

# **Review of the UK Domestic Cheque Guarantee Card Scheme**

June 2009

# Contents

## Page

- 3. Summary and conclusion
- 5. Introduction
- 6. The UK Domestic Cheque Guarantee Card Scheme
- 7. Usage and acceptance of guaranteed cheques and the issuing of cheque guarantee cards
- 9. Consumer attitudes to the scheme and the value that they place on it
- 12. Retailer (and other acceptor) attitudes to the scheme and the value that they place on it
- 15. Issuers' views
- 16. Alternatives to guaranteed cheques
- 18. Financial exclusion issues
- 20. Overall cost benefit analysis
- 23. Cheque guarantee schemes in other countries
  
- 25. Annex A. Market research commissioned in support of the review
- 26. Annex B. Current conditions of use for the UK Domestic Cheque Guarantee Card Scheme
- 27. Annex C. Members of the UK Domestic Cheque Guarantee Card Scheme (1 January 2009)
- 28. Annex D. Cost benefit analysis assumption and key sensitivities

# Summary and conclusion

## Purpose of the review

The role of the Payments Council is to set a strategy for UK payments. It has been established to ensure the views and interests of users', payment service providers' and the wider economy are fully taken into consideration.

As well as developing new and innovative payment systems, it is also our responsibility to consider the future of long established payment schemes once they near the end of their useful life. The UK Domestic Cheque Guarantee Card Scheme, which is the subject of this report, is such a Scheme. No-one has questioned that the Scheme is in terminal decline. The volume of guaranteed cheques has fallen by 70 per cent in the past five years. In 2008, volumes fell by one-third, and by 2011 volumes are projected to be only half of the current level (Section 3 of this report gives further detail). Therefore, and in accordance with the commitment in the National Payments Plan which was published in May 2008, we have undertaken a thorough review of the Scheme. The purpose of the review has been to assess whether, taking into account the interests of those who use guaranteed cheques, of those who accept them ("acceptors") and of the banks who issue cheque guarantee cards, it is in all parties' interests to manage the decline and closure of the Scheme so as to give clarity and certainty about its future.

## Consultation and analysis

Consistent with the Payments Council's remit, the review has been undertaken in a fully open and transparent way. We have consulted with three separate User Forums, representing the interests of consumers, SMEs and large corporates, regularly and at all key stages. We have commissioned specific research into use of the Scheme (Section 4). We have considered the availability of alternative payment methods (Section 7). And we have carried out a thorough cost-benefit analysis of the Scheme (Section 9).

The research indicates that most users have no problem with removal of the Scheme but that some groups have distinct needs that will have to be considered in planning and communicating closure.

The broad consensus from our User Forums was that they would prefer certainty and clarity rather than a disorderly collapse of the Scheme, and that the Payments Council should ensure that communication and advice is provided to the remaining users and acceptors of guaranteed cheques. This would also concentrate on those more vulnerable users who may have concerns about

guaranteed cheques being withdrawn. An aspect needing to be highlighted in the communications strategy is that guaranteed cheques are often used in circumstances where the guarantee is redundant and that it will be important to remember that cheques will continue to be accepted after the guarantee is withdrawn.

Although all cost-benefit analysis is sensitive to the assumptions behind it, our exercise indicated that, on reasonable assumptions, the costs associated with the Scheme (principally arising from the misuse of cheque guarantee cards) outweigh the benefits to users, and that the margin between costs and benefits could well grow over the coming years.

The review has looked particularly at the impact that closure of the Scheme would have on financially excluded users and concluded that, since it would be unusual for members of this group to have a bank account which included a cheque book, there would be no disadvantage to them (Section 8).

Finally, the review has looked at experience elsewhere in the world (Section 10) and established that no other country has an analogous scheme with the exception of Ireland, where a much smaller proportion of debit card holders have cheque guarantee functionality on their cards – around 25% compared with 75% in the UK. As in the UK, usage is also in rapid decline as many of the major retailers in Ireland no longer accept payment by cheque.

## Conclusion

Taking all this evidence into account, the Payments Council, whose Board includes both industry and independent Directors, has decided unanimously that it is in the collective interest of all stakeholders to manage the decline of the Scheme by setting a timescale for its closure. This will give certainty about the Scheme's future to all concerned. It will also avoid any potential confusion which could arise if, as volumes continue to decline over the years, there were further piecemeal withdrawals of the service.

We believe that a realistic timescale for withdrawing the Scheme is two years, which means that the earliest the Scheme will close is mid-2011. The Cheque Guarantee Card Scheme members will now need to agree how to manage the closure of the Scheme; including how to communicate closure to its users and acceptors, particularly for those groups that will need to make changes to the payments they use or be made aware of alternatives. A further announcement will be made confirming the date of closure once this has been agreed.

The Payments Council will be monitoring this project closely and will be receiving regular reports to ensure that we are satisfied that closure will be smooth for all users and acceptors.

The National Payments Plan committed the Payments Council to undertaking an objective review of the UK Domestic Cheque Guarantee Card Scheme, including a cost benefit analysis of potential changes to the Scheme from the perspective of all stakeholders, and research among users of the Scheme.

This report presents the detailed findings from the review, which commenced in summer 2008 following approval by the Payments Council Board of a project plan for the review. The Payments Council Board confirmed that the review should focus on deciding whether or not there was a case for closure of the Scheme, and it should not be concerned with considering other amendments to the Scheme's operation.

The main stages in the review included:

- Consultation with the main stakeholders, including groups representing businesses and consumers, about how the review should be undertaken and how to ensure its objectivity.
- Data collection from members of the Cheque Guarantee Card Scheme relating to fraud and other operating costs associated with cheque guarantee cards, and on the number of such cards being issued.
- Specially commissioning an independent large-scale quantitative market research exercise which was carefully designed to obtain information on the behaviour and views of those consumers who still write guaranteed cheques and of those businesses and other organisations that accept them. This market research was also used to derive up-to-date estimates of the number of guaranteed cheques being used, as these are not available directly from other sources. Details of the market research exercise are given in Annex A.
- Using the collected data and market research to derive an indicative cost benefit analysis for closing the scheme in comparison to its continuation.
- Further consultation with stakeholders on the recommendations arising from the review.

