

Market review into the ownership and competitiveness
of infrastructure provision

PSR MR15/2

Draft Terms of Reference

March 2015



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1 Introduction

Background

- 1.1 This draft Terms of Reference, launches our market review into the ownership and competitiveness of infrastructure provision in payment systems in the UK. We are conducting this review using our general powers under the Financial Services (Banking Reform) Act 2013 (“FSBRA”).
- 1.2 Payment systems infrastructure is crucial to payment systems, the performance of the banking sector and the success of the wider UK economy. By ‘infrastructure’ we mean the hardware, software, connections and operating environments that enable funds, and associated information, to be transferred between end users.
- 1.3 The review will consider whether current infrastructure provision delivers outcomes which are consistent with our objectives of promoting effective competition, innovation and the interests of service-users.
- 1.4 This draft Terms of Reference sets out:
 - why we decided to look into the ownership and competitiveness of infrastructure provision in payment systems
 - the proposed scope of the review
 - what happens next, contact details and the information gathering process
 - what could happen as a result of the review.

Why are we conducting this review?

- 1.5 This review has been prompted by concerns raised during the Financial Conduct Authority’s (FCA) Call for Inputs¹ and the PSR’s evidence gathering process that led to our first Consultation Paper². We have also taken into account the feedback on our Consultation Paper and have held a number of meetings with stakeholders to help inform the proposed scope of the review.
- 1.6 Currently, a similar set of Payment Service Providers (PSPs) together own or control both Interbank Operators and certain Infrastructure Providers, such as Vocalink. While to date, these arrangements have resulted in the development of relatively robust and resilient payment systems and may provide incentives to keep infrastructure costs down, they may also:
 - limit competitive pressure which, in turn, may hamper innovation
 - allow some PSPs to influence infrastructure development in a way that is in their own interests rather than in the interests of service-users.

¹ FCA, *Payment Systems Regulation, Call for Inputs*, March 2014.

² PSR CP14/1, *A new regulatory framework for payment systems in the UK*, November 2014.

- 1.7 Our review aims to gather further detailed evidence in order to determine whether the current ownership arrangements and relationships lead to a state of competition that delivers good outcomes for service-users or whether changes may be warranted.

2 Scope of the review

What does this review cover?

Components of infrastructure underpinning payment systems

- 2.1 We propose that the review will focus on infrastructure related to clearing functions. We will also include the infrastructure used at the boundary between PSPs and clearing functions such as the infrastructure that PSPs use to connect to these clearing functions. This will include services provided to Operators and/or PSPs by firms such as VocaLink and includes:
- central clearing including “switching” services – transmitting and validating payments, and associated information; it usually includes netting and establishing positions for settlement
 - provision of databases - such as the Bank Reference Data, Customer Reference Data and Extended Industry Sort Code Database which include data needed to be able to validate and route payments in the correct way
 - gateways – typically the entry point to the communication channel between the PSP (or any third party service provider such as a bureau) and the central clearing infrastructure
 - communication channels – ranging from standard telecommunication lines to more complex channels such as the Enhanced and SWIFT Transmissions Services (ETS and STS)
 - accreditation services – where individual providers are approved to deliver particular functions within the payment systems
 - other services between central clearing functions and Direct PSPs.
- 2.2 We will also include services provided by providers of central clearing on behalf of PSPs such as ATM managed services and other similar services provided by VocaLink.
- 2.3 At the same time as launching this review, we are also launching a review into Indirect Access, and are also continuing to monitor the development of Technical Access solutions within the regulated payment systems. Issues to do with access solutions and gateway provision are of relevance to both of the reviews and our work on this will feed through into both reviews.
- 2.4 We intend to exclude from our review the following areas.
- The infrastructure used to provide settlement services – settlement services for payment systems are provided primarily by the Bank of England but in some cases are provided by commercial banks. We will continue to engage with the Bank of England about the settlement services it provides for multiple regulated payment systems. We are not aware of concerns associated with settlement through commercial banks from the perspective of ownership or competition.
 - Communication channels between settlement services and central clearing functions – for example the use of SWIFT messaging between the Bank of England and either the central clearing function (for deferred net settlement systems) or Direct PSPs (for CHAPS). Few

concerns have been highlighted to us about the channels that are used to communicate information for settlement.

- Infrastructure within Direct PSPs – for example we do not intend to examine issues such as the detailed construction of PSPs' internal banking and payment IT systems. Similarly, we do not intend to focus on areas such as internet or banking applications which are used by consumers and other service-users to initiate payment instructions.

