

Responses to draft Terms of Reference PSR MR15/2 – Market review into the ownership and competitiveness of infrastructure provision

Respondents

Respondent (<i>non-confidential responses</i>)
Member of Public
Bacs Payment Schemes Limited
BNY Mellon
Faster Payments Scheme Limited
HSBC Bank
Lloyds Banking Group
Nationwide Building Society
Payments Council
Santander UK
Virgin Money
VocaLink

Member of the Public

From: [REDACTED]
Sent: 23 April 2015 15:19
To: infrastructurereview@psr.org.uk
Subject: Comments on the consultation

Hi there,

I have the following questions and comments into the market review of the competitiveness of infrastructure provision.

Firstly could you explain the decision to exclude Visa and MasterCard? VISA Europe board members include representation from RBS, Lloyds, Nationwide and Barclays all of which organisations are represented on VocaLink's board.

Sometimes a natural monopoly can be desirable for a market because it is inherently more efficient than when multiple companies provide a service. Are you considering the possibility in your review that actually in this instance a monopoly of sorts is desirable? It may be that a monopoly providing the underlying infrastructure is desirable so long as access to that infrastructure is fair, and the design is such that innovative overlay services can be easily created to consume that underlying utility.

I should add that these views are my own, and not those of my employer

[REDACTED]

Regards,

[REDACTED]

Bacs

Indirect Access Review Team
Payment Systems Regulator (15th Floor)
25 The North Colonnade
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E14 5HS

Via email: infrastructurereview@psr.org.uk

22 April 2015

Ref: PSR MR15/1

PSR MR 15/2 MARKET REVIEW INTO THE OWNERSHIP AND COMPETITIVENESS OF INFRASTRUCTURE PROVISION DRAFT TERMS OF REFERENCE

Bacs Payment Schemes Limited (Bacs) is pleased to be able to provide feedback on the PSR's draft Terms of Reference 'Market Review into the ownership and competitiveness of infrastructure provision' (PSR MR 15/2). Founded in 1968 Bacs is a not-for-profit, membership based body and is responsible for the schemes behind the clearing and settlement of automated payments in the UK including Direct Debit and Direct Credit. Bacs has been maintaining the integrity of payment related services for over 45 years.

The Government acknowledges that the Bacs payment system is of critical national importance to the UK financial system and has confirmed that it meets the recognition criteria set out in the Banking Act 2009. Bacs is, therefore, regarded as a FMI, recognised as systemically important by HM Treasury and is overseen by the Bank of England. HM Treasury has also designated Bacs under the provisions of the Financial Services (Banking Reform) Act 2013 and the result of such designation decision makes Bacs a regulated payment system, falling under the powers of the Payment Systems Regulator.

We would like to make the following comments on a couple of points raised within the draft Terms of Reference:

- We are pleased to note that paragraph 1.6 recognises the robustness and resilience of payment systems such as Bacs. As a recognised systemically important payment system these qualities are paramount and must be protected if the end user is to have continued confidence in the payments systems. However, it is important to note that Bacs is a company limited by guarantee, it is not owned by its participants but is managed by a board of directors (with explicit fiduciary duty to the system operator) consisting of an independent chairman, independent director, an executive director and a director appointed by each subscribing participant. This governance model both mitigates the potential risk identified in paragraph 1.6 (and also in para 2.10 iii) and has enabled Bacs to deliver a rich history of end user innovation.
- We are pleased to read in para 2.9 that the Market Review intends to take into account the views expressed by the new Payments Strategy Forum.

In response to the three questions detailed in paragraph 3.1:

-
- Bacs is content with the scope of the review (i.e. the components of infrastructure and systems to be examined) although, in providing this view, it has limited its consideration of the question solely in relation to the payment system we operate.
 - Whilst we are supportive of the PSR's intentions outlined in the draft Terms of Reference we would note that:
 - The banks and building societies that participate (including a sub set that may also be shareholders of VocaLink) in Bacs do not own the company or the schemes it operates. Bacs is a membership based company limited by guarantee with participants subscribing to the schemes under a contractual agreement. The board comprises of an independent chairman, independent director, an executive director and a director appointed by each subscribing member. Each new member is extended the right to participate within the governance of the company on an equitable basis.
 - Directors, independent directors and the executive director have a say in the running of the company as board directors with the public interest being protected by the independent directors via a right of veto in the public interest. All directors have an overriding fiduciary duty to act in the interests of the scheme under company law and are required to declare any situational or transactional conflicts of interest that may arise from their position as employees of members in addition to their directorships (this may, in some circumstances, mean that they would be excluded from participation in some decisions).
 - There are advantages of the partially overlapping ownership of VocaLink with the membership of Bacs in respect of the long term desire to provide infrastructure services which might not be so certain if the ownership of VocaLink changed. Such advantages may include financial standing, commitment to banking or payments in the UK and a risk averse approach to the delivery of services.
 - Bacs standing as a 'not for profit' organisation protects against some of the dangers that might be inherent in a 'for profit' organisation which could lead to outcomes not being in the public interest.
 - Development decisions are achieved through fair and proportionate decision making based on a governance model which seeks a majority decision (rather than consensus), with decisions compelling the full membership to both support and adopt, and has generated full funding for each initiative. It is a measure of the effectiveness of these governance arrangements that the Bacs infrastructure has been effectively refreshed, a range of added value automated services have been introduced over the recent years and decisions have been made irrespective of any shareholding a sub set of our direct participants may or may not have in VocaLink.
 - We do not have any other issues to raise in respect of the ownership and competitiveness of infrastructure provision that we believe ought to be included in the review.

Once the Market Review formally commences Bacs would be pleased to engage with the PSR on the supply of indirect access to the services Bacs offers.



Michael Chambers
Chief Executive

BNY Mellon



BNY MELLON

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23 April 2015

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**Re: Market Review into the ownership and competitiveness of infrastructure provision
– Draft Terms of Reference (PSR MR 15/2)**

Introduction

BNY Mellon is a global investments company dedicated to helping its clients manage and service their financial assets throughout the investment lifecycle. As one of the world's largest investment services and investment management firms, BNY Mellon welcomes the opportunity to respond to the PSR MR 15/2 ("CP") in respect of Market Review into the ownership and competitiveness of infrastructure provision

BNY Mellon operates in Europe through: (i) branches of The Bank of New York Mellon (a New York incorporated financial institution) and (ii) directly established and duly authorised subsidiaries established in several EU jurisdictions and branches of those entities operating in most of the core EU member states. It provides services to clients and end-users of financial services globally.

Responses to Specific Questions

Our responses are contained in this document in Annex 1 below.

BNY Mellon looks forward to further engagement with the Payment Systems Regulator in the months ahead in regard to the market review.

David O'Brien
Compliance Director
EMEA Head of Policy, Regulatory Reform and Governance
Compliance & Ethics
BNY Mellon

ANNEX 1 – Responses to Specific 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?

BNY Mellon agrees with the scope of the review with respect to both components.

What are your views on each of the areas of concern that we have set out above? In particular, please provide evidence you have about whether the concerns set out do, or do not, arise in practice?

BNY Mellon agrees with each area of concern set out in the terms of reference.

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?

BNY Mellon believes it would be worthwhile to explore the benefits of including clear scheme rules on Payment Systems websites in addition to joining rules. Some systems in the industry have made a move to publish these, so that they are readily available and clear to participants. With others, the scheme rules are not clear on obligations.

We also recommend that, where necessary, scheme rules are updated with guidance to include both what is expected of Direct and Indirect participants, and what is considered outside of the scheme rules.

