

Mr Paul Horlock  
CEO, Pay.UK Limited  
2 Thomas More Square  
London  
E1W 1YN

29 May 2019

## Pay.UK's programme of work to establish the UK's New Payments Architecture

Dear Paul,

We recognise the progress Pay.UK has made so far in its work to develop and deliver the New Payments Architecture (NPA), including on the competitive procurement process for the NPA's central infrastructure services (CIS). The competitive procurement of the CIS is an important step towards the safe and secure transition to a NPA that will deliver increased capacity and resilience as well as facilitating more dynamic competition and innovation in payments. As you know, we are monitoring closely the development and delivery of the NPA to assure an outcome which supports our statutory objectives. In doing so we are collaborating closely with the Bank of England, in line with its responsibilities for the supervision of systemically important payment systems and, more broadly, financial stability.

We wrote an open letter to you in January 2018 outlining four targets which we think need to be met for the NPA to be considered successful:

- Increased innovation in the payments industry;
- Effective competition across all layers of the NPA, with low entry barriers for Payment Service Providers (PSPs) and other service providers;
- The timely delivery of the NPA, with support and engagement from all stakeholders; and
- The technical robustness and resilience of the NPA.

We also articulated a number of priorities and actions for Pay.UK to consider which, addressed appropriately, would support the achievement of the four targets and we recognise the progress that is being made on those. We are aware that Pay.UK and the bidders are entering the Request for Information phase of the competitive procurement process during which the detailed technical design of the NPA ecosystem will be further developed in conjunction with bidders. This phase presents a valuable opportunity to support the achievement of the four targets, as the procurement process moves towards greater levels of detail from the bidders in terms of the technical solutions, contract terms and proposed governance arrangements.

Furthermore, just as Pay.UK has continued to develop its thinking on how it delivers this ambitious programme of work, we have continued to develop our thinking regarding the four targets as well as the supporting priorities and actions that should be considered. In the interests of transparency, we are sharing our thinking in this open letter.

In particular, we wish to outline our thinking about the risks and issues in relation to competition and innovation that could arise from potential outcomes of Pay.UK's procurement process for the NPA CIS. We do this with the aim of providing clarity to the market about the PSR's expectations of how the outcome of the CIS procurement should support the four targets listed above, and that Pay.UK (and the successful bidders where appropriate) should manage these risks and issues. We appreciate that Pay.UK will be thinking about some of these risks and issues already; as will the bidders.

### Pay.UK's competitive procurement process for NPA CIS – risks and issues to consider

A competitive CIS procurement process is a step towards effective competition in the provision of payments infrastructure. However, as we indicated in our January 2018 open letter, the NPA CIS provider will hold a unique position in the NPA ecosystem and the wider UK payments industry, and Pay.UK should ensure that it minimises the risk of the winning bidder using this position to adversely affect competition or innovation in related markets post-procurement. We have identified two post-procurement scenarios which raise *prima facie* competition issues. These are:

- 1) The NPA CIS provider also (either directly, or indirectly through commercial interests in other businesses) provides overlay services in the NPA.**
- 2) The NPA CIS provider (either directly or indirectly through commercial interests in other businesses) also provides other payment services outside the NPA ecosystem that are (currently or prospectively) substitutable for services that will be provided within the NPA ecosystem.**

As the provider of an essential and core component of the NPA ecosystem, it is important that the NPA CIS provider delivers high quality services at a fair price, in a way which results in low barriers to entry in payment services – so that the NPA delivers competition and innovation as intended. However, in the scenarios outlined above, the CIS provider might have the incentive and ability to restrict or distort competition and impede innovation.

We outline below what we see as the principal issues. These issues may be interrelated, and could materialise to some extent in both of the scenarios described above – although we see that issue 1 and 2 relate primarily to scenario 1; issues 3, 4 and 5 to both scenarios; and issue 6 primarily to scenario 2. In each case, we set out our 'in principle' concerns, but are conscious that the likely impact of these in practice will depend upon the particular facts in each case, and the extent to which Pay.UK and the bidders propose effective mitigations.

**Potential issue 1: CIS provider exploits first-mover advantage to raise barriers to entry for others**

The CIS provider may be in the unique position of being able to design and build ancillary and/or end user overlay services while the central infrastructure is being developed. It may hold information about the design of the CIS that it does not make available to other prospective overlay or ancillary service providers. As a result, other prospective service providers may be unable to develop their services in a similar timeframe because they do not have sufficient information about and/or the ability to impact the design of the NPA CIS. Additionally, through Pay.UK's incremental approach to enabling competition in the provision of technical overlays, the CIS provider would be contracted as the sole provider of some or all of the technical overlay services in the initial phase of the NPA's existence. Therefore, in addition to the potential to gain a first-mover advantage in relation to ancillary and end user overlay services, the CIS provider may be able to gain an incumbency advantage in the provision of technical overlays when these services are opened up to competition as the NPA evolves. It may also have the ability to build the central infrastructure and initial overlay or ancillary services in a way which favours itself (for example, by limiting technical interoperability or using bespoke standards which competitors may have difficulty implementing).

