establishing the Central Utility if they were used. Similarly, under present issuing policy NI numbers are likely to cover all but the most infrequent instances.

However, as NI numbers are only held by individuals aged 16 or over, additional consideration would need to be given for child savings accounts be linked to a unique identifier attached to a NI number. Similarly, a potential disadvantage with linking a unique identifier to a NI number would be that this would potentially link sensitive government-held information to consumers’ payment information. This may have the effect of opening up further challenges for ensuring the safety of sensitive data.

There may also be an advantage in disassociating the unique identifier from any other existing consumer identifier as such association could create unpredicted effects in instances where the originating entity issuing the number to be adopted as the unique identifier, alters its policy on how such numbers are issued.

With arguments from both sides what is clear however is that there needs to be careful consideration about what unique identifiers are attached to. Other innovations in service provision from outside the financial services sector, such as Smart Grids and smart meters, may also require a customer unique identifier to ensure that energy companies can monitor energy usage on a consumer level, and so that

consumers can switch energy providers quickly and easily. The application of unique identifiers to facilitate the provision of more consumer-friendly services is not a unique consideration within the banking sector.

Regardless of what is ultimately used as a unique identifier, the Central Utility will hold a reference table linking the specific current account details to the unique identifier or "Customer Address". This Customer Address will therefore have associated to it all transaction instructions and services (i.e. mandates for direct debits, standing orders, etc...) related to the consumer's current account, regardless of where it is held.

As these mandates are also held within the Central utility, a single point of referral for all included payment information will therefore be available through the use of a single unique identifier. In essence currently existing bank account numbers simply become the "local" identifier used by the bank providing the account to associate an account with a particular consumer, as identified by a Customer Address.

- **Centrally held payments information**

The Central Utility should hold a single repository of consumers' Customer Addresses and a central repository of direct debit, standing order, and whatever other mandates are agreed to be included in Phase 1 of delivery of account switching. All originators would submit direct debit and card payment claims to the Central Utility either through their collecting bank or directly. The Central Utility will then add the relevant instruction to the central repository for mandates as well as link the new mandate to the corresponding Customer Address of the consumer.

The bank at which the consumer holds their current account to which the mandate pertains would then be notified of the new instruction. Once pertinent verifications were conducted, this would all occur electronically and not require manual intervention, thereby reducing the opportunity for error as well as rationalising the process in terms of both time and cost.

The processing of refunds under the direct debit guarantee could also be undertaken centrally by the Central Utility either on a consumer self-service basis or through a Central Utility call centre. Alternatively, retail banks may wish to continue to provide this service directly and be afforded the opportunity of doing so by allowing banks access to the relevant Central Utility's system. This is analogous to current operating procedure, with only the end point of the information and the software / interface used changing. Ultimately, there may be a possible requirement for payments schemes such as BACS to connect to the Central Utility.

From the perspective of reduction of fraud, a centralised direct debit and standing order mandate repository will allow payers to review their full list of mandates from a single interface point. This interface could also be made to provide payers full control over cancellations. The Centralised Utility will also be able to automatically notify payers when a new direct debit mandate is created and associated to their Customer Address through any one of technologically available communication channels (e.g. mobile text, email, recorded voice outbound call, etc.).

In a similar fashion, consumers could be provided with automated pre-notification of direct debit or standing order transactions, where a consumer could select to be informed of a pending outgoing or incoming payment N weeks /days / hours prior to them occurring. This would in essence operate on the basis prescribed in the SEPA Direct Debit Rulebook.

- **Redirection service**

The current Payments Council proposition refers to a "redirection service", but under the scenario described in this document (particularly in the immediately preceding section "Centrally Held Payments Information") payments would always be correctly directed. A redirection service would therefore be rendered redundant, even when an account is switched.

However, it could be argued that if all payments are properly directed using the process described in the previous section ('Centrally Held Payments Information'), there would be no requirement for a redirection service, as there would be a de facto, automatic, permanent redirection service operating for all

accounts. Moreover, it would also work for subsequent switches i.e. if the customer switched accounts more than once.

- **High grade security and resilience**

It was unanimously agreed by the Intellect membership that the concentration of account information represented by a Central Utility mandates that significant data security mechanisms be deployed. This is not only important in maintaining confidence in the Central Utility as a safe provider of a simple, fault free service for consumers, but it is also vital to ensure systemic safety. It was also agreed that this same concentration warrants the need for significant backup, disaster recovery and redundancy mitigating approaches from the outset.

Security would need to be considered in a number of contexts, including physical access to information and premises by employees and visitors alike, potential external “hacking” type threats, data theft or loss (especially considering the sensitive personal and financial information that would be held by the Central Utility), viruses as well as malicious attack. On this later point, it is advisable that consideration in the design of appropriate security also take into account deliberate threats from governments or other organised bodies potentially hostile to the UK government or economy. In short, the Central Utility should be considered and treated as would any strategic economic infrastructure in the UK economy.

Similarly the physical locations of the Central Utility’s infrastructure should be dispersed so as to avoid a geographic concentration. Back-up should be operated on a real-time mirroring basis with triple, if not quadruple, independently located recovery sites. Disaster recovery plans for each of the sites should also be in place from the outset and be regularly reviewed. There may be opportunity for the costs of this infrastructure to be limited by co-locating elements of the Central Utility’s infrastructure (e.g. data centres) with existing data centres owned by banks. However, the feasibility of this may require a more detailed evaluation.

If a virtual or “cloud” approach to procuring the Central Utility’s capacity were pursued, it would be important that physical location of the provider’s infrastructure was verified. Similarly appropriate security, backup and resiliency of any “cloud” based infrastructure should be made a condition of sale to the Central Utility.

- **Customer facing website to facilitate easier switching – possible later phase**

In order to arrive at the wider goal intended by the ICB of introducing increased competition in the UK retail banking market, there is a case for a user-friendly front end to be provided to consumers which enables individual access to personal details stored in the Central Utility. It was suggested that this access could be used to also enable consumers to “self-serve” their retail banking mandates and accounts, in a similar fashion to which they currently use on-line banking.

In support of producing a customer facing front end to the Central Utility, it would enable the consumer to control where the mandates point to. For instance, if the customer had more than one current account, he/she could use the website of the Central Utility to switch payment mandates, either singularly or en masse, between accounts. This would have the benefit of empowering consumers and encouraging banks to offer better customer service levels, or risk losing customers.

However a counter-argument may be that whilst such a central website may be useful in popularising the Central Utility, such access would not necessarily provide customers with any additional information to that which is already provided by the current retail bank at which they hold their account. This existing direct banking relationship between a consumer and their chosen specific provider of a current account would continue irrespective of the Central Utility.

While it was agreed that it is important that consumers have confidence in the ease by which accounts can be switched and should be able to readily access information about the overall processes and progress status of any switching they may be conducting, this need not be provided by the Central Utility. It may be possible for retail banks to embed content and information from the Central Utility within their own retail banking portals thereby providing individual consumers with Central Utility information from within their own customer delivery platforms. As such, the benefits of the additional costs of establishing such a system will need to further evaluated.