Faster Payments Scheme Limited

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23rd April 2015

RESPONSE TO DRAFT ToRs PSR MR15/2 – INFRASTRUCTURE PROVISION

Faster Payments Scheme Limited (FPSL), as a designated Payment Systems Operator under the Financial Services (Banking Reform) Act 2013, and a significant customer for infrastructure provision wishes to provide the following comments concerning the draft terms of reference for the market review into the ownership and competitiveness of infrastructure provision.

Firstly, some general observations:

- **Para 1.2.** The description of 'infrastructure' is described as covering all hardware, software etc. needed to transfer funds between **end users**. In para 2.4 you go on to exclude infrastructure within PSPs (with the exception of gateways). Clarity might be improved if para 1.2 could be reworded to cover transfer of funds between **PSPs**.
- **Para 2.10 I.** In the hypothesised detriment, you suggest that *barriers 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*. In the case of FPS, VocaLink provides infrastructure to FPSL under contract. FPSL is VocaLink's customer. FPSL has an obligation to respond to the needs of service-users. VocaLink should not be responding to the needs of service-users directly, but to the needs of its customer, the Payment Systems Operator. In this para service-users should be replaced by their customers – Payment Systems Operators.
- **Para 2.10 II.** In the example, you state that *providing clearing services may convey an unfair advantage in other markets*. In our view this review needs to determine firstly, whether there are any **undesirable** advantages that might need to be addressed to further promote competition. Whether any advantage is unfair, implying abuse of a dominant position, is a secondary consideration for later in the review.

We cannot identify any other issues that need to be included in the terms of reference at the current time.

As one of the major customers of this market we look forward to early and detailed engagement with you as you progress this review. Whatever the outcomes, we are very keen that they fully support our ability to provide increasingly reliable, efficient and innovative payment services to our service users, through the contracts and operating relationships we have with our current, and any future infrastructure providers.

Yours sincerely,

By email

Craig Tillotson,

Chief Executive

HSBC Bank

HSBC response to the PSR's Draft Terms of Reference for the Market Review into the ownership and competitiveness of infrastructure provision

1. HSBC welcomes the opportunity to comment on the PSR's draft Terms of Reference (Draft ToR).

The scope of this Market Review

2. HSBC considers that the PSR is premature in embarking on a Market Review into infrastructure provision. There are more fundamental issues that should be explored first, and the PSR needs to allow time for the impact of the direction on the governance of Interbank Operators to take effect.
3. It appears that the PSR wants to understand whether or not the larger PSPs, who own the BACS, FPS and Link payment schemes, together with the associated infrastructure provided through Vocalink, are running the UK payments architecture in a way which is in the interest of all service users. It is not clear whether or not the PSR is concerned that these issues may then inhibit competition and innovation downstream.
4. Assessing the ownership and provision of infrastructure in isolation does not get to the heart of this issue: it is the payment schemes who determine how infrastructure is provided, and how payment services are provided generally. This is the case, irrespective of whether infrastructure is managed by payment schemes themselves, or whether it is provided by a third party provider (no matter who owns that provider). If the payment schemes are run in a way which reflects the interests of all service users, then logically it follows that they will provide or procure infrastructure in the interests of all service users. The first step in the PSR's analysis of the provision of infrastructure must therefore be to reach a comprehensive understanding of the incentives of the payment schemes themselves.
5. The PSR should explore the implications of the current ownership structure for the payment schemes, whether they should be complements or competitors to one another, and whether they should be consolidated into a smaller number of payment schemes. The PSR will also need to assess the impact of its direction as to the governance of payment schemes, which does not take effect until September 2015.¹
6. HSBC believes that it is not possible to conduct a rigorous analysis of the provision of infrastructure (i.e. the supply side) without a sound understanding of the incentives of the payment schemes (i.e. the demand side). Once the PSR reaches a view on the payment schemes, it will be better placed to determine whether infrastructure should be managed by the payment schemes themselves, or whether it should be outsourced to a separate entity (and whether that separate entity will face sufficient competition, and who should own that entity). In this regard, the PSR should compare the self-supply of the card schemes to the procurement model of BACS, FPS and Link.
7. In the downstream market, service users have increasing choice in the way that they make payments, leading to competition between the different payment types. By way of example, when settling a utility bill, the end consumer or business can choose whether to pay by Debit Card, Credit Card, Direct Debit, Standing Order, Cash or Faster Payment. Competition further exists between different financial institutions, offering different services. MasterCard and Visa offer

¹ The PSR has made a general direction requiring Interbank Operators (but not Card Operators) to ensure appropriate representation of service users' interests in the decision-making processes of their governing bodies, from September 2015.

competing solutions in the card space, just as HSBC and other PSPs provide various card and other payment offerings. In this context, we believe that the PSR should ask whether competition between different payment types at the downstream level materially affects competition in infrastructure provision at the upstream level, and if so how?

8. The PSR should consider infrastructure used by all the payment schemes, or should at least consider how competition between payment types at the downstream level affects competition in the provision of infrastructure upstream. It should also consider the commercial drivers behind the strategies of the payment schemes themselves, as they are the ultimate decision makers over what infrastructure is used.
9. Operational integrity and resilience are of paramount importance to HSBC and to all users of payment systems. The Market Review must include at its heart a robust consideration of both current levels of operational integrity and resilience and the potential impact that any future initiatives by the PSR (or other regulators) might have on that.

Issues to be explored

10. The PSR has identified three key questions:

- I. Do barriers to entry prevent effective competition in infrastructure provision?**
- II. Does providing one component of infrastructure mean that a firm can limit the ability of others to compete in a related market?**
- III. Do ownership arrangements distort effective competition?**

11. HSBC considers that the PSR should explore the following questions in its Market Review, in addition to the questions it has identified:

- a. Does competition between different payment types at the downstream level materially affect competition in infrastructure provision at the upstream level, and if so how?
- b. Are the incentives of payment schemes regarding the procurement of infrastructure aligned with the interests of service users generally?
- c. Is competition in the market a viable alternative to competition for the market? Would it be possible or desirable for different PSPs to be able to connect to payment systems via different infrastructure providers?
- d. To the extent that the PSR identifies alternative possible infrastructure ownership structures, would those be consistent with the maintenance of the integrity of the UK's payment systems infrastructure?
- e. How much has Vocalink innovated, and what has driven this innovation?
- f. Are costs and risks born and managed efficiently through the current ownership structure (e.g. as between smaller and larger PSPs)?

The PSR's first two questions

12. As indicated above, from the perspective of service users, there is considerable competition between payment types. Payment solutions processed through BACS, FPS and LINK compete with solutions processed through Cheque and Credit Clearing and the card schemes. Any

assessment will need to take account of the impact of these alternative payment types on competition and incentives to innovate.

