

Access to payment systems



November 2014

This Supporting Paper supports the PSR's Consultation Paper '*A new regulatory framework for payment systems in the UK*'. It specifically outlines our approach to access to payment systems that forms part of our broader overall framework for the regulation of UK payment systems.

As with all of our proposals in this consultation, they have been designed to further our objectives of promoting competition, innovation and the interests of service-users. This Supporting Paper is designed for those stakeholders who want a more detailed understanding of our proposed approach.

We are asking for comments on this Consultation Paper by 5pm, Monday, 12 January 2015.

You can send your comments and responses to our consultation questions by email to PSRconsultations@psr.org.uk.

You can also respond in writing to the address below (although we ask all respondents to also provide electronic Word and PDF versions of their response).

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Consultation response team
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We will publish all non-confidential responses to our Consultation Paper along with our final Policy Statement.

We will not regard a standard confidentiality statement in an email message as a request for non-disclosure. Stakeholders who wish to claim commercial confidentiality over specific items in their response should make sure to fill in the cover sheet accordingly, and to identify those specific items which they claim to be commercially confidential by **highlighting them in yellow**.

We may nonetheless be required to disclose all responses which include information marked as confidential, in order to meet legal obligations, in particular if we are asked to disclose a confidential response under the Freedom of Information Act 2000. We will endeavour to consult you in handling such a request. Any decision we make not to disclose a response is reviewable by the Information Commissioner and the Information Rights Tribunal.

You can download this Consultation Paper from our website: www.psr.org.uk

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A.

Introduction

- 4.1 The ability of payment service providers (PSPs) to use the services provided by payment systems to enable the transfer of funds in the UK, i.e. to access payment systems, is a priority area for us. It has implications not only for payment services provided through payment systems, but also the services provided in other markets, as highlighted by the recent Competition and Markets Authority (CMA) market studies and market investigation reference into the provision of personal current accounts (PCAs) and the provision of banking services for small and medium-sized enterprises (SMEs).¹
- 4.2 Stakeholders have also raised this with us as an area of key concern. For these reasons we are making a range of proposals to improve access.
- 4.3 We are proposing to set rules on Operators to provide access on an objective, risk-based and open basis, and to annually report on compliance by 30 June 2015. We also propose rules to improve transparency of access information as well as an initiative with Sponsor Banks to create a PSR-approved Code of Conduct governing arrangements for Indirect Access, which Sponsor Banks will then be required to comply with. To better understand the Indirect Access market, we have begun Pre-Launch scoping work in preparation for the full launch of a market review into the provision of Indirect Access services, which will formally commence by April 2015.
- 4.4 PSPs can access a payment system through either (i) a direct relationship with the Operator (Direct Access), or (ii) through a relationship with a Direct PSP of the payment system (where that PSP acts as a Sponsor Bank for the Indirect PSP) (Indirect Access).
- 4.5 This Supporting Paper is divided into four parts:
- **Part A:** this introduction.
 - **Part B:** provides background on Direct and Indirect Access to payment systems. We discuss who wants access to payment systems, as well as the eligibility requirements they need to meet.
 - **Part C:** discusses Direct Access to payment systems, a summary of relevant evidence; our assessment of concerns raised; how those issues impact on our objectives; our proposals; and costs and benefits of our proposals.
 - **Part D:** discusses Indirect Access to payment systems, a summary of relevant evidence; our assessment of concerns raised; how those issues impact on our objectives; our proposals; and costs and benefits of our proposals.

¹ See the CMA publication '*Consultation: Personal Current Accounts and Banking Services to Small and Medium-sized Enterprises – Provisional decision on market investigation reference*' (18 July 2014) – paragraphs 7-8, p5 and paragraph 3.3, p21, available at <https://www.gov.uk/government/consultations/personal-current-accounts-and-banking-services-to-smes>. See CMA press release of 6 November 2014 at <https://www.gov.uk/government/news/personal-current-account-and-small-business-banking-face-full-competition-investigation> and <https://www.gov.uk/cma-cases/review-of-banking-for-small-and-medium-sized-businesses-smes-in-the-uk>.

- 4.6 Expressions and acronyms we use are defined as appropriate in this Supporting Paper and in our *Glossary*. Where expressions are capitalised in the text (e.g. 'Operator'), a more detailed definition is included in our *Glossary*, included as *Annex 1 to our Consultation Paper*.

B. Background

- 4.7 PSPs can either have Direct Access or Indirect Access to payment systems. The population of PSPs is diverse and is made up of a number of different types of organisations. These include PSPs that are credit institutions – banks, building societies, and credit unions – and PSPs that are not credit institutions (sometimes referred to as non-bank PSPs). Non-bank PSPs include Payment Institutions (PIs) (such as non-bank card issuers) and Electronic Money Institutions (EMIs) (such as issuers of electronic pre-paid accounts for use online). Direct PSPs in interbank payment systems (except for LINK) are almost exclusively large banks/building societies.
- 4.8 In order to access a payment system, a PSP must be able to send and receive payment messages that enable the processing of fund transfers (i.e. it must have Technical Access to payment systems) as well as having a means for settlement of the financial obligations associated with the transfer of funds. PSPs must also adhere to several legal and risk management requirements.
- 4.9 Both Direct and Indirect PSPs need to gain Technical Access to payment systems. PSPs can gain Technical Access by either connecting directly into a payment system's Central Infrastructure, or indirectly, either through a Sponsor Bank's infrastructure, or sometimes through a service provided by a third-party service provider. We discuss Technical Access both in:
- **Part C** on Direct Access - in relation to the technical and operational requirements Operators set for Direct Access, including the accreditation processes that enable third-party service providers to provide Technical Access to PSPs
 - **Part D** on Indirect Access - where we discuss the concerns Indirect PSPs noted regarding their current Technical Access arrangements and the development of alternative Technical Access solutions.

Direct Access

- 4.10 PSPs with significant payment volumes usually prefer Direct Access, whereas smaller PSPs and non-bank PSPs typically rely on Sponsor Banks for Indirect Access. PSPs may favour Direct Access because:²
- it gives better control over the payment services they provide to their end-users
 - it allows them to manage any associated risks (such as system failures) more effectively
 - it gives them involvement in the governance of payment systems

² Preference for Direct Access was noted by both Indirect PSPs and Direct PSPs.

- PSPs believe it offers them a better quality of Technical Access (such as near real-time functionality in FPS) and more timely information on any issues, such as disruptions and outages
 - some PSPs have concerns with Indirect Access (we discuss this further in **Part D** below on Indirect Access).
- 4.11 Operators have established a range of Access Requirements that PSPs must meet to be eligible for Direct Access. Operators also decide the processes that PSPs must follow to gain Direct Access (such as on-boarding and periodic assurance reviews). Access Requirements are the rules (including criteria), terms or conditions (including fees and charges), policies or procedures governing access to or participation in a payment system. As part of the rules under the Access Requirements, Operators set a number of access criteria that PSPs need to meet in order to be eligible for Direct Access. Access Requirements also impose ongoing obligations and requirements on Direct PSPs. Although we are primarily concerned with the barriers to entry and expansion the Access Requirements can potentially create, we also consider the impact and constraints ongoing obligations can impose on current and prospective Direct PSPs.
- 4.12 LINK, MasterCard and Visa are all subject to Article 28 of the Payment Services Directive (PSD) (as implemented by Regulation 97 of the Payment Services Regulations 2009 (PSRs 2009)³), which includes the requirement that an Operator should have objective, proportionate and non-discriminatory rules for access to its system that do not prevent, restrict or inhibit access or participation more than is necessary. Bacs, C&CC, CHAPS, FPS and NICC⁴ are not subject to Article 28 of the PSD.
- 4.13 The table below sets out our high-level understanding of the common types of Access Requirements that PSPs need to meet in order to gain Direct Access to payment systems.

Table SP4-1: General Access Requirements across payment systems

Type of criteria ⁴	Bacs	C&CC	CHAPS	FPS	NICC	LINK	MasterCard	Visa
A) A Bank of England settlement account	✓	✓	✓	✓	✗	✗	✗	✗
B) Regulatory status	Authorised credit institution	Authorised credit institution, public authority or publicly guaranteed undertaking	Participant under Financial Markets Insolvency Regulations ⁵	Authorised PSP under PSD	Authorised credit institution, public authority or publicly guaranteed undertaking	Be regulated by an appropriate body	Financial institutions regulated or supervised by an appropriate authority	Financial institutions regulated or supervised by an appropriate authority
C) Technical and operating requirements	✓	✓	✓	✓	✓	✓	✓	✓
D) Fee requirements	✓	✓	✓	✓	✓	✓	✓	✓
E) Other requirements	✓	✓	✓	✓	✓	✓	✓	✓

³ References to Regulation 97 PSRs 2009 in this paper include references to Regulation 96 as appropriate.

⁴ BBCCL and NICC also operates a different operational business model (BBCCL's rules mirror C&CCCL's rules for cheque clearing in Great Britain and work on a "2-4-6" basis). BBCCL does not play any operational role whereas C&CCCL manages the paper exchange, IBDE network, clearing and settlement through the Bank. An equivalent of the IBDE network does not exist in Northern Ireland; instead there is daily bilateral exchange and net bilateral settlement between the four banks which are Direct PSPs of NICC.

⁵ PSR background paper 'Access to UK Payment Systems' (June 2014) - p12, available at <http://www.fca.org.uk/your-fca/documents/workshops-access-background-material> and our understanding of the common Access Requirements for card payment systems.

⁶ This can include authorised credit institutions or EMLs.

4.14 The Operators' rationale for the access criteria they set is summarised below:

Table SP4-2: Rationale for general Direct Access criteria

Type of criteria	Rationale
A. A Bank of England settlement account	Allows interbank funds to be cleared and settled efficiently with other system PSPs
B. Regulatory status	Organisations that are authorised and regulated to ensure the integrity of the systems
C. Technical and operating requirements	Provides for compatibility with payments infrastructure and safeguards against system compromise
D. Fee requirements	Provides for the recovery of the system's costs, both transactional and operational, as well as a return on capital where relevant.
E. Other requirements, including legal and risk management requirements	Provides a legal framework that governs the operation of the system and maintains the credibility and effective functioning of the system

4.15 Although these categories of Access Requirements are common across Operators, there may be additional requirements specific to the particular payment system.⁷ The scope of the Access Requirements may also vary between payment systems. These differences are discussed further below with reference to the concerns raised regarding Access Requirements for specific payment systems (see **Part C**).

4.16 The number of Direct PSPs in each payment system varies, as does the rate of growth in direct participation.⁸

- With regard to the interbank payment systems, LINK and CHAPS have the largest number of Direct PSPs, followed by Bacs, C&CC, FPS and then NICC (see **Table SP4-3** below). FPS, NICC and C&CC have had no new Direct PSPs join their respective systems within the last six years.⁹ CHAPS recently experienced an increase in Direct PSPs due to the the Bank of England's (the Bank) de-tiering initiative,¹⁰ having on-boarded two new Direct PSPs in the last two years, with four more Direct PSPs due to join in 2015.¹¹ LINK has had five new Direct PSPs join during the past five years.¹²
- Card payment systems have also recently on-boarded a number of new members or licensees (Direct PSPs). Visa had nine new members in the UK in the year to April 2014, which

7 For more information see each Operator's website and the PSR background paper 'Access to UK Payment Systems' (June 2014) – pp 23–41, available at <http://www.fca.org.uk/your-fca/documents/workshops-access-background-material>.

8 Direct participation refers to having Direct Access to a payment system.

9 FPS was launched in 2008 and had no new Direct PSPs join since then. However, an Indirect PSP recently secured Direct Agency Access to FPS. No new Direct PSPs have joined NICC since BBCCL (the system Operator) was formally established in 2007. The last new Direct PSP was admitted into C&CC in the 1990s.

10 See the Bank's 'Payment Systems Oversight Report 2012/13' (March 2013) - p1, available at <http://www.bankofengland.co.uk/publications/Documents/psor/psor2012.pdf>. Also see the Bank's Quarterly Bulletin article on de-tiering 'Tiering in CHAPS' (Q4 2013), available at <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2013/qb130408.pdf>.

11 CHAPS Co press releases 'Handelsbanken joins CHAPS Co' (11 November 2013), 'CHAPS Co welcomes BNY Mellon as a Direct Participant' (19 May 2014), and 'Five International Banks to join CHAPS' (20 December 2013), available at http://www.chapsco.co.uk/media/press_releases/, and CHAPS Co response to *Payment Systems Regulator: Call for Inputs* (15 April 2014) - p21.

12 This included two challenger banks, and three ATM deployers.

included four PIs, four EMIs and a credit institution.¹³ MasterCard had six new Principal licensees and one new Affiliate licensee join in the year to July 2014.

- 4.17 There is currently significant interest in gaining Direct Access to payment systems. Operators (of Bacs, CHAPS, FPS and LINK) notified us that there are at least 48 PSPs (including challenger banks, EMIs and PIs) currently engaging with them on gaining Direct Access (see **Table SP4-3** below).¹⁴ Some PSPs are seeking to obtain Direct Access to more than one payment system. The majority are engaging with the Operators of FPS and CHAPS, but a significant number are also working with the Operators of Bacs and LINK. We are not aware of any PSPs currently engaging with C&CCCL¹⁵ or BBCCL in relation to securing Direct Access. We do not have comparable information for MasterCard and Visa, although as noted above, there seems to be significant interest in joining these card payment systems.
- 4.18 **Table SP4-3** presents (i) the current number of Direct PSPs in each system; and (ii) the number of PSPs currently engaging with Operators to secure Direct Access.

Table SP4-3: PSPs currently negotiating to secure Direct Access vs. current direct participation¹⁶

System	Current Direct PSPs	PSPs engaging with each Operator
Bacs	16	5
C&CC	11	0
CHAPS	21	14
FPS	10	32
LINK	37	6
NICC	4	0

Indirect Access

- 4.19 Indirect Access is the arrangement by which Indirect PSPs access payment systems indirectly through agreements with certain Direct PSPs known as Sponsor Banks. These arrangements enable Indirect PSPs to provide payment services to their own end-users.
- 4.20 Indirect PSPs – which typically include smaller and challenger credit institutions, EMIs and PIs – provide payment services to end-users but do not have Direct Access to a payment system themselves. There is a very large number of PSPs with Indirect Access to payment systems.¹⁷ The needs of PSPs are similarly diverse and their characteristics are typically determined by the demands of the end-users they service, technical capabilities and regulatory status in the UK.

¹³ Visa Europe response to *Payment Systems Regulator: Call for Inputs* (15 April 2014) - p20.

¹⁴ These PSPs are in various stages of negotiations, with some only expressing interest, while others are in the final stages of on-boarding.

¹⁵ However, we understand that C&CCCL have been engaging with some PSPs about potential options for participating in the new clearing model that would flow from the implementation of cheque imaging (see paragraph 4.58).

¹⁶ The number of current Direct PSPs is also available on each Operator's website. For the figures on Current Direct PSPs, the total for Bacs, C&CC and CHAPS includes the Bank, and separate entries for Bank of Scotland and Lloyds Bank (both part of Lloyds Banking Group (LBG)) and for National Westminster Bank and the Royal Bank of Scotland (both part of RBS Group). For LINK, the total includes separate entries for Bank of Scotland, Halifax and Lloyds Bank (all part of LBG) and some non-PSPs that are ATM deployers. The number of PSPs engaging with each Operator was confirmed by each of the Operators in late October 2014.

¹⁷ There are significantly more PSPs with Indirect Access than there are PSPs with Direct Access (as set out in Table SP4-3 above). In the UK there are around 280 banks and building societies, 570 credit unions, 50 EMIs and over 1,000 PIs.

- 4.21 A separate but related category is corporate banking customers, who in the course of their normal business generate large volumes of payments (e.g. payment of staff salaries and suppliers, direct debit origination for bill payment). Corporate banking customers may have a type of 'access' to payment systems. However, we do not consider corporate banking customers to be PSPs, as they do not provide services to persons who are not participants in the system 'for the purposes of enabling the transfer of funds using the payment system', which is the definition of PSP in section 42(5) of the Financial Services (Banking Reform) Act 2013 (FSBRA). Instead, we consider corporate banking customers to be end-users of payment services provided by PSPs with access to payment systems.
- 4.22 There are a range of reasons why a PSP may choose to access interbank payment systems indirectly rather than directly, including:
- the inability to meet Access Requirements for Direct Access and in particular the technical requirements
 - economic considerations such as the size and type of payment services provided to its end-users
 - a desire to avoid the governance requirements associated with Direct Access (please see *Supporting Paper 3: Ownership, governance and control of payment systems*).
- 4.23 Indirect PSPs will use one or more Sponsor Banks to gain access to a payment system.¹⁸ The Direct PSPs that currently offer the vast majority of the sponsoring services to Indirect PSPs are Barclays, HSBC, Lloyds and RBS.¹⁹ The Co-operative Bank also provides sponsoring services, but it is currently in the process of ceasing these activities.²⁰ These four main Sponsor Banks offer access to the four main UK interbank payment systems (Bacs, C&CC, CHAPS and FPS).²¹
- 4.24 Within the sections that follow, we consider in more detail Direct and Indirect Access to payment systems.

18 Our questionnaire on access to interbank payment systems indicated that around 70% of Indirect PSPs with Indirect Access that responded used only one Sponsor Bank (Analysis of the PSR Questionnaire on Access (Interbank) – question 1.4).

19 Our questionnaire on access to interbank payment systems indicated that these four banks account for around 90% of Sponsor Bank relationships with the Indirect PSPs that responded (Analysis of the PSR Questionnaire on Access (Interbank) – question 1.4).

20 The Co-operative Bank response to *Payment Systems Regulator: Call for Inputs* (15 April 2014) – p6.

21 Direct PSPs can also offer Indirect Access to card payment systems. However, as set out below in paragraph 4.193, Indirect Access to card payment systems is much less common than for interbank payment systems. For the LINK payment system, there are no Indirect Access arrangements.

C.

Direct Access to payment systems

What are the issues?