Payment systems in scope

- 2.5 We propose to focus our review on the infrastructure underlying the Bacs, Faster Payments Scheme (FPS) and LINK systems. We will also include within our scope markets that are adjacent or related to the Bacs, FPS and LINK systems in which major providers of infrastructure (e.g. Vocalink) are active.
- 2.6 We intend to exclude from our review infrastructure underlying the following designated systems.
- CHAPS – there are limited functions within the CHAPS system once infrastructure related to settlement and communication channels with settlement providers have been excluded.
 - Cheque & Credit (C&C) and Northern Ireland Cheque Clearing (NICC) – cheque imaging is expected to bring a new model for infrastructure provision within two years. It is therefore of limited value to conduct detailed analysis of the current models used to support C&C and NICC. We will continue to engage with the industry over the development of the future clearing model for cheque imaging but this will be done separately from this review.
 - MasterCard and Visa Europe (Visa) – not all of the issues and concerns that we have identified appear to be as prevalent in the card systems as in other systems. We will, however, take into account how providers of infrastructure within the MasterCard and Visa systems are relevant to the analysis of competition in infrastructure underlying the Bacs, FPS and LINK systems. We expect to become the competent authority for various parts of the EU Interchange Fee Regulation and in our Policy Statement we explain that we will start a programme of policy work around card payment systems.
- 2.7 We do not believe that excluding these other systems will limit our investigation and analysis in the present review. Rather, our approach will enable us to focus on the systems where we have identified concerns about the ownership and competitiveness of infrastructure provision in payment systems.
- 2.8 We will take into account other changes within the payments industry. For example, new technology or competition from other payment systems may affect the volume of payments transacted through Bacs, FPS and LINK. In turn this may affect the appropriate form of ownership of, and competition in, infrastructure provision.
- 2.9 We are also aware of the world class payments project which is being led by the Payments Council. Our review will take into account any proposed developments from this, and from the new Payments Strategy Forum.

Issues to be explored

- 2.10 The three key questions we propose to address in this review are as follows.

I. Do barriers to entry prevent effective competition in infrastructure provision?

Barriers to entry may be created by cost structures, switching costs, lack of interoperability, tender processes and regulation. These may convey market power to existing Infrastructure Providers. This could limit the competitive pressure that Infrastructure Providers face and therefore detrimentally impact price and/or innovation as providers are not sufficiently responsive to the needs of service-users.

II. Does providing one component of infrastructure mean that a firm can limit the ability of others to compete in a related market?

The provision of some components of infrastructure may lead to a firm being able to expand its reach into other adjacent, or related, markets. This might limit the opportunity for alternative providers to deliver services in adjacent markets as well as making it more difficult to change providers. For example, providing central clearing services may convey an unfair advantage in other markets such as gateway provision.

III. Do ownership arrangements distort effective competition?

Ownership arrangements of certain Infrastructure Providers may distort competition. In particular, VocaLink is owned by major PSPs who collectively own and/or control various Operators and are also the main direct users of these systems. This may lead to distortions in competition for both clearing functions and between PSPs. For example, ownership arrangements may limit competitive pressure and thereby hamper innovation or they may allow the owners of VocaLink to influence infrastructure development in a way that may be in their own interests rather than in the interests of a wider group of service-users.

- 2.11 The PSR has not reached any conclusions about whether the concerns raised mean that the current arrangements are, or are not, delivering a good outcome for service-users.

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Next steps

Feedback

- 3.1 We welcome feedback on the proposed scope of the review, as set out in this draft Terms of Reference. We are particularly interested in answers to the following questions.
- Do you agree with the scope of the review with respect to both the components of infrastructure and the systems that we propose to examine?
 - What are your views on each of the areas of concern that we have set out above? In particular, please provide any evidence you have about whether the concerns set out do, or do not, arise in practice.
 - Are there other issues that you think are relevant to the ownership and competitiveness of infrastructure provision in payment systems which we should include in our review?
- 3.2 Following publication of this draft Terms of Reference, we will be continuing to work on the issues highlighted in it. After reviewing feedback to this draft Terms of Reference we will publish our final Terms of Reference for the review which we expect to do by the end of May 2015. This will set out the timetable for the rest of the review.
- 3.3 As well as examining existing research and analysing information that we already hold, we plan to collect additional information from market participants. We will engage with Operators, existing and potential Infrastructure Providers, PSPs and service-users over the coming months. We will use a variety of methods for this engagement including but not limited to: interviews, roundtables and site visits. We expect to gather evidence through the use of specific surveys and requests for detailed information from some participants.

How to submit views

- 3.4 Please send your comments to infrastructurereview@psr.org.uk by **Friday 24 April 2015**. Or in writing to:
- Infrastructure Review Team
Payment Systems Regulator (15th floor)
25 The North Colonnade
Canary Wharf
London E14 5HS
- 3.5 We may make all responses to this draft Terms of Reference available for public inspection; in full or in part, unless the respondent specifically identifies commercially sensitive information for which confidentiality is requested. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure. We will also not accept blanket claims of confidentiality, and will require respondents to identify specific information over which confidentiality is claimed, and to explain the basis on which confidentiality is sought.
- 3.6 Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make

not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

Possible outcomes of the review

3.7 Possible outcomes of our review include:

- making new, or amending existing, directions
- considering making participant-specific directions including in relation to governance arrangements of Infrastructure Providers
- considering requiring the ownership of infrastructure providers to be altered³
- making recommendations for further industry initiatives or enhanced industry self-regulation
- making proposals to the Bank of England, FCA or Prudential Regulation Authority as appropriate
- publishing guidance
- asking the Competition and Markets Authority to consider investigating the market(s)
- taking no further action at this time.

³ The Small Business, Enterprise and Employment Bill includes provisions for the PSR's power to order divestment of ownership interests in payment systems to extend to infrastructure providers. The bill is expected to receive Royal Assent before the end of the Parliamentary Session. The PSR will provide an update on the progress of the bill in due course.