Clearing and settlement: Monopoly or market?

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Foreword

As Tim Jones writes, bankers are a conservative bunch – and regulators even more so. After all, the banking system is built on other people’s money, and everyone involved in it – directly or indirectly, as a regulator or as someone whose job is to maintain the “plumbing” of the banking system – has a fiduciary responsibility towards those people whose money is at risk.

That’s good – generally. But it also predisposes the industry as a whole to eschew competition (and the efficiency and innovation that tend to go with it) in favour of monopoly solutions – even where the monopoly solution might actually end up adding to the total risk by concentrating it in one place.

There may be some room for monopoly solutions in the banking area: Tim, himself, suggests that the management of liquidity in a currency and (perhaps) regulation are two such areas – though there are plenty of free-market economists who might disagree. But, he says, there is no reason whatsoever to believe that the foreign exchange clearing and settlement system needs to be (as it is at the moment) a monopoly – either nationally or cross-border. Indeed, he argues that the existence of an effective monopoly has pushed the price of FX transactions up, particularly cross-border, while pushing service levels down. With even the technology of today, same-day retail cross-border transactions should be routine, easy and almost trivially cheap. Instead, as he reminds us, “it still costs an average of around €24 to remit €100 between banks in two member states of the EU”.

That’s bad enough, but Tim worries that things could get worse.

The typical bureaucratic response to the perception that cross-border FX transactions pose a risk to the global financial system is a monopoly – and, with CLS Bank now coming on stream, that is just what we have (albeit “expensive, complex and difficult to build”, and he is being too kind). But, even if CLS Bank does what it says on the tin, it will be less efficient, more expensive and, crucially, much more dangerous than several competing systems. There is safety in a degree of duplication – and a great deal of avoidable operational risk involved in a single, gigantic mega-system designed to underpin an entire industry.

Tim’s model is the global credit/debit/virtual card industry – in which (he says) Visa and Mastercard have competed fiercely, innovated hard, and driven down costs worldwide. Some may argue that he is a wee bit starry-eyed about the duopoly. But there is no doubt that the combination of competition, shared data formats and overlapping ownership has generated real customer benefits – benefits that have been notably lacking in the universe of national monopolies that characterises the Automated Clearing Houses. He proposes new regional ACHs in countries (mostly in Asia) where a debate is currently underway on setting up their own national monopolies. Build one, he argues, and the benefits (cross-border, same-day FX settlement for the same price as national transactions) will act as a shop-window for the rest of the world.
Tim is a major figure in UK retail banking. Formerly head of retail banking at Natwest, he was also the primary force behind Mondex. For the last two years, he has been promoting what he calls a next-generation ACH, based on a single data format and multi-currency structure. Maybe it will work, maybe it won’t. But, as usual, Tim’s approach is to think outside the box – in this case, to think outside the national ACH monopoly/CLS Bank box. The results are refreshing and thought provoking.

Andrew Hilton
Director, CSFI
Preface

This paper argues for the more general and widespread adoption of competitive supply practices in the world of inter-bank clearing and settlement. Inter-bank clearing and settlement today is characterised by a mix of monopoly and competitive supply structures. Most Automated Clearing Houses, for example, are monopolies, while in the card industry, VISA, MasterCard, Amex and others compete for business.

The paper describes the development of these different systems, highlighting the issues that have led some to be monopolies and others to be competitive. Choosing a set of examples from the industry, the case is argued that a competitive market structure is far more likely to lead to a successful and adaptive clearing infrastructure, while the monopoly approach tends to inhibit innovation and development. The impact of the two approaches to the management of risk in Foreign Exchange (FX) settlement is also discussed.

The barriers to the introduction of competition into this area are then analysed, leading to the conclusion that the regulatory community could play an important role in stimulating change by advocating a more competitive approach.

The paper argues that a competitive design assumption should be applied generally across the whole of the clearing and settlement landscape, both for inter-bank clearing and for the clearing and settlement of securities and other market instruments. Monopoly supply structures should be restricted to those areas where they appear to be the only practical organisational form, such as the ‘lender of last resort’ role, typically performed by a central bank.

1. Introduction

When a banker credits a salary payment on behalf of a corporate customer in the UK, the mechanism used is the Bankers Automated Clearing Service (BACS). When the same banker seeks to make a foreign payment for the same customer, the likelihood is that the bank’s correspondent banking relationships will be used and that the SWIFT message network will be used to carry the instructions between the payer and payee bank.