Strategic guidance during the review was provided by a Steering Group open to all Payments Council members. The Steering Group met approximately monthly throughout the review.

## What is a cheque guarantee card?

A cheque guarantee card is a plastic card that is used with a cheque as a guarantee to the recipient that the payer's bank will pay them the value of the cheque, provided that the cheque is legitimately presented by the account holder and accepted by the payee in accordance with the conditions of use of the Scheme. The card confirms the payer's identity and guarantees a sum up to the limit marked on the cheque card. The limit is normally £50 or £100, but 12% of cards carry a £250 guarantee limit. It is not possible to place a stop on a guaranteed cheque and once the bank receives the cheque they will have to pay it. The cheque guarantee function can be issued on stand-alone cards but is most frequently issued as part of a multi-function card that also has debit and cash withdrawal facilities. Some credit cards also provide cheque guarantee functionality. Cheque guarantee cards are normally only issued to support personal cheques, and are not issued on accounts in the name of limited companies. The current Conditions of Use for the Cheque Guarantee Card Scheme are reproduced at Annex B.

There are a small number of financial institutions which issue their own proprietary cheque guarantee cards that are not part of the Cheque Guarantee Card Scheme. This report does not consider these cards, and any issuer will be at liberty to issue their own proprietary cards irrespective of any decisions about the future of the Scheme.

## History of the scheme

The first cheque card was introduced in October 1965, guaranteeing payment of cheques up to £30. The UK Domestic Cheque Guarantee Card Scheme commenced in July 1969 with the objective of creating common, easily identifiable design features to simplify acceptance procedures at the point-of-sale. The guarantee limit was increased in August 1977 to £50, and subsequently two further limits of £100 and £250 were introduced in 1989. Since 1 October 1990, the common theme has been William Shakespeare and all cards with cheque guarantee functionality depict his image in various ways, for example within the cheque guarantee hologram or logo.

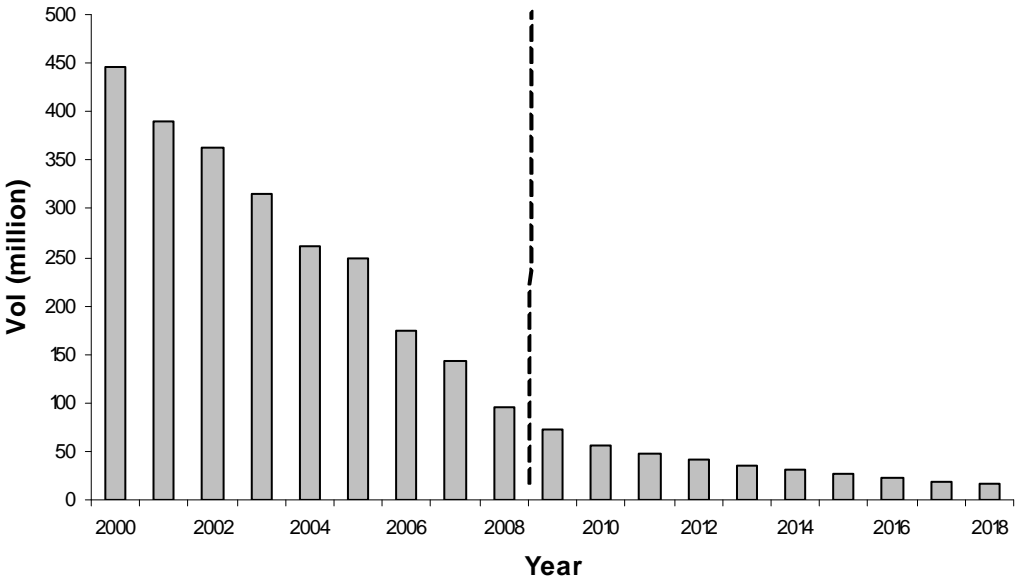
The Scheme currently has 28 members, which are listed at Annex C. The operation of the Scheme is overseen by the Cheque Card Management Committee (CCMC).



# Usage and acceptance of guaranteed cheques and the issuing of cheque guarantee cards

## Volumes of guaranteed cheques

Volume of guaranteed cheques – historic and forecast (2000 – 2018)



The above chart shows the rapid decline in guaranteed cheques since 2000, and the Payments Council’s forecast volumes for the next ten years. The forecasts assume a continuation of current trends in issuing guarantee cards by financial institutions and the acceptance of cheques by retailers. They assume that there will not be any co-ordinated action affecting the scheme or cheques more generally.

It is estimated<sup>1</sup> that 95 million guaranteed cheques were written in 2008, a decline of one-third on the previous year and a fall of 70% over the past five years. This decline has been driven by many retailers, petrol stations and similar outlets taking a decision to no longer accept cheques. No major UK-wide supermarket chain now generally accepts cheques from their customers. As some major retailers stopped accepting cheques only part way through 2008, it is expected that this rapid decline in volumes will continue, with a further 25% fall forecast for 2009, and by 2011 guaranteed cheque volumes are forecast to be only half 2008 levels.

As well as nearly all supermarkets and major petrol station chains, most other high street retailers have also stopped accepting cheques in the last two years including Marks & Spencer, Next, Boots, Currys, W H Smith, Debenhams and Argos. Additionally, London Underground will no longer accept personal cheques for ticket or season ticket purchases. This trend of non-acceptance is now flowing through to other smaller stores and service providers.

“It is expected that this rapid decline in volumes will continue, with a further 25% fall forecast for 2009, and by 2011 guaranteed cheque volumes are forecast to be only half 2008 levels.”