- 4.25 When considering Direct Access to payment systems, we are primarily concerned with the Access Requirements and the barriers that Operators may create, whether knowingly or not, to PSPs gaining Direct Access.
- 4.26 Where Direct Access is restricted to certain types of PSPs, or is difficult to secure, it can act as a barrier to entry for new and emerging PSPs. This can impact on:
- competition in the provision of payment services
 - the development of new payment services and the speed at which they can be brought to the market
 - the development of, and innovation, in payment systems
 - the experience of service-users.
- 4.27 All of these may have significant implications for our objectives. We therefore have a strong interest in ensuring that Direct Access arrangements function effectively.
- 4.28 As set out above, there is potential for a substantial increase in the number of Direct PSPs to these systems.²² A key consideration for us is whether those seeking Direct Access can reasonably do so or, if not, what is preventing them from becoming Direct PSPs.
- 4.29 In this section we discuss Direct Access to regulated payment systems (i.e. Bacs, C&CC, CHAPS, FPS, LINK, NICC, MasterCard and Visa if Treasury designates the systems it is consulting on).²³ In relation to these payment systems, our stakeholders raised concerns regarding:
- the Access Requirements, and the application of such requirements, for gaining and maintaining Direct Access to payment systems
 - the transparency and availability of information for PSPs considering Direct Access
- 4.30 Many stakeholders expressed concerns over the difficulties associated with gaining Direct Access to payment systems and told us that Direct Access was too onerous and complex.²⁴ We have

²² For example, if half of those currently engaging with FPSL were to become Direct PSPs, then this would result in the number of Direct PSPs being more than twice as high as the current number.

²³ Please note that for MasterCard and Visa we are treating Principal membership/licensees as the equivalent to Direct Access in interbank payment systems. We will refer to Direct Access to both card and interbank payment systems throughout in this section.

²⁴ Twenty-two stakeholders noted this in their responses to the *Payment Systems Regulator: Call for Inputs*.

also heard that the differences in the Access Requirements between payment systems increases the cost and complexity for any PSP seeking Direct Access to multiple payment systems.

- 4.31 Some of the Operators, in particular FPS²⁵ and CHAPS,²⁶ have started taking steps towards considering ways to address PSPs' concerns.
- 4.32 Within the rest of this section we discuss the concerns relating to Access Requirements, and the concerns relating to the transparency and availability of information in turn.

Concerns relating to Access Requirements

- 4.33 Stakeholders, and in particular those PSPs seeking to gain Direct Access to payment systems, raised concerns about the different Access Requirements (including the rules and criteria) that need to be met to gain Direct Access to payment systems. Concerns were also raised by existing Direct PSPs and by third party providers. These Access Requirements can be summarised as relating to:
- a Bank of England settlement account
 - regulatory status
 - technical and operating requirements
 - fee requirements
 - other requirements such as legal and risk management requirements
- 4.34 We consider the costs that PSPs incur in gaining Direct Access to payment systems as part of what is required to comply with the relevant Access Requirements imposed by Operators (and in particular the technical and operational requirements), to be distinct from the initial and ongoing fees that Operators charge (as negotiated with Infrastructure Providers) for Direct Access to payment systems. In this Supporting Paper, when we refer to fees or fee requirements we are referring to the fees charged to meet Operators' Access Requirements.
- 4.35 For each category, stakeholder concerns varied by payment system. We have set out below the concerns raised for each payment system with reference to the relevant category of Access Requirements.

Bank of England settlement account requirements

Bacs, C&CC, CHAPS and FPS

- 4.36 One of the requirements for Direct Access to Bacs, C&CC, CHAPS and FPS is that a PSP must hold its own settlement account at the Bank.²⁷ Consequently Direct Access to these payment

²⁵ Two of FPSL's strategic objectives are to improve the ubiquity of the end-user propositions for the system, and the ease with which PSPs can access FPS. In autumn 2013, FPSL created a new Business and System Development team to oversee changes to FPS. It identified the need for more resources, and has recruited two new positions. FPSL told us that it has developed a segmentation of Direct and Indirect PSPs using the system in order to better understand their needs. FPSL has formed an Access Working Group to map the various issues as identified against each segment, including considering proposals for different settlement options to address some concerns.

²⁶ Following representations by the Bank, the CHAPS Co Board approved a proposal in Q4 2013 to undertake a full revision of the existing CHAPS rules, requirements and procedures. We understand that the exercise consisted of an extensive review of the existing documentation, with a view to reviewing and collating all information and participation requirements (including Access Requirements) that could reasonably be construed as proportionate requirements placed upon PSPs into a single CHAPS Manual and for this to reflect the introduction of Participation Categorisation in July 2014. The proposed revised rule set is undergoing an internal and external legal review (that is still ongoing). The proposed revised rule set will be going to the CHAPS Governance and Discipline Committee on 4 November 2014, after which it will go out for consultation to the wider community that participate in CHAPS.

²⁷ For NICC, net settlement occurs on a bilateral basis between each Direct PSP through CHAPS payments. See BBCCL response to *Payment Systems Regulator: Call for Inputs* (3 April 2014) – p1.

systems is dependent on the Bank's legal and policy framework that governs eligibility for settlement accounts.²⁸

- 4.37 Many non-bank PSPs, in particular EMIs and PIs, have told us that they want Direct Access, but are unable to become Direct PSPs as they do not qualify for a settlement account at the Bank and must therefore rely on a Sponsor Bank for Indirect Access.
- 4.38 The Bank's current settlement account policy does not include EMIs and PIs as institutions eligible for settlement accounts. The Bank has noted that it regularly reviews its settlement account policy and the case for incorporating additional cohorts of institutions, such as EMIs, within the eligibility criteria should there be a clear case to do so.
- 4.39 We also note that at least five PIs and three EMIs are currently engaging with Operators to explore alternative Direct Access options that may not be reliant on gaining access to a settlement account, such as Direct Technical Access (see paragraphs 4.52 to 4.64 below).²⁹ FPSL, for example, is considering the development of different settlement models to overcome this constraint.
- 4.40 It is our understanding that, in setting Access Requirements, in particular the requirement to have a settlement account, the Operators have regard to the protections afforded to the designated payment systems (i.e. Bacs, C&CC, CHAPS, and FPS) under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (FMIRs), which are limited to credit institutions and EMIs. The Bank is the competent authority for this legislation in the UK. This legislation is aimed at reducing the systemic risk associated with participation in payment and securities settlement systems, and in particular the risk linked to the insolvency of a participant in such a system. The FMIRs were amended to extend their scope to include EMIs in 2010, and already covered credit institutions. Other PSPs, such as PIs, that may participate in designated payment systems are not covered by these regulations.
- 4.41 In order to extend the same considerations and protections to PIs, without jeopardising financial stability considerations, the applicable scope of the FMIRs would need to be extended, as PIs are not currently covered within this legislation.³⁰

NICC

- 4.42 PSPs do not need a Bank settlement account to secure Direct Access to NICC. Settlement for NICC takes place through CHAPS (for which they need to either have Direct or Indirect Access), not through the direct use of a Bank settlement account.³¹

LINK

- 4.43 A PSP must have access to a settlement account at the Bank to be eligible for Direct Access to LINK, but it does not need to hold the settlement account at the Bank itself. Rather, a PSP could use a Sponsor Bank to provide settlement account services and still be a Direct PSP of LINK.

MasterCard and Visa

- 4.44 A Bank settlement account is not a requirement for Direct Access to either MasterCard or Visa. Visa recently began using the Bank as a settlement agent, enabling its members (Direct PSPs) to settle through settlement accounts at the Bank.³²

²⁸ Also see the following document for more information:

<http://www.bankofengland.co.uk/markets/Documents/paymentsystems/boesettlementaccounts.pdf>.

²⁹ The number of PSPs engaging with each Operator was confirmed by each of the Operators in late October 2014.

³⁰ For details of the current application of the Settlement Finality Directive provision in the UK, see the Treasury's document '*Implementation of EU Directive 2009/44/EC on Settlement Finality and Financial Collateral Arrangements: Summary of Responses*' (November 2010), available at

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/190175/implementation_eudirective2009.pdf.

³¹ BBCCL response to *Payment Systems Regulator: Call for Inputs* (3 April 2014) – p1.

³² Treasury's consultation '*Designation of the Payment Systems for Regulation by the Payments Systems Regulator*' (14 October 2014) – section 3.7 (b), available at

<https://www.gov.uk/government/consultations/designation-of-payment-systems-for-regulation-by-the-payment-systems-regulator>.

Regulatory status

Bacs

- 4.45 In order to gain Direct Access to Bacs, PSPs are required to be authorised credit institutions.³³ BPSL noted that they are currently reviewing this requirement. Some EMLs and PIs submitted to us that they would like to have Direct Access to Bacs if the Access Requirements permitted this.

CHAPS

- 4.46 CHAPS Co noted that an eligible PSP must *“be a participant which falls within the definition of a participant under FMIRs”*.³⁴ However, although the participants under the FMIRs can include EMLs (but not PIs),³⁵ given that CHAPS Co still requires prospective Direct PSPs to have access to a settlement account, Direct Access is effectively only available to credit institutions.³⁶

FPS

- 4.47 FPSL requires Direct PSPs to be ‘authorised PSPs’ as defined under the PSRs 2009. This may include not only credit institutions, but also EMLs and PIs. However, given that FPSL still requires prospective Direct PSPs to have access to a settlement account, Direct Access is effectively only available to credit institutions at present.³⁷

C&CC and NICC

- 4.48 C&CCCL and BBCCL require Direct PSPs to be an authorised credit institution, public authority or publicly guaranteed undertaking. Stakeholders did not raise any concerns about this criterion for gaining access to C&CC and NICC.

LINK, MasterCard and Visa

- 4.49 Since the introduction of the PSD, the type of organisations eligible to join the card payment systems as licensees or member (i.e. Direct PSPs) has broadened to include a number of non-bank institutions (such as PIs). For an organisation to become a member or licensee of a card payment system, it must be regulated by the competent authority for the country in which it is based (in the UK, this is the FCA).
- 4.50 Direct PSPs in LINK are also significantly more diverse than for the other interbank payment systems, and include a number of challenger banks and non-bank ATM deployers.
- 4.51 PSPs did not raise any concerns regarding the regulatory status criterion for gaining Direct Access to LINK, MasterCard and Visa.

Technical and operating requirements

Bacs and CHAPS

- 4.52 While stakeholders did not identify specific concerns regarding the technical and operating criteria and requirements for getting Direct Access to Bacs and CHAPS, there was a general belief that the technical and operating criteria and requirements are too onerous and require the commitment of significant time and resources to adhere to. Stakeholders also noted that the difference in the technical and operating criteria and requirements across the different payment systems creates unnecessary complexities.
- 4.53 Bacs offers Indirect PSPs Direct Technical Access to its payment system. Third parties and service bureaux³⁸ can also access Bacs directly as accredited providers of Technical Access services to Direct and Indirect PSPs.

33 See BPSL’s ‘CPSS-IOSCO Disclosure for Bacs Scheme Payments Limited 2013’ (December 2013), available at http://www.bacs.co.uk/Bacs/DocumentLibrary/CPSS-IOSCO_disclosure_for_Bacs_payment_schemes.pdf.

34 See CHAPS Co ‘Joining CHAPS’, available at http://www.chapsco.co.uk/participation/joining_chaps/.

35 See paragraph 4.40 above on FMIRs.

36 See CHAPS Co ‘2014 CHAPS Co FMI disclosure report’ (April 2014), available at http://www.chapsco.co.uk/files/chaps/chaps_cpss_iosco_summary_report_final.pdf.

37 See FPSL’s ‘CPSS-IOSCO Self-Assessment Public Disclosure for Faster Payments Scheme Limited’ (July 2014), available at <http://www.fasterpayments.org.uk/sites/default/files/FPSL%20FMI%20PUBLIC%20Disclosure%20Summary%20Report%202014%201.0.pdf>.

38 Service bureaux provide an outsourced service for the submission and processing of payments on behalf of service-users. The bureaux may also provide a range of value-added services (such as payroll processing).

- 4.54 We note that CHAPS Co is currently in the process of reviewing the application of its Access Requirements and is considering whether to adopt a more risk-based approach. CHAPS Co anticipates that new Direct PSPs, and in particular smaller PSPs looking to join CHAPS, may potentially fall into a category of Direct PSP which faces less onerous technical and operating criteria and requirements. The technical criteria and requirements CHAPS imposes on PSPs are partly due to the requirements of the Bank, which provides infrastructure for CHAPS through the Bank's Real Time Gross Settlement (RTGS) system.³⁹ The use of the Bank's RTGS system requires PSPs or service-users to meet certain technical requirements, and any changes to these must not impact on payment system infrastructure integrity.

LINK and NICC

- 4.55 We are not aware of any stakeholder concerns over the technical and operating criteria and requirements for Direct Access to LINK and NICC.

C&CC

- 4.56 Stakeholders raised concerns over the technical criteria and requirements associated with C&CC - one challenger bank noted that the requirements for Direct Access to C&CC were particularly onerous relative to the other interbank payment systems (this also relates to the fee requirements as set out in paragraph 4.66 below).

- 4.57 A number of other stakeholders noted the lack of sort code portability in relation to cheque processing, which limits them from becoming Direct PSPs or changing their Indirect Access arrangements. C&CCCL told us that the difficulties in sort code portability stemmed from the current paper processing model in use, which underpins the technical requirements for securing Direct Access at present (under which sort code changes generate significant system reconfiguration requirements).⁴⁰

- 4.58 C&CCCL noted⁴¹ that the new clearing model that would flow from the implementation of cheque imaging⁴² may lower the cost and fees (see further below) of securing access – in particular, by removing the reliance that the current processing arrangements puts on the first two digits of sort codes for the sorting of cheques. C&CCCL noted that this new clearing process is being designed to enable easy access to the clearing system by smaller PSPs, and that C&CC access arrangements will be changed accordingly.⁴³

FPS

- 4.59 A significant number of PSPs are concerned that technical criteria and requirements for FPS may inhibit their ability to secure Direct Access to FPS. We understand that the requirement to be able to comply on a continuous '24/7' basis (i.e. 24 hours a day, 7 days a week, 365 days a year) with the technical and operational requirements can be particularly onerous.⁴⁴

- 4.60 Only one Indirect PSP has Direct Technical Access arrangements for FPS (also known as Direct Agency Access⁴⁵) – securing Direct Technical Access through a third-party provider, without becoming a Direct PSP of FPS.

39 Although the Bank provides the infrastructure for CHAPS through the Bank's RTGS system, the Bank is not 'an Infrastructure Provider' within the meaning of FSBRA, as it is not considered as a participant of any kind in any payment system in accordance with s.42(8) FSBRA.

40 C&CCCL response to *Payment Systems Regulator: Call for Inputs* (14 April 2014) – pp 5 and 7.

41 C&CCCL response to *Payment Systems Regulator: Call for Inputs* (14 April 2014) – pp 5 and 7, and C&CCCL's letter '*C&CCCL Response to HMT Consultation Published 6th March 2014 "Speeding Up Cheque Payments: Legislation for Cheque Imaging"*' (21 March 2014) – p5, available at [http://www.chequeandcredit.co.uk/files/candc/press/05_letter_to_hmt_re_response_on_speeding_up_cheque_payments_\(21march14\).pdf](http://www.chequeandcredit.co.uk/files/candc/press/05_letter_to_hmt_re_response_on_speeding_up_cheque_payments_(21march14).pdf).

42 The Government is working with industry to identify the most appropriate date for implementation of cheque imaging, and intends to bring new legislation into force to meet the identified timetable. See the Treasury's publication '*Speeding Up Cheque Payments: Summary of Responses*' (June 2014) – p4, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/322753/PU1680_final__2_.pdf.

43 C&CCCL response to *Payment Systems Regulator: Call for Inputs* (14 April 2014) – p5, and C&CCCL's letter '*C&CCCL Response to HMT Consultation Published 6th March 2014 "Speeding Up Cheque Payments: Legislation for Cheque Imaging"*' (21 March 2014) – p2, available at [http://www.chequeandcredit.co.uk/files/candc/press/05_letter_to_hmt_re_response_on_speeding_up_cheque_payments_\(21march14\).pdf](http://www.chequeandcredit.co.uk/files/candc/press/05_letter_to_hmt_re_response_on_speeding_up_cheque_payments_(21march14).pdf).

44 FPSL response to *Payment Systems Regulator: Call for Inputs* (14 April 2014) – p5.

45 Direct Agency Access still requires the use of a Sponsor Bank for the provision of settlement services.

- 4.61 Some PSPs noted that there is demand to develop alternative Technical Access options (also see **Part D** below on Indirect Access). Technology providers told us they are looking at developing Technical Access solutions that would enable Indirect PSPs to gain improved Technical Access, and in particular Direct Technical Access, to FPS and potentially also to other payment systems.
- 4.62 PSPs and third-party providers of Technical Access solutions said there was a need for FPS to have adequate accreditation processes in place. Accreditation processes that ensure that a person or solution is compliant with a set of criteria predefined by the Operator could facilitate Direct Technical Access, and the development of Technical Access solutions.
- 4.63 FPSL told us that it is considering ways in which a risk-based assessment of different types of service-users could lead to changes to the technical requirements that could reduce up-front and ongoing technical connection costs for PSPs, including ways to facilitate the development of Technical Access solutions by third-party providers.⁴⁶

MasterCard and Visa

- 4.64 While stakeholders raised no specific concerns over the technical and operating criteria for securing Direct Access to the card payment systems, some provided general comments that the MasterCard and Visa technical criteria and requirements are onerous and complex.

Fee requirements

Bacs, CHAPS, FPS and NICC

- 4.65 There were no concerns expressed about the initial and ongoing fees that are charged for usage of these payment systems.

C&CC

- 4.66 There is an initial fee for joining C&CC. The fee is determined on a cost-recovery basis, taking into account the costs that C&CCCL and all existing Direct PSPs expect to incur in admitting the new Direct PSP into the C&CC system.⁴⁷ A challenger bank that had considered Direct Access to C&CC told us that the single highest expense associated with gaining Direct Access to C&CC results from the fees charged by existing Direct PSPs' to enable them to accept a new PSP's sort code into the process. These fees will not be known or easily ascertained up-front, given that new Direct PSPs will need to negotiate the fees of access with existing Direct PSPs (also see paragraphs 4.56 to 4.58 above in relation to the technical and operational requirements for C&CC).

LINK

- 4.67 A small number of LINK's Direct PSPs raised concerns over the interchange fee arrangements within the payment system, and their limited ability to influence the level of this fee.