Why is there only one BACS? Why is there only one SWIFT? Is this the best way to organise inter-bank clearing and settlement? How else could things be structured?

When a customer uses a bankcard at a cash dispenser or in a shop, the card could be from VISA, MasterCard, Amex, Diners, JCB, or one of many other typically national or regional players, e.g. Carte Aurore in France.

Why is the Automated Clearing House (ACH) sector characterised by national monopolies, when the card business is characterised by global competitors?

The answers lie in history of how inter-bank clearing and settlement developed.
2. Inter-bank clearing and settlement - How we got here

Automated Clearing Houses

Banking developed over the last few centuries as a very local business. Banks were originally established to support local trade, and they exchanged payments manually. Through the twentieth century, however, the industry was characterised by wave after wave of consolidation - leading to the creation of regional and then national-scale banks.

As the banking market has matured, the volumes of transactions have risen and the manual systems have come under pressure. There has, therefore, been a need (and a drive) to mechanise and standardise inter-bank activity. This occurred first in the cheque-clearing world, where local clearings typically gave way to regional or national cheque-clearing structures.

Governments frequently played a crucial role in the development of these systems. Whether through the central bank or some other agency, the government would look to ensure that the system created was robust and reliable. This is because sound money is at the core of a stable society, and it is often difficult to separate the soundness of the currency, the inter-bank credit exposures of the banks and inter-bank payment mechanisms. There are plenty of historical episodes - from Argentina and Russia in the recent past, back to the Weimar Republic in Germany - that amply demonstrate the perils of allowing the monetary system to get out of control, and it is entirely legitimate for governments to ensure effective regulation. It is therefore not surprising that regulation has been applied to both the credit risks and the operational risks of banks.

Governments typically look to solve a problem once. If a new hospital, school or fire station is needed, it is built. If a new inter-bank system is needed, by extension, it too should be built. It is entirely natural for most governments to say, at least until recently, that they will build the solution for an area in which they feel responsible, rather than let the market provide competing solutions.

The banking industry, in creating ACHs, can be excused for creating monopolies when one considers the context in which they were built. The banks needed to build a system to exchange value which could reach any accounting destination. So, one system was built and everyone joined. To get real competition in this area, all parties would need to agree to build more than one - and then to join all of them. Not a very likely or plausible scenario, you may say. Especially since to be really convenient, the different systems would need to agree and share data formats.

Therefore, we have a monopoly ACH covering each nation-state (or geographic region as in the case of the US). We typically have one high value settlement system per currency, and one cheque-clearing system. We also see different data formats around the world in different systems, which is one of the reasons remitting monies abroad is expensive, time consuming and error-prone.
The validity of this approach is predicated on two main hypotheses:

- firstly, that these services are utilities and that it would, therefore, be a waste of resources to duplicate the spend by creating more than one; and

- secondly, that supervision and control is easier to achieve if the supervisor only has to monitor the activity of one system.

Neither of these arguments bears close scrutiny. We are content for General Motors, Ford, Fiat, VW etc to slug it out in the global car market. Surely the presence of so many manufacturers leads to duplication of effort, especially in areas such as product development?

Indeed, there is overlap in some areas. But we tolerate it because the competition between the companies produces benefits which outweigh these duplicative costs. We get better cars. Though it is less obvious, duplication is also better from an operational risk perspective.

Imagine a world with only one car manufacturer. The impact of a product recall would potentially be enormous. In a competitive world, the recall of one model still leaves plenty of other models safely on the roads.

The supervisory argument is no stronger. The danger with supervising one structure is that it is too easy to get stale in your thinking. You don’t enjoy the benefit of competing approaches to the same issue, leading to cross-fertilisation of ideas. You can miss opportunities for improvement and fool yourself into thinking a service is adequate when it is not.

The bankcard industry

These arguments for monopoly supply are not, however, applied in the bankcard industry. The reasons again lie in the history of the development of the business.

It all started one summer’s evening in Manhattan. A group of Citibank executives went out for dinner after a hard day at the office. It was a warm evening and they did not take their jackets. When the time came to pay, they remembered that their cash and cheques were in their jackets back in the office. They suffered the embarrassment of being unable to pay and resolved to form a ‘Diner’s Club’ so that they could charge meals to an account set up by the club, to be settled later.

