UK Finance response to Bank of England Consultation on the supervisory approach to wholesale cash distribution

Date: 10 February 2023

Sent to: Wholesalecashdistribution@bankofengland.co.uk

UK Finance is the collective voice for the banking and finance industry.

Representing more than 300 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

High level comments

UK Finance welcomes the consultation from the Bank of England (hereafter 'the Bank') on its supervisory approach to wholesale cash. It is helpful to see the next level of detail after the Financial Services and Markets Bill publication, and the HMT policy statement in May 2022. The consultation also notes that a further consultation on the detail of the Codes of Practice (CoP) will be published this year. The current consultation suggests that these CoP will give guidance on day-to-day activities. UK Finance members believe that highly prescriptive rules on the day-to-day activities of firms will be challenging and we look forward to having the opportunity to review the CoP further. In general, except where absolutely necessary, we believe the Bank should avoid prescriptive solutions especially in the area of operational practice as any stifling of innovation and variety will impact upon the value of a functioning market.

Another significant point relating to the future of cash in the UK that Members would like to hear more from the Bank and HMT about is the roles and responsibilities of others central to the future efficiency, resilience and sustainability of the WCD – namely the Bank, HMT and The Royal Mint. While the FSM Bill Schedule 9 and the Bank's new powers are focused on wholesale cash *distribution*, that is just a part of the wholesale cash ecosystem in the UK. It is not sufficient to place the burden solely on the private firms to ensure a successful wholesale cash system. The changing dynamics of the wholesale cash ecosystem are being driven by macroeconomic and societal changes that are outside the control of WCD members individually. Members recognise why these powers and oversight are deemed necessary – to help to give a holistic perspective on wholesale cash that might help avoid systemic issues arising from the actions of individual firms. But there is a broader strategic lens that should be overlaid that interconnects the private industry with the authorities with whom ultimate responsibility should lie.

In Q3 2022, UK Finance and its members, through the Cash Policy Committee, put together a high-level note on issues relating to the future of cash that members felt needed to be advocated on with the authorities. This included noting that:

- All players within the ecosystem need to work collaboratively (within the bounds of competition law). This includes the authorities responsible for key elements of the ecosystem.

- A longer-term strategy (particularly for coin) is required in order to ensure that there is a considered approach on issues which no one player can effectively action individually, for example, the future denominational mix, and whether measures like rounding could enhance efficiency. For example, across the industry falling cash transactions are causing excess stock to build (see fig.1 at the end of the document) and there needs to be a holistic consideration of the impacts of this and how it could be managed. In particular it is vital to have plans to deal with excess stock now before further impacts materialise. The three authorities directly part of the WCD ecosystem (the Bank, HMT and The Royal Mint) need to play a central and collaborative role with WCD firms to ensure that the future cash system in the UK is not only efficient, resilient and sustainable, but also effective to meet the changing needs of the UK in a less cash society.

Finally, another overarching point made by members relates to the costs introduced through the new supervisory regime. As a broad point, members note that given the regulators and government acknowledge the pressures on industry to continue to support a declining cash ecosystem, the introduction of additional costs does not necessarily assist firms. It is not only the fees themselves, but the additional work at each firm that must be done to meet the new supervisory requirements. Given this, firms are keen to see more from the Bank about how existing costs and processes can be leveraged as much as possible to fulfil any new requirements. Further to this, members would welcome reviews of the current requirements, e.g. around audits, to ensure that these are not leading to unnecessary cost/impact.

1. Do you agree with the proposed approach to the Bank's oversight of the WCD market?

UK Finance members are broadly supportive of the proposals for the Bank's oversight of the WCD market. Separating out the market oversight and the prudential oversight ensures that the regime is not unnecessarily burdensome where the market is working as it should.

Many members' comments on the consultation focused on what the specific triggers for decisions might be and more specificity/clarity on descriptions of situations. We have explored this further below and it may be that this detail will be present in the consultation on the CoPs.