One area where there is clear consensus is in the need to provide greater transparency on account costs and benefits, in order to facilitate consumer understanding and choice. Although such information could be provided to consumers by the Central Utility, it is also the case that such information could similarly be provided by other entities in the market along the lines of already existing “shop comparison” sites.

Although it is a fact that the ICB’s aim of increased competition in the retail banking sector will only be fully achieved if account switching facilitation is accompanied by an increase in transparency and comparability of account pricing and benefits, it was felt that there are a number of alternative, more effective means by which such information could be best provided to consumers.

In the event that such a consumer front-end was in fact provided by the Central Utility, it would need to adhere to required scalability and operational needs that would enable it to handle “business as usual” volumes, as well as potential significant spikes in such volume triggered by the perception of increased risk at one or more retail banks. Although this may be regarded as ‘non-essential’ (given the possibilities already offered by banks’ existing websites and existing shop comparison websites) and a phase of the Central Utility that could be rolled out at a later date. There should also be significant consideration paid to providing access to the Central Utility’s service for vulnerable sectors of society, the most logical point of contact being a call centre facility.

How will the Central Utility impact upon merchant acquirers?

The issue of debit card recurring payments is quite complex and will need careful consideration when developing a detailed plan of what the Central Utility will look like. It is not, however, insurmountable.

There are significant differences between regular (non-interactive) payments and irregular (interactive) payments taken by organisations. The common denominator is that the payer has already lodged their debit card details with the payee beforehand.

Regular/Periodic (non interactive) payments

In the case of regular payments, such as for utilities, these payments should be redundant because the ultimate source of customer funds is the current account, and the direct debit is cheaper and offers better customer protection through the direct debit guarantee. This anomaly has probably arisen for two reasons:

- It is grown out of recurring credit card transactions
- It is an easy way for merchants/payees (especially smaller businesses) to claim funds without having to connect up to the direct debit system and processes

In such instances, there is no payer interaction at the time of the payment claim and the payee is relying on payment details that the payee holds, which may be out of date.

Irregular (interactive) payments

Another use for recurring debit card payments is where the customer makes purchases at irregular intervals e.g. music downloads and the merchant uses a lodged card number (itself a problem area because of PCI-DSS compliance).

This is different from regular (non-interactive) payments as the payment is taken interactively, so there is the opportunity for the customer/ payer to change his/ her payment details at the time of the purchase – e.g. using Amazon, Ocado, Ticketmaster, etc.

Intellect believes that this “interactive” case should be out of scope for the Central Utility, as the scale of any current problems under the current system are not significant (i.e. the current situation is “good enough”) and trying to solve it will increase the cost of the solution to all parties.

For the regular (non-interactive) payments - the transaction record has a “recurring” marker and can therefore be identified as such. The merchant acquirer could at this stage connect to the central utility (using the card number) to look up if the payment should be redirected to another card number.

There is already a similar process (Visa Account Updater) for redirecting recurring card payments where the card has been replaced (e.g. lost/stolen or expired). However, this currently only works within the same bank, so in its current form will not meet the "account switching" requirement. This could however be expanded to meet the requirements of the Central Utility.

Additionally, this system will also work for credit card payments - indeed it will be quite cumbersome to have different processes for debit cards and credit cards.

However, there are some challenges with this approach that should be considered in the design and implementation of the Central Utility:

- Consumers are more likely to have multiple cards (especially credit cards) than multiple bank accounts, so when the customer closes and opens card accounts, it could be quite complicated to work out where to redirect payments to. Careful modelling of the customer experience will therefore be vital when designing the solution.
- The Central Utility will have to be built to the same levels of performance and resilience as the card systems (merchant acquirers, card schemes, card issuers) to avoid authorisation timeouts. This is an order of magnitude more onerous than for batch-oriented systems such as direct debits and credit transfers.
- Consideration should be given to strengthening consumers' rights for recurring card payments - i.e. an equivalent of the direct debit guarantee.

However, Intellect believes that recurring payments from merchants outside the UK will not (and probably cannot) be covered within the Central Utility. This would need to be an issue that was addressed as part of a more detailed evaluation of the processes of developing a Central Utility.

Stages in achieving a Central Utility & an 'Overall Vision'

Intellect believes there are three key steps to achieving the Overall Vision, which are outlined below. It is very important that an incremental approach to implementation be adopted, for the following reasons:

- The Central Utility cannot be all things to all people on day one. It needs a period of roll-out – and a roadmap – so that key deliverables can be achieved within timeframe and budget.
- That roadmap is informed by short term priorities and strategic direction – these can and probably will change – the Central Utility needs to change with them.
- Politically, there is significant opposition to large-scale IT projects in the wake of highly publicised public sector projects that may be perceived to have 'failed'. By undertaking a staged process (whilst always keeping the ultimate goal in mind), implementation can be constantly evaluated, and subsequent stages can be given the go-head (or not) based on merit, rather than a pre-existing commitment to do so.
- This will allow the implementing body to be able to evaluate the performance of suppliers over the course of each leg of implementation and require retenders if required – ensuring value for money.

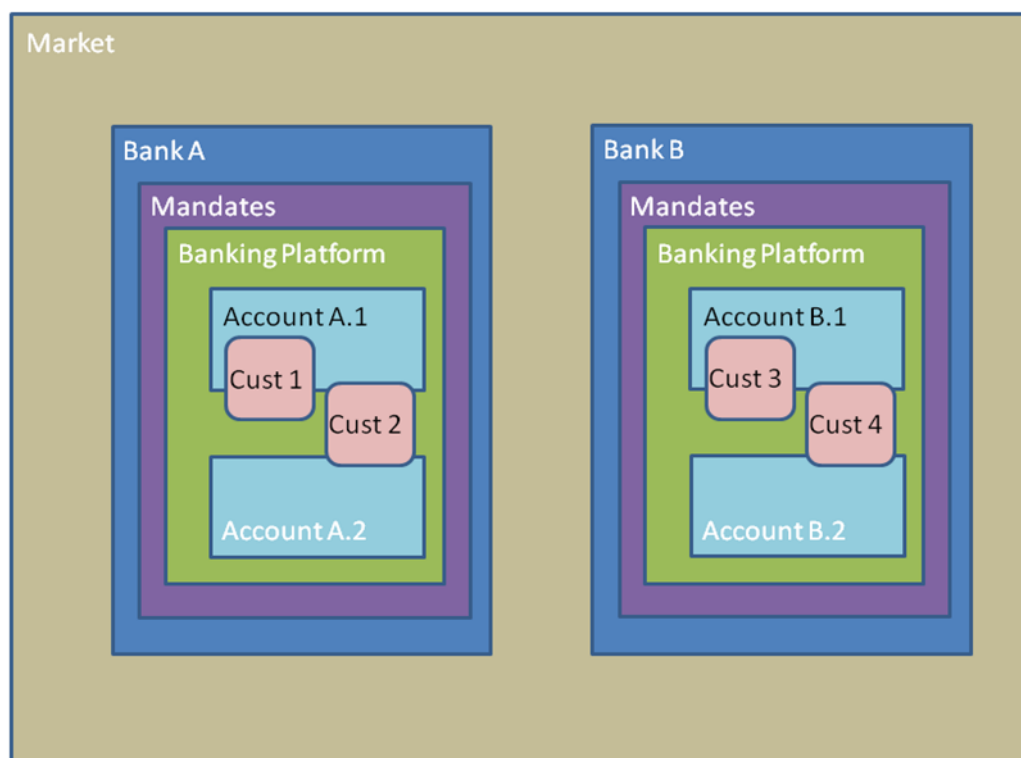
However as an incremental approach is adopted, it is essential that implementation itself does not limit the potential of the Central Utility, or its future capacity to adapt to suit changing demands and priorities. Therefore it is important in designing a Central Utility that can facilitate easier account switching for consumers and mass migration of accounts from a failing bank, that progress is not limited by a failure to factor in 'what comes next' – even if it is not set in stone that this next stage will definitely be undertaken. Keeping the Overall Vision in mind will allow the relevant regulatory authorities to make informed decisions about what should be implemented, based on what a Central Utility could feasibly achieve – i.e. not limiting options by ruling future capability out at an early stage.