So the charge card industry was born. The crucial difference from what had gone before was that the charge card was a ‘nice to have’ not a ‘need to have’ payment system. There was no necessity for any consumer or merchant to participate in it, and therefore the central bank was barely involved. It was viewed as a ‘marketing initiative’, and as long as it was not introducing new systemic risks, did not need significant supervision or oversight.
It took Dee Hock, at Bank of America a few years later, to realise that there was a nice lending business to build by allowing customers to roll-over their debt at the end of a charging period. The revolving credit card was born, the BankAmeriCard, which became VISA. The rest, as they say, is history.

The Bank of America sales force got on aeroplanes and sold rights to exploit the VISA mark around the world. Leading banks, including Barclays and Credit Lyonnais, took up the offer and the credit card spread around the developed world.

At first, central bankers saw the card merely as a substitute mechanism for traditional retail lending, and many mainstream clearing bankers saw the product as a slightly disreputable cousin to the main banking relationship. They left it alone.

Those banks who eventually saw the potential of the new lending vehicle, but who had not been a part of the VISA initiative, then came together to bring forward MasterCard, which has evolved into VISA’s principal global bank card competitor.

These two card associations have slugged it out ever since, competing fiercely for the hearts, minds and wallets of bankers and their personal and retailer customers. First the battle was for cardholder market share, then for share of transaction volume, known in the business as ‘share of wallet’. Next, product innovation came to the fore, with debit cards, corporate cards, procurement cards, cash anywhere, virtual cards for on-line shopping, etc. And the competition was not just between the two major card associations, but between the marketing departments of hundreds of banks.

When you stand back and look at the card industry, what has happened is what seemed so far fetched earlier in relation to the ACH industry. At least two competing schemes have been built and everyone has joined both, using shared data formats.

3. Recent developments

A look at recent developments in both cards and the ACH industry illustrates my main thesis – the more competitive the environment, the more progress is achieved.

Bankcards - The UK debit card story

In the 1980s, these two ethics of monopoly provision and competitive supply collided in the UK with the development of a national debit card scheme.

This scheme was called EFTPOS-UK, and it was initiated by the policy leaders in the cheque and regular payments fields. At that time, the credit card business was organised as a separate
business unit in most banks in the UK. The credit card people, therefore, had relatively little influence on the EFTPOS-UK design.

The design was technically advanced, employing asymmetric cryptography and on-line networking, for example. It was, however, predicated on the belief that the transactions in question were just ‘electronic cheques’.

This was an incorrect design assumption. The cheque is an instrument limited in use to the cheques you have in your possession, that comes with recourse (ie the cheque can be returned in some circumstances) and sometimes with capped transaction guarantee values.

A debit card is different from a cheque in a number of crucially important ways. It can be used as often as you like, as long as funds are available. It borrows its recourse facilities, if it has any, from the ‘chargeback’ structures found in credit cards and it can be used for nearly all spontaneous payment transaction values, with no necessarily fixed ceiling. In fact, a more sensible description of a debit card is to describe it as a credit or charge card that debits a current or checking account with a clearing timetable similar to or shorter than a cheque.

The erroneous ‘electronic cheque’ design assumption eventually led to EFTPOS-UK’s downfall. The initiative was eventually abandoned, with Switch and VISA debit products emerging in its place. This was a victory for common sense and has led to the UK having one of the world’s most successful debit card markets, now accounting for more transactions than credit cards.

The issue is that it took more than seven painful years for this outcome to emerge. EFTPOS-UK was seen as the sole industry solution. It was not developed within a framework that expected any other competing schemes to be necessary, or indeed welcome. There was a strong sense from a number of senior bankers at the time that everyone should ‘stick together’ to create EFTPOS-UK and not break ranks to form competitive structures. Indeed, when the competitive debit cards emerged, banks typically chose only to issue one of the two main brands, ie Switch or VISA debit, rather than seeking to work with both.

In fact, however, the presence of both in the market has been responsible, in part, for their success. Each scheme is constantly looking at the innovations of the other and is seeking new ways to stay ahead. The market is working as it should, providing a spur to progress and development.

Progress in regular payments

So, can the regular payment structures look back in an equally happy frame of mind? The answer is a mixture of ‘yes’ and ‘no’, but there is too much ‘no’ for comfort.

Looking again at the UK, great work was done at BACS (and in the banks that owned it) in the 1980s and 1990s to identify and overcome the perceived customer issues with the direct debit as a product. The result is a direct debit penetration the envy of many other banking communities.
Direct debits are an extremely convenient instrument for consumers and an inexpensive means for collecting a wide range of utility and other regular obligations.