<sup>1</sup> Based on the research specially commissioned for this review and the Payments Council’s continuous Consumer Payments Survey

## Cheque guarantee cards

The number of cheque guarantee cards at the end of 2008 is shown below.

### Cards with cheque guarantee functionality

	End 2007		End 2008	
	m	%	m	%
Total cards in issue with cheque guarantee functionality, <i>of which:</i>	60.8	100%	59.9	100%
Debit cards	55.8	91.8%	55.0	91.8%
Credit/charge cards	4.3	7.0%	4.3	7.2%
Stand-alone cheque guarantee	0.5	0.9%	0.4	0.7%
ATM/Cheque Guarantee cards	0.2	0.3%	0.2	0.3%

This shows that by the end of 2008 the number of cheque guarantee cards had fallen by 1.4% on the number in issue at the end of 2007. This fall has primarily been caused by a change in policy by some issuers who no longer provide a cheque guarantee facility automatically on all current accounts that have a debit card and chequebook, and this is expected to cause an increasing rate of decline in the number of cheque guarantee cards from 2009 onwards. Nearly 99% of cards with cheque guarantee functionality are either multifunction debit or credit cards. The Payments Council's Consumer Payments Survey shows that 73% of people who have a stand-alone cheque guarantee or combined ATM and cheque guarantee card also hold at least one debit card, implying that only 0.3% of cheque guarantee card holders do not have another card with payment functionality.

Over a quarter of all debit cards do not have cheque guarantee functionality. In many cases this is because they are issued on basic bank accounts or other accounts without chequebooks, or on business accounts for which the UK Domestic Cheque Guarantee Card Scheme does not apply. However, there are now over 5 million debit cards in issue on personal accounts with a chequebook that do not have cheque guarantee functionality.



# Consumer attitudes to the scheme and the value that they place on it

The findings in this section are largely based on the results from the specially commissioned quantitative market research exercise, undertaken in Q4 2008, among consumers that have written at least one guaranteed cheque in the previous twelve months.

## Use of guaranteed cheques

The research indicated that there are around 18 million consumers who say that they use guaranteed cheques, and 4 million who use them on a regular basis of once a month or more often. Although the number of users has declined only a little over the past year, as noted in Section 3 there has been a sharp decline in the number of guaranteed cheques with a decrease in volumes of one-third over the same period.

Up until 2007, supermarkets accounted for the biggest place of use of guaranteed cheques. Now they have been replaced by non-grocery shops, closely followed by bill payments. Payments in all shops now account for one-third of guaranteed cheque use (30 million per annum) and paying bills one-sixth (15 million per annum).

Other than use in shops and paying bills, there was a diverse range of uses mentioned by respondents in the market research, accounting in total for the remaining half of all guaranteed cheque payments. These include:

- Paying tradesmen who come to the home
- Payments to clubs and societies
- Leisure activities
- Healthcare – doctor, dentist, etc.
- Delivered items, e.g. milk
- School and educational payments
- Holidays, hotels, B&Bs
- Services, e.g. hairdresser, cleaner
- Vets
- Professional services, e.g. solicitor, accountant
- Tradesmen away from the home, e.g. mechanic
- Restaurant, takeaways, etc.

## Why guaranteed cheques are used

The main reason why consumers say that they use guaranteed cheques is for occasions when they think that cash is the only alternative payment method available, and they are unwilling or unable to pay by cash. Two-thirds of guaranteed cheques are used when cash was the only alternative. Among those expressing a view, around half articulate reasons relating to guaranteed cheques being a better alternative to cash.

A far smaller proportion of respondents express positive reasons for liking cheques or disliking card payments when choosing to pay by cheque rather than plastic card. Around 10% of respondents mentioned positive features of cheques such as the ability to easily keep a record of expenditure, benefiting from a delay before the payment came out of their account, or the ability to post-date the cheque (despite this not being permitted by the rules of the Scheme). Around 12% of respondents mentioned reasons for not using cards such as having forgotten the PIN, a fear that a card payment may be declined, or a general lack of trust of cards.

Across guaranteed cheque users generally there is a strong preference for cards rather than cheques as a method of payment – 73% preferring to pay by plastic card compared with only 8% preferring cheques.

## Why guaranteed cheques are used

Users of guaranteed cheques were asked to consider how much they valued the facility that the UK Domestic Cheque Guarantee Card Scheme offered.

<i>How much users value the ability to guarantee cheques</i>	<i>% of users</i>
Very much	16%
Quite a lot	27%
A little bit	33%
Not at all	22%

If there was no ability to guarantee cheques, 68% of users believe that it would cause them no problems with 20% thinking that their problems would be minor. Only 12% thought that withdrawal of the scheme would cause them major problems.

Among those users who had long-term physical or mental impairments which affected their daily activities, almost twice the proportion (22%) thought that they would have major problems if they could not use guaranteed cheques, but the majority (55%) of those with such disabilities thought that they would have no problems.

To gauge the value of the Scheme to consumers, they were asked if they would be prepared to pay a hypothetical amount as an annual fee for having cheque guarantee functionality on their cards. The amount suggested to each respondent was selected at random from a number of points in a range between £1 and £20, and depending on the response provided, alternative prices were suggested until the figure they were prepared to pay was determined. This method is considered better than simply asking what they are prepared to pay (as often the response is nothing) or having a predictable read-out scale which goes up or down.

Overall, 47% of cheque guarantee users would not be prepared to pay anything for the facility, and the average amount that users are prepared to pay is £3.80 per year. Among the 4 million regular users of guaranteed cheques (who use them at least once per month), 35% are not prepared to pay anything, and the average amount that regular users are prepared to pay is £4.94.