13. In respect of the infrastructure for BACS, FPS, and LINK, competition takes place for the market, through periodic tender processes. It is the payment schemes themselves, as buyers with considerable buyer power, who determine the nature of the competition.
14. In order to understand how competition for the market takes place, the PSR will need to develop a comprehensive understanding of the following:
 - a. On the demand side, what are the drivers behind the decisions of each payment scheme regarding the procurement of infrastructure? Are the incentives of the payment schemes aligned with the incentives of service users generally? What mechanisms do payment schemes use to align the incentives of infrastructure providers with those of the payment scheme and service users? What are the views of service users?
 - b. On the supply side, are there a sufficient number of alternative, credible and financially secure infrastructure providers who are able to bid in competition with the incumbent infrastructure provider?
 - c. To what extent do the payment types which rely on these payment schemes compete with payment types provided through the use of other payment schemes, in particular the card schemes? Is the provision of infrastructure to BACS, FPS and LINK influenced by the nature of the infrastructure which is provided to other payment schemes, in particular the card schemes?
15. At the tender for the provision of infrastructure services to FPS, Vocalink was engaged after a competitive tender process where there was one other bidder. In future, a range of European infrastructure providers could put in tenders in competition with Vocalink. The PSR should ask itself whether this type of competition would be effective – in particular, whether challengers could compete on a level playing field against the incumbent.
16. An alternative to competition for the market may be where competition takes place in the market. In theory, different PSPs could connect to payment systems via different infrastructure providers. The payment schemes would likely bear additional costs as they seek to ensure interoperability with a range of infrastructure providers.
17. In assessing the feasibility of competition in the market, the PSR would need to give consideration to the following:
 - a. The technical feasibility of the development of standard interfaces to enable competition in the market, and what the costs would be. The PSR would need to understand the additional complexity this may generate, and the implications for the resilience of payment systems.
 - b. The impact on competition of requiring existing infrastructure providers to offer access to new market entrants: in particular, it would need to assess the impact this may have on incentives to innovate.
 - c. Whether there would be any interest from PSPs in having a choice between different infrastructure providers.

The PSR's third question: ownership of Vocalink

18. The PSR asks whether the ownership of Vocalink by the largest PSPs is consistent with incentives to innovate, and whether this means that infrastructure is operated in the interests of the larger PSPs at the expense of smaller PSPs. We set out below some practical issues which we believe the PSR should consider.
19. A key strength of the status quo is that as the principal users of Vocalink's infrastructure, its current owners have a strong incentive to ensure the continued resilience of payment systems and to stand behind Vocalink (as they have done to date) if financial or operational difficulties arise. The impact of system and infrastructure failures can be very significant. For this reason, a key focus of the major PSPs, and other stakeholders such as the Bank of England, is resilience. It is critical that the PSR too gives strong and sufficient weight to maintaining the resilience of payment systems and their associated infrastructure as an ultimate objective.
20. Other issues the PSR may want to explore include the following:
 - a. The extent to which Vocalink has innovated in the past five years, and whether there are strong grounds to believe that an alternative provider, or a provider under different ownership, might have innovated to a greater degree. To what extent do the payment schemes themselves drive innovation by Vocalink? International comparisons may be helpful in this regard.
 - b. We encourage the PSR to gather views from smaller PSPs as to whether the ownership of Vocalink generates issues for infrastructure provision, in practice.
 - c. The PSR will want to assess how the costs of infrastructure provision are managed through the current arrangements. We believe that ownership of Vocalink by larger PSPs protects indirect participants from bearing the full costs and risks inherent in infrastructure provision.
 - d. The PSR may also want to consider evidence from other sectors, where similar issues have arisen. For example, there is evidence in some sectors that ownership of an infrastructure provider by the direct users of the infrastructure may have advantages in terms of aligning interests (e.g. the shareholding of airlines in NATS). There is also evidence that even when the infrastructure provider is not owned by larger users, concerns can arise that the views of smaller users are not taken into account by the infrastructure provider (e.g. airport charges, where an obligation has now been placed on larger airports to consult with all airport users).
21. To the extent the PSR identifies concrete competition concerns regarding the ownership of Vocalink, we encourage the PSR to consider as a first step whether its concerns could be addressed through changes to the governance arrangements of Vocalink. Such changes could ensure that the interests of smaller PSPs are taken into account. Changes of this nature would be considerably less disruptive for the industry than mandating any change in ownership, and would generate much less risk to resilience.
22. We encourage the PSR to have regard to the four criteria the Bank of England sets out when assessing whether alternative ownership would be consistent with the PSR's statutory duty to

have regard to the importance of maintaining the stability of the financial system. These four criteria are:

- a. Changes should not lead to an unacceptable increase in settlement risk.
- b. Changes should maintain or enhance robustness/resilience.
- c. Infrastructure should facilitate the continuity of payment services in resolution.
- d. The Bank of England's ability to supervise systemically important payment systems effectively must be maintained.

23. Finally, the PSR is aware that the changes to the UK banking industry required by the government's ring fencing requirements are substantial in nature. If the PSR reaches conclusions that substantial changes to the provision of payments infrastructure are necessary, it will need to ensure that these changes do not conflict with the fundamental and far-reaching changes required by ring fencing. HSBC would question whether it would be feasible or sensible to require significant additional structural changes in parallel with the ring-fence bank process.

Lloyds Banking Group

PSR Market Review into the Ownership and Competitiveness of Infrastructure Provision: Draft Terms of Reference

Lloyds Banking Group response

24 April 2015

Executive Summary

Lloyds Banking Group is committed to helping Britain prosper by being the best bank for customers. We want them to be able to make and receive payments accurately, quickly and safely over infrastructure that is highly resilient, stable and secure. We therefore welcome the opportunity to comment on the draft terms of reference for the Payment Systems Regulator's (PSR) market review into infrastructure provision. LBG has focused its response on VocaLink as it understands that this is where the PSR's main concerns lie.

The UK has an excellent payments infrastructure. VocaLink operates high-availability, resilient and class-leading payment clearing and ATM switching platforms responsible for processing 10.1 billion payments in 2014. It provides a stable and effective platform for the development of innovative and competitive services. Existing ownership arrangements have not impeded this, and we find it difficult to see how regulatory intervention to increase competition could materially improve these outcomes in the interests of users.

LBG does not believe that VocaLink's role as infrastructure provider has slowed innovation at the service user level. The US provides an example of where, despite the central infrastructure being unquestionably underdeveloped (which LBG does not believe to be the case in the UK), there have been many examples of innovation at the service user level.

We are agnostic about the ownership of VocaLink subject to receiving fair value for our shareholding if it were to be diluted or divested. We nevertheless believe that the existing arrangements provide a number of benefits. In particular, participants in the market have a vested interest in ensuring the central infrastructure runs effectively and is resilient, stable and secure. Similar considerations can be seen in the Government's decision in 2001 to sell a controlling stake in National Air Traffic Services to a consortium of seven airlines and subsequently in 2012 to retain its shares rather than sell them to alternative investors.¹

Given their participation in the market, shareholding banks also have a clear interest in providing additional, necessary funding for central infrastructure and are well-positioned to do so; this has been demonstrated where they have been called upon in the past to recapitalise VocaLink. If VocaLink's existing ownership structure is changed then special administration arrangements may need to be put in place in order to ensure the continued provision of core services, as is the case with certain energy companies.

¹ <http://www.m2.com/m2/web/story.php/2001BD431576CD390BAE80256A1C005C9528> and <https://www.gov.uk/government/speeches/government-shareholding-in-nats>.

Response to Specific Questions

Q1: Do you agree with the scope of the review with respect to both of the components of infrastructure and the systems that we propose to examine?

We agree in principle with the scope of the review. We would welcome confirmation that gateways are only in scope if they are not part of the banks' internal infrastructure, as we understand from the PSR's Policy Statement and the draft Terms of Reference.

We note that the PSR has previously said governance and control are perhaps more important than ownership *per se*. It is unclear from the draft Terms of Reference whether they are also within the scope of the review and we would welcome clarity on this. **It is our view that the perceived ownership concerns could be addressed through ensuring the appropriate governance and control frameworks are in place.**

Q2: 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.

We note the PSR has identified three areas of concern in the draft Terms of Reference: (i) barriers to entry to infrastructure provision; (ii) a firm's ability to limit others competing in the market; and (iii) ownership arrangements distorting competition. We set out below a summary of our views on these issues, and look forward to engaging further with the PSR on these points during the course of its review.