MasterCard and Visa

- 4.68 Interchange fees were the focus of the majority of the concerns raised by stakeholders regarding fee arrangements for MasterCard and Visa.⁴⁸

Other requirements including legal and risk management requirements

- 4.69 Stakeholders raised limited concerns with us about other Access Requirements imposed by Operators. Below we only discuss those where stakeholders raised particular issues.

Bacs, CHAPS and FPS

- 4.70 Stakeholders raised issues regarding the legal requirements imposed by BPSL, CHAPS Co and FPSL, and whether they are all relevant or necessary. For example, CHAPS Co may require a

⁴⁶ FPSL has told us that it will adopt a formal risk appetite framework for the system, and is considering how it can factor in the size of PSPs and their relative contributions to the systemic risks in the system. FPSL have said that, based on its new risk appetite, it will review the minimum necessary Direct PSP availability requirements for smaller PSPs. It is also exploring potential solutions for Technical Access to the payment system to reduce the complexity and costs for Direct Access by having discussions with potential bureaux and aggregator service providers.

⁴⁷ See C&CCCL 'Direct Access to the Cheque and Credit Clearing System', available at http://www.chequeandcredit.co.uk/about_us_and_our_members/eligibility_criteria/-/page/2881/.

⁴⁸ We discuss card interchange fees further in *Supporting Paper 5: Interchange fees*.

prospective Direct PSP to provide a legal opinion, and the Direct PSP is charged by CHAPS Co for any external legal fees that CHAPS Co may incur in the on-boarding process.⁴⁹

- 4.71 Other stakeholder concerns were raised in relation to credit and liquidity risk management criteria for Bacs and FPS (with reference to the loss-sharing agreements they have in place⁵⁰). The current loss-sharing arrangements implemented by the Operators created some concerns for smaller and prospective PSPs looking to gain Direct Access. We understand that the Operators of Bacs and FPS will be introducing pre-funding arrangements as a new means of managing credit and settlement risk, whereby each Direct PSP will pledge collateral to cover their daily net payments.⁵¹ We were told that the move away from the loss-sharing arrangements amongst Direct PSPs will make Direct Access to Bacs and FPS more attractive to smaller PSPs, as they would only need to make provision for the risks they bring to the system (rather than fund a broader risk-sharing mechanism).
- 4.72 However, some stakeholders noted that pre-funding may introduce a concern for EMIs and Pls if they become eligible for Direct Access in the future. These institutions may have particular difficulties in providing the required collateral under a pre-funding model.
- 4.73 Some stakeholders also raised concerns relating to the risks that the Bacs Direct Debit Guarantee scheme imposes on PSPs that participate within that system.⁵²

C&CC, LINK and NICC

- 4.74 We are not aware of any other major concerns with C&CC, LINK and NICC around other Access Requirements imposed by these Operators.

MasterCard and Visa

- 4.75 Only a small number of PSPs raised concerns over the risk and liquidity management requirements (in particular the collateral requirements⁵³) of the card payment systems.

Our assessment of the concerns relating to Access Requirements

- 4.76 There appears to be unmet demand for Direct Access in payment systems, with the requirements for gaining access acting as a barrier to entry.
- 4.77 There are legitimate reasons for imposing certain requirements upon Direct PSPs, particularly to ensure the continuing integrity and resilience of payment systems. However, where such requirements, or the application of such requirements are not proportionate, it can limit access and restrict competition and innovation in the provision of payment services, and the development of infrastructure.
- 4.78 The concerns raised by stakeholders highlighted the discrepancies between various requirements imposed by Operators, e.g. the requirements relating to a PSP's regulatory status. There may be objective reasons for these differences between payment systems, but the purpose of the criteria requires clear and adequate justification.

49 If required, a PSP must provide a legal opinion regarding, amongst other things, the institution's capacity to execute and be bound by the CHAPS Rules. CHAPS Co 'CHAPS Scheme Rules' (24 February 2014) – p9, available at http://www.chapsco.co.uk/files/chaps/governance_documents/chaps_co_rules.pdf.

50 Under these arrangements, Direct PSPs must pool their collateral and the total must be sufficient to cover the net settlement of the largest Direct PSPs.

51 FPSL response to *Payment Systems Regulator: Call for Inputs* (14 April 2014) – pp 12-13, and BPSL document '*CPSS-IOSCO Disclosure for Bacs Payment Scheme 2013*' (December 2013) - p11, available at http://www.bacs.co.uk/Bacs/DocumentLibrary/CPSS-IOSCO_disclosure_for_Bacs_payment_schemes.pdf.

52 The Direct Debit Guarantee scheme provides end-users using direct debits a '*money back guarantee*'. The Guarantee is offered by all banks and building societies that accept instructions to pay Direct Debits. Customers are entitled to a full and immediate refund. See BPSL '*Your customers rights*', available at: <http://www.bacs.co.uk/Bacs/Businesses/DirectDebit/Collecting/Pages/CustomerRights.aspx>.

53 PSPs with access to card payment systems may be required to provide collateral (as funds deposited or otherwise) as security. See for example, MasterCard Rules – p28, available at: http://www.mastercard.com/us/merchant/pdf/BM-Entire_Manual_public.pdf.

4.79 We want to ensure that Access Requirements for Direct Access and the application of such requirements are appropriate and proportionate and do not unnecessarily prevent potential Direct PSPs from gaining Direct Access to payment systems. Operators need to consider the Access Requirements they set and the application of such requirements to determine if they are proportionate and appropriate. In paragraphs 4.123 to 4.148, we set out our proposals to achieve this.

Bank of England settlement account

4.80 Operators need to consider the access criteria they set, and the way in which they apply those requirements, including, in particular, whether having a settlement account at the Bank is a necessary requirement.

4.81 We note that there may be alternative solutions or settlement models to consider, given that having a settlement account is not an eligibility criterion applicable to all payment systems.

4.82 We expect Operators to continue to consider ways in which to broaden access to a wider set of eligible PSPs.

Regulatory status

4.83 The required regulatory status of prospective PSPs varies between payment systems. For example, the Operators of CHAPS and FPS in principle allow a broader set of PSPs access to their payment systems, whereas BPSL restricts participation to credit institutions. It is not obvious what the rationale or policy approach is for the differing regulatory status requirements of each payment system.

4.84 LINK, MasterCard and Visa have broader and more open regulatory status criteria and allow both credit and non-credit institutions to have Direct Access to their payment systems. The broader participation criteria which card payment systems have may also be a contributing factor to the greater number of new Direct PSPs joining the card payment systems (see paragraph 4.49 above).

4.85 We consider that broader access to payment systems for different types of PSPs, or just the threat of it, can encourage greater competition between Direct PSPs in payment services, which may introduce innovation and new technologies and lead to more competitive services and greater choice for end-users.

Technical and operating requirements

4.86 There is a significant level of stakeholder concern, in particular from smaller or challenger PSPs, about meeting the technical and operating requirements applied by Operators and ensuring ongoing compliance with these requirements. This creates concerns for us around whether the initial and ongoing technical and operating requirements imposed by Operators are appropriate or unnecessarily burdensome or disproportionate to the risk such a new PSP introduces to the payment system.

4.87 Although the majority of stakeholder concerns raised were related to FPS, given the general concerns expressed by stakeholders that the technical and operating requirements imposed by the Operators are onerous and require the commitment of significant time and resources to adhere to, we believe it is also important to consider the technical and operating requirements of the other Operators.

4.88 Stakeholder concerns over accreditation arrangements for Technical Access highlight the question of whether there are other features of the Access Requirements for Direct Access which unduly inhibit (or do not sufficiently facilitate) the development of alternative Technical Access options.

4.89 We acknowledge the steps currently being taken by the Operators of Bacs, CHAPS and FPS to review their Access Requirements (including the access criteria), or the application thereof

(including introducing or changing accreditation processes for Technical Access), so as to reduce the costs and complexity associated with securing Direct Access to those payment systems.

4.90 For Technical Access in particular we consider:

- A more risk-based approach (e.g. requirements that are more commensurate with the size of PSPs and/or the systemic risks posed by PSPs to the payment system) which may result in changes to technical and operating requirements (including the way in which such requirements are applied to different PSPs) that could reduce up-front and ongoing technical connection costs.
- Changes that facilitate the development of Technical Access solutions, such as the development of accreditation arrangements, which could promote other ways for PSPs to reduce such costs.

4.91 The specific technical concerns, regarding the lack of sort code portability in relation to cheque processing, might be addressed through the development of the new clearing model for C&CC. Options for this new model are currently under consideration by C&CCCL.⁵⁴ We have not been involved in this process to date, but will consider the development of this going forward (see *Supporting Paper 2: Payments industry strategy and areas for collaboration*). It will be important to ensure that the new clearing model will provide appropriate opportunities for future Direct Access to C&CC.

4.92 Although we consider it very important for Operators to consider ways or solutions that may reduce the cost and burden for PSPs associated with gaining Direct Access, we must however have regard to financial stability considerations, and as such would be concerned by any potential changes to the technical and operating requirements for Direct Access that may adversely impact upon the integrity and financial stability of the payment systems.

Fee requirements

4.93 As set out above, we view the cost associated with gaining Direct Access as part of the Access Requirements considered above (and in particular the technical requirements that Operators impose), and therefore as distinct from fee arrangements for ongoing Direct Access to payment systems.

4.94 Given the limited extent of stakeholder concerns raised with initial and ongoing fees associated with Direct Access, we have not assessed the ongoing fees for Direct Access to payment systems in depth. As set out above, we believe concerns raised by stakeholders regarding C&CC will be addressed by the new clearing model being developed. We also consider the matter of interchange fees in *Supporting Paper 5: Interchange fees*.

4.95 We note that fixed fees related to operating and managing payment systems can have an impact on the average cost per transaction for relatively small or challenger PSPs. Some Operators have recently reduced or eliminated these fixed fees (e.g. at the end of 2013, FPSL removed the requirement for Direct PSPs to pay a minimum of 2% of the payment system's operating costs).

4.96 We do not believe that the fees associated with ongoing Direct Access are currently a significant cause of concern, but we will aim to address issues where concerns regarding fees, costs and associated processes are linked to the lack of available information (see below in relation to lack of transparency) or arise in the future.

Other requirements including legal and risk management requirements

4.97 There may be valid justifications for imposing certain other criteria, such as the requirement to provide a legal opinion. While there were few concerns expressed in relation to the other access

⁵⁴ C&CCCL's letter 'C&CCCL Response to HMT Consultation Published 6th March 2014 "Speeding Up Cheque Payments: Legislation for Cheque Imaging"' (21 March 2014) – pp 2 and 6, available at [http://www.chequeandcredit.co.uk/files/candc/press/05_letter_to_hmt_re_response_on_speeding_up_cheque_payments_\(21march14\).pdf](http://www.chequeandcredit.co.uk/files/candc/press/05_letter_to_hmt_re_response_on_speeding_up_cheque_payments_(21march14).pdf).

criteria, we consider that it is important that such requirements do not create unnecessary barriers to securing Direct Access, including for particular types of PSP (such as EMIs and PIs). We will, in particular, monitor the implementation of pre-funding.

Concerns relating to the transparency and availability of information

- 4.98 We have been told that there is a general lack of detailed information available about the Access Requirements including the criteria, costs and associated processes (such as on-boarding) for obtaining Direct Access to interbank payment systems. Stakeholders told us that where information is made available, it can be opaque and complex.
- 4.99 Stakeholders also noted that they may not be able to have sight of standard contract terms and basic information prior to signing a Non-Disclosure Agreement.
- 4.100 There were similar concerns regarding Access Requirements raised in relation to card payment systems, with stakeholders noting that information from the card payment systems is not always clear or readily available. Transparency concerns were raised in particular in relation to access criteria and processes and procedures, as well as in relation to fees, which some stakeholders said could be difficult to assess.

Our assessment of concerns relating to the transparency and availability of information

- 4.101 We consider transparency to be a key issue in relation to Direct Access, as it can have a bearing on the ability of PSPs to adequately assess the case for securing Direct Access. In addition, by enabling PSPs to understand the cost of Direct Access, it can also aid them in evaluating and comparing access offerings that are provided by different Sponsor Banks.
- 4.102 A lack of transparency in relation to operational information about payment systems can also affect the ability of PSPs to manage their customer relationships effectively.
- 4.103 Some Operators are taking steps to improve transparency. For example, in December 2013, FPSL redesigned its website to improve the description and disclosure of certain information.
- 4.104 However, there is a need to ensure greater transparency and the public disclosure of Access Requirements to allow PSPs to both effectively evaluate the most suitable route for them to access payment systems, and to adequately understand the implications of their usage of payment systems when PSPs do access them directly. We discuss our proposals to address our concerns over transparency and the availability of key information in paragraphs 4.149 to 4.158 below.

What is the impact of these concerns relating to the criteria for gaining Direct Access and around lack of transparency and availability of information?

- 4.105 Our main concern is that current Access Requirements for Direct Access may:
- Restrict open access to payment systems – e.g. by imposing limitations on the types of PSPs that are able to directly access payment systems
 - Not be proportionate to the risks being introduced by potential new Direct PSPs, in particular in relation to the technical requirements imposed by Operators.

4.106 We are also concerned that limited transparency and availability of information may be reducing the ability of some PSPs to be more informed buyers or to assess different routes to access payment systems.

4.107 Below we consider the impact of these concerns on competition, innovation and service-users respectively.

Impact on competition

4.108 PSPs may want to gain Direct Access to payment systems for a number of reasons (see paragraph 4.10 above), but especially to compete more effectively in the provision of payment services through, for example, the development of new and innovative services or the use of existing services in new and innovative ways which may not be possible as an Indirect PSP (see paragraph 4.119 for more details).

4.109 The criteria that Operators apply as set out above along with the procedures and processes Operators have in place for granting Direct Access – i.e. Access Requirements – can act as a barrier to entry and expansion for potential and existing PSPs. Access Requirements can also impact on entry and expansion into the provision of infrastructure-related services, for example, for third-party technology providers that may have an interest in developing Technical Access options. The entry (or threat of entry) of new Direct PSPs creates competitive pressures on existing providers that can lead to more effective competition for the provision of payment services.

4.110 There appears to be a technology barrier to Direct Access to payment systems, and in particular to FPS. The perception of Direct Access being expensive can act as a disincentive to new entrants or rivals becoming Direct PSPs. It is clear from the large number of stakeholder concerns raised that the technical requirements set by Operators impose a significant burden on PSPs, which prevents some PSPs from gaining Direct Access to payment systems.

4.111 We are particularly concerned that Access Requirements for Direct Access may adversely affect competition in the provision of services through payment systems, because:

- In pursuing our competition objective, we need to consider the interests of different persons who use, or may use, the services provided by payment systems, including the ease with which those services are used. The Access Requirements for Direct Access will affect the ease with which different PSPs and different types of PSPs (e.g. credit institutions, EMIs and PIs) can secure Direct Access and compete in the provision of payment services.
- In advancing our competition objective, we must consider the cost associated with participation in payment systems, as it affects the ease with which new entrants can enter into the provision of services provided by payment systems. The perceived or real cost of Direct Access can stop or discourage some PSPs from pursuing Direct Access.

4.112 Direct Access may bring a number of additional benefits to a PSP compared to Indirect Access, such as:

- allowing them to better manage the risks (such as system failures) associated with the provision of payment services, and
- giving them access to higher quality services – for example, PSPs with Indirect Access do not always get the same near real-time service that Direct PSPs of FPS receive which may impact on their ability to compete with Direct PSPs.⁵⁵

4.113 Where PSPs do not have enough information available to assess and compare various access options, their ability to compete effectively can be undermined. Relevant to this is how easy it is for PSPs to change their route for accessing payment systems (i.e. from Indirect to Direct Access), and the difficulties they face in obtaining the information they need to make informed

⁵⁵ For a more detailed discussion, see paragraphs 4.251 to 4.258 in **Part D** on Indirect Access.

and appropriate decisions. The inability of PSPs to obtain information about Direct Access can also create barriers to switching, as it can hinder the ability of Indirect PSPs to assess their alternatives, including whether to become Direct PSPs. If PSPs cannot adequately assess the service offerings available to them, and are therefore hindered in their ability to choose alternative access options (be it to become a Direct PSP or to switch Sponsor Bank), the pressures on Operators (and Sponsor Banks) to provide adequate access to payment systems are likely to be dampened.

- 4.114 Securing Direct Access may also enable a PSP to more effectively manage the risks associated with the provision of payment services. It may also allow them higher quality services compared to those received through Indirect Access options (see **Part D** for further details), which may improve the services they provide to their end-users, and hence their ability to compete with other PSPs.

Impact on innovation

- 4.115 In pursuing our innovation objective, we need to consider how to promote the development of, and innovation in, payment systems in the interests of service-users, with a view to improving the quality, efficiency and economy of payment systems. In particular, we are interested in the development of, and innovation, in the infrastructure used to operate payment systems (recognising the impact that infrastructure can have on costs, functionality and the quality of services provided to service-users, including end-users).

- 4.116 The development of new technology solutions (which could advance the quality, efficiency and economy of payment systems) is affected by the Access Requirements for Direct Access set by Operators and the availability of information to third-party service providers. Such innovations in payment systems (and payment system infrastructure) could provide lower cost access solutions to both Direct and Indirect PSPs, and could also improve the quality of services that PSPs are able to deliver to their end-users. For example, the development of Technical Access options could provide both cost savings and functional benefits.

Impact on service-users

- 4.117 We need to ensure that payment systems are operated and developed in a way that takes account of and promotes the interests of service-users.
- 4.118 The ways in which payment systems are operated and developed will affect all service-users. The Access Requirements set by Operators may, for example, limit the entry of alternative Technical Access options that could bring benefits to service-users through new and innovative services or lower cost payment solutions.
- 4.119 The inability of PSPs to directly access payment systems may further limit PSPs' ability to adopt and benefit from new innovations (for example Paym), which in turn limits the services they can provide and the extent to which they can pass the benefits of these innovations on to their end-users.
- 4.120 Transparency in relation to Access Requirements will affect the ability of PSPs to assess their options in an effective manner, and to identify how payment systems can be accessed in ways that can be best expected to promote their interests.

Our proposals on Direct Access

- 4.121 We propose to make a general direction in response to our concerns on Direct Access (the 'Access Package'). Our proposed Access Package includes the introduction of a principles-based access rule (the 'Access Rule') and compliance and reporting obligations⁵⁶ (the 'Reporting Rule').