# Retailer (and other acceptor) attitudes to the scheme and the value that they place on it

## Views of large retailers

The views of a number of large retailers were sought to understand the reasons why they no longer generally accepted cheques at the point-of-sale from their customers. Two main factors were identified:

- The inefficiency of cheques compared with other payment methods, in terms of both the time spent at the till and back office handling costs.
- The increasing costs of fraud, particularly for cheques that were above the cheque guarantee limit.

Those retailers that were contacted as part of this review had experienced little public reaction to their stopping accepting cheques. The change to policy had typically been advertised in a low-key way at tills for about a month prior to it happening. Many retailers only moved to complete non-acceptance across all their outlets after a trial in a limited number of their stores, so that they could take on board any lessons from the trial. None of them had any evidence that they lost any business as a result of the change - the previous cheque payments (which were generally already at a low level) migrated primarily to cash or debit cards.

## Views of those businesses still accepting cheques

The findings in this section are largely based on the results from the specially commissioned quantitative market research exercise among businesses that have accepted at least one payment by guaranteed cheque in the previous six months.

### Payments accepted other than guaranteed cheques

About one-quarter of businesses have accepted payment by guaranteed cheque in the last six months. However, among these businesses the most common method for receiving payment is cash, and over half of them receive five or fewer guaranteed cheques per month. For the typical acceptor of guaranteed cheques, they are a minority method comprising less than 10% of their payment receipts – but for one in eight of acceptors of guaranteed cheques they account for more than half of the payments that they receive.

One-quarter of the businesses accepting guaranteed cheques are in the retail sector, with the remaining three-quarters covering the broad spectrum of

services, construction, leisure and tourism sectors. The sectors which are most likely to have businesses receiving over half their payments by guaranteed cheque are services and construction, with retailers being least likely to do so.

Half of the businesses accepting guaranteed cheques also accept payment by plastic card. Most of those that do not do so either think that it is not appropriate for them because they have no fixed base, such as a shop, or that the nature of the payments that they receive are not appropriate for cards (e.g. primarily low value). However one-quarter of guaranteed cheques are received by businesses that do not accept cards because they consider them too expensive.

Guaranteed cheques are not particularly well liked compared with other methods. Not surprisingly given the profile described above, overall, cash is the preferred method of payment and perceived to be the least expensive when all costs (direct and indirect) are considered. Debit cards and transfers directly into their account are also preferred to guaranteed cheques. Only credit card payments and unguaranteed cheques are rated lower than guaranteed cheques in order of preference, and among plastic card acceptors a credit card is considered preferable to a guaranteed cheque.

### Problems with guaranteed cheques

Just over a quarter of respondents had experience of a 'guaranteed' cheque being returned unpaid, and the fact that the guarantee is not perceived to be absolute is the second biggest drawback mentioned after clearing times. Cheques are considered to be more hassle than card payments – among card acceptors 79% consider cards to be easier to handle than cheques with only 5% considering cheques to be easier.

Card acceptors also overwhelmingly perceive cards to be more secure against fraud – 57% compared with 8% saying guaranteed cheques were more secure. Interestingly, among those who do not accept cards this picture is reversed – with more thinking that guaranteed cheques (32%) are more secure than plastic cards (23%).

### Value of the scheme to users

Acceptors of guaranteed cheques were asked to consider how much they valued the facility that the UK Domestic Cheque Guarantee Card Scheme offered.

<i>How much acceptors value the ability to guarantee cheques</i>	<i>% of acceptors</i>	<i>% of cheques received</i>
Very much	14%	19%
Quite a lot	28%	36%
A little bit	38%	35%
Not at all	16%	8%

If there was no ability to guarantee cheques, 41% of acceptors believe that it would cause them major problems. A further 32% think that there would be minor problems, and 25% say that they would have no problems.

As in the consumer survey, businesses were asked if they would be prepared to pay a hypothetical amount above their current cheque processing fee for having the cheque guaranteed. The amount suggested to each respondent was selected at random from a number of points in a range between 5p and £2.50 per cheque. Overall, 39% of businesses that currently accept guaranteed cheques would not be prepared to pay anything extra for cheque to be guaranteed, and the average extra amount that acceptors would be prepared to pay is 50p per cheque.

The Cheque Card Management Committee (CCMC) which is responsible for the management of the Scheme would welcome clarity on the future of the Scheme and would prefer an orderly withdrawal of the Scheme at the appropriate point. In order to ensure that the views of all cheque guarantee card issuers were taken into account, as well as the collective view expressed through CCMC, the review contacted all cheque guarantee card issuers and asked them confidentially to confirm whether they supported the closure of the scheme in 2011. Two-thirds of the 28 members of the Scheme responded, including nine smaller issuers, all of which supported the Scheme closing in 2011.

# Alternatives to guaranteed cheques

Many of the uses of guaranteed cheques described in Section 3 as being mentioned by consumers in the market research are for purposes where the guarantee is not an essential requirement of the transaction. For example, one-sixth of all guaranteed cheques were said to be in support of bill payments, and it is arguable whether a guarantee is necessary for these, as bills may be settled with a cheque by post which would not be guaranteed. Similarly, around one in ten guaranteed cheques are used to pay people who come to the home, either for work done or for delivered items, such as milk – the guarantee provides an extra convenience for the acceptor that funds will be available, rather than to confirm identity of the payer.

Payments in retailers, where an unknown customer may walk away with goods, are the occasions where a guarantee is most needed by the acceptor of a cheque. Around half of all guaranteed cheques are used in shops, although not all will be from unknown customers. The market research showed that 75% of the retailers that accepted guaranteed cheques also accepted plastic cards. As the value of the guarantee is limited (87% of cards have a £50 or £100 limit), cash will be a potential alternative for some transactions.

“One-sixth of all guaranteed cheques were said to be in support of bill payments, and it is arguable whether a guarantee is necessary for these, as bills may be settled with a cheque by post which would not be guaranteed.”