It is crucial that any central infrastructure ensure reach, security, end-to-end connectivity and systemic resilience, which can be costly to provide and perceived as a natural barrier to entry. As the existing infrastructure provision meets these core requirements, we find it difficult to see how regulatory intervention to increase competition could materially improve these outcomes in the interests of users. Moreover, the characteristics of the UK market should also be taken into account. Whilst several infrastructure providers compete against each other in Europe, this is as a result of a legacy landscape where many countries had their own national infrastructure provider before the introduction of SEPA. SEPA has led to consolidation of these to a considerably smaller number.

With regards to the PSR's third concern on ownership arrangements distorting competition, we wish to highlight that participants' ownership of the central infrastructure also provides a number of benefits. In particular, they have a vested interest in ensuring the infrastructure runs effectively and is resilient, stable and secure. Moreover, they are well-positioned to provide additional, necessary funding for central infrastructure, which may not be otherwise readily available. For example, banks, as shareholders, have provided funding in order to recapitalise VocaLink, to enable it to replace ageing infrastructure (New Bacs), to deliver new services (Faster Payments) and also following losses incurred in commercial ventures (Euro Services and Bankgiro).

Q3: 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?

We do not have any further issues which we believe should be covered by the market review.



Russell Saunders
Managing Director, Global Payments

Nationwide Building Society

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Wiltshire

24th April 2015

Infrastructure Review Team
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Dear Sirs

MARKET REVIEW INTO THE OWNERSHIP AND COMPETITIVENESS OF INFRASTRUCTURE PROVISION PSR MR 15/2

Nationwide Building Society welcomes the opportunity to feedback on the proposed scope of this market review.

Given our scale, broad product range and mutual status, we are able to provide customers with a compelling alternative to the big plc banks and we welcome greater competition in retail banking.

As a co-owner of one of the infrastructure suppliers, VocaLink, and direct members of the Faster Payments, Bacs and Cheque and Credit Clearing schemes whilst holding board membership on both the UK and European Visa Boards, we have a particular interest in the ownership and competitiveness of infrastructure provision in the payments arena.

We fully support the Regulator's objective 'to determine whether current ownership arrangements and relationships lead to a state of competition that delivers good outcomes for service users' and we agree that the market review is an appropriate mechanism through which to make this assessment.

However, Nationwide is concerned that the proposed scope of the review does not encompass the whole market.

The Terms of Reference state that this is a 'market review into the ownership and competitiveness of infrastructure provision in payment systems in the UK'. Therefore, Nationwide would expect the review to include providers of all infrastructure that is critical to the UK's payments industry. We do not feel the draft Terms of Reference adequately explain why high value payments, cheques and card infrastructures have been excluded.

We feel especially strongly that the cards infrastructure needs to be included to provide a full picture of the payments market given the significant volume of transactions made via cards; within Nationwide our card transactions are by far the largest volume of payment transactions made by our customers. The stated rationale for excluding card systems - 'not all of the issues and concerns that we have identified appear to be as prevalent in the card systems as in other systems' - is to us not clear and we would like to understand better the evidence base for the decision to exclude cards from the review.

Whilst we recognise that the PSR intends to conduct future work into payment cards, it is not clear to us that this work will cover the same issues as the market study. We believe that carrying out the work into cards separately from the market study into infrastructure will lead to disjointed view of payments infrastructure, and that a single holistic review would be preferable.

With regard to the specific questions where feedback has been requested:

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?

In our response to the initial FCA consultations on 'Setting the strategy for UK payments' and 'Opening up UK payments' we particularly welcomed that the new regulatory framework encompasses a wide range of stakeholders including card schemes, as this provides a fuller picture of the payments landscape. Although mindful of the need to ensure effort and resources are deployed effectively, we feel that the PSR should enable the benefits of this market review to extend more broadly to other components and systems within the end to end payments journey, such as non-clearing functions, card infrastructures and potentially Schemes themselves. Nationwide feels there are risks associated with limiting the review to just infrastructure providers that support three systems (Bacs, FPS and LINK). As stated above, we are keen to have visibility of a more in-depth rationale for the exclusion of other designated systems from the draft scope of this market review.

What are your views on each of the areas of concern that we have set out? In particular, please provide any evidence you have about whether the concerns set out do, or do not arise in practice.

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

Nationwide does not believe there are barriers to entry for providing infrastructure. Relevant points to note regarding the current infrastructure provision are:

- Costs for transactions are set and apportioned via the schemes, although clearly these have to cover the overall costs negotiated with the infrastructure provider.
- There is a regular tender process in advance of contract renewal for core transaction processing services. This is carried out with the requisite due diligence and is open to a wide range of bidders.
- For collaborative innovation, such as the Faster Payments service and the current cheque imaging plans, there is a separate open tender process with a number of potential suppliers.

Whilst there are some PSPs with part ownership of the current infrastructure supplier who are also represented on the Scheme boards, we do not regard this as creating a barrier. The Scheme operating models are such that the companies are not-for-profit organisations run via boards of directors, on which the PSPs sit, with explicit fiduciary duties. Conflicts of interest are duly noted and may exclude participation in some decisions, as recently with the re-tendering for FPS and Bacs core services.

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

We are not aware of any inherent link between the components which would disadvantage suppliers tendering for provision of one or more of the components covered by this review. There are examples of components where there are more than one supplier [REDACTED]

III. Do ownership arrangements distort effective competition?

Current ownership arrangements have not prevented a range of suppliers bidding for provision of infrastructure across a number of areas of provision. The decisions taken to award contracts have been made based on a balance of requirements including stability, security, value, future capability etc. They have not been made based on ownership.

Are there any 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?

We believe that the full value of this review will be enhanced by focussing on appropriate scheme governance, in balance with the structure of the underlying ownership.

When looking at the current arrangements the benefits of funding from the larger market share participants to deliver change and innovation, created for the smaller players must be understood. It is the collaborative commitment that allows the entire market to then benefit from opportunity created.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Paul Horlock', written in a cursive style.

PAUL HORLOCK
Head of Payments

Payments Council

Note



24 April 2015

To Payment Systems Regulator

DRAFT TERMS OF REFERENCE - PSR MARKET REVIEW INTO THE OWNERSHIP AND COMPETITIVENESS OF INFRASTRUCTURE PROVISION (PSR MR15/2) - PAYMENTS COUNCIL RESPONSE

1 INTRODUCTION

The Payments Council welcomes the opportunity to provide feedback on the Payment Systems Regulator's Draft Terms of Reference for its planned *'Market Review into the ownership and competitiveness of infrastructure provision (PSR MR 15/2)*.

The Payments Council is supportive of the new economic regulator and what it aims to achieve for the industry and its customers. The UK is already a world-leader in its payment systems and services and the Payment Systems Regulator (PSR) can play a positive role in helping the industry to maintain and enhance that position.

We are pleased to note that our work to develop a World Class Payments vision has been recognised in the Draft ToRs and we look forward to continuing our engagement with the PSR on this. As the PSR is aware, the World Class Payments work and input to the market review will be carried forward by the new trade association that will replace the Payments Council this summer.

2 RESPONSES TO QUESTIONS

Please find below some comments in relation to the specific questions put forward in section 3 of the Draft Terms of Reference.



2.1 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?

We believe that a thorough market review of the infrastructure will be helpful in identifying whether the current arrangements lead to poor outcomes for end users and industry participants or whether there are benefits. However, some of our members believe that a thorough market review needs to be wider than currently planned; only reviewing part of the payments market may lead to an unfair competition outcome. If the PSR wants to determine the best mix of competition and collaboration they need, ideally, to explore the entire ecosystem, but should at least include the Operators who administer the rules under which the Infrastructures operate, ensuring meanwhile that the core requirements of stability, resiliency and operational integrity are not negatively affected.