The Overall Vision, as set out below, may be aspirational but it also encapsulates the technological 'art of the possible' and, as such, should be borne in mind at all times so not to limit what is implemented in reality.

From 'where we are today' there are two key steps to achieving a Central Utility that can achieve both competitive account switching and financial stability objectives. From this point, achieving the Overall Vision is less clear cut in terms of specific steps – as this will be defined by the will of the industry as to how far to go – but this can be illustrated as a single step change from the Central Utility.

These stages are outlined below.

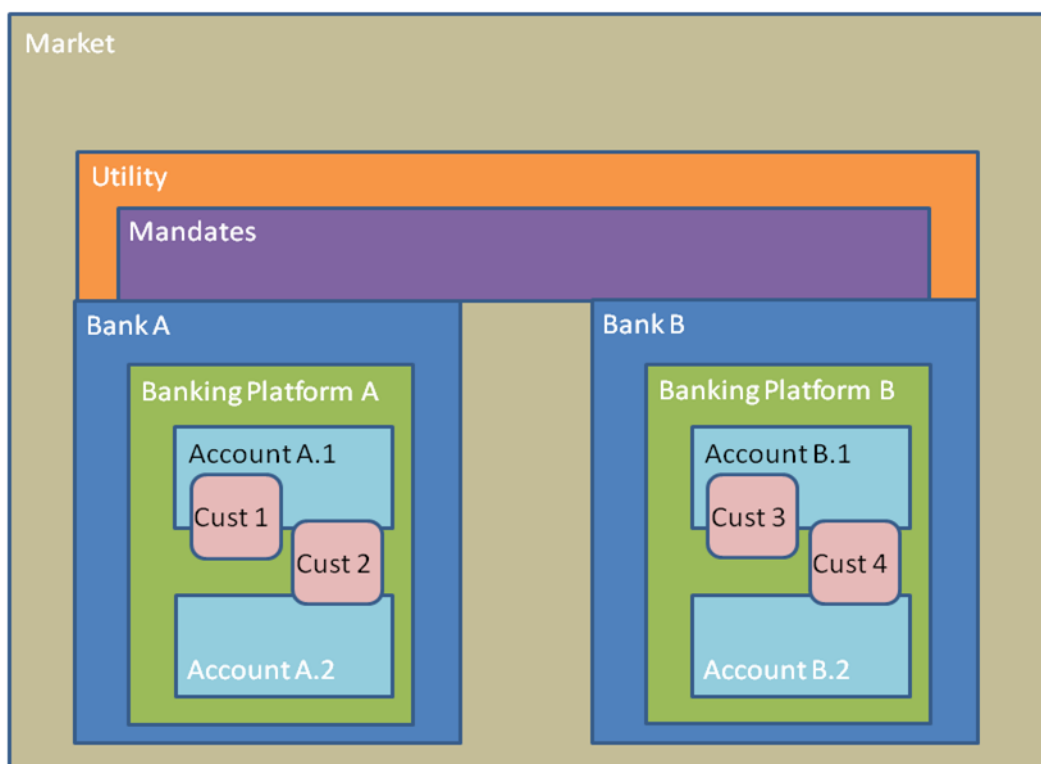
Where we are today...



As outlined above –

- Banks own their own ageing core legacy systems. No sharing of non-competitive systems (other than clearing systems such as BACS, CHAPS and Faster Payments), and therefore no economies of scale. Legacy systems inhibit the introduction of new products/services, business change, implementation of regulation etc (See 'The challenge of banks' legacy systems' – below)
- Account switching is a process that currently takes weeks because often incompatible analogue data has to be transferred between banks and mandates are not readily available between Bank A and Bank B. Each bank has its own parameters and standards for collecting customer data. Moreover, the weakest link in the current set-up is the payment counterparties (e.g. direct debit collectors such as utilities, mortgage companies etc.) who each need to make changes when an account is switched – a domain almost completely out of the banks' direct control.
- Account switching is also difficult from a credit risk perspective with 'new to bank' customers often being categorised as higher risk even if they were very low risk with their old bank.
- The current environment is prohibitive for new entrants, and also makes the banks non-competitive as their infrastructures limit innovation, expeditious business change and reduced cost implementation of regulation.
- The current system also suffers from a failure to update direct debit requests in a timely manner by originators. However, it needs to be emphasised that this is a deficiency with the originators, not the banks.

Phase 1 – Enabling competition – facilitating easier account switching



What does this stage of the Central Utility need to achieve?

- Switching to be completed within 7 days or less. However if all the payment mandates were held in the Central Utility then it is technologically possible for payments to be switched in a far shorter timeframe (i.e. hours not days), once the new account was fully open and registered as belonging to the customer within the Central Utility
- No dropped direct debits, standing orders etc, following an account switch. The reputation of the Central Utility will be key to its success - and its performance will be under public scrutiny
- Easily visible for consumers and easy to use – to encourage greater levels of account switching
- After the account has been switched, there then needs to be a system in place to transfer balances, issue cards and plastics

Key changes and facets

- **Creation of a central mandate repository**
Without the initial creation of a central function that holds mandates, the Central Utility will not be possible. Once this has been established, everything else can ultimately be designed and implemented with the central mandate repository as the foundation. Initially, all mandates relating to direct debits, credit orders, card payments, standing orders and bill payments should be incorporated, but this could be expanded to suit changing economic imperatives. An automatic and permanent redirection service would be provided which would also work for subsequent switches (as opposed to 13 month redirection service set out by the ICB). There would also need to be a defined minimum data format to enable data and customer files to be moved into the Central Utility
- **Unique identifier**
Every bank account (consumer, SME, Corporate) details in every bank are linked to a unique customer identifier held by the Central Utility. Bank accounts on banks' own systems simply become the alias for the accounts recorded in the Central Utility. That alias can be switched between

banks/accounts. It may also be the case that BACS processes for notifications of account changes and cancellations may be simplified by using a unique identifier. One challenge that remains is access to online accounts. Unless passwords to these were also held within the Central Utility, it would not be possible to easily move the PIN numbers from the encrypted devices to a new bank. A possible solution may be that online accounts may become branch accounts at the customer's new bank, and then new online services opened once the account has been switched.