## Likely migration of payment methods if the cheque guarantee facility is no longer available

The likely immediate migration of payments if there was no UK Domestic Cheque Guarantee Card Scheme will depend on what businesses would do in terms of future acceptance, and how consumers would then change their behaviour in light of this.

<i>Future cheque acceptance</i>	<i>% of current guaranteed cheques</i>	<i>Card acceptance</i>	<i>% of current guaranteed cheques</i>
Will continue to accept cheques, but unguaranteed	33%	Already accept plastic cards	52%
Will use a commercial cheque guarantee service	17%	Will start accepting plastic cards	12%
Will start accepting plastic cards	12%	Will continue not to accept plastic cards	36%
Will just stop accepting cheques	38%		
<b>Total</b>	<b>100%</b>	<b>Total</b>	<b>100%</b>



Half of guaranteed cheques are accepted by businesses that currently accept payment by plastic card, and a further 12% of cheques are to businesses who say that they would start accepting cards if guaranteed cheques were not available. One third of guaranteed cheques are to businesses that would carry on accepting them unguaranteed, and 17% are to businesses that would consider using a commercial guarantee service in future. 38% of cheques are to businesses that would simply stop accepting them, without otherwise changing their behaviour.

From consumers, a third of cheques are used when they could have used another method. If cheques were not accepted, 43% of payments would be by debit card and 13% by credit card, if card payment were an option. Otherwise payment would be made by cash. Those under 45 are more likely to pay by card if this is an option.

Combining these responses by businesses and consumers would suggest the following likely one-off migration of payments, over and above general trends in payment volumes:

- 40% would remain as cheque payments (assuming all those businesses who say that they would accept unguaranteed cheques do so, and around half of those considering using alternative guarantee services).
- 35% would migrate to plastic card (25% debit, 10% credit), based on the 56% that would migrate to cards if an option, and the 62% of cheques that are paid to those likely to be card acceptors. Such migration would have a barely noticeable effect on overall plastic card payment volumes, amounting to less than 0.5% of the annual total of card payments.
- The remaining 25% of guaranteed cheques would migrate to cash.

The Payments Council has committed to support the financial inclusion objectives of the Government and others through the National Payments Plan (NPP). In the Plan, it is stated that the impact on financial inclusion will be evaluated in any major collaborative payment system changes. Therefore the Cheque Guarantee Card Scheme Review considered financial inclusion issues against a potential closure of the scheme.

This requirement was addressed throughout the review:

- In the initial phase of stakeholder liaison with representative groups of consumers and businesses to understand who may be negatively impacted through closure of the scheme and how this should be reflected in the approach to the objective review of the scheme;
- In the quantitative market research with cheque guarantee card users;
- By conducting a review of the issues raised in the qualitative market research with cheque users more generally, undertaken as part of the NPP Cheques Phase One project<sup>2</sup>;
- Through a subsequent phase of stakeholder liaison with representative groups of consumers and businesses following the Cost Benefit Analysis in light of a prospective recommendation to close the Cheque Guarantee Card Scheme.

The initial stakeholder liaison confirmed that the organisations contacted were comfortable with the approach taken to the review. The stakeholders concluded that the financial inclusion issues associated with guaranteed cheques are fairly limited compared to those for cheques more generally, a point supported by the qualitative market research conducted for the NPP Cheques Phase One project.

There was a concern that individuals reliant on small traders, such as housebound individuals living in rural areas, might suffer negative impact if such small traders moved to accept cash only following a withdrawal of the Cheque Guarantee Card Scheme. The NPP Cheque Phase One research specifically looked at the cheque use of groups such as the frail and housebound. Although such individuals were highly dependent on cheques, generally these cheques were not supported by a cheque guarantee card and they would not therefore experience a negative impact. Cheques were typically used in their own home, and therefore the requirement of the recipient for guarantee was less. The quantitative market research confirmed that those types of businesses accepting payment in customers' homes are more likely to continue to do so

<sup>2</sup> As part of the National Payments Plan's review of cheques more generally, the first phase conducted in 2008 included the Payments Council commissioning independent market research.

A copy of the NPP review is available on [www.paymentscouncil.org.uk](http://www.paymentscouncil.org.uk)

without the guarantee. Additionally there would be a concern if the removal of the cheque guarantee facility restricted the ability of those who find it difficult to get to a bank or ATM, to obtain access to cash through cashing cheques, for example in local shops. In many cases local cheque cashing arrangements depend on knowing the customer rather than use of a guarantee card.

The qualitative market research conducted for the NPP Cheques Phase One project explored barriers to migration from cheques generally, with a wide range of consumers and SMEs. The research targeted individuals who may be highly dependent on cheques such as individuals who have physical disabilities, are housebound, act on behalf of those with physical or mental impairments (with power of attorney), and individuals who only have a basic bank account (with no chequebook facility). The overall objective of this research was to explore and establish the reasons why users continue to use cheques for particular applications, in order to understand the barriers to migration and the features that would be valued in alternatives.

The findings of this qualitative research suggested that individuals who were housebound or very frail were more reliant on cheques as a payment method compared to other groups because they were used as a flexible and easy way to make payments from the home. A reluctance or inability to use alternative methods meant cheque use was entrenched in use and associated with financial independence. However, the cheque guarantee function was not noted to be of particular value - it was the facility to make payments by cheques that was valued.

Because chequebooks are not issued on basic bank accounts or credit union accounts, withdrawal of the Cheque Guarantee Card Scheme would not impact on those individuals who use these types of accounts.

