The Cash Management Companies Association

Contingency plans and continuity of payments
Cash continuity as a guarantee to payment continuity

ESTA Position paper
December 2018

Executive summary

Cash is what works when nothing else is working. Cash still represents a majority of payments in volume, with around 79% of all payments according to the European Central Bank's household survey of November 2017.

Less cash means however more electronic payments of different types. Electronic payments are not immune from outages as recurrent events show, and recently in Europe during the summer of 2017. These outages can have a number of origins, whether due to a technical failure, the results of cyberattacks or climate change episodes. Further regulatory changes related to the adoption of the second EU Payment Services Directive and its third party providers provisions will also impact the payments services market. Cash is the obvious response to payment continuity in case of failure of payments networks.

However, cash continuity is not only a question of payment continuity. Cash is what allows the financial system to work smoothly. Cashless society cannot work, unless there is a perfect substitute to cash to replace it, which has yet to be invented. E-currencies developed by a number of central banks are only imperfect substitutes, not least because they still require an operational infrastructure/network to be used.

The real issue is however not just in payment continuity. Cash bears the promise that any book money can be converted into cash and withdrawn from the banking sector. Cash is the only means that allows withdrawing deposits from an account in a financial institution. Without cash, this is no longer possible. The confidence of the public in the financial system largely lies in the ability of depositors to make withdrawals through the conversion into cash. Failing this, confidence might be severely undermined with some consequences on the stability of the financial system which relies primarily on this confidence.

The phase out of cash in some countries, such as Sweden, is driven by financial institutions which consider that cash is a cost and that their interest is in promoting alterative payment instruments which are more profitable to them. In Sweden, the Riksbank Committee questioned whether "*Swedes have been forced out of cash*" by commercial banks. There are very effective,

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and discreet, ways of forcing consumers out of cash, such as making withdrawal and deposit more costly and cumbersome and reducing change money available to retail. Cash being essentially made available to consumers through banks, they are in a strong position to determine how, and how much, cash is used.

This document reviews the conditions under which consumers can continue to be able to use cash as they wish. This implies:

- Withdrawal and deposit facilities at any time locally;
- The effective distribution of change money to retail;
- The ability to exchange banknotes denominations without having the prerequisite to deposit cash on a bank/financial institution account;
- A clear understanding of the definitions and implications of legal tender, possibly with a legal status where necessary. There are two possible routes for achieving this, one is to make the *acceptance of cash compulsory*; the other arguably easier route is to establish a *right for citizens* to use cash.

The cash industry can play a very effective role in ensuring that cash remains available and efficient. However, cash is a volume driven economic activity which requires a critical mass to be sustainable. The cash industry can take over the cash functions of banks if commercial banks do no longer want to provide cash services to their customers. This can be made possible if certain conditions are met:

- The business environment, as well as relevant supervisory rules must allow for a certain level of flexibility in the way customers funds are managed. Strict rules in some countries that provide for very strict segregation of funds at any time are artificially increasing the costs and level of procedures of cash management;

- Balance sheet relief or interest compensation mechanisms must be put in place. Banknotes held on behalf of central banks should not be considered as assets of the cash industry;

- The scheme should be opened to nationwide operators to avoid disruptions as they have the ability to operate throughout the territory of the country, whilst the recirculation of notes and coins would remain to be based on very strict criteria.

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ESTA Position paper

I. The need to keep payments safe, efficient and competitive

a. Digital payment systems are not immune from outage

As ESTA's 2017 annual conference has shown, cash is what works when nothing else works. Digital payments are not immune from general failure. Payment continuity is a key feature of financial economic stability, trust of consumers and businesses in the economy and for sustainable economic growth. As the European Central Bank ("ECB") puts it:

> *"The risks in the provision of payment instruments (such as e-money, card schemes, direct debits and credit transfers) have not generally been considered to be of systemic concern, but the safety and efficiency of payment instruments are important for both maintaining confidence in the currency and promoting an efficient economy. The smooth functioning of payment instruments facilitates commercial activities and, thereby, welfare."*[1]

In the field of payment instruments, the ECB has put in place an oversight system for electronic payments and conduct Eurosystem oversight activities. Under these activities, an assessment of the card scheme is underway and should be completed by end of 2018. It has also started an assessment of the EPC's SEPA's direct debit Core system.[2]

Recent events in Europe have shown that the risk of disruption in payment systems exist and although infrequent and to some extend unlikely, new threats such as cyberattacks (whether of terrorist nature or not) or climate change related natural events may cause major disruptions. On 1st June 2018 a major outage at VISA Europe prevented millions of customers completing their purchases, pay at railways stations or petrol stations. Queues formed at ATMs which rapidly ran out of cash.[3] It was followed on 12 July 2018 by a massive outage of MasterCard.[4] Previous cases have shown total outage of the entire card system in a country over a number of hours.