- **Creation of customer facing 'front-end'**

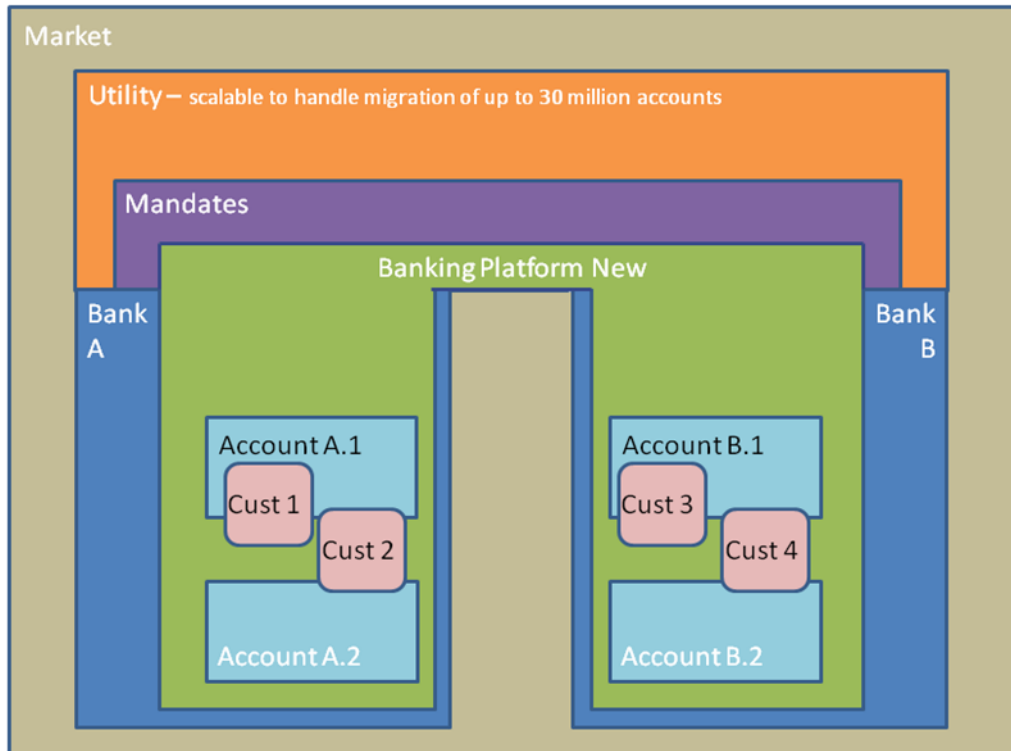
This will help to encourage consumers to switch. However, as set out above, it may be determined that the existing websites of banks and existing comparison web sites may perform the same task, with a reduced need for expenditure. If this was deemed to be an important aspect of the provision of an account switching service, it could also be undertaken as part of a later phase – depending upon the ability of existing bank websites and comparison sites providing appropriate access to the account switching service.

What data will be held in the central utility?

- Customer identification
- Identification credentials
- Pointer(s) to bank account(s) held with one or more institutions
- Lists of standing order, direct debit and recurring card payment mandates
- History of payments made through the utility

Please note: it is important that the system requirements of enabling mass migration of bank accounts (Objective 2) are fully considered when designing the solution for enabling competition (Objective 1), otherwise there may be an unmanageable level of rework required in order to develop the Central Utility so that it can adequately handle the mass migration of bank accounts.

Phase 2 – Enabling Mass Migration



What does this stage of the Central Utility need to achieve?

- Mass migration of up to 30 million accounts from a failing bank to one or more healthy banks 'over a weekend'
- The Central Utility must be able to cope, from the outset, with mass customer switching, prompted by a public fear of a failure of a particular bank – i.e. an online run on a bank
- Scalable for mass transfer of accounts from Day One
- The Central Utility will need to 'know' details of all UK bank accounts so that mass switching can take place if required. This may be within the scope of the FSCS requirements to be able quickly to obtain information on accounts at a failed bank for compensation purposes.

Key changes and facets

- The availability of a central mandate repository is a pre-cursor to mass switching and therefore using this for competitive switching would prove the feasibility of the approach in a non-critical situation, while delivering additional benefits across the banking industry.
- Significant increase in capacity to handle the potential for up to 30 million accounts requiring mass migration in a short period of time – this includes the establishment of the first stage of a shared banking platform between banks.
- It is envisaged that it will take some considerable time, through customer switching, to build up a repository that covers a significant part of the bank current account market, at which point a sweep of the remainder of 'un-switched' accounts will be necessary. This may require the initiation of a 'National Account Migration Scheme' to encourage the public to submit their details so an 'identifier' can be allocated to them, and their mandates attached to this identifier. It will be prudent to undertake this activity before the mass migration functionality goes live. An alternative would be for every bank to automatically lodge all accounts with the Central Utility – this would reduce the need

for a large scale programme to encourage consumers to undertake the process themselves, but may need regulatory intervention to compel all banks to do so.

Phase 2b

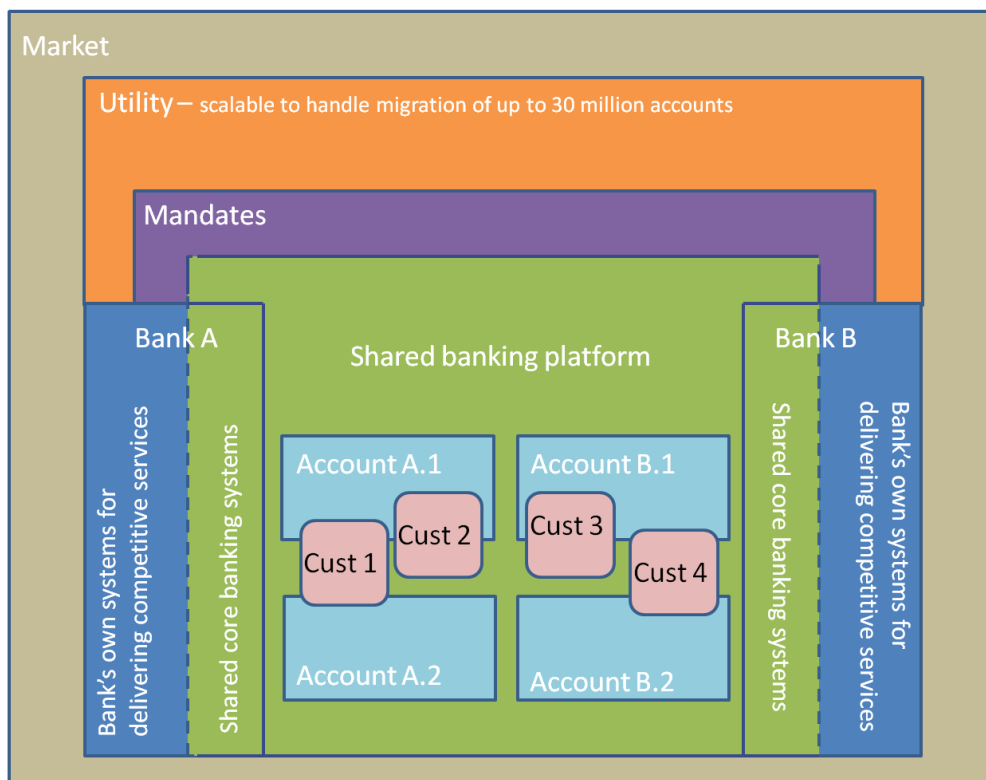
If a decision is taken to only enable the mass migration of one of PCAs or BCAs (as opposed to PCAs and BCAs) as part of Phase 2, it will be possible to create a second Phase – 2b – where whichever of PCAs or BCAs not catered to in Phase 2 becomes the objective of a subsequent Phase 2b

Phase 2c

If deemed desirable to do so, the Central Utility could also be expanded to handle the switching of liabilities, or other financial instruments held by consumers such as loans, overdrafts, mortgages, etc. The entire account history could also be transferred so as to maintain historic continuity and eventual traceability and audit. Although in the former case additional steps in the account switching and mass account migration will likely be required to handle required risk management and due diligence of the liabilities target retail banks would be assuming in accepting such switching.