However, the picture is not as rosy as soon as the spotlight turns towards direct credit services. There are several ways in which the current service fails to meet customers’ needs.

First, consider the question of payment over the Internet. In the UK, the banking community (at forums such as BACS and APACS) has been debating the issue of Internet payments for some years. The idea is that same-day funds transfer for relatively small amounts should be available cheaply and electronically. This would greatly facilitate transfers to and from savings accounts, for example. Unfortunately, there has been very little progress in getting anything built. The argument that the volumes are low has been used to help explain why nothing has happened.

But is this argument valid? Surely, if BACS itself had developed as rapidly as it could, a standard BACS transfer could be same day? There would be no need for a special new service.

Similar shortcomings apply to higher value same-day transfers. CHAPS is the system used to effect such transfers and it is seeing strong growth in transfers below £10,000. But the principal role of CHAPS is to manage liquidity between participants in the sterling banking market. It is not designed for these relatively low value transactions and it is expensive for users, with typical customer tariffs set at around £25 per transfer.

The UK is not alone in failing to respond to the Internet. There has been very little innovation in most of the developed world. Most of these countries have monopoly suppliers of ACH services.

Secondly, consider the question of cross-border transfers. In the European Union, the European Parliament and the Commission have been lobbying Europe’s banks to create cheap, rapid solutions for over eleven years. Nothing very much has happened, however, with the result that it still costs an average of around €24 to remit €100 between banks in two member states of the EU.

Nor is there an imminent resolution available, with the European Central Bank talking about a five year timetable to achieve such a system, probably through the evolution of the structures already established by the Euro Banking Association.

Another issue is the vexed question of international harmonisation of bank account identities for ACH and correspondent banking transactions. Surely here at least the banks would do better by working together? But no. Here there are at least two approaches, the International Bank Account Number (IBAN) and the SWIFT Bank Identifier code (BIC) plus solution, where the SWIFT code that identifies a bank is used in conjunction with account number information to establish a unique accounting source and destination for a payment. No-one knows what the timetable might be for the resolution of which of these solutions will prevail.
Bankcards versus ACHs

I hope the point is becoming clear. Competition spurs innovation and development. Monopoly provision too often leads to stagnation.

Looking again at the unified account number issue, the banking industry has already solved this once, back in the card industry. Here, the emergence of debit cards led to a need to create an international account ID that would allow a UK card bearing the Switch logo to be accepted, for example, in a Portuguese supermarket, sending the debit back to a unique UK account. With VISA and MasterCard both anxious to woo prospective debit card issuers into their respective camps, promises were made (and kept) to resolve this issue.

So, the competition in the card business has again and again led to innovation and growth, because each of VISA and MasterCard knew that the other is right behind ready to steal the market if they fail to produce a solution.

To really understand how ‘Alice in Wonderland’ the situation has become, we only need to look at the assertion, repeated over the years by some bankers, that there is no business case for the development of low cost cross-border transfer solutions, because the volume of such transfers is too low.

Had the ACH sector been competitive, there would have been a natural ‘economies of scale’ argument that would have led to the development of multiple currency ACHs. These structures would have been able to undercut their domestic rivals through sheer volume growth. Cross-border traffic would have been just a little bit more volume sitting alongside the domestic traffic at these systems. The price would have been very attractive, and the service a credit to the banking sector.

But a single-territory domestic ACH is typically not motivated by shareholder value pressure; rather it seeks to ensure that domestic traffic is served efficiently and cheaply. It has no mandate to seek a global role. Indeed, if it were to aspire to one, it would run the risk of being seen as an unwelcome aggressor by other monopoly ACHs around the world.

Is it any wonder that the pace of development has been so slow?

The governance framework of monopoly supply makes it very difficult, even for the most ambitious and innovative banker, to make progress. There are many very able and energetic people in the payments business, both in cards and in the ACH sector. I do not believe that card executives are any more able or more motivated than their colleagues in ACHs, but the structure of the industries makes progress in one area easier to achieve than in the other.
Monopolies and risk management

It is not only in the area of product development and service improvement that the monopolistic nature of inter-bank structures runs the risk of producing sub-optimal outcomes.

There has, in recent years, been an ever-greater interest from regulators and bankers to understand and control risk, be it market risk, credit risk or operational risk.