[1] European Central Bank (ECB) "Harmonised Oversight Approach And Oversight Standards For Payment Instruments"; 2009
[2] ECB Eurosystem Oversight Report 2016
[3] https://www.ft.com/content/d95698a2-65b3-11e8-90c2-9563a0613e56
[4] https://www.pymnts.com/mastercard/2018/outage-declined-credit-card-payments-europe/

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b. *PSD2 will further rock the boat of the payment landscape*

Also of relevance is the adoption of the revised Payment Services Directive (PSD2) which is set to accelerate the competition and digital disruption which will be substantially reshaping the financial services and payment industry across Europe, notably by forcing banks to grant Third Party Providers (TPPs) access to a customer's online account/payment services in a regulated and secure way. In the UK alone, traditional banks providing payment services are expected to lose more than 40% of the revenues derived from payments services by 2020. [5]

This creates a number of challenges for supervisory authorities with the increasing pace of development of new payments services, particularly in the mobile and real time payment area where there is a strong demand from consumers and citizens. This will be accompanied by the increase of payment providers and type of businesses offering payment solutions for which supervisory and oversight structures may not be adapted. And this will in turn increase the number and type of cyber frauds to which consumers may be exposed, undermining the trust in payment systems.

II. Cash is the obvious response to payment continuity.

Whilst cash is an obvious response to the millions who do not want to rely entirely and solely on electronic payments, whether for security or privacy reasons, a number of countries are sending messages to the fact that cash might be eliminated. In its March 2018 consultation, the UK treasury consultations document referred to the role of Government as to be solely "to ensure that cash is available to those who *need it"*, though it should be to ensure that cash is available to all those who *want it.* In France, a report by an expert group mandated by the French government advocated moving towards "*a zero cash society in order to simplify payments and fight against tax fraud*", [6] despite the fact that it has been widely shown that there is no correlation between the use of cash and the illegal economy in a country.[7]

There is indeed no justification for phasing out cash.

Concerns about the anonymity of cash should be put into perspective: first, banknote serial numbers reading technology is spreading and now allows for "digitalisation' of cash allowing traceability of a banknote through its lifecycle. This technology combined with face recognition software make it technically possible to identify a specific note with a specific transaction and

[5] Accenture Payment Services : Seizing the Opportunities Unlocked by the EU's Revised Payment Services Directive; 2016

[6] Comité d'action public « CAP22 » : « *Service Public : se réinventer pour mieux servir : nos 22 propositions pour changer de modèle* » ; June 2018. The zero cash society is listed as proposal 16 and is motivated by the fact that the share of cash transactions in France is lower than in other countries and could be as low as 5% in value and 55% in volume. It states that "in France, one uses cash for low value payment and French People prefer other means of payment when the value increases". The reports omits to recall that France has the lowest cash payment restriction after Greece in the EU and that French people have actually no choice but not to pay in cash above 1,000 euros.

[7] See for example the latest paper from F. Seitz, H-E Reimers and F. Schneider "Cash in circulation and the shadow economy: an Empirical Investigation for Euro area countries and beyond", cesifo Working Papers 7143, July 2018

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with individual parties to these transactions. Anonymity of cash is on the verge of becoming a myth.

These technologies are spreading rapidly as part of efficiency gains in the management of cash. Second, according to the 2017 ECB households survey on the use of cash, the average payment in cash is €18: who needs to trace payments of such amount for security or other - including fiscal – purposes ? Large cash payments are rapidly conspicuous and raise attention much more than anyone looking for anonymity would wish.

On the other hand, a number of countries which are experiencing a sharp reduction of cash in circulation in their economy, and particularly northern/Scandinavian countries where cash use has reduced too far have raised concerns about the risk that this situation creates. Those countries which are looking to foster a zero cash society should take a close look at the challenges raised by low cash in circulation in other countries.