The above Phases 2b and 2c could even be called Phases 3 and 4 - however, the principle remains the same – that a Central Utility would provide the basis for continuous value add to the financial services industry and its regulators at marginal incremental cost, as each Phase delivered would build on the previous.

Phase 3 – The Overall Vision



What systems will form part of the Overall Vision core banking platform?

Portable services by their nature are services which can be offered by all the players within the industry should they choose to do so. Therefore if a bank wishes to create a service that it wants to sell through competitor channels then it could do so. However, it is unclear whether competing banks will want to sell their competitors' products – unless it was of direct benefit for them to do so. It seems logical that the portable services that will be "offered" and as a result centralised either at the Overall Vision central utility or some other third party will include:

- Mandates
- Direct Debits
- Direct Credits
- Recurring debit (and possibly credit) card payments
- Standing Orders
- Bill and Account Payments
- Online purchases

It could be that third parties may develop products that logically sit in the same space such as:

- Share nominees type services
- Lodging security (Like deposit protection services)
- Collection services
- Account application services

It is likely that these portable services will need special regulatory oversight.

What systems and data will remain with the banks?

It is important to emphasise that banks should retain those systems and data that offer them a competitive advantage, and move those systems that do not (and indeed inhibit the ability operate more efficiently) into the central Overall Vision core.

It is anticipated that some of the systems that will remain with the bank could include:

- Know Your Customer (KYC) such as Demographic & psychographic data
- Customer service history
- Customer accounting (current accounts, deposit accounts, etc) i.e. Full account & transaction data
- Loan accounts
- Payments processing systems (i.e. actual money transmission)
- Fraud detection systems across the bank's operations (velocity checking, etc) – but note that one of the key benefits of a Central Utility will be the additional ability to spot fraud
- Customer channels and value added services (e.g. Online banking, mobile payments, call centres, etc)

Costs & timeline for implementation of a Central Utility

Costs

Precise costs will depend on the implementation approach taken, and therefore the degree of change required by the banks to enable phases 1 and 2. However, Intellect's members believe that building at the centre is always more cost effective, leaving just a smaller integration service to build at/for each bank to interface with their systems.

Intellect believes that the costs estimated by banks of facilitating full account portability of approximately £5 billion are extremely high, and a detailed evaluation of how a Central Utility would be rolled out, both at the core at individual bank level, will prove this to be the case.

As outlined below, Intellect estimates that there could, if the Overall Vision were to ultimately be implemented, **be a reduction of up to 80% on current levels of fraud**. When taken in the context of recently released statistics on total fraud losses on UK cards of £169.8m (between January and June 2011), Intellect estimates that this will lead to a reduction of approximately £135m to £34m for the same period. This represents a substantial reduction, and one that could pay for the implementation of the Central Utility over a relatively short period of time, and then continue to lead to savings for all banks.

If just the Central Utility is implemented (and stopping short of the 'Overall Vision') it is envisaged that there would still be a significant reduction in fraud as account data is centralised and a single view of customers (across all banks) is achieved.

Timeline

It is anticipated that the timeline for change will be dependent entirely upon the willingness of banks to invest time and resource into the development of a Central Utility that can achieve both competitive switching and financial stability objectives.

The phased approach postulated will see account switching, as currently envisioned by the Payments Council and the Independent Commission on Banking, being delivered by the 2013 deadline as a Phase 1 of the solution, thereby meeting existing commitments and consumer concerns.

It is envisaged that scaling the Central Utility to handle mass migration of accounts (i.e. Phase 2) would be achievable within a relatively short timeframe, however the transition from the current situation to the 'Overall Vision' would be a large scale project that would require wholesale changes to existing bank systems. This would be both time consuming and expensive – differing from bank to bank.

Assessing the benefits of change

The benefits of change, set out below should be taken against the context that implementing a Central Utility (i.e. Phases 1 & 2) would require significant planning and allocation of resource by banks. The scale of this impact will differ from bank to bank and until an implementation plan is formulated, the scale of this disruption cannot be accurately predicted. However, as set out in this paper, the costs of implementing separate account switching and mass migration utilities will be considerably more disruptive and costly to banks.

Further still, should the 'Overall Vision' be a direction that is deemed desirable by the banking sector, this will require substantial changes to the core systems of individual banks and the development of a central core system. However, banks are increasingly looking at their core systems and how they can be renewed, to reduce the negative impact that they have on their businesses.

However, this section of the paper sets out some of the possible benefits that will be enjoyed by banks, consumers and the wider economy. A more detailed exploration of these benefits may be required as discussion around the Central Utility and the 'Overall Vision' develops.

Business case for banks – Central Utility and the 'Overall Vision'

- **Reduction in fraud**

Intellect believes that one of the biggest opportunities for banks in implementing this central utility is the significant reduction in fraud that will be a direct result of centralising many of the processes around the provision of bank accounts.

It remains a fact that fraud is one of the biggest and persistent threats to the operations of UK banks and on many levels this threat is increasing. Fraud is increasingly regarded as an operating cost by banks and credit card companies alike, given this persistence. For credit card companies, it is often cheaper to write off fraud losses than investigate them. As recent statistics demonstrate, there has been a 58% increase in attempts to open current accounts in UK banks in Q1 2011, compared to Q4 2010, with 35 in every 10,000 applications for an account determined to be fraudulent³. Whilst this ratio may not seem significant taken out of context, banks have millions of current accounts and this can amount to significant levels of fraudulent activity on both institutional and industry levels. Similarly, the Centre for Economics and Business Research has found that 97,000 British people have fallen victim to criminals setting up fraudulent Direct Debits from their accounts. This equates to 10.6% of all identity theft fraud and is expected to escalate over the next three years⁴.

By centralising the information held about individual accounts and indeed attaching multiple accounts related to an individual, to one unique identifier, a more holistic view of fraud can be obtained. Fraudsters do not target just one bank at a time and financial products can be taken out by fraudulent means across any institution. Fraudulent activity is undertaken across all institutions but there is currently limited provision in place for information sharing between institutions on interconnected fraud – especially on a granular and timely basis that can help institutions identify and limit the effects of fraudulent activity in good time. As individual institutions will attest, fraudulent activity is most likely to be identified when banks are viewing activity across the breadth of their own individual operations (i.e. across credit cards, debit cards, online banking, etc – i.e. all transactions of an individual customer being viewed together). However, current practices do not allow aggregated activity to be viewed across institutions, where greater analysis can take place and fraudulent activity that may not have been picked up at an institutional level may be picked up.