⁵⁶ In relation to compliance with the Access Rule or with the access obligations applicable to Operators covered by the Regulation 97 of the PSRs 2009, as applicable.

- 4.122 We intend to engage with Operators with regard to the level of detail and information we will require under our Reporting Rule.

Proposed direction to introduce a principles-based Access Rule

- 4.123 We propose to introduce an Access Rule on Operators of regulated payment systems which are not subject to Part 8 of the PSRs 2009 – i.e. Bacs, C&CC, CHAPS, and FPS. Our preferred Access Rule is that: *'An Operator should have objective, risk-based, and publicly disclosed Access Requirements, which permit fair and open access'*.
- 4.124 We do not consider it appropriate or proportionate to impose the Access Rule on NICC.⁵⁷ We do not propose to apply the Access Rule to the Operators of LINK, MasterCard and Visa, as these Operators are already subject to access obligations under Article 28 PSD/Part 8 of the PSRs 2009.⁵⁸
- 4.125 We will require all pan-GB Operators of non-PSRs 2009 regulated payment systems (i.e. Bacs, C&CC, CHAPS, and FPS) to be compliant with our proposed Access Rule by 30 June 2015.
- 4.126 Our proposed Access Rule introduces a principles-based framework for the provision of access including the rules (and criteria), terms or conditions (including fees and charges), policies or procedures (i.e. Access Requirements) to non-PSRs 2009 regulated payment systems. These Operators will need to satisfy themselves, and us, that their Access Requirements – both the requirements themselves and the application of those requirements – are compliant with our Access Rule.
- 4.127 We note the steps being taken by a number of Operators to address concerns that have been raised about the provision of Direct Access. While we encourage such developments, we are not confident that, in the absence of our proposals, voluntary industry initiatives will deliver appropriate Direct Access arrangements in a timely and comprehensive manner.
- 4.128 Currently, the CPSS-IOSCO Principles for Financial Market Infrastructures (which apply to all systemically important payment systems⁵⁹) include a principle (Principle 18) on access and participation requirements to which relevant Operators must 'have regard to' under the Bank's oversight regime. However, given that concerns remain over the provision of Direct Access, we consider that there is benefit in establishing a substantive regulatory access obligation which must be complied with.
- 4.129 Our proposed Access Rule will give rise to an ongoing obligation to ensure that Access Requirements (and the application of such Access Requirements) are continuously under review and continuously compliant. We consider that this is important, as the Access Requirements set and applied by Operators should support industry and technological developments as they arise over time (including in markets for services provided by payment systems).
- 4.130 This Access Rule will also ensure that the Access Requirements for all regulated payment systems are within an enforceable legal framework (whether under our Access Rule or Regulation 97 of the PSRs 2009) against which we can take action if Operators are not compliant with the relevant regulatory requirements. It will also provide a further basis for the exercise of our powers to grant access or vary terms of access,⁶⁰ if required. We further discuss our approach to our powers to grant access in *Supporting Paper 6: Regulatory tools*.

57 We are not proposing to apply the Access Rule to NICC given the limited nature of stakeholder concerns raised with us, the more limited scope of its activities, and because the development of cheque imaging (see *Supporting Paper 2: Payments industry strategy and areas for collaboration*) means that the future of NICC is unclear.

58 We expect to be the competent authority for Part 8 of the PSRs 2009. We see benefits in terms of comparative regulatory compliance in obtaining a comprehensive view of how individual Operators have interpreted and applied their relevant access obligations.

59 This includes Bacs, CHAPS and FPS.

60 We have the powers to require granting of Direct Access and Indirect Access to payment systems under section 56 FSBRA, and to vary agreements relating to access to payment systems under section 57 FSBRA.

Proposed content of the Access Rule

4.131 We have considered a number of alternative formulations for the substantive content of our proposed Access Rule. In seeking to derive a rule that is fit for purpose, we have considered the extent to which the formulation of the rule:

- addresses the substantive concerns we have identified
- is capable of being understood by those subject to it
- is straightforward to apply
- is supported by existing industry experience or a relevant legal framework.

4.132 We have considered the option of adopting a prescriptive rule as regards the Access Requirements to be applied by (non-PSRs 2009) Operators. A prescriptive rule is more likely to lead to greater certainty in terms of what would be required for compliance (as compared to a principles-based Access Rule) for both Operators and PSPs. However, based on our assessment of the concerns raised by stakeholders, we consider that introducing such a prescriptive rule is not currently warranted and may have unintended consequences by leading to rigidity in Access Requirements.

4.133 Conversely, principles-based obligations can provide clear expectations that amendments to the underlying Access Requirements (or the application of the Access Requirements) are likely to be required, while allowing for flexible implementation by individual Operators, enabling them to take into account the specific circumstances relating to their payment system. We prefer a principles-based rule, but we will keep Direct Access under review. We do not exclude giving consideration to the use of more prescriptive rules, if necessary, in the future.

Option 1 for our Access Rule: Our preferred option is based on CPSS-IOSCO Principle 18

4.134 Our preferred option (Option 1) is to introduce an Access Rule that follows CPSS-IOSCO Principle 18, and which states that *'An Operator should have objective, risk-based, and publicly disclosed Access Requirements, which permit fair and open access'*. As noted above, our Access Rule would apply to pan-GB Operators of regulated payment systems not subject to Part 8 of the PSRs 2009.

4.135 We prefer Option 1 (i.e. the CPSS-IOSCO Principle 18 formulation of the Access Rule) because we believe that it has the following advantages:

- The substantive criteria specifically reference open access to payment systems, which is a consideration we expect Operators to take into account in evaluating how access can be opened up to other PSPs such as EMIs and PIs.
- It is based on an existing industry standard to which most of the Operators to which our proposed Access Rule would apply must already have regard to under the Bank's oversight regime.⁶¹ This should help result in a more timely and effective adoption of the Access Rule as it will be familiar to those Operators.
- CPSS-IOSCO Principles are accompanied by existing guidance to which we would have regard when applying our own Access Rule.
- It specifically requires Access Requirements to be publicly disclosed,⁶² thereby directly addressing stakeholder concerns as to the lack of transparency on Access Requirements and how such requirements will be applied by Operators.

⁶¹ For reasons set out in paragraph 4.128 to 4.133 above we believe that there is benefit in elevating the principle derived from CPSS-IOSCO Principle 18 to a substantive regulatory requirement which must be complied with.

⁶² Unless it is justifiable (for example for security or financial stability reasons) to not disclose information.

- It refers to the need for Access Requirements to be 'risk-based', which we think is an important parameter for Operators. This requirement focuses attention on the key concerns that have been raised, and in particular regarding the Access Requirements for Technical Access where there are concerns that these are not being applied in a manner that adequately reflects the underlying risks.
- It does not require a 'one size fits all' approach to setting Access Requirements including access criteria, thereby addressing concerns that access criteria can be applied in a manner that is inappropriate or disproportionate to the circumstances of the access seeker. This sensitivity to different circumstances is inherent in the requirement that such access criteria be risk-based.

4.136 We have also considered two other alternative formulations.

Option 2 for our Access Rule is based on Article 28 PSD/Regulation 97 PSRs 2009

4.137 Our proposed Option 2 is to introduce an Access Rule that adopts the language of Article 28 of the PSD (as implemented by Regulation 97 of the PSRs 2009), and which would state that '*An Operator should have objective, proportionate and non-discriminatory rules for access to its system that do not prevent, restrict or inhibit access or participation more than is necessary to*

- safeguard against specific risks such as settlement risk, operational risk or business risk; or*
- protect the financial and operational stability of the payment system.'*

4.138 In practice, this option is very similar to our preferred Option 1 (above). It would also align the substantive access obligations across all Operators (i.e. with those applicable currently to Operators subject to Regulation 97 of the PSRs 2009 (LINK, MasterCard and Visa)).

4.139 Option 2 sets out some specific categories of risk that may justify a limitation on access, whereas our preferred Option 1 achieves the same objective by specifying that Access Requirements must be risk-based.

4.140 Unlike our preferred option, Option 2 does not require Operators to publicly disclose their Access Requirements. However, for the reasons outlined below, we nevertheless propose to require all Operators (including those subject to Regulation 97 of the PSRs 2009) to publish their Access Requirements.

4.141 Option 2 also makes a specific reference to a requirement that access rules (i.e. Access Requirements) must be non-discriminatory. It is important that any such requirement is properly understood to mean that like circumstances should be treated in like manner, but also that different circumstances should be treated according to their different contexts. We believe that an Access Rule formulation based on CPSS-IOSCO Principle 18 (i.e. our preferred Option 1) would have a similar practical application as Option 2. Moreover, we note that the principle that access should be granted on non-discriminatory terms is reflected in the guidance to CPSS-IOSCO Principle 18.

4.142 The requirements of Option 2 may be less familiar to those Operators that are not already subject to Regulation 97 of the PSRs 2009 – i.e. the Operators who would be subject to our Access Rule.

Option 3 for our Access Rule – a hybrid approach

4.143 Our proposed Option 3 is a hybrid or bespoke option that would state that '*An Operator should have fair, reasonable and open criteria for access to its system'*.

4.144 This is a streamlined combination of key substantive elements contained in our preferred Option 1 and in the alternative Option 2, and emphasises the requirements of fairness and reasonableness.

4.145 We regard this option as less desirable because there is no existing experience of its application in the payments industry.

4.146 Having considered the above three options, on balance, for the reasons stated above, we prefer Option 1.

Our interpretation of the substantive requirements of our proposed Access Rule

4.147 In evaluating whether Operators are complying with our proposed Access Rule or Regulation 97 of the PSRs 2009 (as applicable) when setting and applying their Access Requirements, we will have regard to, and will take into account, a number of general principles that may include whether:

- The Access Requirements promote open access – an access restriction which unreasonably prevents the emergence of new and different types of PSPs, or products or services, would be inconsistent with the Access Rule or Regulation 97 of the PSRs 2009 (as applicable).
- Operators impose Access Requirements including conditions for access which are reasonable, having regard to the interests of the Operator, PSPs and service-users.
- The Access Requirements including terms and conditions have a sound objective justification that is clear and precise.
- The Access Requirements including the rules and criteria imposed are risk-based: an Operator should consider and calibrate the risks that an actual or prospective PSP may present to the payment system and other PSPs, and any risk-related participation requirements must be imposed in a manner that is commensurate with the risks posed by that specific PSP.
- The Access Requirements including the rules and criteria imposed apply different conditions to PSPs and third party service providers in the same position, or apply the same conditions to PSPs and third party service providers whose circumstances are different, thereby placing them at a disadvantage. We will consider whether the setting of different rules, criteria or conditions for Direct Access for certain types of PSP is appropriate given the applicable circumstances, rather than a ‘one size fits all’ approach – in other words, an Operator may be required positively to differentiate its Access Requirements, including its terms and conditions, in order to comply with the Access Rule.
- Any Access Requirements imposed by an Operator are proportionate. As a minimum, proportionality requires a risk-based approach to the setting of terms – the proportionality or otherwise of a term will be judged by reference to the interests that it serves or risks that it seeks to manage, and the impact on the parties affected.
- An Operator, beyond offering suitable Access Requirements, has actually been willing to engage meaningfully on those Access Requirements with prospective PSPs.

4.148 Our proposed Access Rule would require Operators to keep their Access Requirements under review to ensure ongoing compliance. This should ensure that existing barriers to entry and expansion for PSPs and third-party service providers are reduced and removed, and that further undue barriers do not arise.⁶³ In considering fair and open access we also expect Operators to develop suitable accreditation processes to better allow third-party service providers of Technical Access to facilitate access to payment systems.

Our proposed Reporting Rule

4.149 We propose that all Operators of regulated payment systems required to comply with an access obligation (either our proposed Access Rule or Regulation 97 of the PSRs 2009, as applicable)⁶⁴

⁶³ For example, in relation to the current developments in the context of cheques it will be important that the new C&CC clearing model is not developed in a way that unduly restricts Direct Access.

⁶⁴ Excluding NICC, i.e. Bacs, C&CC, CHAPS, FPS, LINK, MasterCard and Visa.

should be subject to compliance and reporting obligations, to support the relevant regulatory access obligations.

- 4.150 We propose to require all Operators of regulated payment systems to:
- keep under review their Access Requirements and provide us with an annual compliance report, the first being due by 30 June 2015, and to keep us informed of any material updates and changes which are made to their Access Requirements
 - publish their Access Requirements on their website⁶⁵ (and provide us with a link and copy) by 30 June 2015.
- 4.151 Given concerns have been raised regarding both the interbank and card payment systems, as set out above, we consider that there are benefits in terms of consistency in aligning compliance and reporting obligations across all Operators that are subject to a regulatory access obligation. The compliance and reporting obligations will also enable us to monitor compliance with the relevant regulatory access obligation and take enforcement action if necessary. We therefore see benefits in terms of comparative regulatory compliance in obtaining a comprehensive view of how individual Operators have interpreted and applied their relevant regulatory access obligation.
- 4.152 We anticipate that Operators will re-consider their Access Requirements in light of our proposed Access Package. This may include, for example, ensuring that:
- the Operators' Access Requirements clearly set out the details of what is required of PSPs to gain Direct Access and the relevant terms and conditions (including standard fees and charges)
 - the Operators' policies and procedures clearly articulate how their Access Requirements are compliant with the relevant regulatory access obligations
 - the Operators' policies and procedures articulate and justify the purpose and approach of their Access Requirements including access rules and criteria (e.g. eligibility criteria)
 - the Operators' consider their procedures for on-boarding new Direct PSPs
 - the Operators' ongoing requirements imposed on Direct PSPs, including periodic assurance reviews, are compliant with the relevant regulatory access obligations.

Annual compliance report

- 4.153 Operators would be required to provide us with an annual report on compliance of their Access Requirements with the relevant regulatory access obligation. We also require all Operators to inform us, as soon as is reasonably practicable, of any material updates and changes which are made to their Access Requirements. These requirements would apply to all Operators required to comply with a regulatory access obligation (either our proposed Access Rule or Regulation 97 of the PSRs 2009).⁶⁶
- 4.154 The annual report must include at least the following:
- Details of all instances when an expression of interest in potentially securing Direct Access (including Direct Technical Access) has been made in the relevant year and details of the response to, and outcome of, such expression of interest.
 - A statement detailing how the Operator takes into account the relevant access obligation when setting and applying Access Requirements - for example how Operators have

⁶⁵ In due course, publication may, in addition, be affected by any requirement to publish information on a central Information Hub (see paragraphs 4.291 to 4.297 on Indirect Access for further details regarding the Information Hub).

⁶⁶ In other words, the requirements would apply to Bacs, C&CC, CHAPS, FPS, LINK, MasterCard and Visa.

assessed whether technical requirements are risk-based and proportionate, or how their Access Requirements ensure open access to their payment systems. We note that Operators are likely to have existing Access Requirements regarding securing Direct Access (including Technical Access) to their respective payment systems. Operators may need to revisit these existing Access Requirements, and the application of those requirements, to ensure that they are compliant with the relevant regulatory access obligation.⁶⁷

- Confirmation that the Operator has engaged with, and considered the views of relevant interested parties and PSPs, on the operation and effectiveness of its Access Requirements. We expect ongoing engagement to result in payment systems being operated and developed in the interests of current and prospective service-users, and for Operators to have regard to the potential impacts their Access Requirements may have on the provision of payment services provided by payment systems. By requiring Operators to engage with service-users on the suitability of their existing approaches, Operators would obtain valuable feedback on the extent to which it may be necessary to modify their Access Requirements. We have not adopted a prescriptive approach governing the nature and extent of an Operator's engagement with service-users, but we will monitor the approach taken by Operators.
- Details of any anticipated Operator review, or engagement with PSPs and other interested parties, that the Operator plans to take over the coming year in relation to its Access Requirements, and details of any anticipated future developments that the Operator considers may require or justify updates or changes to its Access Requirements. By requiring Operators to inform us of anticipated actions and future developments we are encouraging Operators to be forward-looking with regard to their Access Requirements.

Publication of Access Requirements

- 4.155 Operators will be required to publish their Access Requirements. This requirement would apply to all Operators required to comply with a regulatory access obligation (either our proposed Access Rule or Regulation 97 of the PSRs 2009).⁶⁸
- 4.156 Transparency is integral to our proposed Access Rule (i.e. 'publicly disclosed' Access Requirements). We consider that transparency is required in order to ensure the effectiveness of our proposed Access Rule or the equivalent obligation under Regulation 97 of the PSRs 2009. This implies openness, communication and accountability in relation to the Operator's Access Requirements. Public disclosure of the Access Requirements provides a high degree of certainty in terms of how Operators will apply their Access Requirements and the circumstances in which they would be prepared to depart from any standard terms and conditions.
- 4.157 Public disclosure means, at a minimum, that Operators will publish their Access Requirements on their website (in addition to providing us with a copy and link to the relevant website) and, potentially in the future on the Information Hub. In paragraphs 4.291 to 4.297 on Indirect Access, we discuss the creation of an Information Hub to improve transparency of information to Direct and Indirect PSPs. We believe that an Information Hub will enable greater visibility of, and access to, information across all payment systems, which will also allow PSPs to make comparison across both Direct and Indirect Access offerings.
- 4.158 Operators subject to our proposed Access Rule are required under our preferred Option 1 to publicly disclose their Access Requirements. Operators of regulated payment systems who are subject to the access obligation under Regulation 97 of the PSRs 2009 are currently not obliged to publicly disclose their Access Requirements (or to provide compliance reports or details of material updates and changes to the current competent authority). However, we consider that a requirement on these Operators to publicly disclose their Access Requirements should enhance the transparency, clarity and certainty of obtaining Direct Access to these payment systems. Further, as noted above, we also see benefits in terms of comparative regulatory compliance in

⁶⁷ This may include, for example, Access Requirements relating to the accreditation of third-party providers of Technical Access solutions.

⁶⁸ In other words, the requirements would apply to Bacs, C&CC, CHAPS, FPS, LINK, MasterCard and Visa.

obtaining a comprehensive view of how individual Operators have interpreted and applied their relevant regulatory access obligations.