III. Cash contingency is not solely a question of payment continuity

Cash is not only what works when nothing else works, it is also what allows the financial system to work. A cashless society cannot work, unless a perfect substitute to cash is invented.

a. A cashless society cannot work, unless a perfect substitute to cash is invented.

The recent financial crisis has undermined very substantially the confidence of the people in the financial systems, and so much so that for a large part of the population, the next financial crisis is not a matter of "if", but of "when".

Cash in that context plays a unique feature: in addition to the certainty of the value underpinned by the State, cash also bears the promise that any "book money" such as money held in an account of a financial institution can be converted on demand and without delay into cash. Cash is actually the *only* way of allowing deposits held by banks on behalf of non-bank operators to be withdrawn. Economic operators and the public at large accept the deposit of their money in banks as they have the confidence that, should they need it, they will be able to withdraw it at any time and at no cost from their account. One needs to recall, in order to understanding the importance of this fact, that the financial crisis that started n 2007-2008 was not one of solvency, but one of liquidity resulting from the fact that interbank lending was limited and expensive as banks did not trust each other; a reliable sign of it was that short term interest rates were substantially higher than long term rates. A number of businesses went bust as they failed to have enough liquidity to sustain their operations.

In a cashless society, there would be no way for anyone to withdraw their deposits from a bank account, except to transfer it to another account. If However the issue is the trust in the financial

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system, this is of course no remedy. The prospect of a cashless society could then trigger a bank run without any other reason than bank customers suspecting they may not be able to withdraw their deposits should they want to.

Central banks are aware of the issue and have given some considerations into the issue. A number of them are working on digital central bank currencies, or e-money, as a proxy to cash. However, electronic money remains “electronic”, whether it is issued by the State, its central bank or any private operators and is subject to the same risks and causes of outage, the causes being intended or the result of cyber-attacks or unintended as the results of power failure, climate change, technical breakdown etc. . The weakness of any e-currency is largely due to its common factor with other e-money: their immateriality which requires a network and/or infrastructure and a terminal for their use.

The issue of cash contingency therefore goes beyond the sole issue of continuity of payment but interacts with the broader stability of the financial system and the people’s confidence.

b. *Experience in Sweden: a waking call against cash phase out*

In an interim report published in June, the Enquiry committee of the Swedish Central Bank (Riksbank) draws the attention of the issues raised in Sweden further to the substantial reduction of cash services by banks. The situation is such that withdrawing cash and depositing cash is becoming problematic for people and businesses.

The move is pushed by the banking sector which is contracting cash services and reducing the number of ATMs and safe boxes where cash can be deposited. The report flags the interconnection of all phases of the cash cycle: consumers need to be able to access cash to pay in cash if they so wish. In turn, shops and other businesses need to be able to deposit cash that they have received in payment for their goods or services. Other cash services, including CIT and CMC services will only be sustainable if a critical mass of cash is circulating: cash being a volume driven activity, cash processing is as efficient as the cash in circulation is important.

The mechanisms that led to the Swedish situation are the following:

- Reducing cash withdrawals (i.e. reducing the number of ATMs) and deposits (reducing the number of branches accepting deposits in cash) in order to make cash management by retailers and consumers more cumbersome and more costly;
- Restricting the distribution of change money to retailers in order to make payments in cash impracticable if no change can be given, leading consumers to either accept a higher price for their purchase, or make an electronic payment.

This explains the statement by the enquiry committee that “*Swedes are being forced out of cash*”, and this is being driven by the banks’ commercial interest in phasing out cash.

I) **Concrete steps to cash contingency: the practical requirements**

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a. The conundrum of cash distribution

The situation in Sweden is one which has been driven by commercial banks when they are left in the driving seat of the payment market. Not only do commercial banks identify cash as a 'cost' but they have alternative payment instruments to offer (essentially cards) on which they can generate revenue : "*Resources used in the cash chain are a synonym for cost for banks since there are often no direct revenues from the provision of the cash services*".[8]

This has been very clearly identified in the Swedish Enquiry Committee Report. Already in 2016, other central bankers have also raised concern with this situation:

> "*Banks promote a changeover from cash to other solutions, making cash less available, arguing publicly against cash and promoting their own solutions as phasing out cash to increase the possibility of charging fees for other solutions"*.[9]