Similarly, fraud is very dynamic and as one area of perceived weakness is strengthened, criminals look to exploit another. By attaching all account information – from direct debits, to standing orders, to multiple current accounts – to a unique identifier, this will allow the central body that administers the system a better means to identify and mitigate the effects of fraudulent activity in a timely manner.

³ [UK current account fraud surges in 1st quarter of 2011](#), Experian, 26th July 2011

⁴ [Finextra](#), 23rd November 2010

i.e. allowing them to warn individual banks (or take action itself) about the activity before it becomes too late to limit the costs that a particular strand of fraudulent activity is incurred by a bank.

As set out above, a centralised direct debit and standing order mandate repository will allow payers to review their list of mandates, and have full control of cancellations. The centralised utility will also be able to notify payers when a new direct debit mandate is created (in a similar fashion to the way credit bureaus, today, can notify subscribers of new enquiries against their credit profile) and also provide automated pre-notification of direct debit claims (in a similar way to that prescribed in the SEPA direct debit rulebook). Payers could also raise disputes on-line.

Of course, banks could provide these services individually, but it will be much more efficient (from the point of view of reducing duplication and also end-to-end testing) to build these facilities centrally, especially as fraud reduction should be in the co-operative, rather than the competitive, sphere of activity.

Additionally, in this new world of portable payment services (i.e. services that are offered by all operators in this sector, should they choose to do so), there would be:

- Direct debits
- Direct credits
- Standing orders
- Bill and account payments
- Online purchases

Each of these portable payments services would, over time, replace the equivalent non-portable payment service.

In the current system, the payment service which carries the greatest risk of fraud is online purchases. It is by far and away the payment service that experiences the greatest losses through fraud, by a magnitude of approximately ten. The major reason for this is that it is a "pull" payment process and fraudsters are able to initiate the payment process by 'taking' the money from an account.

In the Overall Vision, the portable online purchase would be a new local scheme (in competition to the likes of Visa, MasterCard, and PayPal). It would open up direct communication channels to both the buyer and seller banks. In addition, the payment service would be supported by a "push" payment process – i.e. where the payer is able to 'give' the money from an account. This process carries significantly less risk and the reduction in fraud will be considerable – Intellect members estimate that this could be as much as an 80% reduction.

Standing order and bill payment, payment services would be supported by "push" payment processes and very little fraud is experienced. In addition, we would expect to support all the new portable services only through "Faster Payments". This more secure, less risky online purchase process would, it is envisaged, also set the standard for national mobile payments.

Intellect estimates that there could, if the Overall Vision were to be implemented, be a reduction of up to 80% on current levels of fraud. When taken in the context of recently released statistics on total fraud losses on UK cards of £169.8m (between January and June 2011), Intellect estimates that this will lead to a reduction of approximately £135m to £34m for the same period. A substantial reduction, and one that could pay for the implementation of the Central Utility over a relatively short period of time, and then continue to lead to savings for all banks. As set out above, if just the Central Utility is implemented (and stopping short of the 'Overall Vision') it is envisaged that there would still be a significant reduction in fraud as account data is centralised and a single view of customers (across all banks) is achieved.

As a general rule of thumb, the more centralised the processing of accounts is (and thus the greater the oversight) the more fraudulent activity will be picked up and the less cost banks will logically incur from fraud. Fraud will not be eliminated altogether, but it will allow the banking sector a means to significantly reduce the operational cost of fraud on a per bank basis.

- **Reduction in personnel and associated costs for banks**

As the process becomes more automated, there would be reduced need for manual intervention in the switching process by a bank's staff, with an associated reduction in costs and by this token, a reduction in the potential for delays in the process through human error. As less human interaction is necessary, there will be a reduction in necessity for staff in this area and this will create opportunities for banks to either redeploy staff in other areas or make cost savings.

As outlined above, a reduction in human intervention in the switching process will also reduce the incidence of internal fraudulent activity, with an associated reduction in the costs that banks incur (and frequently write-off) from this activity.

However, it is necessary to point out that there would inevitably be an associated cost with maintaining the Central Utility (and latterly the Overall Vision) that may impact upon the banks. In what form this takes and what the cost is, is not an issue that Intellect is in a position to make any assertions on.

- **Reduced compliance burdens**

It is envisaged that after the Central Utility (for competitive switching and mass migration) has been implemented, there will be a reduced need for ARROW visits as the utility will be centrally held and, crucially, centrally supervised. As well as ensuring a much higher level of compliance, the costs that banks absorb in preparation for these visits will no longer be necessary which will translate in savings for the bank. In a situation where the Overall Vision has been implemented, compliance of traditional activities will fall further as more activity shifts to the centre. However, it will be envisaged that there will be a greater role for the Financial Conduct Authority (FCA) as banks seek to differentiate themselves through more innovative products and, as outlined below, a market for the development of these products/ services evolves.

Business case for banks – the Overall Vision

- **Revenue generation**

This paper has already set out that it is expected that the costs of implementing the Central Utility and the Overall Vision could be paid for over a relatively short period of time through the savings that will be accrued from a reduction in fraud.

However, if designed appropriately, the Overall Vision can also be a means for banks to differentiate themselves from their competitors and derive additional revenue streams from the new services that they are able to offer their consumers (and those of their competitors'...). One of the key failings of the Single European Payment Area (SEPA) was that it did not offer much in the way of potential for generating revenue for banks – and as such it has failed to attract much interest from financial services providers. The Central Utility and, latterly, the Overall Vision must not make the same mistake and should be designed and implemented not only with competition and financial stability as core objectives, but also the creation of revenue generating opportunities for banks.

It is anticipated that in the "Overall Vision", the payment scheme that evolves becomes predominantly a "Push" payment process – i.e. that the buyer initiates payments (which in itself has positive connotations for the reduction of fraud). This opens up a host of possibilities for banks to offer additional services, especially in relation to mobile payments and banking services. It will seem an ideal opportunity for banks to consider (as indeed they already are doing so) how they can optimise their own internal platforms to maximise the potential for delivering mobile payments and banking services which will almost certainly increase considerably in popularity in the coming years. In 2009, 55 million people used mobile banking services on a global level – by 2015 it is predicted that as many as 894 million people will do so⁵. In Europe the number of banking users has risen by 40 percent since August 2010 amongst Smartphone users⁶. The increase in consumer uptake of mobile banking services is already happening. How banks embrace this is already a key consideration across the banking sector, they can either adapt

⁵ Berg Insight, 'Berg Insight predicts 894 million mobile banking users by 2015', 23/04/10

⁶ Comscore, 'Europe sees 40% growth in mobile banking through Smartphones', 27/05/11

or lose market share to those that do so more readily. The Overall Vision presents a situation where mobile services – banking and payments – can be more readily integrated into banks' businesses.