## Costs of the UK Domestic Cheque Guarantee Card Scheme

There are costs and risks associated with the Scheme. The identifiable costs of the Scheme amounted to £45 million in 2008, comprised as follows:

- The largest component of the identified costs are credit losses and first party fraud<sup>3</sup> perpetrated by cardholders, amounting to £37 million in 2008 and which are borne by the card issuing institution. Not all cheque guarantee card issuers were able to attribute credit losses arising purely from the use of guaranteed cheques, and in such cases no credit losses have been included, so this quoted figure will be an underestimate of the true total.
- Identified third party fraud amounted to £6 million in 2008, with the losses split between the card issuers and the acceptors of payments. The market research undertaken as part of the review showed that just over a quarter of acceptors have experienced 'guaranteed' cheques being returned unpaid due to reasons such as the amount being over the guarantee limit.
- Operational costs arising from the scheme amounted to £2 million in 2008, mainly comprised of issuing stand-alone cheque guarantee cards, adding logos to multifunction cards and the additional costs of handling guaranteed cheques.

<sup>3</sup> Not all cheque guarantee card issuers have been able to separate first party fraud from other credit losses and so they have been combined for the purpose of this analysis.

Costs are likely to fall as card numbers decline and the review has assumed that costs will fall at 5% per annum in line with projections of future card volumes. Reflecting current economic conditions, credit losses and first party fraud are assumed to remain constant in 2009 compared with 2008, and then decline at the same rate as other costs.

## Benefits of the UK Domestic Cheque Guarantee Card Scheme

The existence of the UK Domestic Cheque Guarantee Card Scheme is valued by a significant number of current users. When asked in the market research, just over half of consumers using guaranteed cheques say that they would be prepared to pay an annual fee to have the cheque guarantee functionality maintained on their cards. Similarly, 60% of businesses currently accepting guaranteed cheques say that they would be prepared to pay a premium on top of their current cheque-processing fee for the guarantee to be maintained.

Using a similar methodology to that in the Office of Fair Trading's Payments

Systems Task Force evaluations, the overall benefit provided by the Scheme has been estimated at £35 million in 2008 (comprised of £20 million consumer benefit and £15 million acceptor benefit).

As the scheme declines further, the overall benefit is assumed to reduce in line with the Payment Council's forecast for guaranteed cheque volumes.

Consequently, the overall benefit of the scheme in 2009 will reduce to £26 million, some £2 million less than the forecast costs, and by 2011 reduce further to £17 million.

## Outline cost benefit analysis

An outline cost benefit analysis from the perspective of all stakeholders is shown in the table below. This analysis should be treated with some caution, since the level of costs and benefits are relatively low and rapidly shifting. On the core assumptions, the analysis concludes that the costs of the Scheme outweighed the benefits by £10 million in 2008, and the difference will grow over time. The difference between costs and benefits is sensitive to the assumptions made. Although adopting a range of plausible variations around the core assumptions in most cases still has costs currently outweighing benefits, but in some scenarios this may not happen for up to five years. Full details of the assumptions made and some key sensitivity analyses are given in Annex D.

### Outline cost benefit case for closure of the scheme

Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Guaranteed cheque volumes (m - revised PMR forecasts)	174	143	95	72	56	49	42	36	31	27	23	19	17
Annual decrease in payment volumes		18%	33%	24%	23%	13%	13%	14%	14%	15%	15%	16%	14%
Forecast annual decrease in CG cards				5%	5%	5%	5%	5%	5%	5%	5%	5%	5%
<b>Costs (£m)</b>													
Operating costs			2	2	2	2	2	2	1	1	1	1	1
Third party fraud incurred by issuers			2	2	2	2	2	2	1	1	1	1	1
Fraud returned unpaid to acceptors			4	4	4	3	3	3	3	3	3	3	2
First party fraud and identified credit losses			37	37	35	33	32	30	29	27	26	25	23
<b>Total</b>			<b>45</b>	<b>45</b>	<b>42</b>	<b>40</b>	<b>38</b>	<b>36</b>	<b>35</b>	<b>33</b>	<b>31</b>	<b>30</b>	<b>28</b>
<b>Benefits (£m)</b>													
Consumer value			20	15	12	10	9	8	7	6	5	4	3
Acceptor value			15	11	9	8	7	6	5	4	4	3	3
<b>Total</b>			<b>35</b>	<b>26</b>	<b>21</b>	<b>18</b>	<b>15</b>	<b>13</b>	<b>11</b>	<b>10</b>	<b>8</b>	<b>7</b>	<b>6</b>
<b>Net (£m - benefit less cost)</b>			<b>-10</b>	<b>-18</b>	<b>-22</b>	<b>-22</b>	<b>-23</b>	<b>-23</b>	<b>-23</b>	<b>-23</b>	<b>-23</b>	<b>-23</b>	<b>-22</b>

Given these variations, it could be considered that, in itself, the cost benefit analysis is not absolutely conclusive. However, there are some potentially significant factors which it has not been possible to quantify, but could add millions of pounds per annum to the overall case for closure of the Scheme. These include:

- Credit losses arising from use of the cheque guarantee facility incurred by those institutions which have not been able to provide hard figures. A rough extrapolation from the figures that have been obtained would suggest the addition of another £10 million to these costs.
- The benefits of migration away from cheques to other payment methods. From the market research, it is estimated that the immediate consequence of the removal of the cheque guarantee facility would be that around 40% of payments would remain as cheques (but unguaranteed), 25% of payments would migrate to cash, 25% to debit cards and 10% to credit cards. The market research among acceptors indicated that payment by guaranteed cheque was one of the least preferred methods of payment that they received. It is generally acknowledged that there would be a net benefit to all parties of the migration of a cheque payment to either cash or debit card.
- The existence of the Scheme creates an exposure to a potentially large risk, which it is difficult to mitigate. It provides an opportunity, through chequebook stockpiling, for exploitation by organised crime.

“From the market research, it is estimated that the immediate consequence of the removal of the cheque guarantee facility would be that around 40% of payments would remain as cheques (but unguaranteed), 25% of payments would migrate to cash, 25% to debit cards and 10% to credit cards.”