Our proposed Access Package is consistent with our objectives and duties

- 4.159 We anticipate that our proposed Access Package will address the concerns detailed above by establishing minimum standards we require Operators to meet in order to address barriers that currently hinder Direct Access. The prevailing concerns we have, and how we expect these to be addressed, include:
- The Access Requirements, and in particular the criteria for Direct Access that restrict access for different types of PSPs and providers: by requiring fair and open access to payment systems, Operators need to consider how they could widen access to a broader set of PSPs, including EMIs and PIs. We also expect Operators to consider how to open up access to third-party providers of Technical Access solutions, for example, through suitable accreditation processes.
 - The Access Requirements, and in particular the requirements for Technical Access, imposed by Operators that are not proportionate to the risks introduced by PSPs: by requiring such criteria to meet certain standards of objectivity and risk-based justification, we would expect that the requirements for Technical Access can be met by a greater pool of prospective PSPs because they are not unduly onerous.
 - The lack of availability of information: by requiring Operators to publish information regarding their Access Requirements.
- 4.160 Annual compliance reporting (and the requirement to keep us informed of material updates and changes) provides a further check that the relevant regulatory access obligations are being met by making Operators accountable to us and, indirectly, to their service-users.
- 4.161 We consider that the underlying Access Requirements including the terms and conditions governing Direct (including Technical) Access should be clear, understandable to, and accessible by, all existing and prospective PSPs and other services-users. If the basis for these Access Requirements is inadequate, uncertain or opaque, then PSPs and service-users may face unintended, uncertain or unmanageable disruption which may also create or increase business or operational risks.
- 4.162 We consider that the obligation that Access Requirements be publicly disclosed or published will address our concerns about the difficulties that PSPs face in accessing information and securing Direct Access.
- 4.163 We would expect our proposed Access Package to benefit competition in the provision of services provided by payment systems by promoting fair and open access, while not compromising safety and stability because:
- Improved and potentially broader access to payment systems is likely to increase competition between different PSPs. As noted in paragraph 4.10 above, PSPs may favour Direct Access for a number of reasons which relates to their ability to compete more effectively in the provision of payment services.
 - The technical and operating requirements imposed by Operators (as part of Access Requirements more broadly) have been highlighted as a particular area of concern in securing Direct Access. By requiring active consideration of the objective justification for such requirements, our proposed Access Rule can be expected to improve the burden associated with gaining Direct Access to non-PSRs 2009 payment systems.
 - By promoting greater transparency, we would expect our proposed Access Package to improve the negotiating power of those PSPs for whom Direct Access and/or the use of

alternative Technical Access solutions would now become viable options, even if the PSPs choose not to exercise those options.

4.164 We would expect our proposed Access Package will require Operators to ensure their Access Requirements are more proportionate to the risks introduced by PSPs. It will also require Operators to publish their Access Requirements. This should further our innovation objective in particular because:

- Our proposed Access Rule will require Operators to apply more objective and risk-based Access Requirements for Technical Access. We expect these to facilitate the development of alternative Technical Access solutions, which in turn can promote innovation in the infrastructure used to operate payment systems.
- A more risk-based approach may allow Access Requirements for Direct Technical Access to be met in a more cost-effective manner.
- Innovation in relation to Technical Access options could also improve the quality of payment services available to a wider range of PSPs. As we set out in paragraphs 4.251 to 4.252, many Indirect PSPs raised quality of service concerns in relation to their Indirect Access to FPS.
- Greater transparency and Direct Access to payment systems can provide PSPs greater control over their service provision and over the development of their usage of payment systems. For example, PSPs can have greater clarity and certainty over the economy and quality of the payment services they receive when they have Direct Access as opposed to Indirect Access.

4.165 We expect our proposed Access Package to result in payment systems being operated and developed in ways that better take account of, and better promote, the interests of current and prospective service-users. This should further our service-user objective in particular because it should increase the number of PSPs that have a direct contractual relationship with Operators. This in turn will make Operators more responsive to a greater population of service-user needs. This may be particularly beneficial where the development of particular services or service features is reliant on a change to the Access Requirements.

4.166 We must also have regard to financial stability considerations, and as such would be concerned by any potential changes to the technical or operating requirements for Direct Access that may impact upon the integrity and financial stability of the payment systems.

4.167 As we develop our proposed direction, we have had, and will continue to have, regard to how our proposals could impact on the Bank's functions⁶⁹ and objectives, and the stability of, and confidence in, the UK financial system. We will continue to work closely with the Bank to assess these impacts and ensure there are no adverse impacts.

4.168 We have had regard to our regulatory principles when considering and developing our proposed Access Package. In particular:

- The Access Package would require Operators to determine how service-user needs are taken into account when reviewing and applying ongoing Access Requirements. We would expect this to facilitate greater access and support discussions and negotiations between Operators and PSPs. We believe that this approach represents an efficient allocation of our resources.
- By requiring Operators to report to us on compliance of their Access Requirements with the relevant regulatory access obligation, Operators can align this work with their own ongoing compliance efforts. We believe that this activity is best undertaken by Operators themselves

⁶⁹ In its capacity as a monetary authority, including the Bank's other relevant functions such as settlement service provider, provider of infrastructure, security trustee, Direct PSP in some payment systems, and resolution authority.

since they are best placed to undertake such an assessment. We do not propose to approve any Access Requirements as we regard this activity as a matter for self-assessment by Operators.

We consider that our proposed Access Package is consistent with the principle of proportionality. Specifically, we consider that the proposed Access Package will be effective in addressing the concerns identified, and that we have adopted the least onerous approach to effectively address these concerns. We consider that the costs of compliance with our proposed Access Package are not disproportionate to the benefits in general terms which can be expected to result from our proposed Access Package (we present a discussion of the expected benefits and costs of our proposed Access Package in paragraphs 4.170 to 4.190).

- Our proposed Access Package would introduce requirements on all pan-GB Operators of regulated payment systems. It would result in new responsibilities being put on the senior management of these Operators, and would require them to assess the compliance of their Access Requirements with our proposed Access Package.
- Since the Operators of Bacs, CHAPS and FPS are already required by the Bank to have regard to CPSS-IOSCO Principle 18 (and C&CCCL has indicated that it already takes account of this Principle), and LINK, MasterCard and Visa are also already subject to the access obligations under Regulation 97 of the PSRs 2009, we would expect the incremental burden of complying with our Access Package to be limited.
- We have had regard to differences in the nature of, and objectives of, Operators and PSPs (including prospective PSPs), in formulating our proposed Access Package. By proposing a principles-based Access Rule, rather than a set of detailed requirements, we consider that relevant differences in the nature and objectives of Operators and PSPs can be taken into account. Our proposed Access Rule is principles-based, and will allow Operators to develop Access Requirements for Direct Access that are suitable for their own payment system.
- The requirement to undertake regular reviews and ensure ongoing compliance provides for adaptation as the industry landscape changes and evolves. This flexibility is consistent with us exercising our functions in a way which recognises the differences in the nature of and objectives of businesses carried out by different persons. It is implicit in these procedures that the Access Requirements may change over time and may need refinement to address different circumstances.

4.169 A draft of our proposed Access Package is set out in *Annex 2* to the Consultation Paper and is based on our preferred Option 1 as set out above.

SP4-Q1: Do you agree with our preferred option that an Access Rule, aligned with Principle 18 of the CPSS-IOSCO Principles, should be applied to those pan-GB Operators not subject to Regulation 97 of the PSRs 2009? If you disagree with our proposed approach, please give your reasons.

SP4-Q2: Do you agree with our proposal to introduce a Reporting Rule on all relevant pan-GB Operators (Bacs, C&CC, CHAPS, FPS, LINK, MasterCard and Visa)? If you disagree with our proposed approach, please give your reasons.

SP4-Q3: Do you agree with our proposal to require public disclosure of Access Requirements for Operators subject to Regulation 97 of the PSRs 2009? If you disagree with our proposed approach, please give your reasons.

What are the intended benefits of our proposals and related anticipated costs for industry?

Proposed Access Rule

Intended benefits

- 4.170 As set out below, we expect our proposals to have benefits for those who use, or are likely to use, the services provided by payment systems. In our opinion, it is not reasonably practicable to produce a quantitative estimate of the benefits given the nature of the benefits described below such as improvements to the competitive environment.
- 4.171 We recognise that Operators are already reviewing their Access Requirements and making or considering changes in the light of these reviews. While we encourage those developments which bring the requirements more in line with our proposed Access Rule, we are not confident that, in the absence of our proposals, voluntary industry initiatives would deliver appropriate Direct Access arrangements in a timely and comprehensive manner.
- 4.172 Our proposals include the introduction of an Access Rule requiring certain Operators to apply their Access Requirements in an objective, risk-based manner that permits fair and open access to its payment system. We propose to also require Operators to publicly disclose their Access Requirements.
- 4.173 In this section we do not repeat all the benefits and expected outcomes as set out above, but in summary, we expect:
- Our Access Rule should benefit those currently seeking Direct Access to payment systems. The evidence set out above indicates that there are many PSPs currently considering Direct Access to various payment systems. Proportionate Access Requirements should allow more of these PSPs to secure Direct Access. They should also reduce both the cost of the process of seeking access as well as the costs of meeting ongoing Access Requirements.
 - Our Access Rule should also enhance regulatory predictability. This should bring benefits both for Operators in meeting the expectations of a new regulator as well as for PSPs seeking access who should be able to more easily understand the scope of access obligations. This should also increase the incentives of Operators to take access concerns seriously.
 - Our Access Rule would require Operators to keep their Access Requirements and their processes and procedures under review. This should ensure that the future development and operation of payment systems takes into account the Access Rule in the light of changing needs of PSPs and other service-users. This should bring ongoing benefits by reducing the extent to which problems about access arise in the future compared to the absence of the Access Rule.
 - Our Access Rule may also benefit some existing Direct PSPs by having more proportionate and objective ongoing requirements and processes (e.g. compliance and assurance processes) associated with having Direct Access. In particular, some Direct PSPs might face less onerous Access Requirements where they bring low systemic risks to payment systems. It is also possible that some Direct PSPs will face increased Access Requirements due to the Access Rule. Since such requirements would arise in order to reflect the higher risk that such PSPs might bring to the payment system, this would also be categorised as a benefit.
 - We also believe that a more risk-based approach may allow technical requirements for Direct Access to be met through a greater variety of options including through third-party providers of Technical Access. This should both facilitate a greater variety of PSPs having Direct Access as well as reduce the cost of these technical requirements for some PSPs.
 - Our Access Rule should improve the transparency surrounding information about the options available to PSPs. Greater transparency should aid comparison for those PSPs who could realistically choose between Direct Access, Direct Technical Access and Indirect Access

options. In turn this could strengthen their bargaining position with respect to potential suppliers of Sponsor Bank services for Indirect Access. We are also making specific proposals for Indirect Access, which are set out in **Part D** below.

- The Access Rule may also bring regulatory certainty to Operators by having a clear direction which should increase the incentives of Operators to take access concerns seriously.
- 4.174 The Access Rule should create an environment in which PSPs can more effectively compete in the provision of payment services. Facilitating access to a greater variety of PSPs should also have positive impacts on innovation both by Operators as well as by PSPs.
- 4.175 The extent to which the benefits described here arise will vary between payment systems, in particular:
- For Bacs, our Access Rule should limit future concerns about access conditions by ensuring that the future operation and development of the Bacs payment system takes into account our Access Rule on an ongoing basis.
 - CHAPS Co is already undertaking a review of the application of their Access Requirements and their processes for gaining Direct Access to the payment system. By applying our Access Rule to CHAPS, this should ensure that the progress that they are already making will continue on a timely basis. The implementation of changes should therefore be consistent with the substantive obligations of the Access Rule as they will be able to take this into account while finalising their review.
 - We do not expect our Access Rule to resolve some of the fundamental difficulties (e.g. the portability of sort codes or cheque imaging) with the C&CC payment system. However, it will be important for any new model to be aligned with our Access Rule. The Access Rule therefore should provide more regulatory certainty to C&CCCL as their new model is developed by providing a framework against which the development of the new C&CC clearing model can be measured.
 - Our Access Package should address a significant number of concerns related to gaining Direct Access to FPS, and in particular related to the technical requirements the Operator imposes. We expect our proposals to have a significant impact on FPS service-users, and competition between PSPs.

Related anticipated costs

- 4.176 Operators may need to make amendments to their Access Requirements in order to comply with our proposed Access Rule which may result in some small costs.
- 4.177 Our Access Rule has been derived from existing industry principles (i.e. CPSS-IOSCO Principle 18). Designing a rule around existing principles should minimise the costs associated with complying with it because Operators will already be familiar with the relevant principles.
- 4.178 Our discussions with some of the Operators suggest that these costs are likely to be modest. We note that some of the Operators have already been undertaking review activity, and that further initiatives are already planned. In line with this, in response to interest from PSPs, some Operators have already increased (or plan to increase) the resources they devote to the review and development of their Access Requirements and of their processes for engaging with and on-boarding prospective new Direct PSPs.
- 4.179 The extent of PSP interest in Direct Access differs significantly between Bacs, C&CC, CHAPS and FPS, with much greater levels of interest in CHAPS and – in particular – FPS, than in Bacs and C&CC. Our engagement with the Operators suggests that even where there is significant demand for Direct Access, the resources required to engage with interested PSPs would be unlikely to be large.

- 4.180 While our Access Rule would be likely to have some incremental impact on the resources that Operators devote to access concerns, our engagement with Operators indicates the incremental impact will be of minimal significance. It is unlikely to be more than around £0.5 million per annum in total across all of the relevant Operators.⁷⁰
- 4.181 Where the amendments to Access Requirements encourage greater interest in Direct Access, there may also be additional costs for Operators in order to respond to this interest and, where relevant, to on-board new Direct PSPs. These are likely to vary by Operator and have not been quantified.
- 4.182 It is possible that wider Direct Access to interbank payment systems could alter the incentives for existing Direct PSPs to make investments through the Operators and/or in Central Infrastructure provision. We would expect these investment incentive issues to be considered by the Payments Strategy Forum and as part of our market review into infrastructure.⁷¹
- 4.183 Overall therefore, we expect that the incremental cost associated with complying with our Access Rule, should be of minimal significance and should be exceeded by the benefits explained above.

Reporting Rule

- 4.184 As set out below we expect our proposals to have notable benefits for those who use, or are likely to use, the services provided by payment systems. In our opinion, it is not reasonably practicable to produce a quantitative estimate of the benefits given the nature of the benefits. We also believe that the costs should be of minimal significance.

Intended benefits

- 4.185 The Reporting Rule would require all pan-GB Operators to establish and publicly disclose Access Requirements which are compliant with the Access Package, and notify us of their policies and procedures. The requirement would be expected to increase the level of attention that Operators devote to considering the impact that their Access Requirements have.
- 4.186 This Reporting Rule will apply both to the Operators of the systems that are required to comply with our Access Rule – i.e. Bacs, C&CC, CHAPS and FPS – and to the Operators of the systems that need to comply with the access obligations under Regulation 97 of the PSRs 2009 – i.e. LINK, MasterCard and Visa.
- 4.187 The likely benefits associated with our Reporting Rule are intrinsically linked to the benefits anticipated from complying with our Access Rule and the access obligations under Regulation 97 of the PSRs 2009. In this section we do not repeat all the benefits and expected outcomes as set out above,⁷² but in summary, we expect the Reporting Rule to:
- Provide a consistent review and compliance framework across all pan-GB Operators. Providing a report to us should ensure that we are kept informed about the status of compliance with the Access Rule and therefore aid enforcement of the Access Rule.
 - Improve the disclosure and transparency of information, which should benefit the large number of PSPs that wish to evaluate and assess their access options (whether Direct or Indirect Access). It may also aid comparison between payment systems if PSPs do not wish to obtain access to all payment systems.
 - Increase the flexibility of Access Requirements, and the ease with which PSPs could bring forward new services. Operators will need to explain their response to PSPs requesting new types of access in the knowledge that this will be reviewed by us. Transparent criteria should

⁷⁰ Based on our discussions with Operators, it appears unlikely that incremental costs would exceed the equivalent of five full-time equivalent employees across all of the relevant Operators. Assuming salary costs of around £100,000 per employee, this would equate to £0.5 million. This is considered to be of minimal significance in comparison to overall costs of payment functions that are understood to run to hundreds of millions of pounds within Direct PSPs.

⁷¹ See *Supporting Paper 2: Payments industry strategy and areas for collaboration*.

⁷² See paragraphs 4.170 to 4.175.

also help to provide a clear route for PSPs to bring forward such suggestions. Combined, these could increase the likelihood of new services being developed.

Related anticipated costs

- 4.188 We expect most Operators to already have Access Requirements in place for Direct Access to their payment system. These may, however, not be publicly available. We anticipate that Operators may incur some minimal costs associated with publishing their Access Requirements and providing us with an annual compliance report. We do not expect these to be onerous and we believe that this increase will be of minimal significance.
- 4.189 We consider that a planned annual reporting cycle should also ensure that costs are minimal. This is considered to be a less costly approach to ensuring that we are kept informed compared to irregular requests for information, which we could make under our general information gathering powers.
- 4.190 We expect to work with Operators to ensure that their reporting meets our requirements without imposing a significant compliance burden on them. We intend to discuss these reporting requirements with Operators so as to ensure that this is the case.

SP4-Q4: Do you agree with the costs and benefits identified for our Access Package? Can you provide any data that might further inform our analysis of the likely impact of our proposed directions?

D.

Indirect Access to payment systems

What are the issues?

- 4.191 We want to ensure that Indirect Access is functioning in a manner that promotes competition, innovation and is in the interests of service-users. For this reason, we want to identify any issues that may be preventing the supply of Indirect Access from functioning effectively.
- 4.192 References in this **Part D** on '**Indirect Access**' should be understood to be a reference to Indirect Access to the Bacs, C&CC, CHAPS and FPS interbank payment systems.⁷³
- 4.193 While PSPs can also have Indirect Access to Visa and MasterCard,⁷⁴ given that the majority of PSPs with access to card payment systems have Direct Access,⁷⁵ and that our stakeholders did not identify significant concerns regarding Indirect Access to card payment systems, we have not included card payment systems in our analysis of Indirect Access.
- 4.194 We have received a wide range of views from Indirect PSPs regarding Indirect Access. Although the majority of respondents to our questionnaire on access to interbank payment systems said they were generally satisfied with the service they receive from their Sponsor Banks,⁷⁶ a large number of stakeholders raised concerns with us regarding the supply of Indirect Access more generally. We received over 80 responses to our Call for Inputs⁷⁷ – more than 30 of these were from Indirect PSPs or trade bodies representing Indirect PSPs, with the majority raising various concerns about the supply of Indirect Access.
- 4.195 These concerns fell into nine broad categories:
- lack of choice in Sponsor Banks
 - difficulties accessing and assessing information about different Indirect Access options
 - reliance on downstream competitors for the provision of access to payment systems
 - fees for Indirect Access

⁷³ It is only possible for PSPs to have Direct Access to LINK. We are not proposing to consider NICC given the limited nature of stakeholder concerns raised with us, the more limited scope of its activities, and because of the development of cheque imaging (see **Part C** above on Direct Access and *Supporting Paper 2: Payments industry strategy and areas for collaboration*).