The core systems shared by all banks as part of the Overall Vision will also present possibilities for the creation of 'portable' services. Portable services by their nature are services which can be offered by all the players within the industry should they choose to do so. Therefore if a bank wishes to create a service that it wants to sell through competitor channels then it could so, as these services will be held in the Overall Vision core utility. Whilst there is the overbearing question of whether or not banks will want to sell their competitors' products – and in many cases this will be no – there may be instances where it may suit the interests of two banks to cross sell each other's services where their own offerings may not be sufficient.

Therefore, we could expect that the portable services that will be offered as a result of a centralised Overall Vision utility will be:

- Mandates
- Direct debits
- Direct credits
- Standing orders
- Bill and account payments
- Online purchases

It could also be the case that third parties may develop products that logically sit in the central portability space such as:

- Share nominees services
- Lodging security (such as deposit protection services)
- Collection services
- Account application services

Additionally, third parties can develop products that provide differentiation for banks such as:

- Loyalty programmes
- Price comparisons at point of purchase
- Factoring
- Invoice discounting

That third parties are able to start developing and providing additional services as part of the Overall Vision central utility, is a benefit for both consumers and the wider economy (see below) as it positively impacts upon choice and wealth creation.

It is understandable that banks may see the implementation of a Central Utility, and the longer term [aspirational] prospect of the Overall Vision as a burden upon resources. However, in the longer term (i.e. the time frame that any move towards the Overall Vision will realistically require) the revenue generation possibilities will be more apparent for two main reasons:

- The industry will have moved closer towards the reality of a more dynamic and innovative payments market and the revenue generating possibilities will be clearer (this may be helped by the development of the Payments Council's mobile payments platform).
- By this point there will have been implementation of some if not all elements of the Central Utility and the leap from there to the Overall Vision will not be nearly be as daunting as it is before these stages have been completed. By this point also, the fraud reduction benefits of the Central Utility will have become clearer.

- **Banks could become ‘disintermediated’ from the payments system if they do not adapt**

Not so much a benefit, as a challenge, but under the conditions created by the Central Utility, it is possible that banks will become ‘disintermediated’ if they do not adapt their approach to service delivery and customer interaction. The proposed system is, in principle, firewalling a unique identification number and a bank account – this is essentially what PayPal does today, and a number of innovative technology-providers may follow suit in the near future. As outlined in this paper, by doing this it opens up a host of possibilities for new payments services (especially along the lines of mobile payments) that new, non-traditional entrants to the banking sector can take advantage of. Banks can either adapt, or lose out to these new entrants.

- **Reduction in negative business impact from legacy systems**

See Boxout - below

The challenge of banks’ legacy systems – how the ‘Big Vision’ can remove obstacles and increase efficiency in a banks’ operations

Much has been written in the financial services sector about the obstacles that banks’ legacy IT systems pose to the swift implementation of any sort of internal changes, be they led by reform, changing business imperatives or consumer demand.

Legacy IT systems, the multiple layers of IT platforms within banks that have been built upon over many years, are at the heart of established financial service providers’ operations. They are business critical, interdependent upon other elements of a bank’s IT infrastructure and are often running 24 hours a day. Adding new elements or removing them from these systems is a complex and expensive process that will impact upon a multitude of different aspects of the bank’s systems. Some in the technology industry have equated such changes to ‘open heart surgery’ for banks.

In many cases it is not in the broader interests of a provider to instigate substantial systems changes because of the costs and the disturbance to core systems that unwinding these un-needed systems will incur. As outlined above, changes to the core systems of a bank can be both time consuming and costly. Indeed, Intellect’s members who play central roles in transformation and business change projects in banks across the system, estimate that 70% of the cost of implementing new business functions within a bank is attributable to the cost of integrating new functionality into the existing systems. Similarly resistance to complex policy changes often stems in part from the impact that such changes will have upon the bank’s core systems; the resource that will have to be applied to achieve compliance; and the potential disruption that there will be to everyday banking activities.

The challenge for policy makers and regulators alike is that they understand the limitations and obstacles that legacy systems pose to the swift implementation of new regulation, new, customer friendly products and other essential business change.

The Overall Vision – mitigating this impediment

When the issue of legacy systems is removed from the equation (i.e. as a barrier to change; to the sharing of information; to the development and timely implementation of customer-centric products, etc), this opens up a host of possibilities that can lead to a more efficient, more competitive and more stable financial system. If many aspects of the banks’ legacy systems were moved to a Central Utility (this will be the ‘Overall Vision’)

The benefits for banks and for the wider economy will be significant – and an overview of these benefits is outlined in a separate section of this paper, below. This will not reduce competition as it will allow banks to develop innovative and unique customer facing products and services that – crucially – can actually be reactive to customer demand. The obstacle that legacy systems pose for the development of new services/products is that changes to legacy systems (necessary to roll out a new service) can take months and years. By the time a product is ready to be rolled out, consumer demand will have moved on, or been accommodated by a different supplier.

Benefits for consumers – Central Utility

- **Greater competition and choice**

It is a given that greater competition and choice in the retail banking marketplace will have positive repercussions for consumers, as well as the wider economy. New entrants to the sector will offer greater choice to consumers, with innovative services being used to attract switchers. It is important that the Central Utility or existing web resources (i.e. banks' own websites & comparison websites) offer a greater degree of price transparency.

As transparency increases (a prerequisite for the account switching service to also work, according to the ICB) and new entrants gain a foothold in the market, banks will begin to compete on price more than is currently the case.

It is envisaged that banks will ultimately differentiate on product as new and innovative services come to the market (see below). As was the original motivation for an account switching service, consumer choice will increase as banks seek to maintain their existing customer base and attract new customers from other banks.

- **Improved customer service**

Phase 1 of the Central Utility (competitive account switching) will have spin-off benefits of banks being more attentive to their consumers as they will be more able to 'vote with their feet' and switch accounts more easily if they are dissatisfied with the service of their bank (the ICB's primary focus). In the short term, customer service levels will rise, with banks seeing their interpretation of 'better service' as a key means of differentiation.

In the longer term if the Overall Vision is pursued the channel between the issuer bank and their consumers will evolve as a result of the changing interaction between banks and consumers (largely down to a change from 'pull' to 'push' payments). This will create a climate where new and innovative and 'genuinely value added services' are developed. At this point, banks will begin to compete based on differentiation (service, product, etc) rather than on price. This will create a new dynamism in the market place and even further improved levels of service.

The degree to which it increases will depend upon how the Central Utility is allowed to develop and whether it is given the opportunity to play a role in reforming the banking sector, or whether it is merely a box ticking exercise.

Benefits for consumers – the 'Overall Vision'

- **Better and more timely products 'coming to market'**

As a result of the centralisation of core banking systems, there will be less 'drag' on the timeline of bringing new products to market – currently an issue that can be largely attributed to the challenges posed by banks' existing legacy systems (see above). Changes to these legacy systems (which are often required to bring new products to market - such as contactless payments cards) are time consuming, expensive and potentially disruptive to existing services. By the time some products/services have been brought to market, it can be a number of months if not years after the product/service was proposed. If this was in response to changing consumer trends or demands, this may also have shifted on further by this time. i.e. the banks are constantly behind the curve. Transfer some of these core systems to the Overall Vision utility and this barrier will be reduced substantially.