The sensitivity analyses described in Annex D show that two of the key sensitivities are the assumed level of downweighting applied to the reported benefit of the UK Domestic Cheque Guarantee Card Scheme and the unreported level of credit losses that should be attributed to cheque guarantee. The Annex shows that if the unreported credit losses are similar to those incurred by cheque guarantee card issuers who could provide figures, this would largely offset any pushing back of the break-even year (when costs first outweigh benefits) arising from a lower than assumed reduction in downweighting of benefit.

## Cheque guarantee schemes in other countries

Ireland is the only country known to have a cheque guarantee scheme similar to that in the UK. It operates with a single guarantee limit of €130. However, compared to the UK a much smaller proportion of debit card holders have cheque guarantee functionality on their cards – around 25% compared with 75% in the UK. As in this country, usage is in rapid decline as many of the major retailers in Ireland no longer accept payment by cheque.

Other than Ireland, the only known example of a cheque guarantee scheme was the pan-European guaranteed eurocheque scheme which ran until the introduction of euro notes and coins at the start of 2002. Originally designed as an alternative to travellers' cheques for out-of-country payments, it became used for domestic payments in some countries. However, withdrawal of the scheme involved abolition of the eurocheque as well as the guarantee card so it is not directly comparable to a proposed withdrawal of the UK Domestic Cheque Guarantee Card Scheme. Information has been obtained from the Netherlands and Germany about their experience of the abolition of guaranteed eurocheques:

- In the Netherlands the eurocheque logo was carried on multifunction cards that had expiry dates that were not linked to the cessation of the guarantee. Eurocheques stopped being issued to customers after 31 December 2001, and although ones still in issue could be used after this date they were not guaranteed. So at the point when the guarantee ceased there were cheques still able to be used and cards in issue with later expiry dates. In practice, in the run-up to the closure of the scheme usage had been declining rapidly as a result of the introduction of charges per cheque supplied. Additionally, as the closure date approached requests for new eurocheques were met with packages of 5 cheques compared with 20 cheques previously. The main focus of communication was aimed at Dutch small retailers who received letters advising them not to accept cheques after the end of 2001 because they would be unguaranteed, although cheques could still be deposited after then. After 1 January 2002, eurocheques rapidly disappeared from the scene and the process occurred without incident. This was just part of the much bigger change with the introduction of euro notes and coins from the same date.
- The German experience was very similar to that in the Netherlands. Although multifunction cards bearing the eurocheque logo were still in issue after 31 December 2001, eurocheques were not guaranteed after this date. The removal of the guarantee caused no reported problems, with consumers and retailers being notified well in advance. Eurocheques had virtually ceased

being used by the time the guarantee was removed. One difference between Germany and the Netherlands was that, in the Netherlands, cheques were abolished completely at this time, whereas in Germany domestic cheques remained after the withdrawal of eurocheques.



# Annex A. Market research commissioned in support of the review

## Background to the survey

The independent market research company Synovate conducted two separate market research surveys among consumers and businesses, with fieldwork by telephone taking place from 27 October to 5 December 2008. In each survey around 3,000 respondents were interviewed to achieve 800 full respondents that met the respective criteria for being included:

- For consumers to be included in the full survey they had to have written a guaranteed cheque within the previous twelve months.
- For businesses, they had to have accepted payment by guaranteed cheque within the previous six months. The business sample was taken from Yellow Pages-based business lists compiled by Experian, supplemented by classified adverts taken from free local newspapers from around the country.

For both samples quotas were set and weightings applied to ensure that the results were representative of guaranteed cheque-using consumers and businesses.

## Estimate of guaranteed cheque volumes

There are a number of reasons why it may be expected that the consumer survey will overestimate and the business survey to underestimate the volume of guaranteed cheques made or received in the past year and it is the case that the raw estimates of the number of guaranteed cheques produced by the consumer and business surveys differ. For consistency, a combined annual estimate of 95 million guaranteed cheques in 2008 has been used throughout this analysis. This is also consistent with the figure subsequently derived from the Payments Council's Consumer Payments Survey for 2008.

## Annex B. Current conditions of use for the UK Domestic Cheque Guarantee Card Scheme

The Rules of the UK Domestic Cheque Guarantee Card Scheme state that a card issuer guarantees in any single transaction the payment of only one cheque taken from only one of its own chequebooks for up to £50, or for up to £100 or £250 if indicated in the hologram, provided the cheque is not drawn on the account of a Limited Company, and

- I. The cheque bears the same customer name and, where printed, bank sort code, as the card.
- II. The cheque is dated with the actual date of issue.
- III. It is signed, before the expiry of the card, in the United Kingdom of Great Britain and Northern Ireland, the Channel Islands, Isle of Man, Gibraltar or on the premises of any United Kingdom customs post located outside these territories in the presence of the payee by the account holder.
- IV. The card number is recorded on the reverse of the cheque by the payee (this requirement can only be varied by specific prior agreement of the Scheme's governing body).
- V. The card has not been altered or defaced.
- VI. Where the guarantee is used to support an encashment service, then the following rules will apply:
  - a. The number of guaranteed cheque encashments, when made with the support of a cheque card, is limited to one cheque per customer per day.
  - b. Special "frequency marking" pages are provided at the back of chequebooks, and the appropriate day square is effectively cancelled by cashiers whenever cheque cards are used to support encashments.

The cheque is delivered to the bank of the encashment service provider for collection no later than 3 days after the date upon which the cheque is received by the encashment service provider (for these purposes weekend days and bank holidays shall not be included in the day count, nor the day upon which the cheque is received by the encashment service provider).

These conditions of use are not to be printed on the card but are to be readily accessible to any enquirer at the issuers' branches.

If these conditions are not met the guarantee is void and cheques could be returned.