Take the critically important area of settlement risk in the foreign exchange market. In 1974, Bank Herstatt famously went into liquidation after having received its half of a number of FX deals, but before having remitted the balancing funds in the second currency. The liquidator refused to send the monies due, and insisted on keeping the funds already received by the bank.

This episode crystallised the risks that are regularly being run in FX settlement. A bank typically sent its half of a transaction and waited, fingers crossed, for the other half to come back from the counter-party.

Central banks eventually decided that action was needed to improve the situation. After much deliberation, the solution was agreed and implementation began. That solution is Continuous Linked Settlement Bank, or CLS as it is known in the trade.

CLS works by bringing FX settlements into a single entity, where each transaction is matched. Liquidity is carefully managed through each day by ‘calls’ on each participant for funds, to limit the capacity for any participant to cause a ‘Herstatt’ style problem.

CLS has proved expensive, complex and difficult to build, but should be operational in 2002. (It is currently in end-to-end trials.)

But is CLS the only way to deal with Herstatt risk – indeed, is it even the best way to deal with it?

The arguments against CLS are as follows. Firstly, the transaction level matching is unnecessarily complex, because the risk at issue is much more a counter-party risk than a transaction risk. In other words, if Bank X is going to stay as an FX market participant, it will almost certainly honour all its market commitments. If it is going to fail, there will come a point after which virtually none of its commitments will be honoured.

So, why bother with the complexity of transaction matching?

Secondly, CLS concentrates operational risk, by bringing into one institution nearly all the activity in a critically important global financial market. Is this wise? Indeed, is this necessary?

So, is there another way of mitigating Herstatt risk? Yes, there is.
The key problem in the Herstatt case was that the high-value settlement systems of the major currencies did not temporally overlap. In other words, Bank of Japan Net (BoJNet), for yen, closed before FedWire, for the US dollar, opened. A bank therefore had no choice but to send, for example, yen while BoJNet was open, and hope that the dollars would come back later the same day when FedWire was open.

Nowadays, most of these high-value systems, but especially FedWire, have worked aggressively to extend their operational window. There is now a period where BoJNet and FedWire are both open. So a bank can simply wait until this period begins and then start to send yen. If it does not begin to receive dollars in return, it can simply set a debit cap, i.e. a limit for each counterparty, beyond which it will not remit. So, in the case of Herstatt, counterparties would have limited their exposure since they would not have continued to send funds once they realised that Herstatt was no longer remitting monies.

This approach - aspects of which are being proposed in a solution from a small company called Granularity in the UK - possesses a number of attractive features:

- Firstly, each participant is free to unilaterally set bilateral exposure caps. It can therefore concentrate on those counterparties where it feels there may be an issue.
- Secondly, operational risk is spread because there is no new centralized system where things can go wrong.
- Thirdly, there is no need for an expensive new system.

So is Granularity (or any other similar solution) a panacea for mitigating Herstatt risk?

Not necessarily. Granularity introduces a new problem, that of liquidity management. It could effectively force all or most FX settlements into a relatively small time window, and it is not clear who would blink first by remitting funds to enable sufficient liquidity to be present for all the day’s transactions to get settled. This concentration of FX settlement transactions could significantly impact the treasury management activity of the larger payment banks, who play a key role in intra-day liquidity management.

My purpose is not to criticise, or praise, CLS or Granularity. My point is that, in seeking to mitigate Herstatt risk, the approach has been to create a single, officially - sponsored solution. The alternative would have been to encourage the development of a market of competing solutions. In that alternative scenario, CLS, Granularity and potentially others would have been allowed to compete for the business of providing solutions to the problem. The market mechanism would have determined the eventual victor or victors.

Looking back at the example of car manufacturing discussed earlier, if CLS becomes the sole FX settlement structure, what happens if it needs to be ’recalled’?
4. The barriers to change

So, are there obvious barriers to change that can explain away the slow pace of change in the monopolistic areas of inter-bank clearing and settlement? There are certainly some candidates, including:

- **Bankers’ innate conservatism**: Bankers are generally a conservative lot, for very good reasons. The obligation to look after depositors’ funds, when there are plenty of fools and/or rogues who would like to take them and waste them, requires a careful and sceptical approach to certain aspects of the business. But it is bankers that run the bankcard business as well. Here, they have amply demonstrated their dynamism, so innate conservatism can’t be the real barrier here.