⁷⁴ This involves Principal members of Visa and MasterCard acting as a sponsor to other organisations to allow them to issue and acquire cards.

⁷⁵ As set out above in **Part C**, for MasterCard and Visa we are treating Principal membership/licensees as the equivalent to Direct Access in interbank payment systems.

⁷⁶ Analysis of the PSR Questionnaires on Access (Interbank) – question 1b.34.

⁷⁷ *Payment Systems Regulator: Call for Inputs* (5 March 2014), available at <http://www.fca.org.uk/your-fca/documents/payment-systems-regulation-call-for-inputs>

- communication of important information by Sponsor Banks
- the risk that Sponsor Banks may discontinue the supply of Indirect Access
- contractual arrangements that govern the supply of Indirect Access
- the quality and availability of Technical Access
- demand for alternative access mechanisms.

4.196 We discuss each of these categories of concern below, along with our assessment of each.

Concerns about lack of choice in Sponsor Banks

4.197 A large number of Indirect PSPs told us that they do not have a wide enough choice of Sponsor Banks, and that this has an adverse impact on the terms they are able to negotiate for Indirect Access.

4.198 Currently, five of the main UK banks act as Sponsor Banks, namely Barclays, the Co-operative Bank, HSBC, Lloyds and RBS. The Co-operative Bank has recently decided to cease providing Indirect Access due to *"the high costs of continuing to provide a regulatory compliant agency service"*.⁷⁸

4.199 Certain types of PSPs – specifically PIs and EMIs – appear to have less choice of Sponsor Bank, with some telling us that only one Sponsor Bank is willing to supply Indirect Access to them. We understand that this is driven in part by the decision of Sponsor Banks to review their Sponsor Agreements in light of the perceived risks associated with Anti-Money Laundering (AML) and sanctions regulations (see paragraph 4.201 below). Related to this, we have also heard that increased concerns about the exposure to AML liability is prompting Sponsor Banks to impose increasingly rigorous compliance requirements on their Indirect PSPs.

4.200 In contrast, several Indirect PSPs told us they were comfortable with the current level of choice of Sponsor Banks available to them.

Our assessment of these concerns

4.201 There are certain characteristics of the provision of Indirect Access that may limit the number of Sponsor Banks. In order to provide Indirect Access to PSPs, Sponsor Banks must have:

- Direct Access to the payment systems to which they are providing Indirect Access.
- IT systems capable of sending and receiving payment instructions on behalf of Indirect PSPs, and of interfacing with Indirect PSPs' own infrastructure. They also need a customer support team to provide support to their Indirect PSPs.
- Appropriate operating and accounting processes to deliver a service compliant with regulation and to manage the risks associated with providing Indirect Access. Sponsor Banks have told us that these risks include settlement, liquidity and credit risk, operational risk, reputational risk, and regulatory and compliance risk (particularly with regard to ensuring compliance with AML and sanctions regulations).

4.202 Over and above ongoing operating costs, meeting these conditions involves significant set-up and ongoing fixed costs, including developing IT systems and robust operational and risk management processes. For this reason, Indirect Access only becomes commercially viable once there is a volume of transactions which is high enough to recover these costs.

⁷⁸ Co-operative Bank response to *Payment Systems Regulator: Call for Inputs* (15 April 2014) – p6.

- 4.203 From a Sponsor Bank perspective, the provision of Indirect Access to PSPs has some common characteristics to the provision of payment services to corporates that are not PSPs.⁷⁹ Non-PSP corporates (e.g. a utilities company) may generate large volumes of inbound and outbound payments through the payment of staff salaries and supplier costs, and the receipt of customer payments. Similar to Indirect PSPs, they will expect to initiate payment instructions through their own infrastructure and to receive customised reporting information.
- 4.204 As elements of the investment required to provide payment services to non-PSP corporates can also be used to provide Indirect PSPs with access to payment systems, banks with a large base of non-PSP corporates will typically face lower average costs for the provision of payment system access to Indirect PSPs than an equivalent bank without this non-PSP corporate customer base.
- 4.205 More generally, banks with a large base of non-PSP corporate customers to whom other, non-payment banking services are provided (e.g. the provision of credit) will have an increased opportunity to cross-sell payment services. This will increase the likely economic viability of the provision of payment services (to both PSPs and non-PSP corporates), compared to an equivalent bank without this non-PSP corporate customer base.
- 4.206 The need to secure a sufficient volume of Indirect PSPs and/or a sufficient number of non-PSP corporate banking customers across which to spread the cost of providing payment services (or to cross-sell payment services to) may limit the number of providers of Indirect Access.⁸⁰
- 4.207 The supply of Indirect Access is currently concentrated in a relatively small number of Sponsor Banks. While some Indirect PSPs consider that the current relatively small set of suppliers provides them with sufficient choice, others do not. Some Indirect PSPs, particularly smaller, non-bank PSPs, do not have any choice, with only one Sponsor Bank prepared to engage with them.
- 4.208 We are concerned that for some Indirect PSPs the limited choice of Sponsor Banks may constrain their bargaining power and may impact the terms under which they are able to secure Indirect Access.
- 4.209 As set out in **Part C** above, we want to see Direct Access become a viable option for a greater number of Indirect PSPs. This will benefit even those that choose not to take this option, as it should increase the competitive pressure on suppliers of Indirect Access. As set out in paragraphs 4.318 to 4.324 below, we will also conduct a more detailed market review of the provision of Indirect Access, to better understand how it functions and to consider whether further regulatory intervention is required. As part of this market review, we will engage with other relevant authorities to promote awareness of the adverse impacts that the implementation of AML regulation may be having on choice of Sponsor Bank for some Indirect PSPs.

Concerns about difficulties accessing and assessing information about different Indirect Access options

- 4.210 A number of stakeholders have told us that they have difficulties in accessing and assessing information on the Indirect Access services offered by Sponsor Banks, and in making meaningful comparisons between Sponsor Banks' service offerings.
- 4.211 Reasons for these difficulties included:
- a lack of standardised terminology in the industry
 - a lack of detailed documentation of Indirect Access service offerings

⁷⁹ Some incremental investment is required to provide payment services to Indirect PSPs that is not typically required for the provision of payment services to non-PSP corporates. For example, Sponsor Banks need to be able to allocate sort codes to their Indirect PSPs and to route payments using those sort codes.

⁸⁰ We note, however, that a few of the Direct PSPs that responded to our questionnaire on interbank payment system access indicated that they have not ruled out the idea of offering Indirect Access in the future (Analysis of the PSR Questionnaire on Access (Interbank) – question 2c.6).

- limited transparency of each Sponsor Bank's service offerings, including fee structures
- 4.212 One stakeholder stated that the opaque fee structure for Direct Access also limits their ability to negotiate the terms of Indirect Access.

Our assessment of these concerns

- 4.213 Given the stakeholder concerns raised with us, we are of the view that the level of general information available to Indirect PSPs regarding their different access options can be improved.
- 4.214 We understand that the detailed terms of Sponsor Agreements (such as pricing and the specific services provided) are typically not available to Indirect PSPs until the start of discussions with individual Sponsor Banks. This is common in the provision of business-to-business services, e.g. banks do not generally provide prices for corporate banking services until discussions have begun with potential customers.
- 4.215 However, it is important that Indirect PSPs are able to access basic information regarding the characteristics of the Indirect Access services offered by Sponsor Banks and on how to engage with Sponsor Banks in further discussions. We are concerned that this information may currently not always be easily available to actual and prospective Indirect PSPs.
- 4.216 There are also a number of characteristics of the supply of Indirect Access that may complicate the comparison of Indirect Access propositions between different Sponsor Banks.
- 4.217 While all Sponsor Banks provide a minimum, core set of services – such as payment processing, settlement, reporting services and customer support, the frequency and level of support for these services can vary. In addition, a range of ancillary payment-related services may also be provided by Sponsor Banks, such as message transformation, and assistance with AML and sanctions compliance.⁸¹
- 4.218 Payment services may also be only one of several services that an Indirect PSP sources from a Sponsor Bank. For example, an Indirect PSP may also use the Sponsor Bank for non-payment related services such as the provision of a credit facility. These factors will complicate the comparison of offerings between Sponsor Banks where different portfolios of services are being considered.
- 4.219 The provision of Indirect Access to payment systems is currently a complex, non-standardised service, which means that a direct, like-for-like comparison of offerings between Sponsor Banks is rarely possible. As a result, evaluating the relative benefits and costs of different propositions requires a reasonably high level of expertise on the part of the buyer of these services.
- 4.220 Given this level of required expertise, we are concerned that some PSPs – in particular, new PSPs and smaller PSPs without dedicated payment system specialists – may struggle to effectively evaluate and negotiate Indirect Access arrangements with potential Sponsor Banks.
- 4.221 To address these issues, we want to see better availability of information regarding Indirect Access options to ensure that buyers are properly empowered to make informed choices. We set out our specific proposals to address our concerns in paragraphs 4.280 to 4.290 below.

Concerns about reliance on downstream competitors for the provision of access to payment systems

- 4.222 Several stakeholders identified concerns relating to the fact that the Sponsor Banks are frequently downstream competitors to the Indirect PSPs to which they provide Indirect Access. One PSP noted that in order to secure Indirect Access, their Sponsor Bank requested certain information about their payment services and business model which they viewed as commercially sensitive.
- 4.223 Another Indirect PSP argued that the provision of access by a downstream competitor limited the incentives of Sponsor Banks to improve the services they provide to Indirect PSPs.

⁸¹ Analysis of the PSR Questionnaire on Access (Interbank) – question 1b.30.

Our assessment of these concerns

- 4.224 We understand that Sponsor Banks may request certain information from prospective Indirect PSPs for a number of reasons related to the provision of Indirect Access, including to ensure that they have the necessary capabilities and capacity to provide the services Indirect PSPs require.
- 4.225 We have not received evidence to suggest that Sponsor Banks are in fact taking advantage of being a supplier of a critical input to Indirect PSPs. We expect Sponsor Banks to have robust processes in place to ensure that there are no inappropriate flows of competitively sensitive information within Sponsor Banks, and that information requested is limited to that which is strictly required for the provision of Indirect Access.
- 4.226 We would be concerned if Sponsor Banks took advantage of being a supplier of a critical input to downstream competitors or used the information they received for any purposes other than providing Indirect Access to those PSPs.
- 4.227 We discuss this concern further in relation to the proposed Sponsor Bank Code of Conduct at paragraphs 4.301 to 4.303 below. We will also keep these concerns under review as part of our wider programme of work that will consider the supply of Indirect Access in greater detail (see paragraphs 4.318 to 4.324 below).

Concerns about fees for Indirect Access

- 4.228 Several Indirect PSPs told us that they believe the fees for securing Indirect Access through a Sponsor Bank are too high. One challenger bank observed that the fees for Indirect Access to a payment system were multiples higher than that of Direct Access – they argued that differentials of this magnitude were not consistent with an *“open, well-functioning, and competitive market”*.
- 4.229 In contrast, several Indirect PSPs specifically noted in their submissions to us that the fees charged by their Sponsor Banks were not unreasonable (although some made this point with reference to what they perceived were the high costs of Direct Access).

Our assessment of these concerns

- 4.230 Stakeholder concerns raised with us about the fees for Indirect Access do not appear to be widespread at present.
- 4.231 We note that Sponsor Banks incur a range of incremental costs in the provision of Indirect Access and provide a range of services in connection with this provision. Indirect PSPs also avoid a range of costs that they would otherwise face as Direct PSPs (e.g. investment in infrastructure to achieve compliance with payment systems' Access Requirements).
- 4.232 Further, the assessment of fees is complex and will require a significant amount of time and resource to accurately understand. As such, we are not proposing to take any immediate action around this concern. We will, however, revisit this concern as part of a wider programme of work that will consider the supply of Indirect Access in greater detail (see paragraphs 4.318 to 4.324 below).

Concerns about communication of important information by Sponsor Banks

- 4.233 Several Indirect PSPs highlighted concerns about the communication of important information that supports the Indirect Access they receive from Sponsor Banks. Examples include:
- not receiving important information from Sponsor Banks, e.g. regarding operational incidents or planned future developments at the payment system level
 - Sponsor Bank customer support teams having insufficient technical knowledge on payment systems or being unavailable to respond to their queries

Our assessment of these concerns

- 4.234 Sponsor Banks have a degree of visibility over both their own payments infrastructure and the payment systems themselves that is not available to Indirect PSPs. As large, sophisticated organisations that have Direct Access, Sponsor Banks will typically have a deeper knowledge of the payment systems than Indirect PSPs.
- 4.235 These factors, combined with the critical importance of payment systems access to Indirect PSPs' businesses, makes it vital that Sponsor Banks:
- provide important information on issues that will impact the services received by Indirect PSPs in a timely manner
 - have the systems and staff to respond knowledgeably to support queries from Indirect PSPs
- 4.236 As Sponsor Banks appear to be largely meeting these responsibilities, this is not of immediate concern to us. However, we believe that our proposals targeting other aspects of Indirect Access will help ensure that Sponsor Banks continue to meet these responsibilities and address any instances where there are ongoing stakeholder concerns.

Concerns about the risk that Sponsor Banks may discontinue the supply of Indirect Access

- 4.237 Several Indirect PSPs have told us of their concerns that Sponsor Banks have the ability to discontinue the supply of Indirect Access at their own discretion, despite the Indirect PSP continuing to be compliant with all relevant regulatory requirements.
- 4.238 We received input from two Indirect PSPs whose access arrangements were discontinued by their Sponsor Banks. In one case, the PSP decided to become a Direct PSP of the payment system it had previously accessed indirectly - the Sponsor Bank continued to provide Indirect Access until the PSP had secured Direct Access and assisted with the migration process. In the other case, the Sponsor Bank served the PSP with a notice that it should transfer its business elsewhere but withdrew this decision when the PSP encountered difficulties in finding an alternative supplier (although the Sponsor Bank indicated it still wanted the PSP to continue looking for alternative suppliers).

Our assessment of these concerns

- 4.239 It is clear that some Indirect PSPs have concerns regarding the security of the supply of the Indirect Access they receive from their Sponsor Banks. These concerns are given added relevance by the recent decisions of some banks (including some Sponsor Banks) to scale back, or withdraw completely from, the supply of banking services more generally to certain types of organisations.⁸² In part, this has been prompted by the heightened public scrutiny of financial institutions and the significant financial penalties some have incurred with regard to failures in AML controls.⁸³
- 4.240 This decision has prompted other PSPs – in particular, smaller, non-bank PSPs (such as PIs and EMLs) – to question whether they may lose access to payment systems if their Sponsor Bank was to reappraise its risk appetite.
- 4.241 The loss of access to payment systems would be a significant adverse development for an Indirect PSP for a number of reasons:
- Access to payment systems is a critical input to the supply of payment services – without access, a PSP may not be able to continue to operate.

⁸² For example, in 2013 HSBC announced it was withdrawing completely from offering banking services to money-service businesses. Also in 2013, Barclays announced it was significantly reducing the number of money-service businesses it would provide banking services to. See FT article '*Lenders pull banking facilities from small financial groups*' available at <http://www.ft.com/cms/s/0/22d9d042-d276-11e2-aac2-00144feab7de.html> (12 June 2013).

⁸³ For example, the US\$1.9 billion HSBC paid to US authorities in 2012 to settle a case brought against it. See BBC article '*HSBC to pay \$1.9bn in US money laundering penalties*' available at: <http://www.bbc.co.uk/news/business-20673466> (11 December 2012).

- The degree of choice of alternative suppliers is limited, particularly for certain types of PSPs – if access is terminated, a PSP may struggle to find an alternative supplier.
 - Switching suppliers of Indirect Access is a non-trivial exercise that requires bespoke integration work between the Indirect PSP's and Sponsor Bank's systems.
- 4.242 Commercial organisations such as Sponsor Banks are entitled to make commercial decisions regarding the types of organisation they supply with Indirect Access (subject to compliance with relevant regulations and competition law). However, given that payment systems access is such a critical input to PSPs, we consider that where strategic decisions are taken to discontinue supply to certain customer segments, Sponsor Banks should:
- ensure such a decision is made in a reasonable and orderly fashion with appropriate notice
 - provide reasonable assistance with the transition to alternative supply arrangements, to the extent possible and where appropriate.
- 4.243 We want to see Sponsor Banks make a formal commitment to such responsibilities, which we believe will help to alleviate some of the concerns related to the security of supply of Indirect Access. We discuss this further in paragraphs 4.245 to 4.250 below.
- 4.244 We will also conduct a more detailed market review of the provision of Indirect Access (see paragraphs 4.318 to 4.324 below), to better understand how it functions and to consider whether further regulatory intervention is required. As part of this market review, we will engage with other relevant authorities to promote awareness of the adverse impacts that AML regulation may be having on choice for some Indirect PSPs.

Concerns about contractual arrangements that govern the supply of Indirect Access

- 4.245 A small number of Indirect PSPs have highlighted concerns about the contractual arrangements that govern the supply of Indirect Access from their Sponsor Banks:
- A challenger bank told us that, despite repeated requests, they have been unable to secure a written copy of their contractual arrangements with their Sponsor Bank.
 - A building society told us that their Sponsor Banks had been reluctant to provide what they viewed as being "*suitable contracts*" in support of the provision of Indirect Access.
 - A challenger bank told us that the terms and conditions under which they received Indirect Access from their Sponsor Bank were "*not fit for purpose*". They noted that the terms and conditions were those for a standard corporate bank account, and did not include protections which they would typically expect in a critical outsourcing agreement, such as business continuity, exit management, detailed service levels and redress in the event of failure by the supplier.
- 4.246 The Bank has noted potential issues regarding the contractual relationships between Indirect PSPs and their Sponsor Banks. In its Call for Input response, the Bank noted that its discussions with industry suggested "*the terms on which payment services are provided [to Indirect PSPs] do not address the risk that the service could be withdrawn in stressed circumstances when it is most difficult to find an alternative provider*" and that "*from a financial stability perspective, there would be benefits in contracts which make explicit provisions for periods of stress, so that firms can better understand and manage the risks inherent in their payment relationships.*"⁸⁴
- 4.247 Other Indirect PSPs indicated to us that they were comfortable with the contractual arrangements with their Sponsor Banks. Specifically, some Indirect PSPs stated that they had written contracts in place with their Sponsor Banks that contained terms they viewed as being as reasonable.