## Annex C. Members of the Cheque Guarantee Card Scheme (1 January 2009)

- Abbey National plc
  - Abbey
  - Cater Allen
- Airdrie Savings Bank
- Alliance & Leicester plc
- AIB Group (UK) p.l.c.
  - Allied Irish Bank (GB) Private Banking
  - First Trust Bank
- Arab Bank plc
- Bank of England
- Bank of Ireland
- Bank of Scotland Group
  - Bank of Scotland
  - Bank of Scotland Banking Direct
  - Capital Bank plc
- Barclays Bank plc
  - The Woolwich
- Bristol & West plc
- C Hoare & Co
- Chelsea Building Society
- Citibank International Plc
- Co-operative Bank plc
- Cumberland Building Society
- Halifax plc
- Harrods Bank Ltd
- HSBC Group
  - First Direct
  - HSBC Bank plc
  - HSBC Private Bank (UK) Limited
- Lloyds TSB Bank plc
  - Hill Samuel Bank Ltd
  - Lloyds TSB Private Banking Ltd
- National Australia Group
  - Clydesdale Bank plc
  - Yorkshire Bank plc
- National Bank of Egypt International Ltd
- Nationwide Building Society
- Northern Bank Ltd
- Northern Rock plc
- Reliance Bank Ltd
- Royal Bank of Scotland Group
  - Adam & Co Plc
  - Child & Co.
  - Coutts & Co
  - National Westminster Bank plc
  - NatWest Offshore Limited
  - Royal Bank of Scotland (Gibraltar) Ltd
  - Royal Bank of Scotland (Guernsey) Ltd
  - Royal Bank of Scotland (IOM) Ltd
  - Royal Bank of Scotland (Jersey) Ltd
  - Royal Bank of Scotland Plc
  - Royscot Trust plc
  - Ulster Bank Ltd
- Standard Chartered Grindlays (Offshore) Ltd
- UBS AG

### Assumptions made in the cost benefit case

- All figures in the table shown in the report are rounded to the nearest million. Due to rounding, the columns may not add up exactly. All costs and benefits are shown at current prices.
- The table shown in the report does not include: estimates for credit losses from those cheque guarantee card issuers that were unable to identify them separately; the effect of migration to other payment methods as a result of closure; or the costs that would be incurred in closing the scheme. Additional credit losses and migration effects could be significant (of the order of £10 million - £20 million) and consequently materially affect the overall conclusions.
- Forecasts of guaranteed cheque volumes are based on the Payments Council's Payments Market Review, amended in light of the estimates of 2008 guaranteed cheque volumes derived from the market research. These forecasts do not reflect any proactive initiatives to migrate away from cheques, or any new payment developments, such as mobile payments, which may accelerate such migration.
- Costs are based on collected fraud statistics and CCMC's special exercise to determine operating costs. It is assumed that costs will reduce at a similar rate to the decline in the number of cards in issue with cheque guarantee functionality – assumed to be 5% per annum for the next 10 years. Reflecting current economic conditions, credit losses and first party fraud is assumed to remain constant in 2009 compared with 2008, and then decline at the same rate as other costs.
- Benefits are based on the market research assessment of users' and acceptors' willingness to pay for cheque guarantee functionality, downweighted using the same methodology as the OFT's Payments Systems Task Force to allow for inevitable inertia between what respondents say they would do in a research exercise and what they would actually do in practice. It has been assumed that those who say they value the scheme a lot would, on average, pay 50% of the amount identified in the research and other respondents 25% of the amount. These assumptions are based on previous analysis of take-up of new financial services products, but may vary. A smaller downweighting, of 50% for all respondents, would lead to total benefits in 2008 of £58 million, exceeding the identified costs, and the crossover of costs and benefits not occurring until later in 2009.
- It is assumed that the value of benefits will reduce in line with forecast guaranteed cheque volumes.

## Sensitivity of break even point to assumptions made

As noted in the main report, the difference between costs and benefits of the scheme are sensitive to the assumptions made. One of the key factors is the level of credit losses attributable to guaranteed cheques that have not been included in the core cost benefit case because the cheque guarantee card issuer was not able to identify them separately. Extrapolating from the figures obtained would suggest the addition of another £10 million to these costs. Additionally, there may be opportunity costs from not migrating away from cheques that should also be taken into account. As this can have a big effect, this sensitivity is considered against variations in other assumptions, by testing the effect of additional unquantified costs ranging from nothing (as in the core cost benefit analysis) to £25 million per annum.

Another key sensitivity is the assumed downweighting applied to obtain the benefit the scheme provides, based on the hypothetical price that respondents said in the market research that they would pay to have a card with cheque guarantee functionality, or the premium that acceptors would pay to have cheques guaranteed. The downweighting used in the core cost benefit analysis amounts to 67% of the raw figure, and uses the same methodology as the OFT Payment Systems Task Force used in its evaluations. As can be seen in the table below, if no downweighting were applied then cross-over of costs and benefits would not occur until 2014, but allowing for any unquantified costs would bring this forward a number of years as shown.

### Sensitivity of the cross-over year to the downweighting factor and the level of unquantified costs.

<i>Downweighting factor applied to reported</i>	<i>Amount of unquantified costs</i>					
	0	£5m	£10m	£15m	£20m	£25m
0%	2014	2013	2012	2011	2011	2010
25%	2011	2010	2010	2010	2009	2009
50%	2009	2009				
67%*	2008 or earlier					
75%						

\* - Assumption in core cost benefit case

Additional sensitivity analyses were undertaken considering the effect of varying the assumptions about how quickly costs and benefits will decline over coming years:

- Benefits are assumed to decline in line with forecast guaranteed cheque volumes. Rates of decline of 10% above or below the annual rates in the core scenario were tested.

- Also tested were assumptions of costs decreasing at rates different to the 5% decline (based on the expected reduction in card numbers) assumed in the core analysis – ranging from costs increasing at 5% per annum through to decreasing at 15% per annum.

It was found that the overall case is not particularly sensitive to assumed forecasts of future rates of decline in costs and benefits, and none of the range of assumptions tested alters the conclusion that costs will continue to outweigh benefits each year for next ten years (if the Scheme continues to exist for that period).

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