Payments Council is in some cases (e.g. the Bank Reference Database) a stakeholder in the infrastructure provision. We have already liaised with colleagues within the PSR on questions they have had and will be pleased to continue that engagement.

2.2 What are your views on each of the areas of concern that we have set out? In particular, please provide any evidence you have about whether the concerns set out do, or do not arise in practice.

In general, Payments Council believes that the areas of concern highlighted in the draft Terms of Reference are the right ones to investigate. In terms of the specific questions the PSR proposes to address: on question one (Do barriers to entry prevent effective competition in infrastructure provision?), we note that as part of the Payments Council's World Class Payments project we are exploring whether there are barriers to entry which could potentially be reduced or removed, subject to further analysis, by further improving the customer experience and making more efficient the form and functionality. This would allow new entrants further options (in addition to the current agency arrangements) to access the whole payment systems and all the platforms.

On question three (Do ownership arrangements distort effective competition?), we believe that the scope of this question could usefully be adjusted: if the PSR wants to review the issue of ownership then governance cannot be separated from this. This may appear a semantic issue but we believe that by committing the Market Review to explore whether 'ownership arrangements distort effective competition' the PSR may inadvertently be limiting the outcomes it may wish to pursue. By referring instead to 'governance and



ownership arrangements' the PSR will more easily be able to investigate the full structure of control around the payments infrastructure.

Finally it is worth noting, as we have done in previous consultation responses, that the current ownership model does have a range of benefits e.g. it allows for the costs of infrastructure change (which ultimately benefits all end-users) to be split amongst direct members. While indirect members without an ownership stake (an investment decision those institutions have chosen to make) are required to pay for access to the payment system, they do not bear the majority of infrastructure costs – but do benefit downstream from improvements to the system. Furthermore, ownership of the scheme companies by several competitor organisations allows shared resources and shared infrastructure, minimising costs passed down to consumers, and increases the efficiency of the infrastructure provision. There are also benefits of scale. This is positive for the resilience of the system.

2.3 Are there any 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?

The Payments Council believes that enabling easier access to payment systems and creating a common approach to standards and strategies for integrity and resilience in the infrastructure will benefit access and cost-efficiency providing a better platform for competition and innovation. This is something we continue to explore as part of the World Class Payments project and we welcome the continued engagement of the PSR with this work.

Santander UK

Santander UK plc
Response to Payment Systems Regulator: Draft Terms of Reference for Market
Reviews
24 April 2015

- 1) Santander UK plc (hereafter Santander) welcomes the opportunity to respond to the Payment Systems Regulator's (PSR) draft terms of reference for its proposed market reviews into i) the ownership and competitiveness of infrastructure provision; and ii) the supply of indirect access to payment systems.
- 2) As a scale challenger in the UK retail banking market, and part owner of UK payment systems with a circa 5% market share, Santander is committed to working with the new PSR to ensure the delivery of world class payments systems, supporting an increasingly digital world and customer.
- 3) Below, we consider both market reviews. However, before turning to our specific comments, we have a number of high level observations relating to:
 - (i) how these market reviews fit into the current payments and banking environment; and
 - (ii) the importance of ensuring that these reviews conclude in a manner which leads to coordinated and improved outcomes for customers and payment systems users.
- 4) The timescales for the reviews, planned to commence circa late May 2015 and run for approximately 12 months, will mean it is of paramount importance that remedies are developed in a transparent and coordinated manner with other regulators currently conducting large scale banking-related structural reform projects and market investigations or market studies.
- 5) For instance:
 - We call for detailed coordination at both senior and working level with the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) in relation to the development of Banking Reform, for which final rules are due to be published in H1 2016.
 - We are expecting the Competition and Markets Authority's Retail Banking Market Investigation to conclude in May 2016, potentially introducing significant remedies in the UK banking market.
 - The FCA is working on a number of market studies in relation to credit cards, corporate and investment banking, mortgages (expected) and cash savings (concluded). Each of these may result in remedies required for the banking industry.
- 6) The first half of 2016 is therefore emerging as a key period during which the conclusions, remedies and final rules of a number of these structural and competition-related regulatory reforms will be published. While we support measures which increase competition and choice in retail banking, these measures should not conflict, contradict each other or place additional pressure on bank infrastructure to manage change. In particular, any additional pressure on infrastructure during the

implementation of Banking Reform will risk both the stability of core systems and the quality of service we can provide to our customers.

- 7) Santander is keen to work with regulators to ensure that the long term future of the banking sector is kept front of mind as the array of structural reforms and competition related reviews conclude.

Market review into the ownership and competitiveness of infrastructure provision

- 8) Santander agree with the proposed scope and the issues posed for focus in this market review. In terms of the review's scope, we suggest that the Cheque Company should be brought into the scope of the review to ensure that their direction, both now and in the future, is aligned. We agree that CHAPS does not need to be brought into scope given its distinct nature.
- 9) In relation to other issues relevant to this review which should be included, while we recognise the need for an open and competitive market, it is important to ensure that sensitivity and confidentiality of payments data is maintained.
- 10) We recognise concerns previously expressed about ownership of the System Operators and consider that a market review is a positive opportunity to consider the relationships in a fair and reflective way. As Santander has highlighted in previous consultation responses, we believe the number of Schemes creates further challenges, particularly given the need to compete against each other as individual companies. This reduces the ability to provide a single vision of consolidation and simplification to support the innovation agenda. One single Scheme Company – covering Bacs, Cheques, Faster Payments and Link, which all become services under the single company structure as CASS is today – would simplify this and drive the optimum agenda for innovation. As such, we believe this must be a primary focus of the market review.

Market review into the supply of Indirect Access to payment systems

- 11) Santander agrees with the proposed scope and the issues posed for focus in this market review. As the only retail bank involved in ownership of the payment systems but not acting as a sponsor bank, we are uniquely placed to participate in the market.
- 12) In relation to other issues relevant to this review, we believe that it should not prevent or delay the opportunities for banks to improve indirect access to payment systems to other providers. The complexity of systems presented in this area is significant, and at a time when banks will be seeking to implement Banking Reform changes, there will need to be thorough and robust consideration given to how the model is evolved, without overloading the current sponsor banks and System Operators beyond reasonable stresses. This will help ensure that banks like Santander are able to maintain focus on placing customer needs at the heart of our business and on providing a service which is simple, personal and fair.

Virgin Money



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24 April 2015

Dear Sir/Madam

Financial Conduct Authority (FCA)/Payment Systems Regulator (PSR) Consultation Paper on Market review into the ownership and competitiveness of infrastructure provision: Draft Terms of Reference (PSRMR 15/2)

We welcome the market review of the ownership and competitiveness of infrastructure provision and broadly support the proposed Terms of Reference. As the Consultation paper correctly notes, a similar and small set of Payment Systems Providers (PSPs) together own and/or control both Interbank Operators and certain Infrastructure Providers, such as VocaLink, and we believe that these ownership and control arrangements should be examined in greater detail.

We include below comments on each of the specific points raised in paragraphs 2.10 and 3.1 in the Draft Terms of Reference, and will be happy to provide responses to questions which arise as the market review proceeds.

Scope of the review

We agree that the scope of the review should include central clearing, the provision of databases, gateways, communication channels, accreditation services, other services between central clearing functions and Direct PSPs, and services provided by providers of central clearing on behalf of PSPs such as ATM managed services and other similar services provided by VocaLink.