⁸⁴ Bank of England response to *Payment Systems Regulator: Call for Inputs* (8 May 2014) – p7.

Our assessment of these concerns

- 4.248 While some parties have reported difficulties securing a written copy of their contractual arrangements, or have concerns with the terms within the contract, others are comfortable with the contractual arrangements they have in place.
- 4.249 We want to ensure that all Indirect PSPs receive a written version of their contract and that contracts provide adequate protections and assurances – to both themselves and their Sponsor Bank – and clearly set out the roles and responsibilities of each party. We agree with the Bank that ensuring that contracts include explicit provisions on service termination and ‘periods of stress’ would be beneficial for all contracting parties from a financial stability perspective, which is something we must have regard to under s.49(3)(a) FSBRA.
- 4.250 With this in mind, we want to see Sponsor Banks formalise the commitment to provide an appropriate written contract to Indirect PSPs. We consider that this will help to increase the security of supply Indirect PSPs receive from Sponsor Banks. We discuss this further at paragraphs 4.298 to 4.313 below.

Concerns about quality and availability of Technical Access

- 4.251 A significant number of Indirect PSPs have highlighted to us concerns that the Technical Access capabilities received from their Sponsor Banks are not as good as those available to Direct PSPs. This concern was raised with specific reference to FPS and focussed on the inability of Indirect PSPs to obtain the same near real-time service available to Direct PSPs, and to access FPS on a 24/7 basis.⁸⁵
- 4.252 Indirect PSPs argued that limitations on Technical Access capabilities prevented them from offering the same service levels to their end-users as Direct PSPs, and also prevented them from participating in other services that rely on FPS (such as Paym).

Our assessment of these concerns

- 4.253 Indirect PSPs can gain Technical Access to FPS either through a Sponsor Bank’s infrastructure (as represented in part B of **Figure SP4-4** below) or by connecting directly into the payment system Central Infrastructure (part C of **Figure SP4-4**).
- 4.254 We are concerned that, because of the limitations in the Technical Access that Indirect PSPs receive by connecting through a Sponsor Bank’s infrastructure, Indirect PSPs are currently unable to access FPS on a similar basis to Direct PSPs. Such access is critical to creating a level playing field for all PSPs, particularly as the use of near real-time payments – and innovations based upon them – grows.
- 4.255 Indirect PSPs can also gain Technical Access to FPS by connecting directly into the payment system Central Infrastructure (i.e. Direct Technical Access) in two different ways:
- Indirect PSPs can have a direct technical connection to the FPS payment system Central Infrastructure that enables them to directly submit payment instructions (in batch form). This is sometimes referred to as ‘direct corporate access’ as it is also used by non-PSP corporates that generate large volumes of payments.
 - Under the FPS Direct Agency Access arrangement, an Indirect PSP can connect directly to the payment system Central Infrastructure in a way that enables it to send and receive payment instructions on a near real-time, 24/7 basis.

⁸⁵ We have been told that Indirect PSPs typically access FPS (via their Sponsor Bank) using the SWIFT network, but that the SWIFT network has scheduled maintenance windows at weekends and that affects the availability of the FPS service that Indirect PSPs receive. For more information on the SWIFT network, see the KPMG Infrastructure Report included as an Annex to *Supporting Paper 2: Payments industry strategy and areas for collaboration*.

- 4.256 However, current Direct Technical Access arrangements also have a number of limitations:
- In the case of direct corporate access, Indirect PSPs are only able to send payment instructions, and they therefore need to rely on traditional Indirect Access arrangements to receive payment instructions from other PSPs. Further, this option does not enable payments on a near real-time basis.
 - At present, only one Sponsor Bank provides Indirect PSPs with Direct Agency Access to FPS and we understand that currently only one Indirect PSP is using this service. An Indirect PSP told us that they viewed the current costs to secure Direct Agency Access to FPS as being “prohibitive”.
- 4.257 It is important to note that, before seeking near real-time access to FPS, Indirect PSPs need to ensure their own infrastructure is able to handle payments of this type. The IT systems required to manage near real-time payments are typically more sophisticated than those for batch payments and many Indirect PSPs, particularly smaller PSPs or those with older IT systems, may need to invest in system upgrades before seeking FPS access on a near real-time basis.
- 4.258 We are aware that there are other Sponsor Banks and third-party service providers that are currently considering or actively developing new Technical Access solutions to FPS that should provide Indirect PSPs with a level of service closer to that available to Direct PSPs. We support these developments and would like to see Sponsor Banks develop improved FPS Indirect Access offerings and for third-party service providers to develop new Technical Access solutions (this is discussed further in the following section).

Concerns about demand for alternative access mechanisms

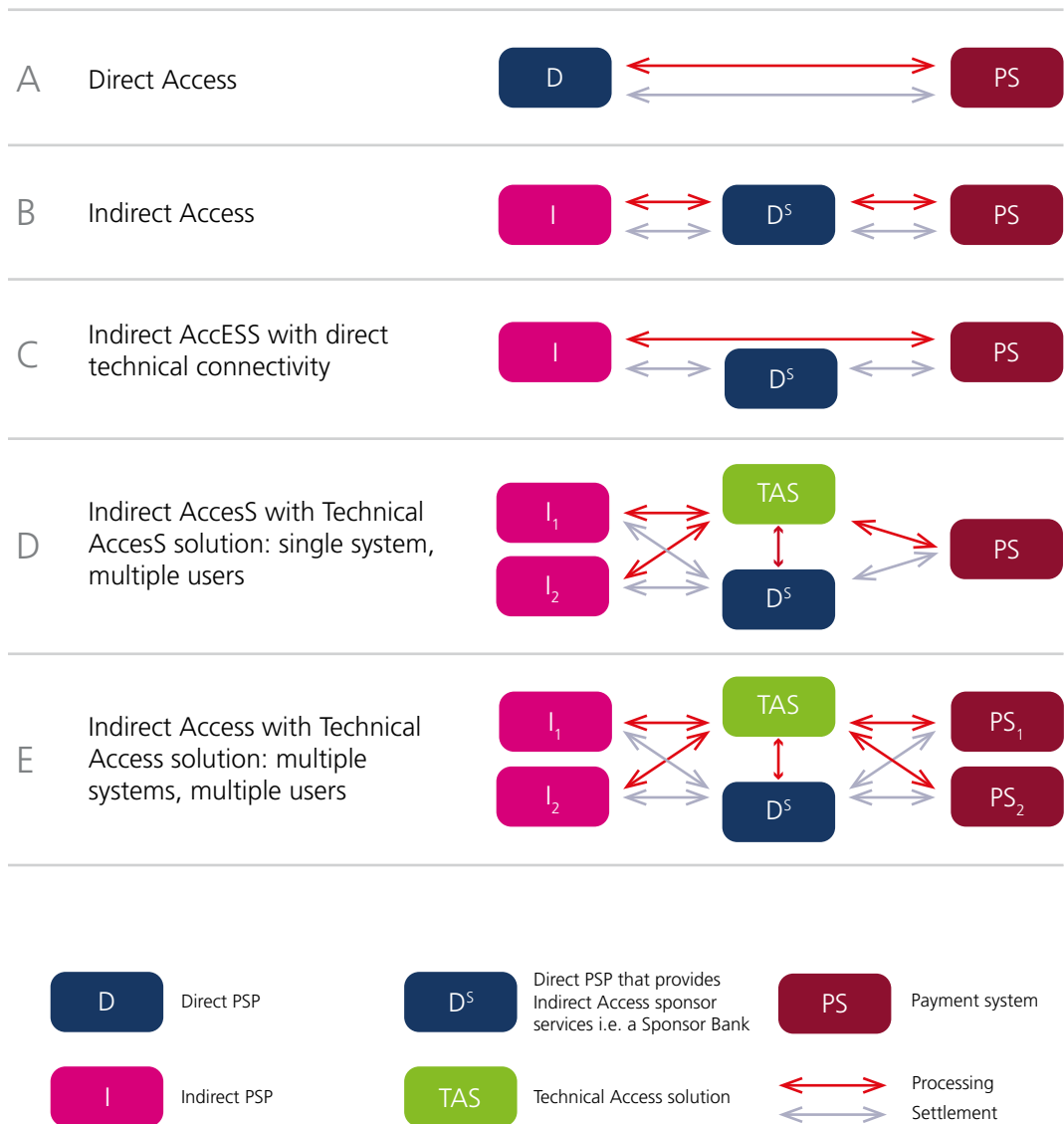
- 4.259 Given the concerns raised above regarding the Technical Access capabilities Indirect PSPs receive, a large number of Indirect PSPs have told us that they would like to see improvements to Direct Technical Access solutions, or the creation of alternative access mechanisms (i.e. ways of accessing payment systems that do not require securing traditional Indirect Access whereby payments must be routed through a Sponsor Bank).
- 4.260 The demand for alternative access mechanisms also appears to relate to the costs of securing Direct Technical Access as a Direct PSP. Specifically:
- Many Indirect PSPs find it prohibitively expensive to meet the technical requirements for Direct Access (especially for FPS – see **Part C** on Direct Access).
 - Each payment system has developed its own standards, protocols and arrangements to connect to the payment system infrastructure. This increases the complexity and cost of securing Technical Access to multiple payment systems.
- 4.261 Stakeholders had a range of views on the potential characteristics that alternative access mechanisms should have. The most common views were that it should:
- provide a central technical hub to which multiple Indirect PSPs can connect, and which would give them Technical Access to a payment system on a functionally equivalent basis to Direct PSPs
 - provide a single gateway that enables access to multiple payment systems, allowing an Indirect PSP to access multiple payment systems through a single point of technical connectivity
- 4.262 This alternative access mechanism was variously described by stakeholders as a ‘hub’, a ‘managed service’, an ‘aggregator’ and a ‘common utility’. From reviewing the different characteristics that stakeholders desire these mechanisms to exhibit, we believe they are best described as Technical Access solutions.

Our assessment of these concerns

4.263 We support the creation of new Technical Access solutions, which we see as having the potential to provide a number of benefits:

- A Technical Access solution could enable multiple Indirect PSPs to access a payment system on a functionally equivalent basis to Direct PSPs (part D in **Figure SP4-4**). This could lower the cost of maintaining access to the payment system for PSPs.
- A Technical Access solution could enable multiple Indirect PSPs to access multiple payment systems, via a single gateway, on a functionally equivalent basis to Direct PSPs (part E in **Figure SP4-4**). Establishing and maintaining a single technical connection should result in cost savings and potentially make access to multiple payment systems simpler, as well as providing interoperability benefits.
- Technical Access solutions might allow some Indirect PSPs to become Direct PSPs (see **Part C** above for further details on the steps Operators are taking to improve Technical Access options).

Stylised Technical Access arrangements (figure SP4-4)



4.264 Technical Access solutions of these types would probably require (initially, at least) Indirect PSPs to have a relationship with a Sponsor Bank for the provision of final settlement at the payment system level. However, by unbundling the provision of payment processing from settlement services, Technical Access solutions could increase competition for processing services that are currently primarily provided by Sponsor Banks.

4.265 We see these Technical Access solutions as being most immediately relevant to providing access to FPS and, to a lesser degree, to Bacs and CHAPS. We do not see these solutions as being immediately relevant to the other interbank payment systems, namely LINK (given that Indirect Access to LINK is not possible) and C&CC (under the current paper-based cheque clearing model).

4.266 We understand that a number of potential third-party service providers are considering developing Technical Access solutions similar to those described above. We support these developments and want to encourage the provision of third-party Technical Access solutions. In considering fair and open access, we also expect Operators to have suitable accreditation processes to better allow third-party service providers to provide Technical Access solutions to PSPs (see **Part C** on Direct Access for more information).

What is the impact of these concerns?

- 4.267 We have a number of concerns about the provision of Indirect Access. We are primarily concerned that, for some Indirect PSPs, a lack of choice of Sponsor Banks, combined with a limited ability to both access and assess information regarding different access options, is contributing to a reduction in bargaining power in relation to the Sponsor Banks. This may be limiting the terms of access that Indirect PSPs are able to negotiate with Sponsor Banks, giving rise to detrimental impacts on competition, innovation and service-users.
- 4.268 We also have concerns that the security of the supply of access provided by Sponsor Banks, and limitations in the technical capabilities of that access, may be having a negative impact on competition, innovation and service-users.
- 4.269 We consider each of these impacts in turn below.

Impact on competition

- 4.270 Some Indirect PSPs face a limited choice of Sponsor Banks and have limited ability to access and assess information regarding their access options. By constraining these Indirect PSPs' bargaining power, this reduces the competitive pressures faced by Sponsor Banks. In turn, this means these Indirect PSPs may have to accept less favourable access terms than they would in an otherwise more competitive environment. This may consequently constrain the ability of these Indirect PSPs to compete effectively with other PSPs in the provision of downstream payment and related banking services.
- 4.271 Aspects of the quality of Indirect Access – especially its technical capabilities – provided by Sponsor Banks may limit the ability of Indirect PSPs to compete with Direct PSPs (e.g. by being unable to provide their end-users with near real-time payments). Further, we are concerned that the insecurity of supply that some Indirect PSPs report may discourage them from undertaking investment that could enable them to compete more effectively with Direct PSPs.
- 4.272 Limitations in the technical capabilities of Indirect Access (e.g. lack of 24/7 access to FPS) may also constrain the ability of Indirect PSPs to develop innovative new products and services that compete more directly with those provided by Direct PSPs.
- 4.273 We are also concerned that the uncertainty that some PSPs experience in the supply of Indirect Access arrangements may similarly constrain their confidence to develop and invest in new and innovative service offerings, limiting their ability to compete in the provision of payment services to end-users.
- 4.274 The choice of Sponsor Banks for non-bank PSPs such as PIs and EMIs seems particularly constrained. Given that non-bank PSPs are a relatively new category of participant and that downstream innovation is frequently driven by new entrants, this constraint is particularly likely to restrict the pace of wider payments innovation.

Impact on innovation

- 4.275 Technical Access solutions can provide innovative ways of accessing payment systems, and, consequently, delays or obstacles to the development of Technical Access solutions can have an adverse impact on innovation. We consider that Technical Access solutions have the potential to promote the development of payment systems in the interests of service-users (e.g. the provision of 24/7 functionality of FPS to more Indirect PSPs) and to improve the quality, efficiency and economy of access to payment systems (also see **Part C** above in relation to the impact we believe our Direct Access proposals will have in relation to Technical Access).

Impact on service-users

- 4.276 We are concerned that reduced bargaining power may be contributing to Indirect PSPs securing Indirect Access on less favourable terms than would be the case in the absence of this issue. These less favourable terms may manifest themselves in the form of a lower quality of Indirect Access which will be passed on to Indirect PSPs' end-users, e.g. the lack of ability of many

Indirect PSPs to experience near real-time access to FPS means such Indirect PSPs are unable to offer near real-time services to their end-users.

- 4.277 As discussed in paragraphs 4.259 to 4.262 above, Indirect PSPs have demonstrated a strong interest in having new Technical Access solutions made available to them. This interest in alternative access mechanisms suggests the current way in which payment systems are developed and operated may not be taking into account the interests of both Indirect PSPs and their end-users to a sufficient extent.

Our proposals on Indirect Access

- 4.278 We expect that our Direct Access proposals (as set out in **Part C** above) will result in some current Indirect PSPs becoming Direct PSPs. However, a large number of PSPs will not want, or will not qualify for, Direct Access to payment systems. We therefore expect that there will be continuing demand for Indirect Access, with Indirect PSPs relying on the critical services and support provided by their Sponsor Banks.
- 4.279 For those that remain as Indirect PSPs – and for new entrants looking to access payment systems indirectly - we want to encourage the functioning of Indirect Access in a manner that promotes competition and innovation, and takes account of the interests of service-users. As such, we are making a number of proposals aimed at addressing the concerns we have identified above.

Proposed direction requiring the publication of information

- 4.280 We are concerned that some Indirect PSPs currently lack the ability to access and assess information regarding the Indirect Access options available to them. This is driven by both the lack of information available to Indirect PSPs, as well as the difficulties some Indirect PSPs experience in assessing available information.
- 4.281 To help address these issues, we want to improve the information available to Indirect PSPs and the ease with which Indirect PSPs can review and assess information. To achieve this, we are proposing to introduce a direction requiring Sponsor Banks to publish certain access-related information.
- 4.282 Our proposed direction would apply to Sponsor Banks. We would expect to see the Sponsor Banks comply with the direction by 1 April 2015 at the latest.
- 4.283 The information we expect to see Sponsor Banks publish includes, but is not limited to:
- descriptions of Indirect Access propositions, including the payment systems to which Indirect Access is offered and the key characteristics of that access, e.g. technical connectivity options
 - any eligibility criteria Sponsor Banks may set for potential Indirect PSPs
 - an appropriate contact for interested parties
- 4.284 The information will be published on the Sponsor Banks' websites and will also be provided to us.⁸⁶
- 4.285 We believe this proposed direction will help to address stakeholders' concerns because it will improve the content and availability of information on Sponsor Bank's Indirect Access propositions and enhance the transparency of each Sponsor Bank's offerings.

⁸⁶ We also expect to see this information published on the Information Hub we want to see developed (see paragraphs 4.291 to 4.297 below).