- **The power of vested interests**: Certainly there are a number of powerful banks who stand to lose ground if new payment and settlement systems come to market. But again, the banking industry has seen the rise and fall of products and banks throughout its life. There are equally a number of powerful banks whose influence might increase as new structures emerge.

Vested interests should not be the dominant barrier to change. They do not prevent change in the card industry. However, I believe they become more powerful in a monopolistic environment and may therefore be a significant part of the problem. Remove the monopoly supply structure and the vested interest problem would diminish with it.

- **The role of central banks and regulators**: It would be wrong to characterise these institutions as barriers to change. We only need to look at the development of e-money initiatives in the 1990s to see that their approach to novel products was essentially open and enabling. Naturally, there were a number of concerns raised, not least around counterfeiting risk and money-laundering. But these concerns were dealt with by debate and careful risk management, not by prohibition.

Indeed, central bankers and regulators could play a significant role in encouraging and enabling a more competitive world to emerge in inter-bank clearing and settlement. The mindset to date has often been to solve a problem once and forever with one structure. An assumption that competitive supply should prevail wherever practicable would be a significant and helpful policy approach.

In short, I believe that there is no convincing argument against competition in clearing. Nor are there barriers to change that would make it, at best, only a theoretical option.
5. Towards a better future

What practical steps might now be taken to realise some of the benefits of a more competitive approach to interbank clearing?

Regulatory intervention

Interestingly, the closest scrutiny from regulators and the judiciary at present is on the card industry. That old chestnut, interchange, is being reviewed in a number of countries. It is argued that VISA and MasterCard only compete in a limited fashion and that more could be done to achieve lower prices, especially for merchants.

I do not wish to take sides on this topic in this article. What I do find surprising, though, is that there isn’t at least as much attention on the more monopolistic areas in interbank clearing and settlement.

However, I am not advocating a regulatory approach to making progress. I believe the best way forward will be for members of the business community to grasp the opportunity themselves.

Business intervention

There are a number of areas where current solutions are inadequate, or where existing players could expand their role to create new and better solutions.

Regional ACHs:
The first such area would be the creation of a regional, multi-currency Automated Clearing House (ACH). There are a number of regions of the world where individual countries have either not yet built an ACH, or where their current ACH is in need of updating. Countries in such a region could get together to co-fund the creation of a new, shared ACH. This would allow them to minimise development costs by sharing a single infrastructure. Critically, it would also allow them to leapfrog the rest of the banking industry, depending on the architecture they choose.

Here, I must declare a personal interest. I currently lead a company, Purseus Limited, that has developed a business design for a next generation ACH. This envisages a non-recourse, single data format, multi-currency structure, which can itself also act as an escrow agent between transacting parties. The Purseus structure would accommodate domestic and cross-border traffic in the same system, giving economies of scale to the lower volume cross-border component of traffic.

Purseus also provides something quite fundamental. For the first time in hundreds of years, it sets out a new and simpler form of international transfer than that achieved through correspondent banking.
Correspondent banking involves two banks entering into a bilateral set of agreements. They hold money with each other, in so-called 'Nostro' (Latin for ‘our’) and ‘Vostro’ (Latin for ‘your’) accounts. When this structure was designed, the concept of simplifying this to a single counterparty jointly owned by many banks would have been politically unfeasible.

But that was then and this is now. The card industry already has global, end of day settlement in place across thousands of banks, so why not use the same concept for retail and commercial interbank transfers?

The region, or group of countries, that will be brave enough to follow this course by setting up its own ACH will have the chance, as a minimum, to create an exciting and functional structure for its own needs. It would also be extremely well placed to invite others to join and significantly extend their influence in the payments arena.

All members of such a shared ACH would benefit from a modern ACH infrastructure, but they would also be able to make international transfers to each other at ACH prices. They would be able to do same day settlement FX transactions in any participating currency.

The creation of such a system would almost certainly provoke a response from banks outside this new club, who would wish to have more clout in payments than that on offer from just joining something established by others. They would probably create a similar structure, inviting their friends to join them. There might be an initial period when individual banks joined only one such system. In time, practical common sense would lead to all banks joining both, and it would not be inconceivable to see the emergence of a third market entrant.
The different systems could compete on a number of fronts. Price, obviously - but also data formats, including the extent to which they provide data translation from one format to another. Speed also provides opportunities for differentiation - with five minutes, one hour, same day, next day etc service possibilities.