We think it important that the review should consider the possible implications of Technical Access Solutions that are being developed or that may be developed, since they should reduce the barriers to entry for new PSPs with innovative products that offer customer benefits, but that may have their own specific infrastructure requirements.

We support the proposals not to include in the scope of the review the infrastructure used to provide settlement services, communication channels between settlement services and central clearing functions and infrastructure within Direct PSPs.

We agree that the review should focus on the infrastructure underlying the Bacs, Faster Payments Scheme (FPS) and LINK systems, and markets that are adjacent or related to them in which the major providers of infrastructure, such as VocaLink, are active. We support the proposals to exclude from the review the infrastructure underlying CHAPS, Cheque & Credit (C&C) and MasterCard and Visa, for the reasons given in paragraph 2.6 of the Draft Terms of Reference.

However, we suggest that the PSR should consider:

- the process for the selection of the provider to C&C of cheque imaging, and whether the outcome is likely to consolidate the provision of infrastructure, or to enable competition in the future for the payments infrastructure; and
- the extent to which VocaLink already competes, or could compete, with infrastructure providers [REDACTED]

I. Effective competition

We support the intention of the PSR to assess whether competition in infrastructure provision is effective (at this stage, irrespective of ownership). Given the dominant position that VocaLink, for historical reasons, currently enjoys, we agree that it is sensible to assess the competitive nature of the market in infrastructure provision by considering possible barriers to entry, such as those identified in paragraph 2.10 of the Draft Terms of Reference, namely cost structures, switching costs, lack of interoperability, tender processes and regulation.

As well as the possible barriers to entry identified in paragraph 2.10, various other barriers may apply in this market. Firstly, there could easily be an understandable preference to use existing providers such as VocaLink (irrespective of ownership) because of their proven track record in supporting secure and stable payment systems - and this mindset might well apply even if alternative providers offer potential benefits such as in supporting new PSPs with innovative products that could be beneficial for consumers. Secondly, alternative providers might be reluctant to seek business in this area if they see the selection process as likely to be biased in favour of existing providers.

Another important test for a competitive market is whether innovation can flourish in it. In an increasingly digital world, we think that it is important to assess whether there is adequate evidence of innovation supporting payments products and services that offer benefits for consumers - and whether such innovation is led by infrastructure providers such as VocaLink, or limited by them.

In the context of effective competition, we suggest that consideration should be given to encouraging open standards. With regard to cards, the main providers (MasterCard, Visa and LINK) have over the years managed to agree some 'semi open' standards. We suggest that agreeing open standards for retail payments mechanisms in the UK (for example ISO20022), and making them publicly available, would reduce barriers to entry and encourage investment and greater competition in infrastructure provision - which would go beyond VocaLink and the large card providers - with benefits for both PSPs and consumers.

II. Competing in related markets

The other two of the three key questions, about effective competition and ownership arrangements, are specific to infrastructure provision. However, the fact that it may be convenient to use generalist suppliers for a range of services, rather than use a range of specialist suppliers, is common to many markets.

We therefore suggest that this part of the review should focus on matters specific to infrastructure provision, such as whether there is an over-reliance on VocaLink (irrespective of its ownership) to provide new as well as existing capabilities, whether it is easy or difficult for specialist infrastructure providers, such as those focusing on online and mobile payments services, to operate on or alongside the infrastructure that is supported by VocaLink, and whether the addition of such other suppliers to core infrastructure supported by VocaLink would make it more complex and expensive to move from VocaLink to another infrastructure provider at some later date.

III. Ownership arrangements

We support the intention to consider whether the ownership arrangements of certain infrastructure providers may distort competition - especially if consideration of the first of the three key questions suggests that competition in infrastructure provision is not effective. While supporting the intention to consider ownership arrangements, particularly of VocaLink, we believe that the arguments are finely balanced. On the one hand, the large banks, as the principal users of payments systems, clearly have a strong interest in security and stability and in low costs, which VocaLink has provided. On the other hand, the large banks have an understandable interest in maintaining the status quo, including their dominant positions in current accounts, which act as a 'gateway' to other financial products.

While we see pros and cons in the current ownership arrangements, we note that *Ownership, governance and control of payment systems* (PSR CP14/1.4) found that some stakeholders believe that decisions about payments are made in the interests of the Direct PSPs rather than other service-users. We share this concern. We therefore think that it is important that the PSR should address this issue by carrying out a comprehensive and objective review as to whether infrastructure providers' ownership arrangements distort effective competition, or not.

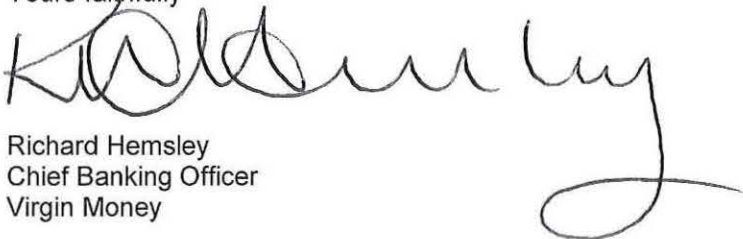
Other issues

We recognise that, while considering the ownership of infrastructure providers (in particular, VocaLink), the review will not consider the ownership of payment systems. However, in the event that the PSR comes to the view that further consideration should be given to requiring the ownership of infrastructure providers to be altered, we suggest that consideration should also be given to the ownership of payment systems.

This is because, if some change is deemed necessary, there is a range of possible arrangements that might deliver better outcomes. For example, competition and innovation might be encouraged by requiring the Direct PSPs to divest their ownership of Interbank Operators and allowing the payment systems to own their own infrastructure.

We would be delighted to support the PSR's ongoing work in this area, and look forward to contributing further to the market review as it progresses. Please do not hesitate to contact me should you wish to discuss our views further prior to the finalisation of the Terms of Reference.

Yours faithfully



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24 April 2015

Dear Sir / Madam,

Re: Market review into the ownership and competitiveness of infrastructure provision - Draft Terms of Reference

Thank you for providing VocaLink with the opportunity to respond on the proposed scope of the PSR's market review into the ownership and competitiveness of infrastructure provision, as set out in your Draft Terms of Reference dated March 2015.

We note that the draft terms of reference would restrict the review almost entirely to VocaLink's business. We believe that this is too narrow a focus to support conclusions on the best way to provide payments infrastructure in the UK. We set out our arguments in the formal response attached to this letter.

The design, build and operation of highly resilient world-leading real-time and batch-processed payments systems in the UK and internationally (in Sweden and Singapore) is at the heart of VocaLink's business. We are also at the forefront of payments innovation and will soon be launching the Zapp payment service, which will provide UK consumers with the first real-time account to account person to business payment mechanism and a genuine alternative to the existing card, cheque and cash payment methods which dominate the market at present.

Please find attached to this covering letter VocaLink's formal response to the Draft Terms of Reference in which we highlight a number of key areas of concern for your consideration. Please note that the views expressed in this response are the views of VocaLink and may not necessarily align with the views expressed by its shareholders in their separate submissions to the PSR (if any), nor with the views of the Interbank Operators (Schemes) who are the contracting parties for the infrastructure provision of Bacs, Faster Payments and LINK.

Throughout the Market Review process, VocaLink will be providing to the PSR a significant amount of commercially sensitive information and information relevant to the security of the infrastructure it provides to its customers. As a result, VocaLink would expect to discuss with the PSR any intention to publish any information

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VocaLink is a trading name of VocaLink Limited

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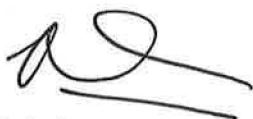
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provided by VocaLink to the PSR, including this response to the Draft Terms of Reference.

