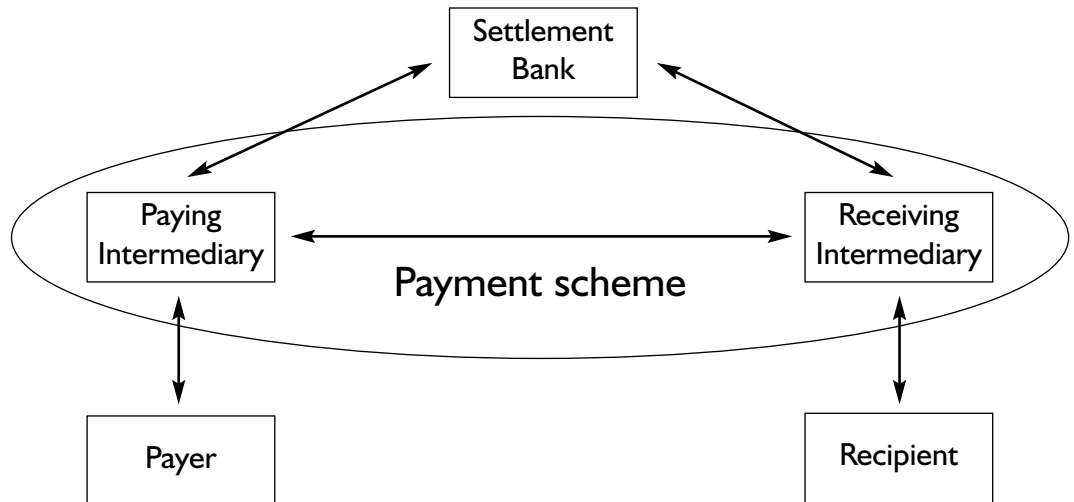


PAYMENT SYSTEMS

AI.1 The simplest type of payment system is cash. There are just two parties directly involved in a transaction – the payer (such as a customer) and the recipient (such as a retailer). A more typical arrangement is what is called the ‘fourparty’ system:



AI.2 The Cruickshank report gave the following description:

3.28 A payment involves transferring money from one party to another... The party making payment is the **payer** and the party who receives the payment is the **recipient**. Recipient and payer are the **end users** of the payment system and it is their demand to transfer money that gives rise to the payment. This payment can be made via one or more intermediaries with whom the end users have contractual relationships (referred to as **paying and receiving intermediaries**). As payment systems are currently set up, these intermediaries are nearly always banks. Banks and building societies are natural intermediaries in payment systems, given that money is generally held in bank and building society deposits. However, other types of firm may also be capable of acting as payment intermediaries in some contexts.

3.29 The process by which value is transferred between parties is known as **settlement**. Settlement between payment intermediaries and their customers takes place in one of two ways. Either intermediaries debit or credit accounts held with them by the customer, or a cash payment is made between the intermediary and the customer. Settlement between intermediaries takes place through a **settlement bank**, with whom both paying and receiving intermediaries hold an account. The settlement bank is often a central bank, but again need not be so. The key to selecting a settlement bank is that its credit should be acceptable to all intermediaries up to the size of exposures needed for the payment system concerned to work effectively. Where the value of transactions is very large, as it is for example with CHAPS, the central bank is best placed to be the settlement bank. For lower value payments, there is more variety in approach. For example, HSBC is the settlement bank for Europay and all members hold an account there. BACS, by contrast, uses the Bank of England for settlement.

AI.3 The four parties directly involved in a **'four-party' system** are the: payer; the paying intermediary; the receiving intermediary; and the recipient. So, for example, in a credit card scheme such as Visa or MasterCard, the four different parties are :

the payer:	a consumer
the recipient:	a retailer or merchant
the paying intermediary:	the consumer's credit card provider (known as the issuing bank)
the receiving intermediary:	the retailer's provider of card acceptance facilities (known as the merchant acquiring bank)

There is also the **settlement bank** which will settle the transactions between the issuing bank and the acquiring bank and the credit card **scheme** itself.

AI.4 In some transactions the paying intermediary and the receiving intermediary maybe the same firm – for example a Barclaycard customer may use their card at a retailer who uses Barclays as its merchant acquiring bank.

AI.5 In **three-party systems** the paying and receiving intermediaries are always the same entity. For example, American Express acts as both the card issuer and the merchant acquirer with its credit and charge card schemes. However, settlement would normally still involve the card holder's bank (in making a payment to American Express) and the merchant's bank (in receiving a payment from American Express) although obviously not for each and every card transaction.

AI.6 A different three-party system which does not involve separate settlement banks is Merita Nordbank's Solo Internet payment scheme in Finland. Here both the consumer and the retailer have to hold a bank account with Merita Nordbank and so the payment is just settled across the bank's own internal accounting systems.

AI.7 There is room for more than two intermediaries in a payment system. For example, there are Internet-based wallet schemes whereby a third intermediary has a direct relationship with both the consumer and the retailer. The provider of the wallet will keep details of a customer's preferred payment method and will provide details of the payment method to the retailer when the customer decides to buy something from its website. The advantage to the consumer is that she does not have to type in all her card details or even her address at every single retailer she wants to buy something from.

AI.8 Another example of a third intermediary is a provider of point of sale (POS) terminals to retailers. In the UK, POS terminals tend either to be provided by the merchant acquiring bank or owned by the retailer itself. However, in some countries there are independent service providers who lease POS terminals to retailers. It is often these service providers who persuade retailers that they should start accepting cards and who will introduce the retailer to a merchant acquirer.

AI.9 In contrast to this proliferation of intermediaries, there are payment systems in which there is no central infrastructure and no central scheme. In such payment systems the paying and receiving bank make arrangements between themselves to settle payments on a bilateral basis. There is no central clearing house. Countries where this happens, to a lesser or greater extent, include Finland and Australia.

AI.10 Further background information on payment systems can be found in the Cruickshank report itself.