As a confirmation of this, the EPC has formally launched on 21st November 2017 its SEPA instant credit transfer which is often referred to as the '*ECP cashless society project'*.[10]

b. Promoting an efficient payment system does not mean reducing cash

The role of the authorities is to promote an *efficient* payment system. The notion of "*efficient payment system*" might change from one stakeholder to another: for the European Payment Council, for example, making cash efficient would suggest starting with "*reducing the use of cash*".[11]

The Swedish experience as analysed by the Riksbank shows however that this is hardly the right way to do it as this creates a number of serious issues. Since, as said earlier, cash is a volume driven business, the reduction of cash in circulation bears the risk of reaching a point of no return where the cost of maintaining the infrastructure required for the cash cycle will become unsustainable, with a risk that it disappears as it is run by private undertakings.

The response from the Riksbank to the Committee's report[12] provides useful hints as to what cash contingency requires. The analysis of the factors that led to the situation in Sweden is also of interest to understand how cash can continue to circulate in all circumstances.

Cash contingency requires:

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[8] Cf E "New SECA Framework, the European Payment Council, 21016. See section 4.1 page 24 (ESTA underlines).

[9] "The impacts of the reduction of commercial banks' footprint in the Norwegian cash cycle"; Leif Veggum,; Norges Bank, presentation at the "Future of Cash conference", 11 April 2016, see more specifically slides 13 and 14

[10] https://www.europeanpaymentscouncil.eu/what-we-do/sepa-instant-credit-transfer

[11] EPC infographic "*improving the cost efficiency of cash*", 2016

[12] "Consultation response on Secure Access to Cash", Banking division of the Swedish Ministry of Finance, 17 October 2017

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- The ability for anyone to withdraw cash at any time in the vicinity of its location;

- The ability to deposit cash also in the vicinity of its location, which is "*a reasonable expectation from bank customers*" as the Swedish Riksbank report states, "*there must be symmetry between cash withdrawal and deposits*": if there are no convenient facilities to deposit cash, the use of cash will be severely constrained;

- The effective distribution of change money for cash transactions to retail distribution: the restriction in the distribution of change money has proven to be the perfect stealth approach to phase out cash in Sweden. It is an extremely efficient way to reduce cash usage in retail, if no change can be given on cash payments;

- The ability to exchange high denomination notes in smaller notes or coins in banks: in a number of countries where cash services are no longer available in branches over the counter, the only way to exchange a high denomination note is to deposit it on one's bank account and withdraw cash in smaller denominations from an ATM. This has two serious limitations to cash users: this can only be done in branches of the bank where one has one's account. Non-residents, such as tourists, which are keen to use cash and are often not subject to cash payment limitations in countries where they apply have no possibility to exchange high denomination notes because they have no bank account in the country they visit.

c. Cash continuity and legal tender

An important aspect of cash continuity relates to the notion of the legal tender of cash. The European Central Bank states on its web site that "*all the [euro] notes are legal tender*", but does not define legal tender any further.

Legal tender is usually understood in reference to debt settlement:

> *"Legal tender has a very narrow and technical meaning, which relates to settling debts. It means that if you are in debt to someone then you can't be sued for non-payment if you offer full payment of your debts in legal tender"*[13]

Legal tender can be limited e.g. in relation to the number of coins allowed for a payment or in relation to payment limits in cash as they are implemented in some member states. The Commission recalled during its consultation on Cash Payment limitations, Recital 19 of Council Regulation (EC) No 974/98 that '*limitations on payments in notes and coins, established by Member States for public reasons, are not incompatible with the status of legal tender of euro*

[13] Bank of England (https://edu.bankofengland.co.uk/knowledgebank/what-is-legal-tender/)

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banknotes and coins, provided that other lawful means for the settlement of monetary debts are available". [14]

d. The case for a legal status of legal tender in Sweden

The report of the Swedish Enquiry Committee report on access to cash does not propose the introduction of any general obligation to accept cash as it would "*impede technological development and be associated with high costs*" and "*would be a disproportionately large encroachment on the freedom to conduct a business*".

ESTA disagrees with the idea that an obligation concerning the acceptance of cash would impede technological development in any way, as legal tender is not about the exclusivity of cash as a payment instrument.

In response to the Committee, the Riksbank rightly considered that "*by taking its view, the Committee is not fully taking into consideration the complexity surrounding the issue of what is legal tender. The question of the existence or non-existence of cash covers more than just its physical prerequisite. It is about the basic needs of society and its citizens for the presence of means of payments that are guaranteed by the State*".