We hope that you find our responses to the Draft Terms of Reference helpful. We would very much welcome the opportunity to discuss the issues raised with you.

Yours faithfully,



Chris Dunne

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VocaLink Limited

Response to Payment Systems Regulator Draft Terms of Reference for the Market Review into the ownership and competitiveness of infrastructure provision

Introduction

While VocaLink notes the PSR's decision to conduct a Market Review focusing on payment systems infrastructure, VocaLink believes that the scope of the Market Review set out in the Draft Terms of Reference is too narrow. The UK payment systems are highly complex and comprise a multiplicity of (often inter-related) service providers and infrastructure providers, offering complementary and competing payment services to service users. Against this backdrop, the proposal is to focus on VocaLink alone, rather than to conduct a fuller review into the ownership and competitiveness of infrastructure provision in the UK. A review with such a narrow scope is unlikely to support conclusions on remedies or further regulatory work, as the central economic influences on VocaLink and its services would have been excluded from consideration.

The PSR has invited responses to the following three questions:

- Question 1** "Do you agree with the scope of the review with respect to both the components of infrastructure and systems that we propose to examine?"
- Question 2** "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."
- Question 3** "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?"

VocaLink sets out below its response to each of these questions.

Question 1 – Scope of the Market Review

The purpose of any market review, including this one, should be to "*see how well [a market is] working for service users*".¹ In conducting that assessment, VocaLink believes that the PSR should conduct a forward-looking analysis, addressing all aspects of the relevant market, and all of the factors that impact on competitive behaviour in that market. The Market Review must also be conducted to a high standard, in terms of both the analysis conducted and the evidence used to support that analysis. However, VocaLink is concerned that the limited scope for the Market Review set out in the proposed Draft Terms of Reference would not appear to permit the PSR to conduct such an analysis.

VocaLink is concerned that the utility of the proposed Market Review would be compromised if it were conducted according to the limited scope set out in the Draft Terms of Reference. Even if the main focus of the Market Review were to be VocaLink's position and ownership, by limiting the scope of the review to those three payment systems for which VocaLink provides the infrastructure, the PSR would

¹ PSR Competition Concurrency Guidance – Consultation Paper, Appendix 2, Paragraph 1.1 (Market reviews, market studies and market investigation references).

be unreasonably ignoring many of the competitive, collaborative and wider economic and regulatory constraints present in the market for payment system infrastructure provision in the UK, and would not be able to come to an in-depth understanding of the mechanisms through which competition can drive innovation.

VocaLink suggests that the PSR needs to consider the wider market and wider economic and competitive context if it is to reach supportable and reasonable conclusions that can be used within future decisions, based on sound factual and economic evidence and analysis. A failure to do this risks the PSR reaching potentially unreasonable and irrational conclusions that do not reflect economic reality, and could also lead to remedies that are unnecessary, disproportionate or positively harmful for the payment systems sector as a whole. Such remedies or further regulatory work based on this analysis would not be sustainable in the face of external scrutiny.

In order to conduct a Market Review that encompasses all of the issues relevant to this complex sector, and in order to reach sound, reasonable and rational conclusions in relation to any issues identified (and any consequent remedial action), VocaLink strongly advocates that the proposed Market Review must encompass at least the following analytical points:

(i) Market definition

In order to conduct a thorough Market Review it will be necessary to define the relevant market for payment systems. This exercise should encompass an evaluation of all the providers of payments systems in the UK, including Card Operators, and the role played by Interbank Operators (Schemes) in setting rules around infrastructure provision. Without such analysis it will be impossible to determine the relative competitive, economic and regulatory constraints.

In this context it is worth highlighting the recent press release issued by Halifax² which reported the following typical customer current account transaction volumes:

Payment Type	2014 - % of current account transactions
Debit Card	56.7%
Direct Debit	19.4%
Cash	16.6%
Standing Order	3.2%
Faster Payments	2.7%
Cheque	1.2%
Bill Payment	0.2%

The most popular consumer payments mechanism is debit cards, of which the vast majority (circa 96%) are processed across the VISA network. By not fully including the card systems [REDACTED] in the scope of the Market Review, the PSR will be leaving out the most widely used consumer payment mechanism in the UK and the mechanism of most concern to retailers and other consumer businesses / organisations. In omitting the card networks the PSR would not be in a position to assess the ways in which the card networks are already, and continue to be, in competition with the Interbank Operators for which VocaLink provides the infrastructure. The conclusions reached would therefore likely be incomplete.

² See Halifax Press Release issued on 13 April 2015.

(ii) Service–users

The stated objective of the Market Review is “...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 services users...”. The PSR has not defined what it means by “service-user” for the purpose of the Market Review, but in other PSR reports and consultation papers an emphasis has been placed on consumers and business-users as service-users. That would potentially bring into scope many types of service-user with whom VocaLink has no direct relationship – the customers for VocaLink’s infrastructure services are limited to the Interbank Operators and members of the payment schemes. VocaLink believes that a broad definition for service-users is necessary, but unless the scope of the Market Review is broadened to include the other payment systems and payment services providers, that provide payment services to the wider service-user market (including those entities responsible for delivering payment services directly to consumers and businesses) it will not be possible for the PSR to reasonably establish the state of competition and innovation across the end to end payments market.

(iii) Role of Interbank Operators (Schemes)

As set out above, it is essential that the Market Review constitutes a full review addressing all aspects of the relevant market. In particular, any assessment of competition and innovation in the sector must take into account the role of Interbank Operators in setting the rules and specifying the contracts that the infrastructure providers then build and operate to. The Interbank Operators do not perform any technical operational activities, but they do have responsibility for setting and administering the payment system rules and (in most cases) for setting the functional specification for the respective system. The Interbank Operators also act as a point of co-ordination for cross industry initiatives. In this way the Interbank Operators control the rules for access to payment systems, which are a critical enabler for driving competition and innovation. It will not be possible to understand the potential link between competition and innovation – a central facet of the PSR’s focus – by only looking at infrastructure providers. It must also take into account the role of the Interbank Operators in setting rules and determining functional specifications, including the way these are informed by the internal systems of the established payment service providers’.

(iv) The impact of the market on resilience

Operational resilience is important to service-users. A review of ownership and competitiveness of infrastructure provision cannot reasonably be conducted without a consideration of both current resilience and the likely impact on future resilience caused by regulatory initiatives.³

(v) The link between competition and innovation

The Draft Terms of Reference suggest that there may be a concern that lack of competitive pressure hampers innovation. The Market Review should therefore look closely at identifying the linkages between competition and innovation, in particular by examining the roles played by all parties involved in providing payment system services and the circumstances in which innovation has arisen – or may reasonably be expected to arise. In that regard, the PSR should take into account the widely recognised specific characteristics of payment systems, including the distinction between collective and unilateral innovations identified in the FCA’s Call for Inputs.

³ Section 49(3) of the Financial Services (Banking Reform) Act 2013 (“FSBRA”) requires the PSR in discharging its general functions to have regard to the importance of maintaining the stability of, and confidence in, the UK financial system.

(vi) Value-chain analysis

The payment systems industry is complex. To understand the link between competition and innovation, the Market Review should look at the entire value chain. The PSR should build on the work done to date to further develop this analysis, to ensure that it takes regulatory action that has the most beneficial impact for services-users overall.