**Potential issue 2: CIS provider over-charges in relation to access**

Access to the CIS will be an input into many of the overlay and ancillary services sold by other providers in the NPA. If the CIS provider is able to directly or indirectly set prices for its central infrastructure services, payable by overlay or ancillary service providers, it will be able to impact the input costs faced by those providers. The CIS provider could set prices for its central infrastructure services that exceed its own efficient economic cost of provision, and this may also allow it to profitably charge prices for overlay and ancillary services which are lower than the costs of provision faced by its competitors. In this way, it could harm the competitive dynamics of the NPA ecosystem and, more generally, service users.

**Potential issue 3: CIS provider distorts prospective third-party competitors' access to the central infrastructure**

While recognising that Pay.UK will be involved in granting access to service providers, it is likely that the CIS provider will also have some involvement with granting this access, for example in facilitating the testing of new services. The CIS provider may have the ability to hinder the process for overlay service providers gaining access to the central infrastructure – the CIS provider would have the incentive to do this particularly if the prospective new overlay service might compete with a service (whether overlay or other) provided by the CIS provider.

**Potential issue 4: CIS provider gains knowledge of competitors' commercial strategies, giving it an unfair commercial advantage**

As described above, the CIS provider is likely to play a role in the process for allowing new entrants access to the CIS. This creates the possibility that the CIS provider, as a (possibly incumbent) competitor to the prospective entrant, could gain knowledge about that prospective entrant's business strategies or innovations

and therefore a commercial advantage over that entrant. The actual or perceived possibility of this occurring could deter entry, leading to reduced innovation in the NPA, or weaken the competitive pressure exerted by entrants.

**Potential issue 5: Access to and inappropriate use of NPA payments data**

The CIS provider might use knowledge gained from its processing and access to data in the NPA CIS to its advantage in its provision of other services – potentially using data obtained from one market to strengthen its position in another market within and/or external to the NPA. For example, the CIS provider’s potential preferential access to NPA payments data, both historical and ongoing, could be used to support its marketing (or other) operations, allowing it an unfair competitive advantage.

**Potential issue 6 – CIS provider deliberately fails to optimise the NPA to the advantage of another service that it provides outside the NPA ecosystem**

If the CIS provider provides competing payment services outside the NPA ecosystem, it could have the incentive and ability to affect sub-optimal development of the NPA in order to favour its services outside the NPA ecosystem. This could take many forms, including insufficient or poorly executed investment in the NPA central infrastructure, the use of commercial information to pre-empt innovation in the NPA (e.g. to develop its own innovative offerings first in its non-NPA service) and/or increasing prices to encourage users to switch away from the NPA.

## Our expectations of Pay.UK

In line with our competition, innovation and service-user objectives as set out in Part 5 of the Financial Services (Banking Reform) Act 2013 (FSBRA), we want to minimise the risk that these harmful outcomes occur. We have outlined our thinking to provide clarity and enable Pay.UK (in conjunction with the bidders where appropriate) to consider how it might mitigate these harmful potential outcomes as it progresses through the NPA CIS procurement process.

As you would expect, we will be considering what, if any, actions we should take to address any relevant issues arising from the procurement, including its outcome and, in particular, the two scenarios outlined above. In general terms, where the relevant issues are adequately addressed in the contractual provisions and detailed design of the proposals from the successful bidder, there would be less need for the PSR to rely on its regulatory powers after contract award.

As you know, we have a range of powers, including powers under FSBRA that allow us to monitor payment systems, to give directions to any participant in a regulated payment system or to require disposal of an interest in a regulated payment system (including the disposal of an interest in an infrastructure provider to the system). In deciding whether

to take action, we will consider all relevant circumstances, including consideration of what mitigations are proposed or have been put in place by Pay.UK (including, where relevant, any mitigations Pay.UK has agreed with bidders).

At this stage, Pay.UK and the bidders should bear in mind the issues raised in this letter so they can be taken into account as the procurement process progresses. Pay.UK should demonstrate to us how it has considered these issues and the approaches it proposes to use to manage them – for example in how the NPA ecosystem will be designed, how the contract(s) with the CIS provider will be structured, and what controls and arrangements Pay.UK proposes to put in place. It will also be important for bidders to consider the steps that they can take to mitigate the risks we have identified. Our view is that an appropriate time for Pay.UK to provide this information to the PSR is towards the end of the Request for Proposal (RFP) stage, before it down-selects bidders to take into the Best and Final Offer (BAFO) stage.

We look forward to continuing our engagement with you and your team on this important programme of work.

Yours sincerely,



Chris Hemsley  
**Co-Managing Director**  
**Payment Systems Regulator**