The Riksbank further suggests that "*any proposal* [on mandatory cash services] *could impose requirement stipulating that activities that are important from a citizen's perspective shall be obliged to accept cash*".

ESTA concurs with these views of the Riksbank although a discrimination of which activities are *important from a citizen's perspective* might be both subjective and difficult to establish. However, the basic needs for society and its citizens in relation to state guaranteed money also extends to the need to secure fair competition and freedom of choice between payment instruments. The decision for a retail shop to accept or refuse cash payments may be seen as a part of the freedom on how to conduct business; however the decision for a full row of high street shops or shopping mall to ban cash would most probably be one of relevance to competition authorities, as it could be construed as coordination with a view to reduce costs for businesses, without a fair share of the benefit for consumers who would be deprived of a major choice of payment

There are two routes to achieve a mandatory provision on cash in the way considered by Sweden. The first would be to make it a legal obligation for *business to accept cash*, the other would be to enshrine in law *the right for citizens and consumers to pay in cash*, and this could be

[14] Commission Inception impact assessment on a Proposal for an EU initiative on restrictions on payments in cash , 23/01/2017, page 2

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justified by different reasons, such as financial inclusion for the unbanked or the right to privacy which is a fundamental right stated in Article 7 of the European Charter of Fundamental's right. A "*right to citizen*" would also arguably be an easier legislative route than "*an obligation to businesses*".

IV. The role of the cash industry in cash contingency

Cash is a volume driven activity which requires a critical mass of cash circulation to be sustainable. As the Riskbank enquiry committee stresses, all stakeholders involved in the cash chain are interconnected. For the cash chain to continue to operate, it is essential that efficient CIT/CMC operations remain in any country, failing which could have vast reaching consequences on the ability of any economy to maintain an operational cash cycle.

As this document recalled earlier, ESTA has regularly denounced the paradox that cash is made available to consumers and citizens through banks, a stakeholder that has conflicting commercial interests in promoting alternatives to cash. This process is likely to aggravate further if, as recalled above, banks are likely to lose further revenue from payment services due to PSD2.

In its response to the EPC "new SECA framework" of 2016, ESTA stated:

> *"ESTA views are that banks are free to disengage from cash, but should do so in a structured and organised manner with other stakeholders so as to ensure that cash remains accessible to consumers. What ESTA feels is not acceptable, is that banks might be - as some NCBs think is already the case – giving consumers no alternative, reducing cash offering and proposing their own payment instruments instead.*
>
> *Cash needs to remain available to consumers. It does not have to be so exclusively through banks."*[15]

There are successful experiences of CIT/CMC companies ensuring cash services to the population in lieu of banks and doing so on behalf of several banking institutions. There are also successful experiences of CIT/CMC companies deploying their own networks of ATMs. The cash industry can take over the responsibility of making cash available to the population.

However, our industry would face difficulty taking over the role of banks in the distribution of cash in lieu of banks unless the business environment is adapted to the activity of the CMC industry, which is obviously radically different from the context in which banks are conducting their cash operations.

[15] ESTA's response to the EPC new SECA framework ; October 2016

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The conditions for this to happen have already been outlined by ESTA, and the main ones are the following:[16]

- The business environment must allow for flexibility in the way cash is managed, together with efficient supervision and controls to ensure that customers' funds are managed safely and reliably. Imposing, as some Member States do, a strict segregation of customers' funds is a major impediment to a flexible and cost effective management of funds. If a number of countries allow for a short term mixing of customers funds under strict and proportionate supervisory rules, all countries should be able to organise a more flexible cash management environment

- Key to this is to organise mechanisms that allow customers' funds to be held off balance sheet by CMCs on behalf of national central banks and with no cost for CMCs (e.g. NHTOs or interest compensation schemes) and Member States would have to decide whether such mechanisms should be backed or not by commercial banks. Of major importance is that notes held by CMCs on behalf of the NCBs should not constitute assets of the CMC company

- The scheme should be opened to operators which have a national wide network to avoid disruptions and allowing them to operate without limitation on the entire territory of the country, whilst recirculation of notes should be based on very strict criteria for checking and controlling the fitness of note

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[16] "*ESTA's views on cash recirculation models in the context of ongoing restructuration of central banks network*", 8 February 2018; please refer to the document for the full criteria identified by ESTA

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