- 4.286 We expect that our proposed direction to publish certain information will help further our competition objective by:
- Increasing the competitive pressures on Sponsor Banks, as Indirect PSPs will be able to more effectively evaluate the relative merits of choosing and changing Sponsor Banks.
 - Strengthening the bargaining position of Indirect PSPs, which we expect should improve the terms on which Indirect PSPs will gain access. This will in turn improve their ability to compete more effectively with other PSPs in the provision of payment services.
- 4.287 By increasing the availability of information we expect our proposal to advance the interests of those who use, or are likely to use, the services provided by payment systems because they will be in a better position to understand, assess and choose the best route for them to access payment systems.
- 4.288 As we develop our proposed direction, we have had and will continue to have regard to how our proposals could impact the Bank's functions⁸⁷ and objectives, and the stability of, or confidence in, the UK financial system. We will continue to work closely with the Bank to assess these impacts and ensure there are no adverse impacts.
- 4.289 We have had regard to our regulatory principles when considering our proposal to issue a direction requiring the publication of certain access-related information. We are of the view that our proposal is consistent with our regulatory principles, and in particular:
- We consider that our proposed direction is consistent with the principle of proportionality. Specifically, we are of the view that the direction will be effective in helping to address certain concerns regarding the ability of Indirect PSPs to access and assess information, and that we have adopted the least onerous approach to effectively addressing this concern. We consider that the costs of compliance with this measure are minimal and not disproportionate to the benefits we see the measure having (we also present a discussion of the expected benefits and costs of our proposal in paragraphs 4.325 to 4.335 below).
 - Our proposal will not remove the requirement for Indirect PSPs to take responsibility for their decisions with regards to payment systems access. It will, however, give them the quality and quantity of information they need to make more informed decisions.
- 4.290 Our draft direction requiring the publication of certain access-related information is set out in *Annex 2* to the Consultation Paper.

SP4-Q5: Do you agree with our proposed direction requiring Sponsor Banks to publish certain information? If you disagree with our proposed approach, please give your reasons.

Industry engagement on the development of an Information Hub

- 4.291 We are aware that the industry is currently developing a website that will act as a central information repository to improve the disclosure and transparency of information for PSPs that want to access payment systems. While its exact content is still to be determined, we understand this initiative will include details of both Direct Access and Indirect Access options and may also provide best practice guidelines regarding access to payment systems for the industry.⁸⁸ We are supportive of this development, and expect the industry to successfully deliver this initiative.

⁸⁷ In its capacity as a monetary authority, including the Bank's other relevant functions such as settlement service provider, provider of infrastructure, security trustee, Direct PSP for some payment systems, and resolution authority.

⁸⁸ These best practice guidelines may also be supportive of our proposal below on the development of a Sponsor Bank Code of Conduct.

- 4.292 We believe that the development of an Information Hub will help address some of our concerns regarding the ability of Indirect PSPs to access and assess information on Indirect Access. An Information Hub would enable greater visibility and access to information across payment systems and Sponsor Banks, which will also allow PSPs to make comparisons across both Direct Access and Indirect Access offerings, and between different Sponsor Banks.
- 4.293 Once developed, an Information Hub could act as a central point for PSPs to refer to when considering their access options. Further, we expect the Information Hub to be used by the industry to publish:
- The information we intend to require Sponsor Banks to disclose by way of our proposed direction (see paragraphs 4.280 to 4.290 above).
 - Operators' Access Requirements that will be publicly disclosed as part of our proposed direction requiring public disclosure of the Access Requirements for Direct Access (as described in paragraphs 4.155 to 4.158 above).
 - The proposed PSR-approved Sponsor Bank Code of Conduct (see paragraphs 4.298 to 4.313 below).
 - Information for PSPs on how to effectively engage with Sponsor Banks (e.g. through best practice guidelines on how to define their specific requirements, procurement processes and contractual arrangements).
- 4.294 As far as possible, we would like to see the terminology used in presenting information on the Information Hub to be aligned across Sponsor Banks and Operators, in order to facilitate comparisons of access options between payment systems and Sponsor Banks.
- 4.295 The development of an Information Hub may require a measure of collaboration between industry participants. For this reason, the industry should be best placed to design and develop an Information Hub that meets the needs of service-users. However, if the current industry initiative does not provide sufficient information to address our concerns – for example it does not contain information from all Sponsor Banks and Operators – we will consider referring it to the Payments Strategy Forum (see *Supporting Paper 2: Payments industry strategy and areas for collaboration*), or taking other appropriate regulatory action.
- 4.296 We consider that an Information Hub will contribute to:
- encouraging greater consistency in the terminology used across the industry, which will facilitate comparison of different access options
 - reducing the research costs incurred by PSPs when evaluating different access options (by having information in a single location)
 - providing information to Indirect PSPs on how to most effectively engage with Sponsor Banks regarding the negotiation of Indirect Access.
- 4.297 We expect the Information Hub to help strengthen the bargaining position of Indirect PSPs, and to enhance the terms on which Indirect PSPs gain access to payment systems. In turn, we expect this to improve the ability of Indirect PSPs to compete more effectively with other PSPs in the provision of payment services.

SP4-Q6: Do you agree with our proposed approach in relation to the development (by industry) of an Information Hub? Or do you consider that we should take a more prescriptive approach at this time? If you disagree with our proposed approach, please give your reasons.

Industry engagement on the development of a PSR-approved Sponsor Bank Code of Conduct

- 4.298 We have concerns regarding aspects of the security of supply of Indirect Access provided by Sponsor Banks. Specifically:
- the risk that Sponsor Banks may discontinue the supply of Indirect Access, and
 - the contractual arrangements that govern the supply of Indirect Access.
- 4.299 Contributing to these concerns is the limited number of alternative suppliers available to some Indirect PSPs if their current supply were to be discontinued, and the impact of regulatory risk related to compliance with AML regulations on Sponsor Banks' willingness to supply Indirect Access. We will consider these specific concerns further as part of our detailed market review into the provision of Indirect Access (see paragraphs 4.318 to 4.324 below).
- 4.300 However, we are of the view that there are some immediate measures that can be taken to at least partly address these concerns. With this in mind, we expect Sponsor Banks to work with us to develop a Code of Conduct. While we will engage with Sponsor Banks to facilitate development of the Code of Conduct, we expect Sponsor Banks to lead this initiative. We will also approve the Code of Conduct prior to its publication and adoption by Sponsor Banks.
- 4.301 We are of the view that a Sponsor Bank Code of Conduct should also be effective in addressing some of the other concerns identified by stakeholders with respect to Indirect Access, including:
- that Indirect Access is provided by a downstream competitor, and
 - the communication of important information between Sponsor Banks and Indirect PSPs in a timely manner.
- 4.302 For the avoidance of doubt, we do not envisage that the Code of Conduct will replace bilateral contractual agreements between Sponsor Banks and Indirect PSPs. Rather, we see it playing a complementary role by:
- publicly committing Sponsor Banks to the responsibilities set out in the Code of Conduct, which will increase the incentives for Sponsor Banks to behave in a manner consistent with the Code of Conduct, and
 - signalling to potential new Indirect PSPs the types of responsibilities Sponsor Banks would commit to when providing Indirect Access.
- 4.303 We expect that the Code of Conduct will set out a range of responsibilities including:
- The responsibility of a Sponsor Bank to provide a clear, transparent and written contract to govern the provision of Indirect Access. We expect contracts to contain clear service level agreements and details of all fees to be incurred for the provision of Indirect Access. Contracts should also contain clear and specific termination clauses and notice periods. We consider that this will help address security of supply concerns by giving Indirect PSPs clarity on the specific contractual terms of their access, particularly around termination. Further, by encouraging best practices with regards to contractual arrangements, this will help to ensure that all Indirect PSPs have appropriate contractual arrangements in place.
 - The responsibility of a Sponsor Bank to provide a description of the support that it will provide to an Indirect PSP if and when the Sponsor Bank decides to discontinue access. We expect Sponsor Banks to commit to ensuring that such decisions are made in a reasonable and orderly fashion with appropriate notice and, where appropriate and to the extent possible, to provide reasonable assistance with the transition to alternative supply arrangements. We expect this to help alleviate some security of supply concerns by providing some comfort to Indirect PSPs as to what will happen if their access is discontinued.

- The responsibility of a Sponsor Bank to ensure that they only use the information they request from Indirect PSPs for the purpose of providing Indirect Access. The information requested should also be limited to the minimum necessary to provide Indirect Access, and should only be shared on a strict need-to-know basis within the Sponsor Bank for the sole purpose of providing the Indirect Access covered by the sponsor services contract. This commitment should lessen concerns raised by some Indirect PSPs regarding the supply of information to Sponsor Banks who they also compete with to provide payment services.
 - The responsibility of a Sponsor Bank to communicate information on system outages and system developments in a timely and easily accessible fashion, and to provide an appropriate level of customer support to assist with Indirect PSPs' queries. This should help to lessen concerns regarding the communication of information by Sponsor Banks, which was raised with us as a concern by some stakeholders.
- 4.304 We will engage with Sponsor Banks to facilitate development of the Code of Conduct. However, we consider that Sponsor Banks should lead this initiative and in doing so will engage with Indirect PSPs to gather their views on the Code of Conduct's potential content. We believe that industry is best placed to develop the Code of Conduct and that, at this stage, this approach is more appropriate and proportionate as compared to us adopting a more prescriptive or interventionist approach from the outset.
- 4.305 We expect that the Code of Conduct will have been approved by us and be in place by 30 June 2015 at the latest, and for all Sponsor Banks to comply with the Code of Conduct from 30 September 2015 onwards.
- 4.306 However, if the Code of Conduct is not developed and complied with in a timely or effective manner, we will consider taking further steps, which may include drafting the Code of Conduct ourselves, and/or directing the Sponsor Banks to comply with it or take other appropriate action.
- 4.307 We expect that the commitments contained in the final Code of Conduct should apply to both existing and future relationships that existing and future Sponsor Banks have with Indirect PSPs.
- 4.308 In approving the Code of Conduct we will consider a number of factors, including whether it:
- is appropriate for both existing Sponsor Banks and potential new Sponsor Banks that may choose to supply Indirect Access in the future
 - contains commitments sufficient to achieve our aims for the Code of Conduct (as set out at paragraph 4.311 below)
 - is compatible with our objectives
- 4.309 Once finalised by the Sponsor Banks and approved by us, we expect that the Code of Conduct will be published on each Sponsor Bank's website and on the Information Hub (see paragraphs 4.291 to 4.297 above).
- 4.310 We will monitor the effectiveness of the Code of Conduct through our proposed detailed market review into the supply of Indirect Access (see paragraphs 4.318 to 4.324 below) and through our ongoing engagement with Indirect PSPs and Sponsor Banks.
- 4.311 We consider that the Code of Conduct will:
- provide greater clarity on commitments of the Sponsor Bank in the event that access is discontinued
 - encourage the provision of clear, robust and written contracts

- publicly commit Sponsor Banks to certain responsibilities, which we expect will help to address other stakeholder concerns regarding certain aspects of Indirect Access (e.g. communication over key events such as outages and provision of commercially sensitive information to competitors)
- 4.312 We expect that the Code of Conduct will have a positive impact, particularly with regard to our competition objective. Specifically, by increasing the confidence that Indirect PSPs have in the supply of access they receive from Sponsor Banks, the Code of Conduct should assist Indirect PSPs in competing more effectively with other PSPs, for example, by increasing the confidence and willingness of Indirect PSPs to invest in new services that better enable them to compete with Direct PSPs.
- 4.313 By increasing the confidence in the supply of access provided by Sponsor Banks, the Code of Conduct will also result in improved outcomes for service-users.

SP4-Q7: Do you agree with our proposed approach in relation to the development (by industry) of a Sponsor Bank Code of Conduct, to be approved by the PSR? Or do you consider that we should take a more prescriptive approach at this time? If you disagree with our proposed approach, please give your reasons.

Industry engagement on the development of Technical Access solutions

- 4.314 Indirect PSPs have identified demand for the development of Technical Access solutions that provide alternative access options. We are supportive of the development of Technical Access solutions, as we believe they have the potential to reduce the cost and increase the quality of Technical Access. As alternative suppliers of payment processing services, third-party Technical Access providers may increase the degree of competition faced by Sponsor Banks in some areas.⁸⁹
- 4.315 To facilitate the development of Technical Access solutions, we will continue to engage with industry on the development of any Technical Access solutions. We will continue to evaluate their development and impact in considering whether we should take further steps to promote their progress.
- 4.316 We do not feel it is appropriate or proportionate at this stage to stipulate detailed technical requirements or issue guidance around what a Technical Access solution should look like, or what features it should have. Rather, we believe that the industry is best placed to design and develop Technical Access solutions that meet the needs of service-users (PSPs and end-users), although we will keep this under review.
- 4.317 In **Part C** above, we also set out a proposal aimed at Operators to encourage the development of accreditation processes for third-party providers of Technical Access solutions, to help address potential barriers to entry at the payment system level for third-party providers of Technical Access solutions.

SP4-Q8: Do you agree with our proposed approach in relation to the development (by industry) of Technical Access solutions? Or do you consider that we should take a more prescriptive approach at this time? If you disagree with our proposed approach, please give your reasons.

⁸⁹ Indirect PSPs that use a third-party provider of Technical Access are likely to still require a Sponsor Bank to effect the final settlement of payments.

Market review into the supply of Indirect Access

- 4.318 We consider that our proposed direction regarding the publication of information and other initiatives we have outlined above will help to address a number of the concerns identified to us with regard to Indirect Access – most importantly, concerns regarding the limited ability of Indirect PSPs to access and assess information and concerns around the security of supply of Indirect Access.
- 4.319 However, there are a number of more fundamental, structural concerns that we would like to develop a deeper understanding of, including the limited degree of choice some Indirect PSPs face when trying to secure Indirect Access.
- 4.320 We therefore intend to undertake a detailed market review into the supply of Indirect Access. This market review will focus on developing a deeper understanding of the economics of the supply of Indirect Access generally, and, more specifically, of what factors limit the degree of choice available to different types of Indirect PSPs.
- 4.321 Our current view of the types of questions the market review will seek to answer include:
- What are the costs (operating and capital) incurred by Sponsor Banks in providing Indirect Access? How do these compare to the revenue generated by providing these (or related) services?
 - What are the risks involved in providing Indirect Access to certain types of Indirect PSP? How are these risks evaluated by Sponsor Banks? Are there alternative ways of managing these risks?
 - What barriers exist for a new provider looking to supply Indirect Access?
- 4.322 We have begun Pre-Launch scoping work in preparation for the full launch of our market review in 2015, formally commencing by April 2015. We will ask stakeholders a number of specific questions and invite them to provide general comments on the supply of Indirect Access. We will then initiate a programme of stakeholder engagement, primarily with Sponsor Banks and Indirect PSPs.
- 4.323 As part of the market review we will also:
- Consider the emerging impact of our proposed direction requiring the publication of certain access-related information, and progress on industry development of the Sponsor Bank Code of Conduct and the Information Hub.
 - Review the emergence of any Technical Access solutions.
 - Continue to engage with other authorities, most importantly the FCA, the Treasury, HMRC and the Bank, regarding the interaction between AML regulations and the supply of Indirect Access to payment systems.
- 4.324 Our market review will also include consideration of the appropriateness of the use of any of our wider regulatory and competition powers to address any concerns we identify during the course of this work. Given the complex nature of the supply of Indirect Access, it will be particularly important to consider the risk of unintended consequences of any regulatory intervention that is considered.

What are the intended benefits of our proposals & related anticipated costs for industry?

- 4.325 We expect that our proposed direction requiring the publication of certain access-related information will result in benefits in excess of its costs. In our opinion, it is not reasonably practicable to produce a quantitative estimate of the benefits given the nature of those benefits and in the light of the fact that the costs are of minimal significance. We have set out below a summary of the intended benefits and anticipated costs of our proposal which draws on the analysis set out earlier in this section.⁹⁰

Intended benefits

- 4.326 We expect the direction on Sponsor Banks to publish certain access-related information to result in a number of benefits. The direction is aimed at mitigating some of the informational concerns regarding Indirect Access (as explained in paragraphs 4.210 to 4.212 above).
- 4.327 Currently, Sponsor Banks do not systematically make access-related information easily available to PSPs seeking Indirect Access. The direction should improve the availability of documentation of each Sponsor Bank's Indirect Access propositions and enhance the transparency of each Sponsor Bank's offerings. For the large number of Indirect PSPs seeking such information, this should reduce the time and cost needed to gather information about the services that different Sponsor Banks offer.
- 4.328 Transparency relating to details of eligibility criteria could also reduce any wasted time that Indirect PSPs spend engaging with Sponsor Banks whose eligibility criteria those Indirect PSPs do not meet. This should bring particular advantages for the types of PSPs that are most likely to fail to meet some Sponsor Banks' eligibility criteria.
- 4.329 As discussed above, many Indirect PSPs have raised concerns that they currently find it difficult to obtain this access-related information. We note that the decision of the Co-operative Bank to withdraw from offering Indirect Access means that this lack of information is particularly problematic at the present time with a number of PSPs seeking to obtain information on and from alternative Sponsor Banks.
- 4.330 Increased transparency of the services that are offered could also bring some degree of increase in the competitive pressures on Sponsor Banks as Indirect PSPs will be able to more effectively evaluate the relative merits of choosing and changing Sponsor Banks. If competitive pressure increases, this should increase pressure on Sponsor Banks to raise the quality of their sponsoring services and/or to reduce prices.
- 4.331 If Indirect PSPs receive better value Indirect Access, end-users should also benefit.

Anticipated costs

- 4.332 This direction requires that a small number of Sponsor Banks publish certain information on their websites. We expect most of the information to already exist. Indeed, many Sponsor Banks respond to requests for proposals relating to the provision of Indirect Access and should therefore have this detail available in written form. Gathering any additional information that is required to describe the propositions and to set out any eligibility criteria that they apply is therefore expected to incur minimal additional cost.
- 4.333 Similarly, since Sponsor Banks have existing websites, the additional costs should be limited to the cost of publishing the information on their website. Updates to websites are very frequent events and we expect this to involve only minimal administrative and systems-related costs. Combined, these costs are expected to be of minimal significance.

⁹⁰ Although we are not obliged to conduct a cost benefit analysis (CBA) where the increase in costs is of minimal significance, we have nonetheless sought to use a CBA framework in order to summarise the expected impact of our proposals.

- 4.334 Given that our proposal should have a reasonably modest effect we do not expect there to be material unintended consequences. We also intend to review the impact of this in further detail during our detailed market review of Indirect Access.
- 4.335 Overall, we expect that the relatively modest benefits of our proposals described above should exceed the costs which are of minimal significance.

SP4-Q9: Do you agree with the costs and benefits identified for our directions on Indirect Access? Can you provide any data that might further inform our analysis of the likely impact of our directions?

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