- For example, the consultation states "The powers will enable the Bank to assess the market-wide impact of any commercial solution…". Our members operate in a commercial environment, and it is important to understand how the Bank envisage reviewing any commercial solution or decision by any firm.
- A further example is that "the Bank expects to be notified when particular events occur. This includes, but is not limited to, if a firm receives notification of termination of a significant client contract, or where rationalisation plans are under consideration by a firm." A consistent description to help to understand what, e.g., a significant client contract would be helpful. Is this limited to contracts and relationships with existing or future WCD participants or more widely applicable to commercial relationships with the end users of the WCD system, separate from, say, the wider retail cash distribution system? How will the Bank determine what forms a "significant" contract?
- The Bank states that it does not wish to stop commercial decisions being made e.g., if a firm were to exit, materially change how it delivers its cash services nationally, or to close/change cash centre sites. However, the examples in table B of the consultation document suggest a level of risk to firms, in that the Bank would have the potential to add additional delays, or conditions and costs that may make it unfeasible or difficult to make strategically important changes.

We note that the approach states that “The Bank will also conduct horizon scanning in order to achieve an overall view of the market, including wider market information gathering and dialogue with other relevant market participants and authorities”. Given the historic and ongoing role of UK Finance Cash Services in wholesale cash, including our cache of 25 years’ worth of data, we look forward to supporting the Bank in this wider market information gathering.

Another query that Members raised during the consultation on the HMT policy statement was the positioning of these new powers to cover both notes and coin. We made the point that historically the Bank has only had a purview over notes. It seems to be a significant addition to their portfolio to also cover all aspects of the coin market, given the dynamics of coin and notes differ in many respects. In addition, this consultation states that these new powers are complementary to the Note Circulation Scheme (NCS). Therefore, there seems to be an acknowledgment that the new powers correlate more closely with the pre-existing oversight of notes. Members would like to hear more from the Bank about if and how coin will work differently within the new wholesale framework.

On the topic of scope:

- CiT – The Bank will appreciate that UK Finance Cash Services members (who make up the entirety of the proposed space to be regulated) carry out a range of different functions within the WCD environment. Some of our members would appreciate more clarity on why CiT operators were not included in the scope of the supervisory powers, and what circumstances might lead to them falling into scope. Some members note that currently the vast majority of wholesale CiT capacity is provided by just two suppliers. The loss of just one of these suppliers for an extended period or permanently would significantly interrupt the ability to ensure notes flow between deficit and surplus firms, and would either impact the ability to either supply customers or efficiently manage NIC to avoid the potential unnecessary printing/issue of notes. It is possible that wholesale CiT alone is unlikely to present an attractive business model for new entrants and therefore has a potentially similar impact to the resilience of the WCD system as the removal of a cash centre, with few other contingency arrangements possible without incurring significant additional cost. Other members are content with the current exclusion of CiT from scope on the understanding that it will remain under close review.
- Members also commented on the fact that the consultation says little about the impacts of these rules and policies on the extended cash supply chain (ATM deployers / retailers / small banks, building societies and indeed the Post Office). There are perhaps scenarios where the wholesale infrastructure adapts to be more efficient and to contain costs, but that could have a negative impact on the extended supply chains, driving in inefficiencies there. For example, one firm noted that any reduced coverage might impact their ability to do “Just in Time” supply, reducing flexibility and increasing their cost to service collections, deliveries and ATM cassette loads. It may also impact their ability to provide recovery services if for some reason scheduled services have not been completed. Overall, Members stated that they want to understand more about how the Bank expects to monitor downstream impacts of the changes in the core WCD ecosystem.

Some members also raised the point that while the purpose of the oversight is to ensure the WCD remains effective, resilient and sustainable there is an overlap with existing legislation already in place such as that covering the issuance of S&NI Banknotes and requirements around contingency plans and other elements of these rules. This is also the case under the NCS. There should be efforts made to harness these synergies to ensure the overall purpose is still achieved, so that the oversight regime is as efficient as possible for everyone involved.