As discussed above, with the likely incidence of push payments, the number of innovative payments services that banks can offer to their consumers will increase – with resulting benefits for customer satisfaction and loyalty (if the products are what consumers want) or increased competitiveness if the bar for the standard of services that are offered across the board, increases.

Benefits for the Economy – Central Utility

- **Reduced financial instability**

Both the competitive account switching and mass migration functions of the Central Utility will help to mitigate the effects of financial instability. Specifically:

- Competitive account switching – by helping to facilitate easier switching of accounts and by doing so enhancing competition within the retail banking sector, it is anticipated that, ultimately, the risk to the economy if one retail bank were to fail will be reduced as their density of current account holders will be more diluted. This does not eliminate systemic risk, but when combined with the mass migration function, it plays a significant role in reducing it. By allowing easier switching of accounts, it is also anticipated that this may encourage more responsible behaviour by banks, in order to avoid consumers switching away from a bank that is perceived to be ‘at risk’.
- Mass migration of accounts from a failing bank to a healthy bank/s – will perform a crucial function within a special resolution regime and will allow the continued provision of economically critical functions by banks. It will also ensure that failing banks can be allowed to fail in an orderly manner and without the need for another bailout using public money.

That these two functions were in place, alongside other ongoing reforms, will also increase international confidence in the UK banking sector. As we have recently seen, 12 UK banks have been downgraded by Moodys in response to fears that the UK Government will not be able to bail them out if they failed. The Central Utility will further reduce the need for a Government bailout of UK banks.

- **Ensuring more responsible behaviour in banks**

In the event of public perception that a specific bank may be about to fail, the account switching facility will, it is anticipated, facilitate the switching of banks of millions of consumers from a perceived failing bank to healthy bank or number of healthy banks. Effectively this will be an online ‘run on a bank’. As the Central Utility will make the switching service simpler, it is therefore important that banks are even more considerate of how their activities and operations impact upon the public’s perception of them.

Benefits for the Economy – the ‘Overall Vision’

- **Economic benefits**

It is anticipated that the wider benefits for the UK economy from a move towards the Overall Vision will stem from the potential for a reduction in the incidence and cost of fraud (see above) but also the development of associated new industries affiliated with the central utility and the new services that it allows banks to develop. The issue of banks’ legacy systems as a barrier to the implementation of new services and products for consumers must be re-emphasised. Remove/reduce the role that legacy systems play within banks and the potential for a completely new approach to customer service is opened up. Such as – **reduced friction in development of ‘technology-enabled payments systems’** – specifically the wealth of opportunities around mobile payments and mobile banking services. It is envisaged that the mobile payments platform being developed by the Payments Council will feed into this Central Utility. With banks’ core IT systems centralised, this will reduce the friction of one of the key barriers to the natural evolution of payments and allow for the development of increased **‘interoperability’ for new payments systems**. As the channel between the issuer bank and their customer develops over time it will create a climate where new, innovative and genuinely value-added services are developed in order to ensure customer loyalty. At this point banks will begin to compete based on differentiation of service, rather than on price, which will in turn create a new dynamism in the market place that will benefit the customer, the banks (revenue generation) and the wider economy as an ‘industry within an industry grows to develop these services.

- **Reduced ‘barriers to entry’ (and therefore greater competition...)**

Sunk costs around core IT systems have been set out by the OFT as a particular barrier to entry to the retail banking market for potential new entrants⁷. By centralising the core banking systems, this will reduce the costs required to start a bank up and increase the potential for new entrants to enter and then, crucially, compete within the banking sector. It is envisaged that the core system will operate with similar principles to cloud computing – where users (i.e. the banks) will only pay for what they use, rather than having to invest heavily in IT before launch and then hope to build business to match and then expand this capacity. New entrants, as outlined in this section are beneficial for consumers and for the wider economy as it will increase financial stability through dilution the market, leaving individual banks posing less risk to the financial system.

Intellect believes that the Central Utility will complement the establishment of a common platform for mobile payments (currently being undertaken by the Payments Council) and the Overall Vision will make it easier for new entrants to enter and gain a foothold in the banking sector – a problem that the OFT was grappling with in 2010⁸. New entrants could be organisations such as Tesco or Virgin Money who have been considering a move into the market for some time, and also less obvious actors such as telecommunications providers which, as a result of the mobile payments angle, may also be able to move into the provision of financial services.

⁷ Office of Fair Trading, ‘Review of Barriers to Entry, Expansion and Exit in Retail Banking’, p107-110, Nov 2010

⁸ Office of Fair Trading, ‘Review of Barriers to Entry, Expansion and Exit in Retail Banking’, Nov 2010

About Intellect & this report

Intellect is the UK trade association for the IT, telecoms and electronics industries; industries that generate around 10% of UK GDP and 15% of UK trade. Our Members include blue-chip multinationals as well as early stage technology companies and play a crucial role in virtually every aspect of our lives. Intellect articulates a cohesive voice for these industries across all market sectors, and is a vital source of knowledge and expertise on all aspects of the technology industry.

Alongside the technology industry's considerable footprint in the UK, Intellect also enables many other industries to operate efficiently in today's economy including:

- financial services
- creative industries
- retail
- transport and logistics
- manufacturing
- defence and aerospace
- pharmaceuticals

We are a trusted partner for Government, both in terms of policy development and policy implementation across numerous sectors. We look to ensure that all relevant engagement of policymakers and regulators with industry is both easy and as valuable as possible in order that the technology industry may play the fundamental role it merits in the success of UK plc.

Intellect's Financial Services Programme brings together over 160 suppliers of information systems, services and consultancy to the banking and insurance sectors.

Many of Intellect's members are heavily involved in providing the fundamentally important technology platforms upon which the UK's financial services industry is built. For example, these Members help facilitate the 5.7 billion automated payments that are made through the banking system on an annual basis. Similarly, the 40 million online bank accounts that are registered in the UK will not function without the technological capability that our members design and supply.

The relationship between the financial services industry and the technology sector is one of fundamental importance. As the Office for Fair Trading has recently stated, "IT systems are the backbone of retail banking activities and are essential to the safety and resilience of financial systems". Technology not only plays a critical role in the functioning of the full spectrum of financial services, it is a hugely important factor in ensuring that the individual institutions within it can operate more responsibly and remain competitive in the global marketplace. The right technology can help depress costs, reduce risk and increase the confidence of lenders and investors, all of which are of paramount importance in the current economic environment. Applied inappropriately or to the wrong ends and it can contribute to systemic risk, lead to reduced inward investment and ultimately have a detrimental effect on the economy.

Consequently, if the UK's banking sector is to be reformed to meet the challenges posed in recent years and provide the backdrop to economic recovery, policy not only needs to reflect what technology can facilitate today, but what it will enable in the future. Reforms will only be effective and durable if they take into account how it will be implemented and how the application of technology can be complementary. For an industry like financial services that relies so heavily upon technology, it is essential that regulatory authorities are equipped with a full understanding of it.

This document represents the information and views arrived at through a number of workshop discussions involving a wide cross section of members.

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