What would emerge would effectively be a re-run of the development of the card industry, which while perhaps not perfect, can still boast a substantial record of innovation and service development.

Mobile commerce:
The second area where something new is likely to happen is in mobile commerce. Despite the current debt burdens of the mobile telephony industry, most commentators agree that the mobile phone is set to become an increasingly important part of the payment scene.

Companies like Vodafone and T-Mobile have already announced plans to provide ‘server wallet’ products. These will allow customers to register payment card details once, and then have a convenient means to trigger payment from any registered product through the phone.

But there is still a significant gap – a payment option to deal with cash replacement.

Could the mobile industry, frustrated at the lack of solutions to be found in today’s interbank scene, be forced into creating solutions of its own which will give it better and more modern architectures for value transfer?
Don’t assume the card industry will sit on its hands

Finally, we should not forget the card industry itself. VISA and MasterCard have enormous experience in payments. Is it too radical to suggest that they might be well placed to enter and develop better interbank transfer services? VISA has already announced a ‘card to card’ credit product for launch in Europe in the near future, responding to the vacuum so eloquently exposed by the European Parliament and Commission.

I believe that capitalism remains the best resource allocation system yet devised. Here, capitalism needs a little nudge, to unblock an area that has become temporarily ossified. Regulators and supervisors should focus on providing that nudge, not looking to enshrine monopoly provision in the creation of utility structures. With all due respect to you, Mr Cruikshank, interbank clearing and settlement needs more competition, not less.

Is competition always the answer?

The short answer is No – but with qualifications. Some industries exhibit characteristics which make free competition very different or even impossible to implement. An example is rail travel. Only one train can occupy a platform at any one time, and only one train can occupy a stretch of track. Only one aeroplane can land on a runway at a time. Only one radio station can broadcast on a given waveband. These restrictions lead to a resource allocation problem which typically involves government intervention.

Are there similar areas in inter-bank clearing and settlement? I believe there are at least two areas where monopoly supply is required.

The first is in the management of liquidity in a currency. It is difficult to see two or more institutions competing for this role. It is typically the reserve bank’s responsibility now, and this seems sensible. It follows that there should be only one RTGS-style structure per currency. The point is that this structure does not need to undertake many transactions. It should be seen for what it is - a liquidity management tool, not a payment system.

The second is the area of regulation and supervision. Again, it seems inappropriate that there should be competing supervisors. International comparison provides a check and balance to the activity of any one supervisor, and I believe that market confidence is provided by the presence of a single, clear supervisory responsibility for each part of the banking industry.

The optimum approach generally would be to require any area that sought a monopoly structure to argue for such a structure, with the assumption that competitive supply is the norm unless a true “natural” monopoly is the only conceivable approach.
6. Conclusion

I believe the issues surrounding governance of the clearing and settlement industry and the way it is structured are important and worthy of debate. If there is no rapid improvement in the rate of innovation, the banking industry runs the risk of holding back the evolution of commerce, slowing down the removal of frictional costs from the business processes of buying, selling and market trading. Other industries will progressively erode the boundaries, and will support new solutions.

I am currently leading development of a new, private-sector multiple currency inter-bank clearing and settlement initiative. I am, therefore, an interested party to the debate - an interest I am happy to acknowledge. However, I believe the issues stand to be debated, irrespective of the merits or otherwise of any one initiative.

Progress in this area has been too slow, and bank customers, be they businesses or individual consumers, deserve better.
Tim Jones is founder and chief executive of Purseus Limited. He has led the development of Purseus from its inception. He has 21 years of business experience, primarily in the banking sector, and most notably as the chief executive of retail banking for NatWest Bank and as the chief executive of Mondex International, the global smart card based electronic purse. Tim graduated in Natural Sciences from Christ’s College, Cambridge.
### CSFI PUBLICATIONS

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<td>of social security in Russia, coupled with guarantee fund for Western</td>
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<td>investors access to the risk management aspects of financial derivatives,</td>
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<td>financial regulation, (prepared pseudonymously by a senior commercial</td>
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<td>at where the next financial crisis is likely to spring from. June 1994</td>
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<td>market-based alternative, using the concept of ‘value-at-risk’, to the</td>
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<td>corporate treasurer discuss lessons for the future from the last banking</td>
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<td>and aggregating them into a liquidity rating.</td>
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<td>figures into where the perceived risks in the financial system lie.</td>
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