2. Do you agree with the proposed principles for the WCD market oversight regime?

- The Bank have said this is the case, but we emphasise that it needs to be clear that nothing in the framework nor principles should restrict a firm from exiting or materially changing its cash services.
- It would be helpful for the Bank to clarify if they intend to impose any specific targets or goals in respect of the principles in the near or medium term.
- Firms are required to complete a self-assessment against the principles.

3. Do you have any initial comments on the early high-level proposals for CoPs for recognised WCD market firms?

- The current consultation suggests that these CoP will give guidance on day-to-day activities. UK Finance members believe that highly prescriptive rules on the day-to-day activities of firms will be challenging and we look forward to having the opportunity to review the CoP further. In general, except where absolutely necessary, we believe the Bank should avoid prescriptive solutions especially in the area of operational practice as any stifling of innovation and variety will impact upon the value of a functioning market.
- One Members suggests that the information gathering should also include the turnover of notes/coin and forecast information within the industry for the next 3 to 5 years. 5 Year business plans are mentioned by organisation but oversight should include forecasts within these plans of how denominations are/will change over a similar period as this will then help drive decisions on potential issues with storage/capacity, which impact on the efficiency of not just one centre or business but the WCD ecosystem more broadly.
- Some of the information requirements outlined, for example, relating to exact costs paid by firms, seem very sensitive and commercial and some members queried whether they are required to that level. This is particularly the case with the suggestion of gathering data around contract profitability.
- The outlined requirements suggest there may be a significantly increased burden of reporting compared to the current voluntary reporting. This would have a cost impact and affect efficiency.

4. Do you agree with the proposed approach to the allocation of supervisory fees for the WCD market oversight regime?

Members would appreciate more information to be provided on the specific makeup of the fees, especially the proposed Market Oversight fee, as these currently feel high. The majority of activity is more likely to be ad hoc linked to specific projects that would be planned and well known in advance by the participants involved, rather than requiring a large amount of everyday activity. Therefore, some members believe that costs of monitoring may be lower than anticipated.

We also note that a penalty statement will be consulted on by the Bank this year too. Members would appreciate a similar breakdown about how any proposed penalties are arrived at.

Overall, while we note that the fees and penalties regime may be consistent with similar regimes for other FMIs, Members are not sure whether enough thought has been given to the fact that this is (as the consultation notes) a contracting industry, and adding costs to it may defeat the purpose.

Some members also noted that it will be important for the Bank to consider risks to efficiency /end user pricing that may arise through some of these newly added costs. The following direct and indirect costs will all likely be absorbed throughout the ecosystem:

- Supervisory fee
- Increased FTE resource required for mandatory reporting if is a big step up on the voluntary reporting.
- Additional cost that could be charged by an operator to support any reporting or other new requirements.
- Additional cost that may be imposed if arrangements change, e.g. if an operator wished to close a cash centre and BoE added requirements with a cost implication.
- Additional cost could be significant if substantial new requirements are imposed in respect of business continuity – for instance, if firms were required to have a contract with a second provider "in case".

5. Do you agree with the proposal for prudential supervision of any systemic entity that may form in the future?

Given no current entity meets the requirements of a systemic statutory entity, members appreciate that there is an element of the hypothetical about describing what might trigger that categorisation. However, Members believe that it would be helpful to understand the detailed specific circumstances that would trigger the creation of a systemic entity and therefore Prudential Supervision.

Fig. 1 – Falling cash transactions leading to a build up of industry stocks in £2 and 2p coins

	Inflow £2	Outflow £2	Net	Average stoc
2019	749,250,126	767,546,582	-18,296,456	52,346,385
2020	418,784,999	412,868,018	5,916,981	51,068,769
2021	386,059,946	404,102,974	-18,043,028	52,018,154
2022	436,509,433	407,201,622	29,307,811	71,213,000
	Inflow 2p	Outflow 2p	Net	Average stoc
2019	25,099,399	25,929,070	-829,671	2,354,462
2020	14,028,289	16,082,321	-2,054,032	2,130,615
2021	12,955,202	14,116,632	-1,161,430	1,812,077
2022	14,645,118	13,761,613	883,505	2,792,077