(vii) Recent and on-going developments in payments systems

The payment systems sector is currently undergoing rapid change, including through the increasing use of mobile payment types, adoption of PSD2, and MIF Regulations. The Market Review should not rely on historic assumptions and must be forward-looking in order to ensure payment systems work for service-users in the future by taking account of prospective developments.⁴

(viii) Payments Strategy Forum (PSF) and PSR's other initiatives

The PSF will be established to set strategic priorities for the payments industry in the UK, which will have significant implications for the development of innovation in the payment systems infrastructure sector. Accordingly, in conducting the Market Review, the PSR should have regard to the role of the PSF and the priorities it agrees. Similarly, the PSR should have regard to its own initiatives to promote access to payment systems, which may also have implications for the development of innovation in payment systems.

VocaLink therefore urges the PSR to expand the proposed scope of the Market Review to encompass all of the above issues, to ensure that the Market Review is a review of the wider payment systems infrastructure market, and all of the interrelating factors that determine how it operates. If it does not do so, VocaLink is concerned that the PSR will not be in a position to reach sound conclusions or identify appropriate actions in the event that concerns are identified.

Question 2 – Areas of concern

Please see below VocaLink's initial views on each of the three issues to be explored set out at section 2.10 of the Draft Terms of Reference.

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

As explained above and in line with established practice in the field of competition law and economics, answering this question requires a careful assessment of relevant markets, the dynamics within them and the scope for innovative change. To understand the link between competition and innovation, it is essential to analyse the roles played by the various parties in the value chain, in particular Interbank Operators and their members who determine the pricing and terms of access for corporates, households and other payment service providers. The question of effective competition in payment infrastructure cannot be meaningfully examined outside the context of the downstream competition between payment services available to consumers and corporates. End-users face extensive choice, with many new innovative services being developed. Advances in access and payment technology will serve to provide even greater choice and an increase in substitutability. Cards are by far the most popular form of payment and are widely-used for bill payment.

⁴

See, for example, London Economics (2014), 'Competition and collaboration in UK payment systems', report commissioned by the Payment Systems Regulator, October, p.36. For example, London Economics explains "As a result, if we frame the questions about relevant markets in more forward looking terms, we may have significantly different answers".

Furthermore, there is not only competition between the different payment methods (e.g., a debit card competes with a credit card, direct debit and a Faster Payment instruction for the payment of a utility bill), but also between different brands [REDACTED] between different issuers or banks [REDACTED] and between different infrastructure providers (e.g., VocaLink and VISA). This context must be carefully understood before examining competition and barriers to entry in infrastructure alone.

There is a complex value chain, consisting of many different functions and a range of different providers. These include clearing and netting, settlement, and authentication (the service through which an infrastructure accesses payment accounts at the payment service provider), and the processing functions fulfilled by the payment service providers, such as the banks, issuers and acquirers.

Most functions are fulfilled by different parties at each of the layers, and the costs attributable to each party's activities can vary significantly. For example, although the VocaLink infrastructure processes a very large number of transactions, it accounts for only between 2% (credit transfers) and 8% (direct debits / standing orders) of total costs of these transactions to the end service-user.

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

The answer to this question requires detailed assessment of the relevant market context for any component of concern. There are established economic frameworks for assessing how essential an input a given component is and for considering proportionate interventions.

Technology and communications products can feature bottleneck elements - elements which, at a given time, other suppliers need to use in order to gain access to end-users. Thus the first element of analysis is whether a component is indeed a genuine bottleneck, or whether there are alternative ways for other suppliers to access end-users.

Even where such a component or element is identified, the question of whether it is limiting competition needs to give weight to dynamic competition, i.e., competition for new products and services. Forcing access may lead to increased competition in existing markets, but may negatively affect investment incentives, reducing choice and service quality in the long run.

If one firm has invested in an innovative technology which is successful in the market, giving rivals access to this component so that they can compete directly with the original firm on related services is likely to harm incentives to invest. It is risky to invest in new systems, platforms or new services across an established platform. Without the certainty of commercial freedom in the event of successful innovation, firms may be loathe to take such risks.

III. Do ownership arrangements distort effective competition?

There are beneficial features of the current ownership structures, in particular a strong alignment of risk, ownership and investment responsibility. Given the very negative outcomes for banks if there is a payment system failure (with the resulting costs many times larger than the direct cost of the payment system itself), owning and controlling security standards, resilience and investment decisions has clear advantages. Collaborative agreements on common standards for payments between banks and the establishment of hub and spoke arrangements can reduce costs not just for the participants but for consumers and

businesses, who ultimately bear the costs and to new entrants, who have only to build one set of interfaces. However, reaching agreement, especially for new services, between competitors can be a slow process and may well not produce the quickest adoption of innovations which would be beneficial for end users.

It is at the Interbank Operator level that key decisions on investment, access, innovation, and changes in membership requirements are often taken. While broader participation should be welcomed, it is important that the prime objective for participants in any Payment System is the stability and security of its operation. Although each of the Payment Systems is currently functionally and technically separate (typically operating on different message standards and technical platforms) over time, there may be an argument for convergence which could result in adoption of common platforms and drive increased efficiency at the infrastructure and Interbank Operator level, as well as reducing costs of entry for new entrants and ultimately producing greater flexibility and lowers costs for businesses and consumers. VocaLink has been considering whether a broadening of ownership might further increase its capacity to invest in new services and innovation.

The lessons from other industries show that customer or broader stakeholder engagement can be an effective way of providing integrated firms with incentives to ensure that their services are designed in line with customer requirements. However, it is important that such approaches are implemented carefully, and that an appropriate balance is maintained between different objectives. Where feasible, the new regulator should provide firms with sufficient flexibility and support in relation to co-investment initiatives. Approaches taken in other industries have shown that this may facilitate effective investment in innovative products and services.

Question 3 – Other relevant issues

Given the importance and potential consequences of the Market Review, VocaLink is concerned that the PSR should ensure: (i) that it conducts the Market Review in a fair and transparent manner; and (ii) that parties subject to the Market Review (including VocaLink) are provided with adequate opportunity to contribute to the Market Review, respond to evidence and analyses (including preliminary reports and analyses) and, if necessary, exercise rights of defence. In that regard, VocaLink notes the principles of transparency and proportionality set out in FSBRA, as well the requirement to use resources in the most efficient and economic way.

In order to satisfy these requirements, VocaLink anticipates that the PSR will adopt processes and procedures that are in line with the well-tested and well-regarded processes and procedures followed by the CMA and other sector regulators, such as Ofcom. For example, the CMA's Market Investigation Guidance suggests the following approach:

- Information gathering;
- Issues statement publication, which would include a description of any theories of harm for the ensuing investigation;
- Assessment;
- Put-backs, for factual accuracy checking;
- Hearings for interested parties;
- Provisional findings and notice of possible remedies;
- Response hearings and the provisional decision on remedies; and
- Final report.

VocaLink is particularly keen that the thinking which will underpin the PSR's theories of harm is outlined early in the process and shared with the parties to allow comment prior to the PSR publishing its preliminary findings in an interim report.

Given that the potential consequences of the PSR's Market Review are similar to those derived through the CMA's Market Study/Investigations processes, VocaLink would expect the PSR to conduct itself following such accepted best practice. Following such best practice is important for the security and stability of the analysis provided by the PSR's Market Reviews, to enable the PSR to make decisions based on the analysis. Also, without a transparent process and an ability for VocaLink and other interested parties to engage, there will be a risk of creating significant regulatory uncertainty over the 12 month Market Review period. Any period of protracted uncertainty will potentially have a detrimental impact on VocaLink's business, including disrupting VocaLink's ability to pursue those commercial opportunities which VocaLink believes would support the PSR's three statutory objectives.

VocaLink requests the PSR to confirm that it will adopt the above regulatory practice in the procedural approach it adopts in the Market Review and that the PSR will outline the process it intends to adopt, within its final terms of reference, and to explain its thinking, if it chooses a different process.

End.